Annual Report 2006

PBZ, a bank of Intesa Sanpaolo group

ČABRANKA

In the idyllic landscape of Gorski kotar lies the greenest municipality in Croatia, with its centre in the town of Čabar and the River Čabranka, bubbling over beautiful cascades.

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CERINSKI VIR

Cerinski vir, the most significant fall in the Samobor hills at 10 m high, flows in a narrow, steep-sided valley, and is particularly beautiful in spring and autumn, when the Javorec stream is full of water and its cascades create a small lake.

Introduction

The Management Board of Privredna banka Zagreb d.d. has the pleasure of presenting its Annual report to the shareholders of the Bank. This comprises summary financial information, management reviews, the audited financial statements and accompanying audit report, and unaudited supplementary statements in EUR. Audited financial statements are presented for the Bank and the Group.

Croatian and English version

This document comprises the Annual Report of Privredna banka Zagreb d.d. for the year ended 31 December 2006 expressed in English. This report is also published in Croatian for presentation to shareholders at the Annual General Meeting.

Legal status

The Annual Report includes the annual financial statements prepared in accordance with International Financial Reporting Standards and audited in accordance with International Standards on Auditing.

The Annual Report is prepared in accordance with section 276 of the Companies Act, which requires the Management Board to report to shareholders of the company at the Annual General Meeting.

Abbreviations

In this Annual Report, Privredna banka Zagreb d.d. is referred to as “the Bank” or “PBZ” or as “Privredna banka Zagreb”, and Privredna banka Zagreb d.d., together with its subsidiary undertakings are referred to collectively as “the Group” or “the Privredna banka Zagreb Group”.

The central bank, the Croatian National Bank, is referred to as “the CNB”.

The European Bank for Reconstruction and Development is referred to as “EBRD”.

In this report, the abbreviations “HRK thousand”, “HRK million”, “USD thousand”, “USD million” and “EUR thousand” or “EUR million” represent thousands and millions of Croatian kunas, US dollars and Euros respectively.

Exchange rates

The following mid exchange rates set by the CNB ruling on 31 December 2006 have been used to translate balances in foreign currency on that date:

CHF 1 = HRK 4.571248
USD 1 = HRK 5.578401
EUR 1 = HRK 7.345081

KRČIĆ

The Krčić waterfall is 22 m high, and is part of the 10 km long stream called Krčić, which ends its watery path as it flows into the Kninsko polje plain. The Krčić waterfall is also known as "Veliki buk" and "Topoljski buk" and there is a legend linked with an old fortress by the bridge on the fall. According to the legend the bridge will be rebuilt if the Krčić never dries up again and when there are no more wars between people.

Five year summary and financial highlights (in HRK million)

Group	2006	2005	2004	2003	2002
Income statement and balance sheet					
Total gross revenue	4,519	3,936	3,768	3,564	3,321
Net interest income	1,714	1,583	1,517	1,492	1,419
Net operating income	3,039	2,688	2,570	2,424	2,264
Net profit for the year	963	814	735	695	641
Total assets	61,974	51,810	43,799	42,441	34,917
Loans and advances to customers	36,910	28,640	24,025	23,387	19,147
Due to customers	36,843	32,391	29,917	27,497	25,905
Shareholders' equity	7,625	4,820	4,286	3,790	3,280
Other data (as per management accounts)					
Return on average equity	18.79%	21.22%	21.83%	26.85%	24.76%
Return on average assets	1.72%	1.73%	1.72%	1.77%	1.90%
Assets per employee	14.8	12.4	11.1	11.3	9.5
Cost income ratio	50.96%	53.47%	54.17%	53.96%	55.12%

Bank	2006	2005	2004	2003	2002
Income statement and balance sheet					
Total gross revenue	3,652	3,341	3,138	2,777	2,606
Net interest income	1,535	1,425	1,354	1,268	1,012
Net operating income	2,270	2,149	2,008	1,767	1,684
Net profit for the year	847	750	678	575	530
Total assets	55,906	48,553	40,655	37,505	30,536
Loans and advances to customers	33,572	26,687	21,858	20,377	16,742
Due to customers	33,491	30,004	27,405	23,791	22,606
Shareholders' equity	7,114	4,433	3,915	3,355	3,026
Other data (as per management accounts)					
Return on average equity	17.28%	20.00%	21.84%	20.16%	21.52%
Return on average assets	1.66%	1.72%	1.74%	1.66%	1.80%
Assets per employee	16.2	13.7	12.6	13.1	10.8
Cost income ratio	48.79%	51.36%	50.59%	51.00%	53.07%

Report from the President of the Supervisory Board

On behalf of the Supervisory Board of Privredna banka Zagreb, it is my honour to present the business results of the Bank and the Group for 2006.
2006 was a remarkable year for Privredna banka Zagreb. It marked 7th year of operations under strategic partnership with Gruppo Banca Intesa, now Intesa Sanpaolo following the merger of Banca Intesa and Sanpaolo IMI. Partnership with the European Bank for Reconstruction and Development since 2002 has proved to be very fruitful. PBZ is fortunate to have two very strong global partners that are fully committed to the Central-Eastern and South East European region and the Croatian market.

The afore-mentioned partnership and trust have been further reinforced by an increase in the share capital of Privredna banka Zagreb through subscription of new issue of 1,897,525 ordinary shares of the Bank by Intesa Sanpaolo and the EBRD. In October 2006, the two leading shareholders collectively contributed EUR 250 million. This step fully outlines the confidence of our strategic partners in the Croatian economy and Privredna banka Zagreb.
Over the past year, Croatian economy recorded sound growth. Economic targets have been met in almost all areas. The annual GDP growth rate in 2006 is predicted to be around 4.6 percent. Despite increasing oil prices, the impressive price stability of the recent years continued in 2006 with the expected year-end consumer price index of 2 percent.
Croatia moved one step forward in the EU membership negotiations in 2006 following initiation of the screening process that started in late 2005. The positive political and macroeconomic environment created in 2006, coupled with positive relationships with the IMF, consequently caused increased interest from foreign investors in Croatia. There was enormous inflow of foreign capital to the country in the previous year.

Under these conditions, monetary policy remained restrictive in 2006. While obligatory reserve rate was lowered from 18 to 17 percent, marginal reserve requirement increased to 55 percent, and a new measure was introduced with a special reserve requirement on liabilities arising from debt securities issued.
Moreover, in December 2006, the Croatian National Bank announced further tightening. Effective from January 2007, the growth of the banks' loan portfolios is restricted to 12 percent per annum. Any excess of the growth rate must be followed by mandatory purchase of obligatory CNB bills. This has been accompanied by severe competition, which is also reflected in the continued trend of falling interest spreads on the domestic market.
Notwithstanding such a difficult environment, PBZ Group managed to achieve excellent results for 2006. We can clearly say that the Group has strengthened its position in 2006 as one of the most efficient banking groups in Croatia. The consolidated net operating income exceeded HRK 3 billion for the first time whilst a net profit recorded HRK 963 million. Our cost/income ratio, a key measure of our efficiency, stands at 50.9 percent, while the ROAE reached 18.8 percent. These are satisfactory figures since they represent a consistently strong performance over the last five years.
The strength and diversity of the Group we are building give us continued scope for growth, and create many strategic options.
In 2006, PBZ Group further reinforced its position as one of the foremost Croatian banks in terms of productivity, returns and value creation for its shareholders.
This is the result of a well-designed strategy that is systematically and consistently applied to continuous improvement, transformation and customer focused innovation.
The markets have also recognised our sustained business success in the past few years, which we greatly appreciated. During 2006 our share price has almost doubled, well outperforming the stock exchange index. This also reflects the fact that the stock market players are puting their trust in us for fulfilling and achieving our targets.
Overall, we made a great deal of progress throughout the organisation, and this positions PBZ strongly for the future. We are well capitalised. We have a distinctive set of businesses. We have a high quality and experienced management team and loyal and dedicated staff, whose expertise and hard work will take us forward. The results are thanks first and foremost to them, and I am extremely grateful for their efforts in helping us achieve another successful year.
I strongly believe in the ability of the PBZ Group to meet its challenges in the years ahead, to play a major role in the Croatian economy, and to provide great benefits to its customers, as well as great opportunities to its employees and shareholders.

At the end I want to express my greatest appreciation of the work of my colleagues in the Supervisory Board, as well as of the Audit Committee members, for their wise counsel and contribution.

Respectfully,

Dr. György Surányi
20 February 2007

Report from the President of the Management Board

Dear Shareholders,

It is a great honour and pleasure for me to present to you, on behalf of the Management Board of Privredna banka Zagreb, the financial results of the Privredna banka Zagreb Group for 2006. PBZ Group generated record results in 2006 by focusing on the most important issues: meeting our customers' needs, controlling costs, achieving excellent returns to our shareholders and investing in our future.

Financial results and capital management

2006 was an excellent year for PBZ Group. We posted a net attributable profit of HRK 963 million, a figure that is 18.3 percent higher than for 2005 and constitutes a new record for our Group. We managed to accelerate the advancement of activities in all our businesses, furthermore expanding our profitability. Higher revenues in practically all businesses fired the increase, clearly outpacing growth in costs.

As a consequence, consolidated total revenue surpassed HRK 4.5 billion achieving an annual increase of 14.8 percent. Net interest income grew 8.3 percent whilst commission and fees continued to increase more than expected due to high volumes recorded in domestic payments and credit card activity. Overall, net non-interest income of the Group now contributes 44 percent to total operating income, compared to 41 percent in 2005.

Profit from trading activities reached a record high, fuelled by improved market opportunities in the country. We also experienced a strong increase in brokerage, corporate finance and underwriting fees.

All performance indicators support excellent achievements and provide evidence of improvements in profitability and productivity. The return on average equity at the level of the Group was 18.8 percent. The consolidated return on average assets reached the very respectable level of 1.72 percent. Earnings per share, the most evident reflection of the value we create for our shareholders, increased by 16.2 percent, amounting to HRK 56.9 per share. At the same time, we managed our costs carefully. In general, expenses increased less than revenues, which resulted in the cost to income ratio, on a consolidated basis, equalling 50.9 percent for 2006.

The balance sheet of the PBZ Group increased by 19.6 percent and almost reached the figure of HRK 62 billion. The most significant contribution to this growth of the balance sheet came from the increase of the loan portfolio in corporate but particularly in SME and retail banking areas. The growth of the loan portfolio was accompanied by a conservative loan approval policy and improved measures and procedures for risk monitoring. This, in addition to higher volumes of loans, resulted in the improved quality and structure of the portfolio, which now shows greater diversification.

The asset growth of the Group was influenced by stronger deposit base, whose increase in 2006 was largely due to retail deposits. Total deposits from customers in 2006 rose by 13.8 percent. If we consider the total structure of the balance sheet, customer deposits account for 59.5 percent. In addition, during the year we recorded higher level of shareholders' equity.

In October 2006, main shareholders and strategic partners of the Bank, Intesa Sanpaolo (then Banca Intesa through Intesa Holding International) and the EBRD, increased its share capital by subscribing to the new issue of ordinary shares of Privredna banka Zagreb. Intesa Sanpaolo and the EBRD collectively paid in HRK 1.8 billion (counter value of EUR 250 million) and thus significantly improved our capital base.

Furthermore, effective from December 2006, Privredna banka Zagreb acquired controlling stake in LT Gospodarska banka d.d. Sarajevo, Bosnia and Herzegovina. Following the acquisition of UPI banka d.d., Sarajevo by Intesa Sanpaolo (then Banca Intesa) in February 2006, our subsequent takeover of LT Gospodarska banka at the end of 2006 strengthened position of Gruppo Intesa Sanpaolo in the region, which is viewed as one of important markets by our strategic partners.

Qualitative results and market share

I am pleased to report that we have succeeded in improving our customer base as well. We attracted additional 50 thousand clients, mostly retail. We are particularly satisfied with expansion of the SME portfolio which was one of our core strategic plans. At present, we serve approximately 50 thousand SME clients nationwide.

With a base of more than 1.7 million clients, both corporate and private, the PBZ Group is today a modern, universal-type banking group whose market share, measured by the size of the balance sheet, stands at 19.1 percent whereas in retail banking that share reached almost 22 percent.

More importantly, we hold larger part of market share in innovative distribution channels. Namely, more than 200 thousand of our clients use Internet banking, more than 1.6 million transactions were carried out in 2006 through mPay product (the mobile

phone payment system) whilst total turnover on all our EFT-POS terminals exceeded HRK 7 billion in 2006. PBZ Group holds the leading position on the credit and debit card market with a market share of 30.3 percent. In 2006 there were 87.5 million transactions executed with all outstanding cards of the Group with corresponding volume of HRK 30.8 billion.
Moreover, total indirect deposits, i.e. funds under management of PBZ Invest (investment funds) and PBZ Croatia osiguranje (pension fund) as well as funds and securities received in custody on behalf of third parties, collectively surpassed HRK 15.7 billion, which is an increase of 74 percent compared to 2005.

Products and services

On top of improved financial performance, considerable progress has been made in terms of the increased quality of operations and services offered. We began 2006 with a new organisational structure, which essentially involved increasing the number of front office staff at expense of support divisions in order to strengthen business units. This has improved the customer focus, empowered decision-making ability and stimulated innovation.
In order to get closer to our clients, PBZ Group continued to expand its business network and renovate existing branches in accordance with our recognisable visual identity. Therefore, in 2006, we opened or renovated 21 branches throughout the country which at the end of the year amounted to a total 219. The ATM and EFT POS network is being continuously expanded so that, at the end of 2006, there were 491 ATM machines and 15,321 EFT POS terminals in operation.
The Bank also retained a prominent role on the capital markets and in corporate banking. During the year, we successfully arranged 60 issues of commercial bills in domestic currency for our clients which accounted for 91 percent of all issues in Croatia.
Being actively engaged in the launching of new products and relying on a well formulated strategy, PBZ has become an important institution in terms of public sector financing, and a leader in the area of loan syndications and handling of security issues.
I am pleased to report that we have further expanded activities of PBZ Corporate Academy, a program designed for lower, middle and senior management of the Bank. This project, deemed as one of the most important projects in the Bank, aims to create new forces for meeting modern trends and standards in the banking industry, not only in Croatia but in South and Eastern Europe as well. Currently, 240 managers and employees of the Bank attend PBZ Corporate Academy in the desire to develop their strategic and operational skills.

Awards

We are also extremely proud of being named the winner of “The Best Bank in Croatia” award for 2006 by the Global Finance magazine as well as winner of the prestige domestic award “Golden Share of the Year” for 2006. We believe the awards are recognition of our strong competitive position and excellence.

Conclusion

In view of the results achieved as well as our strong capital adequacy, the Management Board of Privredna banka Zagreb will propose, at the forthcoming Annual General Meeting, payment of a dividend of HRK 10.00 per share to shareholders of the Bank. The remaining portion of the profit will be allocated to reserves and retained earnings for the purpose of increasing our capital, which will help us sustain growth well into the future.
Finally, I would like to take this opportunity to express my gratitude to my colleagues, members of the Management Board and all employees of the PBZ Group for their excellent performance and hard work in 2006. Also, I would like to thank our distinguished clients and business partners for their professionalism in mutual contacts and trust they have placed in us. I would particularly like to express my most sincere gratitude to all members of the Supervisory Board of the Bank for their most valuable cooperation and support.

Božo Prka, M.S.
President of the Management Board
20 February 2007

ZELENI VIR

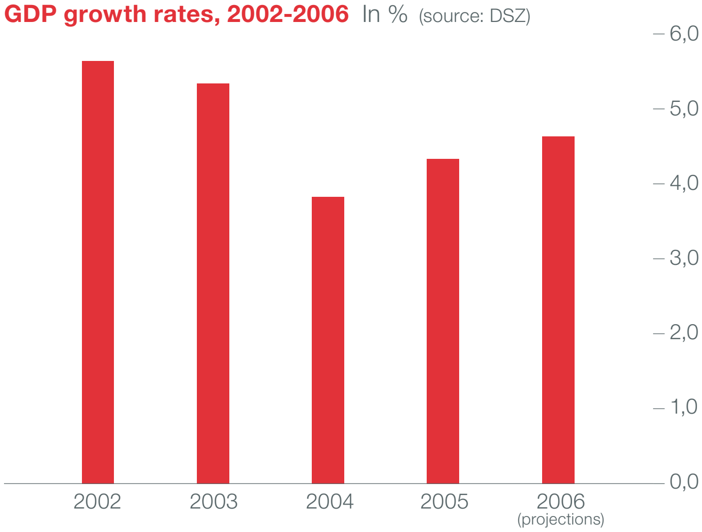
Zeleni vir is actually the powerful source of the Iševničica stream at the bottom of a broad, shallow cave, above whose entrance stands a vertical rock, 70 m high, down which this picturesque waterfall crashes, creating a shining curtain of water.

Review of the Croatian economy in 2006

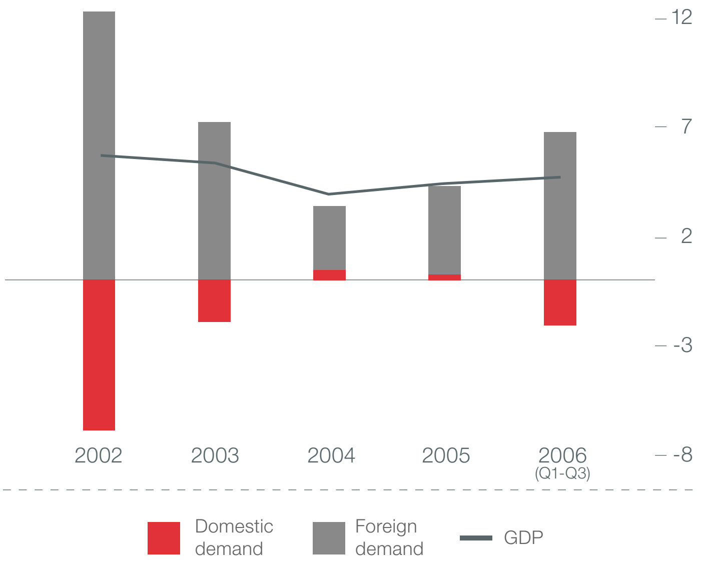
After strong growth in the first quarter of the last year, when the GDP growth rate increased to 6 percent, the following two quarters brought a slowdown, lowering the overall growth of the economy to 4.7 percent in the first nine months of 2006, with the data for the last three months showing the overall economic growth for the year around 4.6 percent.

Unlike the 2005, when growth was achieved both through increase in personal consumption and fixed capital investments, the upsurge of fixed capital investments which expanded by 11.4 percent (up from 4.8 percent increase in the whole of 2005) was the main driver of the growth in the first three quarters of 2006. Personal consumption, however, kept pace, posting 3.3 percent rise at the same time, compared to the previous year's 3.4 percent increase. On the downside, after a two-year period of faster pace of growth in exports than imports, 2006 brought a negative turning point, with the first nine months growth rate for exports of 5.7, and imports of 8.1 percent.

GDP growth rates, 2002-2006 In % (source: DSZ)

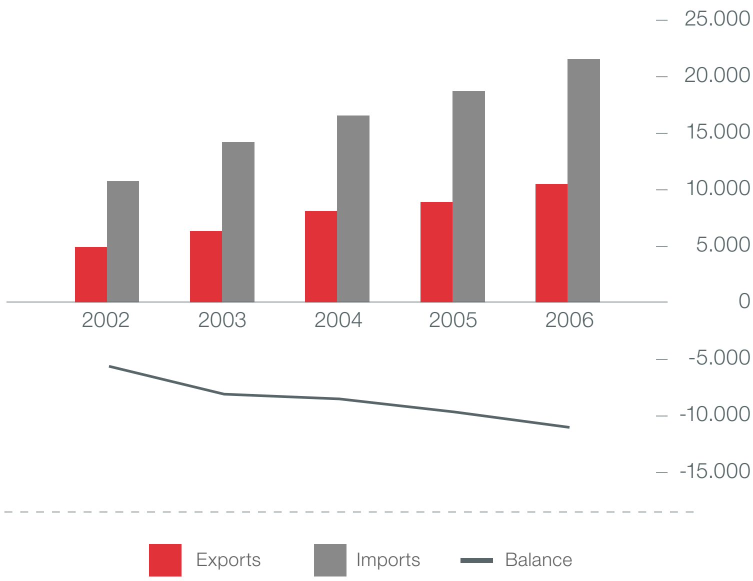


Contribution of domestic and foreign demand to GDP growth In % (source: CNB)



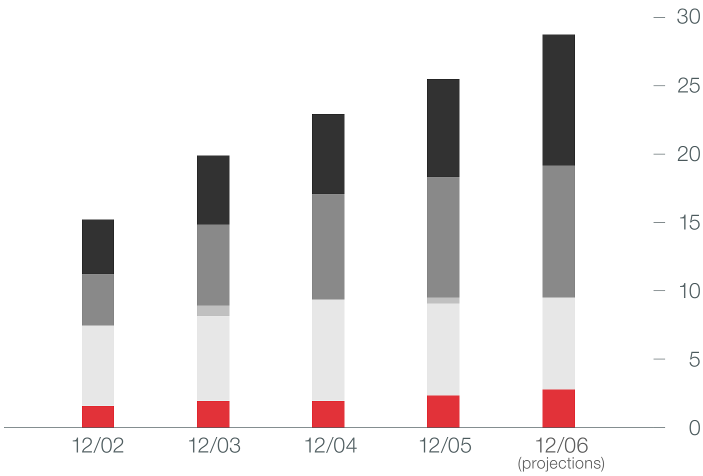
Even though a significant improvement of developments in foreign trade in goods was recorded during the last three months of 2006, the deficit for the entire year reached USD 11.1 billion or 13.5 percent more than in 2005, pushing the current account deficit from 6.4 percent of GDP in 2005 to an estimated 8 percent in 2006. This outcome is not surprising seeing that only in the first three quarters of 2006 the current account deficit amounted to 1.2 billion euros, almost 2.5 times higher than in the same period in 2005. Nevertheless, the deficit in foreign trade of goods grew somewhat slower than a year before, with exports up by 18.3 percent and imports by 15.8 percent on an annual basis.

Foreign trade USD million (source: CBS)

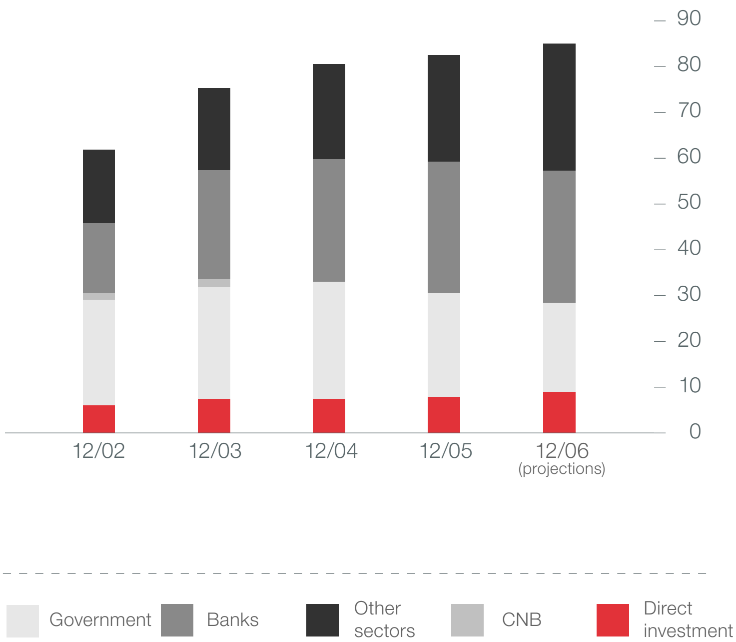


The monetary policy remained restrictive in 2006. While the obligatory reserve rate was lowered from 18 to 17 percent, the marginal reserve requirement was increased to 55 percent, and a new measure was introduced with a special reserve requirement on liabilities arising from issued securities of 55 percent. Besides this, the CNB retained the measure on the minimum required amount of foreign currency claims of 32 percent.
Prompted by the negative BOP developments, along with the continuing growth of foreign debt and placements, towards the end of the year the Croatian National Bank announced a loan growth restriction measure to be applied in 2007, by which the banks with annual loan growth exceeding 12 percent are obliged to purchase compulsory CNB bills.

External debt by debtors EUR bn (source: CNB)



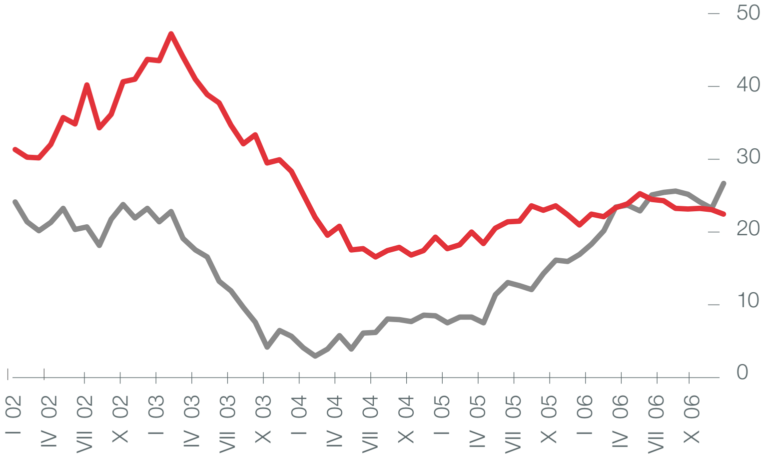
External debt by debtors in % of GDP (source: CNB)



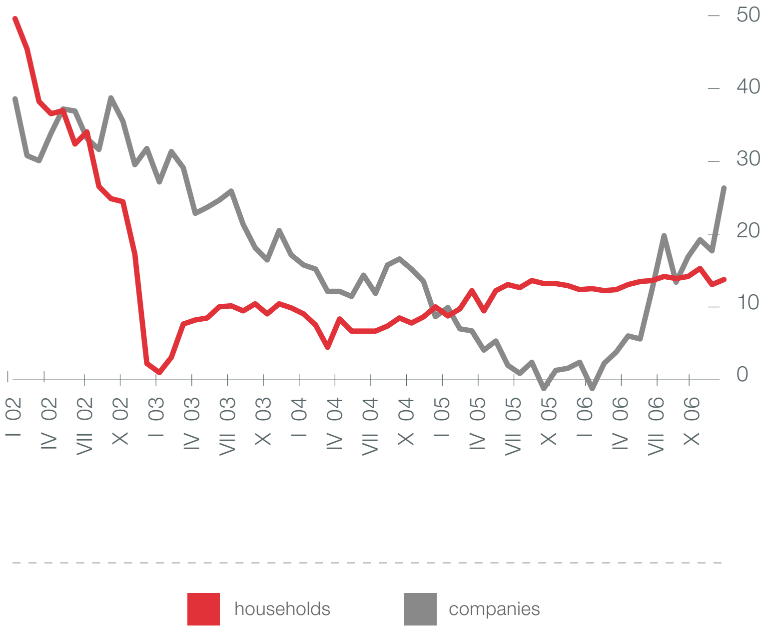
The total placements by commercial banks stood at 190.1 billion kunas at the end of 2006, which is 22.7 percent more than at the end of 2005 (c.f. growth in 2005 was 20.3 percent). Seen in terms of structure, the largest proportion of the loans were granted to households (50.3 percent), while 41.2 percent of loans were to companies, and 7.7 percent in loans to central and local government. The total retail loans reached the figure of 95.7 billion kunas, recording an annual growth rate of 21.8 percent, whilst loans to enterprises exceeded 78 billion kunas, with an annual growth rate of 26.1 percent, which is the highest annual growth rate in the past nine years.

In 2006 the sharpest rise was seen in housing loans, with an annual growth rate of almost 34 percent. At the same time, the proportion of housing loans in the total retail loans rose by 3.5 percent to 38.6 percent by the end of the year.

Loans to companies and households year-on-year growth rates in % (Source: CNB)



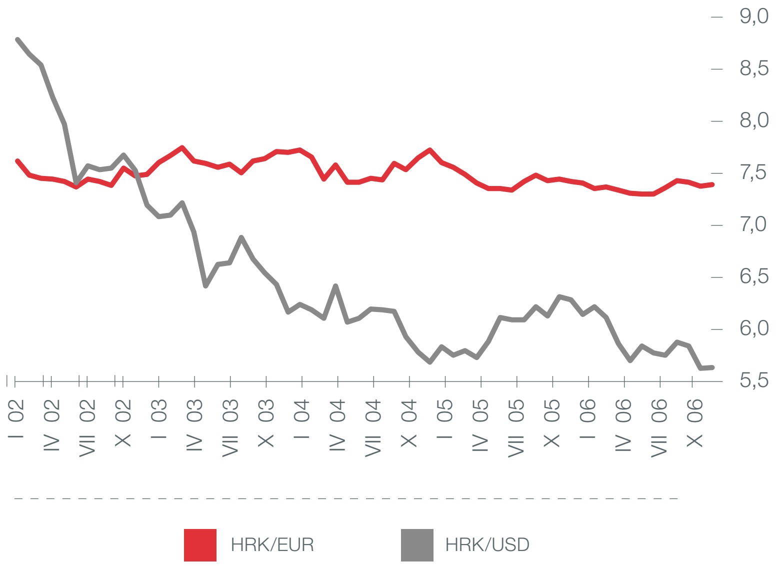
Deposits of companies and households year-on-year growth rates in % (Source: CNB)



Total deposits in banks (not including central government deposits) reached 167 billion kunas at the end of 2006, which is an increase of 18.1 percent year on year (c.f. growth in 2005 was 10.6 percent). The total retail deposits at the end of 2006 amounted to 112.6 billion kunas, recording an annual growth rate of 13.4 percent, while company deposits reached 43.2 billion kunas, with an annual growth rate of 26.1 percent. An upward trend was recorded in 2006 for kuna term deposits whose share in the retail deposits rose from 13.3 percent at the end of 2005 to 18.4 percent at the end of last year. However, foreign currency term deposits continued to be the most important retail deposits, accounting for more than 50 percent of the total retail deposits.

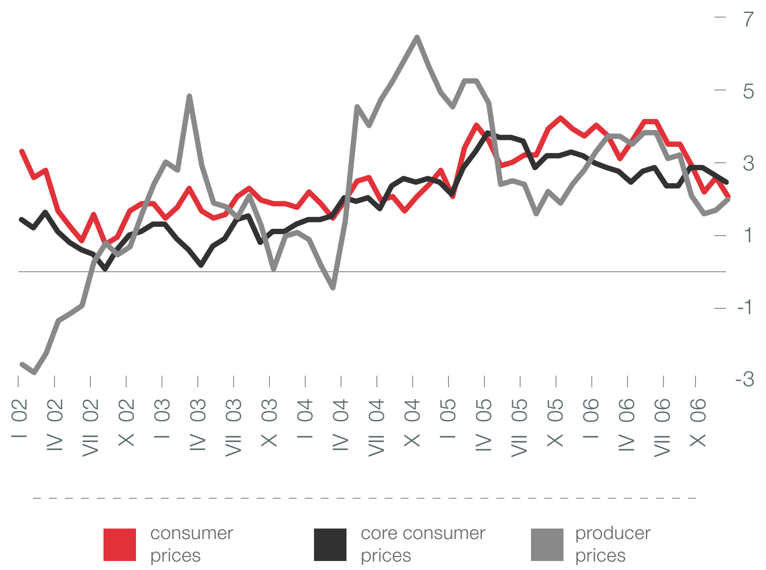
In the last year, the kuna strengthened against the euro on average by 1 percent and by 1.9 percent against the dollar. The exchange rate of kuna against the euro stood at 7.35 kunas at the end of 2006 or 0.4 percent less than at the end of 2005 when it stood at HRK 7.38/EUR. As a result of the strengthening of the euro against the dollar on the world exchange markets, the kuna gained value against the dollar, and the exchange rate dropped by 10.5 percent in 2006, from 6.23 kunas per dollar at the end of 2005 to 5.58 kunas per dollar at the end of last year.

Exchange rate developments, CNB midpoint, end of period
(source: CNB)



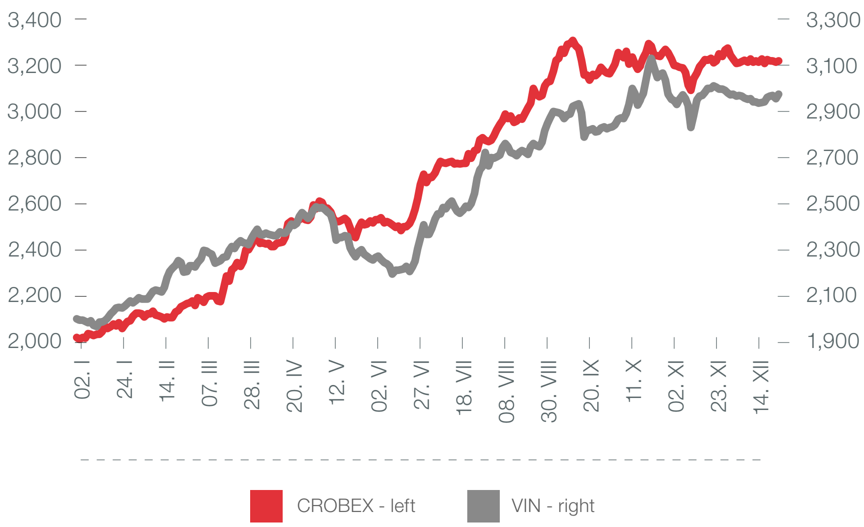
The overall rise in prices 2006 can for the most part be attributed to higher energy and administra-tively regulated utility prices. Thus the largest contribution to the rise in consumer prices in 2006, of 1.2 percentage points, came from the rise in the prices of utility services, especially water and energy, while the second main driver was the higher price of food, contributing 0.6 percentage points. Inflation in 2006, measured by the CPI, amounted to 2 percent annually in December last year, and on average in 2006 prices were 3.2 percent higher than the average for 2005.

Prices, annual growth rates (Source: CBS, CNB)



2006 was another successful year for the domestic capital markets, with a strong upturn in the volume of trading, as well as a leap in both share indices. The total turnover on the Zagreb Stock Exchange (ZSE) amounted to HRK 45.3 billion, which is growth of 32.5 percent compared with the year before and the index of the exchange, the Crobex, jumped by 60.7 percent on an annual level. Total turnover on the Varaždin Stock Exchange (VSE) rose to HRK 3.7 billion, up by 66.3 percent compared with 2005 and by the end of the year the VIN index was 48.7 percent higher than a year before.

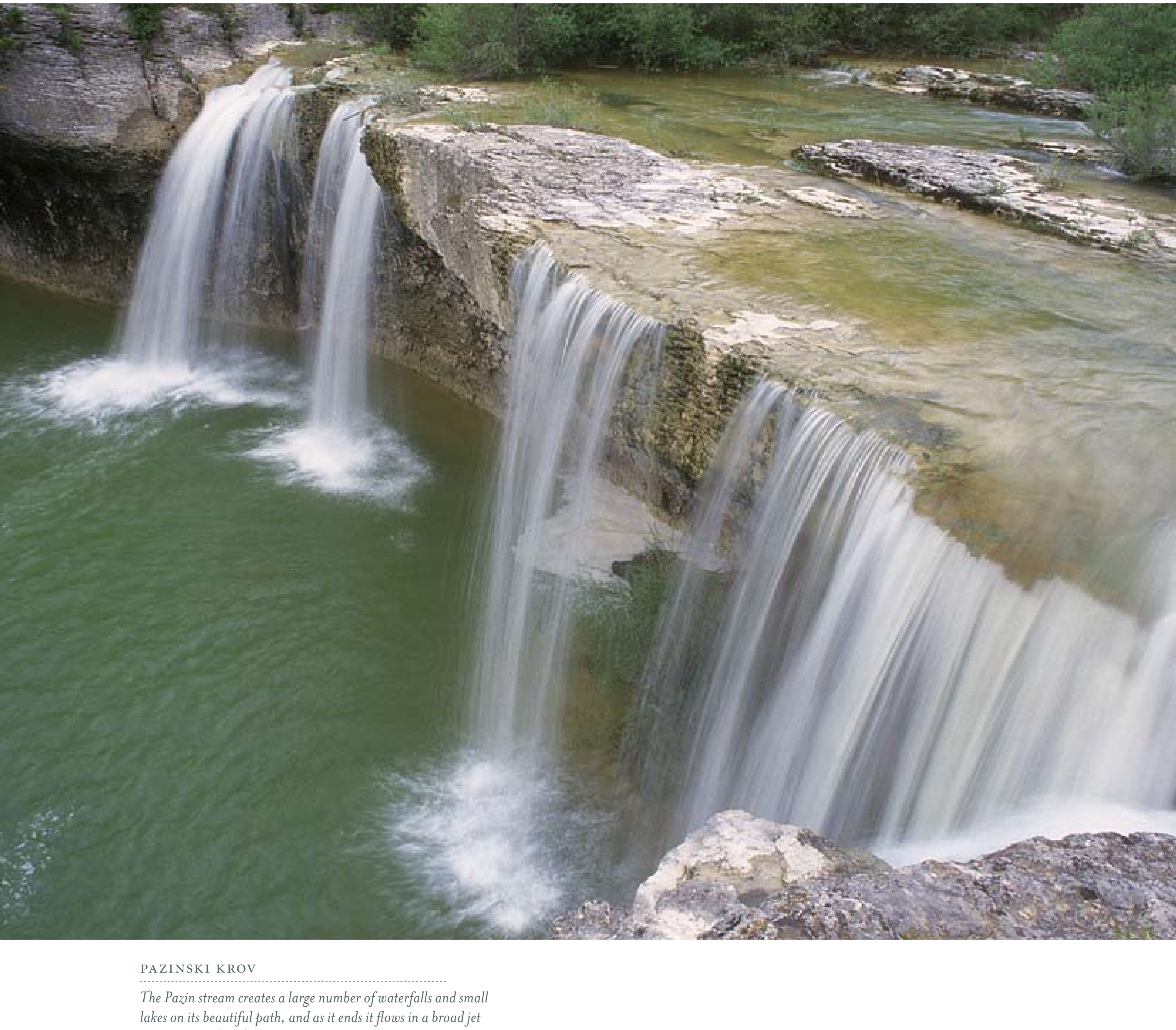
Crobex and Vin Index 2006 (Source: ZSE, VSE)



Macroeconomic indicators

	Year-on-year, eop	Indicator value	Year-on-year	Indicator value
Consumer prices, % ch.	XII/2006	2.0	I-XII/2006	3.2
Producer prices, % ch.	XII/2006	1.9	I-XII/2006	3.0
Industrial production, % ch.	XII/2006	3.1	I-XII/2006	4.5
Retail trade, real, % ch.	XII/2006	4.0	I-XII/2006	2.1
Construction, % ch.	XI/2006	7.3	I-XI/2006	9.9
Tourist nights, % ch.	XII/2006	13.8	I-XII/2006	3.1
Export of goods, mil. USD	XII/2006	1,080	I-XII/2006	10,376
Imports of goods, mil. USD	XII/2006	1,846	I-XII/2006	21,488
Current account balance, mil. EUR	Q3/2006	2,176.4	Q2/2006	-1,299.7
Average net salary, in kunas	XII/2006	4,735	I-XII/2006	4,602
Real net slaries, %. ch	XI/2006	3.7	I-XI/2006	1.8
Number of unemployed, CES	XII/2006	293,153	XI/2006	292,269
Unemployment rate, CES, %	XII/2006	17.0	XI/2006	16.9
Unemployment rate, ILO, %	H1/2006	11.8	H2/2005	12.3
Central government debt, bil. kn.	XI/2006	108.6	XII/2005	109.6
External debt, bil. EUR	XI/2006	28.3	XII/2005	25.5
GDP, growth rate, %	Q3/2006	4.7	Q2/2006	3.6

eop - end of period
avg - everage
Source: CBS, CES, MoF, CNB



PAZINSKI KROV

The Pazin stream creates a large number of waterfalls and small lakes on its beautiful path, and as it ends it flows in a broad jet over the roof (krov) of Pazin gorge.

Organisational chart

Supervisory Board
György Surányi, President of the SB

- Office of the Supervisory Board
- Audit Committee
- Internal Audit Division resp. to MB President

Management Board
Božo Prka, President of the MB

- Office of the Management Board
- Subsidiaries Management
- Human Resources Division
- Legal Affairs Division
- Taxation Management Services
- Office for Corporate Communications
- Office for Ec. Research & Strateg. Planning
- Project Management Office
- Business Continuity Manag. Office

Corporate, Treasury & Invest. Banking Group
Ivan Gerovac
- Public Sector (Entities) Division
- Large Companies & Foreign Companies Division
- Financial Institutions & Spec. Financing Division
- Treasury Division
- Investment Banking Division
- Support Division
- Strategic ALM Office

Small & Medium- - Size Enterprises (SME) Group
Mario Henjak
- Small &Medium Size Enterprises Division
- Product Development & Branch Coordin. Division

Retail Banking Group
Tomislav Lazarić
- Retail and SME Groups Office
- Distribution Channel Development Division
- Product Development Division
- Private Banking Division
- Analysis and Client Relationship Development Division
- Product and Service Marketing Division

Risk Management & Control Group
Giancarlo Miranda
- Risk Management Division
- Credit Analysis Division
- Credit Risk Monitor. & Reporting Division
- Loan Recovery & Restructuring Division
- Compliance Division

IT & Operations Group
Draženko Kopljar
- Business Processes Organization Division
- Operations Division
- Payment Transactions Division
- **ICT Sub-group**
  - Central functions: ICT Governance Office
  - Application software: Application SW Division; Application Operations Division; VIRT Department
  - Central system infrastructure: System Infrastructure Division; Telecom & Distributed Systems Division

Acc., Fin. Control & General Admin. Group
Gabriele Pace
- Office of the CFO
- Accounting Division
- Financial Control Division
- General Administration Division

Business description of the Bank

Privredna banka Zagreb d.d. is one of the largest and among the oldest financial institutions in the Republic of Croatia, with a long continuity of banking operations. It was founded in 1962 as an universal bank on the basis and banking tradition of The First Croatian Savings Bank which was initially established in 1846 in Zagreb by the members of the Farming Association of Croatia and Slavonia.
During all periods of its history, PBZ supported the largest investment programs in tourism, agriculture, industrialisation, shipbuilding, electrification and road construction. PBZ has become a synonym for economic vitality, continuity and the Croatian identity.
Privredna banka Zagreb today is a modern and dynamic financial institution, which has actively sought and won the role of market leader on the financial markets in Croatia. It is a fully licensed bank with nationwide branch network. With its nationwide network of branches and outlets, as well as a broad group of banking and non-banking subsidiaries, PBZ is one of the universal banks that cover the whole territory of the Republic of Croatia.

Organisational Structure and Business Activities

Nowadays, PBZ is the leading bank in Croatia in terms of subscribed share capital and the second bank in terms of total assets. It has consistently been a leading financial institution on the Croatian market with an established business base and recognised national brand name.
Upon successful privatisation in December 1999, PBZ became a member of Gruppo Banca Intesa (as of 1 January 2007 Gruppo Intesa Sanpaolo) - the largest Italian banking group and one of the most significant financial institutions in Europe. With this partnership, supported by the EBRD through its minority shareholding stake, PBZ has retained its business strategy aimed at modern forms of banking and new products, confirming its image of a dynamic and modern European bank, which meets the demands of the market and its clients. The benefits of strategic partnership are clearly visible in the continuously improving financial results of the Bank, as well as of the PBZ Group.
Along with the adoption of the business and corporate governance standards set by its parent bank, Privredna banka Zagreb has maintained the strategic development orientation of a modern, client oriented, technically innovative universal financial institution. PBZ is focused on the continued advancement of its economic performance well into the future, as well as solidifying its position as a product leader in offering the most progressive banking products, through the optimal mix of traditional and modern distribution channels. This ensures that PBZ will continue to be able to set standards of the highest quality for product innovations and services offered to both its domestic and international clients.
This commitment to quality and advanced banking practices is clearly seen in the fact that Privredna banka Zagreb received the Best Bank in Croatia award from Euromoney in 2001, as well as in 2002 and 2004. In 2005 PBZ received The Best Debt House in Croatia award by Euromoney. PBZ also received The Banker's Award for the Croatian Bank of the Year in 2002 and 2005. In 2003, 2004, 2005 and in 2006, PBZ's quality was confirmed again when it received Global Finance's Award for the Best Bank in Croatia. In 2003, 2004, 2005 and in 2006 PBZ received the domestic prestige awards - the Golden Share Award for the Best Banking Share in the country, and the Golden Kuna Award in 2004 and 2005.
Privredna banka Zagreb currently employs some 3,451 employees and provides a full range of specialized services in the areas of retail, corporate and investment banking services. The business activities of the Bank are organized into 3 principal client-oriented business groups.

Retail Banking Group

With respect to the retail banking segment, PBZ holds a comparative advantage over its competitors given its wide spread branch network in Croatia, consisting of 202 organisational units in 18 regions which cover the entire territory of the country. Moreover, the banking subsidiary in the Group, Međimurska banka covers the Međimurska County and provides an effective presence in that particular region.

In accordance with its business philosophy of focusing on client needs and demands, five years ago the Bank introduced personal bankers and the 0-24 hour self-service banking zones to the branch networks, while increasing the quality of services through continued staff training and undertaking quality control measures such as the "Mystery Shopper" project. These activities are constantly in development with the emphasis being placed on the standardisation of business processes. To illustrate this orientation we would like to mention the package of products (named Innovation) by which the Bank rewards its clients who are owners of several groups of products, giving them discount on certain forms of fees and awarding them an incentive interest rate if they have placed their funds on time deposit with the Kuna Plus savings account. On top of that, PBZ has introduced Private banking, a specially designed service aimed at VIP clients. In addition to restructuring and repositioning the traditional distribution channel of the business network, PBZ also continues to develop and improve the distribution channel of direct banking. It has extended its network of ATMs which accept Maestro, MasterCard, Visa Classic and Visa Electron as well as American Express cards (a total of 491 ATMs have been installed). The number of EFT POSs (points of sale) has increased from 3,500 at the end of 2000 to the present 15,321.

As a leader in modern technologies, PBZ has also expanded its distribution channels and products by applying the most advanced technology in order to implement its PBZ 365 services; PBZ365TEL telephone banking service and PBZ365SMS service. With Internet banking PBZ365NET (PBZ365-Optima and PBZ365-Lite) and PBZ365WAP services a client can access his/her accounts 24 hours a day from any location in the world. In 2004, PBZ introduced mPay - a system of payment using mobile phones, as the first bank in Croatia offering such a service, with 61,716 clients today. These achievements have firmly established PBZ as the market leader in electronic banking as well as the technological leader on the financial market in the country. PBZ is the first bank in Croatia which has implemented secure e-commerce based on 3 D Secure technology (Verified by Visa). At present, approximately half of all transactions with retail customers are executed through electronic channels. The Bank is constantly modifying and supplementing its wide range of retail products and services. Thus, it has introduced several types of new loans on the basis of credit scoring. Besides the consumer and cash loans for PBZ Card card-holders, from 2002 to 2006 the Bank launched four very successful tranches of so called quick loans (cash loans at demand to customers who meet certain criteria). Overall in the period from 2000 until mid 2006, PBZ established itself as the market leader in retail loans with a 19.9 percent share of the loan market. In the area of savings, PBZ has significantly increased its deposits to more than HRK 24.2 billion to date, which is 20.5 percent of the Croatian retail deposit market. On a consolidated level, PBZ Group holds almost 22 percent of the overall Croatian retail deposits.

In the card products segment, PBZ, as a card issuer and acceptor, replaced all cheque cards of retail current accounts with the internationally accepted Cirrus Maestro debit card; it offered internationally valid Visa Electron debit card linked to a foreign currency account and issued internationally valid Visa Business Electron debit cards linked to gyro account of private persons, craftsmen and corporates, as well as MasterCard and Visa revolving credit and charge products, and it is the only Bank in Croatia offering Maestro prepaid gift cards.
In January 2006 card operations of PBZ were shifted to the new company, PBZ Card (former PBZ American Express), that deals with all card operations of the PBZ Group. Together with PBZ Card, the Bank has issued more than 1.7 million cards to its clients which accounts for 30.3 percent of the domestic card market.
Retail operations in Privredna banka Zagreb comprise the following divisions: the Division for the development of distribution channels, the Division for product development, the Division for private banking, the Division for analysis and client relationshiop development, the Division for product and service marketing and the Office for retail and SME groups.

Division for the Development of Distribution Channels

This division is responsible for defining, structuring, implementing and monitoring classical and direct distribution channels for the delivery of retail products and services (branch network, ATM and EFT POS network, PBZ 365 services - telephone banking, internet banking, SMS banking, WAP banking, mPay, personal bankers, retail network education). It prepares and coordinates the budget and supervises the achievement of its goals for all distribution channels. It chooses the appropriate distribution channels for end products intended for specific targeted client groups. In association with the Division for product development and the Division for the development of client relationships and marketing, it chooses the right moment for the launch of a new product/service and is responsible for informing the distribution channels of all pursuant marketing activities which may have an effect on them.

Division for Product Development

In cooperation with the Division for the Analysis and Client Relationship Development and the Division for the Development of Distribution Channels, this Division monitors the macroeconomic environment, the activities of direct competitors as well as the market position of the Bank in retail operations. It controls the entire process of defining products for a targeted group of clients, determines the prices of the products and delivers end products to the Division for the development of distribution channels, to which it proposes an appropriate approach and suitable moment for the product launch.
In cooperation with the Division for the development of distribution channels, it participates in the monitoring of overall profitability (product distribution).

Private Banking Division

The Private Banking Division provides financial services to high net worth individuals and their families in Croatia. Utilising the most suitable products from the marketplace, the Private Banking Division works with its clients to offer both traditional and innovative ways to manage and preserve wealth whilst optimising returns. Specialist advisers of the Division are available to deliver products and services that are tailored to meet the full range of financial needs requested by our VIP clients. These services include asset manage-ment, financial consulting, monitoring and evaluation of the clients' investments, custodian services, special deposit taking, sale of insurance policies, etc. The Division has recently introduced bespoke electronic platform which enables clients to place orders on-line.

Division for Analysis and Client Relationship Development

The Division for Analyis and Client Relationship Development is responsible for the analysis and development model which includes supervision and implementation of measuring key indicators for performance assessment of the distribution network and products for retail customers.
The activities relating to the analysis and segmentation of the market include: monitoring the profitability of segmented client databases, the analysis of existing products and services intended for individual client segments and their requirements. This Division also engages in the development of models for measuring the quality of client service by executing Mystery shopper activities, structured market researches, monitoring customer complaints and the overall satisfaction of our clients.

Division for Product and Service Marketing

The prime role of the Division for Product and Service Marketing is marketing management for all the products and services for retail clients of the entire PBZ Group. The activities of this Division include the selection and coordination of appropriate marketing campaigns, selection of the most suitable communica-tion channels to the defined market segment and media planning as well as planning and defining marketing messages in the branch network. It continuously monitors and improves the quality of services throughout the branch network. It also prepares proposals for the marketing budget and oversees it throughout the year.

Corporate, Treasury and Investment Banking Group

Privredna banka Zagreb is one of the leading Croatian banks when it comes to corporate banking. With a wide range of products and services offered to its corporate clients both locally and internationally it is hard to find a major company in Croatia today that does not bank with Privredna banka Zagreb. Supported by powerful electronic distribution channels, our network of well-organised branches is the key driving force in serving our clients effectively. We strive to create additional value by providing integrated financial solutions to meet the individual requirements of our clients. PBZ has thoroughly developed a platform for supporting classic cash and non-cash transactions for corporate clients within the Bank's network. Due to its wide network of correspondent banks, Privredna banka Zagreb offers its clients fast and affordable services in the area of international payments. Also, PBZ has significantly changed the process of handling domestic payments. The Bank directly participates in the Croatian RTGS system (HSVP) and in the national clearing system (NKS) and thus has the ability to process any payment through the most appropriate channel. Improved with the new functionality, Internet banking for corporate clients - PBZ COM@NET service - is available for both domestic and international payments. In terms of finance banking, Privredna banka Zagreb is a dominant participant on the Croatian market. PBZ has originated many contemporary products and has largely initiated the development of the financial market in the country. Consequently, PBZ, with its active role in the foreign exchange market, money market and primary and secondary capital market, has earned the title of market leader. We are determined to be recognized as the best financial services company in the region. We have achieved this recognition from our clients through our ability to deliver the best quality in everything we do.

Following the adoption of the new organisation of Privredna banka Zagreb, the Corporate Banking Group and the Finance Banking Group created the Corporate, Treasury and Investment Banking Group with particular emphasis on banking with large companies, financial institutions and the Government institutions and agencies.
The Corporate, Treasury and Investment Banking Group consists of the following divisions: Public Sector Division, Large Companies and Foreign Companies Division, Financial institutions and special financing division, Treasury Division, Investment Banking Division and Support Division.

Public Sector (Entities) Division

Public Sector (Entities) Division is responsible for performing transactions with government institutions, local and self-government units, public enterprises and public utility companies, insurance companies, large companies, affiliates and institutions.
Recognising and taking into account the requirements of its clients for banking products and services, the Division offers all types and forms of short-term and long-term financing, purchase of receivables, B/E discounting, factoring, letters of guarantees, letters of credit, and renders services involving the opening of business accounts, cash pooling, contracting Internet banking, multi-purpose facilities, providing financial support to export businesses, active participation in the conclusion of deals of its clients abroad, as well as different models of deposit transactions and other innovative solutions adjusted to the requirements of each single client.
Apart from the operations mentioned, it is also important to highlight the services in agency business - transactions performed on behalf and for the account of the ordering party, and commission business - deals made in its own name and for the account of the ordering party.

We particularly wish to bring into focus our financial advising services, applicable to whatever line of business/branch a legal entity is associated with, and the creation of the best possible solution for the respective entity. In coordination with other units of the Bank, we participate in cross selling of all the PBZ Group products. By managing the overall business relationship between the Bank and the client, through a synergic effect we strive for the creation of new supplementary value for our clients.
Appreciating the diversity of its clients' business activities, employees of the Public Sector (Entities) Division, through their individual approach to each client, as well as in team work, provide support to clients in all aspects of their business activities by affording them the use of a wide range of the Bank's services and products, thus developing long-term business relations and partnerships.
In every segment of its business activities, operations and service rendering, the Division endeavours to promote the highest quality banking standards, first and foremost in being professionally and flexibly oriented, both to its present, and to its potential clients.

Large Companies and Foreign Companies Division

The Large Companies and Foreign Companies Division is responsible for business transactions with large domestic companies, companies in foreign ownership, as well as with foreign legal entities - non-residents.
The Division offers all types of banking products and services rendered in cooperation with other Bank's organisation units - opening business accounts, contracting Internet banking, approving loan facilities, purchase of receivables, B/E discounting, issuing of letters of guarantees and opening of letters of credit, investing liquidity excess, cash handling services (organising, transporting, gathering and transferring cash, cash pooling, global cash management), card operations, leasing, retail products and other.
Major domestic clients are building companies (building construction and civil engineering), companies engaged in tourism, and large trading companies.
To companies engaged in the construction of residential and business premises intended for sale we offer the complete project implementation service - from the control of project documentation and building supervision to the financing of construction and of the sale of real estates to final buyers.
In view of the well-developed business network of Privredna banka Zagreb with as many as 200 branches and branch offices, we have successfully organised the complete conduct and management of cash transactions for some of our clients, who are also some of the largest chain stores, and companies engaged in tourism.
The International Desk forms part of the Division, and is in charge of performing transactions with domestic companies in foreign ownership and of coordinating activities of Privredna banka Zagreb and its parent bank - Intesa Sanpaolo. All banking and advisory services are provided by the International Desk to Intesa Sanpaolo Group clients present on the Croatian market, as well as to other companies in foreign ownership. Apart from conducting business relations, this unit also assists foreign investors in the process of setting up a new company in Croatia, provides advisory services and general information on business terms and conditions in Croatia, contacts clients and puts them in touch with institutions exigent in the performance of regular business activities.
The non resident department is responsible for establishing and developing co-operation with foreign entities (foreign companies and private individuals engaged in business activities, foreign diplomatic and consular representative offices and representative offices of foreign legal entities, foreign associations, foundations and other non-profit organisations, international missions).
Co-operation includes opening and managing of accounts, depositing funds, providing the clients with all necessary information required for conducting business in Croatia, which requires the constant monitoring of all national currency regulations (close co-operation with CNB and Ministry of Finance-Foreign Exchange Inspectorate in money laundry prevention issues).

Financial Institutions and Special Financing Division

The key responsibilities of this Division are establishing, monitoring and promoting the complete range of business relations with domestic and international banks and financial institutions.
In order to provide better services to PBZ clients and fully utilize its internal synergies, the Documentary Business (i.e. Guarantees and Documentary Credits) became part of the Financial Institutions and Special Financing Division in 2006.
As part of the special financing services, this Division offers all the Bank's clients tailor made financing solutions including trade and project financing, credit and special arrangements with financial institutions (both domestic and international) as well as with supranational organizations (e.g. EBRD, etc.), buyer's credits for the promotion of Croatian exports, open lines of credit guaranteed by state export agencies, commodity loans for export and import financing. One of the most notable financial services provided by this Division has been arranging and participating in syndicated loan facilities on behalf of the Bank and its clients (PBZ is the market leader in Croatia in arranging syndicated loans). Through this Division PBZ is an active

participant in the secondary loan market and forfeiting transactions.
The PBZ's Group funding has also been a part of this Division's responsibilities.

Treasury Division

The PBZ Treasury Division is an important and among the top players on the Croatian market with a broad spectrum of financial solutions for large corporate and institutional investors.
The treasury division offers a comprehensive range of services, involving transactions on both the international and domestic money markets, capital markets, foreign currency markets and also manages the liquidity of the bank. The PBZ Treasury division is a reliable financial partner and has an active role in trading securities issued by the Ministry of Finance, currency and short-term cash derivatives on the money market.
The Treasury division consists of three sections: Securities, Foreign exchange, Money market. The Securities department operates with short, medium and long-term debt and owners' financial instruments. The money market section is involved in short-term securities, domestic and international T-bills, repo arrangements and deposits. In the foreign exchange section the most important segment of the activities is covered by the Corporate desk. It is mainly oriented to corporate clients and fulfilling their needs, wants and demands.
The foreign exchange department operates with foreign currencies on spot and forward, options and banknotes. The banknotes segment covers delivering, dispatching, processing and warehousing various shipments of foreign currencies. Privredna banka d.d. acts on the domestic market as one of the leading banks in this particular banking area. We are the market maker, especially in securities, commercial papers, government, municipal and corporate bonds issued on domestic and foreign markets. Considering the above, we can most proudly conclude that as well as participating domestically, as a priority we are focused and open towards the global markets.

Investment Banking Division

As the leader in the Croatian investment banking industry, the Bank's Investment Banking Division provides institutional and private clients with a wide spectrum of investment banking products and services through capital market activities, financial advisory and structured finance services, research, as well as asset management, brokerage and custody services. In cooperation with Banca Intesa and its affiliates in Hungary (CIB), Slovakia (VUB), Bosnia & Herzegovina (Upi banka) and Serbia (Banca Intesa Beograd), services to our clients are extended across South Eastern Europe.
With an outstanding reputation for innovative financial solutions, the Bank has been consistently recognized as the leading Underwriter and Arranger of debt issues in the Republic of Croatia. The Bank specializes in originating, underwriting and sales of a comprehensive range of debt securities, such as corporate commercial papers, eurobonds, corporate bonds, government bonds and municipal bonds. Through capital market activities, we provide financial solutions to a variety of debt issuers, including government entities, municipalities, corporate clients and institutional investors on the Croatian capital markets.
Within its structured finance activities, the Bank offers its clients services involving the origination and execution of securitization processes and project finance transactions. These encompass, among others, preparation of financial forecasts for planned projects; identification of structured transactions risks and proposals for risk reduction measures; due diligence processes and execution of securities issues for structured transaction purposes.
In the process of Croatia's transition to a market economy, encompassing numerous privatisations and company restructurings, the Bank introduced a series of financial advisory services to meet the requirements of the investment market. Our financial advisory services include: mergers and acquisitions; corporate restructuring and divestments; employee stock ownership programs; MBO's, LBO's and other transaction-based projects. We provide valuable insights into how companies can grow and enhance their shareholder value. Aligned with our industry capability and strong network base, we understand the dynamics of the marketplaces in which our clients operate as well as the intricacies of deal structuring and negotiations. We have represented clients in numerous industries, including oil and gas, IT, pharmaceuticals, food processing, confectionery, tourism, banking, retail, paper and paper products, sporting goods and others.
The Bank's research capacities are an indispensable information source to our investment banking operations. Through company valuations, financial analyses, credit potential analyses, company profiles and industry research reports, our clients are supplied with valuable information required for their investment banking decisions. Through asset management services, the Bank provides clients with customized strategic investment solutions in a range of traditional and alternative asset classes. Our offer includes: advisory services; asset allocation; cash management; investment management in equities and fixed income; real estate and other alternative areas. While maintaining an ongoing trustworthy relationship with our clients, assessing their investment objectives and respecting their risk tolerances, we strive to ensure that each client achieves competitive returns and maximum value added on assets invested.

In addition to the purchase and sale of securities on domestic and foreign stock exchanges, the Bank's brokerage services consist of providing detailed information on trading activities, supply and demand readily available through electronic trading systems, prompt reporting of securities transactions and margin loans. As the leader on the Croatian market, the Bank provides high quality custody services to institutional clients from all over the world who have faced the critical challenge of finding the right partner to deliver efficient local custody services with in-depth expertise in local market practice. The Bank is proud to emphasize that it is a sub-custodian for five of the world's largest and well-known global custodians. At the same time, by establishing and continuously developing its own custody network, the Bank offers domestic institutional and private clients access to local and foreign markets. As a depository bank for top Croatian investment funds, we ensure that investors' assets are protected, managed and valued according to regulatory requirements and acknowledged accounting standards. Our dedicated staff in the Investment Banking Division, focused know-how and experience, combined with the ability to access local and regional markets effectively, provide our clients with top quality products and services and the assurance required in successfully accomplishing all their business goals.

Support Division

This division offers full business support to all organisational units of the Corporate, Treasury and Investment Banking Group. In order to improve communication and relations with clients, the Support division has established an Information Centre where clients can obtain all relevant information pertaining to the products and services of the Corporate, Treasury and Investment Banking Group.

Small and Medium-size Enterprises Group

As part of the new organizational structure of the Bank, which has been in force since February 2006, the Small and Medium-size Enterprises Group was formed, so instead of the previous sector within the Corporate Banking Group, this segment of its operations has been raised to the highest organizational level.

A new form of business was introduced last year with small and medium sized enterprises based on Credit Scoring and today the Bank has four products related to Credit Scoring. Approximately 20 percent of the growth of the balance sheet in 2006 related to this Group was influenced by the Credit Scoring products. Credit Scoring enables flexibility and ensures proactive, direct approach to clients.

Project factoring was also introduced last year. Today the factoring desk is a modern and flexible part of the organization, with highly educated and motivated staff. Thanks to support from Intesa Mediofactoring, and the training and know how passed on, PBZ can now deal in international factoring, and PBZ is the only bank in Croatia to receive an international license in this field.

The "cluster" project was launched recently. In this way we have a special line of credit for sub-contractors of companies producing high quality and original Croatian products. It is planned to create similar lines for other products with confirmed Croatian quality, which are able to compete on the European market.

Currently, there are 50 SME desks already developed throughout PBZ's branch network. The development of the SME desk project for financial transactions has grown from a project into a permanent organizational structure.

RM online - new front line software application has recently been introduced to facilitate the work of our relationship managers. Through the use of this application, we will significantly reduce the paper work involved in the process today.

The SME Group consists of two divisions:

Small and Medium-size Enterprises (SME) Division

This division is responsible for operations with small-medium enterprises and companies owned by foreign institutions. In order to adequately run these operations the Division has split duties between three teams: Team for Small-Medium Enterprises, International Clients Acquisition Desk and Factoring Desk.
In addition to the afore-mentioned duties, the Division also coordinates and supervises operations of the Bank's subsidiaries, PBZ Leasing and Međimurska banka, which are subordinated to and under the control of the Division.

Division for Product Development and Branch Coordination

This Division is responsible for market research, product development primarily oriented towards small and medium enterprises as well as craftsmen, development of payment systems, SME desk management, branch coordination, call centre supervision and SME credit administration.
With the aim of running these operations appropriately the Division is supported by the following teams and departments: Team for branch coordination, Department for product development, Department for distribution channels and Credit administration department.

Logistics areas

Business areas focusing on client requirements can only fully exploit their potential if they are provided with a reliable and efficient infrastructure.
The Accounting, Financial control and General Administration Group, led by the Chief Financial Officer, provide skilful and in-depth support with regard to all financial monitoring and reporting matters, financial planning and budgeting as well as administrative assistance to the business groups.
The IT and Operations Group represents a key part of the organisation that serves the entire Bank by providing IT and communications assistance, supporting distribution channels and feeding the system with financial information.
Risk management and control is a crucial part of our commitment to providing consistent, high-quality returns for our shareholders. It is our belief that delivery of superior shareholder returns greatly depends on achieving the appropriate balance between risk and return. In this context, we established the Risk Management and Risk Control Group to protect the Bank from the risk of severe loss as a result of unlikely events arising from any of the material risks we face and to limit the scope of materially adverse implications to shareholder returns. Within the same Group there is a Loan recovery and restructuring division established with the goal of helping clients, who are unable to meet their financial obligations, to accomplish economic recovery through restructuring.
The Subsidiaries management division, the Human resource division, the Legal affairs and taxation management division, the Corporate communications office, the Economic research and strategic planning office, the Project management office, the Management Board office as well as the Supervisory Board office are integral elements of the overall logistics and support of the business groups and the management.

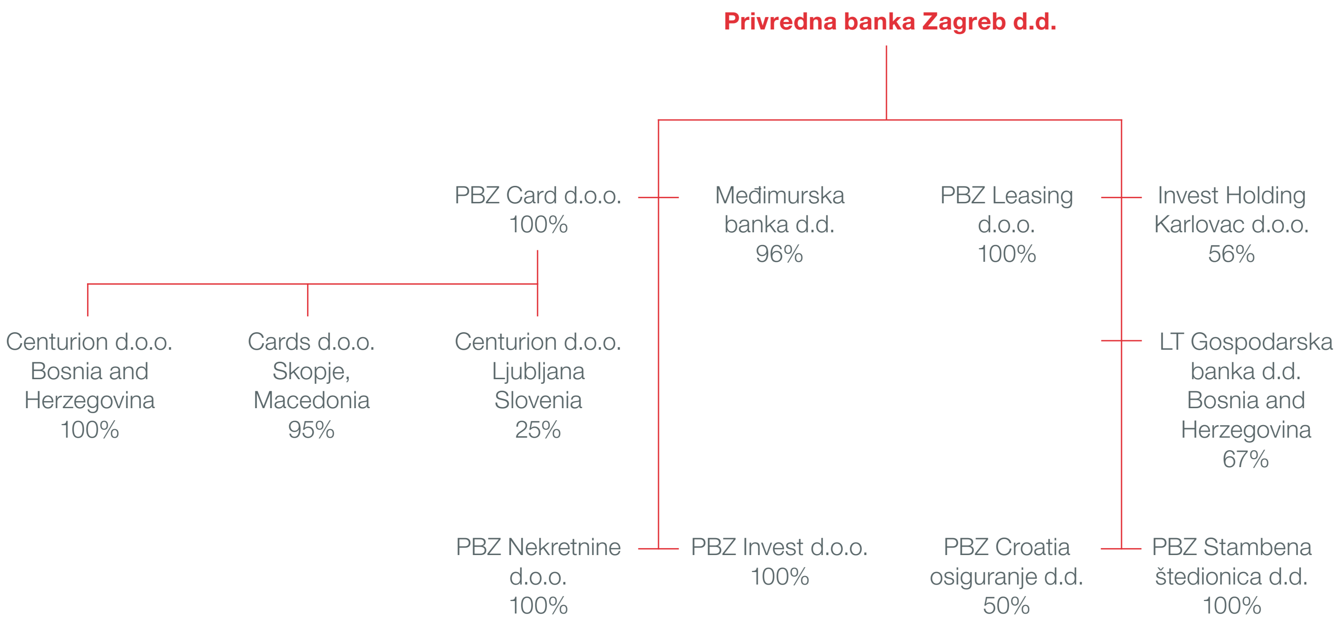
PLITVICE LAKES

The Plitvice Lakes, consisting of 16 colorful lakes, linked together by many travertine cascades, are a unique natural phenomenon and make the River Korana one of the most beautiful rivers in the world.

The Group

The Privredna banka Zagreb Group is a Croatian based financial services group which provides a full range of retail and corporate banking services to customers in Croatia. The Group employs some 4,178 employees and serves over 1.78 million both private and corporate clients in the country. PBZ Group today is a well-organized institution whose market share in the overall banking system stands at 19.1 percent.

On 31 December 2006 the Group consisted of Privredna banka Zagreb and 10 subsidiaries and 2 associates. The composition of the Group and a brief description of each subsidiary are set out below.



Međimurska banka

Međimurska banka was established in 1954 under the name of Zadružna banka i štedionica Čakovec. Since that time, the bank has experienced many changes both in name and organisational structure. It began operations under its current name in 1978 and became a joint stock company at the end of 1989. During 1996 Međimurska banka was among the first banks in Croatia to obtain the certificate for quality management standards in line with the ISO 9002 quality system.
Privredna banka Zagreb acquired a majority stake in Međimurska banka at the end of 2000, making it a member of the PBZ Group and Gruppo Banca Intesa (now Gruppo Intesa Sanpaolo).
Currently the bank has 17 branches located in the region of Međimurje. It uses its network to provide services to more than 5 thousand companies and over 150 thousand individual clients.
While monitoring the global trends in banking, the bank has continuously worked on expanding and updating its products and services. The bank is recognised as a pioneer in electronic banking in the country. Its main activities are concentrated on lending, and several new products have been launched including customer deposits, direct banking, card operations, kuna and foreign currency processing.
At the beginning of 1998, the bank introduced an interactive telephone banking service. Only a year later, they were the first in the country to launch the Internet banking system. The bank also significantly increased the number of ATMs and EFT POS units during the year.
Međimurska banka successfully completed the implementation and launch of its payment system during the payment system reform in 2002. The bank operates the system independently.
It opens and runs business accounts and payment transactions for corporate clients while offering them one-stop shop for banking services in less time and with lower costs.
Međimurska banka plans to continue operating in all its different activities with the support of PBZ while maintaining its own legal and business identity that is recognized by the market.

LT Gospodarska banka

LT Gospodarska banka, Sarajevo, Bosnia and Herzegovina, was established based on the ten year experience and business reputation of Gospodarska banka Sarajevo and LT Komercijalna banka Livno. Both banks merged in 2004 with aim of creating stronger capital base of the joint bank able to cover the entire territory of the Federation of Bosnia and Herzegovina.
In late 2006 Privredna banka Zagreb acquired the controlling interest of LT Gospodarska banka.
LT Gospodarska banka is the universal-type bank that provides services to corporate, retail as well as SME customers following the principles of Privredna banka Zagreb and according to modern banking standards. The Bank is currently expanding its presence outside the Federation of Bosnia and Herzegovina in order to reach larger customer base and increase its balance sheet.

PBZ Card

In late December 2005 charge, credit and debit card operations of PBZ were integrated with PBZ American Express into the new company, PBZ Card, that deals with all card operations of the PBZ Group. By combining all card brands - American Express, MasterCard and Visa, the largest card institution in the region has been established with around 1.7 million cards issued. The new company has established a joint IT platform for processing American Express, MasterCard and Visa products in Croatia and also for companies in Gruppo Intesa Sanpaolo that reside in several foreign markets. The aim of PBZ Card is to be the leader in the launch of innovative products and development of new technologies in the region. The company will strive to maintain the leading position and to continue its market penetration that will further increase PBZ's market share in card operations. PBZ Card aims to be a centre of excellence and market leader in card processing for all brands not just in the PBZ Group but also in Intesa Sanpaolo. No matter if American Express, MasterCard or Visa cards, the three leading card brands in the world, are used for shopping or for taking advantage of the related benefits and services linked to these cards, PBZ Card makes this possible throughout the world. PBZ Card is providing service to its clients 365 days in a year. American Express is an internationally recognised trademark always associated with exceptional quality. The trademark has been present here on the Croatian market since 1965. PBZ American Express was operating as a subsidiary of Privredna banka Zagreb from 1998. It has grown into the largest company in the country with over 1.7 million issued cards being accepted at approximately 50,000 service establishments countrywide. The company recorded total turnover on all cards in circullation in amount of more than HRK 15.7 billion.

PBZ Invest

PBZ Invest is a subsidiary of Privredna banka Zagreb specialising in the establishment and management of investment funds. The company was established in 1998 and is fully owned by Privredna banka Zagreb. PBZ Invest is an active member of the Financial Brokerage Association within the Croatian Employers' Association, as well as a member of the Group of investment fund management companies within the Croatian Chamber of Commerce.
Investment funds are state-of-the-art financial instruments managed by specialist managers that enable investors to earn a competitive return on money invested. PBZ Invest is confident that there is a good future for investment funds on the Croatian financial market. The company intends to offer its clients a wide range of investment funds, thus meeting the needs of investors with a variety of preferences and investment goals, ranging from conservative clients who prefer safety and liquidity of investment to those who are not averse to risk and want to see their investment grow over a long-term period.
With that in mind, PBZ Invest commenced with its first fund in 1999 - PBZ Novčani fond, an open-ended investment fund. At the "Golden Share" award ceremony for 2003, PBZ Invest received the award for the best company for investment fund management in Croatia. In recent years, six new funds were established: PBZ Euro novčani fond, PBZ Kunski novčani fond, PBZ Global fond, PBZ Bond fond, PBZ Dollar fond and PBZ Equity fond. In cooperation with PBZ, during 2005, PBZ Invest launched two tranches of a structured product - PBZ Protecto. The product is a combination of investment funds and classic savings with a Bank, with guarantee for invested money.

To date, assets under management in the funds run by the company have exceeded HRK 4 billion, which is an increase of more than 20.9 percent as compared to the previous year.

PBZ Novčani fond, open-ended investment fund

PBZ Novčani fond is an open-ended investment fund with a strictly conservative investment philosophy, focusing on low risk investments and high liquidity. The goal of the fund is to offer all its investors a low-risk investment, an uninterrupted and unconditional liquidity option, return on investment that is competitive by market standards and protection from adverse movements in the kuna exchange rate (investment with a currency clause option). Purchasing units of the Fund enables investors to earn higher returns on their investment than would be in a case with the usual savings account.

PBZ Bond Fund, open-ended investment fund

The investment fund was developed in association with Intesa Sanpaolo. The goal of the Fund is to enable both private and institutional investors to earn income by investing in first-class global bonds, issued by foreign governments, local governments and the most stable global corporations, denominated in stable global currencies.

PBZ Global Fund, open-ended investment fund

The Fund's operations consist of attracting cash assets by public bidding of its shares and investment of assets thus collected in safe and profitable instruments, offered on both domestic and foreign financial markets.
Given the strategy and the choice of instruments, the Fund is chosen by investors who want to invest their assets for a period of two to five years.

PBZ Euro novčani fond and PBZ Kunski novčani fond, open-ended investment funds

These funds are open-ended investment funds established in 2002, designed for domestic investors who wish their investments to be pegged to the Euro or Kuna.

PBZ Dollar Fund, open-ended investment fund

This money market fund was launched in May 2005 as the first domestic Money Market Mutual Fund denominated in USD. Assets are invested into low risk short-term Government securities, primarily issued by USA and securities denominated in USD issued by member countries of the EU and OECD. It is suitable for conservative investors who are more inclined to invest in dollars.

PBZ Equity Fund, open-ended investment fund

The newest fund of PBZ Invest and a higher risk fund offers its investors possibility of investing specifically in domestic and foreign shares. This fund is appropriate for individual investors interested in high return at significant risk.

PBZ Nekretnine

PBZ Nekretnine is a wholly owned subsidiary of Privredna banka Zagreb which engages in property transaction services, construction management and real estate valuation. Privredna banka Zagreb established PBZ Nekretnine with the goal of providing its clients with a complete range of services relating to property and investment in business projects. PBZ Nekretnine offers apartments, houses, business premises, construction sites and other properties for sale.
The activities of PBZ Nekretnine involve property transactions, property transaction services, property renting, construction, planning, construction supervision, construction evaluation, appraisal of property value, preparation of feasibility studies for investments, as well as legal supervision of works.
PBZ Nekretnine has a professional team capable of answering all its clients' complex requests. The company provides all kinds of services related to the activities mentioned, no matter how specific and complicated the clients' demands are. PBZ Nekretnine has 80% highly educated employees, five of which are court experts in the field of construction.
The company has been operating successfully within the Group since it was founded at the beginning of 1999. For the needs of its clients, PBZ Nekretnine has developed a network of associates and at the moment collaborates with almost 60 associates.

PBZ Leasing

PBZ Leasing is wholly owned by Privredna banka Zagreb. It was founded in 1991 under the name of PBZ Stan. In the beginning it dealt with property appraisals and restructuring of the public housing fund. During 1995, the company commenced granting car purchase loans by placing funds of Privredna banka Zagreb.
In the past several years, leasing has become core business activity of the company. Through both finance and operating leases, the company engaged in financing of real estates, vehicles, leasure boats, heavy machinery and equipment. Until the end of 2006, PBZ Leasing made over 5.3 thousand lease arrangements with customers, which in financial terms exceeded HRK 992 million.

PBZ Croatia osiguranje

PBZ Croatia osiguranje is a joint stock company for compulsory pension fund management. The company was incorporated on 26 July 2001 in accordance with the new changes in Croatian pension legislation and it is a joint project of both Privredna banka Zagreb d.d. and Croatia osiguranje d.d. with ownership in the company of 50 percent belonging to each shareholder.

The principal activities of PBZ Croatia osiguranje include establishing and management of the compulsory pension fund. After the process of the initial stages of gathering members, PBZ Croatia osiguranje fund became one of the three largest compulsory funds in the country. Despite fierce competition on the market, the company's pension fund continued to operate successfully during 2006. In the successful management of its funds, PBZ Croatia osiguranje relies on its positive experience to date in managing investment funds and association with Gruppo Intesa Sanpaolo asset management. At this point, the fund has close to 223 thousand members and net assets in personal accounts exceeding HRK 2.7 billion which represents a sound base for the long-term stable and profitable operation of the company.

PBZ Stambena štedionica

PBZ Stambena štedionica is the third largest building society on the Croatian financial market. It was founded by Privredna banka Zagreb. Given the large number of our clients interested in housing savings, the company offers them three types of savings: Prima, Basic and Golden savings. At present there are more than 115 thousand savings contracts which amount to more than HRK 983 million.

Prima and Basic types are aimed at clients whose goal is to make use of a housing loan with exceptionally favourable interest rates. Golden savings are designed for clients whose first intention is long-term saving. These forms of saving are run with a foreign currency clause in euros whilst deposits are insured in accordance with the Banking Law. There is also the possibility of changing the type of savings account whilst saving. Clients have the opportunity to manage their own savings accounts from their own home by means of Internet banking through PBZ365@NET and PBZ365 Optima services.

Invest Holding Karlovac

Invest Holding is a limited liability company incorporated on 11 November 1990. On 22 November 1990 it was registered in the Court Register in Karlovac. The sole founder of the company was Karlovačka banka d.d. On 12 December 1990 Karlovačka banka sold 56.38 percent of its shares in the company to Privredna banka Zagreb. The company is registered for various activities, however it mainly engages in renting its own premises acquired through the liquidation of Jugoturbina Karlovac.

CURAK

When the snow begins to melt from the mountain tops of Gorski kotar in the area around Skrad, the water collects in the Curak stream, which crashes down over the layered rocks like a free-fall parachutist into the spacious cave of Zeleni vir.

Overview of Activities in PBZ's Social Responsibility Program

Appendix to the Annual Report

PRIJATELJ

PROGRAM DRUŠTVENE ODGOVORNOSTI
PRIVREDNE BANKE ZAGREB

Introduction

We are aware that success in business is not only measured by financial results but, in today's modern society, it equally implies activities in the field of social responsibility and a contribution to sustainable development. Therefore PBZ has directed its energy at playing a proactive role in society and endeavors to be the initiator and supporter of ideas aimed at improving and advancing the quality of life in Croatia.

The corporate values promoted by Privredna banka Zagreb are: commitment to clients, team work, innovation and know-how, reliability and responsibility, ethics and transparency.

We aim to create a society that cares for the needs and potential of all its members and for this reason we launched a comprehensive program of social responsibility entitled PBZ Friend (PBZ Prijatelj).

We present below a brief overview of the activities in the Program in 2006.

PBZ and its Environment

1. The PBZ team

PBZ plans the development and training of its employees carefully and thoroughly, investing in creating a pleasant working environment, and endeavors to make it possible for each individual to fulfill his or her professional goals.

1.1. Training and professional development

The standard training programs include courses in basic business roles; for bank clerks, personal bankers, RSM, and cover the areas of technical know how and skills, software skills and legal regulations (safety at work, prevention of money laundering, etc). The courses are conducted by the Bank's internal trainers who work locally, in the regional offices. Alongside the standard internal programs, in conjunction with external experts/companies, courses are continuously run in foreign languages (including c. 10% of Bank employees) and in IT training, and specialized programs and courses aimed at development of management skills. With the aim of providing continuous training and management development for the Bank, the PBZ Business School was founded, offering 3 certified courses of management training: General Management, Operative/Sales management and Strategic Management. Each course includes 12 modules spread over three years - 4 modules a year, and the first generation of participants will include a total of 220 students, from young potential to senior management. The PBZ Business School will begin work at the beginning of 2007.

Analysis of Training in 2006	No. students	Total hours
INTERNAL COURSES	7,280	118,169
EXTERNAL COURSES	376	17,170
TOTAL	**7,656**	**135,339**
Postgraduate studies	40	

1.2. Internal communications

Internal communication takes place through a variety of channels. The Bank's Intranet contains operational news for employees (access is possible in all dislocated offices and it has more than 2300 visits (hits) daily). Some parts of the Bank have the authority to send e mail messages to "Everyone in PBZ", sending notices and information directly to employees' mail boxes.

Along with the periodical Moja Banka (My Bank) (containing mainly corporate news), in 2006 we also launched the monthly magazine PBZXpress which covers internal events and acquaints employees with one another. Both magazines are distributed to all Bank employees.

1.3. Care for employees

As part of its projects to support employees' families, the Bank organizes summer holidays for children of Bank employees from lower income families. Children aged from 6 to 12 years can stay in the Follonica Children's Village in Italy. Families of staff (close family members) can take part in the activities of the PBZ Standard Sport's Club, founded by employees of PBZ with the primary aim of organizing a variety of recreational sporting activities in a wide range of sports in all regional offices. By providing recreational activities, PBZ STANDARD seeks to improve the quality of life and health of every employee (and members of their families) and directly reduce sick leave. As well as sporting activities, PBZ STANDARD is about to launch the educational project "Prema Boljem Zdravlju" (Towards Better Health) for employees of the PBZ Group (and members of their families) which will organize talks by eminent experts in the field of medicine, sport, healthy nutrition etc.

The Bank also implements its social responsibility policy by helping former employees or the families of former employees suffering from illness or who have low incomes and help with the education of the children of former employees under certain conditions.

2. Donation and sponsorships

Privredna banka Zagreb endeavors to make a contribution and show its responsibility towards the wider community through sponsorship and donations. In 2006 a total of 5.3 million kunas was earmarked for donations, and 13.9 million kunas for sponsorship. The Bank contributes to development of local communities by actively involving our Regional branch offices into sponsorship and donation programs which comprises institutions, associations and individuals in Croatia.

2.1. Donations

Donations in 2006

Science and education	173,000 kn
Sport	821,000 kn
Culture	940,000 kn
Social solidarity	1,590,000 kn
Other	1,776,000 kn
Total	**5,300,000 kn**

We would like to emphasize especially some of the projects supported by PBZ this year:

- As part of its social responsibility program, PBZ donated three projects in the town of Vukovar. The donations were aimed at the restoration of the birth house of the world famous chemist and the first Croatian Nobel Prize winner, Lavoslav Ružička, purchase of land to build a sports and recreation centre beside Trpinjska cesta, and to build a modern children's playground on Mladost Island.
- PBZ donated a large amount of money to the town of Gospić for the Nikola Tesla Memorial Centre.
- In July 2006, PBZ, in conjunction with Zagrebačka and Splitska banks successfully completed the project started last year to purchase very expensive and valuable CT equipment and the machine was handed over for use to Zagreb General Hospital
- In terms of donations to cultural institutions and events, we mention in particular donations to the Croatian National Theatre in Varaždin, the Croatian Academy of Arts and Sciences, the Dubrovnik Summer Festival, the Vinkovci Autumn Festival, the Krapina Festival etc.
- There are numerous donations to sport, associations and events, we mention in particular: Football school Mravunac Fegeli (HNK Cibalia), Sailing club Rijeka, ŽKK Gospić, gymnastics club Ogulinski sokol, etc.

For several year Privredna banka Zagreb has been donated its written off computers, printers and other IT equipment to institutions, children's kindergartens, schools and individuals who show a need for this kind of equipment. This year we would like to point out in particular the donation of 10 computers to children at the children's homes St. Theresa of the Infant Jesus in Vrhovac and St. Joseph's in Hrvatski Leskovac, as part of the traditional humanitarian campaign of the Automobile Association Overboost.

2.2. Sponsorship

Sponsorship in 2006

Science and education	200,000 kn
Sport	12,482,000 kn
Culture	364,000 kn
Social solidarity	315,000 kn
Other	570,000 kn
Total	**13,931,000 kn**

Through its sponsorship policy, as well as promoting its own brand name, PBZ also seeks to support and encourage a large number of projects in the fields of culture, sport and science, and in that way contribute to the development of Croatian society.

- From its very outset in 2003 PBZ has been involved in the major Caritas fundraising campaign "For One thousand Joys". The aim of the campaign is to raise money to help 1000 low income families in Croatia from funds which businesses set aside for Christmas and New Year's parties. As well as donating money, PBZ supports the campaign by buying Caritas' Christmas cards.
- As a member of the Croatian Olympic POOL, PBZ earmarks funds every year to finance the Croatian Olympic Committee and in that way provides for the quality preparation of our Olympic sportsmen and women
- The bank is a sponsor of numerous sport teams eg. VK Jug Dubrovnik (waterpolo), KK zadar (basketball) and various football teams.

Over the past years we have supported a large number of projects related to literature, music, the theatre and art, whether by already established artists or young emerging talent.

3. Culture

"Codex Atlanticus"

From 6th December 2006 to 25th February 2007 the exhibition - Leonardo da Vinci - Codex Atlanticus was on display at the Arts and Crafts Museum in Zagreb.
PBZ was the sponsor of this valuable project, which came to Zagreb under the auspices of the Ministry of Culture of Republic of Croatia, the City of Zagreb, the Italian Embassy and the Italian Cultural Institute.
The world of the ideas of the brilliant mind of the Renaissance artist and scientist, Leonardo da Vinci, gathered together in the famous exhibition "Codex Atlanticus" attracted more than 70 thousand visitors in under 2 months. The exhibition was accompanied by interesting talks on the many facets of this great man, who left his mark in all fields of life.
As well as the projects we have emphasized, PBZ supports many cultural institutions, events and projects to protect and restore cultural monuments.

4. Humanitarian work

The PBZ Voluntary Blood Donors Society

In 2006 the work continued of the Voluntary Blood Donors Society, which has been operating within PBZ for 16 years. The Society has about 150 active members and they work to encourage other employees to take part, so this number grows from year to year. They donate blood three times a year (in February, June and October), when about 300 doses of blood are collected.

PBZ Scholarships

From its profits in 2005 PBZ earmarked a million kunas for scholarships for 50 students from low income families. The money was given for the 2006/2007 academic year, and 500 applications were received in response to the offer. According to criteria set earlier, 50 annual scholarships were awarded, amounting to 1600 kunas a month.

AC Milan Camp

In August 2006 PBZ organized a sports camp for young people in Zagreb and Split - the AC Milan Junior Camp. With the help of Banca Intesa, who has been a sponsor of the club for many years, AC Milan enabled children to train with one of the best football schools with the help of coaches from Dinamo and Hajduk. This camp was free for 300 children from all over Croatia, including 60 children from the children's homes in Nazorova, Hrvatski Leskovac, and Maestral in Split. All the children who took part in the camp were given free football equipment and they were able to work with top coaches. The people of Zagreb had the opportunity to enjoy the program of the AC Milan Park, which was open free for all visitors.

5. Projects/cooperation

- In cooperation with UNDP in Croatia and the Croatian Banking Association, PBZ is actively involved in a pilot project of responsibility in banking, organizing educational interactive workshops entitled "Managing your Personal Finances". The Bank will continue its successful cooperation this year on this project again, and it will be run in a further seven major centers in Croatia as well as in Zagreb.

- PBZ has joined the international student exchange program for pupils aged 15 to 18 years run by the AFS (Associated Field Service), a highly regarded international voluntary, not-for-profit organization dealing in exchanges of pupils. PBZ sponsors two one year scholarships in Italy.
- PBZ has launched the PBZ Bridge project - the first program of student loans with extremely favorable terms which enables students (for now in the pilot phase, students of the Faculty of Electrical Engineering and Computing) to bridge more easily the period from study to employment. For the five best students scholarships are awarded in conjunction with Banca Intesa and they have the opportunity to take part in the Double Degree program at one of the most prestigious Italian faculties - Politecnico di Milano.

PBZ supports and participates in the work of the Community for Social Responsibility within the Croatian Chamber of Commerce, works with the UNDP in Croatia on projects in the field of social responsibility and has recently joined the global initiative Global Compact.

6. Ecology

As part of its care for the environment, when plans are being made to fit out its business premises, the Bank prescribes the use of ecologically acceptable materials. It is required that the equipment and apparatus used in the business premises does not contain or does not use substances that are harmful to the environment beyond the values defined by regulations. Also when decorating and equipping the Bank's business premises, the use of apparatus and equipment is prescribed with low levels of energy consumption and a high level of energy use. In the course of its work, the Bank generates various types of waste - printer cartridges, shredded paper, office paper, cardboard and plastic bottles. All of the aforementioned types of waste are collected, sorted and forwarded by the Bank for recycling.

7. Business policies

Social criteria plays an important role in our business practice and includes the following:

- equal employment opportunities, regardless of gender, nationality, age, disability, sexual orientation, or religion;
- adherence to high ethical standards when dealing with our clients;
- contribution to society through our business activities;
- participation in environmental management processes.

In relation to this, we do business completely in accordance with the Decisions by the Management Board of the Bank, especially the one adopting the Procedure on Prevention of Financing of Excluded Activities and the Procedure for monitoring ecological risk, relating to non-fulfilment of criteria for environment protection or business opposed to general moral standards. Three basic instruments which Bank uses in measurement of clients ecological risk are 1. Ecological evaluation of client on the basis of his field of activity; 2. Eco questionnaire and Eco statement (depending whether client was classified in low, medium or high risk category); 3. Obligatory contract clause. Through anti money laundering procedures set by Bank, as well as through cooperation with market regulators, the Bank contributes to society and makes effort to protect its business operations.

Corporate governance

In accordance with the Companies Law and its Article of Association, the Bank has a Supervisory Board and a Management Board. The two boards are separate and no individual may be a member of both boards. The duties and responsibilities of members of both boards are regulated by the Companies Law.

Supervisory Board

The Supervisory Board consists of seven members. The Board meets quarterly and oversees the Management Board. The current members of the Bank's Supervisory Board, appointed on the three year term by the Extraordinary General Assembly held on 30 January 2007, are as follows:

György Surányi
(President of the Supervisory Board, Intesa Sanpaolo)
Giovanni Boccolini
(Vicepresident of the Supervisory Board, Intesa Sanpaolo)
Adriano Arietti
(Member of the Supervisory Board, Intesa Sanpaolo)
Massimo Malagoli
(Member of the Supervisory Board, Intesa Sanpaolo)
Massimo Pierdicchi
(Member of the Supervisory Board, Intesa Sanpaolo)
Paolo Grandi
(Member of the Supervisory Board, Intesa Sanpaolo)
- appointed on 1 July 2006
Anne Fossemalle
(Member of the Supervisory Board, EBRD)
- appointed on 1 July 2006

Luigi de Puppi de Puppi
(Member of the Supervisory Board, Intesa Sanpaolo)
- resigned on 30 June 2006
Claudio Viezzoli
(Member of the Supervisory Board, EBRD)
- resigned on 31 May 2006

Management Board

The Management Board consists of seven members with each being allocated a specific area of responsibil-ity. The Management Board meets at least twice a month to discuss and determine the operating policies of the Bank.
Following the three year term the mandate of the former Management Board expired on 6 February 2006. Accordingly, the new Management Board was appointed on the three year term effective from 7 February 2006.

Management Board members:

Božo Prka,
President of the Management Board
Giancarlo Miranda,
Vicepresident of the Management Board, responsible for the Risk Management and Control Group
Tomislav Lazarić,
Vicepresident of the Management Board, responsible for the Retail Banking Group
Gabriele Pace,
Chief financial officer, responsible for the Accounting, Financial Control and General Administration Group
Ivan Gerovac,
responsible for the Corporate, Treasury and Investment Banking Group
Mario Henjak,
responsible for the SME Banking Group
Draženko Kopljar,
responsible for the Information Technology and Operations Group

Report on the Bank's Corporate Governance

Privredna banka Zagreb d.d. deems responsible corporate governance an essential part of the Bank's identity and a prerequisite for the realization of long-term values, both for the shareholders and others who are interested in efficient performance of the Bank, as well as an important element of safe and stable business operations.
In view of the foregoing, the Bank implements currently valid external and internal regulations, along with the rules of the parent bank - Intesa Sanpaolo S.p.A, whenever these rules are not contrary to the valid regulations of the Republic of Croatia, and monitors the compatibility of its organizational structure, in order to be able to identify in due time the need for an organizational change or adjustment.
The Bank believes that good corporate governance is not only achieved by full satisfaction of regulatory requirements, but that it also stems from the corporate culture established in the Bank as well as personal integrity of the Bank management and its employees.
Key principles of the Bank's corporate governance involve:

(1) protection of the shareholders' rights,
(2) establishment of a structure enabling the Bank to set the strategic objectives and promote key corporate values as well as establishment of an adequate infrastructure required for their implementation and monitoring, which is achieved, among other, through the supervision of business activities by the Supervisory Board and functioning of the internal control system,
(3) successful cooperation between the Supervisory Board and the Management Board of the Bank,
(4) establishment of clear lines of responsibility in the Bank,
(5) good and transparent relations and communication between all the Bank's bodies, employees, management, shareholders, Bank's customers and the public.

The Management Board and the Supervisory Board of the Bank, in cooperation with the Bank's organizational unit in charge of the subsidiary management and supervision, provide for adequate implementation of the basic principles of corporate governance in the member companies of the PBZ Group.

Corporate governance principles of Privredna banka Zagreb d.d. are implemented in the following way:

1. Shareholders and General Meeting of the Bank

1.1. Shareholders

Shareholders are entitled to vote at the General Meeting of the Bank if registered with the Central Depositary Agency as the Bank's shareholders on the working day immediately preceding the holding of the General Meeting. Each share gives the right to one vote, the right to dividend and other rights granted by the law and the Articles of Association of the Bank.

1.2. General Meeting

The Management Board calls the General Meeting of the Bank at least once a year by publishing the announcement on calling of the General Meeting and the draft decisions in "Narodne novine", the official gazette of the Republic of Croatia. The General Meeting of the Bank cannot decide on agenda items that have not been properly announced.
The Annual General Meeting is called by the Management Board of the Bank immediately after the Supervisory Board has examined the annual financial reports, reports on the Bank's business operations and the draft decision on the profit allocation. The General Meeting takes note of the annual financial reports and the report of the Management Board of the Bank on the operation of the Bank, and in accordance with them it adopts the decision on the allocation of profit and the decisions on granting the approval of action to the members of the Management Board and the Supervisory Board of the Bank, thereby approving their handling of the Bank affairs in the relevant business year.
Pursuant to the law and the Articles of Association of the Bank, the General Meeting also decides on the amendments to the Articles of Association, increase and decrease of the share capital, election and recalling of members of the Supervisory Board and appointment of auditors who will carry out the audit of business operations of the Bank.

2. Cooperation of the Management Board and the Supervisory Board of the Bank

Effective cooperation between the Management Board and the Supervisory Board has been established for the benefit of the Bank. In view of the aforesaid, the Management Board of the Bank adopts, subject to the consent of the Supervisory Board of the Bank, basic operating documents - the budget for the current year and the three-year strategic business plan, and regularly discusses their realization with the Supervisory Board (through financial reports submitted on a quarterly, semi-annual and annual basis).
The law, Articles of Association and decisions of the Supervisory Board of the Bank prescribe that certain types of activities may be carried out only subject to a prior consent of the Supervisory Board, such as: changes to the Bank's organizational structure, approval of limits on the Bank's risk exposure to one person and its related parties, including also loan restructuring, approval of trading limits on market risks exposures and other.
An important element of successful cooperation is related to the fact that the Management Board provides the

Supervisory Board with conscientiously prepared, accurate and timely reports, generally made in writing, in particular reports that deal with the business policy and possible departures from the previous forecasts (explaining causes of such departures); reports on financial plans, risk management, transactions that might affect the profitability and liquidity of the Bank, the course of business operations, especially the Bank's income and financial position, as well as all other matters related to the conduct of affairs. Furthermore, the Supervisory Board can at any time request the Management Board to provide it with information on the matters related to the conduct of the Bank's affairs which have or might have a substantial impact on its position.
Good cooperation is reflected in an ongoing open dialogue between the Management Board and the Supervisory Board, and between members within those bodies.

3. Management Board of the Bank

The Management Board of the Bank manages the Bank's operation at its own responsibility and represents the Bank in respect to third persons. The Management Board acts in the Bank's best interest in order to ensure making of a profit.

3.1. Authorities and composition of the Management Board and remuneration paid to its members

The Management Board of the Bank in particular ensures: the Bank's compliance with the risk management rules; monitoring of risks that the Bank is exposed to in the business operations and adoption of risk management procedures; systematic monitoring, assessment and strategy for maintaining or achieving capital adequacy in respect to the risks that the Bank is exposed to in its business operations; functioning of the internal control system for all the business areas of the Bank; undisturbed internal auditing; keeping of business and other books and business documentation, preparation of bookkeeping documents, reasonable assessment of assets and liabilities, drafting of financial and other reports pursuant to the accounting regulations, standards and the law; reporting and notifying the Croatian National Bank in pursuance of the law and implementing measures imposed by the central bank.
The Management Board of the Bank consists of seven members, of whom one is the president and two are deputy presidents of the Management Board. Decision on the distribution of authorities, adopted with the consent of the Supervisory Board, defines the authorities and the responsibilities of the president, deputy presidents and other members of the Management Board.
The president of the Management Board of the Bank manages the work of the Management Board, coordinates and harmonizes all business functions and support functions in the Bank and, in the name of the Management Board, submits reports to the Supervisory Board and the General Meeting of the Bank. Individual members of the Management Board are in charge of and responsible for specific business areas.
The Supervisory Board of the Bank makes the decisions, through its advisory body - the Executive Committee, on remuneration to be paid to the members of the Management Board of the Bank, which includes the fixed amount of the annual salary and the variable part (bonus based on participation in the profit sharing, as stipulated by the bonus policy adopted by the Bank, in which respect the amount to be paid to the management and the employees is published in the decision adopted by the General Meeting), taking into account that the total remuneration to a member of the Management Board should be in consistence with the work performed by a particular member, as well as with the Bank's position.

3.2. Conflict of interest

Rules (internal and external) governing the conflict of interest are observed by the Bank in the best possible manner and transparently.
According to the said rules, and especially the Code of Ethics of the Bank, members of the Management Board of the Bank: (1) must not, without the consent of the Supervisory Board, carry out, for their own account or for the account of others, any transactions falling within the Bank's scope of activities (prohibition of competition), (2) cannot be members of the management board of another commercial company, (3) cannot be members of the supervisory board of a bank registered in the Republic of Croatia and, if they are members of the supervisory board of a commercial company, they are required to inform the Supervisory Board of the Bank of that without delay, (4) are required to report every transaction whereby they directly or indirectly acquire or sell the securities issued by the Bank to the Agency for the Supervision of Financial Services and to the Zagreb Stock Exchange, on which the securities are listed.
Granting of loans to the members of the Management Board, their immediate family and to legal entities related to the members of the Management Board is, according to the law, subject to the previous consent of the Supervisory Board.
When discharging their duties, members of the Management Board of the Bank cannot make decisions or perform activities which are contrary to or in conflict with the Bank's interests, and which are thus irreconcilable with their position. Furthermore, they must not disclose privileged information, use their knowledge of the privileged information in order to make profit for

themselves or for third persons, or use such privileged information for other inadequate purposes, or receive gifts whose value exceeds a symbolic one.

3.3. Committees of the Management Board

The following permanent bodies assist the Management Board of the Bank in its work: Asset and Liability Committee, Credit Committee of the Bank, Asset Quality Monitoring Committee, Committee for the Bonus Policy in the Member Companies of the PBZ Group, Change Management and Compliance Committee - with the Compliance Subcommittee, and the Real Estate Committee.

4. Supervisory Board of the Bank

4.1. Authorities and composition of the Supervisory Board and remuneration paid to its members

The Supervisory Board of the Bank once a year submits to the General Meeting of the Bank a report on its work and the work of the committees it established.

The Supervisory Board appoints and recalls members of the Management Board of the Bank, directs the Bank's business policy, actively contributes to its realization, and supervises the conduct of affairs.

In that respect, the Supervisory Board of the Bank: (a) considers the reports referring to the business policy, financial results of the Bank and the PBZ Group, the quality of risk assets of the Bank and its subsidiaries, operational risk, work of the internal audit, status of elimination of the irregularities found during the supervision conducted by the central bank, external auditors, auditors of the parent bank and the Bank's internal auditors, (b) gives consents to the decisions of the Management Board and other bodies of the Bank in accordance with the law, the Bank's regulations and its own decisions, (c) adopts the annual work plan and programme of the Bank's internal audit, and (d) determines, together with the Management Board, draft decisions to be submitted to the General Meeting of the Bank.

In pursuance of the Articles of Association and the decision of the General Meeting of the Bank, the Supervisory Board of the Bank has seven members who, from among themselves, elect the president, who also chairs the General Meeting, as well as the deputy president. According to the rules of Intesa Sanpaolo, the president of the Supervisory Board once a year receives the reward for his work in the amount established by the decision of the General Meeting of the Bank published in "Narodne novine".

Five members of the Supervisory Board are elected by the General Meeting of the Bank, while two of them are directly appointed by the largest shareholders of the Bank (Intesa Holding International S.A., Luxembourg, and the European Bank for Reconstruction and Development, London).

4.2. Conflict of interest

All members of the Supervisory Board are required to act in the best interest of the Bank, which means that they may not pursue their personal interests when adopting decisions or use their position in order to achieve personal benefit.

As regards the conflict of interest, rules applicable and set out for the members of the Management Board adequately apply also to the members of the Supervisory Board.

4.3. Committees of the Supervisory Board of the Bank

For the purpose of better preparation of decisions that fall within the scope of authority of the Supervisory Board as well as better monitoring of implementation of these decisions, which is aimed at increasing the efficiency of the Supervisory Board, the Audit Committee, whose establishment is required by law, and the Executive Committee were set up. Both of the aforementioned committees regularly report to the Supervisory Board on their activities at the Board meetings.

The Audit Committee deals with the following matters that fall under the responsibility of the Supervisory Board of the Bank, especially: financial reporting; the internal audit process and its efficiency and the internal control system; the risk management system; harmonization of business operations of the Bank and members of the PBZ Group with recommendations of auditors from the central bank, other supervisory institutions, and the parent bank; progress in the preparation of procedures and instructions in the Bank and the PBZ Group members; observance of laws and by-laws and the Bank's regulations; as well as the supervision of the auditing of financial and consolidated reports and maintenance of the permanent contact with the external auditors.

The Executive Committee especially contributes to fast and efficient handling of requests regarding the Bank's credit risk exposure to customers - legal entities and their related parties. Furthermore, the Executive Committee gives consent to the organizational changes that need to be effected in order to increase the quality of the Bank's business operations.

5. Internal Control System

In order to protect its assets, the Bank has set up the system of internal controls, which is a system of procedures and processes designed to monitor the efficiency of the Bank's operations, reliability of financial reporting as well as compliance with legal regulations, by-laws and good business practices. Along with the members of the Management Board and the Supervisory Board, all employees and organizational units of the Bank take part

in the implementation of the above mentioned control measures which are directly or indirectly incorporated into the business processes.
The system of internal controls is implemented via three mutually independent functions: (1) risk management function, (2) compliance function, with special emphasis on the anti-money laundering measures, and (3) internal audit function.
A well-organized internal control system enables the Bank to monitor and identify in due time any material risk to which the Bank is exposed in the course of its business operations.

6. Transparent and timely reporting

The Bank, as a socially responsible financial institution, has defined basic communication principles that provide guidelines for daily communication and relations with the public and for the internal communication. Special emphasis has been put on the relations and communication with customers, which is subject to the provisions of the Bank's Code of Ethics and Code of Professional Ethics, as approved by the Croatian Chamber of Economy and accepted by the Bank.
The Bank's shareholders and the public are notified in due time, via the media and the Zagreb Stock Exchange, of the Bank's financial results and material facts that might affect the capital structure of the Bank and the assessment of value of the issued securities, such as the intention to increase the share capital, the acquisition or sale of a larger number of treasury shares, substantial status changes and other facts considered important for the capital market.

With respect to the foregoing, Privredna banka Zagreb d.d. hereby declares that an adequate corporate structure has been set up and that the Bank, taking into account the environment in which it operates, is appropriately organized and that all the accepted principles of corporate governance were observed in 2006 and will continue to be observed henceforth.

Privredna banka Zagreb d.d.

RASTOKE

Rasoke in Slunj are the finest example of the harmonious union of man and nature, a community of mills, where the waters of the Korana and the Slunjčica flow and join together to fall down to the valley from incredible heights.

Statement of responsibilities of the Management Board

Pursuant to the Croatian Accounting Law in force, the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with the International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB) which give a true and fair view of the financial position and results of the Bank and the Group for that period.

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

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

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

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

Signed on behalf of the Management Board

Božo Prka, M.S.
Privredna banka Zagreb d.d.
Račkoga 6
10000 Zagreb
Republic of Croatia

20 February 2007

Independent auditors’ report

Deloitte.

Deloitte d.o.o.
Heinzelova 33
10 000 Zagreb
Croatia

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Independent auditors' report

To the shareholders of Privredna banka Zagreb d.d.:

We have audited the accompanying financial statements of Privredna banka Zagreb d.d. (the 'Bank') and of Privredna banka Zagreb d.d. and its subsidiaries (the 'Group') (page 56 to 116), which comprise the balance sheet as at 31 December 2006, and the related income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's and the Group's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the Bank and of the Group as at 31 December 2006, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte d.o.o.
Branislav Vrtačnik, Certified Auditor

Zagreb, Republic of Croatia
1 March 2007

Income statement

(in HRK million)	NOTE	GROUP 2006	GROUP 2005	BANK 2006	BANK 2005
Interest income	2	2,976	2,610	2,720	2,416
Interest expense	2	(1,262)	(1,027)	(1,185)	(991)
Net interest income		**1,714**	**1,583**	**1,535**	**1,425**
Fee and commission income	3	1,077	935	488	524
Fee and commission expense	3	(218)	(221)	(197)	(201)
Net fee and commission income		**859**	**714**	**291**	**323**
Other operating income	4	466	391	444	401
Operating income		**3,039**	**2,688**	**2,270**	**2,149**
Provisions	5	(153)	(118)	(57)	(56)
Other operating expenses	6, 7	(1,420)	(1,323)	(1,007)	(1,007)
Depreciation and amortisation of property and equipment and intangible assets	8	(255)	(227)	(165)	(163)
Share of the profit and loss accounted for using the equity method		8	6	-	-
Profit before income taxes		**1,219**	**1,026**	**1,041**	**923**
Income taxes	9	(254)	(210)	(194)	(173)
Net profit for the year		**965**	**816**	**847**	**750**
Attributable to:					
Equity holders of the parent		963	814	847	750
Minority interests		2	2	-	-
		965	**816**	**847**	**750**
			in HRK		**in HRK**
Basic/diluted earnings per share	48	56.9	49.0	50.1	45.2

The accompanying accounting policies and notes are an integral part of this Income statement.

Balance sheet

Assets (in HRK million)	NOTE	GROUP 2006	GROUP 2005	BANK 2006	BANK 2005
Cash and current accounts with other banks	10	2,576	1,949	2,328	1,860
Balances with Croatian National Bank	11	7,262	5,395	7,049	5,184
Financial assets at fair value through profit or loss	12	3,056	4,467	3,074	4,467
Derivative financial instruments	13	44	17	44	17
Due from banks	14	7,235	7,829	6,935	7,585
Loans and advances to customers	15	36,910	28,640	33,572	26,687
Assets available for sale	16	1,305	386	53	24
Held to maturity investments	17	1,358	1,352	1,158	1,329
Equity investments in subsidiaries and associates	18	45	38	404	298
Intangible assets and goodwill	19	200	147	65	62
Property and equipment	20	1,381	1,172	883	743
Investment property	21	14	14	14	14
Non-current assets held for sale	22	18	101	18	94
Other assets	23	449	230	226	129
Deferred tax assets	9	121	73	83	60
Total assets		**61,974**	**51,810**	**55,906**	**48,553**

Balance sheet / continued

Liabilities (in HRK million)	NOTE	GROUP 2006	GROUP 2005	BANK 2006	BANK 2005
Due to banks	24	4,518	3,273	4,503	3,911
Due to customers	25	36,843	32,391	33,491	30,004
Derivative financial instruments	26	15	19	15	19
Financial liabilities held for trading	12	735	1,188	735	1,188
Other borrowed funds	27	9,956	8,231	9,147	7,978
Debt securities issued	28	119	19	-	19
Other liabilities	29	1,832	1,569	649	759
Accruals and deferred income	30	120	112	66	67
Provisions for risks and charges	31	211	188	186	175
Total liabilities		**54,349**	**46,990**	**48,792**	**44,120**
Equity attributable to equity holders of the parent					
Share capital	33	1,907	1,666	1,907	1,666
Treasury shares		(27)	(20)	(27)	(20)
Share premium		1,570	-	1,570	-
Reserves and retained earnings	34	3,167	2,338	2,817	2,037
Profit and loss attributable to equity holders of the parent entity		963	814	847	750
		7,580	4,798	7,114	4,433
Minority interests		45	22	-	-
Total shareholders' equity		**7,625**	**4,820**	**7,114**	**4,433**
Total liabilities and shareholders' equity		**61,974**	**51,810**	**55,906**	**48,553**

The accompanying accounting policies and notes are an integral part of this Balance sheet.
These financial statements were signed on behalf of the Management Board on 20 February 2007.

Božo Prka, M.S.
President of the Management Board

Gabriele Pace
Chief financial officer

Cash flow statement

(in HRK million)	GROUP 2006	GROUP 2005	BANK 2006	BANK 2005
Cash flow from operating activities				
Net profit for the year	965	816	847	750
Provisions for bad and doubtful debts	153	118	57	56
Gains from sale of property and equipment	(38)	(17)	(37)	(16)
Depreciation and amortization	255	227	165	163
Taxes paid	(200)	(196)	(164)	(162)
	1,135	**948**	**868**	**791**
(Increase)/decrease in operating assets				
Balances with Croatian National Bank	(1,867)	(798)	(1,865)	(829)
Due from banks	307	(152)	147	(348)
Loans and advances to customers	(8,037)	(4,566)	(6,923)	(4,624)
(Acquisitions)/sale of assets held for trading and assets available for sale	579	(1,066)	1,383	(1,086)
Other assets	(327)	56	(89)	72
Increase/(decrease) in operating liabilities				
Due to banks	1,208	3,215	592	3,365
Due to customers	3,961	2,461	3,487	2,599
Other liabilities	(8)	325	(408)	127
Net cash (used in)/from operating activities	**(3,049)**	**423**	**(2,808)**	**67**
Cash flows from investing activities				
Purchase of property and equipment and intangible assets	(376)	(486)	(253)	(264)
Acquisition of subsidiary, net of cash acquired	90	-	(81)	-
Acquisition of long term investment	(7)	(1)	(25)	-
Repayment/(purchase) of assets held to maturity	(6)	322	171	334
Net cash (used in)/from investing activities	**(299)**	**(165)**	**(188)**	**70**
Cash flows from financing activities				
Dividends paid	-	(271)	-	(271)
Additional paid in capital	1,811	-	1,811	-
Other borrowed funds	1,806	322	1,150	129
Net cash (used in)/from financing activities	**3,617**	**51**	**2,961**	**(142)**
Net increase/(decrease) in cash	**269**	**309**	**(35)**	**(5)**
Cash and cash equivalents at the beginning of the year	8,778	8,469	8,542	8,547
Cash and cash equivalents at the end of the year	9,047	8,778	8,507	8,542
Supplementary information				
Interest paid	1,307	1,043	1,185	990
Interest received	2,494	2,244	2,202	2,107
Dividends paid	-	271	-	271
Dividends received	1	2	104	106

The accompanying accounting policies and notes are an integral part of this Cash flow statement.

Statement of changes in equity

(in HRK million)	Share capital	Treasury shares	Share premium	Reserves and retained profits	Total	Minority interests	Total equity
	Attributable to equity holders of the parent						
Group							
Balance at 1 January 2005	**1,666**	**(12)**	**-**	**2,610**	**4,264**	**22**	**4,286**
Effect of changes in accounting policies	-	-	-	(11)	(11)	-	(11)
As restated	**1,666**	**(12)**	**-**	**2,599**	**4,253**	**22**	**4,275**
Capital gain on disposal of treasury shares	-	-	-	7	7	-	7
Net profit for the year	-	-	-	799	799	2	801
Effect of changes in accounting policies on Income statement	-	-	-	15	15	-	15
Effect of changes in accounting policies on Other reserves	-	-	-	4	4	-	4
Total income and expense for the year	**-**	**-**	**-**	**825**	**825**	**2**	**827**
(Purchase)/sale of treasury shares	-	(8)	-	-	(8)	-	(8)
Dividends paid	-	-	-	(271)	(271)	-	(271)
Other movements	-	-	-	(1)	(1)	(2)	(3)
Balance at 31 December 2005	**1,666**	**(20)**	**-**	**3,152**	**4,798**	**22**	**4,820**
Net gains on available for sale financial investments	-	-	-	4	4	-	4
Capital gain on disposal of treasury shares	-	-	-	11	11	-	11
Total income and expense for the year recognised directly in equity	**-**	**-**	**-**	**15**	**15**	**-**	**15**
Net profit for the year	-	-	-	963	963	2	965
Total income and expense for the year	**-**	**-**	**-**	**978**	**978**	**2**	**980**
Increase of share capital	241	-	1,570	-	1,811	-	1,811
(Purchase)/sale of treasury shares	-	(7)	-	-	(7)	-	(7)
Acquisition of LT Gospodarska banka	-	-	-	-	-	21	21
Balance at 31 December 2006	**1,907**	**(27)**	**1,570**	**4,130**	**7,580**	**45**	**7,625**

Statement of changes in equity / continued

(in HRK million)	Attributable to equity holders of the parent: Share capital	Treasury shares	Share premium	Reserves and retained profits	Total	Minority interests	Total equity
Bank							
Balance at 1 January 2005	**1,666**	**(12)**	**-**	**2,261**	**3,915**	**-**	**3,915**
Capital gain on disposal of treasury shares	-	-	-	7	7	-	7
Net profit for the year	-	-	-	752	752	-	752
Effect of changes in accounting policies on Income statement	-	-	-	(2)	(2)	-	(2)
Total income and expense for the year	**-**	**-**	**-**	**757**	**757**	**-**	**757**
Integration of Laguna banka	-	-	-	40	40	-	40
(Purchase)/sale of treasury shares	-	(8)	-	-	(8)	-	(8)
Dividends paid	-	-	-	(271)	(271)	-	(271)
Balance at 31 December 2005	**1,666**	**(20)**	**-**	**2,787**	**4,433**	**-**	**4,433**
Net gains on available for sale financial investments	-	-	-	19	19	-	19
Capital gain on disposal of treasury shares	-	-	-	11	11	-	11
Total income and expense for the year recognised directly in equity	**-**	**-**	**-**	**30**	**30**	**-**	**30**
Net profit for the year	-	-	-	847	847	-	847
Total income and expense for the year	**-**	**-**	**-**	**877**	**877**	**-**	**877**
Increase of share capital	241	-	1,570	-	1,811	-	1,811
(Purchase)/sale of treasury shares	-	(7)	-	-	(7)	-	(7)
Balance at 31 December 2006	**1,907**	**(27)**	**1,570**	**3,664**	**7,114**	**-**	**7,114**

There was no distribution of dividends during 2006. In 2005 16.3 HRK per share was disbursed to equity holders.
The accompanying accounting policies and notes are an integral part of this Statement of changes in equity.

Accounting policies

1 | Accounting policies

A summary of the Group's principal accounting policies is set out below.

Basis of accounting

The Bank and the Group maintain their accounting records in Croatian Kuna and in accordance with Croatian law and the accounting principles and practices observed by financial enterprises in Croatia.

Basis of preparation

The financial statements of the Bank and the Group are prepared in million of Croatian Kuna and all values have been rounded to the nearest million, unless stated otherwise.

These consolidated and Bank only financial statements are prepared in accordance with the International Financial Reporting Standards as published by the International Accounting Standards Board. The consolidated and Bank only financial statements are prepared under the historical cost convention as modified by the revaluation of assets available for sale and financial assets and financial liabilities at fair value through profit and loss.

The financial statements have been presented in a format generally accepted and internationally recognised by banks and in accordance with International Accounting Standard (IAS) 30 "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" and International Financial Reporting Standards.

Basis of consolidated (Privredna banka Zagreb Group) and Bank only financial statements

Financial statements are presented for the Bank and the Group. The Group financial statements comprise the consolidated financial statements of the Bank and entities controlled by the Bank (its subsidiaries). Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal. All intercompany transactions, balances and unrealised surpluses and deficits on transactions between group companies have been eliminated. Where necessary, the accounting policies used by subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Minority interests in the net assets (excluding goodwill) of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Investments in associates are accounted for by the equity method of accounting in the consolidated financial statements and at cost in the Bank's financial statements. These are undertakings over which the Group generally has between 20 percent and 50 percent of the voting rights, and over which the Group has significant influence, but which it does not control. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Unrealised gains on transactions between the Group and its associated undertakings are eliminated to the extent of the Group's interest in the associated undertakings. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The Group's investment in associated undertakings includes goodwill. Equity accounting is discontinued when the carrying amount of the investment in an associated undertaking reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated undertaking. Where necessary, the accounting policies used by the associate have been changed to ensure consistency with the policies adopted by the Group.

Business combination

Acquisitions of subsidiaries are accounted for using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 Business Combinations are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

Interest and similar income and expense

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.
Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income. As well savings deposits origination fees are recognized as an adjustment to the effective yield of deposit and adjust interest expense.
When loans become impaired, they are written down to their recoverable amounts and interest income thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount. Other fees receivable are recognised when earned. Dividend income is recognised when earned.
Interest income on financial instruments at fair value through profit or loss represent nominal coupon interest.

Fees and commission income

Fees and commission income are comprised mainly of fees receivable from enterprises for loans and guarantees granted and other services provided by the Bank and the Group, together with commissions from managing funds on behalf of legal entities and individuals and fees for foreign and domestic payment transactions.
Fees and commissions are generally recognised on an accrual basis. Loan origination fees for loans which are likely to be drawn down, are generally deferred and recognised as an adjustment to the effective yield on the loan.

Operating income

Operating income includes net interest income, net fee and commission income, foreign exchange trading gains, unrealised gains on securities at fair value, realised gains on securities classified as assets available for sale, foreign exchange revaluation, gains from disposal of fixed assets, dividends earned and other income.

Foreign currencies

Income and expenditure arising from transactions in foreign currencies are translated to Croatian Kuna at the official rates of exchange on the transaction date. Assets and liabilities denominated in foreign currencies are translated to Croatian Kuna at the mid market exchange rate of the CNB on the last day of the accounting period. Gains and losses resulting from foreign currency translation are included in the income statement for the year.
The Group has receivables and liabilities originated in HRK, which are linked to foreign currencies with one-way currency clause. Due to this clause the Group has an option to revalue the asset by the higher of: foreign exchange rate valid as of the date of repayments of the receivabes by the debtors, or foreign exchange rate valid as of the date of origination of the financial instrument. In case of the liability linked to this clause the counterparty has this option. Due to the specific conditions of the market in Republic of Croatia the fair value of this option can not be calculated as the forward rates for HRK for periods over 9 months are generally not available. As such the Group revalues its receivables and liabilities linked to this clause by the agreed reference rate valid at the date of the balance sheet or foreign exchange rate agreed by the option (rate valid at origination), whichever is higher.

Personnel expenses

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Personnel social contributions

According to local legislation, the Group is obliged to pay contributions to the Pension Funds and the State Health Care Fund. This obligation relates to full-time employees and provides for paying contributions in the amount of certain percentages determined on the basis of the gross salary as follows:

	2006	2005
Contributions for Pension Funds	20.00%	20.00%
Contributions for State Health Care Fund	15.00%	15.00%
Contributions for Unemployment Fund	1.70%	1.70%
Injuries at work	0.50%	0.50%

The Group is also obliged to withhold contributions from the gross pay on behalf of the employee for the same funds. The contributions on behalf of employees and on behalf of the employer are charged to expenses in the period to which they relate (refer to note 7).

Accounting policies

Retirement allowances

Under the Labour Code, if determined in the employment contract or the Regulation on Personal income, the Group and the Bank are obliged to pay a retirement allowance of HRK 8 thousand to individuals who are retiring.
IAS 19 Employee benefits requires post-retirement benefits and other long-term benefits to be recorded on an accrual basis. The Group and the Bank assessed their liabilities for long-term benefits in accordance with the IAS and recorded a provision in the accompanying financial statements.
The obligation and costs of pension benefits are determined using a projected unit credit method, which considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. Certain actuarial assumptions were made by the Management in this assessment.

Taxation

Corporation tax payable is provided on taxable profits for the year at the current rate. Deferred taxes are calculated 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 using the tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.
Deferred tax assets and liabilities are recognised regardless of when the timing difference is likely to reverse. Deferred tax assets are recognised when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. On each balance sheet date, the Bank re-assesses unrecognised deferred tax assets and the appropriateness of carrying amount of the tax assets.
The Bank is subject to a tax rate of 20 percent in accordance with the Profit Tax Law.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days remaining maturity, including cash and current accounts with other banks.

Financial instruments

Financial assets and financial liabilities recorded on the balance sheet include cash and cash equivalents, marketable securities, trade and other accounts receivable and payable, long-term loans and leasing, deposits and investments. The accounting principles for these items are disclosed in the respective accounting policies.
The Bank recognises financial assets and liabilities on its balance sheet when, and only when, it becomes a party to the contractual provisions of the instrument.
Financial assets and liabilities held by the Group are categorised into portfolios in accordance with the Group's intent on the acquisition and pursuant to the Group's investment strategy. Financial assets and liabilities are classified as "At fair value through profit or loss", "Held to maturity", "Assets available for sale" or as "Loans and receivables". The principal difference among the portfolios relates to the measurement of financial assets and the recognition of their fair values in the financial statements as described below.
Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.
Regular way transactions with financial instruments are accounted for at the date when they are transferred (settlement date). Under settlement date accounting, while the underlying asset or liability is not recognised until the settlement date, changes in fair value on the underlying asset or liability are recognised starting from trade date.
When a financial asset or financial liability is recognised initially, the Group measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Financial instruments at fair value through profit or loss

Financial instruments included in this portfolio are carried at fair value financial instruments, which were either acquired for generating a profit from short-term fluctuations in price or dealer's margin, or are securities included in a portfolio in which a pattern of short-term profit taking exists, that are classified as held for trading. These instruments are initially recognised at fair value. The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions, reference to the current market value of another instrument, which is substantially the same, and discounted cash flow analysis. All related realised and unrealised gains and losses are included in the income statement. Interest earned whilst holding these instruments is reported as interest income. Dividends earned are included in dividend income.

Financial liabilities held for trading

Trading liabilities include debt securities that the Group has sold to other parties but does not own at the balance sheet date (“short” selling). The Group is obliged to purchase securities at a future date to cover the short positions. Trading liabilities are stated at fair value, with gains and losses from revaluation recognised directly in Income statement within Other operating income.

Held to maturity investments

Financial instruments included in this portfolio are non-derivative financial assets with fixed or determinable payments and fixed maturity, where management has both the intent and the ability to hold to maturity. All held-to-maturity financial instruments are carried at amortised cost, less any provision for impairment. Interest earned from held-to-maturity financial instruments is reported as interest income and recognized based on effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset’s net carrying amount. The Group assesses on a regular basis whether there is any objective evidence that an investment held to maturity may be impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount which is equal to the present value of the expected future cash flows discounted at the financial instrument’s original effective interest rate. The amount of the impairment loss for assets carried at amortized cost is calculated as the difference between the asset’s carrying amount and the present value of the expected future cash flows discounted at the financial instrument’s original effective interest rate. When an impairment of assets is identified, the Group recognizes allowances through the income statement.

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

Loans and receivables

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

This portfolio comprises loans provided to customers.

Loans and receivables are measured at initial recognition at fair value, and are subsequently measured at amortized cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers. Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

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

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

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (ie, on the basis of the Group’s grading process that considers asset type, counter party type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors’ ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group.

When a loan is deemed uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited to the income statement.

Accounting policies

Assets available for sale

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

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

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost less impairment.

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

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

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

Dividends on securities available for sale are recorded as declared and included as a receivable in the balance sheet line “Other assets” and in “Other operating income” in the income statement. Upon payment of the dividend, the receivable is offset against the collected cash.

Collateral pending sale

The Group occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of cost of the related loans and advances and the current fair value of such assets. Gains or losses on disposal are recognised in the income statement.

Sale and repurchase agreements

Securities sold under sale and repurchase agreements (repos) are retained in the financial statements and the counterparty is included in due to banks or customers as appropriate. Securities purchased under agreements to resell (reverse repo) are recorded as due from banks and loans and advances to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements.

Leases

Finance - Group as lessor

When assets are leased under finance lease arrangements, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Initial direct costs are recognised as expenses in the income statement in the period when incurred.

Operating - Group as lessor

Assets leased under operating lease arrangements are included in tangible assets in the balance sheet. They are depreciated over their expected useful lives which is based on the duration of lease contracts (see tangible fixed assets accounting policy). Initial direct costs incurred specifically to earn revenues from an operating lease are recognised as an expense in the income statement in the period in which they are incurred.

Operating - Group as lessee

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

Property and equipment

Property and equipment is stated at cost less accumulated depreciation less any provision for impairment. When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the income statement.
The initial cost of property and equipment comprises its purchase price, including import duties and non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed assets have been put into operation, such as repairs and maintenance, are normally charged to the income statement in the period in which the costs are incurred.
Construction-in-progress represents properties under construction and is stated at cost. This includes cost of construction, property and equipment and other direct costs. Construction-in-progress is not depreciated until such time as the relevant assets are completed and put into operational use and reclassified to the apropriate category of property and equipment.
Property and equipment is depreciated on a straight-line basis using useful lives. The useful lives are as follows:

	2006 years	2005 years
Buildings	40	40
Furniture	5	5
Computers	4	4
Motor vehicles	5	5
Equipment and other assets	2 to 10	2 to 10

Land is not depreciated.
The assets' residual values, useful lives and methods are reviewed, and adjusted if appropriate, at least at each financial year end.
The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Intangible assets and goodwill

Intangible assets are measured initially at cost. Intangible assets are recognised if it is probable that the future economic benefits attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. Intangible assets are amortized on a straight line basis over the best estimate of their useful lives. The amortization period and the amortization method are reviewed at each reporting period.
According to IFRS 3, Business Combinations, any excess of the cost of the acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired on the date of the acquisition is presented as goodwill and recognized as an asset. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment at least annually, or more frequently if events or changes in circumstances that the carrying value may be impaired.
Impairment is determined by assessing the recoverable amount of the cash-generating unit (or the group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.
Intangible assets are amortised over the period of 4 years. Amortisation period and amortisation method are reviewed at least at each year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

Investment property

Investment property is measured initially at its cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property. After initial recognition, investment property is stated at cost less accumulated depreciation and any provision for impairment. Investment property is depreciated on a straight-

line basis using the useful lives of the assets in accordance with the policy stated under Property and equipment.
Investment property is derecognised when either it has been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.
Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner-occupation, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sale.

Non-current assets held for sale
The Group classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. A non-current asset classified as held for sale is measured at the lower of its carrying amount and fair value less costs of sale and is no longer depreciated.
Impairment losses on initial classification as held for sale are included in the income statement, as well as gains and losses on subsequent measurement.

Impairment of assets
Property and equipment, intangible assets, investment property and non-current assets held for sale are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised in the income statement for items of property and equipment and intangibles carried at cost and treated as a revaluation decrease for assets that are carried at their revalued amount to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for the same asset. The recoverable amount is the higher of an asset's net selling price and its value in use.

Derivative financial instruments
Derivative financial instruments are initially recognised in the balance sheet in accordance with the policy for initial recognition of financial instruments and subsequently remeasured at their fair value. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and options pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Gains and losses on foreign exchange derivatives are included in Foreign exchange revaluation.
The Group had no hedge accounting in 2006.

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

Managed funds
The Bank manages a significant amount of assets on behalf of third parties. A fee is charged for this service. These assets are not recorded in the Bank's balance sheet. The details are set out in note 36.

Dividend policy
The Bank has a policy of paying dividends to its shareholders based on the audited annual results.

Changes in accounting policies
In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (the IFRIC) of the IASB that are relevant to its operations and effective for annual reporting periods beginning on 1 January 2006. The adoption of these new and revised Standards and Interpretations has resulted in changes to the Group's accounting policies in the following areas that have affected the amounts reported for the current or prior years:

- financial investments classified as at fair value through profit or loss; and
- financial guarantee contracts.

The impact of these changes is discussed in detail later in this note.

Limitation of ability to designate financial assets and financial liabilities through profit or loss
Following amendments to IAS 39 Financial Instruments: Recognition and Measurement in June 2005, the ability of entities to designate any financial asset or financial liability as “at fair value through profit or loss” (FVTPL) has been limited. Financial assets that can no longer be designated as at FVTPL are now classified as available-for-sale financial assets, and continued being measured at fair value with changes in fair value recognised in equity.
These changes have been applied by the Group in accordance with the transitional provisions of IAS 39 with effect from the beginning of the comparative reporting period presented in these financial statements (i.e. with effect from 1 January 2005). The amendments result in Government bonds, equity shares and units in open investment funds held by the subsidiaries with a carrying amount at 1 January 2006 of HRK 143 million that were previously designated as “at fair value through profit and loss” being restated as available-for-sale investments. Although ordinarily the designation of a financial asset as available-for-sale is made on initial recognition, the transitional provisions of IAS 39 allow such designation to be made on the date of de-designation. Fair value movements after 1 January 2006 are recognised directly in equity in reserves.
The impact of reclassification is a decrease in the profit for the year ended 31 December 2005 of HRK 4,065 thousand and an increase in unrealized gains recognised in the reserves for the year ended 31 December 2005 of HRK 4,065 thousand. The profit for the 2006 financial year is HRK 2,138 thousand lower than it would had the previous classification continued to apply. Had the relevant unrealized gains been recognised in the income statement, they would have been dealt with in the line item “Other operating income”.

Accounting for financial guarantee contracts
The IASB has also amended IAS 39 Financial Instruments: Recognition and Measurement to require certain financial guarantee contracts issued by the Group to be accounted for in accordance with that Standard. Financial guarantee contracts that are accounted for in accordance with IAS 39 are measured initially at their fair values, and subsequently measured at the higher of:
• the amount of the obligation under the contract, as determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets; and
• the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the revenue recognition policies.
The management of the group has assessed that adoption of this amendment to IAS 39 does not materially impact the amounts reported in current or prior periods.
The following reclassifications have been made to the Group 2005 balances to conform to the 2006 presentation (amounts in HRK million).

Amount	Previously reported	As reclassified
44	Other intangible assets	Other assets - leasehold improvements
25	Property and equipment	Other assets - collaterals received in satisfaction of non-performing loans

The Group has not applied the following IFRSs and Interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that have been issued but are not yet effective:

International Financial Reporting Standards (IFRS)
IFRS 7 IFRS 7 *Financial Instruments: Disclosures*

International Accounting Standards (IAS)
IAS 1 Amendments to IAS 1 *Presentation of Financial Statements Capital Disclosures*

International Financial Reporting Interpretations Committee (IFRIC)
IFRIC 8 Scope of IFRS 2
IFRIC 9 Reassessment of Embedded Derivatives
IFRIC 10 Interim financial reporting and impairment

The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group’s financial statements in the period of initial application.
The Group has not early adopted any IFRS standards where adoption is not mandatory at the balance sheet date. Where transition provisions in IFRS adopted give an entity a choice whether to apply the new standards prospectively or retrospectively the Group has elected to apply the standard prospectively from the date of transition.

Accounting policies

Significant accounting judgements and estimates

Judgements

In the process of applying the Group's accounting policies, the management made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Operating Lease Commitments - Group as Lessor

The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of properties which are leased out on operating leases.

Held to maturity investments

The Group follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity, other than under specific circumstances (such as selling an insignificant amount close to maturity) it will be required to reclassify the entire class as available for sale and measure it at fair value instead of amortised cost.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Allowance for impairment of loans and receivables

The Group regularly reviews its loans and receivables to assess impairment. The Group uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Group uses its experienced judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

Impairment of Goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2006 was HRK 95 million (2005: HRK 59 million). More details are given in note 19.

Notes to the Bank and the Group Financial Statements

2 | Interest income and expense (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Interest income				
Citizens	1,544	1,374	1,403	1,235
Companies	651	519	588	489
Bonds and securities	286	271	242	252
Banks	227	204	221	200
Public sector and others	268	242	266	240
	2,976	**2,610**	**2,720**	**2,416**
Interest expense				
Citizens	654	603	598	556
Companies	149	134	142	127
Banks	387	219	376	238
Public sector and others	72	71	69	70
	1,262	**1,027**	**1,185**	**991**

3 | Fee and commission income and expense (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Fee and commission income				
Fees and commission on credit card services	581	511	71	152
Payment transaction fees and commission	250	246	248	235
Fees and commission on customer loans	32	32	30	31
Fees and commission on guarantees given	35	34	34	33
Fees and commission on customer services	27	23	24	22
Other fee and commission income	152	89	81	51
	1,077	**935**	**488**	**524**
Fee and commission expense				
Payment transaction charges	90	109	87	106
Fees and commission expense on credit card services	88	66	83	65
Bank charges	11	16	9	10
Commission to post offices for citizens' current accounts	1	1	1	1
Other fee and commission expense	28	29	17	19
	218	**221**	**197**	**201**

4 | Other operating income (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Foreign exchange trading gain	128	149	119	138
Net gains on securities at fair value	86	74	84	71
Foreign exchange revaluation	58	12	58	13
Operating lease	57	44	3	3
Gains from disposal of non-current assets held for sale	24	-	25	-
Realised gains on securities classified as assets available for sale	22	21	20	21
Gains from disposal of property and equipment	14	17	12	16
Dividends earned	1	2	104	106
Other income	76	72	19	33
	466	**391**	**444**	**401**

5 | Provisions (in HRK million)

	NOTE	GROUP		BANK	
		2006	2005	2006	2005
Provisions for loans and advances to customers	15	126	139	38	61
Provisions for due from banks	14	-	1	-	4
Provisions for legal claims	31	35	(10)	31	(9)
Provisions for guarantees and commitments	31	(8)	(12)	(12)	-
		153	**118**	**57**	**56**

6 | Other operating expenses (in HRK million)

	NOTE	GROUP		BANK	
		2006	2005	2006	2005
Personnel expenses	7	669	616	531	502
Materials and services		462	417	310	298
Deposit insurance premium		64	66	56	60
Indirect and other taxes		16	17	15	10
Other operating expenses		209	207	95	137
		1,420	**1,323**	**1,007**	**1,007**

7 | Personnel expenses (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Net salaries	316	295	255	245
Health insurance costs	73	69	58	57
Taxes and surtaxes due to local authorities	74	64	57	51
Pension insurance costs	94	89	75	73
Other personnel expenses	112	99	86	76
	669	**616**	**531**	**502**

Salaries and other related costs of employees include a bonus for the management and employees of the Bank in the gross amount of HRK 30.0 million (2005: HRK 28.4 million), of which the remuneration of the Bank's Management Board accounts for gross amount of HRK 5.5 million (2005: HRK 5.0 million).
During the year the average number of employees within the Group was 4,421 (2005: 4,037) of which the Bank accounted for 3,471 employees (2005: 3,443).

8 | Depreciation and amortization of property and equipment and intangible assets (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Depreciation of property and equipment	204	172	126	115
Depreciation of investment property	1	1	1	1
Amortisation of leasehold improvements	18	17	18	17
Amortization of intangible assets	32	37	20	30
	255	**227**	**165**	**163**

There is an amount included within depreciation and amortization of fixed and intangible assets related to the impairment and write off of property and equipment and intangible assets of the Group of HRK 16.1 million (2005: HRK 6.9 million) and the Bank of HRK 14.5 million (2005: HRK 4.9 million).

9 | Taxation

Profit tax is payable at the rate of 20 percent (2005: 20 percent) on adjusted operating income.
Generally, tax declarations remain open and subject to inspection for at least a three-year period. The management believes that it has adequately provided for tax liabilities in the accompanying financial statements. However, the risk remains that the relevant authorities could take differing positions with regard to interpretative issues and the effect could be significant.
Taxation expense comprises:

		GROUP		BANK
(in HRK million)	2006	2005	2006	2005
Current income tax expense	(301)	(223)	(216)	(183)
Deferred tax assets utilised during the year	(73)	(59)	(60)	(49)
Deferred tax liabilities utilised during the year	1	-	1	-
Deferred tax assets relating to temporary differences	121	73	83	60
Deferred tax liability relating to temporary difference	(2)	(1)	(2)	(1)
Tax charge per income statement	**(254)**	**(210)**	**(194)**	**(173)**

The reconciliation between accounting profit and taxable profit is set out below:

		GROUP		BANK
(in HRK million)	2006	2005	2006	2005
Accounting profit before taxation	**1,219**	**1,026**	**1,041**	**923**
Statutory tax rate	20%	20%	20%	20%
Expected nominal tax	**244**	**205**	**208**	**185**
Tax effects of:				
Non deductible expenses	89	50	57	46
Non taxable income	(32)	(32)	(49)	(48)
Current income tax expense	**301**	**223**	**216**	**183**
Effective tax rate	**24.7%**	**21.7%**	**20.7%**	**19.8%**

9 | Taxation / continued

Movements of deferred tax assets are as follows:

	GROUP		BANK	
(in HRK million)	2006	2005	2006	2005
Deferred tax assets recognised at 1 January	**73**	**58**	**60**	**49**
Integration of Laguna banka	-	-	-	4
Tax (profits)/losses in the year recognised as deferred tax assets	121	74	83	60
Deferred tax (debit)/credit in the income statement	(73)	(59)	(60)	(53)
Deferred tax assets recognised at 31 December	**121**	**73**	**83**	**60**

Deferred tax assets consist of:				
Deferred loan origination fees as an adjustment to the effective yield	71	51	54	44
Retirement benefits	5	5	3	2
Impairment of real estate	8	6	7	6
Unrealised losses on negative revaluation of securities and derivatives	15	5	15	5
Other	22	6	4	3
	121	**73**	**83**	**60**

10 | Cash and current accounts with other banks (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Current accounts held with central bank	1,351	1,011	1,322	980
Cash in hand	1,026	864	946	816
Current accounts and amounts at call with foreign banks	178	49	42	43
Current accounts and amounts at call with domestic banks	7	14	5	12
Other cash items	14	11	13	9
	2,576	**1,949**	**2,328**	**1,860**

11 | Balances with Croatian National Bank (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Obligatory and marginal reserve	7,259	5,392	7,046	5,181
Other deposits	3	3	3	3
	7,262	**5,395**	**7,049**	**5,184**

Obligatory reserve represents the amount of liquid assets required to be deposited with the Croatian National Bank. At the end of each month the obligatory reserve is calculated on certain balances of attracted funds for the previous month. The obligatory reserve is calculated as 17 percent of HRK denominated (2005: 18 percent) and 17 percent of foreign currency denominated balances (2005: 18 percent). From that amount the banks should maintain at least 70 percent for the kuna obligatory reserve and 50 percent for the obligatory reserve in foreign currency with the Croatian National Bank.
Marginal reserve represents the amount of foreign and related parties' borrowings required to be deposited with the Croatian National Bank. In December of 2006, the marginal reserve requirement was 40 percent of net increase in funds received from non-residents and related parties from June 2004 and an additional 15 percent of net increase in funds received from non-residents and related parties from November 2005. Marginal reserve balances maintained with the Croatian National Bank bore no interest during 2006.
The balances maintained with the Croatian National Bank earned annual interest of 0.75 percent for HRK amounts (2005: 0 percent). The balances in foreign currencies maintained with the Croatian National Bank bore annual interest of 2.25 percent for USD and 1.25 to 1.75 percent for EUR amounts (2005: 1.6875 percent for USD and 1.125 percent for EUR amounts). 50 percent of the foreign currency obligatory reserve should be maintained in HRK. USD and EUR rates are not fixed.
As of the year end, the Bank and the Group maintained 70 percent of its HRK obligatory reserve and 50 percent of its foreign currency obligatory reserve (in USD) with the Croatian National Bank. The remaining 30 percent of the HRK obligatory reserve and 50 percent of the foreign currency obligatory reserve were maintained as balance on nostro accounts or deposits with other banks.

12 | Financial assets and financial liabilities at fair value through profit or loss (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Financial assets at fair value through profit or loss				
Domestic treasury bills	1,174	1,269	1,174	1,269
Foreign government bonds	473	356	473	356
Foreign corporate bonds	408	320	408	320
Foreign treasury bills	396	1,017	396	1,017
Domestic corporate bonds	204	57	222	57
Equities and shares	185	414	185	414
Domestic government bonds	165	960	165	960
Accrued interest	51	74	51	74
	3,056	**4,467**	**3,074**	**4,467**
Financial liabilities held for trading				
Foreign government bonds	**735**	**1,188**	**735**	**1,188**

13 | Derivative financial assets (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Fair values:				
Foreign exchange derivatives	44	16	44	16
Security derivatives	-	1	-	1
	44	**17**	**44**	**17**
Notional amounts:				
Foreign exchange derivatives	8,480	3,629	8,480	3,629
Security derivatives	-	152	-	152
	8,480	**3,781**	**8,480**	**3,781**

Foreign exchange derivatives mostly relate to foreign exchange currency deals bought and sold forward. Security derivatives include bonds bought forward.
The notional amounts of certain types of financials instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks.

14 | Due from banks (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Term deposits	5,439	5,605	5,172	5,282
Demand deposits	2	2	-	-
Loans to banks	1,809	2,021	1,778	2,102
Other receivables	-	216	-	216
	7,250	**7,844**	**6,950**	**7,600**
Provisions	(15)	(15)	(15)	(15)
	7,235	**7,829**	**6,935**	**7,585**

Term deposits are normally short-term deposits (up to one month) with local and foreign banks bearing an average annual interest rate of 3.20 percent to 5.48 percent (2005: 2.83 and 3.53 percent respectively).
The Bank's placements with other banks include HRK 9.3 million (2005: HRK 16.0 million) related to refinanced borrowings due to the Republic of Croatia and HRK 79.9 million (2005: HRK 112.0 million) of refinanced borrowings due to Government agencies. For more details refer to note 27.
The related currency analysis is provided in note 45.

a) Geographical analysis

	GROUP		BANK	
	2006	2005	2006	2005
Italy	1,959	325	1,916	295
Republic of Croatia	1,359	1,257	1,433	1,364
Germany	1,244	2,022	1,186	1,957
Great Britain	826	1,556	799	1,523
Belgium	459	446	369	381
France	448	487	448	487
Switzerland	263	54	247	37
United States of America	165	163	137	147
Austria	13	446	1	423
Other countries	514	1,088	414	986
	7,250	**7,844**	**6,950**	**7,600**
Provisions	(15)	(15)	(15)	(15)
	7,235	**7,829**	**6,935**	**7,585**

14 | Due from banks / continued (in HRK million)

b) Provisions for losses

	GROUP		BANK	
	2006	2005	2006	2005
Balance at 1 January	**15**	**14**	**15**	**11**
Provisions	-	1	-	4
Balance at 31 December	**15**	**15**	**15**	**15**

15 | Loans and advances to customers (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
a) Analysis by type of customer				
Citizens	20,602	15,689	18,021	13,637
Companies	13,968	10,498	12,678	10,169
Public sector and other	4,943	4,866	4,916	4,861
	39,513	**31,053**	**35,615**	**28,667**
Provisions	(2,078)	(1,951)	(1,661)	(1,637)
Deferred interest and fees recognised as an adjustment to the effective yield	(525)	(462)	(382)	(343)
	36,910	**28,640**	**33,572**	**26,687**
b) Analysis by sector				
Citizens	20,602	15,689	18,021	13,637
Wholesale and retail trade	3,414	2,720	2,873	2,407
Construction	1,513	1,027	1,355	909
Transport and communication	1,486	1,368	1,402	1,289
Hotels and restaurants	903	941	857	921
Agriculture, forestry and fishing	726	782	680	736
Food and beverages	438	548	420	528
Energy products	369	489	365	478
Oil refining and gas	100	76	100	76
Other	9,962	7,413	9,542	7,686
	39,513	**31,053**	**35,615**	**28,667**
Provisions	(2,078)	(1,951)	(1,661)	(1,637)
Deferred interest and fees recognised as an adjustment to the effective yield	(525)	(462)	(382)	(343)
	36,910	**28,640**	**33,572**	**26,687**

Within Loans and advances to customers were loans under reverse repurchase agreements of HRK 1,241.8 million (2005: HRK 345.1 million). Such agreements are secured with the debt securities of the Republic of Croatia and corporate bonds.

15 | Loans and advances to customers / continued (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
c) Provisions for losses				
Balance at 1 January	**1,951**	**1,907**	**1,637**	**1,624**
Amounts collected	(172)	(173)	(90)	(148)
Amounts written off	(63)	(86)	(49)	(52)
Foreign exchange (gain)/loss	64	(9)	35	4
Amortisation of the discount	(41)	(57)	(41)	(57)
Provisions	339	369	169	266
Balance at 31 December	**2,078**	**1,951**	**1,661**	**1,637**
Reconciliation with income statement line item Provisions for loans and advances to customers				
Provisions	339	369	169	266
Amounts collected	(172)	(173)	(90)	(148)
Amortisation of the discount	(41)	(57)	(41)	(57)
Charge in the income statement	**126**	**139**	**38**	**61**

The Group manages its exposure to credit risk by the application ot a variety of control measures: regular assessment using agreed credit criteria; diversification of sector risk to avoid undue concentration in type of business or geographic terms. Where necessary, the Group obtains acceptable collateral to reduce the level of credit risk.
On 31 December 2006 the aggregate amount of non performing loans and receivables for the Group equalled HRK 947 million and for the Bank HRK 837 million (2005: HRK 1,129 million and HRK 974 million respectively).

(d) Loans and contingencies under guarantee

The state budget includes support for certain key industries in the Republic of Croatia. The recovery of such loans is provided from the state budget. In addition, the Republic of Croatia issues warranties for certain loans and contingent liabilities.
The support and guarantee of the Republic of Croatia was taken into consideration when determining the level of provisions required against loans to certain legal entities.
Total Bank and the Group loans and contingencies guaranteed by the Republic of Croatia or repayable from the state budget amount to HRK 2,177 million (2005: HRK 1,610 million).

(e) Refinanced loans

Included in loans and receivables are HRK 65 million (2005: HRK 108 million) related to refinanced borrowings due to the Republic of Croatia and HRK 252 million (2005: HRK 335 million) of refinanced borrowings due to the Government Agencies.
For more detail on refinanced loans refer to note 27.

16 | Assets available for sale (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Balance at 1 January	**386**	**502**	**24**	**30**
Purchases/(disposals)	919	(116)	29	(6)
Balance at 31 December	**1,305**	**386**	**53**	**24**

16 | Assets available for sale / continued (in HRK million)

The following table sets out equity investments considered available for sale.

EQUITY INVESTMENTS	COUNTRY	NATURE OF BUSINESS	2006 holding %	2005 holding %
Questus Private Equity Kapital	Croatia	finance	29	-
Alstom Power d.o.o.	Croatia	manufacturing	20	20
Europay Hrvatska d.o.o.	Croatia	card services	15	15
Hrvatski registar obveza po kreditima d.o.o.	Croatia	finance	14	14
Tehnološko inovacijski centar d.o.o.	Croatia	manufacturing	11	11
Agromeđimurje d.d.	Croatia	agriculture	11	11
Tržište novca i kratkoročnih vrijednosnica d.d.	Croatia	finance	8	8
Međimurske novine d.o.o.	Croatia	newspaper	7	7
Varaždinsko tržište vrijednosnica d.d.	Croatia	finance	3	3
Zagrebačka burza d.d.	Croatia	finance	2	2
Veterinarska stanica d.o.o. Čakovec	Croatia	food processing	2	2
MBU d.o.o.	Croatia	finance	1	7
Regionalna razvojna agencija Porin d.o.o.	Croatia	manufacturing	1	1
Središnja depozitarna agencija d.d.	Croatia	finance	1	1
Elan d.d.	Slovenia	manufacturing	1	1
Metronet telekomunikacije d.d.	Croatia	telecommunications	-	19
Hospitalija trgovina d.o.o.	Croatia	trade	-	15
Tele 2 d.o.o.	Croatia	telecommunications	-	14
Karlovačka banka d.d.	Croatia	banking	-	1

17 | Held to maturity investments (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Recapitalisation bonds	725	836	725	836
Rehabilitation bonds	379	435	379	435
Republic of Croatia bonds	196	-	-	-
Replacement bonds	27	26	24	23
Other Government bills	-	20	-	-
Accrued interest	31	35	30	35
	1,358	**1,352**	**1,158**	**1,329**

Investment securities on 31 December 2006 were split into held to maturity investments and assets available for sale (refer to note 16) based on whether the management had the positive intent and ability to hold certain securities until maturity at that date.
Republic of Croatia bonds relate to the bonds of the Ministry of Finance of the Republic of Croatia purchased by PBZ Stambena štedionica. They are denominated in EUR, bear interest rate from 4.25 percent to 5.50 percent and become due from 2014 to 2019.
Recapitalisation bonds and rehabilitation bonds were issued by the State Agency for Bank Rehabilitation and Deposit Insurance (DAB). These bonds are guaranteed by the Republic of Croatia.
Replacement bonds were originaly issued by the Ministry of Finance. These kuna denominated bonds that mature in 2011, bear an interest rate of 5 percent payable in semi annual instalments.

18 | Equity investments in subsidiaries and associates (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Consolidated subsidiaries	-	-	376	270
Associates accounted for under equity method in Group accounts (cost in Bank accounts)	45	38	28	28
	45	38	404	298
Movements				
Balance at 1 January	**38**	**33**	**298**	**358**
Consolidation effect arising from equity method	8	6	-	-
Payment of additional capital	3	-	25	-
Payment of dividend	(4)	(1)	-	-
Acquired/(integrated)	-	-	81	(60)
Balance at 31 December	**45**	**38**	**404**	**298**

18 | Equity investments in subsidiaries and associates / continued (in HRK million)

The principal investments in subsidiaries and associates are as follows:

CONSOLIDATED SUBSIDIARIES	COUNTRY	NATURE OF BUSINESS	2006 holding %	2005
Međimurska banka d.d.	Croatia	banking	97	97
PBZ Card d.o.o.	Croatia	card services	100	100
Cards d.o.o.	Macedonia	card services	95	95
PBZ Leasing d.o.o.	Croatia	leasing	100	100
PBZ Invest d.o.o.	Croatia	finance	100	100
PBZ Nekretnine d.o.o.	Croatia	real estate	100	100
PBZ Stambena štedionica d.d.	Croatia	building society	100	100
Invest Holding Karlovac d.o.o.	Croatia	finance	56	56
Centurion financijske usluge d.o.o.	Bosnia and Herzegovina	card services	100	100
LT Gospodarska banka d.d.	Bosnia and Herzegovina	banking	67	-
ASSOCIATES				
PBZ Croatia osiguranje d.d.	Croatia	finance	50	50
Centurion d.o.o. (formerly Atlas American Express d.o.o.)	Slovenia	card services	25	25

PBZ Croatia osiguranje d.d. and Centurion (formerly Atlas American Express d.o.o.) are accounted for under the equity method. The following table illustrates summarised financial information of the Group's investment in associates:

	2006	2005
Share of the associates' balance sheet		
Current assets	45	40
Non current assets	4	2
Current liabilities	(2)	(3)
Non current liabilities	(2)	(1)
Net assets, being carrying amount of investment	**45**	**38**
Share of the associates' revenue and profit		
Revenue	18	15
Profit	8	6

18 | Equity investments in subsidiaries and associates / continued (in HRK million)

In December 2006, the Bank completed its acquisition of 66.99 percent of the share capital of LT Gospodarska banka d.d. following the approvals given by the appropriate regulatory authorities. The cost of acquisition (including directly attributable costs) amounted HRK 81.1 million, out of which 36.1 million was allocated to goodwill. At the date of finalisation of financial statements, the market valuations and other calculations had not been finalised and goodwill has therefore only been provisionally determined based on the management's best estimate. The subsidiary was first consolidated as of 31 December 2006, having no effect on 2006 results of the Group. If the combination had taken place at the beginning of the year, the total profit for the year attributable to equity holders of the Bank would have been HRK 53 thousand higher.

The fair value of the identifiable assets and liabilities acquired and goodwill arising as at the date of acquisition were:

(in HRK million)	**Carrying value**
Cash and current accounts with other banks	171
Due from banks	70
Loans and advances to customers	359
Intangible assets	4
Property and equipment	13
Other assets	16
	633
Due to banks	(37)
Due to customers	(489)
Other borrowed funds	(19)
Other liabilities	(13)
Accruals and deferred income	(8)
Provisions for risks and charges	(1)
	(567)
Carrying value of net assets	66
Adjustment to fair value	2
Fair value of net assets	**68**
Value of acquired stake (66.99%)	45
Goodwill arising on acquisition	36
Cost of acquisition	**81**
Cash inflow on acquisition of the subsidiary:	
Net cash acquired with the subsidiary	171
Cash paid	(81)
Net cash inflow	**90**

19 | Intangible assets and goodwill (in HRK million)

Group	Goodwill	Software	Other intangible assets	Assets in preparation	Total
Cost or revaluation					
Balance at 1 January 2005	**59**	**218**	**3**	**10**	**290**
Additions	-	25	3	25	53
Disposals and eliminations	-	(1)	-	(20)	(21)
Balance at 31 December 2005	**59**	**242**	**6**	**15**	**322**
Balance at 1 January 2006	**59**	**242**	**6**	**15**	**322**
Additions	-	59	-	6	65
Effect of LT Gospodarska banka acquisition	36	1	3	-	40
Disposals and eliminations	-	(31)	-	-	(31)
Balance at 31 December 2006	**95**	**271**	**9**	**21**	**396**
Amortization					
Balance at 1 January 2005	**-**	**139**	**-**	**-**	**139**
Charge for the year	-	37	-	-	37
Disposals and eliminations	-	(1)	-	-	(1)
Balance at 31 December 2005	**-**	**175**	**-**	**-**	**175**
Balance at 1 January 2006	**-**	**175**	**-**	**-**	**175**
Charge for the year	-	32	-	-	32
Disposals and eliminations	-	(11)	-	-	(11)
Balance at 31 December 2006	**-**	**196**	**-**	**-**	**196**
Net book value					
Balance at 31 December 2006	**95**	**75**	**9**	**21**	**200**
Balance at 31 December 2005	**59**	**67**	**6**	**15**	**147**

19 | **Intangible assets and goodwill / continued** (in HRK million)

Bank	Software	Assets in preparation	Total
Cost or valuation			
Balance at 1 January 2005	**177**	**8**	**185**
Additions	19	23	42
Disposals and eliminations	-	(19)	(19)
Balance at 31 December 2005	**196**	**12**	**208**
Balance at 1 January 2006	**196**	**12**	**208**
Additions	34	6	40
Disposals and eliminations	(27)	-	(27)
Balance at 31 December 2006	**203**	**18**	**221**
Amortization			
Balance at 1 January 2005	**116**	**-**	**116**
Charge for the year	30	-	30
Disposals and eliminations	-	-	-
Balance at 31 December 2005	**146**	**-**	**146**
Balance at 1 January 2006	**146**	**-**	**146**
Charge for the year	20	-	20
Disposals and eliminations	(10)	-	(10)
Balance at 31 December 2006	**156**	**-**	**156**
Net book value			
Balance at 31 December 2006	**47**	**18**	**65**
Balance at 31 December 2005	**50**	**12**	**62**

As from 1 January 2005, the date of adoption of IFRS 3, goodwill was no longer amortised but is now subject to annual impairment testing. Accumulated amortisation up to that date was eliminated accordingly.
Goodwill acquired through business combinations was allocated to two individual cash generating units for impairment testing - PBZ Card (American Express part of the business) and Međimurska banka. The recoverable amounts of cash generating units have been determined based on a value in use calculation using cash flow projections based on financial plans covering a five-year period. The discount rate applied to cash flow projections was 9.79 percent for PBZ Card and 8.20 percent for Međimurska banka, while the cash flows beyond the 5-year period were extrapolated using a no growth assumption (zero percent growth rate).

20 | Property and equipment (in HRK million)

Group	Land and buildings	Furniture and other equipment	Motor vehicles	Computer equipment	Property and equipment in preparation	Total
Cost or valuation						
Balance at 1 January 2005	**898**	**246**	**172**	**478**	**34**	**1,828**
Additions	51	54	72	68	241	486
Transfers to Investment property	(27)	-	-	-	-	(27)
Transfers to Non-current assets held for sale	(147)	(7)	-	-	-	(154)
Transfers to Other assets	(25)	-	-	-	-	(25)
Disposals and eliminations	(78)	(15)	(23)	(22)	(1)	(139)
Balance at 31 December 2005	**672**	**278**	**221**	**524**	**274**	**1,969**
Balance at 1 January 2006	**672**	**278**	**221**	**524**	**274**	**1,969**
Additions	351	171	56	69	(182)	465
Effect of LT Gospodarska banka acquisition	7	4	1	2	-	14
Reclassifications	-	19	(8)	(11)	-	-
Disposals and eliminations	(4)	(50)	(33)	(54)	(7)	(148)
Balance at 31 December 2006	**1,026**	**422**	**237**	**530**	**85**	**2,300**
Depreciation						
Balance at 1 January 2005	**248**	**133**	**48**	**318**	**-**	**747**
Charge for the year	16	44	33	79	-	172
Transfers to Investment property	(12)	-	-	-	-	(12)
Transfers to Non-current assets held for sale	(50)	(5)	-	-	-	(55)
Disposals and eliminations	(5)	(11)	(12)	(27)	-	(55)
Balance at 31 December 2005	**197**	**161**	**69**	**370**	**-**	**797**
Balance at 1 January 2006	**197**	**161**	**69**	**370**	**-**	**797**
Reclassifications	-	9	(3)	(6)	-	-
Charge for the year	34	61	39	70	-	204
Disposals and eliminations	(2)	(18)	(18)	(44)	-	(82)
Balance at 31 December 2006	**229**	**213**	**87**	**390**	**-**	**919**
Net book value						
Balance at 31 December 2006	**797**	**209**	**150**	**140**	**85**	**1,381**
Balance at 31 December 2005	**475**	**117**	**152**	**154**	**274**	**1,172**

Furniture and other equipment and Motor vehicles of the Group include assets leased under operating leases with a net book value of total of HRK 176.5 million (2005: HRK 173.0 million).

20 | Property and equipment / continued (in HRK million)

Bank	Land and buildings	Furniture and other equipment	Motor vehicles	Computer equipment	Property and equipment in preparation	Total
Cost or valuation						
Balance at 1 January 2005	**726**	**198**	**21**	**385**	**28**	**1,358**
Effect of integration of Laguna banka	29	6	-	2	-	37
Additions	50	34	2	41	137	264
Transfers to Investment property	(27)	-	-	-	-	(27)
Transfers to Non-current assets held for sale	(142)	(7)	-	-	-	(149)
Transfers to Other assets	(25)	-	-	-	-	(25)
Disposals and eliminations	(78)	(6)	(2)	(18)	-	(104)
Balance at 31 December 2005	**533**	**225**	**21**	**410**	**165**	**1,354**
Balance at 1 January 2006	**533**	**225**	**21**	**410**	**165**	**1,354**
Additions	234	64	1	69	(73)	295
Disposals and eliminations	(14)	(15)	(3)	(168)	(7)	(207)
Balance at 31 December 2006	**753**	**274**	**19**	**311**	**85**	**1,442**
Depreciation						
Balance at 1 January 2005	**202**	**104**	**11**	**267**	**-**	**584**
Effect of integration of Laguna banka	4	3	-	1	-	8
Charge for the year	13	34	3	65	-	115
Transfers to Investment property	(12)	-	-	-	-	(12)
Transfers to Non-current assets held for sale	(50)	(5)	-	-	-	(55)
Disposals and eliminations	(4)	(5)	(2)	(18)	-	(29)
Balance at 31 December 2005	**153**	**131**	**12**	**315**	**-**	**611**
Balance at 1 January 2006	**153**	**131**	**12**	**315**	**-**	**611**
Charge for the year	30	39	3	54		126
Disposals and eliminations	(6)	(14)	(4)	(154)	-	(178)
Balance at 31 December 2006	**177**	**156**	**11**	**215**	**-**	**559**
Net book value						
Balance at 31 December 2006	**576**	**118**	**8**	**96**	**85**	**883**
Balance at 31 December 2005	**380**	**94**	**9**	**95**	**165**	**743**

21 | Investment property (in HRK million)

	GROUP	BANK
Cost or revaluation		
Balance at 1 January 2006	**28**	**28**
Balance at 31 December 2006	**28**	**28**
Depreciation		
Balance at 1 January 2006	**13**	**13**
Charge for the year	1	1
Balance at 31 December 2006	**14**	**14**
Net book value		
Balance at 31 December 2006	**14**	**14**
Balance at 31 December 2005	**14**	**14**

The Bank reclassified certain properties, which were used as investment property from Property and equipment in 2005. The estimated fair value of investment property held by the Bank as at 31 December 2006 amounted to HRK 23 million (2005: HRK 23 million). The fair value was estimated by PBZ Nekretnine, a wholly owned subsidiary of Privredna banka Zagreb, engaged in real estate management.
The property rental income earned by the Bank from its investment property, all of which was leased out under operating leases, amounted to HRK 3 million (2005: HRK 3 million).

22 | Non-current assets held for sale (in HRK million)

The Bank's Management Board resolved to dispose of two office buildings together with related fixtures and fittings in 2005. The assets were classified as non-current assets held for sale and presented separately in the balance sheet.
The proceeds of the disposal are estimated to exceed the net carrying amount of the relevant assets and, accordingly, no impairment loss was recognised on the classification of these assets as held for sale.
The major classes of assets comprising the non-current assets held for sale are as follows:

	GROUP		BANK	
	2006	2005	2006	2005
Land and buildings	18	99	18	92
Furniture and other equipment	-	2	-	2
	18	**101**	**18**	**94**

As at 31 December 2006 non-current assets held for sale include properties for which the Bank has already contracted the sale. The management expects that this sale will be realised until mid 2007.

23 | Other assets (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Leasehold improvements	51	44	51	44
Amounts due - deriving from foreign currency transactions	42	-	42	-
Amounts receivable from debtors	37	25	1	3
Collaterals received in satisfaction of non-performing loans	37	25	37	25
Fees on payment transactions	32	24	24	23
Amounts to be debited under processing	24	10	23	9
Prepaid expenses	8	14	8	9
Other	218	88	40	16
	449	**230**	**226**	**129**

24 | Due to banks (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Term deposits	4,237	3,152	4,205	3,784
Demand deposits	281	121	298	127
	4,518	**3,273**	**4,503**	**3,911**

25 | Due to customers (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Term deposits	23,674	20,654	21,222	18,897
Demand deposits	13,169	11,737	12,269	11,107
	36,843	**32,391**	**33,491**	**30,004**

26 | Derivative financial liabilities (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Fair values:				
Foreign exchange derivatives	14	19	14	19
Security derivatives	1	-	1	-
	15	**19**	**15**	**19**
Notional amounts:				
Foreign exchange derivatives	8,447	3,642	8,447	3,642
Security derivatives	204	-	204	-
	8,651	**3,642**	**8,651**	**3,642**

Foreign exchange derivatives mostly relate to foreign exchange currency deals sold and bought forward. Security derivatives include bonds bought forward.
The notional amounts of certain types of financials instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to credit or price risks.

27 | Other borrowed funds (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Domestic borrowings	2,836	3,063	2,541	3,039
Foreign borrowings	6,562	4,346	6,050	4,117
Refinanced debt	558	822	556	822
	9,956	**8,231**	**9,147**	**7,978**

(a) Refinanced debt - Amounts due to the Republic of Croatia - London Club
These amounts relate to foreign currency borrowings from commercial banks falling due under the New Financing Agreement signed on 20 September 1988. Repayments of principal under this agreement were due to commence in February 1994 with the first of 26 semi-annual instalments. However, negotiations continued regarding the assumption of the liabilities of the former Yugoslavia, and interest payments since 25 May 1992 and capital payments were delayed. During 1996 HRK 4,030 million liabilities to commercial banks under the New Financing Agreement were transferred from the Bank to the Rehabilitation Agency as part of the Bank's rehabilitation.
On 31 July 1996 the Government of the Republic of Croatia assumed responsibility for 29.5 percent of all rescheduled liabilities of the former Yugoslavia to commercial banks under the New Financing Agreement (London Club), representing the Republic of Croatia's share of the debt of the former Yugoslavia. This liability was settled by the issue of bonds of the Republic of Croatia and the first payment of principal and interest was made on 31 January 1997. Consequently, the Bank's liabilities to commercial banks under the New Financing Agreement were replaced by amounts due to the Republic of Croatia.
The liabilities assumed by the Republic of Croatia were further rescheduled, for a period of 10 to 14 years; they are denominated in USD and carry interest at LIBOR + 13/16 percent. The amounts due to the Republic of Croatia by the Bank were similarly rescheduled and redenominated. The Bank expects to recover the majority of this amount from the Croatian companies who were the original borrowers of the funds.

27 | Other borrowed funds / continued

(b) Refinanced debt - Amounts due to Government agencies - Paris Club

Repayments of foreign currency borrowings previously due between 1984 and 1988 were rescheduled and refinanced by the agreement concluded with the Paris Club. Under this agreement repayments of principal were to be made in 24 semi-annual instalments commencing January 1999.
During 1996 further discussions were held with each of the contracting parties and substantially all of the Bank's liabilities were rescheduled under the series of Consolidation Agreements. The Bank expects to recover this amount from the Croatian companies who were the original borrowers of the funds by rescheduling the loans in a manner similar to the above-described arrangements.

(c) Payables under repurchase agreements

Payables under repurchase agreements of the Bank under other borrowed funds include HRK 1,207 million in relation to Government bonds issued by the Ministry of Finance pledged under repurchase agreements (2005: HRK 1,370 million).

28 | Debt securities issued

In April 1999 the Bank issued long-term bonds with a repayment schedule linked to the euro. These bonds were issued with maturity of 7 years and carry interest of 7.5 percent and repaid in full in 2006. The amount due at 31 December 2005 stood at HRK 19 million.
In April and October 2006 PBZ Card issued two tranches of commercial bills in total nominal amount of HRK 140 million. These securities were issued with maturity of 364 days and carry interest of 4.41 percent and 5.11 percent per tranche respectively.

29 | Other liabilities (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Amounts payable to creditors	1,098	780	49	33
Items in course of payment and other liabilities	479	591	422	552
Salaries and other staff costs	137	152	120	139
Taxes	118	46	58	35
	1,832	**1,569**	**649**	**759**

30 | Accruals and deferred income (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Deferred tax liabilities	2	1	2	1
Accrued interest not paid	-	2	-	1
Deferred income	22	19	7	6
Accrued expenses	96	90	57	59
	120	**112**	**66**	**67**

31 | Provisions for risks and charges (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
a) Analysis				
Provisions for contingent liabilities and commitments	108	118	102	115
Provisions for legal claims	89	62	84	60
Provisions for other risks and charges	14	8	-	-
	211	**188**	**186**	**175**
b) Movements				
Balance at 1 January	**188**	**224**	**175**	**192**
Release of provisions	(4)	(13)	(8)	(7)
Provisions for guarantees and commitments (note 5)	(8)	(12)	(12)	-
Provisions for legal claims (note 5)	35	(10)	31	(9)
Foreign exchange loss	-	(1)	-	(1)
Balance at 31 December	**211**	**188**	**186**	**175**

32 | Contingent liabilities and commitments

Legal claims

As at 31 December 2006 there were several litigations outstanding against the Group. In the opinion of legal experts, there is a probability that the Group may lose certain cases. For this reason the level of provisions for potential loss in litigation as at 31 December 2006 made by the Group stood at HRK 89 million whilst the Bank provided HRK 84 million (refer to note 31).

Credit related contingencies and commitments

The primary purpose of these instruments is to ensure that funds are available to a customer when required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that customers cannot meet their obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Cash requirements under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The Group assessed that a provision of HRK 108 million is necessary to cover risks due to default of the respective counterparties (refer to note 31).

32 | Contingent liabilities and commitments / continued (in HRK million)

The aggregate amounts of outstanding guarantees, letters of credit and other commitments at the end of the period were:

		GROUP		BANK
	2006	2005	2006	2005
Undrawn lending commitments	10,565	6,651	10,360	6,456
Performance guarantees	1,478	1,345	1,407	1,324
Foreign currency guarantees	446	333	430	319
Foreign currency letters of credit	348	277	338	273
HRK guarantees	236	242	212	227
Other contingent liabilities	44	63	5	52
	13,117	**8,911**	**12,752**	**8,651**

On 31 December 2006 the Group and the Bank had long-term commitments in respect of rent for business premises and equipment lease agreements expiring between 2007 and 2011. The Management Board is confident that the future net revenues and funding will be sufficient to cover this commitment. The future minimum commitments for each of the next five years along with comparative numbers for 2006 are presented below:

	2006	2007	2008	2009	2010	2011	Total
Group							
Premises	32	34	35	35	36	37	**209**
Equipment	1	2	2	2	3	3	**13**
	33	**36**	**37**	**37**	**39**	**40**	**222**
Bank							
Premises	30	33	34	34	35	36	**202**
Equipment	1	2	2	2	3	3	**13**
	31	**35**	**36**	**36**	**38**	**39**	**215**

33 | Share capital

The total number of authorised registered shares on 31 December 2006 was 19,074,769 (2005: 16,660 thousand) with a nominal value of HRK 100 per share (2005: HRK 100 per share).

On 17 December 1999, the State Agency for Deposit Insurance and Bank Rehabilitation and Comit Holding International (now Intesa Holding International) through Banca Commerciale Italiana (now Banca Intesa) signed the Share Purchase Agreement in Relation to Privredna banka Zagreb. By this contract, which came into effect on 28 January 2001, Banca Commerciale Italiana acquired 11,046,005 ordinary shares amounting to 66.3 percent of the total share capital of the Bank. According to this agreement the State Agency for Deposit Insurance and Bank Rehabilitation kept 4,165,002 ordinary shares which accounted for 25 percent (plus two shares) of the total share capital of the Bank (prior to 28 January 2001 the State Agency for Deposit Insurance and Bank Rehabilitation was the majority shareholder holding 15,211,007 ordinary shares which accounted for 91.3 percent of total share capital of the Bank).

Furthermore, on 22 November 2002, the State Agency for Deposit Insurance and Bank Rehabilitation, Intesa Holding International and the European Bank for Reconstruction and Development signed a three-party Share Purchase Agreement Relating to Privredna banka Zagreb whereby the EBRD acquired 15 percent of the nominal capital whilst Intesa Holding International gained the remaining 10 percent from the State Agency for Deposit Insurance and Bank Rehabilitation.

Following finalisation of the public tender, as required in such circumstances by the Croatian law on the take-over of joint stock companies, Intesa Holding International and the EBRD concluded a contract on 22 January 2003 for the purchase of 965,746 shares by the EBRD from Intesa Holding International.

In November 2006, following Decision of the Extraordinary General Assembly held on 31 August 2006, Intesa Holding International and the EBRD subscribed to additional capital of the Bank in amount of HRK 1,811,076,750 of which Intesa Holding subscribed HRK 1,423,143,750 and the EBRD HRK 387,933,000. The new share capital was registered in the Commercial Court in Zagreb on 16 November 2006.

33 | Share capital / continued

The ownership structure as at 31 December 2006 was as follows.

	REGISTERED SHARES			
	31 December 2006		31 December 2005	
	Number of shares	Percentage of ownership	Number of shares	Percentage of ownership
Intesa Holding International	14,609,532	76.6%	12,712,007	76.3%
EBRD	3,981,990	20.9%	3,464,746	20.8%
Minority shareholders	439,858	2.3%	435,118	2.6%
Treasury shares	43,389	0.2%	48,129	0.3%
	19,074,769	**100%**	**16,660,000**	**100%**

During the year the movement of treasury shares was as follows.

(number of shares)	2006	2005
Balance at 1 January	**48,129**	**48,434**
Increase	27,484	30,332
Decrease	(32,224)	(30,637)
Balance at 31 December	**43,389**	**48,129**

34 | Reserves and retained earnings

In accordance with local legislation, 5 percent of the net profit of the Bank is required to be transferred to non-distributable legal reserves to equal 5 percent of the share capital of the Bank.
On 10 April 2006, at their General Shareholders Meeting the shareholders of Privredna banka Zagreb approved the bonus payment to the management and employees of PBZ in amount of HRK 28,408,000 as a share based bonus payment.
During 2006, the Bank purchased a total of 27,484 treasury shares on the open market for own purposes.

35 | Cash and cash equivalents (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
Cash and current accounts with other banks (note 10)	2,576	1,949	2,328	1,860
Due from banks with maturity of up to 3 months (note 14 and 46)	6,471	6,829	6,179	6,682
	9,047	**8,778**	**8,507**	**8,542**

36 | Managed funds for and on behalf of third parties (in HRK million)

	GROUP		BANK	
	2006	2005	2006	2005
LIABILITIES				
Local authorities and similar organisations	447	495	446	491
Companies	4	4	4	3
Banks and other institutions	258	266	252	261
	709	**765**	**702**	**755**
LESS: ASSETS	703	757	696	747
	6	**8**	**6**	**8**

The Group manages funds for and on behalf of third parties, which are mainly in the form of loans to various organisations for capital investment. These assets are accounted for separately from those of the Group. Income and expenses arising from these funds are credited and charged to the corresponding sources and no liability falls on the Group in connection with these transactions. The Group is compensated for its services by fees chargeable to the funds.

37 | Leases

PBZ Leasing d.o.o., the company wholly-owned by the Bank, has entered as a lessor into both finance and operating lease arrangements of various items of equipment, vessels and vehicles. Net investments in finance lease in the Group financial statements are included within loans and advances to customers in the total amount of HRK 773.1 million (2005: HRK 558.0 million) (refer to note 15). The amounts related to operating lease arrangements are classified within property and equipment (refer to note 20). The net book value of leased tangible fixed assets was HRK 176.5 million (2005: HRK 173.0 million).

Future minimum lease payments under finance leases together with the present value of the net minimum lease payments are set out below:

	Minimum payments	Present value of payments	Minimum payments	Present value of payments
(in HRK million)	**2006**	**2006**	**2005**	**2005**
Next year	216	163	166	127
Between one and five years	516	404	371	294
After five years	297	230	197	153
Total minimum lease payments receivable	**1,029**	**797**	**734**	**574**
Unearned finance income	(232)	-	(160)	-
Total investment in finance lease	**797**	**797**	**574**	**574**
Less: Allowance for uncollectable amounts	(24)	(24)	(16)	(16)
Net investment in finance lease	**773**	**773**	**558**	**558**

Future minimum rentals receivable under non-cancellable operating leases are as follows:

	2006	**2005**
Within one year	55	46
After one year but no more than five years	109	82
More than five years	67	4
	231	**132**

38 | Related party transactions (in HRK million)

As of 31 December 2006 Privredna banka Zagreb and its subsidiaries are under controlling interest of Banca Intesa, which owned 76.59 percent of the share capital at that date.
Related parties include companies controlled or influenced by the Bank by virtue of its shareholdings and also companies that can influence the Bank by virtue of their shareholdings in the Bank, together with other companies forming part of the Intesa Group. In addition, companies influenced by the key management personnel of the Bank are also considered to be related parties.
The Bank grants loans to or places deposits with the companies to which it is related. Such loans are made in the ordinary course of business at terms and conditions available to third parties.
The volumes of related party transactions and outstanding balances at the year end were as follows:

	Key management personnel	Related companies
Group		
LOANS GIVEN		
Loans outstanding at 1 January 2006	**2**	**504**
Changes during the year	-	1,656
Loans outstanding at 31 December 2006	**2**	**2,160**
DEPOSITS AND LOANS RECEIVED		
Balance at 1 January 2006	**17**	**5,226**
Changes during the year	2	3,318
Balance at 31 December 2006	**19**	**8,544**
Guarantees issued	-	92
Bank		
LOANS GIVEN		
Loans outstanding at 1 January 2006	**1**	**1,336**
Changes during the year	-	1,127
Loans outstanding at 31 December 2006	**1**	**2,463**
DEPOSITS AND LOANS RECEIVED		
Balance at 1 January 2006	**15**	**5,732**
Changes during the year	(2)	2,168
Balance at 31 December 2006	**13**	**7,900**
Guarantees issued	-	23

No provisions were recognised in respect of loans given to related parties (2005: nil).

38 | Related party transactions / continued (in HRK million)

Key management compensation:

	GROUP		BANK	
	2006	2005	2006	2005
Salaries and other short-term benefits	28	26	16	15
Bonus payments	10	6	9	6
Termination benefits	1	-	-	-
	39	**32**	**25**	**21**

Key management personnel include Management Board and Supervisory Board members, as well as executive directors directly responsible to the President of the Management Board.

39 | Financial risk management policies

This section provides details of the Group's exposure to risk and describes the methods used by the management to control risk. The most important types of financial risk to which the Group is exposed are credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate risk and equity price risk.
An integrated system of risk management is being established at the Group level by introducing a set of policies and procedures, determining the limits of risk levels acceptable to the Group. The limits are set according to the amount of regulatory capital and apply to all types of risk. Methodology and models for managing operational risk have been developed.

Credit risk

The Group is subject to credit risk through its trading, lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees. The risk that counter parties to both derivative and other instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Group deals with counter parties of good credit standing, and when appropriate, obtains collateral.
The Group'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 on the balance sheet. In addition, the Group is exposed to off balance sheet credit risk through commitments to extend credit and guarantees issued - refer to note 32.
Exposure to credit risk has been managed in accordance with the Group's policies. Credit exposures to portfolios and individual group exposures are reviewed on a regular basis against the set limits. Breaches are reported to appropriate bodies and personnel within the Bank authorised to approve it. Any substantial increases in credit exposure are authorised by the Credit Committee. The Assets Quality Committee monitors changes in credit-worthiness of credit exposures and reviews proposed impairment losses. Credit risk assessment is continuously monitored and reported, thus enabling an early identification of impairment in the credit portfolio. The Group has been continually applying prudent methods and models used in the process of the credit risk assessment.
The Group's policy is to require suitable collateral to be provided by certain customers prior to the disbursement of approved loans. Collateral for loans, guarantees, and letters of credit is usually in the form of cash, inventory, listed investments or other property.

Liquidity risk

Liquidity risk arises in the general funding of the Group's activities and in the management of positions. It includes both the risk of being unable to fund assets at the appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.
The Group has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits, borrowings, subordinated liabilities including deposits, borrowings and share capital. The Group continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall Group strategy. In addition, the Group holds a portfolio of liquid assets as part of its liquidity risk management.
The Group adjusts its business activities in compliance with liquidity risk according to regulatory and internal policies for maintenance of liquidity reserves, matching of liabilities and assets, limits control, preferred liquidity ratios and contingency planning procedure. Needs for short-term liquidity are planned every month for a period of one month and controlled and maintained daily. The treasury manages liquidity reserves daily, ensuring also the fullfilment of all customer needs.

39 | Financial risk management policies /continued

Market risk

All trading instruments are subject to market risk, the risk that future changes in market conditions may make an instrument less valuable or more onerous. The instruments are recognised at fair value, and all changes in market conditions directly affect net trading income. The Group manages its use of trading instruments in response to changing market conditions. The limits are defined following the needs and strategy of the Group and in accordance with senior management risk policy indications.

Exposure to market risk is formally managed in accordance with risk limits approved by senior management and revised at least annually in terms of positional (nominal) exposure, VaR, PV01 and stop loss limits. The exposure figures and limit utilisation are delivered daily to the senior management and the lower management levels in the Treasury Division, which enables informed decision-making at all management and operational levels.

Currency risk

The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The foreign exchange risk exposure is monitored on the overall balance sheet level in terms of foreign exchange open position as prescribed by the regulatory provisions and additionally through the internal limits based on the advanced market risk models (FX VaR) on a daily basis.

Interest rate risk

Interest rate risk is the sensitivity of the Group's financial condition to movements in interest rates. Mismatches or gaps in the amount of assets, liabilities and off-balance sheet instruments that mature or reprice in a given period generate interest rate risk.

The Group'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 Group is also exposed to basis risk, which is the difference in the repricing characteristics of the various floating rate indices.

Asset-liability risk management activities are conducted in the context of the Group's sensitivity to interest rate exchanges. Exposure to interest rate risk is monitored and measured using repricing gap analysis, net interest income and economic value of equity. Risk management activities are aimed at optimising net interest income and the economic value of equity, given market interest rate levels consistent with the Group's business strategies.

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 held for trading and available for sale.

Derivative financial instruments

The Group enters into derivative financial instruments primarily to satisfy the needs and requirements of the customers. Derivative financial instruments used by the Group include foreign exchange swaps and forwards. Derivatives are contracts individually negotiated over-the-counter.

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk. In order to efficiently measure and manage operational risk exposure at the Group level, the Bank is developing an internal model for operational risk exposure management in line with the Basel II prescribed framework. The main goals of the internal model are: to implement techniques enabling detailed insight into the profile of the Bank's risk exposure such as (quantitative ('ex-post') and qualitative (ex-ante') risk exposure assessment); to support the management decision making process by developing efficient policies for management and mitigation of operational risk at the Group level; adjustment of the pricing/provisioning policy by incorporation of expected losses and allocation of adequate economic/regulatory capital for unexpected losses.

40 | Capital

The Bank maintains an actively managed capital base to cover risks in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Croatian National Bank in supervising the Bank. During the past year, the Bank complied in full with all its externally imposed capital requirements.

Regulatory capital (in HRK million)

	BANK	
	2006	2005
Tier 1 capital	6,842	4,380
Tier 2 capital	426	384
Deductions	(312)	(142))
Total capital	**6,956**	**4,622**
Risk weighted assets and other risk elements	**44,157**	**32,875**
Tier 1 capital ratio	**15.49%**	**13.32%**
Total capital ratio	**15.75%**	**14.06%**

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, retained earnings including current year profit, capital gains and other reserves. The other component of regulatory capital is Tier 2 capital, which includes provision for collective impairment up to 1.25 percent of total risk weighted assets.

41 | Fair values of financial assets and liabilities

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arms length basis. Financial instruments held for trading are measured at fair value. Loans and advances to customers and assets held to maturity are measured at amortised cost less impairment.
The following methods and assumptions have been made in estimating the fair value of financial instruments.
• As at 31 December 2006 marginal reserve with the Croatian National Bank earned no interest. The fair value of balances with the Croatian National Bank for the Group is estimated to be 7,233 million kuna and for the Bank 7,029 million kuna;
• Loans and advances to customers are net of specific and other provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected future cash flows are estimated considering credit risk and any indication of impairment. As the Group has a limited portfolio of loans and advances with fixed rate and longer term maturity, the fair value of loans and advances is not significantly different from their carrying value;
• The fair value of securities is based on market prices, with the exception of unquoted equity investments where fair value is based on the latest available financial statements of the issuer;
• For some of investments carried at amortised cost less impairment a quoted market price is not available and fair value is, where possible, estimated using mark to model techniques and, as a result, their estimated fair value appeared not to be materially different from their carrying value. The fair value of securities held to maturity for the Group is estimated to be at HRK 1,443 million kuna and for the Bank 1,251 million kuna;
• For demand deposits and deposits with no defined maturities, fair value is determined to be the amount payable on demand at the balance sheet date.
• Most of the Group's long-term debt borrowings bear floating interest rates which are linked to market and reprice regularly. As such the management believes that the book value of the long term borrowings approximates their fair value.

42 | Financial information by segment (in HRK million)

The following tables present information on the income statement and certain assets and liabilities regarding the Group's business segments for the years ended 31 December 2006 and 2005. The operating businesses are organised and managed separately according to the nature of the products and services provided, with each segment representing strategic segment units that offer different products and serve different markets.

GROUP	Banking	Card services	Leasing	Other financial services	Non financial services	Consolidation adjustments	Total
As at 31 December 2006							
Interest income	2,837	58	53	28	-	-	2,976
Interest expense	(1,226)	(3)	(14)	(19)	-	-	(1,262)
Intersegment	22	3	(22)	6	-	(9)	-
Net interest income	1,633	58	17	15	-	(9)	1,714
Fee and commission income	497	504	4	55	17	-	1,077
Fee and commission expense	(193)	(11)	-	(6)	(8)	-	(218)
Intersegment	16	(12)	-	(12)	1	7	-
Net fee and commission income	320	481	4	37	10	7	859
Other operating income	454	27	101	-	9	(125)	466
Operating income	2,407	566	122	52	19	(127)	3,039
Provisions, other operating expenses and depreciation and amortisation	(1,324)	(371)	(111)	(24)	(9)	11	(1,828)
Share of the profit and loss accounted for using the equity method	-	-	-	8	-	-	8
Income taxes	(203)	(41)	(3)	(5)	(2)	-	(254)
Minority interests	(1)	-	-	-	(1)	-	(2)
Net profit for the year	**879**	**154**	**8**	**31**	**7**	**(116)**	**963**
Segment assets	58,883	1,668	1,067	1,060	55	(804)	61,929
Equity investments in subsidiaries and associates	41	4	-	-	-	-	45
Total assets	**58,924**	**1,672**	**1,067**	**1,060**	**55**	**(804)**	**61,974**
Segment liabilities	51,425	1,277	1,030	994	3	(498)	54,231
Taxes payable	59	48	5	5	1	-	118
Total liabilities	**51,484**	**1,325**	**1,035**	**999**	**4**	**(498)**	**54,349**

Notes to the Bank and the Group Financial Statements

42 | Financial information by segment / continued (in HRK million)

GROUP	Banking	Card services	Leasing	Other financial services	Non financial services	Consolidation adjustments	Total
As at 31 December 2005							
Interest income	2,513	53	41	3	-	-	2,610
Interest expense	(1,013)	-	-	(14)	-	-	(1,027)
Intersegment	16	(8)	(29)	21	-	-	-
Net interest income	1,516	45	12	10	-	-	1,583
Fee and commission income	538	354	1	27	15	-	935
Fee and commission expense	(198)	(10)	(1)	(6)	(6)	-	(221)
Intersegment	8	(5)	8	(2)	-	(9)	-
Net fee and commission income	348	339	8	19	9	(9)	714
Other operating income	407	15	69	2	8	(110)	391
Operating income	2,271	399	89	31	17	(119)	2,688
Provisions, other operating expenses and depreciation and amortisation	(1,308)	(281)	(83)	(25)	(11)	40	(1,668)
Share of the profit and loss accounted for using the equity method	-	-	-	6	-	-	6
Income taxes	(180)	(24)	(2)	(3)	(1)	-	(210)
Minority interests	(1)	-	-	-	(1)	-	(2)
Net profit for the year	**782**	**94**	**4**	**9**	**4**	**(79)**	**814**
Segment assets	50,722	1,288	841	703	49	(1,831)	51,772
Equity investments in subsidiaries and associates	37	1	-	-	-	-	38
Total assets	**50,759**	**1,289**	**841**	**703**	**49**	**(1,831)**	**51,810**
Segment liabilities	46,049	1,015	810	647	4	(1,581)	46,944
Taxes payable	36	6	2	2	-	-	46
Total liabilities	**46,085**	**1,021**	**812**	**649**	**4**	**(1,581)**	**46,990**

43 | Interest rate risk (in HRK million)

Group As at 31 December 2006	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	Over 1 year	Non-interest bearing	Total
Assets						
Cash and current accounts with other banks	177	-	-	-	2,399	**2,576**
Balances with Croatian National Bank	4,637	-	-	-	2,625	**7,262**
Financial assets at fair value through profit or loss	679	399	1,011	782	185	**3,056**
Derivative financial assets	-	-	-	-	44	**44**
Due from banks	7,189	42	4	-	-	**7,235**
Loans and advances to customers	31,700	565	1,115	3,530	-	**36,910**
Assets available for sale	60	120	148	974	3	**1,305**
Held to maturity investments	30	3	-	1,325	-	**1,358**
Equity investments in subsidiaries and associates	-	-	-	-	45	**45**
Intangible assets and goodwill	-	-	-	-	200	**200**
Property and equipment	-	-	-	-	1,381	**1,381**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	18	**18**
Other assets	-	-	-	-	449	**449**
Deferred tax assets	-	-	-	-	121	**121**
	44,472	**1,129**	**2,278**	**6,611**	**7,484**	**61,974**
Liabilities						
Due to banks	4,458	14	9	37	-	**4,518**
Due to customers	33,571	847	1,144	1,207	74	**36,843**
Derivative financial liabilities	-	-	-	-	15	**15**
Financial liabilities held for trading	735	-	-	-	-	**735**
Other borrowed funds	7,862	29	311	1,754	-	**9,956**
Debt securities issued	-	-	119	-	-	**119**
Other liabilities	-	-	-	-	1,832	**1,832**
Accruals and deferred income	-	-	-	-	120	**120**
Provisions for risks and charges	-	-	-	-	211	**211**
	46,626	**890**	**1,583**	**2,998**	**2,252**	**54,349**
Interest sensitivity gap	**(2,154)**	**239**	**695**	**3,613**	**5,232**	**7,625**

43 | Interest rate risk / continued (in HRK million)

Bank As at 31 December 2006	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	Over 1 year	Non-interest bearing	Total
Assets						
Cash and current accounts with other banks	47	-	-	-	2,281	**2,328**
Balances with Croatian National Bank	5,224	-	-	-	1,825	**7,049**
Financial assets at fair value through profit or loss	697	399	1,011	782	185	**3,074**
Derivative financial assets	-	-	-	-	44	**44**
Due from banks	6,903	32	-	-	-	**6,935**
Loans and advances to customers	29,527	498	838	2,709	-	**33,572**
Assets available for sale	53	-	-	-	-	**53**
Held to maturity investments	30	-	-	1,128	-	**1,158**
Equity investments in subsidiaries and associates	-	-	-	-	404	**404**
Intangible assets and goodwill	-	-	-	-	65	**65**
Property and equipment	-	-	-	-	883	**883**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	18	**18**
Other assets	-	-	-	-	226	**226**
Deferred tax assets	-	-	-	-	83	**83**
	42,481	**929**	**1,849**	**4,619**	**6,028**	**55,906**
Liabilities						
Due to banks	4,479	12	-	12	-	**4,503**
Due to customers	31,648	787	968	88	-	**33,491**
Derivative financial liabilities	-	-	-	-	15	**15**
Financial liabilities held for trading	735	-	-	-	-	**735**
Other borrowed funds	8,075	14	220	838	-	**9,147**
Debt securities issued	-	-	-	-	-	-
Other liabilities	-	-	-	-	649	**649**
Accruals and deferred income	-	-	-	-	66	**66**
Provisions for risks and charges	-	-	-	-	186	**186**
	44,937	**813**	**1,188**	**938**	**916**	**48,792**
Interest sensitivity gap	**(2,456)**	**116**	**661**	**3,681**	**5,112**	**7,114**

43 | Interest rate risk / continued (in HRK million)

Group As at 31 December 2005	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	Over 1 year	Non-interest bearing	Total
Assets						
Cash and current accounts with other banks	63	-	-	-	1,886	**1,949**
Balances with Croatian National Bank	2,162	-	-	-	3,233	**5,395**
Financial assets at fair value through profit or loss	790	793	1,359	1,113	412	**4,467**
Derivative financial assets	-	-	-	-	17	**17**
Due from banks	7,587	135	105	2	-	**7,829**
Loans and advances to customers	27,411	619	221	389	-	**28,640**
Assets available for sale	55	34	137	146	14	**386**
Held to maturity investments	35	-	20	1,297	-	**1,352**
Equity investments in subsidiaries and associates	-	-	-	-	38	**38**
Intangible assets and goodwill	-	-	-	-	147	**147**
Property and equipment	-	-	-	-	1,172	**1,172**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	101	**101**
Other assets	-	-	-	-	230	**230**
Deferred tax assets	-	-	-	-	73	**73**
	38,103	**1,581**	**1,842**	**2,947**	**7,337**	**51,810**
Liabilities						
Due to banks	3,048	104	109	12	-	**3,273**
Due to customers	30,845	494	250	763	39	**32,391**
Derivative financial liabilities	-	-	-	-	19	**19**
Financial liabilities held for trading	1,188	-	-	-	-	**1,188**
Other borrowed funds	6,553	691	91	896	-	**8,231**
Debt securities issued	-	-	-	19	-	**19**
Other liabilities	-	-	-	-	1,569	**1,569**
Accruals and deferred income	-	-	-	-	112	**112**
Provisions for risks and charges	-	-	-	-	188	**188**
	41,634	**1,289**	**450**	**1,690**	**1,927**	**46,990**
Interest sensitivity gap	**(3,531)**	**292**	**1,392**	**1,257**	**5,410**	**4,820**

43 | Interest rate risk / continued (in HRK million)

Bank As at 31 December 2005	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	Over 1 year	Non-interest bearing	Total
Assets						
Cash and current accounts with other banks	55	-	-	-	1,805	**1,860**
Balances with Croatian National Bank	2,097	-	-	-	3,087	**5,184**
Financial assets at fair value through profit or loss	790	793	1,359	1,167	358	**4,467**
Derivative financial assets	-	-	-	-	17	**17**
Due from banks	7,575	-	10	-	-	**7,585**
Loans and advances to customers	26,121	49	209	308	-	**26,687**
Assets available for sale	24	-	-	-	-	**24**
Held to maturity investments	35	-	-	1,294	-	**1,329**
Equity investments in subsidiaries and associates	-	-	-	-	298	**298**
Intangible assets and goodwill	-	-	-	-	62	**62**
Property and equipment	-	-	-	-	743	**743**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	94	**94**
Other assets	-	-	-	-	129	**129**
Deferred tax assets	-	-	-	-	60	**60**
	36,697	**842**	**1,578**	**2,769**	**6,667**	**48,553**
Liabilities						
Due to banks	3,686	104	109	12	-	**3,911**
Due to customers	29,225	490	220	69	-	**30,004**
Derivative financial liabilities	-	-	-	-	19	**19**
Financial liabilities held for trading	1,188	-	-	-	-	**1,188**
Other borrowed funds	7,246	64	59	609	-	**7,978**
Debt securities issued	-	-	-	19	-	**19**
Other liabilities	-	-	-	-	759	**759**
Accruals and deferred income	-	-	-	-	67	**67**
Provisions for risks and charges	-	-	-	-	175	**175**
	41,345	**658**	**388**	**709**	**1,020**	**44,120**
Interest sensitivity gap	**(4,648)**	**184**	**1,190**	**2,060**	**5,647**	**4,433**

44 | Weighted average interest rates

The weighted average interest rates at year end are disclosed as follows:

	GROUP	GROUP	BANK	BANK
	Weighted average interest rate	Weighted average interest rate	Weighted average interest rate	Weighted average interest rate
	2006 (%)	2005 (%)	2006 (%)	2005 (%)
Cash reserves	0.84	0.25	0.78	0.25
Balances with the CNB	0.97	1.14	0.98	1.14
Securities held for trading	3.74	3.80	3.84	3.75
Due from banks	3.35	2.65	3.44	2.73
Loans and advances to customers	6.88	7.47	6.92	7.48
Public debt due from the Republic of Croatia	5.00	5.00	5.00	5.00
Replacement bonds	5.00	5.00	5.00	5.00
Due to customers	2.59	2.58	2.57	2.57
Other borrowed funds	3.03	2.45	3.03	2.57

45 | **Currency risk** (in HRK million)

The Group manages its exposure to currency risk through a variety of measures including the use of revaluation clauses, which have the same effect as denominating HRK assets in other currencies, and foreign currency deals bought and sold forward.

Group **As at 31 December 2006**	EUR	CHF	USD	Other currencies	HRK	Total
Assets						
Cash and current accounts with other banks	319	26	43	189	1,999	**2,576**
Balances with Croatian National Bank	3,638	-	-	-	3,624	**7,262**
Financial assets at fair value through profit or loss	1,403	-	87	30	1,536	**3,056**
Derivative financial assets	6	-	-	-	38	**44**
Due from banks	4,890	113	1,188	274	770	**7,235**
Loans and advances to customers	19,021	4,408	477	164	12,840	**36,910**
Assets available for sale	837	-	27	-	441	**1,305**
Held to maturity investments	1,331	-	-	-	27	**1,358**
Equity investments in subsidiaries and associates	-	-	-	45	-	**45**
Intangible assets and goodwill	-	-	-	4	196	**200**
Property and equipment	-	-	-	14	1,367	**1,381**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	18	**18**
Other assets	42	3	8	21	375	**449**
Deferred tax assets	-	-	-	-	121	**121**
	31,487	**4,550**	**1,830**	**741**	**23,366**	**61,974**
Liabilities						
Due to banks	1,212	559	40	35	2,672	**4,518**
Due to customers	23,081	395	2,244	492	10,631	**36,843**
Derivative financial liabilities	-	-	-	-	15	**15**
Financial liabilities held for trading	735	-	-	-	-	**735**
Other borrowed funds	7,586	28	338	20	1,984	**9,956**
Debt securities issued	-	-	-	-	119	**119**
Other liabilities	132	6	33	54	1,607	**1,832**
Accruals and deferred income	5	-	-	2	113	**120**
Provisions for risks and charges	8	-	12	1	190	**211**
	32,759	**988**	**2,667**	**604**	**17,331**	**54,349**
Net on balance sheet position	**(1,272)**	**3,562**	**(837)**	**137**	**6,035**	**7,625**

45 | Currency risk / continued (in HRK million)

The Bank manages its exposure to currency risk through a variety of measures including the use of revaluation clauses, which have the same effect as denominating HRK assets in other currencies, and foreign currency deals bought and sold forward.

Bank As at 31 December 2006	EUR	CHF	USD	Other currencies	HRK	Total
Assets						
Cash and current accounts with other banks	287	24	39	41	1,937	**2,328**
Balances with Croatian National Bank	3,574	-	-	-	3,475	**7,049**
Financial assets at fair value through profit or loss	1,403	-	87	30	1,554	**3,074**
Derivative financial assets	6	-	-	-	38	**44**
Due from banks	4,500	96	1,156	267	916	**6,935**
Loans and advances to customers	17,218	4,353	476	15	11,510	**33,572**
Assets available for sale	-	-	27	-	26	**53**
Held to maturity investments	1,133	-	-	-	25	**1,158**
Equity investments in subsidiaries and associates	-	-	-	45	359	**404**
Intangible assets and goodwill	-	-	-	-	65	**65**
Property and equipment	-	-	-	-	883	**883**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	18	**18**
Other assets	41	3	8	3	171	**226**
Deferred tax assets	-	-	-	-	83	**83**
	28,162	**4,476**	**1,793**	**401**	**21,074**	**55,906**
Liabilities						
Due to banks	1,196	559	38	16	2,694	**4,503**
Due to customers	20,618	345	2,209	265	10,054	**33,491**
Derivative financial liabilities	-	-	-	-	15	**15**
Financial liabilities held for trading	735	-	-	-	-	**735**
Other borrowed funds	6,712	5	338	17	2,075	**9,147**
Debt securities issued	-	-	-	-	-	-
Other liabilities	114	6	30	40	459	**649**
Accruals and deferred income	-	-	-	-	66	**66**
Provisions for risks and charges	8	-	12	-	166	**186**
	29,383	**915**	**2,627**	**338**	**15,529**	**48,792**
Net on balance sheet position	**(1,221)**	**3,561**	**(834)**	**63**	**5,545**	**7,114**

45 | Currency risk / continued (in HRK million)

Group As at 31 December 2005	EUR	CHF	USD	Other currencies	HRK	Total
Assets						
Cash and current accounts with other banks	277	24	43	80	1,525	**1,949**
Balances with Croatian National Bank	2,159	-	3	-	3,233	**5,395**
Financial assets at fair value through profit or loss	2,332	25	113	95	1,902	**4,467**
Derivative financial assets	1	-	-	-	16	**17**
Due from banks	5,138	21	2,428	242	-	**7,829**
Loans and advances to customers	18,577	1,352	613	19	8,079	**28,640**
Assets available for sale	129	-	-	-	257	**386**
Held to maturity investments	1,305	-	-	-	47	**1,352**
Equity investments in subsidiaries and associates	-	-	-	1	37	**38**
Intangible assets and goodwill	-	-	-	-	147	**147**
Property and equipment	-	-	-	-	1,172	**1,172**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	101	**101**
Other assets	4	-	-	1	225	**230**
Deferred tax assets	-	-	-	-	73	**73**
	29,922	**1,422**	**3,200**	**438**	**16,828**	**51,810**
Liabilities						
Due to banks	3,197	12	50	14	-	**3,273**
Due to customers	20,992	386	2,600	265	8,148	**32,391**
Derivative financial liabilities	1	-	-	-	18	**19**
Financial liabilities held for trading	1,188	-	-	-	-	**1,188**
Other borrowed funds	5,333	7	547	21	2,323	**8,231**
Debt securities issued	19	-	-	-	-	**19**
Other liabilities	148	7	37	44	1,333	**1,569**
Accruals and deferred income	2	-	-	-	110	**112**
Provisions for risks and charges	17	-	9	-	162	**188**
	30,897	**412**	**3,243**	**344**	**12,094**	**46,990**
Net on balance sheet position	**(975)**	**1,010**	**(43)**	**94**	**4,734**	**4,820**

45 | Currency risk / continued (in HRK million)

Bank As at 31 December 2005	EUR	CHF	USD	Other currencies	HRK	Total
Assets						
Cash and current accounts with other banks	274	22	42	35	1,487	**1,860**
Balances with Croatian National Bank	2,094	-	3	-	3,087	**5,184**
Financial assets at fair value through profit or loss	2,326	25	113	95	1,908	**4,467**
Derivative financial assets	1	-	-	-	16	**17**
Due from banks	4,755	-	2,406	237	187	**7,585**
Loans and advances to customers	17,266	1,328	613	19	7,461	**26,687**
Assets available for sale	-	-	-	-	24	**24**
Held to maturity investments	1,305	-	-	-	24	**1,329**
Equity investments in subsidiaries and associates	-	-	-	-	298	**298**
Intangible assets and goodwill	-	-	-	-	62	**62**
Property and equipment	-	-	-	-	743	**743**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	-	-	-	94	**94**
Other assets	2	-	-	1	126	**129**
Deferred tax assets	-	-	-	-	60	**60**
	28,023	**1,375**	**3,177**	**387**	**15,591**	**48,553**
Liabilities						
Due to banks	3,517	12	50	14	318	**3,911**
Due to customers	19,141	338	2,577	259	7,689	**30,004**
Derivative financial liabilities	1	-	-	-	18	**19**
Financial liabilities held for trading	1,188	-	-	-	-	**1,188**
Other borrowed funds	4,640	7	547	21	2,763	**7,978**
Debt securities issued	19	-	-	-	-	**19**
Other liabilities	129	7	34	43	546	**759**
Accruals and deferred income	1	-	-	-	66	**67**
Provisions for risks and charges	17	-	9	-	149	**175**
	28,653	**364**	**3,217**	**337**	**11,549**	**44,120**
Net on balance sheet position	**(630)**	**1,011**	**(40)**	**50**	**4,042**	**4,433**

 Liquidity risk (in HRK million)

Group **As at 31 December 2006**	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and current accounts with other banks	2,576	-	-	-	-	**2,576**
Balances with Croatian National Bank	7,154	25	47	36	-	**7,262**
Financial assets at fair value through profit or loss	485	399	1,033	686	453	**3,056**
Derivative financial assets	44	-	-	-	-	**44**
Due from banks	6,331	140	152	508	104	**7,235**
Loans and advances to customers	5,506	1,680	5,884	13,892	9,948	**36,910**
Assets available for sale	91	50	190	68	906	**1,305**
Held to maturity investments	30	3	-	24	1,301	**1,358**
Equity investments in subsidiaries and associates	-	-	-	-	45	**45**
Intangible assets and goodwill	-	-	-	24	176	**200**
Property and equipment	-	-	1	250	1,130	**1,381**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	18	-	-	-	**18**
Other assets	398	14	30	6	1	**449**
Deferred tax assets	112	-	1	4	4	**121**
	22,727	**2,329**	**7,338**	**15,498**	**14,082**	**61,974**
Liabilities						
Due to banks	4,347	23	11	25	112	**4,518**
Due to customers	18,866	5,288	8,700	3,285	704	**36,843**
Derivative financial liabilities	15	-	-	-	-	**15**
Financial liabilities held for trading	735	-	-	-	-	**735**
Other borrowed funds	1,362	225	685	6,980	704	**9,956**
Debt securities issued	-	-	119	-	-	**119**
Other liabilities	1,811	-	21	-	-	**1,832**
Accruals and deferred income	98	1	13	-	8	**120**
Provisions for risks and charges	191	6	7	1	6	**211**
	27,425	5,543	9,556	10,291	1,534	**54,349**
Net liquidity gap	**(4,698)**	**(3,214)**	**(2,218)**	**5,207**	**12,548**	**7,625**

46 | Liquidity risk / continued (in HRK million)

Bank **As at 31 December 2006**	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and current accounts with other banks	2,328	-	-	-	-	**2,328**
Balances with Croatian National Bank	7,049	-	-	-	-	**7,049**
Financial assets at fair value through profit or loss	504	399	1,032	686	453	**3,074**
Derivative financial assets	44	-	-	-	-	**44**
Due from banks	6,053	126	145	507	104	**6,935**
Loans and advances to customers	4,353	1,611	5,382	12,980	9,246	**33,572**
Assets available for sale	53	-	-	-	-	**53**
Held to maturity investments	30	-	-	24	1,104	**1,158**
Equity investments in subsidiaries and associates	-	-	-	-	404	**404**
Intangible assets and goodwill	-	-	-	-	65	**65**
Property and equipment	-	-	-	-	883	**883**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	18	-	-	-	**18**
Other assets	226	-	-	-	-	**226**
Deferred tax assets	83	-	-	-	-	**83**
	20,723	**2,154**	**6,559**	**14,197**	**12,273**	**55,906**
Liabilities						
Due to banks	4,368	21	2	1	111	**4,503**
Due to customers	17,768	5,017	8,108	1,928	670	**33,491**
Derivative financial liabilities	15	-	-	-	-	**15**
Financial liabilities held for trading	735	-	-	-	-	**735**
Other borrowed funds	1,723	210	553	6,004	657	**9,147**
Debt securities issued	-	-	-	-	-	-
Other liabilities	649	-	-	-	-	**649**
Accruals and deferred income	66	-	-	-	-	**66**
Provisions for risks and charges	183	1	2	-	-	**186**
	25,507	**5,249**	**8,665**	**7,933**	**1,438**	**48,792**
Net liquidity gap	**(4,784)**	**(3,095)**	**(2,106)**	**6,264**	**10,835**	**7,114**

46 | Liquidity risk / continued (in HRK million)

Group As at 31 December 2005	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and current accounts with other banks	1,949	-	-	-	-	**1,949**
Balances with Croatian National Bank	5,395	-	-	-	-	**5,395**
Financial assets at fair value through profit or loss	518	795	1,394	602	1,158	**4,467**
Derivative financial assets	17	-	-	-	-	**17**
Due from banks	6,731	98	251	527	222	**7,829**
Loans and advances to customers	3,501	1,167	5,199	12,471	6,302	**28,640**
Assets available for sale	15	50	137	141	43	**386**
Held to maturity investments	35	-	20	-	1,297	**1,352**
Equity investments in subsidiaries and associates	-	-	-	-	38	**38**
Intangible assets and goodwill	-	-	-	-	147	**147**
Property and equipment	-	-	-	-	1,172	**1,172**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	94	7	-	-	**101**
Other assets	162	-	-	-	68	**230**
Deferred tax assets	73	-	-	-	-	**73**
	18,396	**2,204**	**7,008**	**13,741**	**10,461**	**51,810**
Liabilities						
Due to banks	3,042	110	109	1	11	**3,273**
Due to customers	16,226	5,304	7,187	3,082	592	**32,391**
Derivative financial liabilities	19	-	-	-	-	**19**
Financial liabilities held for trading	1,188	-	-	-	-	**1,188**
Other borrowed funds	1,405	400	1,340	4,217	869	**8,231**
Debt securities issued	-	-	-	-	19	**19**
Other liabilities	1,569	-	-	-	-	**1,569**
Accruals and deferred income	112	-	-	-	-	**112**
Provisions for risks and charges	188	-	-	-	-	**188**
	23,749	**5,814**	**8,636**	**7,300**	**1,491**	**46,990**
Net liquidity gap	**(5,353)**	**(3,610)**	**(1,628)**	**6,441**	**8,970**	**4,820**

46 | **Liquidity risk / continued** (in HRK million)

Bank **As at 31 December 2005**	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and current accounts with other banks	1,860	-	-	-	-	**1,860**
Balances with Croatian National Bank	5,184	-	-	-	-	**5,184**
Financial assets at fair value through profit or loss	516	793	1,394	721	1,043	**4,467**
Derivative financial assets	17	-	-	-	-	**17**
Due from banks	6,678	4	156	526	221	**7,585**
Loans and advances to customers	3,132	1,049	4,897	11,818	5,791	**26,687**
Assets available for sale	-	-	-	-	24	**24**
Held to maturity investments	35	-	-	-	1,294	**1,329**
Equity investments in subsidiaries and associates	-	-	-	-	298	**298**
Intangible assets and goodwill	-	-	-	-	62	**62**
Property and equipment	-	-	-	-	743	**743**
Investment property	-	-	-	-	14	**14**
Non current assets held for sale	-	94	-	-	-	**94**
Other assets	59	-	-	-	70	**129**
Deferred tax assets	60	-	-	-	-	**60**
	17,541	**1,940**	**6,447**	**13,065**	**9,560**	**48,553**
Liabilities						
Due to banks	3,679	110	110	1	11	**3,911**
Due to customers	15,387	5,060	6,813	2,185	559	**30,004**
Derivative financial liabilities	19	-	-	-	-	**19**
Financial liabilities held for trading	1,188	-	-	-	-	**1,188**
Other borrowed funds	2,254	278	1,188	3,436	822	**7,978**
Debt securities issued	-	-	-	-	19	**19**
Other liabilities	759	-	-	-	-	**759**
Accruals and deferred income	67	-	-	-	-	**67**
Provisions for risks and charges	175	-	-	-	-	**175**
	23,528	**5,448**	**8,111**	**5,622**	**1,411**	**44,120**
Net liquidity gap	**(5,987)**	**(3,508)**	**(1,664)**	**7,443**	**8,149**	**4,433**

47 | Concentration of assets and liabilities (in HRK million)

	Group			Bank		
	Assets	Liabilities	Off balance sheet items	Assets	Liabilities	Off balance sheet items
As at 31 December 2006						
Geographic region						
Republic of Croatia	55,418	41,988	12,988	49,719	36,475	12,623
European Union	5,479	10,642	4	5,151	10,604	4
Other countries	1,077	1,719	125	1,036	1,713	125
	61,974	**54,349**	**13,117**	**55,906**	**48,792**	**12,752**
Industry sector						
Citizens	18,589	26,369	31	17,640	24,134	40
Finance	15,890	5,722	93	13,984	4,373	13
Government	7,726	1,178	711	6,697	1,108	711
Commerce	3,063	1,015	825	2,873	956	782
Tourism	860	189	40	857	189	40
Agriculture	705	41	72	680	38	49
Other sectors	15,141	19,835	11,345	13,175	17,994	11,117
	61,974	**54,349**	**13,117**	**55,906**	**48,792**	**12,752**

	Group			Bank		
	Assets	Liabilities	Off balance sheet items	Assets	Liabilities	Off balance sheet items
As at 31 December 2005						
Geographic region						
Republic of Croatia	41,722	34,405	8,877	38,829	31,768	8,617
European Union	8,821	10,767	9	8,475	10,534	9
Other countries	1,267	1,818	25	1,249	1,818	25
	51,810	**46,990**	**8,911**	**48,553**	**44,120**	**8,651**
Industry sector						
Citizens	14,083	21,973	2,894	13,296	20,168	2,814
Finance	13,549	6,499	32	12,767	6,125	16
Government	6,719	1,163	1,169	6,372	1,144	1,144
Commerce	2,691	933	752	2,407	877	715
Tourism	944	190	37	921	187	36
Agriculture	780	64	41	736	59	39
Other sectors	13,044	16,168	3,986	12,054	15,560	3,887
	51,810	**46,990**	**8,911**	**48,553**	**44,120**	**8,651**

48 | Earnings per share

For the purpose of calculating earnings per share, earnings represent net profit after tax. The number of ordinary shares is the weighted average number of ordinary shares outstanding during the year after deducting the number of ordinary treasury shares. The weighted average number of ordinary shares used for basic earnings per share was 16,913,334 (2005: 16,611,811).

Supplementary financial statements in EUR (unaudited)

Income statement (in EUR million)

	GROUP		BANK	
	2006	2005	2006	2005
Interest income	406	353	371	327
Interest expense	(172)	(139)	(161)	(134)
Net interest income	**234**	**214**	**210**	**193**
Fee and commission income	147	127	67	71
Fee and commission expense	(30)	(30)	(27)	(27)
Net fee and commission income	**117**	**97**	**40**	**44**
Other operating income	64	54	60	54
Operating income	**415**	**365**	**310**	**291**
Provisions	(21)	(19)	(8)	(8)
Other operating expenses	(194)	(179)	(138)	(136)
Depreciation and amortisation of property and equipment and intangible assets	(35)	(31)	(22)	(22)
Share of the profit and loss accounted for using the equity method	1	1	-	-
Profit before income taxes	**166**	**137**	**142**	**125**
Income taxes	(34)	(28)	(26)	(23)
Net profit for the year	**132**	**109**	**116**	**102**
Attributable to:				
Equity holders of the parent	132	109	116	102
Minority interests	-	-	-	-
	132	**109**	**116**	**102**

Income statement items were translated from measurement currency (HRK) to euro at the average exchange rates in 2006 (1 EUR = 7.322849 HRK) and in 2005 (1 EUR = 7.400185 HRK).

Supplementary financial statements in EUR (unaudited)

Balance sheet (in EUR million)

	GROUP		BANK	
	2006	2005	2006	2005
Assets				
Cash and current accounts with other banks	351	264	317	252
Balances with Croatian National Bank	989	731	960	703
Financial assets at fair value through profit or loss	416	625	419	606
Derivative financial instruments	6	2	6	2
Due from banks	985	1,063	944	1,028
Loans and advances to customers	5,025	3,882	4,571	3,619
Assets available for sale	178	33	7	3
Held to maturity investments	185	183	158	180
Equity investments in subsidiaries and associates	6	5	48	39
Intangible assets and goodwill	27	26	16	16
Property and equipment	188	162	120	104
Investment property	2	2	2	2
Non-current assets held for sale	2	14	2	13
Other assets	61	22	31	8
Deferred tax assets	16	10	11	8
Total assets	**8,437**	**7,024**	**7,612**	**6,583**

Balance sheet items were translated from measurement currency (HRK) to euro at the closing exchange rates in 2006 (1 EUR = 7.345081 HRK) and in 2005 (1 EUR = 7.375626 HRK).

Balance sheet / continued (in EUR million)

	GROUP		BANK	
	2006	2005	2006	2005
Liabilities				
Due to banks	615	444	613	530
Due to customers	5,017	4,391	4,561	4,068
Derivative financial instruments	2	3	2	3
Financial liabilities held for trading	100	160	100	160
Other borrowed funds	1,355	1,116	1,245	1,082
Debt securities issued	16	3	-	3
Other liabilities	249	213	88	103
Accruals and deferred income	16	15	9	9
Provisions for risks and charges	29	28	25	24
Total liabilities	**7,399**	**6,373**	**6,643**	**5,982**
Equity attributable to equity holders of the parent				
Share capital	250	217	250	217
Treasury shares	(4)	(3)	(4)	(3)
Share premium	214	-	214	-
Reserves and retained earnings	440	325	393	285
Profit and loss attributable to equity holders of the parent entity	132	109	116	102
	1,032	**648**	**969**	**601**
Minority interests	6	3	-	-
Total shareholders' equity	**1,038**	**651**	**969**	**601**
Total liabilities and shareholder's equity	**8,437**	**7,024**	**7,612**	**6,583**

Balance sheet items were translated from measurement currency (HRK) to euro at the closing exchange rates in 2006 (1 EUR = 7.345081 HRK) and in 2005 (1 EUR = 7.375626 HRK).

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