OPEN

E INDUSTRY SMEs ENVIRONMENTA
S START-UPS FINANCIAL RESTRUCT
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UPS FINANCIAL RESTRUCTURINGO
MEs ENVIRONMENTAL PROTECTION
FINANCIAL RESTRUCTURING FINA

HBOR

ANNUAL REPORT **2007**

OPEN

OPERATE SUCCESSFULLY AND LET NOTHING STOP YOU. THE PROGRAMMES OF HRVATSKA BANKA ZA OBNOVU I RAZVITAK OPEN UP NEW POSSIBILITIES FOR YOU BOTH IN CROATIA AND ABROAD.

Contents:

HBOR Highlights in 2007

6.5

BILLION HRK OF COMMITTED LOANS

17.4

BILLION HRK OF ASSETS

53%

OF LOANS COMMITTED FOR EXPORT PROMOTION PURPOSES

15

YEARS OF OPERATIONS

Letter of the President of the Supervisory Board

"In 2007, Hrvatska banka za obnovu i razvitak proved again to be a good partner in providing support to the Government in its endeavours aimed at developing the economy of Croatia."

Ladies and Gentlemen,

In 2007, Hrvatska banka za obnovu i razvitak proved again to be a good partner in providing support to the Government in its endeavours aimed at developing the economy of Croatia. HBOR's role and results evidence that such a state-owned development and export bank is indispensable for the Republic of Croatia. Export promotion and strengthening the competitiveness of the economy and entrepreneurs have always been our goals. HBOR has been successfully providing financial support to Croatian exporters for 15 years now and has facilitated their access to new markets through its proactive approach and international co-operation activities.

In 2007, favourable trends in the Croatian economy continued. The share of public debt in GDP was reduced, and the ILO survey based unemployment rate for the first time equalled 8.4% in the third quarter of 2007. The number of registered unemployed people has been declining by approximately 16,000 p.a. on average over the last four years, and the number of employed people has risen by 128,000. I am confident that a significant number of these new jobs created can be attributed to HBOR's loans extended to small and medium-sized enterprises, to the agricultural sector and the tourism industry.

In addition, the state budget deficit was reduced to 2.3%, which is lower than the planned deficit of 2.6%. In 2007, GDP rose by 5.6%. Further growth in GDP, reduction in unemployment, restructuring of unprofitable industries and general economic strengthening of the state are the goals that have to be accomplished by Croatia in order to increase the competitiveness of the entire national economy and make Croatia an equal partner to the EU member states. All the above figures support us in our statement that the Croatian economy is moving in the right direction. I believe that Croatia's uninterrupted approach to Euro-Atlantic integrations will have a positive impact on the growth of the Croatian economy, especially through increased foreign and domestic investment.

Small and medium-sized enterprises are definitely among the most significant driving forces behind the growth of the Croatian economy. By implementing the strategic policy of the Government of the Republic of Croatia, HBOR provided strong support to this segment of the economy also in 2007, which led to an increase of more than 20% in both the number and amount of loans committed. In the last three years, the Bank has joined the implementation of the operational programmes of the Croatian Government and has started to finance projects for the development of perennial plants, vegetable growing, cattle-breeding, pig breeding, the production of "kulen" and the reconstruction and modernisation of the fishing fleet. By the end of 2007, the volume of funds committed for this purpose exceeded HRK 650 million.

HBOR's role in promoting Croatia's exports is extremely significant. Over the period of 15 years of its operations, more than HRK 15 billion of loans were committed, whereas the volume of export transactions insured against political and commercial risks exceeded HRK 5.5 billion. In 2007, HBOR continued to support Croatian exporters by financing and insuring export projects in the volume of more than HRK 5.4 billion.

The preconditions for intensifying economic activities and increasing the competitiveness of economic entities were created through the reconstruction and construction of infrastructure at the level of counties, cities and municipalities. This operating policy of HBOR is in line with the endeavours to enable the balanced and sustainable development of the Republic of Croatia as well as a good quality of life for all its citizens.

On behalf of the Supervisory Board, of which I am the President, I would like to express my satisfaction with the operations of HBOR in 2007 and to thank all the members of the Supervisory Board and the Managing Board for the outstanding results achieved. I believe that good operating results will also be recorded in 2008, which will fully justify the confidence given to the Bank once again.

President of the Supervisory Board

Ivan Šuker

Letter of the President of the Managing Board

“Since its establishment in 1992, HBOR has financed more than 36 thousand projects in the amount of more than HRK 61 billion”

Ladies and Gentlemen,

It is my pleasure to announce the operating results of Hrvatska banka za obnovu i razvitak in 2007, the year we celebrated 15 years of successful business.

Since its establishment in 1992, HBOR has financed more than 36 thousand projects in the amount of more than HRK 61 billion. Construction of infrastructure, export promotion, support for SMEs, and the financing of agricultural programmes, inventions and environmental protection activities are just some of the tasks carried out by HBOR in promoting the development of the Croatian economy. Today, HBOR performs export credit insurance and guarantee activities and implements 25 own loan programmes based on the best experiences of the European and world development banks, with which HBOR has successful long-lasting co-operation.

By implementing the economic policy of the Government of the Republic of Croatia in 2007, HBOR extended HRK 6.5 billion in loans to the Croatian economy, which enabled the creation of more than 4,000 jobs. The volume of loans extended through special programmes intended primarily for small entreprises reached approximately HRK 760 million, an increase of 22% compared to 2006. Three new loan programmes for this target group were launched: Development of Rural Tourism, Micro-Loans and Mezzanine Finance.

HBOR’s role in the promotion of Croatia’s exports during the reporting period is best illustrated by the fact that 53% of all loans committed were intended for exporters. The amount of committed loans exceeded HRK 3.4 billion, and the amount of issued export guarantees reached approximately HRK 250 million. The volume of export credit insurance totalled more than HRK 2 billion, an increase of 34% compared to the previous year. We continued with the implementation of the operational programmes of the Croatian Government in 2007 and invested, through our loan programmes, about HRK 260 million in the planting of perennial crops, vegetable growing, cattle breeding, pig breeding, the production of ”kulen“, and the reconstruction and modernisation of the fishing fleet. In 2007, we extended approximately one billion kuna of loans to the tourism industry, an increase of 72% in comparison with 2006. Within the framework of its operations, HBOR supports the sustainable development of the Republic of Croatia and a responsible standpoint regarding the development and preservation of the environment as well as the promotion of renewable energy resources and energy efficiency in accordance with the standards of the European Union. In 2007, HBOR extended about HRK 500 million for infrastructure and environmental projects.

Great significance is given by HBOR to the counselling of entrepreneurs with the objective of achieving as successful investments as possible. This type of support is intended primarily for start-ups and small enterprises. Throughout the year, representatives of HBOR, in addition to their regular activities, organised workshops and round tables in all regions of the Republic of Croatia in order to familiarise borrowers with the possibilities for utilising HBOR’s programmes.

We are proud that HBOR became the first Croatian bank to be a shareholder in the European Investment Fund and also in the European Association of Public Banks towards the end of the year. When speaking about international co-operation and exchange of experience, we should mention HBOR’s already traditional International Conference on Export Promotion that took place in Dubrovnik. Until now, we have signed 40 co-operation agreements with export banks and export credit agencies, and during the reporting year, we signed agreements with the Japan Bank for International Cooperation and the French bank BNP PARIBAS.

Last year, we mourned the untimely passing away of Mr. Krešimir Leko, a member of HBOR’s Managing Board. Mr. Leko contributed immensely to the development of HBOR, and, with his passing away, we lose not only a great expert and teacher for upcoming generations of young bankers but also a close colleague and friend.

I believe that the results achieved fully justify the confidence given to the Bank and that we shall continue to promote Croatia’s economic development with a special focus on strengthening Croatia’s export possibilities and SMEs. We will keep on promoting an even development of all regions and the further implementation of environmental and energy projects.

I would like to thank the Prime Minister and the Ministers in the Croatian Government, the President and the Members of the Supervisory Board as well as the President and the Members of the Croatian Parliament for their support and confidence.

I also thank all the employees of HBOR for their devoted work and efforts aimed at achieving good business results.

President of the Managing Board

Anton Kovačev

Introduction

The Annual Report includes the summary of financial information, description of operations and audited financial statements with the independent auditor's report for the year ended 31st December 2007.

Legal status

The Annual Report includes annual financial statements prepared pursuant to the Accounting Law and audited pursuant to the International Accounting Standards.

Exchange rate

For the purpose of translating amounts in foreign currencies into HRK, the following exchange rates of the Croatian National Bank have been applied:

31st December 2007	EUR 1= HRK 7.325131	USD 1 = HRK 4.985456
31st December 2006	EUR 1 = HRK 7.345081	USD 1 = HRK 5.578401

Abbreviations

HBOR	Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development)
KfW	Kreditanstalt für Wiederaufbau
CEB	Council of Europe Development Bank
OECD	Organisation for Economic Cooperation and Development
EIB	European Investment Bank
HNB	Hrvatska narodna banka (Croatian National Bank)
UBAF	Union de Banques Arabes et Françaises
JBIC	Japan Bank for International Cooperation
EIF	European Investment Fund
EAPB	European Association of Public Banks
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
EUR	euro

About HBOR

Establishment

HBOR was established on 12th June 1992 by the Act on Hrvatska kreditna banka za obnovu (HKBO). The Bank was renamed Hrvatska banka za obnovu i razvitak by changes and amendments to the above Act in December 1995. In December 2006, the Croatian Parliament passed a new Act on HBOR, which came into force on 28th December 2006.

Strategic goals

In its operations, HBOR, within the framework of its powers and authorisations, promotes systematic, sustainable and balanced economic and social development pursuant to the general strategic goals of the Republic of Croatia.

Main activities

- Financing the reconstruction and development of the Croatian economy,
- Financing infrastructure,
- Promoting exports,
- Promoting SMEs,
- Environmental protection,
- Export credit insurance of Croatian goods and services against non-market risks.

Audit

The audit of operations for 2007 was conducted by the auditing company Ernst & Young d.o.o., which gave a positive opinion.

Credit rating

- A1 by Moody's
- BBB by Standard & Poor's

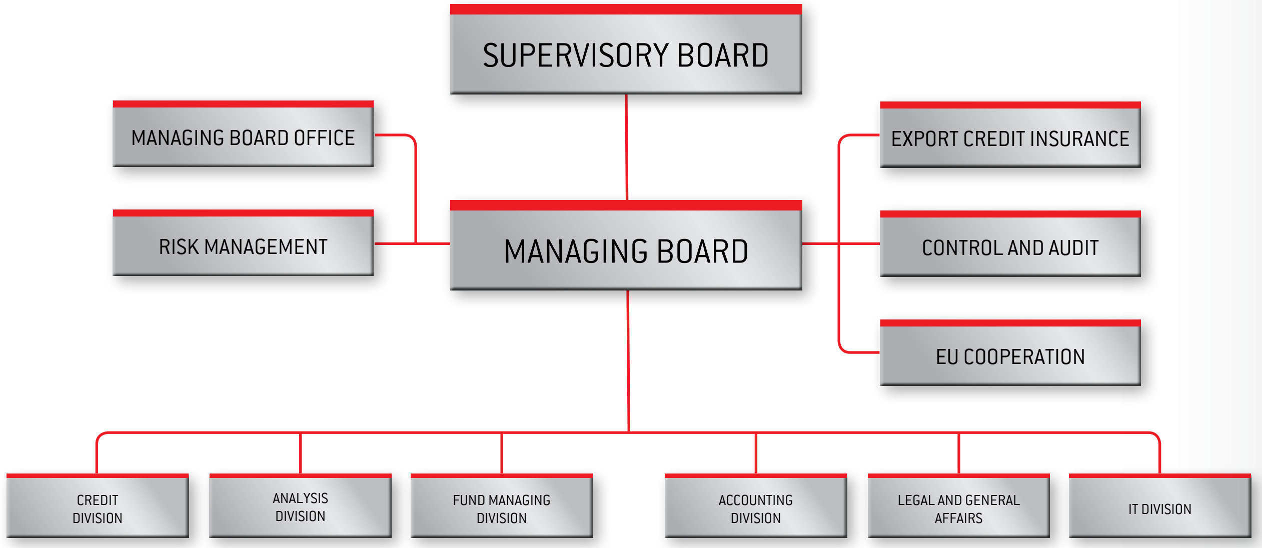
Regional offices

- Regional office for Slavonia and Baranja
- Regional office for Dalmatia
- Regional office for Istria
- Regional office for Lika
- Regional office for Primorje and Gorski kotar

Number of employees

There were 232 employees in HBOR on 31st December 2007.

Organisation structure of HBOR

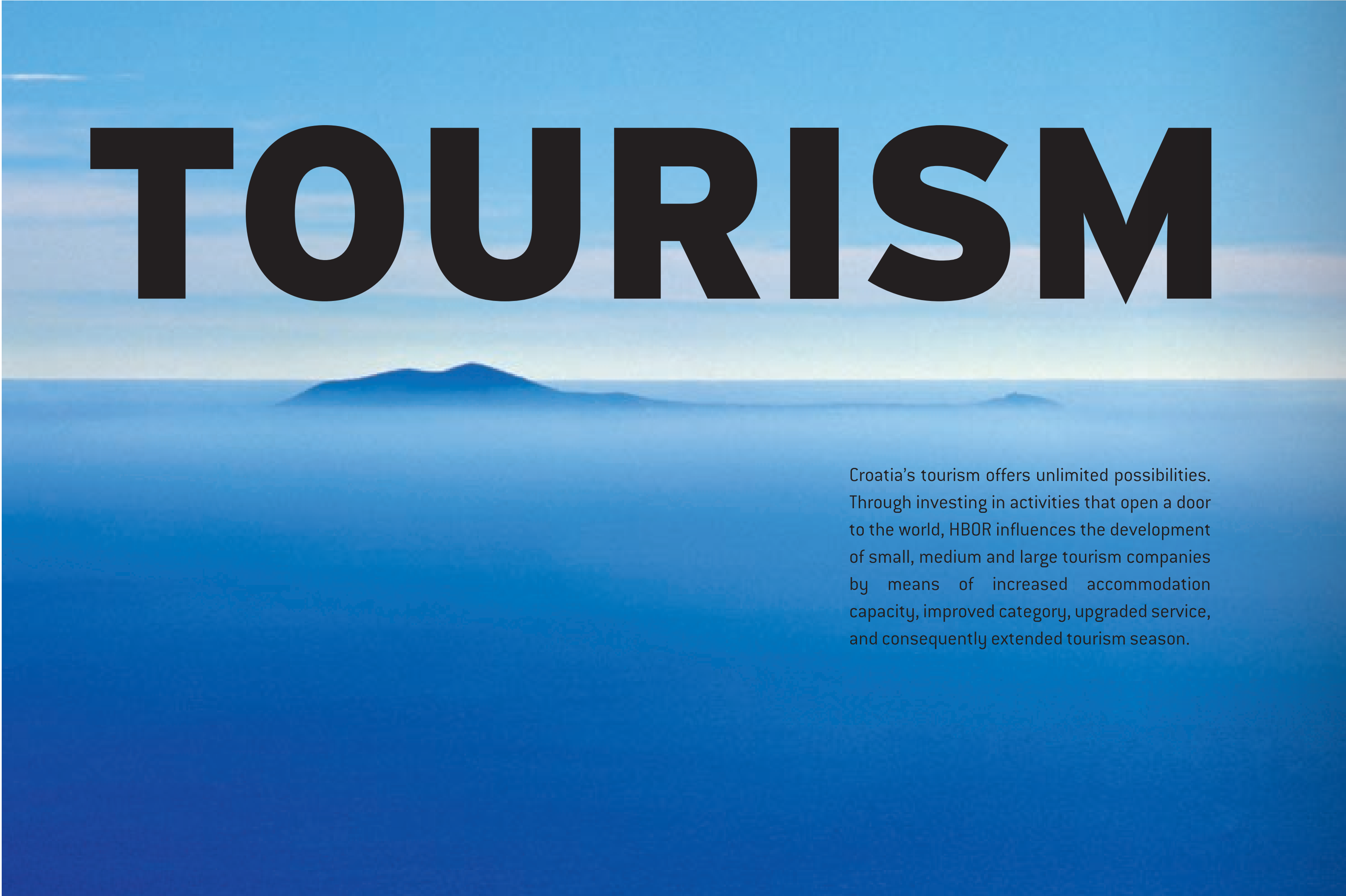


OPEN

THE DOOR OF CROATIA

TOURISM

Croatia's tourism offers unlimited possibilities. Through investing in activities that open a door to the world, HBOR influences the development of small, medium and large tourism companies by means of increased accommodation capacity, improved category, upgraded service, and consequently extended tourism season.



Corporate Governance

HBOR continuously monitors best practice in the field of corporate governance and integrates corporate governance principles in its operations pursuant to sound banking practices.

Corporate governance principles are implemented by HBOR through:

Principle of public operations

- Annual Financial Statements of the Bank are confirmed by the Supervisory Board and submitted to the Croatian Parliament for adoption
- Financial Statements of the Bank are regularly published on the web sites of the Ministry of Finance, the Zagreb Stock Exchange and HBOR
- The rating of the Bank is issued by two international independent rating agencies on an annual basis (Standard & Poors, Moody's)
- Pursuant to the Access to Information Act, reports on received requests for information about the operations of the Bank are submitted to the Central State Office on an annual basis

Supervisory Board of HBOR, powers, composition

- The Supervisory Board determines the principles of HBOR's operating policy and strategy, supervises HBOR's business activities, adopts HBOR's lending policies, adopts the Annual Financial Statements, and considers Internal Audit reports and reports drafted by external independent auditors and by the State Audit Office
- The Supervisory Board monitors and controls the legality of the business activities of the Managing Board, and appoints and dismisses the President and the members of the Managing Board
- The Supervisory Board consists of nine members: five Government ministers, three Members of Parliament and the President of the Croatian Chamber of Economy
- The Supervisory Board has established the Audit Committee in accordance with the Audit Act

Managing Board of HBOR, powers, composition

- The Managing Board represents HBOR, conducts the Bank's business and administers its assets ; it is obliged and authorised to undertake all actions and pass all resolutions it considers necessary for the legal and successful conduct of business
- Powers of the Managing Board: managing and conducting the business of HBOR, adopting normative acts that determine the manner of operations and the internal organisation of HBOR, adopting loan programmes, making individual loan approval decisions and decisions on other financial transactions, making decisions on the appointment and dismissal of employees that have special powers, making decisions on the rights and obligations of employees and reporting to the Supervisory Board
- The Managing Board consists of three members appointed by the Supervisory Board, one of whom is appointed as President. The President and the members of the Managing Board are appointed for a five-year term of office and may be reappointed thereafter; HBOR is represented by the Managing Board jointly by two of its members
- For the purpose of ensuring efficient and effective risk management procedures and minimising the risk, the following bodies have been established with the Managing Board: Asset and Liability Management Committee, Credit Committee, Credit Risk Assessment and Measurement Committee and Liquidity Commission

Internal Control System

- In order to ensure permanent measuring, assessment and management of all risks HBOR is exposed to within the framework of its operations, an independent organisational

unit for risk management has been established

- Internal Audit, as an independent organisation unit, is in charge of verifying the adequacy of risk management procedures and the internal control system, including risk monitoring, compatibility with regulations and the code of professional conduct, and implementing internal policies and Bank procedures as well as anti-money laundering activities
- In order to harmonise HBOR's operations with the EU regulations, EU Co-operation has been established as an organisation unit within HBOR with the main task of harmonising HBOR's operations with the EU acquis communautaire

Co-operation between the Managing Board and the Supervisory Board

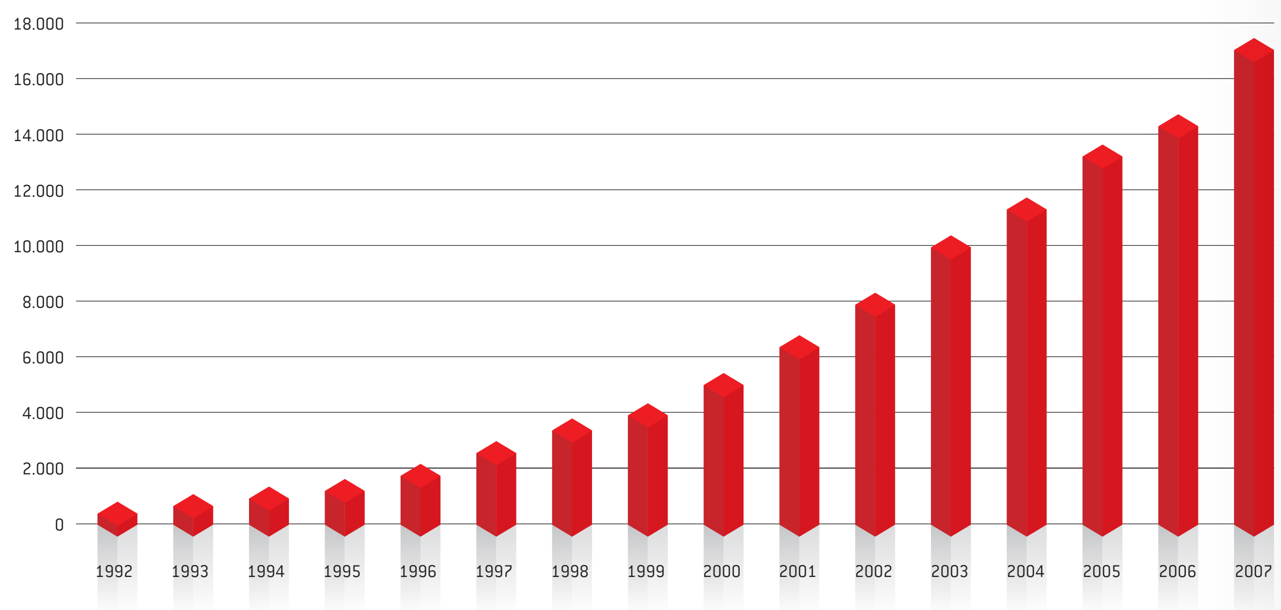
- The Managing Board and the Supervisory Board successfully co-operate through open discussions; the timely submission of thorough written reports to the Supervisory Board represents the basis for this co-operation
- The Act on HBOR, the By-laws of HBOR and decisions made by the Supervisory Board determine the activities that HBOR may perform only with prior consent of the Supervisory Board

Business activities of HBOR in 2007

The reporting year 2007 was of extreme importance for Hrvatska banka za obnovu i razvitak - apart from achieving good business results, the Bank celebrated fifteen years of operation.

Since the very beginning of its operations , HBOR's work has been directed towards the reconstruction and development of the Croatian economy and the regional direction of funds for the purpose of the balanced development of all Croatian regions, with emphasis on promoting the development of regions of special state concern and the islands. In its 15 years of development and growth, HBOR has recognised and supported key projects that were the driving force of economic progress. The construction of infrastructure, export promotion, promotion of SMEs, and the financing of tourism, the shipbuilding industry, agriculture programmes, innovations and environmental protection are just a part of the activities through which the Bank has monitored and directed developments in domestic industry. HBOR implements its operations through 23 loan programmes that it has developed by using the best experience of the European and world development banks with which it has established close co-operation. In its fifteen years of operations, the Bank has provided support to more than 36 thousand projects in the total amount of over HRK 60 billion. The bank's assets amounted HRK 335 million in 1992 and HRK 17.4 billion at the end of 2007.

Assets in HRK million:



In 2007, HBOR continued its activities from the previous years, pursuing the goals of the Croatian Government's economic policy.

OVERVIEW OF HBOR LENDING OPERATIONS IN 2007

(in million)

	COMMITTED EUR	COMMITTED HRK
INDUSTRY	249	1,826
EXPORT	469	3,435
INFRASTRUCTURE	66	487
SMALL AND MEDIUM ENTERPRISES	104	760
TOTAL LENDING OPERATIONS (1+2+3+4)	888	6,508

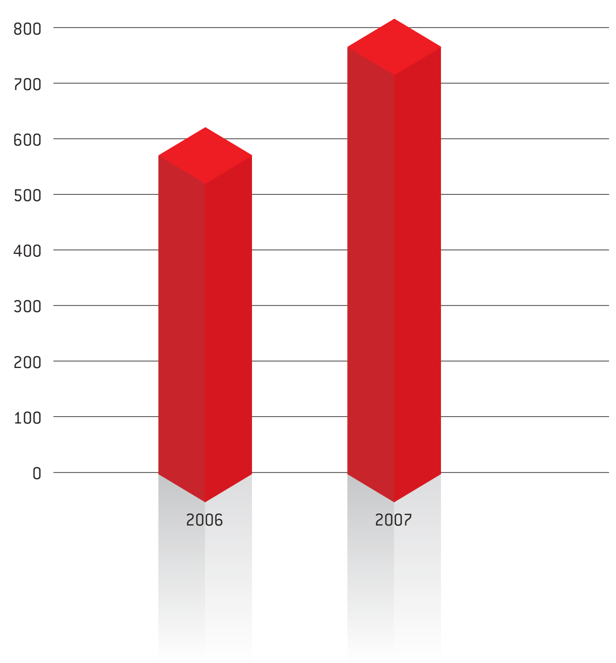
SMALL AND MEDIUM ENTERPRISES **11.7%**
INDUSTRY **28.1%**
INFRASTRUCTURE **7.5%**
EXPORT **52.7%**

Small and Medium Enterprises

The aim of HBOR is the continuous strengthening of small and medium enterprises, agriculture and tourism. As a development bank, HBOR also pays special attention to programmes for financing business start-ups and innovators. In spite of its high risk, this segment is necessary to increase the competitiveness and development of the economy.

In 2007, the amount of HRK 760 million was granted under special programmes for small and medium enterprises (11 programmes), an increase of 22% in comparison with 2006. Beside the increased amount of granted loans for this segment of the economy, the number of granted loans was also increased by 20%. If we take into account loans to small and medium enterprises under all

Small and medium enterprises in HRK million:



HBOR programmes in 2007 (23 loan programmes), the total loans granted amount to HRK 3 billion. For the purpose of providing even stronger support, in October 2007, HBOR introduced new categories of borrowers and reduced interest rates. Through this change, the right to contract an interest rate of 4% was extended to all small and medium-sized enterprises. Borrowers investing into a hilly or mountainous area were also extended the right to an interest rate of 4% p.a., or 2% p.a. if they proved their competitiveness. A new category of borrowers are entrepreneurs investing into fishery, and they also have the right to an interest rate of 4% p.a., or 2% p.a. if they prove their competitiveness in the market.

Business Activities of HBOR in 2007

Agriculture

In the promotion of agricultural production, loans in the amount of about HRK 130 million were granted in 2007 through the Loan Programme for Financing Agriculture and Balanced Development. In the last three years, HBOR has been participating in the implementation of the operational programmes of the Government of the Republic of Croatia and started the implementation of financing the development of perennial plants, cattle-breeding, the production of "kulen", the reconstruction and modernisation of the fishing fleet and vegetable growing. For these purposes, loans in the amount of over HRK 650 million were granted in 2007.

With loan funds in the amount of HRK 30 million intended for planting perennial plants, 209 hectares of new orchards, vineyards and olive groves were planted in 2007. With an amount of HRK 109 million, the construction or modernisation of over 50 cattle-breeding farms with a capacity of 2,480 heads of cattle was carried out. Seven borrowers of HBOR's loans belong to the 50 largest producers of milk in the Republic of Croatia. For the purpose of developing pig-breeding, loans in the amount of HRK 47 million were granted with the aim of establishing specialised family farms for pig-breeding that will be competitive and profitable in the open market conditions by their size, technological process of production, quality of products and ecological standards. Two borrowers of HBOR's loans obtained the Decision of the SAPARD Agency on co-financing the project under Measure I (investment in farms - Meat production sector) for the projects "Construction and equipping of facilities for breeding of dairy cows" and "Construction of a pig-breeding farm". The SAPARD Agency approved grants under the SAPARD Programme in the total amount of HRK 2.5 million per project for the mentioned projects, the maximum possible amount under the Programme.

In 2007, HBOR started to implement three new loan programmes intended for small and medium enterprises - the Loan Programme for the Development of Rural Tourism, the Programme for Micro-loans and the Mezzanine Finance Programme.

The Bank started to implement the financing of rural tourism with the goal of developing tourist services in the continental part of the Republic of Croatia. These tourist services were introduced as an additional activity on farms and to enhance the quality of life in rural areas. The loan programme was implemented pursuant to the work programme guidelines of the Government of the Republic of Croatia and the tourism development strategy of the Ministry of Tourism of the Republic of Croatia. The interest rate for borrowers is fixed at 8% p.a., and the Ministry subsidises the interest rate for the borrower with 6% fixed p.a., so that the interest rate for the final borrower finally is 2% p.a.

The Programme for Micro-loans was introduced to finance micro-enterprises and small and medium enterprises with the purpose of self-employment, the establishment of crafts and companies, the modernisation and expansion of existing businesses and an increase in the number of new jobs. The Programme for Micro-loans and lending to micro-enterprises was designed and implemented in co-operation with KfW, CEB and the European Commission, which participates in the implementation of this credit line by extending grants.

HBOR developed the Mezzanine Finance Programme with the purpose of financing new projects with extensive development possibilities when the investors are faced with a lack of capital and security for loans. Under the Programme, investments are financed by the investor, a commercial bank and HBOR, and, as security for loan repayment, HBOR has a secondary security on immovable/movable property that is subordinate to the security created in favour of the commercial bank.

Infrastructure and Environmental Protection

Within the scope of its operation, HBOR strives to support the sustainable development of the Republic of Croatia, which implies responsible behaviour towards the enhancement and preservation of the quality of the environment, promoting the introduction of renewable energy resources and achieving energy efficiency in compliance with the EU standards.

In 2007, HBOR continued intensive activities on the promotion of investments in infrastructure projects, environmental protection, energy efficiency and renewable energy resources projects, for which loans in the amount of HRK 487 million were approved.

At the end of 2007, HBOR and the German development bank KfW signed a Loan Agreement in the amount of EUR 19.5 million for financing the Energy Efficiency and Renewable Energy Resources Project. The main objective of the Programme is to improve the energy efficiency and utilisation of renewable energy resources in order to support climate protection and increase the safety of the energy supply. The Programme is intended for financing investments in renewable energy resources and energy efficiency through providing loans either directly via HBOR or through on-lending banks.

In July 2007, new secondary legislation came into force for renewable energy resources, which is a key factor for the continuation of HBOR's activities on the Renewable Energy Resources Project. Besides providing support to significant institutions for the development of renewable energy resources, the Programme for the Preparation of Renewable Energy Resources Project enables the extending of loans to both the private and public sectors.

HBOR's role is also very important in the Bank Guarantees Issuance Programme within the Energy Efficiency Programme. The Republic of Croatia was approved a Grant for the development of the Energy Efficiency Project in the total amount of USD 11.4 million by the Global Environmental Facility via the International Bank for Reconstruction and Development and the United Nations Development Programme.

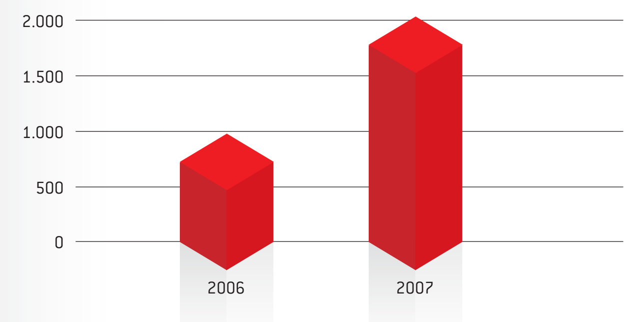
The goal of the Project is to eliminate obstacles in applying cost-effective technologies and procedures for the enhancement of energy efficiency and the development of the market for goods and services relating to energy efficiency. Within the framework of the project implementation, HBOR was entrusted the role of the Implementing Agency for the Bank Guarantee Issuance Programme and disposes of funds of the Grant in the total amount of USD 2.6 million. The aim of the Programme is to provide support to local commercial banks for financing investments in projects aimed at energy saving, strengthening the economic power and competitiveness of Croatian companies, and developing the energy market of the Republic of Croatia.

In 2007, HBOR joined two groups within the UNEP Finance initiative: the "Climate Change" and "Central and Eastern Europe" working groups. These groups were established with the objective of determining the role of the financial sector in mitigating climate changes and adjusting to new requirements in preventing the emission of greenhouse gasses. The importance of joining these groups is in informing the financial and industrial sector, decision-makers and the wider public on the global and regional challenges of climate changes, as well as supporting and expanding the practice of sustainable finance in Central and Eastern Europe. This is achieved through raising the level of consciousness about the interconnectivity between environmental protection and the financing of investments.

Industry

By extending loans to large businesses, HBOR strives to have a direct influence on boosting the competitiveness of Croatian businesses and expanding the scope of existing business activities.

Loans to large businesses in HRK million:



The funds are intended for financing the modernisation of production, the introduction of new technologies and products, and the construction of new production capacities.

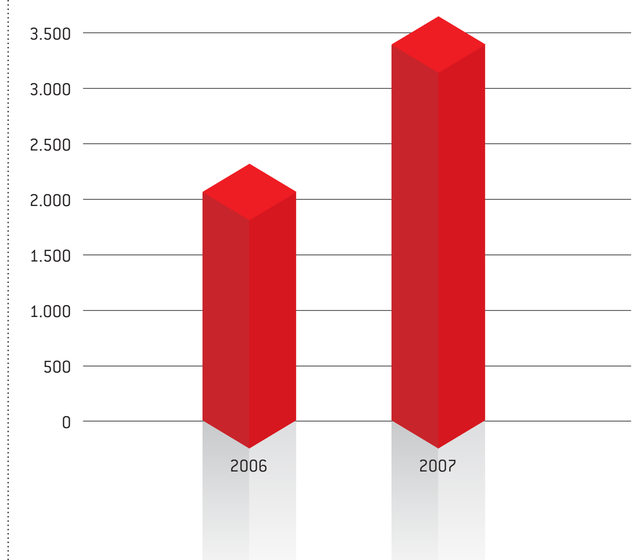
In 2007, loans in the amount of over HRK 1.8 billion were extended and mostly directed to the production of food and beverages (25%), agriculture and fishery (16%), production of metal products (9%), production of chemicals and chemical products (7%), and publication and printing industry (5%).

It is hard for a company to successfully enter foreign markets without a strong position in the domestic market. By contributing to the increased competitiveness of Croatian enterprises, HBOR directly supports their success both in the domestic and international markets. In terms of export promotion, HBOR has developed an efficient financial support system that is competitive with those in other western European countries. HBOR participates in the process aimed at creating Croatia's export products from production preparation to the settlement of the export transaction.

In confirmation of its role as the Croatian export bank, HBOR has signed memoranda of understanding with leading export banks and export credit agencies. In this way, it promotes co-operation on joint entry into third markets and strengthens support for Croatian exporters.

In 2007, HBOR continued to provide strong support to Croatian exporters by offering loans and issuing bank guarantees. Loans totalling over HRK 3.4 billion were approved for export purposes; ; the amount of guarantees issued amounted to HRK 248 million.

Export finance, in HRK million:



As in the previous years, the most active programme was the pre-export finance programme, under which 293 loans totalling HRK 2.1 billion were approved.

Business Activities of HBOR in 2007

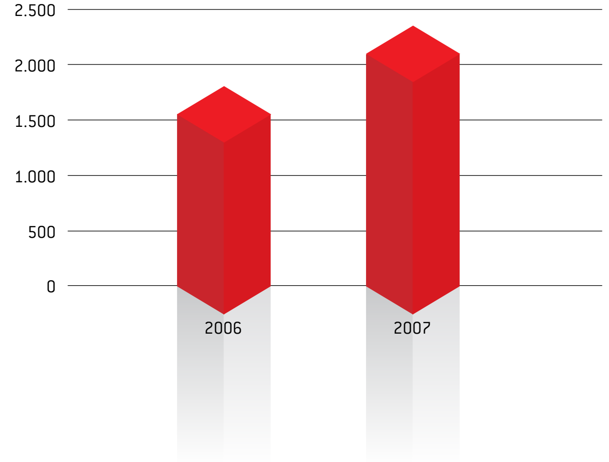
Insuring the collection of export receivables

As the national export credit agency, HBOR provides insurance of export transactions against non-marketable risks* for and on behalf of the Republic of Croatia. In the Republic of Croatia, non-marketable risks include commercial and political risks regardless of their maturity and importing country since the private receivable insurance market has not been completely developed.

The share of export transactions insured through HBOR's export insurance programmes in the total exports of the Republic of Croatia increased from 2.5% in 2006 to 3.1% in 2007.

In 2007, the total volume of insured export transactions amounted to HRK 2.05 billion, 34% more than in the previous year.

Insured export transactions, in HRK million:



In terms of short-term export credit insurance, an increase of 36% was recorded (HRK 1.5 billion) in comparison with 2006, and the medium to long-term insurance volume rose by 29% (HRK 529 million). A total of 839 applications for insurance were approved, an increase of 27% in comparison with the previous year.

Total net collected premium amounted to HRK 27.6 million, an increase of 135% compared to 2006.

A continuous increase in export credit insurance is a result of rising entrepreneurs' awareness of risk coverage in export markets, of commercial banks' growing demand for this kind of collateral as well as of HBOR's constant adjustment to the needs of exporters and to the world practice.

At the end of 2007, the most significant markets in terms of export credit insurance exposure were Albania, Russia, Bosnia and Herzegovina, Algeria, Germany, Libya and Romania. In addition to the above countries, HBOR approved insurance for export projects in Syria, Belorussia, Algeria and Serbia.

OP

CROATIA TO THE WORLD

EN

EXPORTS

As an export bank, HBOR has developed a number of programmes for exporters in order to enable them to compete in the international market on equal terms. Through its programmes, it provides support to domestic enterprises during the whole export cycle: from negotiating an export transaction until collecting payment for it.

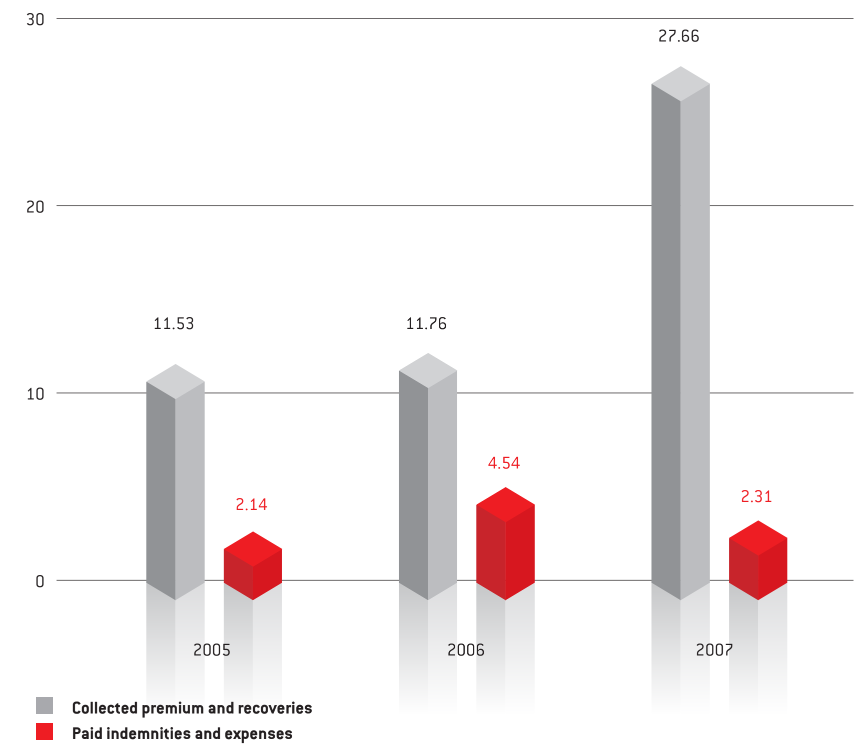
Business Activities of HBOR in 2007

One of the significant projects in which HBOR participated as an insurer in 2007 was the "Construction of Tirana-Podgorica 400 kV Transmission Line and the Transformer Stations Elbasan and Podgorica". The value of the project was EUR 42 million. The contract for the project was awarded to Dalekovod d.d. at an international tender, and the project was financed by a loan extended by KfW, the German development bank. HBOR joined the project by providing buyer credit insurance, thus enabling the successful implementation of this important export transaction.

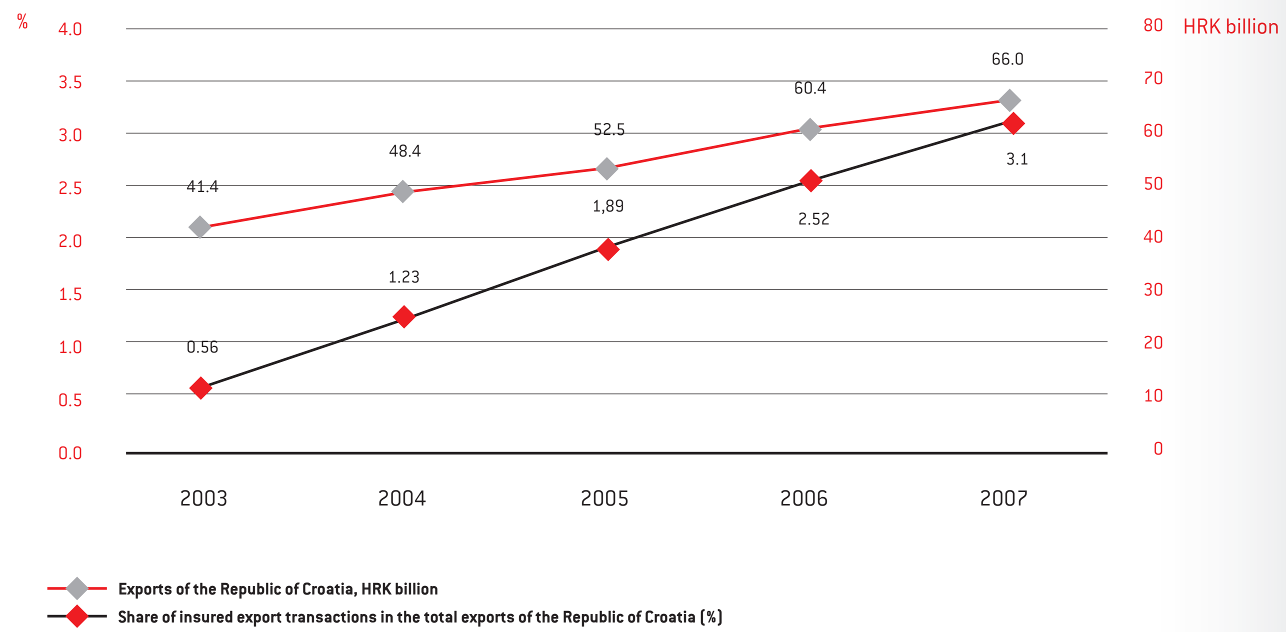
In 2007, 9 indemnities were paid in the total amount of HRK 1.9 million, and simultaneously recovery costs were reimbursed to insured parties in the amount of HRK 0.4 million.

Among other activities carried out in 2007, special attention should be drawn to the process of the further harmonisation of HBOR's export credit insurance activities with the provisions of the EU acquis communautaire and to the organisational improvement of business in accordance with the practice of other world export credit agencies.

Premiums and indemnities, in HRK million:



Share of insured export transactions in total exports of the Republic of Croatia



In the coming period, HBOR plans to separate insurance activities in the field of marketable risks from the activities carried out for and on behalf of the Republic of Croatia by establishing a separate company. With respect to insurance activities performed for and on behalf of the Republic of Croatia, HBOR will develop existing products and introduce new ones offered to small and medium-sized enterprises together with guarantee insurance products.

* Non-marketable risks are, in accordance with the EU acquis communautaire, all commercial and political risks of the OECD and EU countries maturing in more than 2 years as well as all commercial and political risks of the non OECD and EU countries regardless of the maturity.

Fund Raising

In 2007, HBOR raised a total of EUR 434.5 million in the financial markets.

In June 2007, the Bank issued Eurobonds in the amount of EUR 250 million with a 10-year term. The issue was arranged by Deutsche Bank and UBS. The funds raised were used for the financing of HBOR's loan programmes.

In October 2007, a EUR 40 million Global Loan II was signed with the EIB for the financing of small and medium-sized enterprises and projects in environmental protection, energy saving and infrastructure.

The co-operation with special financial institutions was continued, and a EUR 19.5 million agreement was signed with KfW in November 2007 for the financing of energy efficiency and renewable energy resource projects. In the same month, HBOR and a consortium of banks consisting of Bank Austria Creditanstalt AG, Commerzbank AG, Dresdner Kleinwort - the investment banking division of Dresdner Bank AG, DZ Bank AG, Erste Bank der Oesterreichischen Sparkassen AG and Raiffeisen Zentralbank Oesterreich AG signed a Loan Agreement in the amount of EUR 110 million. The term of the loan is five years. The loan funds were also used for the financing of HBOR's loan programmes.

In December 2007, HBOR concluded another agreement with KfW in an amount of EUR 15 million for the purpose of promoting the financing of projects implemented by micro, small and medium-sized enterprises.

Having in mind the significance of co-operation with special financial institutions, HBOR will further enhance its relations with CEB, EIB, KfW and other similar financial institutions in the coming period. Currently, several new loan agreements are being prepared, the focus of which is on the promotion of small and medium-sized enterprises and infrastructure in the Republic of Croatia.

Risk Management

Pursuant to the HBOR Act, the Bank is obliged to reduce the risk in its operations to the lowest level possible by applying the principles of banking. In its day-to-day operations, the Bank manages credit risk, market risk and operational risk through appropriate policies, procedures, limits, committees and controls.

For the purpose of measuring and monitoring the risk, the Bank uses various measurement methods based on historical data, operational plans, market conditions and the specific features of the Bank as a special financial institution. The Bank's risk management strategy is aimed at preparing for the implementation of advanced methods for calculating capital requirements for risks in accordance with "Basel II" recommendations, for each area of risk separately, by obeying the recommendations and regulations of the Croatian National Bank and the standards of good banking practice.

The Bank's Managing Board implements a conservative credit risk management policy. The system of credit risk management is the most important part of the Bank's operational policy and a significant element of its operational strategy. In order to mitigate credit risk and reduce operating costs, the Bank, in accordance with the HBOR Act, extends part of its loans through commercial banks that assume the risk of collecting repayments from final borrowers.
Most direct placements are secured by mortgages on immovable property, and, if possible, the Bank requires guarantees issued by the Croatian Agency for Small Business and other first class guarantees. The Bank determines the required ratio between the placement value and insurance coverage according to the type of collateral, loan programme, general terms and conditions of insurance and decision of the body in charge.

The Bank's developmental loan programmes cover the entire territory of the Republic of Croatia with a focus on the areas of special state concern. Credit risk is broken down by geographical regions and developmental loan programmes. By creating new loan programmes, the Bank aims at preventing the excessive concentration of credit risk and enabling the balanced development of the geographical regions in Croatia in accordance with the state development strategy for individual occupations.

As a market risk management technique, the Bank uses a change in one or more risk factors and an assessment of the possible effects of individual events on the financial situation. The technique is implemented through scenario analysis and sensitivity analysis in stress conditions and under regular business conditions.

The Bank, as a special financial institution, is not profit orientated and does not trade in derivatives. Derivatives may only be used for the protection of its own positions.

For the purpose of managing liquidity risk, the Bank maintains the necessary level of liquidity reserves, continuously monitors day-to-day liquidity, provides sufficient kuna and foreign currency funds necessary for timely settlement of obligations and special purpose disbursements under committed loans.

The Bank manages the interest rate risk by monitoring the match between interest rates receivable and payable by means of interest rate gap analysis. The interest rate gap is analysed by specified periods on the basis of the possibility of change in interest rates and illustrates the sensitivity of the Bank to such changes. A VaR model (variant-covariant method) is also being developed, and it will be used as a platform for enabling better decisions relating to interest rate risk management.

For the measurement of currency risk exposure, the Bank implements the calculation methodology prescribed by the Croatian National Bank, the simple value calculation method and the adjusted delta method. The majority of HBOR's loans are foreign currency indexed, in which way the Bank protects itself from exposure to currency risk on a cumulative basis.

HBOR endeavours to reduce its operational risk to the lowest level possible by introducing controls in the operating procedure and by developing a unique and comprehensive IT system. The Bank implements the Basel II Guidelines and IT system good management practices. Exposure to this risk is reduced by continuous employee education, the monitoring of frequent errors and prevention measures.

Internal Control and Internal Audit

The Control and Audit organisation unit is part of HBOR's internal control system and is in charge of monitoring overall operations based on the principles of legality, the implementation of accounting and other standards and procedures, and the execution of business policies, internal procedures, methodologies and documents. Control and Audit, as an organisation unit, carries out its tasks and determines the manner of its operations, reporting, and the preparation of its opinions and recommendations independently by following the Croatian Internal Audit Standards. It is directly responsible to the Managing Board, the Audit Committee and the Supervisory Board of HBOR. Reports are submitted on a three-monthly basis or semi-annually. Individual reports were drafted on controls carried out in 2007 and submitted to the Managing Board within the regular reporting scheme.

In 2007, the employees of Control and Audit joined two newly established professional organisations - the Chamber of Audit and the Croatian Institute of Internal Auditors.

Other activities

The International Conference on Export Promotion organised by HBOR in September 2007 for the sixth time in Dubrovnik gathered experts in the field of exports from Croatia and abroad. The conference aroused discussion on the impact of globalisation on the flows of international co-operation and the exchange of goods and services, as well as forms of support provided by export credit agencies. Special emphasis was placed on promoting innovative entrepreneurship, strengthening links between exporters and diplomacy, and including export credit agencies in the negotiations relating to contracting export projects at the very beginning of negotiations.

A Loan Agreement between HBOR, UniCredit Zagrebačka banka d.d. Mostar and Zagrebačka banka d.d. Zagreb as the lender and JP Elektroprivreda Hrvatske zajednice Herceg Bosne d.d. Mostar as the borrower was signed at the conference. For the purpose of expanding international co-operation, a Memorandum of Understanding was also signed at the conference between HBOR and the French bank BNP PARIBAS. Further to the successful co-operation which started at HBOR's fifth export promotion conference, in April 2007, a Memorandum of Understanding was signed with the French bank UBAF with the primary objective of promoting and financing international trade with the Arab countries. Beside the mentioned memoranda, HBOR also signed a memorandum with JBIC in the reporting year.

In September 2007, HBOR signed a Co-operation Agreement with the Faculty of Economics at the University of Split with the purpose of creating the preconditions for connecting theoretical and empirical knowledge in the field of financing small and medium enterprises,. This agreement established guidelines of co-operation that include researches in the field of financing small and medium enterprises, the publication of results during annual meetings and the co-operation and exchange of experience of other participants in the financing of small and medium enterprises. The first result of this Agreement is the first Conference on Financing Small and Medium Enterprises in the Republic of Croatia held in November 2007 in Split. The conference was attended by many scientists, entrepreneurs and representatives of the Ministry of the Economy, Labour and Entrepreneurship, the Croatian Chamber of Economy, commercial banks, agencies and development centres. The outcome of the first Conference on Financing Small and Medium Enterprises are the Recommendations for Operation that were forwarded to the ministries in charge, units of local and regional government, chambers of economy and crafts as well as other relevant financial institutions.

In 2007, HBOR became a shareholder of the EIF. As an EIF shareholder, HBOR continues its successful co-operation with the EIB group, and its membership in the Fund enables it to gain further knowledge and experience that is necessary in developing new and improving the existing ways of financial support provided to small and medium enterprises by HBOR.

In the reporting year, HBOR became a member of the European Association of Public Banks (EAPB), the first financial institution from Croatia to do so. This association was established in 2000 as a response to the complex European legislation in the field of providing financial services and banking supervision, and its primary objective is to support the interests of its members, with regular reporting and advice to members on possible financial, political or legal measures that influence their operation. The EAPB gathers the opinions of its members on individual acts and proposals of changes and amendments and informs the EU legislation bodies thereon. Membership in the EAPB will enable HBOR to participate actively in drafting and passing regulations and legislation that directly influence the financial and banking system in the EU and in the Republic of Croatia.

Marking the 15th anniversary of HBOR

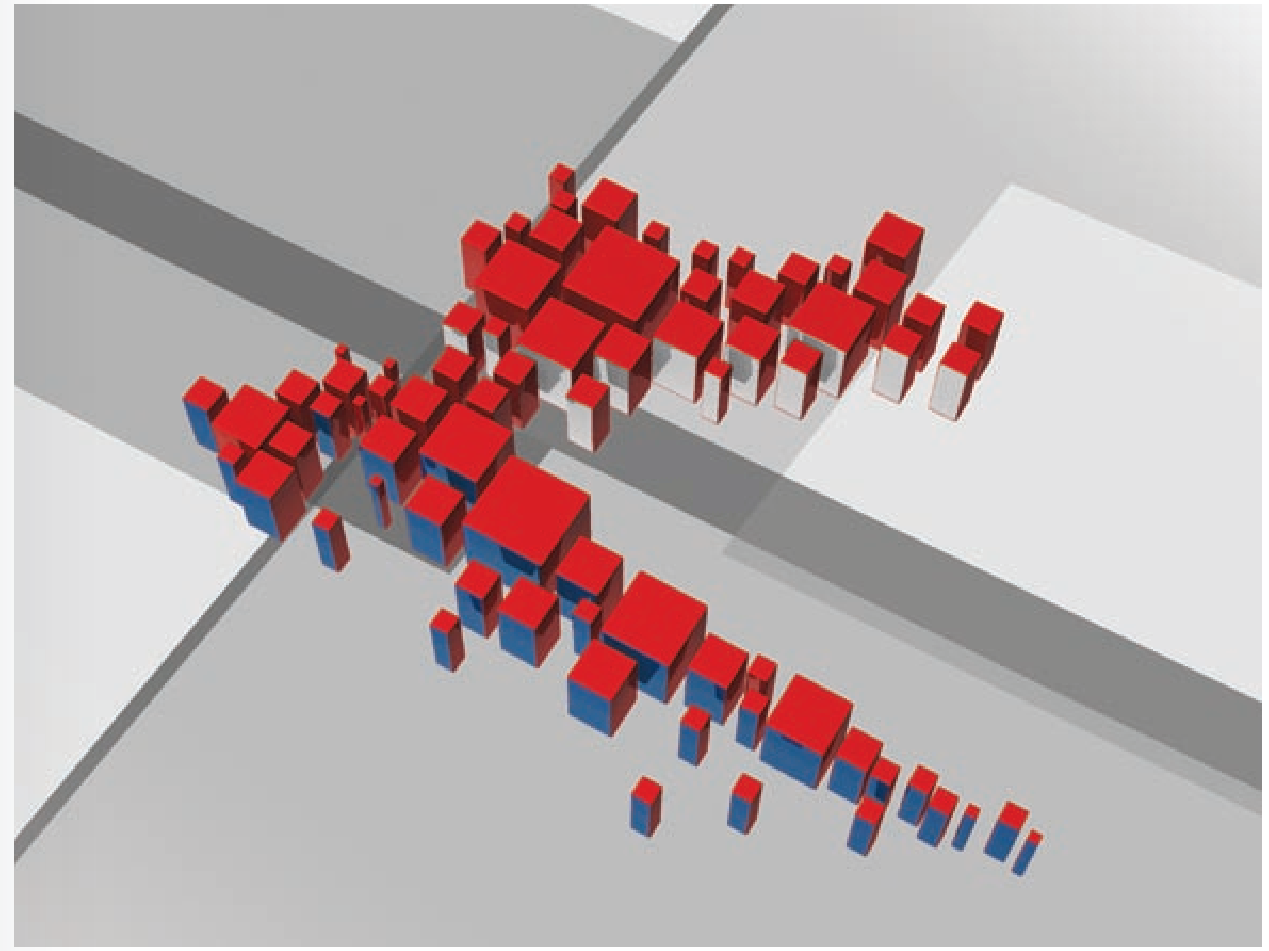
HBOR marked its 15th anniversary with a number of activities pursuant to its role in the economic life of the Republic of Croatia and in socially responsible business operation.

The leading idea of the humanitarian action of reconstruction of the Regional school "Zagorje" in Gornje Zagorje was to help others, especially children. The idea was initiated in HBOR's Human Resources and was widely supported by the Managing Board and all employees of the bank. 160 HBOR employees painted the school interior and a 16 m long wall in the schoolyard. HBOR also donated computers and accompanying equipment to the school, and HBOR's employees working in the IT Department renovated the information science laboratory. The school library was enriched through a voluntary collection of books.

A ceremonial meeting of the Supervisory Board, attended by Mr. Ivo Sanader Ph.D., the Croatian Prime Minister, was held on 12th June 2007, the date of establishment of the Bank.

A celebration was held on 14th June 2007 in the Museum of Arts and Crafts in Zagreb. It was attended by Mr. Stjepan Mesić, the President of the Republic of Croatia, Mr. Vladimir Šeks, the Chairman of the Croatian Parliament, Mr. Ivan Šuker, Minister of Finance and Chairman of the Supervisory Board of HBOR, representatives of the Prime Minister, many esteemed Croatian businessmen and politicians, and representatives of foreign banks and institutions,.

During 2007, the activities called "15 workshops for 15 years" were implemented. Within these activities, representatives of HBOR organised additional workshops and roundtables across the Republic of Croatia for the purpose of easier access to information relating to HBOR's loans.



HBOR 15 GODINA

Financial Operations in 2007

The balance sheet total as at 31st December 2007 amounted to HRK 17,402.1 million, which is an increase of 17% compared to the beginning of the year.

Cash on hand and due from banks

As at 31st December 2007, cash on hand and due from banks amounted to HRK 609.3 million, representing 3% of total assets.

Loans to banks and other customers

Total net loans as at 31st December 2007 stood at HRK 16,456.3 million (95% of total assets), an increase of 17% against the previous year.

Total gross loans amounted to HRK 18,269.2 million, an increase of 16% against the beginning of the year.

Placements to banks based on lending activities rose by 31% gross in comparison with the beginning of the year, mostly the result of disbursements under the programmes for financing the economy, pre- and post-shipment export and the tourist industry.

Placements to other customers decreased by 2% in gross figures.

Assets held to maturity

Assets held to maturity comprised bonds of the Republic of Croatia acquired in exchange for outstanding receivables.

These assets were reduced by 48% in comparison with the beginning of the year due to collection upon maturity.

Assets available for sale

Assets available for sale were comprised primarily of debt securities and to a lesser extent of ownership securities.

This item amounted to HRK 191.2 million, which represents a decrease of 15% compared to the beginning of the year, mostly due to the bonds of the Ministry of Finance of the Republic of Croatia maturing in the amount of EUR 5 million.

The decrease in this item was additionally caused by exchange rate developments and by the fair value of securities in the domestic capital market. The effects of these developments are recognised in the Income Statement and in the capital.

In 2007, HBOR acquired five shares in the EIF. The amount paid in represents 20% of the nominal value of the purchased shares, and the remaining 80% was recorded as contingent liability towards the EIF in the amount of EUR 4 million.

Investments in associates

Investments in associates are a constituent part of the Programme for Equity Investments in Companies - small and medium enterprises - and were stated at acquisition cost in the amount of HRK 26.2 million (HRK 28.3 million in 2006).

The investment value was fully impaired because of its estimated irrecoverability.

In 2007, an ownership interest in one company amounting to HRK 2.1 million was sold.

Total liabilities

Total liabilities as at 31st December 2007 amounted to HRK 11,622.7 million, which represents 67% of total liabilities, capital and guarantee fund.

Total liabilities rose by 21% compared to the beginning of the year as a result of new HBOR borrowings abroad:

- Eurobond issue for EUR 250.0 million, and
- Loan taken out in the amount of EUR 110.0 million.

Capital

Capital and supplemental capital amounted to HRK 5,779.4 million, representing 33% of total liabilities, capital and guarantee fund.

HBOR's total capital is comprised of the Founder's capital contributed from the budget of the Republic of Croatia, retained profits formed from the profits generated in the previous years,

OPEN

A NEW CHAPTER

SMEs

The main driving force behind the development of every modern economy is the SME sector. Therefore, HBOR pays special attention to this segment of the economy. Through more favourable terms and conditions of funding, it encourages the growth and development of legal entities classified as SMEs in accordance with the laws.

other reserves, profits for the current period and supplemental capital.

In the reporting period, contributions from the budget into the Founder's capital amounted to HRK 215.0 million.

The total amount of capital contributed from the budget of the Republic of Croatia amounted to HRK 3,963.1 million, revaluation reserves to HRK 426.6 million, retained profits and reserves to HRK 1,137.6 million, supplemental capital to HRK 13.0 million and profits for the current period to HRK 240.9 million.

In the reporting period, supplemental capital increased by EUR 300 thousand due to a payment effected by DEG as a financial contribution (grant) of the Government of the Federal Republic of Germany for the coverage of possible losses under the guarantees issued and loans extended through the Loan Programme for Incentives to Start up Small Enterprises in the Republic of Croatia.

Successful operations of HBOR

In the period from 1st January until 31st December 2007, HBOR generated a total income of HRK 894.6 million, expenses of HRK 653.7 million and profits of HRK 240.9 million.

Net interest income

Net interest income amounted to HRK 445.4 million, which is at the same level as in the previous year.

Interest income amounted to HRK 868.6 million, an increase of 13% in comparison with the previous year. This was mainly a result of an increase in the volume of lending.

Interest expenses amounted to HRK 423.2 million, an increase of 31% in comparison with the same period last year. The increase in interest expenses was a result of rising interest reference rates in the world markets and new borrowings in 2007.

Net revenues/(expenditures) from financial activities

Net revenues/(expenditures) from financial activities are comprised of net foreign exchange gains/losses on the principal amount of receivables and liabilities, net revenues or expenditures arising out of loan contracts with embedded call option, gains/(losses) arising out of value adjustments of property stated at fair value in the Income Statement, and assets available for sale.

In the reporting period, net expenditures from financial activities amounted to HRK 2.3 million, whereas net revenues of HRK 8.2 million were recorded in the same period last year.

At year level, the kuna appreciated by 0.3% against the euro and by 10.6% against the USD.

Foreign currency or foreign currency indexed assets and sources of funds are converted by HBOR into HRK equivalent value in accordance with the exchange rate of the Croatian National Bank valid at the Balance Sheet date.

Foreign currency revenues and expenditures are converted in accordance with the exchange rate at the transaction date. The resulting foreign exchange gains or losses are recorded in the Income Statement in net figures.

Operating costs

Operating costs include general and administrative costs and other operating costs and amounted to HRK 92.3 million, which represents an increase of 13% compared to the same period last year.

There were 232 employees in the Bank as at 31st December 2007. The number of employees as at 31st December 2006 was 244.

Impairment losses and provisioning

In the reporting period, net impairment losses on placements on an individual and group basis amounted to HRK 135.1 million.

In accordance with the regulations and general documents, HBOR determines the amount of impairment losses and provisions and maintains it at the level it considers adequate for the coverage of possible future risks.

Financial statements for the year 2007 together with the Independent auditor's report

Contents:

Independent Auditor's Report

Ernst & Young

Ernst & Young d.o.o.
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Independent Auditor's Report

To the owner of the Croatian Bank for Reconstruction and Development:

We have audited the accompanying financial statements ("the financial statements") of the Croatian Bank for Reconstruction and Development (the "Bank" or HBOR) which comprise the Balance sheet as at 31 December 2007 and Income statement, Statement of changes of equity and Cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 4 to 85. The financial statements of the Bank for the year ended 31 December 2006 were audited by other auditors who have, in their report dated 21 March 2007, expressed an unqualified opinion on those financial statements.

Management Responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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 risk of material misstatement of the financial statements, whether due to the fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2007 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young d.o.o.

Ernst & Young d.o.o.
Zagreb, 31 March 2008

Management Responsibility

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

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

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

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

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

Signed on behalf of the Managing Board:

Anton Kovačev
President of the Managing Board

Croatian Bank for Reconstruction and Development
Strossmayerov trg 9
10 000 Zagreb

Zagreb, 31 March 2008

Income Statement

For the year 2007

(All amounts are expressed in HRK thousand)

	Notes	2007 HRK '000	2006 HRK '000
Interest income	3	868,590	768,167
Interest expense	4	(423,228)	(323,525)
Net interest income		**445,362**	**444,642**
Fee income	5	20,887	23,168
Fee expenses	5	(797)	(842)
Net fee income		**20,090**	**22,326**
Net gains/(loses) on financial operations	6	(2,299)	8,213
Other income		5,076	3,697
Operating income		**468,229**	**478,878**
Operating expenses	7	(92,236)	(81,409)
Impairment loss and provisions	8	(135,078)	(217,154)
Profit before income tax		**240,915**	**180,315**
Income tax	2	-	-
Profit after income tax		**240,915**	**180,315**

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

Balance Sheet

As of 31 December 2007

(All amounts are expressed in HRK thousand)

	Notes	2007 HRK '000	2006 HRK '000
ASSETS			
Cash on hand and due from banks, net	9	24,660	19,862
Deposits with other banks, net	10	584,630	405,118
Loans to banks, net	11	10,523,533	7,898,957
Loans to other customers, net	12	5,932,731	6,209,913
Assets held to maturity	13	39,161	75,925
Assets available for sale	14	191,220	225,847
Investments in associates	15	-	-
Property, plant and equipment and intangible assets	16	49,052	52,109
Assets for resale	17	50,267	35,431
Other assets, net	18	6,797	4,430
Total assets		**17,402,051**	**14,927,592**
LIABILITIES			
Deposits	19	558,550	518,338
Borrowings	20	3,795,359	3,738,098
Bonds payable	21	6,012,845	4,150,427
Other liabilities	22	1,255,918	1,190,265
Total liabilities		**11,622,672**	**9,597,128**
EQUITY			
Founder's capital		4,389,737	4,174,737
Retained earnings and reserves		1,137,611	957,296
Other reserves		(1,869)	7,098
Net profit for the year		240,915	180,315
Total equity		**5,766,394**	**5,319,446**
Guarantee fund	23	12,985	11,018
Total equity and guarantee fund		5,779,379	5,330,464
TOTAL LIABILITIES, TOTAL EQUITY AND GUARANTEE FUND		**17,402,051**	**14,927,592**

The accompanying accounting policies and notes are an integral part of this balance sheet.

Signed on behalf of the Croatian Bank for Reconstruction and Development on 31 March 2008 by:

Anton Kovačev
President of the Managing Board

Irena Adžić-Jagodić
Accounting Division Executive Director

Statement of Cash Flow

For the year 2007

(All amounts are expressed in HRK thousand)

	2007 HRK '000	2006 HRK '000
OPERATING ACTIVITIES		
Profit before income tax	240,915	180,315
Adjustments to reconcile to net cash from and used in operating activities:		
Depreciation	6,181	5,256
Impairment loss and provisions	135,078	217,154
Accrued interest	44,665	15,173
Deferred fees	13,582	5,479
Operating profit before working capital changes	440,421	423,377
Changes in operating assets and liabilities:		
Net (increase)/decrease in deposits with other banks, before provision for impairment	(181,363)	13,239
Net (increase) in loans to banks, before provision for impairment	(2,655,227)	(1,512,535)
Net decrease in loans to other customers, before provision for impairment	168,253	11,919
Net (increase)/decrease in other assets, before provision for impairment	(1,849)	469
Net (increase) in assets held for resale	(14,836)	(17,278)
Net increase in deposits from banks and companies	40,212	1,587
Net increase in other liabilities, before provisions	56,859	123,140
NET CASH USED IN OPERATING ACTIVITIES	**(2,147,530)**	**(956,082)**
INVESTMENT ACTIVITIES		
Net decrease in assets available for sale	24,963	873
Net decrease in assets held to maturity	36,445	34,377
Sale of investments in associates	2,100	4,328
Net (purchases) of property, plant and equipment and intangible assets	(3,124)	(7,590)
NET CASH PROVIDED BY INVESTMENT ACTIVITIES	**60,384**	**31,988**
FINANCIAL ACTIVITIES		
Net increase in founder's capital	215,000	215,000
Net increase/(decrease) in borrowings	61,929	(424,018)
Net increase in bonds payable	1,813,091	1,090,640
Net increase in guarantee fund	1,967	3,643
NET CASH PROVIDED BY FINANCIAL ACTIVITIES	**2,091,987**	**885,265**
Net increase/(decrease) in cash and cash equivalents	4,841	(38,829)
Balance as of 1 January, before provisions	19,994	58,823
Net increase/(decrease) in cash	4,841	(38,829)
BALANCE AS OF 31 DECEMBER, BEFORE PROVISIONS	**24,835**	**19,994**
OPERATIONAL CASH FLOWS FROM INTEREST		
Interest paid	374,970	298,394
Interest received	672,323	551,947

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

Statement of Changes in Equity

For the year 2007

(All amounts are expressed in HRK thousand)

	Founder`s capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Net profit for the year HRK '000	Total HRK '000
BALANCE AS OF 1 JANUARY 2006	**3,959,737**	**786,621**	**16,212**	**170,675**	**4,933,245**
Profit after income tax	-	-	-	180,315	180,315
Increase in fair value of assets available for sale	-	-	5,360	-	5,360
Decrease in fair value of assets available for sale	-	-	(14,474)		(14,474)
TOTAL RECOGNIZED INCOME AND EXPENSE FOR THE PERIOD	**-**	**-**	**(9,114)**	**180,315**	**171,201**
Payment from the State budget	215,000	-	-	-	215,000
Transfer of profit 2005 to retained earnings	-	170,675	-	(170,675)	-
BALANCE AS OF 31 DECEMBER 2006	**4,174,737**	**957,296**	**7,098**	**180,315**	**5,319,446**
Profit after income tax	-	-	-	240,915	240,915
Increase in fair value of assets available for sale	-	-	1,238	-	1,238
Decrease in fair value of assets available for sale	-	-	(10,103)	-	(10,103)
Foreign exchange losses on owners' securities	-	-	(20)	-	(20)
Transfer of realized gain into IS	-	-	(2,045)	-	(2,045)
Transfer of realized loss into IS	-	-	1,963	-	1,963
TOTAL RECOGNIZED INCOME AND EXPENSE FOR THE PERIOD	**-**	**-**	**(8,967)**	**240,915**	**231,948**
Payment from the State budget	215,000	-	-	-	215,000
Transfer of profit 2006 to retained earnings	-	180,315	-	(180,315)	-
BALANCE AS OF 31 DECEMBER 2007	**4,389,737**	**1,137,611**	**(1,869)**	**240,915**	**5,766,394**

The accompanying accounting policies and notes are an integral part of this statement of changes in equity.

Notes to the financial statements

For the year 2007

(All amounts are expressed in HRK thousand)

1. General information

The Croatian Bank for Reconstruction and Development ('HBOR' or 'the Bank') was established on 12 June 1992 under the Act on the Croatian Credit Bank for Reconstruction ("Zakon o Hrvatskoj kreditnoj banci za obnovu" - HKBO). In December 1995, the Bank changed its name to Croatian Bank for Reconstruction and Development (Hrvatska banka za obnovu i razvitak). The Bank's legal address is Strossmayerov trg 9, Zagreb, Croatia.

The founder and 100% owner of HBOR is the Republic of Croatia.

With the new Act on the Croatian Bank for Reconstruction and Development passed in December 2006, HBOR's founding capital was HRK 7 billion, the payment schedule of which is determined by the State budget.

The Republic of Croatia guarantees HBOR's liabilities unconditionally, irrevocably and on first call, without issuing any particular guarantee. The responsibility of the Republic of Croatia as guarantor for HBOR´s liabilities is joint and several.

The principal activities of the Bank as defined by the new Act on the Croatian Bank for Reconstruction and Development ("Zakon o Hrvatskoj banci za obnovu i razvitak") comprise the following: financing of the reconstruction and development of the Croatian economy, financing of infrastructure, promoting exports, providing support to the development of SMEs, promoting environmental protection, and providing domestic goods and services export insurance against non-marketable risks for and on behalf of the Republic of Croatia.

HBOR may perform other financial activities according to the decision of the Government of the Republic of Croatia if in their opinion it is in the best interest of the Republic of Croatia.

As of 31 December 2007 there were 232 employees at the Bank (31 December 2006: 244 employees).

HBOR bodies:

SUPERVISORY BOARD

- Ivan Šuker, Minister of Finance - ex officio President of the Supervisory Board,
- Branko Vukelić, Minister of the Economy, Labour and Entrepreneurship - ex officio Vice President of the Supervisory Board,
- Božidar Kalmeta, Minister of the Sea, Tourism, Transport and Development,
- Petar Čobanković, Minister of Agriculture, Forestry and Water Management,
- Nadan Vidošević, President of the Croatian Chamber of Economy,
- Šime Prtenjača, Member of the Croatian Parliament,
- Gordan Jandroković, Member of the Croatian Parliament
- Željko Pecek, Member of the Croatian Parliament.

MANAGING BOARD

- Anton Kovačev, President of the Managing Board,
- Ružica Adamović, Member of the Managing Board,
- Krešimir Leko, Member of the Managing Board (mandate ended on 23 November 2007 due to death),
- Emilija Nagj, Member of the Managing Board from 1 February 2008.

1. General information (continued)

HBOR bodies (continued):

After the elections for the Croatian Parliament (on 24 and 25 November and 9 December 2007) and the Parliament constitution (the constitutional session was held on 11 January 2008), the Government of the Republic of Croatia, on sessions held on 21 and 29 February 2008, passed the Resolution on appointing the President, Vice President and certain Members of the Supervisory Board of the Bank. Furthermore, the Croatian Parliament passed the Resolution on appointing HBOR's Supervisory Board members and deputy members.

Therefore, the new members of HBOR's Supervisory Board appointed by the Government of the Republic of Croatia are as follows:

- Ivan Šuker, Minister of Finance - ex officio President of the Supervisory Board,
- Damir Polančec, Vice President of the Republic of Croatia Government and Minister of the Economy, Labour and Entrepreneurship - ex officio Vice President of the Supervisory Board,
- mr. sc. Božidar Pankretić, Minister of Agriculture, Fisheries and Rural Development,
- Damir Bajs, Minister of Tourism,
- Božidar Kalmeta, Minister of Sea, Transport and Infrastructure

The new members of HBOR's Supervisory Board appointed by the Croatian Parliament are as follows:

- dr. sc. Goran Marić, Member of the Croatian Parliament, President of the Finance and Central Budget Committee,
- prof. dr. sc. Dragan Kovačević, Member of the Croatian Parliament, President of the Committee on the Economy, Development and Reconstruction,
- Dragica Zgrebec, Member of the Croatian Parliament, Vice President of the Finance and Central Budget Committee.

Mr. Nadan Vidošević, President of Croatian Chamber of Economy, ex officio Member of the Supervisory Board.

Audit Committee:

HBOR's Audit Committee was formed following a Supervisory Board decision passed on 2 March 2006.

During 2007 the Audit Committee was organized as follows:

- Ivan Šuker, Minister of Finance, President of the Audit Committee,
- Ružica Adamović, Member of the Audit Committee (up to 21 March 2007),
- Verica Čirjak, Member of the Audit Committee,
- Nadan Vidošević, Member of the Audit Committee (from 21 March 2007).

The Supervisory Board named new members of the Audit Committee as of 19 March 2008 as follows:

- Ivan Šuker, Minister of Finance, President of the Audit Committee,
- Nadan Vidošević, Member of the Audit Committee,
- Mladen Kober, Member of the Audit Committee.

2. Summary of significant accounting policies

Accounting policies

A summary of basic accounting policies is set out below.

Basis of accounting

The Bank maintains its accounting records in HRK in accordance with Croatian law and the accounting principles and practices observed by enterprises in the Republic of Croatia.

Basis of presentation

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

The financial statements are prepared on an accrual and a going concern basis.

The financial statements are prepared based on the Bank´s accounting records and they include proper adjustments and reclassifications necessary for truthful and objective presentation in accordance with IFRS.

Significant accounting judgments and estimates

For preparing financial statements in accordance with IFRS, the Managing Board is required to give estimations and make assumptions that affect the reported balances of assets and liabilities and to disclose contingent amounts of assets and liabilities on the date of the financial statements and also the stated revenues and expenses for the reporting period. Estimations are based on information available on the reporting date, so that actual amounts may differ from those estimated.

Judgments

In preparation of financial statements the Managing Board applied following judgment:

- Classification of investment securities as held to maturity.

Estimations

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

2. Summary of significant accounting policies (continued)

Significant accounting judgments and estimates (continued)

FAIR VALUE OF FINANCIAL INSTRUMENTS

When the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

PROVISIONS FOR LOAN IMPAIRMENT

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank 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 the 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 Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

PROVISION FOR LEGAL CASES

The Bank performs a risk classification of law suits taking into consideration legal basis of the claim, prior legal practice, opinions of relevant in-house lawyers, opinions of the outsourced attorneys and the Bank's own experience.

2. Summary of significant accounting policies (continued)

Adoption of new and revised International Financial Reporting Standards

- In the current year, the Bank has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2007, being:
- IFRS 7 Financial Instruments: Disclosures (for annual periods beginning on or after 1 January 2007);
- Amendment to IAS 1 Presentation of financial statements: Capital Disclosures (effective for annual periods beginning on or after 1 January 2007);
- Revised IAS 23 Borrowing Costs (effective for financial years beginning on or after 1 January 2009)
- IFRIC 8 - Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006);
- IFRIC 9 Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006);
- IFRIC 10 Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006);
- IFRIC 11 Scope of IFRS 2 Group and transactions with own securities (effective for annual periods beginning on or after 1 March 2007);
- IFRIC 12 Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008);
- IFRIC 13 Customer Loyalty Programmes (for annual periods beginning on or after 1 July 2008);
- IFRIC 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after 1 January 2008).

IFRS 7 Financial Instruments: Disclosures introduces new disclosures in order to improve information on financial instruments. IFRS 7 requires disclosure of qualitative and quantitative information on financial instruments risk exposure, including specification of minimal disclosures that relate to credit risk, liquidity risk and market risk including sensitivity analysis for market risks the entity is exposed to. IFRS 7 supersedes IAS 30 Disclosures in Financial Statements of Banks and Similar Financial Institutions and the presentation requirements within IAS 32 and is obligatory for all entities that prepare financial statements in compliance with IFRS.

Changes of IAS 1 Presentation of Financial Statements introduces new capital disclosures including capital management disclosure.

The Managing Board assessed that these standards have impact only on presentation and disclosures in the financial statements for the year 2007 and have no financial impact on the Bank's financial statements.

2. Summary of significant accounting policies (continued)

Adoption of new and revised International Financial Reporting Standards (continued)

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

IFRIC 8 Scope of IFRS 2 requires IFRS 2 Share-based Payment to be applied to any arrangements where equity instruments are issued for consideration, which appears to be less than fair value. Due to HBOR's ownership structure, the interpretation had no impact on the financial position of the Bank.

IFRIC 9 Reassessment of Embedded Derivatives interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Managing Board assesses that the interpretation had no impact on the financial position of the Bank.

IFRIC 10 Interim Financial Reporting and Impairment prohibits reversal of impairment losses recognised in interim periods in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. The Managing Board assesses that the interpretation had no impact on the financial position of the Bank.

IFRIC 11 Scope of IFRS 2 Group and transactions with own securities requires that share-based payments where the entity receives goods or services as consideration for its own equity instruments should always be accounted for as equity-settled share-based payment transactions, regardless of way the equity instruments were acquired. Furthermore, it provides guidelines whether share-based payments to goods and services suppliers where a supplier receives the entity's shares should be accounted for as cash settled or share-based payment transactions. Due to HBOR's ownership structure, this interpretation is not applicable and has no impact on the financial position of the Bank.

IFRIC 12 Service Concession Arrangements was issued in November 2006 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. This Interpretation will have no impact on the Bank.

2. Summary of significant accounting policies (continued)

Adoption of new and revised International Financial Reporting Standards (continued)

IFRIC 13 Customer Loyalty Programmes Interpretation was issued in June 2007 and becomes effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Bank expects that this interpretation will have no impact on the Bank's financial statements as no such schemes currently exist.

IFRIC 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction was issued in July 2007 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under IAS 19 Employee Benefits. The Bank expects that this Interpretation will have no impact on the financial position or performance of the Bank.

Reporting currency

The Bank's financial statements are prepared in HRK, rounded to a nearest thousand. The effective exchange rate of HRK as of 31 December 2007 was HRK 7.325131 per 1 Euro and HRK 4.985456 per 1 United States dollar (31 December 2006: HRK 7.345081 per 1 Euro and HRK 5.578401 per 1 United States dollar), unless otherwise contracted.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and current accounts with the Croatian National Bank and other banks less provisions for impairment and uncollectability.

Loans to banks and other clients

Amounts advanced by HBOR by providing funds directly to the borrower at drawdown are categorized as loans to customers and are carried at amortized cost derived from using the effective interest rate method and adjusted for possible impairment.

The amount of the subsidized interest provided for the final user under the Programme of Preferential Financing through HBOR's Loan Programmes is presented as deferred interest income in other liabilities and released over the term of the loan and is shown in the income statement on a time basis during the repayment of the loan. Therefore, the loan is carried at amortized cost derived from using an interest rate without considering any effect of subsidies paid by the state.

2. Summary of significant accounting policies (continued)

Loans to banks and other clients (continued)

All loans and advances are recognized when cash is advanced to borrowers.

Provision for impairment is established if there is objective evidence that HBOR will not be able to collect all amounts due. The Managing Board of HBOR determines the adequacy of the provision based upon analysis of various factors, structure of loan portfolio and past experience.

The amount of the provision is the difference between the carrying and recoverable amounts of the balance outstanding, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted based on the effective interest rate.

The loan loss provision also covers losses where there is objective evidence that probable losses are present, specifically identified in components of the loan portfolio at the balance sheet date. These have been estimated based upon historical patterns of losses (in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate).

If there is no objective evidence that an impairment loss has been incurred, whether it is significant or not, the financial asset is grouped on the basis of the Bank's internal credit grading system that considers similar credit risk characteristics as a financial asset of similar credit risk characteristics and all assets from this group are subject to joint estimation for the purpose of a collective evaluation of impairment. Contracted cash flows and historical loss experience for assets with similar credit risk characteristics subject to collective evaluation of expected cash flows. Asset for which impairment is assessed on individual level and for which impairment losses are recognized, i.e. are continued to be recognized, is not included in joint estimation of impairment.

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

Reverse repo agreements

Securities purchased under agreements to purchase and resell ('reverse repos') are recorded as assets in the balance sheet line 'Loans to banks'. Interest earned in the period from the purchase until the resale of the security is accrued on a daily basis and reported as 'Interest income' in the income statement.

2. Summary of significant accounting policies (continued)

Securities

Securities held by the Bank are classified into portfolios in accordance with the Bank's intent on the acquisition of the securities and pursuant to the Bank's security investment strategy. On the adoption of IAS 39, the Bank developed security investment strategies and, reflecting the intent of the acquisition, allocated securities to the 'Assets at fair value through profit or loss' portfolio, 'Available for sale' portfolio and the 'Held to maturity' portfolio. The principal difference among the portfolios relates to the measurement approach of securities and the recognition of their fair values in the financial statements. All securities held by the Bank are recognized using settlement date accounting and initially are measured at fair value plus, in case of investments not at fair value trough profit and loss, directly attributable transaction costs.

The Bank does not make acquisitions of securities and investments to achieve gain/loss from short term trading activities.

a) Assets at fair value through profit or loss

Assets at fair value through profit or loss comprise financial assets which are not actively traded. Those assets were acquired principally for the purpose of maintaining the liquidity reserve and managing the Bank's short-term liquidity.

Upon initial recognition, financial assets carried at fair value through profit or loss are accounted for and presented at fair value based on quoted prices or amounts derived from acceptable valuation models. The Bank includes unrealized gains and losses in 'Net gains/(losses) on financial operations'.

b) Investments held to maturity

Investments held to maturity are financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intent and ability to hold to maturity. This portfolio comprises treasury bills and debt securities. Held-to-maturity investments are carried at amortized cost using the effective yield method, less any provision for impairment.

The Bank 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 Bank recognises provisions through the income statement under 'Impairment loss and provisions'.

2. Summary of significant accounting policies (continued)

c) Assets available for sale

Assets available for sale are financial assets designated as available for sale or not classified as either held to maturity or carried at fair value through profit or loss. This portfolio comprises equity and debt securities and investment funds shares acquired for liquidity maintenance and risk management. Furthermore, it comprises of investments acquired for placements of available funds up to the moment of further long term placements with original due date over one year or which are intended to be held for an indefinite period of time.

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 the specific circumstances of the issuer.

For available-for-sale assets, gains and losses arising from changes in fair value are recognized directly in equity, 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 on available-for-sale assets are reported in the income statement. If the fair value of an equity instrument subsequently increases, the increase will be recognized through equity, and will not be subsequently reversed in the income statement. Impairment losses recognized in profit or loss for debt instruments are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition.

As of 31 December 2007 and 2006, no impairment of securities available for sale was identified.

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

Foreign exchange gains/(losses) 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 gains/(losses) related to available-for-sale debt instruments held in foreign currency are reported in the income statement.

2. Summary of significant accounting policies (continued)

Investments in associates

Investments in associates relate to investments where HBOR has between 20% and 50% of the voting rights and where HBOR has significant influence, but no control. They are accounted for at cost and decreased for impairment when necessary.

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

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

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

Property, plant and equipment and intangible assets

Property, plant and equipment and intangible assets are stated at the original cost. Depreciation is computed using the straight-line method, by applying to the cost of assets the annual rates from 3.03% to 33.3% over their estimated useful lives.

Estimated useful life is as follows:

	2007 Years	2006 Years
Buildings	33	33
Computers	3	3
Furniture and equipment	5 - 8	5 - 8
Vehicles	3	3
Other	5	5
Intangible assets	3 - 5	3 - 5

2. Summary of significant accounting policies (continued)

Property, plant and equipment and intangible assets (continued)

Depreciation is not calculated on construction in progress. Repairs and maintenance are expensed in the income statement as incurred. Expenses that increase the future operating capacity of existing assets (improvements) are capitalized.

Impairment of assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the net present value of future anticipated cash flows including anticipated recoveries from guarantees and collateral, discounted at original effective interest rates, is recognized in the income statement.

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in the 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 recognized in the income statement for items of property, plant and equipment and intangibles carried at cost, or it is treated as a revaluation decrease for assets that are carried at revalued amount to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for the same assets. The recoverable amount is the higher of an asset's net selling price or its value in use.

Assets for resale

Assets for resale consist of property, plant and equipment that the bank acquired in exchange for uncollected and other receivables. The Bank expects to sell these assets rather than use them.

The Bank measures those assets at the lower of its carrying amount and fair value (determined by the independent assessor) less cost to sell.

Furthermore, depreciation on these assets is not charged.

Impairment provisions as well as gains/losses on sale are charged to the income statement.

Fair values of financial assets and liabilities

Fair value represents the amount at which an asset may be exchanged or a liability settled on an arm's-length basis. When verifiable market prices are not available for a significant portion of the Bank's financial assets and liabilities, fair values (for these items) have been based on the Managing Board assumptions according to the profile of the asset and liability base. This includes prices achieved in late transactions agreements between informed and willing sides, referring on other in essentially similar instruments, analyses of discounted cash flows using information from the market and trying not to lean on subject specifications.

2. Summary of significant accounting policies (continued)

Fair values of financial assets and liabilities (continued)

The Managing Board, considering all available information, concludes that there are no major differences between carrying values and fair values and those carrying values of assets and liabilities represent market (fair) value.

The carrying amounts of cash and balances with the Croatian National Bank are generally deemed to approximate their fair values.

The estimated fair value of amounts due from banks approximates their carrying amounts since all amounts due from banks mature up to 90 days. Provisions are not taken into account when calculating fair values.

Loans and advances to banks and to other customers are presented net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. The interest subsidies recognized as deferred income within other liabilities are taken into account in fair value considering. The fair value of HRK loans with one-way foreign currency clause is assessed as described in this note under the Foreign currency transactions and foreign currency clause paragraph.

Assets held to maturity consist of unquoted bonds acquired from the Government of the Republic of Croatia in exchange for receivables from Dubrovačka banka d.d., Dubrovnik. The fair value of the stated bonds approximates their carrying value.

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

Fair value of bonds issued by HBOR on 31 December 2007 is stated in note 21.

Financial instruments

Financial assets and financial liabilities presented on the balance sheet include cash and cash equivalents, marketable securities, trade and other accounts receivable and payable, long-term loans and leases, deposits and investments. The accounting for each of these items is disclosed in the respective accounting policies.

2. Summary of significant accounting policies (continued)

Founder's capital and reserves

Under the new HBOR Act, the prescribed founder's capital should amount to HRK 7,000,000 thousand, paid from the State Budget in accordance with the schedule determined by the Croatian Parliament in the process of adoption of the State Budget of the Republic of Croatia and from other sources as specified by separate laws. As of 31 December 2007, the paid-in capital amounted to HRK 3,963,106 thousand. The outstanding amount of capital to be paid from State Budget of the Republic of Croatia up to the amount prescribed by the HBOR Act was HRK 3,036,894 thousand.

Bank borrowings and bonds payable

Borrowings and bonds payable are measured at amortized cost determined using the effective interest rate method. The Bank recognizes interest expense related to borrowings in the income statement.

Government grants

Lending interest for the borrowers qualifying for subsidised interest under the Programme of Preferential Financing through HBOR's Loan Programmes, the Development and Employment Programme, the Regional Development Programme and the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet is subsidised by the Republic of Croatia, the Fund for Development and Employment, the Fund for Regional Development, the Ministry of Agriculture, Forestry and Water Management, the Ministry of the Sea, Tourism, Transport and Development, the Ministry of the Economy, Labour and Entrepreneurship and the Environmental Protection and Energy Efficiency Fund during the entire loan repayment period.

The amount of the interest subsidies provided for the final user is presented as deferred interest income in other liabilities and is recognized in the income statement on a time basis during the repayment of the loan. As such, the loans are carried at amortized cost determined by using interest rates, without taking into account any effect of subsidies paid by the State.

Guarantees and other credit related commitments

In the ordinary course of business the Bank issues financial guarantees, consisting of letters of credits that are recorded off balance sheet. Financial guarantee contracts are initially measured at their fair values. Subsequent to initial recognition guarantees are measured at the higher of the amount of the obligation under the contract and the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Contingent liabilities under guarantees and letters of credit are mostly secured by guarantees of the Government of the Republic of Croatia.

The provision for commitments, undrawn loans and issued guarantees is maintained at a level that the Managing Board of HBOR believes is adequate to absorb potential losses.

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

For the year 2007 (All amounts are expressed in HRK thousand)

2. Summary of significant accounting policies (continued)

Interest income and expense

Interest income and expenses are recognized in the income statement when earned or incurred.

Interest income and expenses are recognized in the income statement for all interest bearing instruments on an accrual basis using the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or on a shorter period, where appropriate. Interest income includes coupons earned on fixed income investments.

Loan origination fees together with estimated related costs are deferred and recognized as an adjustment to the effective yield on the loan.

Notional interest is recognized on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value.

Fee and commission income

Fee and commission income is comprised mainly of fees receivable from enterprises for loans and guarantees granted and other services provided by the Bank, together with commissions for managing funds on behalf of legal entities and fees for foreign and domestic payment transactions. Fees and commissions are generally recognized in the period when the related service is provided.

Fees on issued financial/payment guarantees are deferred and released over the term of guarantee.

Pension and health insurance cost

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

	2007	2006
Contributions for state health insurance fund	15.00%	15.00%
Contributions for employment fund	1.60%	1.60%
Special contribution for employment of disabled persons	0.20%	0.20%
Contribution for injuries at work	0.50%	0.50%

The Bank is also obliged to withhold and pay contributions from gross pay on behalf of the employees to the State Pension Fund and Mandatory Pension Fund.

The contributions on behalf of employees and on behalf of the employer are charged to expense in the period to which they relate.

2. Summary of significant accounting policies (continued)

Foreign currency transactions and foreign currency clause

Assets and liabilities expressed in foreign currencies are converted into HRK at the exchange rates quoted by the Croatian National Bank at the balance sheet date. Income and expenses arising in foreign currencies are converted at the rate of exchange on the transaction date. Resulting foreign exchange gains and losses are recorded in the income statement.

The Bank has assets originated in HRK, which are linked to the foreign currency with one-way currency clause. Due to this clause, the Bank has an option to revalue the asset using a foreign exchange rate favourable for the Bank valid as of the date of maturity, compared to the foreign exchange rate valid as of the date of origination of asset. Due to the special circumstances of the market in the Republic of Croatia, the fair value of this option can not be calculated since the forward rates for HRK for periods over 6 months are not available. As such the Bank applies the following procedure: if the result of the translation of these assets by the middle rate of the Croatian National Bank at the date of balance sheet is positive, the carrying amounts of respective assets are adjusted at the balance sheet date. If the result of the translation of these assets by the middle rate of the Croatian National Bank at the date of the balance sheet is negative, the carrying amounts of respective assets are adjusted at the balance sheet date up to the agreed foreign exchange rate of the option.

The Bank has assets originated in Croatian kunas that are linked to a foreign currency with two-way currency clause. These assets are translated to Croatian kunas as if they were originated in foreign currency.

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

31 December 2007	EUR 1 = HRK 7.325131	USD 1 = HRK 4.985456
31 December 2008	EUR1 = HRK 7.345081	USD 1 = HRK 5.578401

Use of estimates

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

Taxation

Based on Article 9 of the Act on the Croatian Bank for Reconstruction and Development, the Bank is not obliged to pay income tax.

2. Summary of significant accounting policies (continued)

Managed funds - agency business

The Bank manages significant assets in the name and on behalf of the Ministry of Finance, Ministry of the Economy, Labour and Entrepreneurship, Ministry of the Sea, Tourism, Transport and Development, Ministry of Agriculture, Forestry and Water Management, the Fund for Development and Employment, the Fund for Regional Development of Republic Croatia, the Environmental Protection and Energy Efficiency Fund, Vodovod i kanalizacije d.o.o., Split and the Croatian Agency for Small Business ("HAMAG"), that are used for the financing of reconstruction and development programmes. As these amounts do not represent assets of HBOR, they are excluded from the balance sheet. Revenues and expenses relating to this business activity are charged to the third party, and the Bank does not have other liabilities. The Bank charges a fee under certain programmes and certain programmes are implemented without a fee charged by the Bank (See Note 25)

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

3. Interest income

Interest income by borrowers:

	2007 HRK '000	2006 HRK '000
Public sector	76,895	89,980
State-owned companies	139,163	130,297
Foreign companies	4,170	2,134
Other companies	329,955	333,815
Domestic banks	263,330	167,330
Foreign banks	14,823	7,347
Other	29,168	28,050
Penalty interest	11,086	9,214
	868,590	**768,167**

Interest income by type of facility:

	2007 HRK '000	2006 HRK '000
INTEREST ON LOANS		
- Long-term loans	812 658	716,581
- Short-term loans	1,424	725
- Collected prior year suspended interest	16,584	21,698
	830,666	739,004
Investments in securities	15,537	18,622
Deposits	22,387	10,541
	868,590	**768,167**

4. Interest expense

Interest expense by type of payee:

	2007 HRK '000	2006 HRK '000
Companies	3	16
Domestic banks	33	537
Foreign banks	423,186	322,964
Other	6	8
	423,228	**323,525**

Interest expense by type of facility:

	2007 HRK '000	2006 HRK '000
Borrowings	164,639	147,843
Securities	255,146	175,490
Deposits	3,443	192
	423,228	**323,525**

5. Net fee income

	2007 HRK '000	2006 HRK '000
Fee income:		
From given guarantees	11,921	13,845
From Managed funds - agency business	7,385	7,225
From money transfers	1,553	2,089
Other	28	9
	20,887	**23,168**
Fee expense	(797)	(842)
Net fee income	**20,090**	**22,326**

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

6. Net gains/(losses) on financial operations

	2007 HRK '000	2006 HRK '000
Net foreign exchange gains/(losses) on foreign currency assets:		
Cash on hand, accounts at banks and due from banks	868	(9,775)
Loans given to banks and other customers	(76,903)	(83,288)
Investments held to maturity	(152)	(683)
Assets available for sale	(602)	(872)
Other	5,337	5,183
	(71,452)	**(89,435)**
Net foreign exchange gains/(losses) on foreign currency liabilities:		
Deposits	13,637	9,401
Borrowings and issued long term securities	51,929	78,489
Other	2,537	8,625
	68,103	96,515
Net foreign exchange gains/(losses) on foreign currency assets and liabilities	(3,349)	7,080
Gains on assets at fair value through profit or loss	1,050	1,133
Net	**(2,299)**	**8,213**

7. Operating expenses

Operating expenses can be shown as follows:

	2007 HRK '000	2006 HRK '000
General and administrative expenses:		
Employee expenses	52,977	50,732
Depreciation	6,181	5,256
Administration expenses	12,619	7,000
Material and services	16,981	16,258
	88,758	79,246
Other expenses:		
Taxes and contributions	226	186
Other expenses	3,252	1,977
	3,478	2,163
	92,236	**81,409**

8. Impairment loss and provisions

Movements in the provision for impairment losses, guarantees and commitments, may be summarized as follows:

Movements in provision Increase/(decrease)	2007 HRK '000	2006 HRK '000
Impairment losses on cash on hand and due from banks	43	54
Impairment losses on deposits with other banks	1,978	(195)
Impairment losses on loans to banks	24,079	335
Impairment losses on loans to other customers and interest	105,108	228,186
Impairment losses on investments in associates	(2,100)	(4,328)
Impairment losses on other assets	(518)	617
Total increase/(decrease) in provision for impairment losses on assets	**128,590**	**224,669**
Provision for guarantees and commitments	4,795	(11,530)
Other provisions	1,693	4,015
Total (decrease)/increase in provision for guarantees and commitments	**6,488**	**(7,515)**
Total increase of provisions	**135,078**	**217,154**

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

9. Cash on hand and due from banks, net

	2007 HRK '000	2006 HRK '000
Account with the Croatian National Bank	8,303	6,816
Due from domestic banks in foreign currency	74	347
Due from foreign banks in foreign currency	16,458	12,831
	24,835	19,994
Provision for impairment losses	(175)	(132)
	24,660	**19,862**

The movements in the provision for impairment losses on amounts due from banks may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Balance as of 1 January	132	78
Provision for impairment losses on due from banks	43	54
BALANCE AS OF 31 DECEMBER	**175**	**132**

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10. Deposits with other banks, net

	2007 HRK '000	2006 HRK '000
Deposits with foreign banks	494,558	181,424
Deposits with domestic banks	95,926	227,697
Accrued interest	216	89
	590,700	409,210
Provision for impairment losses	(6,070)	(4,092)
	584,630	**405,118**

The movements in the provision for impairment losses on deposits with other banks may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Balance as of 1 January	4,092	4,287
Provision for impairment losses on deposits with other banks	1,978	(195)
BALANCE AS OF 31 DECEMBER	**6,070**	**4,092**

11. Loans to banks, net

Loans to banks, net of provision for impairment losses, may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Loans due within one year	3,801,130	2,805,313
Loans due in over one year	7,325,999	5,667,179
Accrued interest	26,603	22,046
Deferred recognition of interest income - fees for loans	(37,572)	(26,443)
	11,116,160	8,468,095
Provision for impairment losses	(592,627)	(569,138)
	10,523,533	**7,898,957**

The movements in the provision for impairment losses on loans to banks may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Balance as of 1 January	569,138	568,320
Provision for impairment losses on loans to banks	24,203	335
Foreign exchange gains/losses on provision for impairment losses, net	(714)	483
Collection of off balance receivables	(124)	-
Transfer of provisions from off balance records	124	-
BALANCE AS OF 31 DECEMBER	**592,627**	**569,138**

11. Loans to banks, net (continued)

Loans to banks, net of provision for impairment losses, may be summarized by programme as follows:

	2007 HRK '000	2006 HRK '000
Economic reconstruction and development	3,670,417	2,894,137
Export	4,803,461	3,820,455
Infrastructure reconstruction and development in the Republic of Croatia	103,866	80,779
Small and medium enterprises	1,108,311	814,949
Reconstruction of housing and business facilities damaged in war	25,651	33,458
Other	1,415,423	828,714
Accrued interest	26,603	22,046
Deferred recognition of interest income - fees for loans	(37,572)	(26,443)
	11,116,160	8,468,095
Provision for impairment losses	(592,627)	(569,138)
	10,523,533	**7,898,957**

Interest rates on loans were from 1% to 4% annually during 2007 and 2006, respectively, depending on the purpose of the loan and area of investments.

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

12. Loans to other customers, net

Loans to other customers, net of provision for impairment losses, may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Domestic companies	3,803,524	3,884,206
State-owned companies	1,906,644	2,090,566
Public sector	899,431	989,638
Foreign companies	98,122	20,714
Non profit institutions	2,983	808
Other	453,612	338,027
Accrued interest	49,177	52,851
Deferred recognition of interest income - fees for loans	(60,457)	(60,310)
	7,153,036	7,316,500
Provision for impairment losses	(1,220,305)	(1,106,587)
	5,932,731	**6,209,913**

The movements in the provision for impairment losses on loans to other customers may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Balance as of 1 January	1,106,587	918,157
Correction of opening balance - transfer from off balance sheet	-	3,124
Provision for impairment losses on loans to other customers and interest	123,134	232,856
Foreign exchange gains/(losses) on provision for impairment losses, net	(3,302)	853
Collection of off balance sheet receivables	(18,026)	(4,669)
Provisions transferred from off-balance sheet	18,026	3,928
Write-offs	(5,345)	(8)
Transfer to off balance sheet - loans	(769)	(47,654)
Balance as of 31 December	**1,220,305**	**1,106,587**

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12. Loans to other customers, net (continued)

Loans to other customers, net of provision for impairment losses, may be summarized by programme as follows:

	2007 HRK '000	2006 HRK '000
Economic reconstruction and development	2,539,040	3,039,636
Export	1,417,263	1,694,389
Infrastructure reconstruction and development in the Republic of Croatia	2,223,624	2,067,545
Small and medium enterprises	675,220	482,136
Other	309,169	40,253
Accrued interest	49,177	52,851
Deferred recognition of interest income - fees for loans	(60,457)	(60,310)
	7,153,036	7,316,500
Provision for impairment losses	(1,220,305)	(1,106,587)
	5,932,731	**6,209,913**

Interest rates on loans were from 2% to 6% annually during 2007 and 2006, depending on the purpose of the loan and area of investments.

13. Assets held to maturity

	2007 HRK '000	2006 HRK '000
Bonds issued by the Republic of Croatia	38,821	75,266
Accrued interest	340	659
	39,161	**75,925**

HBOR acquired bonds issued by the Republic of Croatia in exchange for receivables from Dubrovačka banka d.d., Dubrovnik amounting to EUR 5,300 thousand and EUR 10,247 thousand as of 31 December 2007 and 31 December 2006. Repayments are due every six months and the last instalment is due on 15 November 2008. The interest rate on these bonds is 7% per annum.

14. Assets available for sale

	2007 HRK '000	2006 HRK '000
Debt securities:		
Listed debt securities:		
Bonds of the Ministry of Finance of the Republic of Croatia	161,633	207,240
Corporate bonds	14,504	15,153
Accrued interest	2,601	3,298
	178,738	**225,691**
Equity securities:		
Unlisted equity securities:		
Investments in shares of foreign companies	18	18
Investments in financial institution shares	138	138
Shares of foreign financial institutions - EIF (Note 24)	12,326	-
	12,482	**156**
	191,220	**225,847**

14. Assets available for sale (continued)

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-125A) issued with foreign currency clause on 23 January 2003 are repayable over 9 years with an interest rate of 6.875%. As of 31 December 2007 the value of these outstanding bonds amounted to HRK 46,148 thousand (31 December 2006: HRK 48,940 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-085A) issued in HRK on 28 May 2003 are repayable over 5 years with an interest rate of 6.125%. As of 31 December 2007 the value of these outstanding bonds amounted to HRK 7,485 thousand (31 December 2006: HRK 7,695 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-19BA) issued with foreign currency clause on 29 November 2004 are repayable over 15 years with an interest rate of 5.375%. As of 31 December 2007 the value of these outstanding bonds amounted to HRK 10,939 thousand (31 December 2006: HRK 11,763 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-077A) issued with foreign currency clause on 7 July 2004 are repayable over 3 years with an interest rate of 3.875%, redeemed on 9 July 2007 which was regular due date (31 December 2006: HRK 36,505 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-142A) issued with foreign currency clause on 10 February 2004 are repayable over 10 years with an interest rate of 5.5%. As of 31 December 2007 the value of these outstanding bonds amounted to HRK 73,325 thousand (31 December 2006: HRK 77,784 thousand).

Bonds of Pliva d.d., Zagreb (RHPLVA-O-115A) issued with foreign currency clause on 12 May 2004 are repayable after 7 years with an interest rate of 5.75%. As of 31 December 2007 the value of these outstanding bonds amounted to HRK 14,504 thousand (31 December 2006: HRK 15,153 thousand).

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

14. Assets available for sale (continued)

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-103A) issued in HRK on 8 March 2005 are repayable over 5 years with an interest rate of 6.75%. As of 31 December 2007 the value of these outstanding bonds amounted to HRK 23,736 thousand (31 December 2006: HRK 24,533 thousand).

In February 2007, HBOR made acquisitions of three, and in July 2007 of two more, shares of the European Investment Fund. The payment made is 20% of the nominal amount of purchased shares and the other 80% represents a contingent liability towards EIF. On 31 December 2007, this contingent liability was EUR 4 million. In accordance with the Fund's legal documents, investors pay 20% of the acquired shares, while the remaining subscribed amounts have to be paid by investors at the Fund's General Meeting.

15. Investments in associates

	2007	2006
	HRK '000	HRK '000
Investments in associates	26,157	28,257
Adjustments	(26,157)	(28,257)
	-	-

Investments in associates are part of a Program of investments in equity of companies - small and medium sized entrepreneurs. HBOR has a significant influence in the associated companies through its representative in the Supervisory Board. The investments are stated using the equity method, according to the policy of the Bank.

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15. Investments in associates (continued)

	Line of business	2007 Investments	% ownership in 2007	2006 Investments	% ownership in 2006
		000 kuna		000 kuna	
Lika d.d., Donji Lapac	Production. processing and of meat preservation	2,470	26.04%	2,470	26.04%
Bila boja d.o.o., Grohote	Production of plastic products	1,813	23.65%	1,813	23.65%
THC d.d.. Obrovac	Production of metal products	6,000	38.45%	6,000	38.45%
Tri D Drvo d.o.o., Vrhovine	Wood processing, production of wood products	4,374	26.00%	4,374	26.00%
Kupres d.o.o., Donji Miholjac	Wood processing, production of wood and cork products	-	-	2,100	25.65%
Pounje d.d., Hrvatska Kostajnica	Textile industry - clothes production	6,000	18.36%	6,000	18.36%
Metal-Sint Oklaj d.d., Oklaj	Metal industry sintered products and composed material production	5,500	40.84%	5,500	40.84%
		26,157		28,257	

The investments in Kupres d.o.o., Donji Miholjac, which presented 25.65% of the company's share capital, were disposed of in 2007 with sales price equalling the nominal investment amount of HRK 2,100 thousand.

16. Property, plant and equipment and intangible assets

	Buildings	Computers	Furniture, equipment and vehicles	Construction in progress	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Cost							
At 31 December 2006	49,532	12,099	11,605	274	73,510	10,212	83,722
Additions	-	-	-	3,137	3,137	-	3,137
Transfer from construction in progress	550	994	1,124	(3,241)	(573)	573	-
Disposal	-	(982)	(803)	-	(1,785)	(155)	(1,940)
Transfer from/to	-	-	-	(75)	(75)	75	-
At 31 December 2007	**50,082**	**12,111**	**11,926**	**95**	**74,214**	**10,705**	**84,919**
Accumulated depreciation							
At 31 December 2006	7,969	7,915	8,123	-	24,007	7,606	31,613
Depreciation for 2007	1,509	1,834	1,491	-	4,834	1,347	6,181
Disposals	-	(983)	(789)	-	(1,772)	(155)	(1,927)
At 31 December 2007	**9,478**	**8,766**	**8,825**	**-**	**27,069**	**8,798**	**35,867**
Net book value at 31 December 2007	40,604	3,345	3,101	95	47,145	1,907	49,052
Net book value at 31 December 2006	41,563	4,184	3,482	274	49,503	2,606	52,109

17. Assets for resale

	2007 HRK '000	2006 HRK '000
Assets for resale	50,267	35,431
	50,267	**35,431**

In 2007, HBOR took over assets for resale of HRK 18,673 thousand (2006: HRK 18,513 thousand) comprised of: land in the amount of HRK 837 thousand (2006: HRK 8,749 thousand), buildings in the amount of HRK 15,694 thousand (2006: HRK 7,168 thousand), apartments in the amount of HRK 453 thousand (2006: HRK 2,596 thousand), furniture and vehicles in the amount of HRK 1,516 thousand (2006: HRK 0 thousand) and property, plant and equipment in the amount of HRK 173 thousand (2006: HRK 0 thousand).

In 2007, HBOR sold assets for resale of HRK 3,837 thousand (2006: HRK 1,235 thousand) comprised of: land in the amount of HRK 338 thousand (2006: HRK 0 thousand), buildings in the amount of HRK 2,618 thousand (2006: HRK 584 thousand) and apartments in the amount of HRK 881 thousand (2006: HRK 651 thousand).

18. Other assets, net

	2007 HRK '000	2006 HRK '000
Fees receivable	441	425
Cash in transit	-	297
Other assets	6,515	4,426
	6,956	**5,148**
Provision for impairment losses	(159)	(718)
	6,797	**4,430**

18. Other assets, net (continued)

The movements in the provision for impairment losses on other assets may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Balance as at 1 January	718	202
Provision for impairment losses on other assets	(483)	675
Repayment of off-balance sheet items receivable	(35)	(58)
Provisions brought forward from the off-balance sheet	35	58
Write off	(13)	(10)
Transfer to off balance sheet	(63)	(149)
BALANCE AS OF 31 DECEMBER	159	718

19. Deposits

	2007 HRK '000	2006 HRK '000
Bank deposits	829	1,367
Foreign currency accounts of companies	1,291	1,071
Foreign currency account of the Ministry of Finance of the Republic of Croatia	16,979	15,151
Foreign currency accounts of companies - special purpose	219,786	72,934
Deposits by local authorities and fund organizations	64,572	64,284
Deposits by state institutions	254,952	363,204
Other deposits	141	327
	558,550	518,338

The major portion of the balance of the foreign currency account of the Ministry of Finance of the Republic of Croatia relates to the Guarantee Fund in respect of reinsurance premiums for export insurance operations performed by HBOR for and on behalf of the Republic of Croatia.

A vista deposits by State institutions relate to the Bank's operations carried out in the name of, and on behalf of, the Ministry of Finance of the Republic of Croatia, Ministry of the Economy, Labour and Entrepreneurship, Ministry of the Sea, Tourism, Transport and Development, Ministry of Agriculture, Forestry and Water Management, the Fund for Development and Employment, the Fund for Regional Development, the Environmental Protection and Energetic Efficiency Fund, Vodovod i kanalizacije d.o.o., Split and the Croatian Agency for Small Business ('HAMAG').

HBOR does not pay interest on the above deposits.

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

20. Borrowings

	2007 HRK '000	2006 HRK '000
Balance as of 1 January	3,738,098	4,162,802
New borrowings	924,993	561,355
Repayments	(854,066)	(935,817)
Foreign exchange gains/(losses)	(39,471)	(80,715)
Accrued interest	25,805	30,473
BALANCE AS OF 31 DECEMBER	3,795,359	3,738,098

Interest rates on borrowings ranged from 2% fixed per annum to variable interest rates on the International money market (LIBOR EUR; EURIBOR; LIBOR USD) increased by 0.225 - 1.5 percentage points annually.

The Bank is subject to different contract covenants. As of 31 December 2007, the Bank complied with all the required contract covenants.

21. Bonds payable

	Effective interest rate %	Fair value 2007 HRK '000	Net book value 2007 HRK '000	Fair value 2006 HRK '000	Net book value 2006 HRK '000
Bonds EUR 100 million	5.899	744,307	732,513	767,708	734,508
Bonds EUR 300 million	5.021	2,192,924	2,188,518	2,244,642	2,191,797
Bonds EUR 150 million	4.836	1,068,224	1,097,384	1,105,508	1,100,193
Bonds EUR 250 million	5.076	1,756,566	1,821,174	-	-
Accrued interest		-	173,256	-	123,929
		5,762,021	6,012,845	4,117,858	4,150,427

The book value of bonds includes interest.

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21. Bonds payable (continued)

According to the Agreement dated 28 November 2002 between HBOR and J.P. Morgan Europe Limited (as lead manager), HBOR issued bonds under the EMTN program on 4 December 2002, with a guarantee of the Republic of Croatia in the amount of EUR 100,000 thousand (HRK 732,513 thousand as at 31 December 2007 and HRK 734,508 thousand as at 31 December 2006) and with a maturity period of 10 years and a fixed interest rate of 5.75%. Interest is paid annually, in arrears.

According to the Agreement between HBOR and Deutsche Bank AG London and UBS Limited (as joint lead managers), HBOR issued bonds under the EMTN program on 11 February 2004, with a guarantee of the Republic of Croatia in the amount of EUR 300,000 thousand (HRK 2,188,518 thousand as at 31 December 2007 and HRK 2,191,797 thousand as at 31 December 2006) and with a maturity period of 7 years and a fixed interest rate of 4.875%. Interest is paid annually, in arrears.

According to the Agreement between HBOR and Deutsche Bank AG London (as lead manager), HBOR issued bonds on 11 July 2006 in the amount of EUR 150,000 thousand (HRK 1,097,384 thousand as of 31 December 2007 and HRK 1,100,193 thousand as at 31 December 2006) with a maturity of 10 years and a fixed interest rate of 4.807%. Interest is paid annually, in arrears.

According to the Agreement between HBOR and UBS Investment Bank and Deutsche Bank AG London (as joint lead managers), HBOR issued bonds on 14 June 2007 in the amount of EUR 250.000 thousand (HRK 1,821,174 thousand as of 31 December 2007) with maturity of 10 years and fixed interest rate of 5.0%. Interest is paid annually, in arrears.

22. Other liabilities

	2007 HRK '000	2006 HRK '000
Deferred recognition of interest income	675,714	639,579
Liabilities in respect of subsidized interest	285,247	207,336
Provision for guarantees and commitments	231,564	229,193
Liabilities for preferential financing of housing loans with State support	32,410	32,410
Provisions for other liabilities	12,712	11,019
Accrued salaries	4,605	5,361
Deferred recognition of income from fees for guarantees (notes 5 and 24)	2,306	-
Liabilities to suppliers	2,063	1,189
Liabilities for prepaid receivables	647	380
Liabilities in connection with special purpose funds	-	54,897
Other liabilities	8,650	8,901
	1,255,918	**1,190,265**

Liabilities in respect of subsidised interest represent advances taken in respect of interest subsidies on loans, which are provided to final customers at lower interest in accordance with the following programmes implemented by HBOR for and on behalf of the Republic of Croatia:

- HRK 269,711 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (2006: HRK 192,698 thousand);
- HRK 14,046 thousand in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet (2006: HRK 14,638 thousand).
- HRK 1,284 thousand in respect of the Fund for Regional Development
- HRK 206 thousand in respect of the Environmental Protection and Energy Efficiency Fund (see note 25).

Deferred recognition of interest income of HRK 675,714 thousand (2006: HRK 639,579 thousand) consists of the state subsidies for interest in respect of loans of HRK 175,767 thousand (2006: HRK 176,482 thousand), which are provided and drawn down by final customers at lower interest rates (see Note 2) but have not been in the repayment stage, and of the state subsidies for interest in respect of loans of HRK 499,947 thousand (2006: HRK 463,097 thousand), which are provided and drawn down by final customers at lower interest rates but have already been in the repayment stage (see Note 2).

Provision for guarantees and commitments is the best estimation of the expenditures needed for settling the outstanding liabilities at the balance sheet date and is determined in accordance with IAS 37 - Provisions, Contingent Liabilities and Contingent Assets.

22. Other liabilities (continued)

Out of the total provisions for guarantees and commitments, HRK 29,594 thousand relates to the banks (2006: HRK 22,904 thousand), HRK 81,333 thousand relates to the domestic companies (2006: HRK 74,781 thousand), HRK 104,167 thousand relates to the state-owned companies (2006: HRK 118,220 thousand), HRK 728 thousand relates to the public sector (2006: HRK 354 thousand), HRK 6,882 thousand relates to foreign companies (2006: HRK 1,829 thousand) and HRK 8,860 thousand relates to others (2006: HRK 11,105 thousand).

Movements in the provision for guarantees and commitments may be summarized as follows:

	2007 HRK '000	2006 HRK '000
Balance as of 1 January	229,193	248,392
Provision for guarantees and commitments	4,795	(11,530)
Foreign exchange gains/(losses) on provision for impairment losses, net	(2,424)	(7,669)
PROVISION FOR GUARANTEES AND COMMITMENTS	**231,564**	**229,193**
Balance as of 1 January	11,019	7,004
Provisions for potential losses on other liabilities	1,693	4,015
PROVISIONS FOR OTHER LIABILITIES	**12,712**	**11,019**
BALANCE AS OF 31 DECEMBER	**244,276**	**240,212**

23. Guarantee fund

The guarantee fund in the total amount of HRK 12,985 thousand and HRK 11,018 thousand as of 31 December 2007 and 2006 respectively, relates to funds of the guarantee fund from Deutsche Investitions- und Entwicklungsgesellschaft (DEG) in respect of a financial contribution (granted funds) for the account of the German Government, which are used for covering contingent losses on guarantees issued for loans granted for financing business start-ups in Croatia.

24. Guarantees and commitments

In order to meet the financial needs of customers, the Bank enters into various commitments and contingent liabilities. Even though these obligations may not be recognised on the balance sheet, they do contain credit risk and are therefore part of the overall risk of the Bank.

	2007 HRK '000	2006 HRK '000
Guarantees issued in HRK	691	1,270
Guarantees issued in foreign currency	2,311,044	2,214,749
Issued bills of exchange	31,105	21,118
Open letters of credit in foreign currency	88,934	69,040
Undrawn loans	1,815,862	1,152,931
EIF - subscribed, not called up capital	29,301	-
Deferred recognition of income from fees for guarantees (notes 5 and 22)	(2,306)	-
	4,274,631	3,459,108
Provisions for guarantees and commitments	(231,564)	(229,193)
	4,043,067	**3,229,915**

Guarantees and letters of credit are mainly guaranteed by the Government of the Republic of Croatia.

Contingent liabilities

Letters of credit, guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods and other purposes specified in the contracts with the customers. Guarantees and standby letters of credit carry the same credit risk as loans.

Undrawn commitments to lend

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contractual amounts do not necessarily represent future cash requirements.

However, the potential credit risk is less than the total unused commitments since most commitments to extend credit are contingent upon customers meeting of terms and conditions. The Bank monitors the term to maturity of credit commitments because long-term commitments generally have a greater degree of credit risk than short-term commitments.

25. Managed funds - Agency business

The Bank manages funds on behalf of and for the account of the Ministry of Finance, Ministry of the Economy, Labour and Entrepreneurship, Ministry of the Sea, Tourism, Transport and Development, Ministry of Agriculture, Forestry and Water Management, the Fund for Development and Employment, the Fund for Regional Development, the Environmental Protection and Energy Efficiency Fund, Vodovod i kanalizacije d.o.o., Split and the Croatian Agency for Small Businesses ("HAMAG"), which are largely used for various reconstruction and development programmes. These assets are separated from the Bank's assets. The income and expense relating to these transactions are credited to the owner, and the Bank does not have any other liabilities. The Bank charges a fee for part of the services and part of the services are performed free of charge depending on the mandate contract and taking into account that the stated amounts are insignificant for the Bank.

Agency business funds per individual programmes amount to:

Programme	2007	2006
	HRK '000	HRK '000
Fish processing	-	12,971
Development and reconstruction of rural housing	95,624	100,681
Employment of former soldiers	470,187	451,260
Emergency Reconstruction Project (loan IBRD 3760 - HR)	438	2,980
Loans to companies having difficulties - MF funds	70,676	68,663
Loans to companies having difficulties - HZZ funds	1,222	2,232
Municipal Environmental Infrastructure Investment Program - MEIP	683,298	633,298
Collection of receivables under HAMAG guarantees	297	289
Insurance of export transactions	166,055	130,633
Programme of Preferential Financing through HBOR's Loan Programmes	269,711	192,698
Program for Development and Employment - loans	298,107	291,034
Program for Regional Development of the Republic of Croatia - loans	26,596	24,178
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy, Labour and Entrepreneurship	40,717	17,549
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Sea, Tourism, Transport and Development	28,939	17,463
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture, Forestry and Water Management	31,434	20,869
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy, Labour and Entrepreneurship - interest subsidy	1,442	781
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Sea, Tourism, Transport and Development - interest subsidy	2,743	2,741
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture, Forestry and Water Management - interest subsidy	9,861	11,116
Renewable Energy Resources Project	2,880	3,069
VIK - EKO account A - dedicated water charge	308,048	-
VIK - EKO account B - VAT	66,162	-
Energy efficiency projects - UNDP	2,991	-
Fund for Regional Development - interest subsidy	1,284	-
The Environmental Protection and Energy Efficiency Fund - interest subsidy	206	-
	2,578,918	**1,984,505**

26. Related-party transactions

Related parties are companies that directly or indirectly, through one or more intermediaries, control, or are controlled by, the reporting company.

The majority of related party transactions relate to the transactions with the Republic of Croatia, the 100% owner of the Bank.

All transactions stated were performed under usual banking market conditions.

As of 31 December 2007 and 31 December 2006, balances arising from transactions with related parties, including the Bank's Managing Board and Directors, include the following:

	2007	2006
	HRK '000	HRK '000
Loans to other customers, net		
Members of the Managing Board and Directors	1,322	2,245
Associates	24	48
Owner	456,972	489,979
Government funds, executive authorities and agencies	317,424	365,104
State-owned companies	1,902,204	2,086,590
Assets held to maturity		
Government funds and agencies	39,161	75,925
Assets available for sale		
Owner	164,118	210,425
Other assets, net		
Owner	9	-
Government funds, executive authorities and agencies	506	471
TOTAL ASSETS	**2,881,740**	**3,230,787**
LIABILITIES PER DEPOSITS		
Owner	214,087	343,828
Government funds, executive authorities and agencies	51,451	33,606
State-owned companies	209,388	55,067
Other liabilities		
Owner	303,311	225,957
Government funds, executive authorities and agencies	14,252	14,638
TOTAL LIABILITIES	**792,489**	**673,096**
Guarantees received		
Owner	3,735,647	4,525,913
Government funds, executive authorities and agencies	214,048	130,061

26. Related-party transactions (continued)

As of 31 December 2007 and 31 December 2006, transactions with related parties comprised:

	2007 HRK '000	2006 HRK '000
INTEREST INCOME		
Members of the Managing Board and Directors	55	98
Associates	6,673	2,107
Owner	44,488	51,654
Government funds, executive authorities and agencies	24,646	30,053
State-owned companies	133,006	129,989
IMPAIRMENT LOSS AND PROVISIONS		
Members of the Managing Board and Directors	9	1
Associates	22,849	(1,170)
Owner	333	3,094
Government funds, executive authorities and agencies	513	1,230
State-owned companies	24,503	(49,766)
SALARIES AND BONUSES		
Members of the Managing Board and Directors	(6,260)	(5,754)

	2007 HRK '000	2006 HRK '000
UNDRAWN LOANS		
State-owned companies	-	73,344
LETTERS OF CREDIT AND ISSUED GUARANTEES		
State-owned companies	2,039,932	2,150,865

Salaries and bonuses include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, jubilee awards, as well as other benefits considered Managing Board and Executives' remuneration.

Remuneration for the work of the members of the Supervisory Board amounted to HRK 399 thousand (2006: HRK 356 thousand) and relates to the HBOR Supervisory Board member eligible for remuneration and members of supervisory boards at associates who were appointed by HBOR.

27. Risk management

27.1. Introduction

Based on the Act on the Croatian Bank for Reconstruction and Development, the Bank is obliged to mitigate business risks directed by the principles of banking operations.

In the process of risk management, the Bank continuously measures, estimates and manages the risks to which it is exposed in the course of business. The criteria, mode and measurement methods, as well as evaluation and risk management are prescribed by the general acts of the Bank. The Bank manages credit, market and operating risks using policies, procedures, limits, committees and controls on a daily basis.

Risk management structure

The Supervisory Board is responsible for monitoring the appropriateness and effectiveness of the risk management process in the Bank.

The Managing Board of the Bank is responsible for establishing and implementing an effective and reliable risk management system. The Managing Board establishes acts, procedures and instructions which regulate all areas of business and risk management. For the purpose of accomplishing their function, the Managing Board delegated their authority to three risk management committees.

Risk management boards

- Assets and liabilities management committee - manages market risks (liquidity risk, interest rate risk and currency risk) within the framework of the prescribed policies and procedures for assets and liabilities management.
- Credit risk evaluation and measurement committee - manages credit risks within the framework set through credit policies, risk management procedures and other internal acts that involve the issues related to credit risk.
- Liquidity committee - manages daily and short term liquidity which includes daily monitoring and planning of liquidity, ensuring the availability of funds necessary for regular operations and placement of temporarily available funds.

Risk Management unit

The Bank formed a functionally and organizationally separate organizational unit for the control of business risks which is directly responsible to the Managing Board. The Risk Management unit is responsible for identification, measurement, supervision and control of all risks the Bank is exposed to.
The Risk Management unit performs its role by evaluation and measurement of the Bank's exposure to credit and non-credit risks, development of risk-related procedures and methodology, recommendation of exposure limits, evaluation of the quality of the loan portfolio, reporting to the Managing Board and other boards and committees on risks etc. The risk management strategy is directed towards preparation for applying advanced methods of calculation of capital demands for risks according to "Basel II" recommendations, separately for each risk area, accepting recommendations and secondary legislation of the Croatian National Bank and good banking practices.

27. Risk management (continued)

27.1. Introduction (continued)

Control and Audit

Control and audit is organized as a separate organizational unit, functionally and organizationally independent from the activities subject to its audit and other organizational units of HBOR. The Control and Audit unit is responsible to the Managing Board, Supervisory Board and Audit Committee. The Control and Audit unit verifies the application and efficiency of the procedures and methodologies for risk management. Their role is achieved through testing of the risk management system for risks resulting from business activities of the Bank according to the principles of operational stability, including managing IT resources and other associated technologies.

Risk measurement and reporting systems

For risk measurement and monitoring, the Bank uses various measurement methods based on historical data, business plans, market conditions and the specific characteristics of the Bank as a special financial institution. For risk monitoring and control, a system of limits is introduced for the management of credit risk and market risks. Liquidity and open currency positions are monitored on a daily basis, based on which reports are generated and delivered to the members of the Liquidity committee and to the organizational units' directors. The Credit risk evaluation and measurement committee determines the risk level of the loan portfolio and monitors the appropriateness of the level of provisions on a monthly basis, which is recorded in minutes.

The Bank monitors liquidity risk and interest rate risk by way of scenario analyses, preparing worst-case scenarios and scenarios of variation of certain parameters in a model. An analysis of the credit portfolio risk is reported semi-annually to the Managing Board. High exposures are reported to the Managing Board and the Supervisory Board through quarterly reports. Credit risk management limits are determined quarterly and communicated to the Managing Board and organizational units where credit risk is generated and monitored. Quarterly reports on capital adequacy and other various reports related to the monitoring of risk exposure are prepared. Systems of pro-active risk management are developed for the purpose of minimizing future risks in time before exposure. Reports on the collection of high risk placements and actions of intense monitoring and collection from clients in difficulties are prepared and reported to the Managing Board on a quarterly basis. Annual reports on monitoring clients based on analyses of financial reports, movements between risk groups and undertaken activities are prepared. Based on the Internal audit proposals, the Managing Board decides on corrective measures to be taken in the risk management process.

For reporting purposes, the Bank relies on historical data, their statistics and regular checks of prescribed quantitative estimation and measurement models with the intention of developing consistency in risk management.

Risk mitigation

The Bank, as a special financial institution, is not profit-oriented and therefore does not trade in derivatives. Derivatives can be used only for hedging of the Bank's positions.

27. Risk management (continued)

27.2. Credit risk

Credit risk encompasses loss derived from full or partial default, i.e. an untimely discharge of a financial obligation by the client.

The Bank controls credit risk by way of credit policies and prescribed procedures which determine internal control systems aiming to act preventively.

The Bank's Managing Board leads a conservative credit risk policy. The Credit risk management system forms a crucial part of the Bank's business policy and it is an important strategic factor, and therefore this area is regulated by separate Credit risk management procedures, applied in all phases of the process (from the process of development of new bank products or from the credit application until the final repayment).

Credit risk management procedures are included in a comprehensive document comprised of separate methodologies aimed at the evaluation of different targeted groups of clients:

- Credit risk evaluation methodology which encompasses collateral valuation methodology,
- Credit scoring methodology,
- Methodology for evaluation and selection of banks,
- Methodology for evaluation and selection of foreign banks.

In the case of direct clients, the Bank uses the Credit risk evaluation methodology to determine credit risk exposure (for loans over HRK 700 thousand) or the Credit scoring methodology (for loans below HRK 700 thousand). The Credit scoring methodology was developed in cooperation with USAID and thereby the estimation and measurement of credit risks that belong to the "small portfolio" is advanced, containing three scoring models: placements up to HRK 200 thousand, placements from HRK 200 thousand to HRK 700 thousand to companies and placements from HRK 200 thousand to HRK 700 thousand to all other entrepreneurs.

The Bank controls related party risk upon credit approval by requesting the clients to list their related parties. The information thereby gathered is verified and the type of relationship is defined and analyzed as to whether improvement or worsening of economic and financial conditions of one related party can influence the economic or financial position of the other related party.

Subjective and objective analyses of clients are separated and control systems are embedded in the procedures. The Bank, as a developmental financial institution, supports growth and development of the Croatian economy through investment construction. For this reason, the clients mainly approach the Bank with applications for credit financing of investment projects. In order to minimize risk and objectively estimate which projects project development as well as a return on investment, the Bank is constantly improving existing organizational and technical solutions, proposals of organization regulations and implementation instructions, technology and process organization, reports and acts.

By continuous monitoring and evaluation of the clients' businesses, the Bank makes an effort to identify difficulties in their operation on a timely basis. For clients with difficulties, the Banks tries to find appropriate ways to collect receivables by considering the possibilities of alternative repayment terms with a view to continue the production process and employment increase.

27. Risk management (continued)

27.2. Credit risk (continued)

Special emphasis is placed on identifying and monitoring reasons for bad debts, and procedures for prevention are built in operational procedures with a view to decreasing the share of high risk placements of the Bank.

In the last two years the Bank's existing acts for evaluation and measurement as well as monitoring of credit risk were updated and changed in accordance with organizational changes, implementing measures and monitoring currency-induced credit risk, government grants, development of credit scoring methodology, methodology for evaluation and selection of foreign banks and development of exposure limits and sub-limits towards banks.

Concentration of risk and highest credit risk exposure

The table below shows the highest gross credit risk exposures according to positions in the Balance sheet and in Guarantees and commitments, before considering collateral received:

	Gross highest exposure 2007	Gross highest exposure 2006
	HRK '000	HRK '000
Assets		
Cash on hand and due from banks, net	24,656	19,858
Deposits with other banks, net	584,630	405,118
Loans to banks, net	10,523,533	7,898,957
Loans to other customers, net	5,932,731	6,209,913
Assets held to maturity	39,161	75,925
Assets available for sale	191,220	225,847
Other assets, net	5,186	3,157
Total	**17,301,117**	**14,838,775**
Guarantees and commitments		
Issued guarantees in domestic currency	683	1,257
Issued guarantees in foreign currency	2,180,479	2,119,660
Issued bills of exchange	30,794	20,907
Open letters of credit in foreign currency	85,954	45,013
Undrawn loans	1,715,856	1,043,078
EIF - subscribed, not called up capital	29,301	-
Total	**4,043,067**	**3,229,915**
Total credit risk exposure	**21,344,184**	**18,068,690**

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

The Bank, with its developmental loan programmes, covers the entire Republic of Croatia with a special emphasis on special concern areas. Credit risk is diversified across geographical areas and developmental credit programmes. Through development of new loan programmes (products), the Bank takes into account concentration of credit risk with a view to evenly develop all areas of the Republic of Croatia.

Through financing of different sectors by stimulating production and development with the purpose of developing the Croatian economy, the Bank is creating a better base for repayment of loans and minimization of risk.

As of 31 December 2007, the highest credit exposure to one debtor was HRK 1,369,484 thousand (31 December 2006: HRK 1,086,821 thousand) after considering received collateral, as the client is included in the risk group "A", i.e. the client is a first class debtor. Collateral policy is disclosed in note 27.2.

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before considering collateral received:

2007	Republic of Croatia	EU countries	Other countries	Total
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and due from banks, net	8,314	1,975	14,367	24,656
Deposits with other banks, net	95,059	489,571	-	584,630
Loans to banks, net	10,483,266	-	40,267	10,523,533
Loans to other customers, net	5,835,953	-	96,778	5,932,731
Assets held to maturity	39,161	-	-	39,161
Assets available for sale	178,876	12,344	-	191,220
Other assets, net	5,183	3	-	5,186
Total	**16,645,812**	**503,893**	**151,412**	**17,301,117**
Guarantees and commitments				
Issued guarantees in domestic currency	683	-	-	683
Issued guarantees in foreign currency	2,180,479	-	-	2,180,479
Issued bills of exchange	-	30,794	-	30,794
Open letters of credit in foreign currency	85,954	-	-	85,954
Undrawn loans	1,545,420	-	170,436	1,715,856
EIF - subscribed, not called up capital	-	29,301	-	29,301
Total	**3,812,536**	**60,095**	**170,436**	**4,043,067**
Total credit risk exposure	**20,458,348**	**563,988**	**321,848**	**21,344,184**

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before considering collateral received (continued):

2006	Republic of Croatia	EU countries	Other countries	Total
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and due from banks, net	7,112	10,849	1,897	19,858
Deposits with other banks, net	225,471	179,647	-	405,118
Loans to banks, net	7,841,617	-	57,340	7,898,957
Loans to other customers, net	6,189,968	-	19,945	6,209,913
Assets held to maturity	75,925	-	-	75,925
Assets available for sale	225,829	18	-	225,847
Other assets, net	3,150	7	-	3,157
Total	**14,569,072**	**190,521**	**79,182**	**14,838,775**
Guarantees and commitments				
Issued guarantees in domestic currency	1,257	-	-	1,257
Issued guarantees in foreign currency	2,119,660	-	-	2,119,660
Issued bills of exchange	-	20,907	-	20,907
Open letters of credit in foreign currency	45,013	-	-	45,013
Undrawn loans	862,027	-	181,051	1,043,078
Total	**3,027,957**	**20,907**	**181,051**	**3,229,915**
Total credit risk exposure	**17,597,029**	**211,428**	**260,233**	**18,068,690**

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, before and after considering collateral received:

	Gross highest exposure	Net highest exposure	Gross highest exposure	Net highest exposure
	2007 HRK '000	2007 HRK '000	2006 HRK '000	2006 HRK '000
Financial intermediation	12,138,610	39,715	8,834,656	76,788
Shipbuilding	2,635,806	276,746	3,128,643	526,389
Tourism	996,974	33,321	963,885	73,446
Water and electric supply and other infrastructure	1,895,873	1,412,621	1,776,648	1,377,390
Agriculture and food industry	631,742	164,922	623,988	169,969
Other industry	475,587	47,895	545,155	37,604
Private household with employees	316,508	37,036	218,169	12,808
Construction industry	445,590	252,846	315,234	276
Leather and textile industry	86,323	15,391	92,324	16,003
Health	19,244	-	24,026	-
Transport, warehousing and connections	956,215	16,543	992,822	17,084
Other	745,712	597,719	553,140	420,812
Total credit risk exposure	**21,344,184**	**2,894,755**	**18,068,690**	**2,728,569**

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

The fair value of collateral in 2007 was HRK 18,449,429 thousand (2006: HRK 15,340,121 thousand), however in the total net highest exposure in 2007, the credit risk in the amount of HRK 2,243,895 thousand (2006: HRK 2,374,566 thousand) is not covered with ordinary collaterals, but it relates to receivables and received funds from the Republic of Croatia in the amount of HRK 649,032 thousand (2006: HRK 685,704 thousand), from local (regional) authorities in the amount of HRK 131,329 thousand (2006: HRK 91,532 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally in the amount of HRK 320,120 thousand (2006: HRK 365,893 thousand), government fund in the amount of HRK 7,698 thousand (2006: HRK 12,950 thousand), government bonds in the amount of 164,118 thousand (2006: HRK 210,424 thousand), corporate bonds in the amount of HRK 14,620 thousand (2006: HRK 15,267 thousand) and government agency bonds in the amount of HRK 39,161 thousand (2006: HRK 75,925 thousand). In addition, an amount of HRK 917,817 thousand (2006: HRK 916,871 thousand) relates to receivables from the state-owned company.

Part of the placements with net exposure relates to placements provisionally and partially covered with collateral and further increase in exposure has been stopped pending the submission of the full collateral necessary for compliance with the requested collateral coverage ratio.

Financial intermediation includes mainly commercial banks, the operation and collateral quality for placements with commercial banks is described further in note 27.2 under Collateral for placements with commercial banks.

For the year 2007 (All amounts are expressed in HRK thousand)

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

Credit risk exposure by internal credit rating:

Internal credit rating	Historical default rate (%)	Total 2007	Total 2006
		000 kuna	000 kuna
A	0.82	19,213,293	16,852,900
B	7.24	2,130,697	1,215,596
C	55.11	194	194
Total		**21,344,184**	**18,068,690**

Internal methodology is not comparable with rating agencies' methodology, and the stated credit ratings are not comparable with the ratings of world recognized rating agencies.

Internal methodology for estimation of credit risk

For the evaluation of various target groups of clients, the Bank has prescribed internal methodologies. They represent the basis for decisions on approval of loans, guarantees and letters of credit and determination of the amount of provision for potential losses.

The methodology for evaluation of credit ratings is applied for the evaluation of credit risk for direct placements to companies over HRK 700,000. It comprises two main evaluation areas: client evaluation and project/investment evaluation and the combination of these two evaluations. All evaluation areas consist of three basic parts: financial, non financial analyses and correction of evaluation through currency-induced credit risk (VIKR). Clients are classified in 10 ranks depending on the number of points gained through the criteria of the client's creditworthiness, evaluation of project criteria and exposure to VIKR criteria.

Methodologies of credit scoring are used during credit risk evaluation for all direct placements below HRK 700 thousand where the Bank is exposed to credit risk. Credit scoring is a process where pre-defined subjective and objective client criteria are scored. The final result of scoring determines whether the client is acceptable for credit placement. The quality and value of collateral for the placement are a part of the credit scoring procedure. The Methodology for evaluation and selection of banks and the Methodology for evaluation and selection of foreign banks are used for evaluation of domestic and foreign banks. The methodologies include the estimation of the financial risk (quantitative evaluation), the estimation of business risks for analyzed banks (qualitative evaluation) and the estimation of reputation risk.

The result of application of the methodologies for the evaluation of banks is the internal rating of the bank which is transformed into a risk assessment.

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

Estimation of credit risk according to the internal credit rating (continued):

Impairment loss and provisions

The Bank forms provisions for identified losses in accordance with CNB regulations and its own procedures and methodologies. Forming provisions is under the jurisdiction of the Credit risk evaluation and measurement committee.

Provisioning on an individual basis

Provisioning on an individual basis represents impairment of partly recoverable and irrecoverable investments (risk groups "B" and "C"). Allocation of debtors on an individual basis into risk groups is performed by objective and subjective criteria and quality of collateral. By objective criteria, receivables are allocated according to the debtors' regularity of repayment upon maturity. Exceptionally, receivables from debtors from the small credits portfolio are allocated only by objective criteria.

According to the subjective criteria, receivables are allocated by creditworthiness of the debtor which is estimated based on: character of debtor (status, economic and financial as well as personal characteristics), the debtor's capital, liquidity, profitability, the strength of the debtor's assets and general conditions of business and perspective of his activity.

The Bank does not determine the present value of discounted cash flows for partially recoverable placements where the expected inflow is expected within one year from the financial statements date.

Provisioning on the collective basis

Provisions on a collective basis are formed for fully recoverable placements or placements and commitments allocated in risk group "A". Allocation of debtors within the risk group is performed according to credit worthiness, industry risk factor, geographical area, type and the debtor's foreign currency alignment. Investments 80% or more covered with first class collateral are allocated in risk group "A".

The Managing Board of HBOR believes that the policies and procedures of forming provisions are adequate and that they ensure sufficient provisions for potential losses.

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

The table below shows the book value of rescheduled loans:

	Total 2007	Total 2006
	HRK '000	HRK '000
Loans to banks and other customers	24,022	26,900
Total	**24,022**	**26,900**

27. Risk management (continued)

27.2. Credit risk (continued)

Credit risk quality according to type of financial assets

Credit risk analysis before and after considering the collateral received according to type of financial assets on positions of assets and guarantees and commitments by internal system of credit rating:

2007	Gross exposure of portfolio of risk group A	Gross exposure of portfolio of risk group B	Gross exposure of portfolio of risk group C	Gross exposure of total portfolio	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and due from banks, net	24,656	-	-	24,656	-	-	-	-
Deposits with other banks, net	584,630	-	-	584,630	-	-	-	-
Loans to banks, net	9,928,561	594,972	-	10,523,533	-	554	-	554
Loans to other customers, net	5,045,666	886,871	194	5,932,731	2,057,321	91,384	194	2,148,899
Assets held to maturity	39,161	-	-	39,161	39,161	-	-	39,161
Assets available for sale	191,220	-	-	191,220	178,738	-	-	178,738
Other assets, net	5,159	27	-	5,186	1,166	27	-	1,193
Total	**15,819,053**	**1,481,870**	**194**	**17,301,117**	**2,276,386**	**91,965**	**194**	**2,368,545**
Guarantees and commitments								
Issued guarantees in domestic currency	683	-	-	683	-	-	-	-
Issued guarantees in foreign currency	1,861,513	318,966	-	2,180,479	100	221,497	-	221,597
Issued bills of exchange	30,794	-	-	30,794	-	-	-	-
Open letters of credit in foreign currency	83,341	2,613	-	85,954	-	2,613	-	2,613
Undrawn loans	1,388,608	327,248	-	1,715,856	163,775	138,225	-	302,000
EIF - subscribed, not called up capital	29,301	-	-	29,301	-	-	-	-
Total	**3,394,240**	**648,827**	**-**	**4,043,067**	**163,875**	**362,335**	**-**	**526,210**
Total credit risk exposure								
	19,213,293	**2,130,697**	**194**	**21,344,184**	**2,440,261**	**454,300**	**194**	**2,894,755**

27. Risk management (continued)

27.2. Credit risk (continued)

In the total net highest exposure the amount of loans to other customers in the amount of HRK 2,025,996 thousand is not covered by ordinary collaterals, but it relates to receivables and received funds from the Republic of Croatia in the amount of HRK 649,032 thousand, local (regional) authorities in the amount of HRK 131,329 thousand, public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally in the amount of HRK 320,120 thousand and the government fund in the amount of HRK 7,698 thousand. An additional amount of HRK 917,817 thousand relates to receivables from a majority (51%) state-owned companies. The amount of assets held to maturity is not covered by ordinary collateral but it relates to government agency bonds.

The amount of assets available for sale is not covered by ordinary collateral but it relates to government bonds in of HRK 164,118 thousand and corporate bonds of HRK 14,620 thousand.

27. Risk management (continued)

27.2. Credit risk (continued)

Credit risk quality according to type of financial asset (continued)

Credit risk analyses before and after considering the collateral received according to type of financial assets on positions of assets and guarantees and commitments by internal system of credit rating (continued):

2006	Gross exposure of portfolio of risk group A	Gross exposure of portfolio of risk group B	Gross exposure of portfolio of risk group C	Gross exposure of total portfolio	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and due from banks, net	19,858	-	-	19,858	-	-	-	-
Deposits with other banks, net	405,118	-	-	405,118	-	-	-	-
Loans to banks, net	7,689,861	209,096	-	7,898,957	-	863	-	863
Loans to other customers, net	5,462,621	747,105	187	6,209,913	2,163,495	113,562	187	2,277,244
Assets held to maturity	75,925	-	-	75,925	75,925	-	-	75,925
Assets available for sale	225,847	-	-	225,847	225,691	-	-	225,691
Other assets, net	3,131	19	7	3,157	636	19	7	662
Total	**13,882,361**	**956,220**	**194**	**14,838,775**	**2,465,747**	**114,444**	**194**	**2,580,385**
Guarantees and commitments								
Issued guarantees in domestic currency	1,257	-	-	1,257	-	-	-	-
Issued guarantees in foreign currency	2,016,615	103,045	-	2,119,660	-	21,259	-	21,259
Issued bills of exchange	20,907	-	-	20,907	-	-	-	-
Open letters of credit in foreign currency	15,842	29,171	-	45,013	-	29,171	-	29,171
Undrawn loans	915,918	127,160	-	1,043,078	83,829	13,925	-	97,754
Total	**2,970,539**	**259,376**	**-**	**3,229,915**	**83,829**	**64,355**	**-**	**148,184**
Total credit risk exposure	**16,852,900**	**1,215,596**	**194**	**18,068,690**	**2,549,576**	**178,799**	**194**	**2,728,569**

In total net highest exposure in 2006 the amount of loans to other customers in the amount of HRK 2,072,950 thousand is not covered by ordinary collaterals, but it relates to receivables and received funds from the Republic of Croatia in the amount of HRK 685,704 thousand, local (regional) authorities in the amount of HRK 91,532 thousand, public companies for whose commitments the Republic of Croatia

27. Risk management (continued)

27.2. Credit risk (continued)

guarantees jointly and unconditionally in the amount of HRK 365,893 thousand and the government fund in the amount of HRK 12,950 thousand. An additional amount of HRK 916,871 thousand relates to receivables from a majority (51%) state-owned company.

The amount of assets held to maturity is not covered by ordinary insurance instruments but it relates to government agency bonds.

Amount of assets available for sale is not covered by ordinary insurance instruments but it relates to government bonds in the amount of HRK 210,424 thousand and corporate bonds in the amount of HRK 15,267 thousand.

Credit risk quality according to type of financial asset (continued)

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments according to the internal credit risk system:

2007	Gross exposure neither past due nor impaired	Gross exposure past due not impaired	Gross exposure individually impaired	Total
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and due from banks, net	24,656	-	-	24,656
Deposits with other banks, net	584,630	-	-	584,630
Loans to banks, net	9,868,816	59,745	594,972	10,523,533
Loans to other customers, net	4,953,860	91,806	887,065	5,932,731
Assets held to maturity	39,161	-	-	39,161
Assets available for sale	191,220	-	-	191,220
Other assets, net	5,158	1	27	5,186
Total	**15,667,501**	**151,552**	**1,482,064**	**17,301,117**
Guarantees and commitments				
Issued guarantees in domestic currency	683	-	-	683
Issued guarantees in foreign currency	1,861,513	-	318,966	2,180,479
Issued bills of exchange	30,794	-	-	30,794
Open letters of credit in foreign currency	83,341	-	2,613	85,954
Undrawn loans	1,388,608	-	327,248	1,715,856
EIF - subscribed, not called up capital	29,301	-	-	29,301
Total	**3,394,240**	**-**	**648,827**	**4,043,067**
Total credit risk exposure	**19,061,741**	**151,552**	**2,130,891**	**21,344,184**

27. Risk management (continued)

27.2. Credit risk (continued)

Credit risk quality according to type of financial asset (continued)

Credit risk quality due to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments according to the internal credit risk system (continued):

2006	Gross exposure neither past due nor impaired	Gross exposure past due not impaired	Gross exposure individually impaired	Total
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and due from banks, net	19,858	-	-	19,858
Deposits with other banks, net	405,118	-	-	405,118
Loans to banks, net	7,647,059	42,802	209,096	7,898,957
Loans to other customers, net	5,403,406	59,215	747,292	6,209,913
Assets held to maturity	75,925	-	-	75,925
Assets available for sale	225,847	-	-	225,847
Other assets, net	2,703	428	26	3,157
Total	**13,779,916**	**102,445**	**956,414**	**14,838,775**
Guarantees and commitments				
Issued guarantees in domestic currency	1,257	-	-	1,257
Issued guarantees in foreign currency	2,016,615	-	103,045	2,119,660
Issued bills of exchange	20,907	-	-	20,907
Open letters of credit in foreign currency	15,842	-	29,171	45,013
Undrawn loans	915,918	-	127,160	1,043,078
Total	**2,970,539**	**-**	**259,376**	**3,229,915**
Total credit risk exposure	**16,750,455**	**102,445**	**1,215,790**	**18,068,690**

27. Risk management (continued)

27.2. Credit risk (continued)

Credit risk quality according to type of financial asset (continued)

Aging analysis of past due but not impaired loans per class of financial asset:

	Up to 2 days 2007	3 to 45 days 2007	46 to 90 days 2007	Over 90 days 2007	Total 2007	Up to 2 days 2006	3 to 45 days 2006	46 to 90 days 2006	Over 90 days 2006	Total 2006
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets										
Loans to banks, net	29,894	29,661	46	144	59,745	42,457	180	74	91	42,802
Loans to other customers, net	90,747	753	122	184	91,806	58,172	617	224	202	59,215
Other assets, net	-	1	-	-	1	407	10	8	3	428
Total	**120,641**	**30,415**	**168**	**328**	**151,552**	**101,036**	**807**	**306**	**296**	**102,445**

From total due and not impaired loans to banks in 2007, an amount of HRK 28,660 thousand or 48% relates to approved but not executed prolongations of revolving loans within the export credit financing programme.

From total due and not impaired loans to others in 2007, an amount of HRK 90,747 thousand or 99% relates to delays of two days. Part of these receivables of HRK 41,412 thousand or 45% is covered by guarantees of the Republic of Croatia, and receivables of HRK 45,843 thousand or 50% of stated receivables were collected until 16 January 2008.

From total due and not impaired loans to banks in 2006, an amount of HRK 42,457 thousand or 99% related to delays of two days and mostly because 31 December 2006 was a non-working day (Sunday).

From the total amount of due and not impaired loans to others, HRK 58,172 thousand or 98% relates to delays of two days. Receivables of HRK 36,581 thousand or 62% are covered by guarantees from the Republic of Croatia.

27. Risk management (continued)

27.2. Credit risk (continued)

Collateral and other instruments

Collateral for the Bank's placements are:

1. obligatory (bills of exchange and promissory notes),
2. ordinary (property, ships, airplanes, bank guarantees, guarantees from the Republic of Croatia, guarantees from the local and regional authorities, guarantees from HAMAG (Croatian Agency for Small Business), insurance policy from political and/or commercial risks), and
3. other collateral (movable property, bills of exchange or guarantees from other companies with solid creditworthiness, fiduciary or pledge of securities or shares in companies, repossession of cash receivables or assignment for collectible receivables, deposit repossession, restriction of transferability on insurance policy of assets and/or person, pledge on a trademark, etc.).

All Bank placements have to be secured with obligatory collateral. The Bank secures placements by property transfer or mortgage (super-mortgage) on real estates/movables.

Standard and other collaterals are classified according to quality in five groups. The evaluation of collateral is based on quality, estimated based on marketability, documentation and possibility of supervision by the Bank as well as the possibility of enforced collection. Only the acceptable collateral is evaluated while the sixth group of collateral is unacceptable.

When deciding on loan approval, weak creditworthiness cannot be replaced by quality collateral, except when the insurance instruments are first class instruments: guarantees from the Republic of Croatia, guarantees of local/regional authorities (JLS), guarantees from HAMAG, insurance policy for political and/or commercial risks, guarantees from banks with first class rating and when the Republic of Croatia, JLS or other government bodies guarantee for clients implicitly (through legal acts).

Collateral for placements with commercial banks

For the purpose of mitigation of credit risk and reduction of business costs, and in compliance with the Act on the Croatian Bank for Reconstruction and Development, the Bank approves part of its placements with commercial banks. As collateral for placements approved to final customers through commercial banks, the Bank uses mandatory collateral from commercial banks. The commercial bank is obliged to deliver them based on the Mutual business cooperation agreement, but not for each individual placement to the final customer based on that Agreement. In the individual contracts for placements to the final customers, the use of obligatory collateral delivered with the Agreement on mutual business cooperation is contracted. As the commercial bank takes on the risk of default by the final customer, it is given the option to contract sufficient collateral with the final customer.

Where the loan approved through a commercial bank is higher than HRK 700 thousand, depending on the commercial bank's internal rating, the Bank contracts a super-mortgage. In this case, either the commercial bank transfers the ownership over the collateral, while the Bank takes a mortgage over the same collateral, or the commercial bank forms a mortgage on the collateral, while the Bank takes a super-mortgage on the same collateral.

27. Risk management (continued)

27.2. Credit risk (continued)

Collateral and other instruments (continued)

Collateral for placements with commercial banks (continued)

By signing the Agreement on mutual business cooperation, a transfer of any claims the commercial bank may have towards the final customer is made to HBOR. Pursuant to the Agreement, the commercial bank authorises HBOR to unilaterally inform the bank in written form that, in the case of the commercial bank's insolvency or threat of liquidation, untimely repayments or default on the commitments agreed in the individual contract on interbank loan or actual (insolvent or regular) liquidation, the Bank assumes the receivable towards the final customer from the commercial bank, with the effect of an assignment of receivables in the place of contract fulfilment.

Additionally, based on the Agreement on mutual business cooperation and based on the said unilateral statement, the commercial bank authorises HBOR to transfer ownership over all collateral that the bank had agreed with the final customer on the particular placement, without having to obtain any additional approvals or permissions from the bank.

From the moment of the assignment, the final customer is further obliged to make all payments related to the assigned receivable directly to HBOR. Should the commercial bank receive any payments in the name of collection of receivables per particular placement, the bank is obliged to immediately transfer the funds to HBOR.

Collateral for direct placements

All direct placements are mainly secured with a mortgage over real estate and, if that is possible, the Bank obtains as security against credit risk a guarantee from HAMAG, a guarantee from the local (regional) authority, a guarantee from the Republic of Croatia, etc.

The Bank has the right to review the appraisal of the collateral value and such a confirmed appraisal is considered as the final collateral value.

Depending on the type of collateral, the credit programme, the general terms of insurance or the decision of an authorised body, the Bank has determined the necessary ratio of placements and collaterals.

For real estate, the necessary ratio between the amount of placement and the appraised value of the real estate is 1:1.5 except for investments in areas of special concern, where the ratio is 1:1.3. For movable property, the necessary ratio between the amount of placement and the appraised value of the movable is 1:2.

The insured amount for insurance policies against political and/or commercial risks should cover at least 80% of the principal of the placement.

27. Risk management (continued)

27.2. Credit risk (continued)

Collateral and other instruments (continued)

Collateral for placements with commercial banks (continued)

The Bank continuously monitors the value of the collateral and has formed a special organizational unit for:

- appraisal and confirmation of already appraised offered collateral (real estate and movables),
- technical and technological analysis of investment projects, and
- supervision over the withdrawal of loan funds for the purpose of the construction of the investment project.

In the event that it is not possible for the Bank to collect from regular operations, the Bank starts collection from the collateral at its disposal. This encompasses initiating collection from the obligatory collateral, and then from the mortgage or fiduciary ownership of the real estate or movable property, including their repossession with a view to decreasing or fully settling the Bank's receivables. The Bank does not use repossessed assets for business purposes.

27. Risk management (continued)

27.3. Liquidity risk

Liquidity risk is a risk of financial loss which occurs if the Bank is unable to solve their due liabilities.

The basic principles for managing the Bank's liquidity are defined by the existing internal manuals (Liquidity risk manual, Short term operations manual, Liquidity committee manual) and decisions from the Supervisory Board, the Managing Board, the Assets and liabilities committee and the Liquidity committee.

In order to manage liquidity risk, the Bank maintains the necessary level of liquidity reserve, continuously monitors current liquidity, ensures sufficient HRK and foreign currency funds necessary for timely settlement of liabilities and for special purpose disbursements of approved loans. The current surplus of available funds is invested in highly liquid state securities, short term loans (to domestic banks and the state) and deposits with first class domestic and foreign banks.

Due to contracted clauses with special financial institutions, the Bank holds liquid assets of 10% of net assets.

The Bank manages liquidity risk through monitoring of daily, weekly, monthly, annual and multi-annual cash flow compatibility. Plans of inflow and outflow of liquidity are made on an annual basis. The realization of plans is monitored on a monthly basis. Managing short term liquidity encompasses monitoring and managing daily liquidity, and planning liquidity for the current and the next four weeks, which is performed weekly (on the first day of the week).

Under short term liquidity, daily and five-weekly incompatibility of cash flow is monitored as well as the compliance with the liquidity management limit. Liquid assets consist of: cash on hand and deposits with domestic and foreign banks, placements and loans to financial and state institutions with the maturity of up to 90 days, highly liquid government bonds and marketable securities.

With long term liquidity, the Bank monitors the compatibility of sources and placements according to maturity and ability to finance long term assets with a maximum maturity compatibility with sources.

The Bank monitors liquidity risk through scenario analysis. Scenarios are made for cases of regular operations, unfavorable market terms and changes in the Bank's business. Projections of movements of certain parameters in the model are used in stress tests.

The Bank has prescribed liquidity management limits in operations with commercial banks

27. Risk management (continued)

27.3. Liquidity risk

The table below provides the analysis of the Bank's assets and liabilities as of 31 December 2007 placed into relevant maturity groupings based on the remaining period as at the balance sheet date related to the contractual maturity date as follows:

2007	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks, net	24,660	-	-	-	-	24,660
Deposits with other banks, net	554,776	29,854	-	-	-	584,630
Loans to banks, net	830,887	1,033,000	1,748,564	1,964,865	4,946,217	10,523,533
Loans to other customers, net	160,258	277,666	735,920	1,462,302	3,296,585	5,932,731
Assets held to maturity	-	340	38,821	-	-	39,161
Assets available for sale	188,619	2,601	-	-	-	191,220
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	49,052	49,052
Assets for resale	-	-	16,806	28,716	4,745	50,267
Other assets, net	5,908	574	247	68	-	6,797
TOTAL ASSETS (1)	**1,765,108**	**1,344,035**	**2,540,358**	**3,455,951**	**8,296,599**	**17,402,051**
LIABILITIES						
Deposits	557,866	23	287	374	-	558,550
Borrowings	26,739	60,054	1,917,929	1,117,350	673,287	3,795,359
Bonds payable	-	173,256	146,503	293,005	5,400,081	6,012,845
Other liabilities	374,044	44,298	192,035	309,384	336,157	1,255,918
TOTAL LIABILITIES	**958,649**	**277,631**	**2,256,754**	**1,720,113**	**6,409,525**	**11,622,672**
EQUITY						
Founder's capital	-	-	-	-	4,389,737	4,389,737
Retained earnings and reserves	-	-	-	-	1,137,611	1,137,611
Other reserves	-	-	-	-	(1,869)	(1,869)
Net profit for the year	-	-	-	-	240,915	240,915
TOTAL EQUITY	**-**	**-**	**-**	**-**	**5,766,394**	**5,766,394**
Guarantee fund	-	-	-	-	12,985	12,985
TOTAL EQUITY AND GUARANTEE FUND	**-**	**-**	**-**	**-**	**5,779,379**	**5,779,379**
TOTAL LIABILITIES, TOTAL EQUITY AND GUARANTEE FUND (2)	**958,649**	**277,631**	**2,256,754**	**1,720,113**	**12,188,904**	**17,402,051**
NET ASSETS/LIABILITIES (1) - (2)	**806,459**	**1,066,404**	**283,604**	**1,735,838**	**(3,892,305)**	**-**
CUMULATIVE ASSETS/LIABILITIES, NET	**806,459**	**1,872,863**	**2,156,467**	**3,892,305**	**-**	**-**

* Receivables of HRK 1,112,823 thousand relate to reverse repo transactions. The maturity of the part of receivables was prolonged after the balance sheet date, and an amount of HRK 655,146 thousand was placed in the 1 up to 3 months maturity category.

27. Risk management (continued)

27.3. Liquidity risk (continued)

The table below provides the analysis of the Bank's assets and liabilities as of 31 December 2006 placed into relevant maturity groupings based on the remaining period as at the balance sheet date related to the contractual maturity date as follows (continued):

2006	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks, net	19,862	-	-	-	-	19,862
Deposits with other banks, net	405,118	-	-	-	-	405,118
Loans to banks, net	564,750	497,358	1,567,016	2,296,586	2,973,247	7,898,957
Loans to other customers, net	121,836	204,545	844,700	1,606,900	3,431,932	6,209,913
Assets held to maturity	-	659	36,339	38,927	-	75,925
Assets available for sale	222,549	3,298	-	-	-	225,847
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	52,109	52,109
Assets for resale	593	5,557	25,170	3,995	116	35,431
Other assets, net	3,825	329	276	-	-	4,430
TOTAL ASSETS (1)	**1,338,533**	**711,746**	**2,473,501**	**3,946,408**	**6,457,404**	**14,927,592**
LIABILITIES						
Deposits	517,403	64	136	665	70	518,338
Borrowings	106,555	49,917	709,024	2,255,373	617,229	3,738,098
Bonds payable	-	95,354	28,572	293,804	3,732,697	4,150,427
Other liabilities	313,178	78,067	193,907	291,475	313,638	1,190,265
TOTAL LIABILITIES	**937,136**	**223,402**	**931,639**	**2,841,317**	**4,663,634**	**9,597,128**
EQUITY						
Founder's capital	-	-	-	-	4,174,737	4,174,737
Retained earnings and reserves	-	-	-	-	957,296	957,296
Other reserves	-	-	-	-	7,098	7,098
Net profit for the year	-	-	-	-	180,315	180,315
TOTAL EQUITY	**-**	**-**	**-**	**-**	**5,319,446**	**5,319,446**
Guarantee fund	-	-	-	-	11,018	11,018
TOTAL EQUITY AND GUARANTEE FUND	**-**	**-**	**-**	**-**	**5,330,464**	**5,330,464**
TOTAL LIABILITIES, TOTAL EQUITY AND GUARANTEE FUND (2)	**937,136**	**223,402**	**931,639**	**2,841,317**	**9,994,098**	**14,927,592**
NET ASSETS/LIABILITIES (1) - (2)	**401,397**	**488,344**	**1,541,862**	**1,105,091**	**(3,536,694)**	**-**
CUMULATIVE ASSETS/LIABILITIES, NET	**401,397**	**889,741**	**2,431,603**	**3,536,694**	**-**	**-**

*Receivables of HRK 503,924 thousand relate to reverse repo transactions. The maturity of part of the receivables was prolonged after the balance sheet date and an amount of HRK 290,865 thousand was placed in the 1 up to 3 months maturity category.

27. Risk management (continued)

27.3. Liquidity risk (continued)

The table below provides the analysis of the Bank's undiscounted financial liabilities placed into the relevant maturity groupings based on the remaining period as at the balance sheet date related to the contractual maturity date:

2007	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
FINANCIAL LIABILITIES						
Deposits	557,866	23	287	374	-	558,550
Borrowings	27,473	46,985	2,054,149	1,254,777	718,154	4,101,538
Bonds payable	-	107,130	333,004	854,997	6,384,703	7,679,834
Other liabilities	374,045	44,299	192,038	309,385	336,157	1,255,924
TOTAL	**959,384**	**198,437**	**2,579,478**	**2,419,533**	**7,439,014**	**13,595,846**
2006						
FINANCIAL LIABILITIES						
Deposits	517,403	64	136	665	70	518,338
Borrowings	106,638	45,288	820,035	2,366,722	653,541	3,992,224
Bonds payable	-	107,422	95,196	690,592	4,263,027	5,156,237
Other liabilities	313,178	78,068	193,912	291,481	313,638	1,190,277
TOTAL	**937,219**	**230,842**	**1,109,279**	**3,349,460**	**5,230,276**	**10,857,076**

27. Risk management (continued)

27.4. Market risk

The Bank ensures quality market risk management through the Board for assets and liabilities management. Market risk management implies the reduction of interest rate risk, currency risk and liquidity risk to a minimal level. All organizational units are included in the Board's operations in order to ensure an integrated and comprehensive Risk management system.

The Bank uses a technique of changing one or more risk factors for market risk management and monitors the potential effect of certain events on the financial position. This technique is used throughout scenario analysis and sensitivity analysis in both a stressed and regular business environment.

27.4.1. Interest rate risk

Interest rate risk is the financial risk that occurs due to interest rate mismatching of the value and maturity of interest-sensitive assets, liabilities and off balance sheet positions.

The Board for assets and liabilities management manages interest rate risk in the way that it monitors the matching of interest rates of assets and liabilities. Depending on the level of the interest gap, the type of interest rates on future borrowings as well as on future placements is determined in order to reduce the gap to the lowest possible level. From the funds that bear a certain types of interest rate, loans with the same interest rate increased by a margin are approved. In this way the Bank reduces its market movement sensitivity as well as its sensitivity to reference interest rates. Furthermore, current market conditions and movements in forecasted market indicators are also monitored.

The Bank performs an interest gap analysis as a way of measuring and monitoring the interest rate risk. An interest gap is made for certain periods, depending on the possibility of changes in interest rates (fixed and floating), and displays the Bank's sensitivity to the changes of interest rates. Detailed elaboration of interest rates per currency, type and value of interest rate is also made.

HBOR does not have financial instruments held for trading in its portfolio.

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest rate risk (continued)

The following tables demonstrate the sensitivity of HBOR to a reasonable possible change in interest rates as of 31 December 2007 and 2006 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter.

Assets and liabilities on which interest rates are not charged are placed into the non interest bearing category.

The tables below demonstrate the estimation of HBOR´s interest rate risk exposure as of 31 December 2007 and 2006 which may not be indicative for the positions in other periods. In case of a significant increase of interest rates in the market, HBOR is entitled to change interest rates on the loans to banks and other debtors.

2007	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non interest bearing	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS							
ASSETS	-	-	-	-	-	24,660	24,660
Cash on hand and due from banks, net	554,725	29,691	-	-	-	214	584,630
Deposits with other banks, net	824,494	1,798,787	1,731,734	1,801,388	4,340,527	26,603	10,523,533
Loans to banks, net	121,441	521,589	2,184,833	1,015,411	2,041,166	48,291	5,932,731
Loans to other customers, net	-	-	38,821	-	-	340	39,161
Assets held to maturity	-	-	7,485	23,736	157,398	2,601	191,220
Assets available for sale	-	-	-	-	-	-	-
Investments in associates	-	-	-	-	-	49,052	49,052
Property, plant and equipment and intangible assets	-	-	-	-	-	50,267	50,267
Assets for resale	-	-	-	-	-	6,797	6,797
Total assets (1)	**1,500,660**	**2,350,067**	**3,962,873**	**2,840,535**	**6,539,091**	**208,825**	**17,402,051**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest rate risk (continued)

2007	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non interest bearing	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
LIABILITIES							
Deposits	52	23	287	374	-	557,814	558,550
Borrowings	26,738	1,278,301	2,129,219	187,338	147,958	25,805	3,795,359
Bonds payable	-	-	146,503	293,005	5,400,081	173,256	6,012,845
Other liabilities	-	-	-	-	-	1,255,918	1,255,918
TOTAL LIABILITIES	**26,790**	**1,278,324**	**2,276,009**	**480,717**	**5,548,039**	**2,012,793**	**11,622,672**
EQUITY							
Share capital	-	-	-	-	-	4,389,737	4,389,737
Retained earnings and reserves	-	-	-	-	-	1,137,611	1,137,611
Other reserves	-	-	-	-	-	(1,869)	(1,869)
Net profit for the year	-	-	-	-	-	240,915	240,915
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**5,766,394**	**5,766,394**
Guarantee fund	-	-	-	-	-	12,985	12,985
TOTAL EQUITY AND GUARANTEE FUND	**-**	**-**	**-**	**-**	**-**	**5,779,379**	**5,779,379**
TOTAL LIABILITIES, TOTAL EQUITY AND GUARANTEE FUND (2)	**26,790**	**1,278,324**	**2,276,009**	**480,717**	**5,548,039**	**7,792,172**	**17,402,051**
NET ASSETS/ LIABILITIES (1) - (2)	**1,473,870**	**1,071,743**	**1,686,864**	**2,359,818**	**991,052**	**(7,583,347)**	**-**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest rate risk (continued)

2006	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non interest bearing	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS							
Cash on hand and due from banks, net	-	-	-	-	-	19,862	19,862
Deposits with other banks, net	405,118	-	-	-	-	-	405,118
Loans to banks, net	554,053	1,195,896	1,578,415	2,161,066	2,387,481	22,046	7,898,957
Loans to other customers, net	100,300	709,355	2,253,608	933,253	2,163,605	49,792	6,209,913
Assets held to maturity	-	-	36,339	38,927	-	659	75,925
Assets available for sale	-	-	36,505	7,695	178,349	3,298	225,847
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	52,109	52,109
Assets for resale	-	-	-	-	-	35,431	35,431
Other assets, net	-	-	-	-	-	4,430	4,430
TOTAL ASSETS (1)	**1,059,471**	**1,905,251**	**3,904,867**	**3,140,941**	**4,729,435**	**187,627**	**14,927,592**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest rate risk (continued)

2006	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non interest bearing	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
LIABILITIES							
Deposits	22	64	136	665	70	517,381	518,338
Borrowings	215,711	52,703	3,040,100	211,429	187,682	30,473	3,738,098
Bonds payable	-	-	-	293,804	3,732,694	123,929	4,150,427
Other liabilities	-	-	-	-	-	1,190,265	1,190,265
TOTAL LIABILITIES	**215,733**	**52,767**	**3,040,236**	**505,898**	**3,920,446**	**1,862,048**	**9,597,128**
EQUITY							
Share capital	-	-	-	-	-	4,174,737	4,174,737
Retained earnings and reserves	-	-	-	-	-	957,296	957,296
Other reserves	-	-	-	-	-	7,098	7,098
Net profit for the year	-	-	-	-	-	180,315	180,315
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**5,319,446**	**5,319,446**
Guarantee fund	-	-	-	-	-	11,018	11,018
TOTAL EQUITY AND GUARANTEE FUND	**-**	**-**	**-**	**-**	**-**	**5,330,464**	**5,330,464**
TOTAL LIABILITIES, TOTAL EQUITY AND GUARANTEE FUND (2)	**215,733**	**52,767**	**3,040,236**	**505,898**	**3,920,446**	**7,192,512**	**14,927,592**
NET ASSETS/ LIABILITIES (1) - (2)	**843,738**	**1,852,484**	**864,631**	**2,635,043**	**808,989**	**(7,004,885)**	**-**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest rate risk (continued)

Sensitivity analysis

Assumptions used in preparing the interest risk sensitivity analysis relate to changes in basis points (b.p.) in relation to higher or lower movements in reference interest rates than expected in order to assess the hypothetical effect on HBOR's profit and equity.

Volatility of 22% for 2007 (2006: 13%) on the daily changes of the interest rates linked to EUR has been determined using standard deviation method. Based on such determined volatility used in the sensitive analysis for 2007, hypothetical impact of the changes of the interest rate linked to EUR by 25 basis points (2006: 15 basis points) has been analyzed.

Volatility of 49% for 2007 (2006: 16%) on the daily changes of the interest rates linked to USD has been determined using standard deviation method. Based on such determined volatility used in the sensitive analysis for 2007, hypothetical impact of the changes of the interest rate linked to USD by 50 basis points (2006: 20 basis points) has been analyzed.

The analysis presents the sensitivity of interest rates to reasonably expected changes in basis points. All other variables remain constant.

The sensitivity of profit is influenced by hypothetical changes in interest rates during a period of one year based on interest bearing assets and liabilities with a variable interest rate

Currency	Increase in b,p, in 2007	Effect on profit and equity in 2007	Increase in b,p, in 2006	Effect on profit and equity in 2006
		HRK' 000		HRK' 000
EUR	+25	(341)	+15	429
USD	+50	65	+20	(6)

Currency	Decrease in b,p, in 2007	Effect on profit and equity in 2007	Decrease in b,p, in 2006	Effect on profit and equity in 2006
		HRK' 000		HRK' 000
EUR	-25	341	-15	(429)
USD	-50	(65)	-20	6

27. Risk management (continued)

27.4. Market risk (continued)

27.4.2. Currency risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Bank assesses currency risk exposure by monitoring foreign currency positions.

The Bank uses a methodology proscribed by the Croatian National Bank, a simple value calculation method and adjusted delta method when assessing currency risk exposure. A report on open foreign currency positions is generated on a daily basis. The total open foreign currency position of the Bank (including options) is the combination of the sum of all other long positions and the sum of all short positions in each currency, depending which of the two sums is higher. In addition, the Bank monitors currency risk through proscribed limits and through asset and liability currency compatibility.

Most of HBOR's loan placements include currency clauses which represents a means of currency risk protection.

27. Risk management (continued)

27.4. Market risk (continued)

27.4.2. Currency risk (continued)

Total assets and liabilities as of 31 December 2007 and 31 December 2006 in HRK and foreign currencies can be shown as follows:

2007	USD	EUR	Other foreign currency	Total foreign currency	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks, net	661	6,313	9,382	16,356	8,304	24,660
Deposits with other banks, net	158,897	396,093	-	554,990	29,640	584,630
Loans to banks, net	29,777	5,980,808	-	6,010,585	4,512,948	10,523,533
Loans to other customers, net	279,755	2,993,713	-	3,273,468	2,659,263	5,932,731
Assets held to maturity	-	39,161	-	39,161	-	39,161
Assets available for sale	-	159,328	-	159,328	31,892	191,220
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	49,052	49,052
Assets for resale	-	-	-	-	50,267	50,267
Other assets, net	-	3	-	3	6,794	6,797
Total assets (1)	**469,090**	**9,575,419**	**9,382**	**10,053,891**	**7,348,160***	**17,402,051**
LIABILITIES						
Deposits	161,740	67,767	9,519	239,026	319,524	558,550
Borrowings	202,276	3,593,083	-	3,795,359	-	3,795,359
Bonds payable	-	6,012,845	-	6,012,845	-	6,012,845
Other liabilities	27,396	89,816	-	117,212	1,138,706	1,255,918
Total liabilities	**391,412**	**9,763,511**	**9,519**	**10,164,442**	**1,458,230**	**11,622,672**
EQUITY						
Share capital	-	-	-	-	4,389,737	4,389,737
Retained earnings and reserves	-	-	-	-	1,137,611	1,137,611
Other reserves	-	-	-	-	(1,869)	(1,869)
Net profit for the year	-	-	-	-	240,915	240,915
Total equity	**-**	**-**	**-**	**-**	**5,766,394**	**5,766,394**
Guarantee fund	-	12,985	-	12,985	-	12,985
Total equity and guarantee fund	**-**	**12,985**	**-**	**12,985**	**5,766,394**	**5,779,379**
Total liabilities, total equity and guarantee fund (2)	**391,412**	**9,776,496**	**9,519**	**10,177,427**	**7,224,624**	**17,402,051**
Net assets/liabilities (1) - (2)	**77,678**	**(201,077)**	**(137)**	**(123,536)**	**123,536**	**-**

*Amounts linked to a to one-way currency clause represent HRK 3,421,200 thousand,

27. Risk management (continued)
27.4. Market risk (continued)
27.4.2. Currency risk (continued)

Total assets and liabilities as of 31 December 2007 and 31 December 2006 in HRK and foreign currencies can be shown as follows (continued):

2006	USD	EUR	Other foreign currency	Total foreign currency	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks, net	1,104	9,923	2,019	13,046	6,816	19,862
Deposits with other banks, net	-	405,118	-	405,118	-	405,118
Loans to banks, net	42,351	3,623,106	-	3,665,457	4,233,500	7,898,957
Loans to other customers, net	581,422	2,451,602	-	3,033,024	3,176,889	6,209,913
Assets held to maturity	-	75,925	-	75,925	-	75,925
Assets available for sale	-	192,926	-	192,926	32,921	225,847
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	52,109	52,109
Assets for resale	-	-	-	-	35,431	35,431
Other assets, net	-	7	-	7	4,423	4,430
Total assets (1)	**624,877**	**6,758,607**	**2,019**	**7,385,503**	**7,542,089***	**14,927,592**
LIABILITIES						
Deposits	55,274	35,524	52	90,850	427,488	518,338
Borrowings	452,933	3,285,165	-	3,738,098	-	3,738,098
Bonds payable	-	4,150,427	-	4,150,427	-	4,150,427
Other liabilities	79,583	18,718	285	98,586	1,091,679	1,190,265
Total liabilities	**587,790**	**7,489,834**	**337**	**8,077,961**	**1,519,167**	**9,597,128**
EQUITY						
Share capital	-	-	-	-	4,174,737	4,174,737
Retained earnings and reserves	-	-	-	-	957,296	957,296
Other reserves	-	-	-	-	7,098	7,098
Net profit for the year	-	-	-	-	180,315	180,315
Total equity	**-**	**-**	**-**	**-**	**5,319,446**	**5,319,446**
Guarantee fund	-	11,018	-	11,018	-	11,018
Total equity and guarantee fund	**-**	**11,018**	**-**	**11,018**	**5,319,446**	**5,330,464**
Total liabilities, total equity and guarantee fund (2)	**587,790**	**7,500,852**	**337**	**8,088,979**	**6,838,613**	**14,927,592**
Net assets/liabilities (1) - (2)	**37,087**	**(742,245)**	**1,682**	**(703,476)**	**703,476**	**-**

*Amounts linked to a one-way currency clause represent HRK 4,484,211 thousand.

27. Risk management (continued)
27.4. Market risk (continued)
27.4.2. Currency risk (continued)

Sensitivity analysis was performed for the foreign currency risk which HBOR was exposed to on the reporting date.

Assumptions used in preparing the foreign currency risk sensitivity analysis relate to movements in exchange rates in respect to movements of EUR/HRK and USD/HRK exchange rates, higher or lower than the actual rates, in order to assess the hypothetical effect on HBOR's profit and equity during a period of one year.

Volatility of 1.8% for 2007 (2006: 2.03%) on the monthly changes of the foreign exchange rate EUR/HRK have been determined using standard deviation method. Based on such determined volatility and asset liability ratio in EUR as stated in note 27.4.2. within sensitive analysis in 2007, rate of increase of 4% (2006: 5%) have been applied.

Volatility of 5.39% for 2007 (2006: 7.66%) on the monthly changes of the foreign exchange rate USD/HRK have been determined using standard deviation method. Based on such determined volatility and asset liability ratio in USD as stated in note 27.4.2. within sensitive analysis in 2007, rate of increase of 7% (2006: 8%) have been applied.

The effect of the assumed changes in assets and liabilities in EUR and USD currency with two-way currency clauses is stated below. The effect and treatment of one-way currency clauses was described within Note 2.

Currency	Change in currency rate in % 2007	Effect on profit and equity in	Change in currency rate in % 2006	Effect on profit and equity in
		HRK' 000		HRK' 000
EUR	+4	(7,944)	+5	(37,518)
USD	+7	5,497	+8	2,985

27.5. Operational risk

Operational risk is the risk of loss arising from system failure, human errors or external events.

The Bank seeks to minimize operational risk by implementing controls in operating procedures and by building a unique and comprehensive IT system. The Bank applies the guidelines of Basel II and good IT system managing practice. In order to reduce its exposure to operational risk that is present in day-to-day operations, the Bank constantly educates its employees, monitors the frequency of errors and implements controls for the prevention of errors.

28. Capital management

The primary objectives of the Bank's capital management are to ensure the presumptions of going concern and to respect regulatory and contracted demands imposed by creditors regarding a certain capital adequacy level.

The Bank has identified liable capital as a manageable capital category.

Liable capital has to be, at every moment, at least at the level of share capital or at the level that ensures that the capital adequacy ratio is at least 10%, and that is sufficient for covering capital requirements regarding business risks.

Liable capital consists of main capital (Tier 1) and additional capital (Tier 2), and is calculated in accordance with bank regulations in the Republic of Croatia.

The Bank has determined measures for the implementation and monitoring of the capital management policy as follows:

- At the reporting date, liable capital has to be at least at the level of founder's capital for the reporting period.
- The capital adequacy ratio at the reporting date has to be at the level prescribed for the banks in the Republic of Croatia as well as at the level stated within regular financial covenants determined in loan contracts and contracts with special financial institutions that HBOR has concluded as a borrower.

The calculation of the capital adequacy rate is performed in line with the regulations prescribed for the banks in the Republic of Croatia and does not differ from international banking practice.

Notes to the financial statements (continued)
For the year 2007 (All amounts are expressed in HRK thousand)

	2007	2006
	HRK '000	HRK '000
Core capital - Tier 1	5,768,263	5,312,348
Supplementary capital - Tier 2	184,429	134,172
Total liable capital	**5,952,692**	**5,446,520**
Risk weighted asset	6,425,218	5,361,433
Capital requirements for currency risk	3,377,499	3,235,319
Total capital requirements	**9,802,717**	**8,596,752**
	%	%
Capital ratio (Tier 1)	58.84	61.79
Capital adequacy ratio	60.73	63.36
	000 kuna	000 kuna
Liable capital needed for ensuring capital adequacy according to regulatory requirements	**980,272**	**859,675**

The minimum capital adequacy ratio determined for banks in the republic - 10%

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