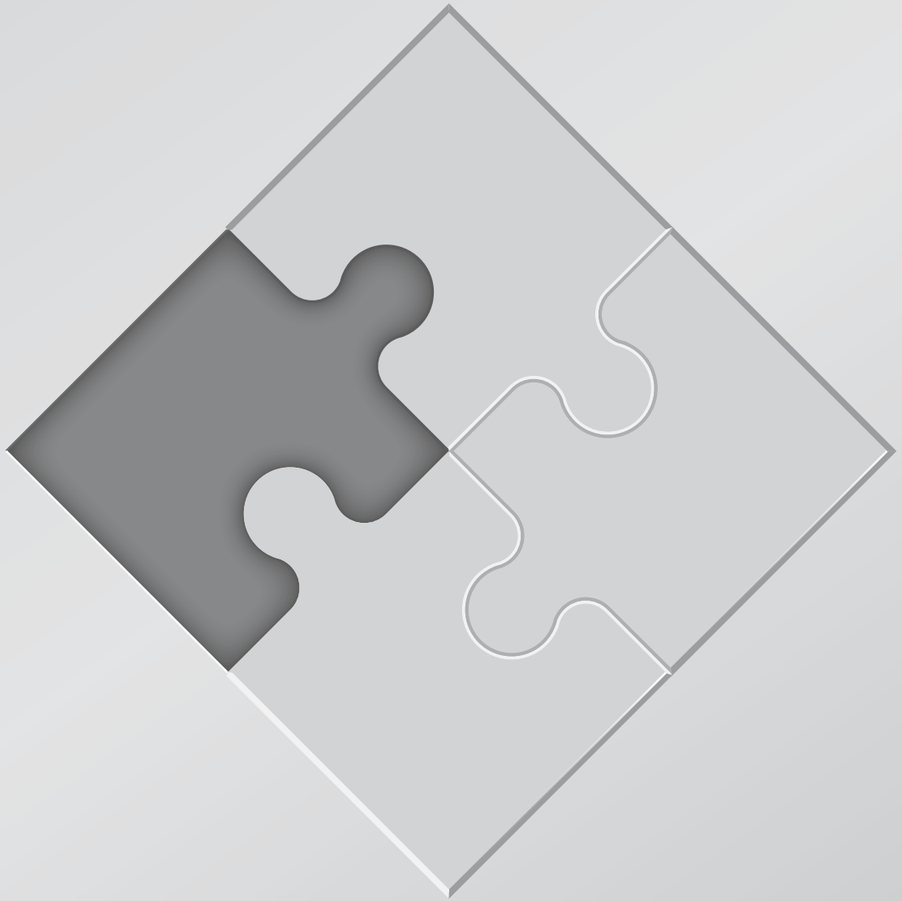
ANNUAL REPORT **2008**




SEA
WIND
PEOPLE
HIGHWAYS
RIVERS
HBOR

Highlights in 2008:

HRK billion in assets

HRK billion in insured exports

increase in the amount of loans committed for export promotion

HRK billion committed to small and medium-sized enterprises

HRK billion in support of the Croatian economy

Croatia
is a country of
great **potentials.**
We preserve our natural
beauties and cultural tradition and
simultaneously encourage social and
economic development of all areas of
the Republic of Croatia.
Potentials create ideas,
ideas create
success.

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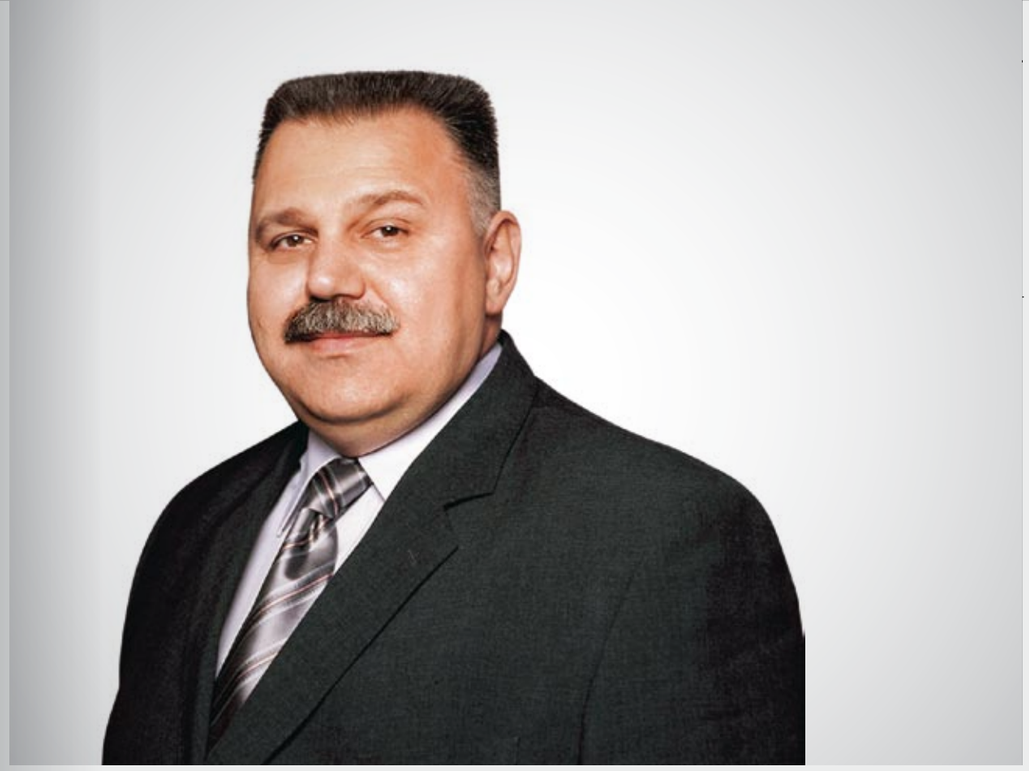


Ladies and Gentlemen,

2008 was marked by the world financial crisis, inflation pressures, a slowdown in economic growth, and significant fluctuations in the oil and other raw materials markets. The Republic of Croatia has confronted the escalation of the world financial crisis relatively well. However, the unfavourable macroeconomic environment will have the effect of slowing down Croatia's economic growth as a result of weak foreign demand and less favourable borrowing conditions in the international financial market. In such macroeconomic conditions, the fiscal policy will be the pillar of the overall economic policy of the Croatian Government. A key determinant of fiscal policy in the period to come will be the continuation of fiscal consolidation and the achievement of a balanced budget.

Strengthening entrepreneurship and the entrepreneurial climate is a key measure for the further development of the Croatian economy. Hrvatska banka za obnovu i razvitak plays an important role in the attainment of this goal. In 2008, almost HRK 1 billion of loans were committed under special programmes for small and medium enterprises, which is an increase of 23% in comparison with 2007. The total volume of loans committed for small and medium enterprises under all HBOR loan programmes in 2008 exceeded HRK 3 billion. This increased support is extremely important taking into account that the economic crisis has the greatest impact on small businesses, which are key players in overcoming it since they are more able to adjust to changes in the market than large businesses.

In order to enable HBOR to perform its role in 2009, the Croatian Government will endeavour to provide sufficient funds for unhindered lending activity of the Bank under all loan programmes. An agreement has been reached with the European Investment Bank on a loan in the amount of EUR 250 million, the funds of which will be intended primarily for small and medium enterprises. For other segments of the economy, such as agriculture, big businesses and the tourist sector, negotiations are held with the World Bank and other financial institutions.

HBOR, as a development and export bank, provides assistance in the development of a recognisable economy ready for entering the European and world markets. The development strategy of Croatia, particularly concerning its exports, has to be based primarily on innovations and science. What we are trying to achieve is to make Croatia a country of well-educated and professional young people and not a country of a cheap work force. In order to become successful exporters, businesses need comprehensive preparation and analysis, a clear strategy, and support through all stages of this very complex business process. HBOR's support to exporters and their interest in the Bank's programmes was clearly demonstrated in 2008. The most demanded programme was Pre-Export Finance, under which about HRK 3.3 billion were committed. Export credit insurance is another significant segment through which HBOR supports the Croatian economy for and on behalf of the Republic of Croatia. In 2008, the total volume of insured export transactions amounted to HRK 2.1 billion, covering 3% of Croatia's exports.

The development of rural areas and promotion of entrepreneurship in agriculture also have an important role in the economic policy. Croatia is a small country but has good natural predispositions and development potential. In the last four years, HBOR has been participating actively in the implementation of the operational programmes of the Croatian Government and implementing the programmes for financing the development of perennial plants, cattle-breeding, pig-breeding, the production of "kulen", the reconstruction and modernisation of the fishing fleet, vegetable growing and flower growing. This time of crisis may be the right moment for Croatia to enhance agricultural production in order to provide sufficient quantities of food for its own needs and also for export. A balanced regional economic development will also be supported by HBOR's infrastructure investments that enable the additional growth and development of all business entities.

In the circumstances of crisis, we all have to take the responsibility for the economy. In this respect, the government will do everything within its power to mitigate the negative effects of crisis on the economy and the people. The current unfavourable situation should be considered as a chance for restructuring and beginning the creation of a sound basis for strengthening and developing all our potentials.

On behalf of the Supervisory Board of Hrvatska banka za obnovu i razvitak, I would like to express my satisfaction with the successful operations of HBOR in 2008. The Bank has proved once again that it successfully supports Croatian business entities and contributes to the development of the Croatian economy. I would like to thank the members of the Supervisory Board for their co-operation. Finally, I believe that HBOR will continue to record good operating results in the future.

President of the Supervisory Board
Ivan Šuker

Letter of the President of the Managing Board

Ladies and Gentlemen,

2008 was one of the most challenging years in financial terms - the majority of business news had a negative undertone, and the word "crisis" was heard everywhere. It was not easy to operate in the times of limited availability of financial funds; nevertheless, Hrvatska banka za obnovu i razvitak achieved good business results.

During the reporting year, the demand for HBOR funds was significantly higher than in the previous year. For the first time, the Bank committed more than 1,000 loans in one business year, providing more than HRK 6.5 billion of loans to Croatian business entities.

Almost HRK 4 billion, i.e. more than 60% of loans in 2008, were committed for exports, an increase of 15.5% compared to 2007. The most active programme in 2008, as in the last few years, was "Pre-Shipment Export Finance". The significance of this programme for exporters is evidenced by the result that companies that made use of HBOR funds in 2008 showed a 15.6% increase in exports compared to 2007.

Good operating results in 2008 were also achieved in the field of export credit insurance performed by HBOR for and on behalf of the Republic of Croatia. As for short-term insurance, the volume of insured exports amounted to HRK 1.8 billion, an increase of 29% compared to the previous year.

The majority of loans were extended to small and medium enterprises. Under all HBOR programmes for this segment of the economy, 995 loans were extended totalling over HRK 3 billion. The strengthening of agriculture as an important branch of the economy is of extreme importance at the time of Croatia's accession to the EU, particularly in the circumstances of ever-increasing food prices throughout the world. It is therefore encouraging that the largest number of loans was extended under the loan programmes for agriculture and small businesses. In 2008, HRK 172 million in loans were extended for the development of cattle breeding, pig breeding, vegetable growing, the planting of perennial plants, and the modernisation and construction of fishing boats. Great interest was also expressed in the "Micro-loans" programme, under which 73 loans totalling HRK 26 million were extended.

The long-lasting successful cooperation with international financial institutions, such as the European Investment Bank (EIB), the Council of Europe Development Bank (CEB) and the German development bank, KfW, resulted in the signing of loan agreements in June and December 2008. A Global Loan Finance Contract amounting to EUR 60 million was signed with EIB; these funds are intended for financing small and medium enterprises and projects in the field of environmental protection, energy efficiency and infrastructure. A Framework Loan Agreement for EUR 50 million was signed with CEB for SME financing, and a Loan Agreement for EUR 15 million was signed with KfW for financing water supply and wastewater disposal projects.

In January 2008, HBOR became an active member of the European Association of Public Banks (EAPB). We can proudly say that some of HBOR's suggestions were included in EAPB's opinion on the draft Commission Communication relating to the establishment of a framework system of state aid support aiming to facilitate access to finance in the financial crisis. HBOR has recently become a member of the Network of European Financial Institutions for SMEs (NEFI) and is the only member outside the European Union borders. At the beginning of the year, HBOR signed a Co-operation Agreement with the Croatian Chamber for Trades and Crafts (HOK), according to the model of cooperation already established with the Croatian Chamber of the Economy (HGK). Support to crafts and small and medium enterprises is one of the strategic determinants of HBOR operations; our cooperation with HOK, as one of the most significant business associations in Croatia, contributes to our efforts to better inform Croatian small businesses of HBOR loan programmes and all the other forms of support that we can provide. For the seventh year in succession, the Bank organised its International Conference on Export Promotion, this year held for the first time in Split.

Higher capital costs, a more conservative approach to loan granting and more restrictive risk management will shape the operations of banks, including HBOR, in 2009. It will be of extreme importance in the coming period that all participants in the financial and economic sphere exhibit financial discipline and responsible behaviour. However, I believe that, despite the difficult circumstances for business operations, we will be able to provide quality support to the Croatian economy. In 2009, we will continue to strengthen Croatia's export capacities and provide support to small and medium enterprises and to agriculture.

I would like to thank the Prime Minister, the Ministers in the Croatian Government, and the Members of the Croatian Parliament for their support. I would also like to thank the President and the Members of the Supervisory Board for their understanding and support in the achievement of our business results. On behalf of the Managing Board, I would also like to thank all the employees of HBOR for the good results and their achievements in 2008.

President of the Managing Board
Anton Kovačev

ANNUAL REPORT 2008
HBOR

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 2008.

Legal status

The Annual Report includes annual financial statements prepared pursuant to the Accounting Act 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:

31 December 2008	EUR 1 = HRK 7.324425	USD 1 = HRK 5.155504
31 December 2007	EUR 1 = HRK 7.325131	USD 1 = HRK 4.985456

Abbreviations

AZTN Agencija za zaštitu tržišnog natjecanja (Croatian Competition Agency)
DEG Deutsche Investitions-und Entwicklungsgesellschaft
CEB Council of Europe Development Bank
EAPB European Association of Public Banks
EIB European Investment Bank
EIF European Investment Fund
EUR Euro
HAMAG Hrvatska agencija za malo gospodarstvo (Croatian Agency for Small Business)
HBOR Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development)
HNB Hrvatska narodna banka (Croatian National Bank)
HOK Hrvatska obrtnička komora (Croatian Chamber of Trades and Crafts)
KfW Kreditanstalt für Wiederaufbau
HRK Croatian kuna
SME Malo i srednje poduzetništvo (Small and Medium-sized Enterprise)
NEFI Network of European Financial Institutions for SMEs

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,
- Financing projects of environmental protection, energy efficiency and renewable energy resources,
- Export credit insurance of Croatian goods and services against non-market risks.

Audit

The audit of operations for 2008 was conducted by the auditing company Ernst & Young d.o.o., which gave an unqualified opinion.

Credit rating

- A3 by Moody's
- BBB by Standard & Poor's

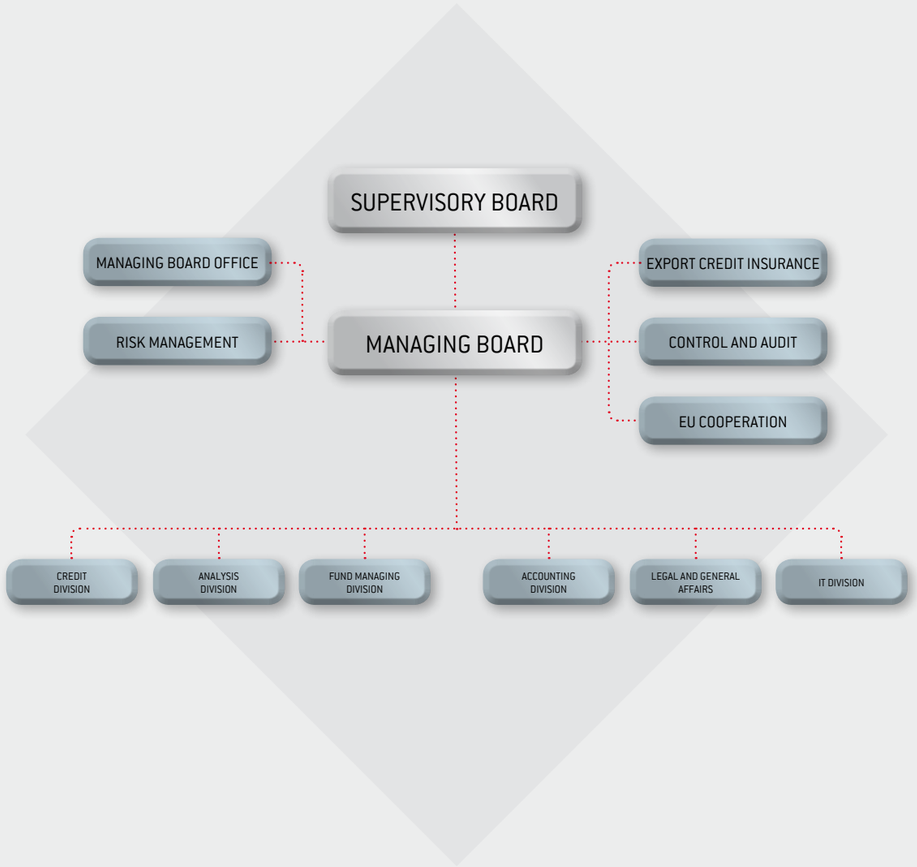
Regional offices

- 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 235 employees in HBOR on 31st December 2008.

Organisational structure of HBOR



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HBOR

SEA.

The preservation of the natural beauties of the Croatian Adriatic Sea and of the traditional values inherent in the Croatian culture and people is a precondition for the sustainable development of tourism, fishing and fishery.

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.

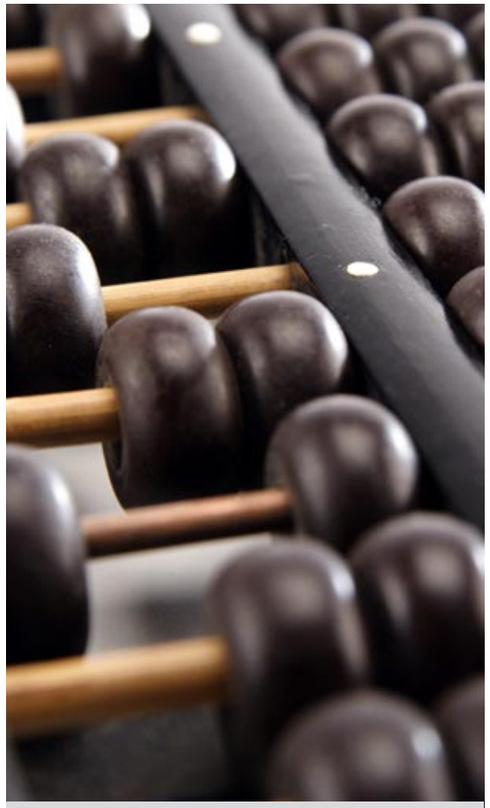
- Powers of the Managing Board: managing and conducting the business of HBOR, adopting normative acts that determine the manner of operations and the internal organisation of HBOR, adopting loan programmes, making individual loan approval decisions and decisions on other financial transactions, making 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 and Credit Risk Assessment and Measurement Committee.

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.



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Business Activities Of HBOR in 2008

Throughout the reporting year, there was an exceptional demand for HBOR money, which is reflected in an increase in both the number and the amount of loans committed. By the end of 2008, altogether 1,163 loans were committed totalling HRK 6 billion 484 million.

Such a significant volume of lending gains in importance in the context of the current adverse macroeconomic environment that has resulted from the world financial crisis and in which it is difficult to gain access to funds in the market and prices are significantly higher. Under such circumstance, especially in the second half of the year, HBOR made its best efforts to provide the funding needed for financing the Croatian economy. Through its 25 loan programmes, HBOR supported investments in projects in the SME sector, exports, agriculture, tourism, infrastructure, environmental protection and energy efficiency.

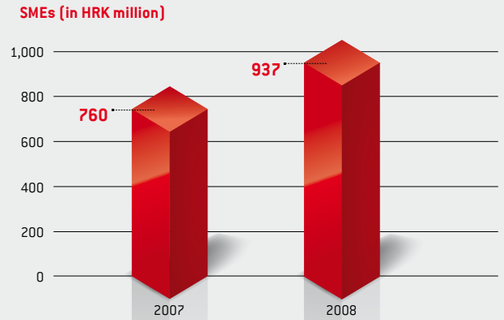
In 2008, HBOR provided the strongest support for Croatian exporters by allocating approximately 60% of its total amount committed to this sector, while the highest number of individual loans was extended to the SME sector. These figures illustrate the orientation of the Bank towards promoting the most significant sectors of the Croatian economy.

Lending activity in 2008

	No.	IN HRK '000
INDUSTRY	92	1,356,564
EXPORTS	480	3,889,445
INFRASTRUCTURE	25	300,670
SMEs	566	936,956
TOTAL	**1,163**	**6,483,635**

Small and Medium Enterprises

The strengthening of the competitiveness of sole proprietors and small and medium-sized enterprises, balanced regional development and new jobs are the key objectives pursued by HBOR through its loan programmes targeted at the SME sector. In 2008, the amount of HRK 937 million was granted under special programmes for small and medium enterprises (12 programmes), an increase of 23% in comparison with 2007. The number of granted loans showed an increase of 24%. If we take into account loans extended to small and medium enterprises under all HBOR programmes in 2008 (25 loan programmes), the total amount exceeds HRK 3 billion.



- increase in amount of committed loans by 23% in comparison with 2007
- increase in number of committed loans by 24%
- In 2008, an amount of more than HRK 3 billion was committed under all programmes for the financing of SMEs

During the reporting year, two new loan programmes were introduced for the purpose of improving the utilisation of EU pre-accession funds. Through the SAPARD Loan Programme, funds were extended to candidate projects that would be nominated for co-financing under the Special Accession Programme for Agriculture and Rural Development (SAPARD); the entire investment value can be financed within the framework of this loan programme. Even before this programme was launched, HBOR had, through its then existing loan programmes, financed investors that applied for funding under the SAPARD programme. Of the 36 projects approved in previous tenders, 15 were financed by HBOR loan funds totalling HRK 225 million, of which 8 through direct financing loan programmes and 7 through on-lending programmes. Through the programme for financing PHARE 2006 projects, HBOR extends funds to small and medium-sized enterprises applying for the PHARE 2006 grant scheme.

In the course of the year, another new loan programme was launched: the Programme for Micro-loans. This programme aroused considerable interest among small and medium-sized enterprises. As a result, 75 loans were committed in the amount of HRK 37 million. The purpose of the Programme is to finance micro-enterprises as well as small and medium-sized enterprises in order to create the conditions for self-employment, to establish sole proprietorships and companies, to modernise and expand existing companies and to create 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.

TRAFFIC INFRASTRUCTURE.

Connectedness, speed and safety in road, sea and air traffic constitute the basis for successful co-operation of the Croatian entrepreneurs with the entire world.

Agriculture

With the purpose of reducing dependence on imports and promoting the development of rural areas, investing in the agricultural sector is one of the key objectives of both the Government of the Republic of Croatia and HBOR. In 2008, within the framework of the activities aimed at promoting agriculture through the Loan Programme for Agriculture and Balanced Development, altogether 204 loans were committed in the amount of HRK 160 million. In the last four years, HBOR has actively participated in the implementation of the Operational Programmes of the Government of the Republic of Croatia by investing in perennial plants, cattle breeding, pig breeding, the production of "kulen", the reconstruction and modernisation of the fishing fleet, and vegetable and flower growing. For these purposes, loans in the amount of over HRK 172 million were granted in 2008.

Industry and Infrastructure

By extending loans to large businesses and financing infrastructure projects, HBOR strives to have a direct influence on boosting the competitiveness of Croatian businesses and expanding the scope of existing business activities as well as upgrading the level of communal standards and the standard of living of Croatian citizens. In 2008, 117 loans were granted in the amount of HRK 1.7 billion. One should note here that, through these activities, a significant contribution was made to the creation of new jobs and the preservation of existing ones. These investments have multiplicative and long-lasting favourable effects on the development of the entire economy in the Republic of Croatia.

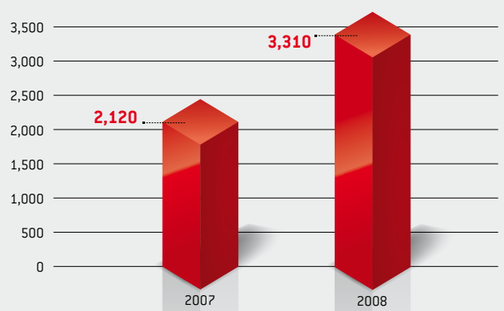
Export Finance

Export represents one of the most complex business challenges for every company and requires comprehensive preparations and analyses, a clear strategy and strong support throughout all its phases. HBOR offers financial support to exporters through its loan and guarantee programmes covering the key phases of an export transaction, from pre-shipment export finance to the collection of payment for an export transaction.

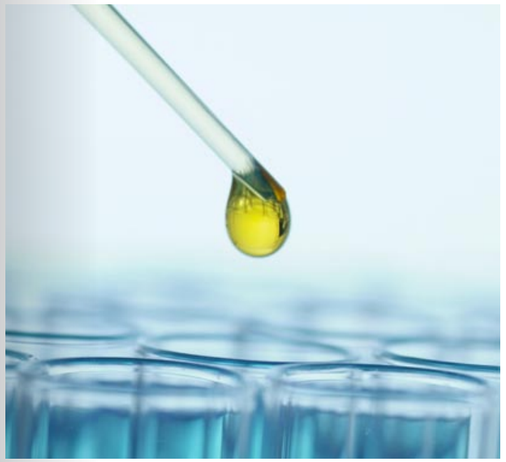
In 2008, HBOR's most used programme was the Pre- and Post-Shipment Export Finance Programme, through which loans in the amount of approximately HRK 3.3 billion were extended. Analysis of the effect of this programme on exporters' business results show that companies that utilised HBOR funds recorded an increase in exports of 15.6% in 2008 compared with 2007. The loans were mostly directed to the production of food and beverages (28.4%), machines and devices (7.0%), chemicals and chemical products (6.2%), metal products (6.2%) and other non-metal mineral products (5.8%).

The strength and competitiveness of exporters during the prequalification phase are determined not only by the market acceptability and price acceptability of their products but also by the ability to provide for the financing of the project. This is the reason why HBOR enables Croatian exporters the issuing of indicative offers for the financing of foreign buyers. In the reporting year, altogether 16 indicative offers were issued totalling more than EUR 127.2 million.

Pre-Shipment Export Finance (in HRK million)



- increase in amount of committed loans by 56% in comparison with 2007
- increase in number of committed loans by 44%



Export Credit Insurance

For ten years, HBOR has been providing support to the Croatian economy through its activities in the field of export credit insurance. Its export credit insurance programmes offer the possibility of insuring the risks related to the export of consumer goods, equipment and capital goods as well as those related to bank loans extended for the purpose of supporting exports, providing pre-shipment export finance and covering political risks associated with investing abroad.

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, which has been completely harmonised with the EU acquis communautaire by the passing of the Export Credit Insurance Regulation. In the Republic of Croatia, non-marketable risks currently include commercial and political risks regardless of their maturity and importing country since the private receivable insurance market has not been completely developed.

Over the past ten years, the volume of export credit insurance carried out by HBOR has reached the amount of HRK 7.8 billion, and that of indemnities and costs HRK 14.5 million.

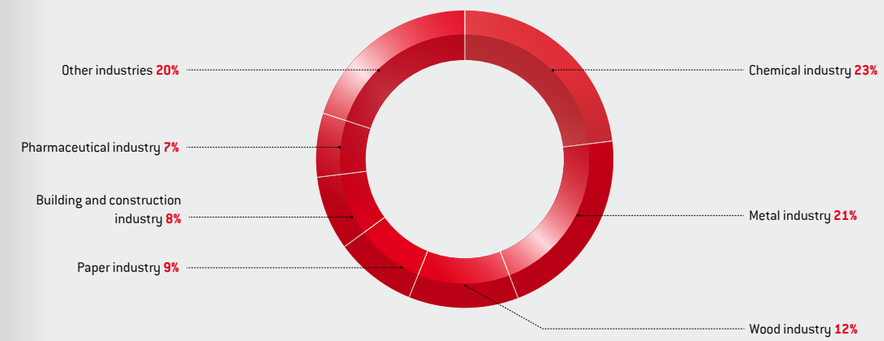
In 2008, the total volume of insured export transactions reached HRK 2.1 billion, an increase of 3% compared with the previous year, which covered 3.1% of the exports of the Republic of Croatia. The total collected premium amounted to HRK 9 million.

The export credit insurance of consumer goods, which is short-term export credit insurance, recorded an increase of 34% compared with 2007; the volume of HRK 2 billion of export receivables was covered and the amount of HRK 6.6 million was collected in insurance premium, representing an increase of 27% compared with 2007. Broken down by the amount of insured export transactions, the first position was occupied by the chemical industry (23%), followed by the metal industry (21%) and the wood industry (12%).

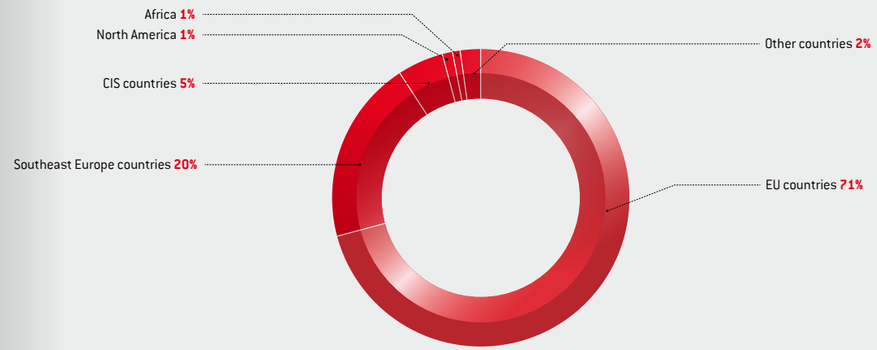
In 2008, 1,045 new credit limits were approved, mostly to the buyers from among the EU countries (71%). Approximately 20% of credit limits was related to the countries of Southeast Europe, among which Serbia was in the first position (9%) and Bosnia and Herzegovina in the second (7%).

With regard to the export credit insurance of capital goods, the volume of export transactions insured reached the amount of HRK 42.2 million, primarily with regard to the markets of Serbia, Belorussia, Hungary and Kosovo. In terms of the type of goods, these exports included food industry equipment, signalisation equipment and a project of bridge construction by INGRA d.d. in Kosovo.

Breakdown by industry



Breakdown by importing countries



In 2008, within the framework of export credit insurance policies for pre-shipment export finance, the volume of insured loans extended to exporters by local banks for the manufacture of goods intended for export reached HRK 45 million, an increase of 138% compared with 2007. The programme provided support for the manufacture of food products, mine clearing machines for the American army, and machines to be used in the mines of the Republic of South Africa (exporter: DOK-ING d.o.o.).

In the reporting period, HBOR issued a letter of intent to KfW, the German development bank, for the insurance of a buyer credit amounting to HRK 19.8 million, pursuant to which DALEKOVOD d.d., in a consortium with an Austrian partner, was awarded a contract through an international competitive bidding for the expansion of transformer stations in Montenegro to be implemented in 2009.

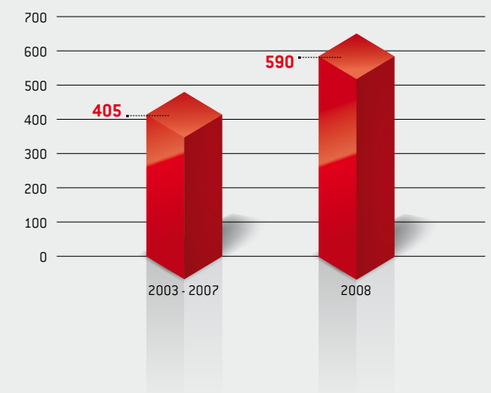
Indemnities and related costs were paid in the total amount of HRK 2.3 million, which remained on the previous year's level. However, an analysis of indemnities paid (without costs relating mostly to the indemnities from previous years) showed an increase of 11% compared with 2007.

Broken down by the number of indemnities paid in 2008, the wood industry occupies the first position (45%), followed by the chemical, metal and textile industries (18%). In terms of the risk occurred, 36% of cases were associated with bankruptcy proceedings and 64% with prolonged non-payment. The indemnities were paid due to non-payment by buyers in the markets of Germany, Italy, Bosnia and Herzegovina, Slovak Republic, France and Serbia.

In 2008, HBOR collected the amount of HRK 590 thousand in recovery payments on the basis of previously paid indemnities. The amount collected in the reporting period exceeds the total amount collected in the period from 2003 to 2007 by 45%.

In the coming period, due to the effects of the global financial crisis on the real sector, an increase in the number of bankruptcies and the volume of non-payments is expected, which will lead to an increase in the number of indemnities. Simultaneously, a relatively significant share of recoveries compared with the total amount of indemnities and costs paid would be retained together with a considerable increase in the interest of exporters in export credit insurance products.

Recoveries (in HRK thousand)



Fund Raising

In 2008, HBOR raised more than EUR 450 million in the financial markets.

In June 2008, HBOR and a consortium of banks with lead arrangers DZ Bank AG, Bank Austria Creditanstalt AG, The Bank of Tokyo-Mitsubishi UFJ, Ltd, Bayerische Landesbank and ING Bank N.V. signed a Syndicated Amortizing Term Loan Facility in the amount of EUR 230 million. In the same month, a Global Loan Finance Contract was signed with the European Investment Bank (EIB) amounting to EUR 60 million for the financing of SMEs, environmental protection, energy efficiency and infrastructure. In November 2008, HBOR and a syndicate of banks consisting of Erste Group (Erste & Steiermärkische Bank d.d. Zagreb and Erste Group Bank AG), Hypo Alpe-Adria-Bank d.d., Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d. and Societe Generale - Splitska banka d.d. signed a Club Loan Facility Agreement of EUR 100 million.

Co-operation with special financial institutions continued, and, in December 2008, HBOR signed two loan contracts with KfW, the German development bank: one of EUR 12 million and the other of EUR 3 million, both for the purpose of financing waste water supply and wastewater disposal projects in Croatia.

In addition, a Framework Loan Agreement amounting to EUR 50 million was signed with the Council of Europe Development Bank (CEB) in December for financing SMEs. The signing of the above agreements is another confirmation to HBOR and the Republic of Croatia that international financial institutions have confidence in the Croatian financial market, which is best illustrated by the terms and conditions of borrowings that remained on the same level as those before the outbreak of the global financial crisis.

LAND.

Long tradition, preserved environment and diligent people are a precondition for further development of the Croatian agriculture.

EU Co-Operation

EU Co-operation was established as a separate organisational unit at the beginning of 2008 for the purpose of carrying out activities in the field of harmonisation of HBOR's operations with the EU acquis communautaire and testing the possibility for the participation of HBOR in the use of the resources made available through EU funds (EU pre-accession funds, EU structural funds and other funds and support programmes implemented by EU bodies) as well as co-operating with the EU bodies on the carrying out of the aforementioned activities.

TIn 2008, there were significant changes in the state aid regulations in effect in the EU that are, in accordance with the Stabilisation and Association Agreement, directly implemented in the Republic of Croatia and, consequently, by HBOR due to its obligation to follow these regulations. The most important changes include the introduction of a new methodology for determining the interest reference rate for every individual business enterprise separately depending on its credit rating and the quality of offered collateral. For the purpose of adopting the new methodology and harmonising it with the requirements of the new regulations, HBOR prepared the new Regulations on Determining Reference and Discount Interest Rate that were approved and adopted by the Croatian Competition Agency (AZTN).

With AZTN, HBOR started an initiative for a temporary reduction in the base rate following the possibilities offered by the Communication from the Commission dated 17th December 2008 concerning temporary state aid measures for the purpose of facilitating access to finance in the conditions of the current economic crisis. Furthermore, in October 2008, a procedure was launched aimed at the renewal of the exemption clause for the coming two-year period (until 14th October 2010) with regard to the activities of export credit insurance of marketable risks performed by HBOR for and on behalf of the Republic of Croatia.

During the first year of operations of this organisational unit, significant improvements were achieved concerning EU pre-accession funds, primarily with regard to the passing of two separate loan programmes: the loan programme for financing SAPARD candidate projects and the loan programme for financing PHARE 2006 candidate projects.

Successful co-operation was established with the state administration bodies in charge, numerous regional development agencies and other associations and organisations active in the field of EU pre-accession funds. In addition to uniting and summarising all relevant information relating to the pre-accession funds and the possibilities offered through them, HBOR also assumes an advisory role and renders financial and support services to possible beneficiaries of EU funds, thus offering a complete package of services in this field. As a result, HBOR has become a recognisable financial institution and a reference centre for good and updated information as well as a reliable partner in the process of EU fund utilisation.

EU Co-operation organises regular internal workshops and training seminars for the employees with regard to the implementation of new state aid regulations and the possibilities made available through the EU pre-accession funds.

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Human Resources

HBOR pays special attention to the needs of its employees and their development in accordance with the goals of human resources development as well as the development of the bank as whole.

In 2008, a survey on work satisfaction was implemented via a standardised questionnaire. The results were made available to all employees and served as a basis for a number of measures aimed at increasing employee satisfaction. The quality of human resources management in HBOR is reflected in the Employer-Partner Certificate assigned by the group Selectio and Internet web site MojPosao as recognition of excellence in human resources management. HBOR also undergoes the process of recertification, thus obtaining better assessments from year to year.

After the successful humanitarian action in 2007, when HBOR employees reconstructed the "Zagorje" Regional School in Gornje Zagorje near Ogulin, the employees of the bank were unanimous in their wish to enrich their gatherings in 2008 with humanitarian work. On this occasion, assistance was provided to socially deprived citizens of Zagreb that are in the Red Cross files, through the preparation of additional meals and packets with foodstuffs.

At the end of the reporting year, there were 235 employees in HBOR, of which 79.15% with a university degree. The average age of employees is 40.

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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 operations. In the risk management process, the Bank continuously performs measurement, assessment and management of all risks it is exposed to in its operation. The criteria, manner and risk measurement procedures are prescribed by the Bank's general documents. In its day-to-day operations, the Bank manages credit risk, market risk and operational risk through appropriate policies, procedures, limits, committees and controls.

The Bank has a functionally and organisationally separate organisational unit for the control of business risks which is directly responsible to the Managing Board. The Risk Management Unit is responsible for the identification, measurement, supervision and control of all risks the Bank is exposed to. The Risk Management Unit performs its role by evaluating and measuring the Bank's exposure to credit and non-credit risks, developing risk-related procedures and methodology, recommending exposure limits, evaluating the quality of loan portfolio, reporting to the Managing Board and other committees on risks, etc.

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. HBOR regularly checks the prescribed quantitative methods of risk assessment and measurement. Systems of pro-active risk management are developed for the purpose of preventing potential risks.

The Managing Board of HBOR is responsible for establishing and implementing an effective and reliable risk management system. For the purpose of accomplishing its function, the Managing Board has delegated its authority to two risk management committees: the Assets and Liabilities Management Committee and the Credit Risk Evaluation and Measurement Committee. The 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. The Credit Risk Evaluation and Measurement Committee monitors the quality of assets, manages credit risk within the limits set through the policies, procedures and other internal acts related to credit risk and considers the proposed provisions.

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.

Credit risk

Credit risk encompasses loss derived from full or partial default, i.e. 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 HBOR Managing Board conducts a conservative credit risk policy. The credit risk management system forms a crucial part of HBOR 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 to the final repayment. Credit Risk Management Procedures are included in a comprehensive document comprised of separate methodologies aimed at evaluating the various target groups of clients.

In order to mitigate credit risk and reduce operating costs, the Bank, in accordance with the HBOR Act, extends part of its placements 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, the loan programme, the general terms and conditions of insurance and the 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 region and developmental loan programme. By creating new loan programmes (products), 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.

Market risk

The bank ensures quality market risk management through the Assets and Liabilities Management Committee. Market risk management implies minimising interest rate risk, currency risk and liquidity risk. All organisational units are included in the Committee's operation in order to ensure an integrated and comprehensive risk management system.

HBOR uses the technique of changing one or more risk factors for market risk management and monitors their potential effect on the financial position. This technique is used through scenario analysis and sensitivity analysis in both stressed and regular business environments.

HBOR, 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. In its portfolio, HBOR does not hold financial instruments intended for trading purposes only.

Liquidity risk

Liquidity risk is a risk of financial loss that occurs if the bank is unable to meet its due liabilities. The basic principles for managing HBOR's liquidity are defined by the Liquidity Risk Management Procedures and the decisions made by the Supervisory Board, the Managing Board and the Assets and Liabilities Management Committee. The Bank has prescribed limits for managing liquidity in its operation with commercial banks.

For the purpose of managing liquidity risk, the bank maintains the necessary level of liquidity reserves, continuously monitors day-to-day liquidity, and provides sufficient kuna and foreign currency funds necessary for timely settlement of obligations and special purpose disbursements under committed loans. The current surplus of available funds is invested in highly liquid state securities, short-term loans (to local banks and the state) and deposits with first-class local and foreign banks. With long-term liquidity, the Bank monitors the compatibility of sources and placements according to maturity and ability

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to finance long-term assets with a maximum maturity compatibility with sources. The Bank monitors liquidity risk through scenario analysis and sensitivity analysis. Scenarios are made for cases of regular operation and deterioration of market conditions.

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 Assets and Liabilities Management Committee manages the interest rate risk by monitoring the match between interest rate receivable and payable by means of interest rate gap analysis. The interest rate gap is analysed by specific periods on the basis of possibility of change in interest rates and illustrates the sensitivity of the Bank to such changes. Depending on the level of the interest rate gap, the Committee determines the type of interest rates on future borrowings and placements in order to reduce the gap to the lowest level possible. Detailed elaboration of interest rates per currency, type and value of interest rate is also made. Current market conditions and movements in forecasted market indicators are also monitored.

Currency risk

Currency risk is the risk of loss of financial instruments value due to foreign exchange gains/losses. For the measurement of currency risk exposure, the Bank monitors foreign currency positions and implements the calculation methodology prescribed by the Croatian National Bank, the simple value calculation method and the adjusted delta method. A report on open 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 short positions in each currency, depending on which of the two sums is higher. In addition, the Bank monitors currency risk through prescribed limits and through asset and liability currency liquidity. Most of HBOR's loan placements include currency clauses, which represents a means of currency risk protection.

Operational risk

Operational risk is the risk of loss arising from system failure, human error or external events. The Bank 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 training, the monitoring of frequent errors and prevention measures.

Internal Control And Internal Audit System

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, application of the Croatian Internal Audit Standards and HBOR internal acts. The 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. 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 2008 and submitted to the Managing Board and the Supervisory Board within the regular reporting scheme. The employees of Control and Audit are members of professional organisations - the Chamber of Audit and the Croatian Institute of Internal Auditors.

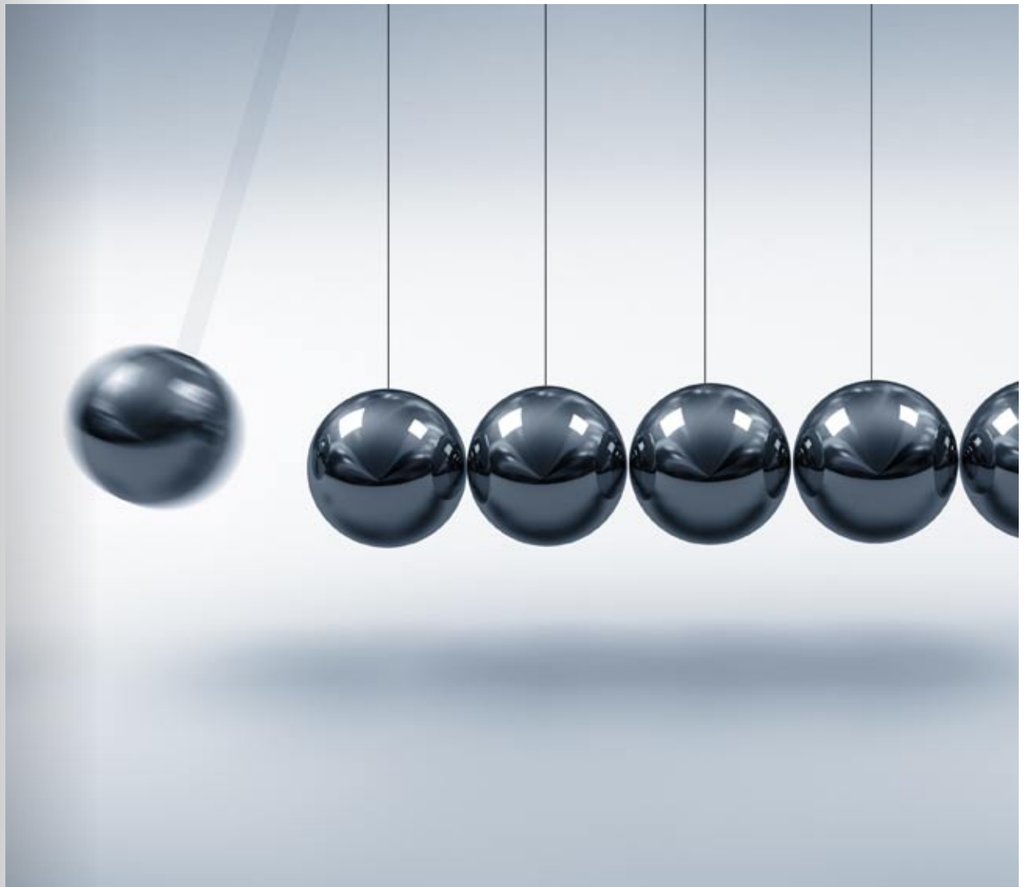
Other Activities

In January 2008, HBOR became an active member of The European Association of Public Banks (EAPB), a renowned association that represents the interests of its members vis-à-vis the legislation of the European Union and the European Parliament. The members of the Association are export and development banks, agencies, commercial banks and other financial institutions in the European Union, Switzerland, EEC countries, and recently also from candidate countries, that have state ownership shares. HBOR is the first financial institution from Croatia invited to become a member of the EAPB. Active participation in the Association is evidenced by the fact that some of HBOR's suggestions were included in EAPB's opinion on the draft Commission Communication relating to the establishment of a framework system of state aid support aiming to facilitate access to finance in the financial crisis.

At the year beginning, a Co-operation Agreement was signed with the Croatian Chamber of Trades and Crafts with the objective of providing stronger support to sole proprietorships and small and medium enterprises through providing quality information to sole proprietors on HBOR loan programmes and all other types of support that can be provided by the Bank.

As in past years, in September 2008, HBOR organised the International Conference on Export Promotion. This was the 7th such Conference and it was held for the first time in Split, with about two hundred participants. The main topics of the conference were export enhancement, the internationalisation of business operations, co-operation between exporters, commercial banks and export-credit agencies, and risk management in international trade.

At the year end, HBOR accepted the offer for membership in the Network of European Financial Institutions for SMEs (NEFI). This non-formal organisation gathers 13 financial institutions from the area of EU countries, and, from 1st January 2009, HBOR will become the only associate member outside the borders of the European Union.



Financial Operations

The balance sheet total as at 31st December 2008 amounted to HRK 18,751.7 million, which is an increase of 8% compared to the beginning of the year.

Cash on hand and due from banks

As at 31st December 2008, cash on hand and due from banks amounted to HRK 833.9 million, representing 4% of total assets.

Loans to banks and other customers

Total net loans as at 31st December 2008 stood at HRK 17,635.8 million (94% of total assets), an increase of 7% against the previous year. Total gross loans amounted to HRK 19,717.7 million, an increase of 8% against the beginning of the year.

Placements to banks based on lending activities rose by 14% 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, as well as programmes intended for financing SMEs. 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 receivables from Dubrovačka banka d.d., Dubrovnik. The bonds were settled on their maturity date of 17th November 2008.

Assets available for sale

Assets available for sale consisted primarily of debt securities and to a lesser extent of ownership securities. This item amounted to HRK 164.9 million, which represents a decrease of 14% compared to the beginning of the year.

The decrease of this item was caused by the following circumstances:

- Premature redemption of corporate bonds of Pliva d.d., Zagreb (RHPLVA-O-115A) in the amount of EUR 2.0 million that were sold to the issuer
- Fluctuation of the exchange rate and "fair" value of securities in the domestic capital market, the effects of which are recognised in the income statement and in the equity

In 2008, HBOR acquired shares in Brodogradilište Viktor Lenac d.d., Rijeka. In December 2003, upon the commencement of bankruptcy proceedings over Brodogradilište Viktor Lenac d.d., Rijeka, HBOR effected a 100 % impairment of value for the full amount of receivables from the company due to their estimated uncollectibility as bad receivables.

By the conclusion of the bankruptcy proceedings in April 2008, the equity of Brodogradilište was divided into 12,407,813 common shares of nominal value HRK 10.00 per share, issued in the procedure of conclusion of the bankruptcy proceedings by registration of rights - receivables in cash. HBOR registered a part of the established receivables from the bankruptcy proceedings in the amount of HRK 13,673,000 into the equity of the debtor, by which the Bank acquired an 11.0194 % stake in the company. The conversion of a portion of receivables into equity in the above mentioned amount was recorded and stated with a 100% value adjustment.

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 26.2 million in 2007). The investment value was fully impaired because of its estimated irrecoverability.

Total liabilities

Total liabilities as at 31st December 2008 amounted to HRK 12,467.9 million, which represents 66% of total liabilities, capital and guarantee fund.

Total liabilities rose by 7% compared to the beginning of the year as a result of new HBOR borrowings in the country and abroad:

- for general purposes in the amount of EUR 340.0 million, and
- from special financial institutions in the amount of EUR 125.0 million: disbursement of funds under loan agreements signed with the European Investment Bank in the amount of EUR 100.0 million and CEB in the amount of EUR 25.0 million.

Capital

Capital and guarantee fund amounted to HRK 6,283.8 million, representing 34% 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, 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 334.0 million. The total amount of capital contributed from the budget of the Republic of Croatia amounted to HRK 4,297.1 million, revaluation reserves to HRK 426.6 million, retained profits and reserves to HRK 1,378.5 million, guarantee fund to HRK 12.4 million and profits for the current period to HRK 174.9 million.

OPERATING SUCCESS

In the period from 1st January to 31st December 2008, HBOR generated a total income of HRK 964.7 million, expenses of HRK 789.8 million and profits of HRK 174.9 million.

Net interest income

Net interest income amounted to HRK 405.7 million, a decrease of 9% against the previous year.

Interest income amounted to HRK 920.2 million, an increase of 6% in comparison with the previous year. This was mainly a result of an increase in the volume of lending.

Interest expenses amounted to HRK 514.5, an increase of 22% in comparison with the same period last year. The increase in interest expenses was a result of rising reference interest rates in the world markets during 10 months of 2008 and new borrowing during the reporting year.

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 an 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 17.3 million, whereas net revenues of HRK 2.3 million were recorded in the same period last year.

At year level, the kuna appreciated by 0.01% against the euro and depreciated by 3.4% 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 87.2 million, which represents a decrease of 5% compared to the same period last year.

Impairment losses and provisioning

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. In the reporting period, net impairment losses on placements amounted to HRK 186.8 million.

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Financial statements for the year 2008 together with the Independent auditor's report

Contents

Responsibility for the Financial Statements

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; 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 2009

Independent Auditor's Report

ERNST & YOUNG

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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 of the Balance sheet as of 31 December 2008 and Income Statement, Statement of Changes in Equity and Statement of Cash Flow for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 4 to 85.

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 of 31 December 2008 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 2009

Income Statement

For the year 2008

(All amounts are expressed in HRK thousand)

	Notes	2008	2007
		HRK '000	HRK '000
Interest income	3	920,219	868,590
Interest expense	4	(514,549)	(423,228)
Net interest income		**405,670**	**445,362**
Fee income	5	21,904	20,887
Fee expenses	5	(1,249)	(797)
Net fee income		**20,655**	**20,090**
Net gains/(losses) on financial operations	6	17,278	(2,299)
Other income		5,339	5,076
Operating income		**448,942**	**468,229**
Operating expenses	7	(87,204)	(92,236)
Impairment loss and provisions	8	(186,832)	(135,078)
Profit before income tax		**174,906**	**240,915**
Income tax	2	-	-
Profit after income tax		**174,906**	**240,915**

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

Balance Sheet

As of 31 December 2008

(All amounts are expressed in HRK thousand)

	Notes	2008	2007
		HRK '000	HRK '000
ASSETS			
Cash on hand and due from banks	9	14,020	24,660
Deposits with other banks	10	819,837	584,630
Loans to banks	11	11,987,708	10,523,533
Loans to other customers	12	5,648,101	5,932,731
Assets held to maturity	13	-	39,161
Assets available for sale	14	164,913	191,220
Investments in associates	15	-	-
Property, plant and equipment and intangible assets	16	66,091	49,052
Non-current assets held for sale	17	41,441	50,267
Other assets	18	9,603	6,797
TOTAL ASSETS		**18,751,714**	**17,402,051**
LIABILITIES			
Deposits	19	439,017	558,550
Borrowings	20	5,020,121	3,795,359
Bonds payable	21	5,868,681	6,012,845
Other liabilities	22	1,140,055	1,255,918
Total liabilities		**12,467,874**	**11,622,672**
EQUITY			
Founder's capital		4,723,739	4,389,737
Retained earnings and reserves		1,378,526	1,137,611
Other reserves		(5,754)	(1,869)
Net profit for the year		174,906	240,915
Equity excluding Guarantee fund		**6,271,417**	**5,766,394**
Guarantee fund	23	12,423	12,985
Total equity including Guarantee fund		6,283,840	5,779,379
TOTAL LIABILITIES AND TOTAL EQUITY INCLUDING GUARANTEE FUND		**18,751,714**	**17,402,051**

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 2009 by:

Anton Kovačev
President of the Managing Board

Irena Adžić-Jagodić
Accounting Division Executive Director

Statement of Cash Flow

For the year 2008

(All amounts are expressed in HRK thousand)

	2008	2007
	HRK '000	HRK '000
Operating activities		
Profit before income tax	174,906	240,915
Adjustments to reconcile to net cash from and used in operating activities:		
Depreciation	5,922	6,181
Impairment loss and provisions	186,832	135,078
Accrued interest	24,605	44,665
Deferred fees	8,406	13,582
Operating profit before working capital changes	*400,671*	*440,421*
Changes in operating assets and liabilities:		
Net (increase) in deposits with other banks, before provision for impairment	(237,685)	(181,363)
Net (increase) in loans to banks, before provision for impairment	(1,586,717)	(2,655,227)
Net decrease in loans to other customers, before provision for impairment	109,053	168,253
Net (increase) in other assets, before provision for impairment	(2,852)	(1,849)
Net decrease/(increase) in non-current assets held for sale	8,826	(14,836)
Net (decrease)/increase in deposits from banks and companies	(119,736)	40,212
Net (decrease)/increase in other liabilities, before provisions	(35,128)	56,859
Net cash used in operating activities	**(1,463,568)**	**(2,147,530)**
Investment activities		
Increase in assets available for sale	-	(12,087)
Decrease in assets available for sale	22,100	36,530
Decrease in assets held to maturity	38,103	36,292
Sale of investments in associates	-	2,100
Net (purchases) of property, plant and equipment and intangible assets	(22,961)	(3,124)
Net cash provided by investment activities	**37,242**	**59,711**
Financing activities		
Net increase in founder's capital	334,002	215,000
Increase in borrowings - withdrawn funds	3,569,236	924,993
(Decrease) in borrowings - repayments of principal	(2,363,936)	(823,593)
Increase in bonds payable - new issues	-	1,832,538
(Decrease) in bonds payable - repayment of amortizing note	(142,406)	-
Increase in Guarantee fund - payment	-	2,186
Decrease in Guarantee fund - write off	(556)	(201)
Net cash provided by financing activities	**1,396,340**	**2,150,923**
Effect of foreign currency to cash and cash equivalents		
Foreign exchange gains/(losses)	15,730	(50,963)
Decrease/(increase) in bonds payable discount	3,627	(7,219)
Net loss from investment in assets available for sale	(144)	(81)
Net effect	**19,213**	**(58,263)**
Net (decrease)/increase in cash and cash equivalents	(10,773)	4,841
Balance as of 1 January, before provisions	24,835	19,994
Net (decrease)/increase in cash	(10,773)	4,841
Balance as of 31 December, before provisions	**14,062**	**24,835**
Additional note - Operational cash flows from interest		
Interest paid	498,688	374,970
Interest received	749,168	672,323

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

Statement of Changes in Equity

For the year 2008

(All amounts are expressed in HRK thousand)

	Founder`s capital	Retained earnings and reserves	Other reserves	Net profit for the year	Total equity excluding Guarantee fund	Guarantee fund	Total equity including Guarantee fund
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January 2007	**4,174,737**	**957,296**	**7,098**	**180,315**	**5,319,446**	**11,018**	**5,330,464**
Increase in fair value of assets available for sale	-	-	*1,238*	-	***1,238***	-	***1,238***
Decrease in fair value of assets available for sale	-	-	*(10,103)*	-	***(10,103)***	-	***(10,103)***
Foreign exchange losses on available for sale equity securities	-	-	*(20)*	-	***(20)***	-	***(20)***
Transfer of realized gain into IS	-	-	*(2,045)*	-	***(2,045)***	-	***(2,045)***
Transfer of realized loss into IS	-	-	*1,963*	-	***1,963***	-	***1,963***
Total income and expense for the year recognised directly in equity	-	-	(8,967)	-	***(8,967)***	-	***(8,967)***
Profit for the year	-	-	-	240,915	***240,915***	-	***240,915***
Total recognized income and expense for the period	**-**	**-**	**(8,967)**	**240,915**	**231,948**	**-**	**231,948**
Payment	215,000	-	-	-	**215,000**	**2,186**	**217,186**
Write-off						**(201)**	**(201)**
Net foreign exchange						**(18)**	**(18)**
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**	**12,985**	**5,779,379**
Increase in fair value of assets available for sale	-	-	*8,250*	-	***8,250***	-	***8,250***
Decrease in fair value of assets available for sale	-	-	*(11,994)*	-	***(11,994)***	-	***(11,994)***
Foreign exchange gains on available for sale equity securities	-	-	*3*	-	***3***	-	***3***
Transfer of realized gain into IS	-	-	*(3,245)*	-	***(3,245)***	-	***(3,245)***
Transfer of realized loss into IS	-	-	*3,101*	-	***3,101***	-	***3,101***
Total income and expense for the year recognised directly in equity	-	-	(3,885)	-	**(3,885)**	-	**(3,885)**
Profit for the year	-	-	-	174,906	**174,906**	-	**174,906**
Total recognized income and expense for the period	**-**	**-**	**(3,885)**	**174,906**	**171,021**	**-**	**171,021**
Payment	334,000	-	-	-	**334,000**	-	**334,000**
Other payment	2	-	-	-	**2**	-	**2**
Write off	-	-	-	-	-	**(556)**	**(556)**
Net foreign exchange	-	-	-	-	-	**(6)**	**(6)**
Transfer of profit 2007 to retained earnings	-	240,915	-	(240,915)	-	-	-
Balance as of 31 December 2008	**4,723,739**	**1,378,526**	**(5,754)**	**174,906**	**6,271,417**	**12,423**	**6,283,840**

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 2008

(All amounts are expressed in HRK thousand)

1. General Information

1.1. Foundation, headquarter and ownership

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.

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.

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.

As of 31 December 2008 there were 235 employees at the Bank (31 December 2007: 232 employees).

1.2. Principal Activities:

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.

1.3. HBOR's Bodies:

Supervisory Board

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.

1. General Information (continued)

1.3. HBOR's Bodies (continued):

Therefore, from March 14, 2008 the members of HBOR's Supervisory Board appointed by the Government of the Republic of Croatia were 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,
- Božidar Pankretić, MSc, Minister of Agriculture, Fisheries and Rural Development,
- Damir Bajs, Minister of Tourism,
- Božidar Kalmeta, Minister of Sea, Transport and Infrastructure,
- Nadan Vidošević, President of Croatian Chamber of Economy, ex officio Member of the Supervisory Board,
- Goran Marić, Ph.D., Member of the Croatian Parliament,
- Dragan Kovačević, Ph.D., Member of the Croatian Parliament,
- Dragica Zgrebec, Member of the Croatian Parliament.

Until the appointment of new members, the Supervisory Board members were as follows:

- 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 Sea, Transport and Infrastructure,
- Petar Čobanković, Minister of Agriculture, Forestry and Water Management,
- Nadan Vidošević, President of Croatian Chamber of Economy, ex officio Member of the Supervisory Board,
- Šime Prtenjača, Member of the Croatian Parliament,
- Gordan Jandroković, Member of the Croatian Parliament,
- Željko Pecek, Member of the Croatian Parliament.

Managing Board

In 2008, members of the Managing Board were as follows:

- Anton Kovačev, President of the Managing Board,
- Ružica Adamović, Member of the Managing Board,
- Emilija Nagj, Member of the Managing Board from 1 February 2008.

Audit Committee

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

The Supervisory Board appointed the following new members of the Audit Committee as at 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.

The Audit Committee operated with the above mentioned members during the whole of 2008.

Prior to the appointment of the new members, the Audit Committee was comprised of the following members:

- Ivan Šuker, Minister of Finance, President of the Audit Committee,
- Verica Čirjak, Member of the Audit Committee,
- Nadan Vidošević, Member of the Audit Committee.

2. Summary of significant accounting policies

2.1. Accounting Policies

These financial statements were approved by the Managing Board on 19 February 2008 and will be presented to the Supervisory Board for authorization and Croatian Parliament for adoption.

A summary of principal accounting policies is summarized below.

Accounting policies were consistently applied to all periods presented in these financial statements.

Basis of Accounting

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

Basis of Financial Statements 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.

Reporting Currency

The Bank's financial statements are prepared in Croatian Kuna (HRK) as the functional and reporting currency of the Bank.

Amounts presented are rounded to a nearest thousand, unless otherwise stated.

The effective exchange rate of HRK as of 31 December 2008 was HRK 7.324425 per 1 Euro and HRK 5.155504 per 1 United States dollar (31 December 2007: HRK 7.325131 per 1 Euro and HRK 4.985456 per 1 United States dollar), unless otherwise contracted.

2. Summary of significant accounting policies (continued):

Interest Income and Expense

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

Interest income and expense 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 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 companies for loans and guarantees granted and other services rendered by the Bank, together with commissions for managing funds for and 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 rendered.

Fees on issued financial/payment guarantees are deferred and proportionally recognized as income over the term of guarantee.

Pension and Health Insurance Costs

Pursuant 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:

	2008	2007
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 expense arising in foreign currencies are converted at the rate of exchange on the transaction date. The resulting foreign exchange gains and losses are recorded in the income statement.

The Bank has assets originated in HRK and linked to a foreign currency with a one-way currency clause. Due to this clause, the Bank has an option to revalue the asset using a foreign exchange rate beneficial 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.

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 2008	EUR 1 = HRK 7.324425	USD 1 = HRK 5.155504
31 December 2007	EUR 1 = HRK 7.325131	USD 1 = HRK 4.985456

Taxation

Based on Article 9 of the Act on the Croatian Bank for Reconstruction and Development, the Bank is exempt from profit tax.

Cash and Cash Equivalents

For the purposes of the cash flow reporting, cash and cash equivalents comprise cash and current accounts with the Croatian National Bank and other banks less provisions for impairment and un-collectable amounts.

The difference between interest income and interest received or collected (see Statement of Cash Flow) mostly relates to the income in respect to interest subsidies inflows that are recorded upon payment. The discounted amount of the interest subsidies provided for the final user is presented as deferred interest income (see note 22 Other liabilities) and is recognized in the income statement on a time basis during the repayment of the loan. Interest income earned on this basis in 2008 amounts to HRK 193,502 thousand (2007: HRK 188,608 thousand).

2. Summary of significant accounting policies (continued):

Cash and Cash Equivalents (continued)

Further, the difference between interest income and interest collected relates to the amount of loan fees and accrued interest. Loan fees are collected after origination of the loan, but their recognition in the Income Statement is done on a time basis during the repayment of the loan. Accrued interest is recognized in the Income Statement on a time basis, but is collected upon maturity.

The difference that occurs between interest expense and interest paid (see Statement of Cash Flow) mostly relates to the changes in the amount of interest accrued in relation to prior year and changes in the amount of bonds payable discount.

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 Bank classifies its own financial instruments into following categories:

- financial assets at fair value through profit or loss,
- available for sale financial assets,
- held to maturity financial assets,
- loans and receivables.

Financial instruments owned by the Bank are classified into the mentioned categories pursuant to the Bank's intention on the acquisition. Classification of financial instruments at initial recognition and accounting principles of their measurement are prescribed by accounting policies of the Bank brought by the Managing Board.

The principal difference among the categories relates to the measurement approach of financial assets and the recognition of their fair values in the financial statements that is described in the text below.

All securities held by the Bank are recognized using settlement date accounting and are initially measured at fair value plus, in case of investments not at fair value through profit or loss, directly attributable transaction costs.

The Managing Board decided that Bank does not make acquisitions of securities and investments to attain gain/loss from short term trading activities.

a) Financial Assets at Fair Value through Profit or Loss

Assets at fair value through profit or loss comprise financial assets that are not regularly traded on the market and the Bank has designated it at fair value trough Profit and Loss.

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 the closest quoted prices or amounts obtained by the application of acceptable valuation models. The Bank includes unrealized gains and losses in 'Net gains/(losses) on financial operations'.

2. Summary of significant accounting policies (continued):

Financial Instruments (continued)

b) Available for Sale Financial Assets

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 or loans and receivables.

This portfolio comprises equity and debt securities and investment funds shares acquired for liquidity maintenance and risk management or acquired for placement of available funds up to the moment of further long term placements to loans with original due date over one year that 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, while 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, unrealized gains and losses arising from changes in fair value are recognized directly in equity, until the its disposal or impairment, 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 presented in the income statement. If the fair value of an equity instrument subsequently increases, the increase will be recognized as other comprehensive income, 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.

When a decline in the fair value of available for sale financial assets has been recognized in equity and there is an objective evidence that the asset is impaired according to IAS 39 provisions, the cumulative loss that has been recognized in equity shall be reclassified from equity to profit or loss as a reclassification adjustment, even though the financial asset has not been derecognized.

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

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

2. Summary of significant accounting policies (continued):

Financial Instruments (continued)

c) Held to Maturity Financial Assets

Investments held to maturity are financial assets with fixed or identifiable payments and fixed maturities for which the Bank has the 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 recognizes provisions through the income statement under 'Impairment loss and provisions'.

d) Loans to Banks and Other Customers

Amounts paid-out by HBOR in 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 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.

All loans and advances are recognized when cash is paid-out to borrowers.

Provision for impairment is performed 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, the structure of the 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 possible 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).

2. Summary of significant accounting policies (continued):

Financial Instruments (continued)

d) Loans to Banks and Other Customers (continued)

If there is no objective evidence that an impairment loss has been incurred, whether it is significant or not, the financial asset is classified into the group of assets with 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 are subject to collective evaluation of expected cash flows. Assets for which impairment is assessed on an individual level and for which impairment losses are recognized, i.e. are continued to be recognized, are not included in the joint estimation of impairment.

When a loan is deemed uncollectible, it is written off against the related provision for impairment. Subsequent recoveries of these loans are recognized in the income statement.

e) Reverse Re-purchase 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.

At the end of 2008 the Bank's REPO deals amounted to HRK 73,244 thousand (2007: HRK 1,112,823 thousand) collateralized by securities in the amount of HRK 74,492 thousand (2007: HRK 1,134,024 thousand).

Investments in Associates

Investments in associates relate to investments where HBOR holds 20% to 50% of the voting rights and where HBOR has significant influence, but no control.

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 financial performance and assets and liabilities of associates are presented in these financial statements by 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 directly in profit or loss.

2. Summary of significant accounting policies (continued):

Property, Plant and Equipment and Intangible Assets

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

Estimated useful lives are as follows:

	2008	2007
Buildings	33	33
Computers	3	3
Furniture and Equipment	5 - 8	5 - 8
Vehicles	3	3
Other assets and investments not mentioned	5	5
Intangible Assets	3 - 5	3 - 5

Depreciation is not charged on property, plant and equipment and intangible assets in the course of construction, until they are available for use. Repairs and maintenance are expensed in the income statement as incurred. Expenditure that increase the future economic benefits of existing tangible and intangible assets (improvements) is capitalized.

Impairment of Assets

An assessment of financial assets 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 and any impairment loss, based on the net present value of future anticipated cash flows including anticipated recoveries from guarantees and collateral instruments, discounted by the original effective interest rate, is recognized in the income statement.

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in the income statement for items of property, plant and equipment and intangible assets carried at cost, or it is treated as a revaluation decrease for assets that are carried at re-valued 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 and its value in use.

Non-current Assets Held for Sale

Non-current assets held for sale consist of property, plant and equipment that the Bank acquired in settlement of un-collected and other receivables. For these assets, it is expected that its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

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

Furthermore, depreciation on these assets is not charged.

2. Summary of significant accounting policies (continued):

Non-current Assets Held for Sale (continued)

Impairment provisions as well as gains/losses on sale are recognized in the income statement.

Fair Value of Financial Assets and Liabilities

Fair value represents the amount at which an asset may be exchanged or a liability settled in an arm's-length transaction. If there is no active market for the financial assets and liabilities, or if due to any other reason, the fair value cannot be reliably measured by the market price, the Managing Board uses an evaluation technique for fair value estimation. Such techniques include prices achieved in recent transactions agreements between informed and willing sides, reference to similar financial instruments, and discounted cash flow analysis, making maximum use of market inputs and relying on entity-specific inputs.

The carrying amounts of cash and balances with the Croatian National Bank approximately present their fair values.

The estimated fair value of deposits approximates their carrying amounts since all deposits mature up to 90 days.

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 that are recognized as deferred income in discounted amounts and presented within other liabilities are taken into account in estimating fair value. 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 of this Note.

Assets held to maturity consist of unquoted bonds of the Government of the Republic of Croatia acquired in settlement of receivables from "Dubrovačka banka d.d.", Dubrovnik. The fair value of the stated bonds is approximates their carrying values. Bonds were issued with instalment repayments, and the last one was due on 17 November 2008.

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. As the Bank's long-term debt bears variable interest, there is no significant difference between its carrying amount and its fair value.

The fair value of bonds issued by HBOR on 31 December 2008 is stated in Note 21.

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 and from other sources as specified by separate laws.

As of 31 December 2008, the paid-in capital amounted to HRK 4,297,107 thousand. The outstanding amount of capital to be paid from the State Budget of the Republic of Croatia up to the amount prescribed by the HBOR Act was HRK 2,702,893 thousand.

The schedule of annual amounts of payment and the time schedule of payments out of the State Budget into the capital is not set in advance, but is determined by the Croatian Parliament as part of the process of adoption of the State Budget of the Republic of Croatia.

Within the Accounting Policies, the Bank has set out its objectives of capital management, as well as measuring and assessing the policies for capital management. Capital management is described and presented in Note 28.

Bank's Borrowings and Bonds Payable

Borrowings and bonds payable are measured at amortized cost determined using the effective interest method. Interest expense related to borrowings and bonds payable is recognized in the income statement.

Government Grants

Interest for the borrowers qualifying for subsidized interest under the Programme of Preferential Financing through HBOR's Loan Programmes, the Development and Employment Programme, the Regional Development Programme, the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet and the investments into entrepreneurial zones is subsidized by the Republic of Croatia, the Fund for Development and Employment, the Fund for Regional Development, the Ministry of Agriculture, Fisheries and Rural Development, the Ministry of the Sea, Transport and Infrastructure, the Ministry of the Economy, Labour and Entrepreneurship and the Environment and Energy Efficiency Fund during the entire loan repayment period.

The discounted 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 Loan Related Commitments

In the ordinary course of business the Bank issues financial guarantees, including letters of credit 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 are mostly collateralized by guarantees of the Government of the Republic of Croatia, while letters of credit are fully covered by the deposits.

2. Summary of significant accounting policies (continued):

Guarantees and Other Loan Related Commitments (continued)

Provisions for commitments upon undrawn loans and issued guarantees are maintained at a level considered as adequate by the Managing Board in order to absorb potential losses.

Provisions are recognized when the Bank has a present legal or contractual 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.

Managed Funds For and On Behalf of Third Parties

The Bank manages significant assets for and on behalf of the Ministry of Finance, Ministry of the Economy, Labour and Entrepreneurship, Ministry of the Sea, Transport and Infrastructure, Ministry of Agriculture, Fisheries and Rural Development, the Fund for Development and Employment, the Fund for Regional Development of Republic Croatia, the Environment and Energy Efficiency Fund, Vodovod i kanalizacija 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 and are excluded from the Bank's balance sheet.

Revenues and expense relating to this business activity are charged to third parties, and the Bank does not have other liabilities and bears no risks. For the services provided, the Bank charges a fee under certain programmes, but certain programmes are performed without a fee charged by the Bank (See Note 25).

2.2. Significant Accounting Judgements and Estimates

For the preparation of the financial statements in accordance with IFRS's, the Managing Board is required to give estimations and make assumptions that influence the reported balances of assets and liabilities and to disclose contingent amounts of assets and liabilities at the date of the financial statements, and present income and expense for the reporting period. Estimations are based on information available at the reporting date, so that actual amounts may differ from those estimated.

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

a) Fair Value of Financial Instruments

If there is no active market for a certain financial instrument, or if the fair value of financial assets and financial liabilities presented in the balance sheet cannot be reliably measured by the market price, the Bank uses various valuation techniques including the use of mathematical models. The input data for these models are taken from other recognizable markets where possible, but if it is not possible, there is a certain degree of judgment required in determining fair values.

2. Summary of significant accounting policies (continued):

2.2. Significant Accounting Judgements and Estimates (continued)

b) Loan Impairment Provisions

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experience of judgments 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 using the data indicating 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 experience and judgment to adjust available data for a group of loans or receivables according to current market conditions.

c) Legal Cases Provisions

The Bank performs a risk classification of legal cases taking into consideration the 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.

The Bank seeks to make provisions for those cases, where, in management's opinion, more than a 50% probability exists that the Bank is not likely to win the case. In estimating provisions, the Bank takes into account the due legal process in the Republic of Croatia, which allows a multiple appeal procedure in certain cases.

d) Liabilities for Retirement and Jubilee Benefits

In calculating liabilities for retirement and jubilee benefits, the Bank discounts expected future cash flows in respect of the liabilities, using discount rates that, in the opinion of the Bank's management, best represent the time value of the money.

2.3. Adoption of New and Amended International Financial Reporting Standards (IFRS)

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 financial statements for 2008, as follows:

- Amended IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures - Reclassification of Financial Assets (effective for periods beginning on or after 1 July 2008) that permits an entity to reclassify:
  - non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances, and

2. Summary of significant accounting policies (continued):

2.3. Adoption of New and Amended International Financial Reporting Standards (IFRS) (continued)

- financial assets available for sale to the loans and receivables category that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future.

The Bank considers that the mentioned amendments have no impact on the financial performance for 2008.

- IFRIC 11 Scope of IFRS 2 Group and Treasury Share Transactions (effective for periods beginning on or after 1 March 2007) 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 the 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 (effective for periods beginning on or after 1 January 2008) applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. This Interpretation will not impact the Bank.
- IFRIC 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for periods beginning on or after 1 January 2008) 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 not impact the financial position or performance of the Bank.

The Bank has also considered 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 applicable and effective for financial statements for 2009 and subsequent to December 2009 year-end, as follows:

- Amended IFRS 1 First-time Adoption of International Financial Reporting Standards - Cost of Investment in a Subsidiary, Jointly Controlled Entity or Associate (effective for periods on or after 1 January 2009) that allows an entity, in its separate financial statements, to determine the cost of investment in subsidiaries, jointly controlled entities or associates (in its opening IFRS financial statements) as a cost determined in accordance with IAS 27 or at fair value of the investment at the date of transition to IFRS, determined in accordance with IAS 39. This determination is made for each investment. The Bank expects that this standard will not impact the financial performance of the Bank.
- Amended IFRS 2 Share-based Payment - Vesting conditions and Cancellations (effective for periods beginning on or after 1 January 2009) that gives greater clarity in vesting conditions as a condition that includes explicit or implicit requirement to provide services and cancellations. Due to HBOR's ownership structure, this interpretation is not applicable and has no impact on the financial position of the Bank.

2. Summary of significant accounting policies (continued):

2.3. Adoption of New and Amended International Financial Reporting Standards (IFRS) (continued)

- Amended IFRS 7 Improving Disclosures about Financial Instruments (effective for periods beginning on or after 1 January 2009) introduced a three-level fair value disclosure hierarchy that distinguishes fair value measurements by the significance of the inputs used. In addition, the amendments enhance disclosure requirements on the nature and extent of liquidity risk arising from financial instruments to which an entity is exposed. The Bank estimates that the mentioned amendments will not impact the financial performance of the Bank.
- IFRS 8 Operating Segments (effective for periods beginning on or after 1 January 2009) introduces the management approach to segment reporting. Standard requires the disclosure of segment information based on the internal reports regularly reviewed by an entity's chief operating decision maker in order to assess each segment's performance and to allocate resources to them. The Bank expects that this standard will have no impact on the financial result of the Bank.
- Revised IAS 1 Presentation of Financial Statements (effective for periods beginning on or after 1 January 2009) enhances the usefulness of information presented in the financial statements. The key changes take account that the statement of changes in equity includes only transactions with owners and all non-owners are presented in equity as a single line, with details included in a separate statement. The Standard introduces a new statement of comprehensive income that combines all items of income and expense recognized in profit or loss together with "other comprehensive income". The Standard clarifies that amounts reclassified to profit or loss that were previously recognized in other comprehensive income must be separately disclosed, either in the statement of comprehensive income itself or in the notes. Apart from that mentioned, entities must disclose the income tax relating to each component of other comprehensive income. Also, when an entity restates its financial statements or retrospectively applies a new accounting policy, a statement of financial position must be presented as the beginning of the earliest comparative period with related notes. Dividends to equity holders can now be shown only in the statement of changes in equity or in the notes. Revisions introduce a new terminology, replacing "balance sheet" with "statement of financial position" and "cash flow statement" with "statement of cash flows". The Bank estimates that the mentioned revisions will not impact the financial position and performance of the Bank, but will broaden disclosures in the financial statements.
- Revised IAS 23 Borrowing Costs (effective for periods beginning on or after 1 January 2009) eliminates the option of expensing all borrowing costs and requires borrowing costs to be capitalized if they are directly attributable to the acquisition, construction or production of 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.

2. Summary of significant accounting policies (continued):

2.3. Adoption of New and Amended International Financial Reporting Standards (IFRS) (continued)

- Amended IAS 27 Consolidated and Separate Financial Statements - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (effective for periods beginning on or after 1 January 2009) abandoned the cost method and all dividends will be recognized in profit or loss but the payment of such dividends requires the entity to consider whether there is an indicator of impairment. Also, the Standard determines the treatment of reorganizations where a new parent is inserted above an existing parent of a group. The Bank estimates that the mentioned amendments will not impact the financial performance of the Bank.
- Amended IAS 27 Consolidated and Separate Financial Statements (effective for periods beginning on or after 1 July 2009) introduced that changes in ownership interests of a subsidiary will be accounted for as an equity transaction and will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, losses incurred by the subsidiary will be allocated between the controlling and non-controlling interests. On a loss of control of a subsidiary, any retained interest will be measured to fair value which will impact the gain or loss recognized on disposal. The Bank estimates that the mentioned amendments will not impact the financial performance of the Bank.
- Amended IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation (effective for periods beginning on or after 1 January 2009) determine that puttable financial instruments will be classified as equity if they have all of the features specified by the Standards. In addition, the Standard requires that an instrument that imposes on the entity an obligation to deliver a „pro rata" share of the entity's net assets only upon liquidation should be classified as equity if it has features broadly similar to those determined for puttable financial instruments. Such obligations occur when liquidation is certain and outside the control of the entity or is uncertain and within the control of the holder of the instrument. The Bank estimates that the mentioned amendments will not impact the financial performance of the Bank.
- Revised IFRS 3 Business Combinations (effective for periods beginning on or after 1 July 2009) increases the number of transactions to which it must be applied, by including combinations of mutual entities and combinations without consideration (e.g., dual listed shares). The Bank estimates that the mentioned revisions will not impact the financial performance of the Bank.
- Amended IAS 39 Financial Instruments: Recognition and Measurement - Eligible hedged items (effective for periods beginning on or after 1 July 2009) addresses only the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. The Standard clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item. The amendment indicates that inflation is not a separately identifiable risk and cannot be designated as the hedged risk unless it represents a contractually specified cash flow. The Bank estimates that the amendments will not impact the financial position of the Bank.

2. Summary of significant accounting policies (continued):

2.3. Adoption of New and Amended International Financial Reporting Standards (IFRS) (continued)

- IFRIC 13 Customer Loyalty Programmes (effective for periods beginning on or after 1 July 2008) addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. The interpretation becomes obligatory for 2009 financial statements. The Bank expects that this interpretation will not impact the Bank's financial statements as such schemes currently do not exist.
- IFRIC 15 Agreements for the Construction of Real Estate (effective for periods beginning on or after 1 January 2009) determines whether an agreement for the construction of real estate is within the scope of IAS 11 Construction Contracts or IAS 18 Revenue. Considering the scope of the interpretation and the related standards that are aimed at real estate constructors or developers, the mentioned Interpretation will not impact the financial position and performance of the Bank.
- IFRIC 16 Hedges of a Net Investment in a Foreign Operation (effective for periods beginning on or after 1 October 2008) provides guidance in respect of hedges of foreign currency gains and losses on a net investment in a foreign operation. The Interpretation clarifies that an entity can hedge the foreign exchange gains and losses on a net investment arising from differences between the functional currency of the foreign operation and the functional currencies of either its direct parent, or of any intermediate parent or of its ultimate parent. The hedged item can be an amount of net assets equal to or less than the carrying amount of the net asset of the foreign operation in the consolidated financial statements. As in other hedge relationships, an exposure cannot be hedged twice. Also, a hedging relationship designated by a parent entity need not be maintained at the ultimate parent entity level. The Bank estimates that this will not impact the financial position and performance of the Bank.
- IFRIC 17 Distribution of Non-Cash Assets to Owners (effective for periods beginning on or after 1 July 2009) applies to non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners: distributions of non-cash assets and distributions that give owners choice of receiving either non-cash assets or a cash alternative. The Bank estimates that the mentioned Interpretation will not impact the financial position and performance of the Bank.
- IFRIC 18 Transfers of Assets from Customers (should be applied prospectively to transfers of assets from customers received on or after 1 July 2009) applies to the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers. The Bank estimates that the mentioned Interpretation will not impact the financial position and performance of the Bank.

3. Interest income

Interest income by borrowers:

	2008	2007
	HRK '000	HRK '000
Public sector	53,123	76,895
State-owned companies	130,876	139,163
Foreign companies	9,110	4,170
Other companies	318,649	329,955
Domestic banks	348,007	263,330
Foreign banks	13,180	14,823
Other	34,763	29,168
Penalty interest	12,511	11,086
	920,219	**868,590**

Interest income by type of facility:

	2008	2007
	HRK '000	HRK '000
Interest on loans		
- Long-term loans	886,938	829,242
- Short-term loans	2,500	1,424
	889,438	830,666
Investments in securities	11,251	15,537
Deposits	19,530	22,387
	920,219	**868,590**

4. Interest expense

Interest expense by type of payee:

	2008	2007
	HRK '000	HRK '000
Companies	-	3
Domestic banks	11,479	33
Foreign banks	503,065	423,186
Other	5	6
	514,549	**423,228**

Interest expense by type of facility:

	2008	2007
	HRK '000	HRK '000
Borrowings	220,085	164,639
Debt securities	292,369	255,146
Deposits	2,095	3,443
	514,549	**423,228**

5. Net fee income

	2008	2007
	HRK '000	HRK '000
Fee income:		
From issued guarantees	*12,768*	*11,921*
From Managed funds for and on behalf of third parties	*7,364*	*7,385*
From money transfers	*1,750*	*1,553*
Other	*22*	*28*
	21,904	**20,887**
Fee expense	(1,249)	(797)
Net fee income	**20,655**	**20,090**

6. Net gains/(losses) on financial operations

	2008	2007
	HRK '000	HRK '000
Net foreign exchange gains/(losses) on foreign currency assets:		
Cash on hand, accounts at banks and due from banks	*(8,677)*	*868*
Loans given to banks and other customers	*37,665*	*(76,903)*
Investments held to maturity	*(718)*	*(152)*
Assets available for sale	*(327)*	*(602)*
Other	*4,312*	*5,337*
	32,255	(71,452)
Net foreign exchange gains/(losses) on foreign currency liabilities:		
Deposits	*(866)*	*13,637*
Borrowings and issued long-term securities	*(14,601)*	*51,929*
Other	*(49)*	*2,537*
	(15,516)	68,103
Net foreign exchange gains/(losses) on foreign currency assets and liabilities	16,739	(3,349)
Gains on assets at fair value through profit or loss and realized gains on assets available for sale	539	1,050
Net gains/(losses) on financial operations	**17,278**	**(2,299)**

7. Operating expenses

Operating expenses can be shown as follows:

	2008	2007
	HRK '000	HRK '000
General and administrative expenses:		
Employee expenses	51,642	52,977
Depreciation	5,922	6,181
Administration expenses	8,697	12,619
Material and services	16,109	16,981
	82,370	88,758
Other expenses:		
Taxes and contributions	251	226
Other expenses	4,583	3,252
	4,834	3,478
	87,204	**92,236**

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)	2008	2007
	HRK '000	HRK '000
Impairment losses on cash on hand and due from banks	(133)	43
Impairment losses on deposits with other banks	2,363	1,978
Impairment losses on loans to banks	119,542	24,079
Impairment losses on loans to other customers and interest	146,142	105,108
(Decrease) in impairment losses on investments in associates - disposal of associate	-	(2,100)
Impairment losses on other assets	46	(518)
Total increase in provision for impairment losses on assets	267,960	128,590
Provision for guarantees and commitments	(85,754)	4,795
Other provisions	4,626	1,693
Total (decrease)/increase in provision for guarantees and commitments	(81,128)	6,488
Total increase of provisions	**186,832**	**135,078**

9. Cash on hand and due from banks

	2008	2007
	HRK '000	HRK '000
Account with the Croatian National Bank	9,870	8,303
Due from domestic banks in foreign currency	170	74
Due from foreign banks in foreign currency	4,022	16,458
-	14,062	24,835
Provision for impairment losses	(42)	(175)
	14,020	**24,660**

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

	2008	2007
	HRK '000	HRK '000
Balance as of 1 January	175	132
Provision for impairment losses	(133)	43
Balance as of 31 December	**42**	**175**

10. Deposits with other banks

	2008	2007
	HRK '000	HRK '000
Deposits with foreign banks	661,029	494,558
Deposits with domestic banks	167,140	95,926
Accrued interest	101	216
	828,270	590,700
Provision for impairment losses	(8,433)	(6,070)
	819,837	**584,630**

The funds of a limited deposit account of HRK 15,300 thousand that were paid-in to the capital of a future credit insurance company are presented as deposits with domestic banks. HBOR started a procedure of company registration, and all necessary applications for authorization and approvals for a new company in order to carry on insurance business were submitted to HANFA (Croatian Financial Services Supervisory Agency) that exercises supervision over the operations of insurance companies in the Republic of Croatia. After authorisation to carry on insurance business and registration in the judicial register of the companies are completed, these funds will be presented as investments in subsidiary due to HBOR's intended 51 % share in the company's equity.

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

	2008	2007
	HRK '000	HRK '000
Balance as of 1 January	6,070	4,092
Provision for impairment losses on deposits with other banks	2,363	1,978
Balance as of 31 December	**8,433**	**6,070**

11. Loans to banks

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

	2008	2007
	HRK '000	HRK '000
Loans due within one year	4,945,198	3,801,130
Loans due in over one year	7,769,986	7,325,999
Accrued interest	33,295	26,603
Deferred recognition of loan origination fees	(47,264)	(37,572)
	12,701,215	11,116,160
Provision for impairment losses	(713,507)	(592,627)
	11,987,708	**10,523,533**

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

	2008	2007
	HRK '000	HRK '000
Balance as of 1 January	592,627	569,138
Provision for impairment losses on loans to banks	119,542	24,203
Foreign exchange gains/(losses) on provision for impairment losses, net	1,338	(714)
Collection of off-balance receivables	-	(124)
Provisions transferred from off-balance sheet	-	124
Balance as of 31 December	**713,507**	**592,627**

11. Loans to banks (continued)

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

	2008	2007
	HRK '000	HRK '000
Economic reconstruction and development	4,739,149	3,670,417
Export	5,484,318	4,803,461
Infrastructure reconstruction and development in the Republic of Croatia	284,922	103,866
Small and medium enterprises	1,636,277	1,108,311
Reconstruction of housing and business facilities damaged by war	23,474	25,651
Other	547,044	1,415,423
Accrued interest	33,295	26,603
Deferred recognition of loan origination fees	(47,264)	(37,572)
	12,701,215	11,116,160
Provision for impairment losses	(713,507)	(592,627)
	11,987,708	**10,523,533**

Interest rates on loans ranged from 0.5 % to 5 % annually during 2008 (1 % to 4 % annually during 2007), depending on the purpose of the loan and area of investments.

12. Loans to other customers

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

	2008	2007
	HRK '000	HRK '000
Domestic companies	3,922,257	3,803,524
State-owned companies	1,699,295	1,906,644
Public sector	688,748	899,431
Foreign companies	166,681	98,122
Non-profit institutions	-	2,983
Other	580,207	453,612
Accrued interest	18,063	49,177
Deferred recognition of loan origination fees	(58,778)	(60,457)
	7,016,473	7,153,036
Provision for impairment losses	(1,368,372)	(1,220,305)
	5,648,101	**5,932,731**

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

	2008	2007
	HRK '000	HRK '000
Balance as of 1 January	1,220,305	1,106,587
Provision for impairment losses on loans to other customers and interest	146,731	123,134
Foreign exchange gains/(losses) on provision for impairment	1,552	(3,302)
losses, net	(589)	(18,026)
Collection of off-balance sheet receivables	589	18,026
Provisions transferred from off-balance sheet	(216)	(5,345)
Write-offs	-	(769)
Balance as of 31 December	**1,368,372**	**1,220,305**

12. Loans to other customers (continued)

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

	2008	2007
	HRK '000	HRK '000
Economic reconstruction and development	2,312,827	2,539,040
Export	1,383,941	1,417,263
Infrastructure reconstruction and development in the Republic of Croatia	2,092,720	2,223,624
Small and medium enterprises	926,578	675,220
Other	341,122	309,169
Accrued interest	18,063	49,177
Deferred recognition of loan origination fees	(58,778)	(60,457)
	7,016,473	7,153,036
Provision for impairment losses	(1,368,372)	(1,220,305)
	5,648,101	**5,932,731**

Interest rates on loans ranged from 2% to 6% annually during 2008 and 2007, respectively, depending on the purpose of the loan and area of investments.

13. Assets held to maturity

	2008	2007
	HRK '000	HRK '000
Bonds issued by the Republic of Croatia	-	38,821
Accrued interest	-	340
	-	**39,161**

The last instalment of amortized bonds issued by the Republic of Croatia that HBOR acquired in settlement of receivables from "Dubrovačka banka d.d.", was regularly due on 17 November 2008 (31 December 2007: EUR 5,300 thousand).

14. Available for sale assets

	2008	2007
	HRK '000	HRK '000
Debt securities:		
Listed debt securities:		
Bonds of the Ministry of Finance of the Republic of Croatia	149,524	161,633
Corporate bonds	-	14,504
Accrued interest	2,447	2,601
	151,971	**178,738**
Equity securities:		
Unlisted equity securities:		
Investments in shares of foreign companies	20	18
Investments in financial institution shares	161	138
Shares of foreign financial institutions - EIF (Note 24)	12,761	12,326
Corporate shares	-	-
	12,942	**12,482**
	164,913	**191,220**

14. Available for sale assets (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 2008, the value of these outstanding bonds amounted to HRK 45,045 thousand (31 December 2007: HRK 46,148 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-085A) issued in HRK on 28 May 2003 as a 5-year term note with an interest rate of 6.125% were regularly redeemed by the issuer on 28 May 2008 (31 December 2007: HRK 7,485 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 2008, the value of these outstanding bonds amounted to HRK 9,930 thousand (31 December 2007: HRK 10,939 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 2008, the value of these outstanding bonds amounted to HRK 71,779 thousand (31 December 2007: HRK 73,325 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%. The bonds were pre-redeemed in 2008 by the issuer (31 December 2007: HRK 14,504 thousand).

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 2008, the value of these outstanding bonds amounted to HRK 22,770 thousand (31 December 2007: HRK 23,736 thousand).

In February 2007, HBOR made acquisitions of three, and in July 2007 of two more, shares of the European Investment Fund (EIF). 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 2008 this contingent liability was EUR 4 million (Note 24).

The General Meeting, acting on a proposal from the Board of Directors, may require payment of the subscribed but not paid capital to the extent required for the Fund to meet its liabilities towards its creditors. Such payment shall be effected within 90 days from the decision of the General Meeting.

Corporate shares comprise shares in capital of the shipyard company Brodogralište Viktor Lenac d.d., Rijeka. Upon the commencement of bankruptcy proceedings of the company Brodogradilište Viktor Lenac d.d. in December 2003, , HBOR effected a 100 % impairment of value for the complete amount of receivables from the company, due to the estimated uncollectability, and the receivables were classified as bad and doubtful receivable.

On the conclusion of the bankruptcy proceedings in April 2008, the equity of the shipyard company was divided into 12,407,813 common shares of nominal value HRK 10.00 per share, issued in the procedure of conclusion of the bankruptcy proceedings by registration of rights - receivables in cash. HBOR registered a part of the recognized receivables of HRK 13,673 thousand from the bankruptcy proceedings into the equity of the debtor, by which the Bank acquired 11.0194 % of the equity of the company. The conversion of a portion of receivables into the equity in the above mentioned amount has been recorded and stated with a 100 % value adjustment, transferred from off-balance sheet. The company's shares were listed in 2008 at the Zagreb Stock Exchange, but have still not been traded.

15. Investments in associates

	2008	2007
	HRK '000	HRK '000
Investments in associates	26,157	26,157
Value adjustments	(26,157)	(26,157)
	-	-

Investments in associates were carried out within a Program of investments in the equity of companies - small and medium sized entrepreneurs or pursuant to single decisions of authorized bodies of HBOR. The investments were made for a period ranging from 4 to 6 years with the right of HBOR to sell the shares after the contracted term of holding an equity stake. 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.

	Line of business	2008 Investments	% ownership in 2008	2007 Investments	% ownership in 2007
		HRK '000		HRK '000	
Lika d.d. in liquidation, Donji Lapac	Production, processing and meet 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%
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		26,157	

16. Property, plant and equipment and intangible assets

	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not yet ready for use	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 2007	**50,082**	**12,111**	**11,926**	**95**	**74,214**	**10,705**	**84,919**
Additions	-	-	-	22,964	22,964	-	22,964
Transfer from assets not yet ready for use	875	427	905	(4,007)	(1,800)	1,800	-
Disposals	-	(618)	(704)	-	(1,322)	-	(1,322)
At 31 December 2008	**50,957**	**11,920**	**12,127**	**19,052**	**94,056**	**12,505**	**106,561**
Accumulated depreciation							
At 31 December 2007	**9,478**	**8,766**	**8,825**	**-**	**27,069**	**8,798**	**35,867**
Depreciation for 2008	1,522	1,861	1,190	-	4,573	1,349	5,922
Disposals	-	(618)	(701)	-	(1,319)	-	(1,319)
At 31 December 2008	**11,000**	**10,009**	**9,314**	**-**	**30,323**	**10,147**	**40,470**
Net book value at 31 December 2008	**39,957**	**1,911**	**2,813**	**19,052**	**63,733**	**2,358**	**66,091**
Net book value at 31 December 2007	**40,604**	**3,345**	**3,101**	**95**	**47,145**	**1,907**	**49,052**

16. Property, plant and equipment and intangible assets (continued)

	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not yet ready for use	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 assets not yet ready for use	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. Non-current assets held for sale

	2008	2007
	HRK '000	HRK '000
Non-current assets held for sale	41,441	50,267
	41,441	**50,267**

In 2008, HBOR took over non-current assets held for sale of HRK 1,128 thousand (2007: HRK 18,673 thousand) comprised of HRK 371 thousand (2007: HRK 837 thousand), buildings of HRK 0 thousand (2007: HRK 15,694 thousand), apartments of HRK 757 thousand (2007: HRK 453 thousand), furniture and vehicles of HRK 0 thousand (2007: HRK 1,516 thousand) and property, plant and equipment of HRK 0 thousand (2007: HRK 173 thousand).

In 2008, HBOR sold non-current assets held for sale of HRK 9,954 thousand (2007: HRK 3,837 thousand) comprised of land of HRK 0 thousand (2007: HRK 338 thousand), buildings of HRK 6,544 thousand (2007: HRK 2,618 thousand), apartments of HRK 1,721 thousand (2007: HRK 881 thousand), furniture and vehicles of HRK 1,516 thousand (2007: HRK 0 thousand) and other non-current assets of HRK 173 thousand (2007: HRK 0 thousand).

18. Other assets

	2008	2007
	HRK '000	HRK '000
Fees receivable	439	441
Receivables derived from foreign currency conversion	3,188	-
Other assets	6,124	6,515
	9,751	**6,956**
Provision for impairment losses	(148)	(159)
	9,603	**6,797**

18. Other assets (continued)

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

	2008	2007
	HRK '000	HRK '000
Balance as at 1 January	159	718
Provision for impairment losses on other assets	79	(483)
Collection of off-balance sheet items receivable	(33)	(35)
Provisions transferred from off-balance sheet	33	35
Write-offs	(15)	(13)
Transfer to off-balance sheet	(75)	(63)
Balance as of 31 December	**148**	**159**

19. Deposits

	2008	2007
	HRK '000	HRK '000
Bank deposits	20,955	829
Foreign currency accounts of the companies	410	1,291
Foreign currency account of the Ministry of Finance of the Republic of Croatia	21,521	16,979
Foreign currency special purpose accounts of companies	61,655	219,786
Deposits by local authorities and fund organizations	62,021	64,572
Deposits by state institutions	194,205	254,952
Deposits by foreign financial institutions	77,332	-
Other deposits	715	141
Accrued interest	203	-
	439,017	**558,550**

The foreign currency account of the Ministry of Finance of the Republic of Croatia relates to the Export Insurance Guarantee Fund comprising of reinsurance premiums paid for export insurance operations of HRK 12,915 thousand (2007: HRK 12,572 thousand), grant funds provided by the Global Environment Facility (GEF) aimed at the Renewable Energy Resources Project of HRK 2,420 thousand (2007: HRK 1,308 thousand), the grant funds provided by the GEF aimed at the Programme of issuing bank guarantees for energy efficiency projects within the Energy Efficiency Project of HRK 6,186 thousand (2007: HRK 2,991 thousand), all managed by HBOR for and on behalf of the Republic of Croatia.

Demand 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, the Ministry of the Economy, Labour and Entrepreneurship, the Ministry of the Sea, Tourism, Transport and Development, the Ministry of Agriculture, Forestry and Water Management, the Fund for Development and Employment, the Fund for Regional Development, Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for Small Business ('HAMAG').

HBOR does not pay interest on the above deposits, except on bank deposits and deposits from foreign financial institutions.

20. Borrowings

	2008	2007
	HRK '000	HRK '000
Balance as of 1 January	3,769,554	3,707,625
New borrowings	3,569,236	924,993
Repayments	(2,363,936)	(823,593)
Foreign exchange gains/(losses)	19,353	(39,471)
	4,994,207	3,769,554
Accrued interest	25,914	25,805
Balance as of 31 December	**5,020,121**	**3,795,359**

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 - 2.85 percentage points annually.

The Bank is subject to different financial covenants arising from contracts. As of 31 December 2008, the Bank was in compliance with all the required contractual financial covenants.

21. Bonds payable

	Effective interest rate	Fair value 2008	Net book value 2008	Fair value 2007	Net book value 2007
	%	HRK '000	HRK '000	HRK '000	HRK '000
Bonds EUR 100 million	5.899	554,147	585,954	744,307	732,513
Bonds EUR 300 million	5.021	2,095,826	2,190,884	2,192,924	2,188,518
Bonds EUR 150 million	4.836	930,096	1,097,465	1,068,224	1,097,384
Bonds EUR 250 million	5.076	1,454,490	1,821,860	1,756,566	1,821,174
Accrued interest		-	172,518	-	173,256
		5,034,559	**5,868,681**	**5,762,021**	**6,012,845**

The book value of bonds includes interest.

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 Amortizing Notes due in 2008 - 2012 under the EMTN program on 4 December 2002, with a guarantee of the Republic of Croatia of EUR 100,000 thousand (HRK 585,954 thousand as at 31 December 2008 and HRK 732,513 thousand as at 31 December 2007) and with a maturity period of 10 years and a fixed interest rate of 5.75%. Interest is paid annually, in arrears. The first instalment was due and paid in December 2008 and the amount outstanding as at 31 December 2008 was EUR 80,000 thousand.

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 of EUR 300,000 thousand (HRK 2,190,884 thousand as at 31 December 2008 and HRK 2,188,518 thousand as at 31 December 2007) 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 of EUR 150,000 thousand (HRK 1,097,465 thousand as of 31 December 2008 and HRK 1,097,384 thousand as at 31 December 2007) 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 of EUR 250.000 thousand (HRK 1,821,860 thousand as at 31 December 2008 and HRK 1,821,174 thousand as at 31 December 2007) with maturity of 10 years and fixed interest rate of 5.0%. Interest is paid annually, in arrears.

22. Other liabilities

	2008 HRK '000	2007 HRK '000
Deferred recognition of interest income	792,252	675,714
Liabilities in respect of subsidized interest	133,772	285,247
Provisions for guarantees and commitments	145,797	231,564
Liabilities for preferential financing of housing loans with State support	32,410	32,410
Provisions for other liabilities	17,338	12,712
Accrued salaries	4,151	4,605
Deferred recognition of income from fees on issued guarantees (note 24)	2,699	2,306
Liabilities to suppliers	1,042	2,063
Liabilities for prepaid receivables	1,720	647
Other liabilities	8,874	8,650
	1,140,055	**1,255,918**

Liabilities in respect of subsidised interest represent advances taken in respect of interest subsidies on loans, which are provided for final customers at a lower interest rate in accordance with the following programmes implemented by HBOR for and on behalf of the Republic of Croatia (see Note 25). These liabilities include:

- HRK 114,075 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (2007: HRK 269,711 thousand);
- HRK 13,697 thousand in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet (2007: HRK 14,046 thousand).
- HRK 0 thousand in respect of the Fund for Regional Development (2007: HRK 1,284 thousand),
- HRK 1,000 thousand in respect of the Environment and Energy Efficiency Fund (2007: HRK 206 thousand) (see note 25),
- HRK 5,000 thousand in respect of loans granted to the borrowers investing into entrepreneurial zones.

Deferred recognition of interest income of HRK 792,252 thousand (2007: HRK 675,714 thousand) consists of the state subsidies for interest in respect of loans of HRK 178,879 thousand (2007: HRK 175,767 thousand), which are provided and drawn down by final customers at lower interest rates (see Note 2) but are not in the repayment stage, and of the state subsidies for interest in respect of loans of HRK 613,373 thousand (2007: HRK 499,947 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).

Provisions for guarantees and commitments represent the best estimation of the outflow for settlement of the outstanding liabilities at the balance sheet date and are 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 23,453 thousand relates to banks (2007: HRK 29,594 thousand), HRK 87,814 thousand relates to domestic companies (2007: HRK 81,333 thousand), HRK 15,016 thousand relates to state-owned companies (2007: HRK 104,167 thousand), HRK 356 thousand relates to the public sector (2007: HRK 728 thousand), HRK 6,153 thousand relates to foreign companies (2007: HRK 6,882 thousand) and HRK 13,005 thousand relates to others (2007: HRK 8,860 thousand).

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

	2008	2007
	HRK '000	HRK '000
Balance as at 1 January	231,564	229,193
Provision for guarantees and commitments	(85,754)	4,795
Foreign exchange gains/(losses) on provision for impairment losses, net	(13)	(2,424)
Provision for guarantees and commitments	**145,797**	**231,564**
Balance as at 1 January	12,712	11,019
Provisions for potential losses on other liabilities	4,626	1,693
Provisions for other liabilities	**17,338**	**12,712**
Balance as at 31 December	**163,135**	**244,276**

23. Guarantee fund

The Guarantee fund, of HRK 12.423 thousand and HRK 12.985 thousand as of 31 December 2008 and 2007 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. The funds of the Guarantee fund are unconditionally contributed and have no maturity.

The decrease presented in relation to the prior year relates to the write-off of the receivable upon paid guarantee of HRK 556 thousand and foreign exchange gains of HRK 6 thousand. The write-off was performed due to and after all available options of enforced collection were exercised.

24. Guarantees and commitments

In order to meet the financial needs of customers, the Bank contracts various commitments and contingent liabilities. The purpose of these instruments is to ensure that the funds are available to a customer when required.

These obligations contain credit risk and are therefore part of the overall risk of the Bank.

	2008	2007
	HRK '000	HRK '000
Guarantees issued in HRK	518	691
Guarantees issued in foreign currency	1,700,574	2,311,044
Issued bills of exchange	41,183	31,105
Open letters of credit in foreign currency	28,135	88,934
Undrawn loans	1,147,058	1,815,862
EIF - subscribed, not called up capital (note 14)	29,298	29,301
Deferred recognition of income from fees for guarantees (note 22)	(2,699)	(2,306)
	2,944,067	4,274,631
Provisions for guarantees and commitments	(145,797)	(231,564)
	2,798,270	**4,043,067**

Issued guarantees and open letters of credit

Issued guarantees and open letters of credit oblige the Bank to make payments on behalf of customers in the event of a specific act, generally related to the export or import of goods and other purposes specified in the contracts with the customers. Guarantees and open letters of credit bear the same credit risk as loans.

Bank guarantees are mostly guaranteed by the Government of the Republic of Croatia, while open letters of credit are fully covered by deposits (see note 19).

Commitments upon undrawn loans

The Bank has an obligation to disburse funds for loans and revolving loans upon committed undrawn loans. The expiry date of disbursement or other termination clause is determined by the contract. Disbursements are exercised in several withdrawals, depending on the purpose of the loan, phase of the project or documentation needed for disbursement. Since commitments may expire without being drawn upon, the total contractual amounts do not necessarily represent future cash outflows.

Committed undrawn loans include less potential credit risk than loans, since most commitments depend upon meeting specific terms and conditions by the customers in order to use the funds. The Bank monitors the terms to maturity of loan commitments.

25. Managed funds for and on behalf of third parties

The Bank manages funds on behalf of and for the account of the Ministry of Finance, the Ministry of the Economy, Labour and Entrepreneurship, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, Fisheries and Rural Development, the Fund for Development and Employment, the Fund for Regional Development, the Environmental and Energy Efficiency Fund, Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for Small Businesses ("HAMAG"), that are mainly used for various reconstruction and development programmes. These assets are separated from the Bank's assets and do not represent the Bank's risk. 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 contract with the customer and taking into account that the stated amounts are insignificant for the Bank. Agency business funds per individual programmes amount to:

Programme	2008	2007
	HRK '000	HRK '000
Development and Reconstruction of Rural Housing	78,097	95,624
Employment of Former Soldiers	489,159	470,187
Emergency Reconstruction Project (loan IBRD 3760 - HR)	365	438
Loans to companies having difficulties - Ministry of Finance funds	72,840	70,676
Loans to companies having difficulties - Croatian Employment Agency funds	1,058	1,222
Municipal Environmental Infrastructure Investment Program - MEIP	723,298	683,298
Collection of receivables under HAMAG guarantees	285	297
Insurance of export transactions	181,943	166,055
Programme of Preferential Financing through HBOR's Loan Programmes	114,075	269,711
Program for Development and Employment - loans	289,695	298,107
Program for Regional Development of the Republic of Croatia - loans	27,605	26,596
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy, Labour and Entrepreneurship	39,197	40,717
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Sea, Transport and Infrastructure	41,126	28,939
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture, Fisheries and Rural Development	51,779	31,434
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy, Labour and Entrepreneurship - interest subsidy	657	1,442
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Sea, Transport and Infrastructure - interest subsidy	1,937	2,743
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture, Fisheries and Rural Development - interest subsidy	11,103	9,861
Renewable Energy Resources Project	5,789	2,880
VIK - EKO account A - dedicated water charge	353,764	308,048
VIK - EKO account B - VAT	90,022	66,162
Programme of Issuing Bank Guarantees for Energy Efficiency Projects - UNDP	3,093	2,991
Fund for Regional Development - interest subsidy	-	1,284
The Environment and Energy Efficiency Fund - interest subsidy	-	206
Programme of Issuing Bank Guarantees for Energy Efficiency Projects - IBRD	3,093	-
Interest subsidies for the loans to the entrepreneurs who invest in entrepreneurial zones	5,000	-
Loan Programme for the Energy Efficiency Projects - interest subsidy	1,000	-
	2,585,980	**2,578,918**

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 and state-owned companies (in which the Republic of Croatia holds 51 % or more of the ownership).

All transactions stated were carried out under usual/regular conditions of the Bank.

As of 31 December 2008 and 31 December 2007, balances arising from transactions with related parties, including the Bank's key management personnel, include the following:

a) Related party transactions

	Exposure	Liabilities	Income	Expense	Exposure	Liabilities	Income	Expense
	2008	2008	2008	2008	2007	2007	2007	2007
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Owner	415,442	282,140	53,638	-	621,099	517,398	47,025	-
Government funds, executive authorities and agencies	254,709	93,362	22,151	-	357,091	65,703	26,810	-
State-owned companies	3,184,455	61,854	229,707	-	3,942,136	209,388	168,709	-
Associates	21	-	157	-	24	-	29,522	-
Key management personnel	1,604	-	57	3	1,322	-	64	-
Total	**3,856,231**	**437,356**	**305,710**	**3**	**4,921,672**	**792,489**	**272,130**	**-**

Exposures include loans to other customers, available for sale assets, assets held to maturity, non-current assets held for sale, other assets and off-balance sheet exposure relating to guarantees and commitments.

Liabilities include deposits and other liabilities.

Income includes interest income, fee income and decrease in impairment loss and provisions.

Expense includes impairment loss and provisions.

Expenses in relation to key management members do not include salaries that are presented in note 26.c). Key management personnel comprise Managing Board members and Directors.

b) Collateral received:

	2008	2007
	HRK '000	HRK '000
The Republic of Croatia	3,113,346	3,735,647
State agencies	303,946	214,048
Total	**3,417,292**	**3,949,695**

26. Related-party transactions (continued)

b) Collateral received (continued)

Collateral received relates to first-class collateral instruments received as security for HBOR's placements comprising Republic of Croatia guarantees, HAMAG guarantees, insurance policies of export transactions against political and/or commercial risks and statutory guarantees in cases when the Republic of Croatia or other state executive body guarantees the liabilities of certain borrowers pursuant to provisions of certain laws.

c) Salaries of key management personnel

Salaries include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, jubilee awards. In 2008, salaries amounted to HRK 5,760 thousand (2007: HRK 6,260 thousand).

Remuneration for the work of the members of the Supervisory Board amounted to HRK 370 thousand (2007: HRK 399 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 risk management area, the Managing Board delegated their authority to two risk management committees.

Risk management boards

- **Assets and liabilities management committee (ALCO)** - 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 issues related to credit risk.

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 to which the Bank is exposed. The Risk Management unit performs its role by evaluating and measuring the Bank's exposure to credit and non-credit risks, developing risk-related procedures and methodology, recommending exposure limits, evaluating the quality of the loan portfolio, reporting to the Managing Board 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 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 ALCO. The Bank carries out monitoring of market risks through scenario analysis and sensitivity analysis.

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. 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. Capital adequacy and other various reports related to the monitoring of risk exposure are prepared on a quarterly basis. Systems of pro-active risk management are developed for the purpose of minimizing potential future risks. 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 clients' financial reports, movements between risk groups and activities undertaken in cases of deteriorated creditworthiness of the client are prepared.

For reporting purposes, the Bank relies on historical data, their statistics and regular checks of prescribed quantitative methods of estimation and measurement.

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 losses 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 has a conservative credit risk policy. The credit risk management system is a crucial part of the Bank's business policy and it is an important strategic factor of business conduct, and therefore this area is regulated by a separate act - Credit risk management procedures, that are applied in all phases of the process (from the development of new bank products or from the credit application until its 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 state their related parties. The information thereby gathered is verified and the type of intra-relationship is determined as well as the occurrence of the influence of the improvement or worsening of economic and financial conditions of one related party to 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 economic sustainability of the project as well as a return on investment, the Bank is constantly improving existing organizational and technical solutions, reports and internal acts and proposes new organization regulations and implementation instructions.

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 Bank 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. 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.

27. Risk management (continued)

27.2. Credit risk (continued)

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 2008	Gross highest exposure 2007
	HRK '000	HRK '000
ASSETS		
Cash on hand and due from banks	14,017	24,656
Deposits with other banks	804,537	584,630
Loans to banks	11,987,708	10,523,533
Loans to other customers	5,648,101	5,932,731
Assets held to maturity	-	39,161
Assets available for sale	164,913	191,220
Other assets	8,030	5,186
Total	**18,627,306**	**17,301,117**
Guarantees and commitments		
Issued guarantees in domestic currency	513	683
Issued guarantees in foreign currency	1,652,182	2,180,479
Issued bills of exchange	40,771	30,794
Open letters of credit in foreign currency	27,854	85,954
Undrawn loans	1,047,652	1,715,856
EIF - subscribed, not called up capital	29,298	29,301
Total	**2,798,270**	**4,043,067**
Total credit risk exposure	**21,425,576**	**21,344,184**

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 2008, the highest credit exposure to one debtor was HRK 1,467,850 thousand (31 December 2007: HRK 1,369,484 thousand) after considering collateral received, as the client is included in the risk group "A", i.e. the client is a first class debtor. The collateral policy is disclosed further 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, as at 31 December 2008 and as at 31 December 2007 is as follows:

2008	Republic of Croatia	EU countries	Other countries	Total
	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS				
Cash on hand and due from banks	10,007	1,834	2,176	14,017
Deposits with other banks	150,323	601,663	52,551	804,537
Loans to banks	11,956,698	-	31,010	11,987,708
Loans to other customers	5,483,671	-	164,430	5,648,101
Assets held to maturity	-	-	-	-
Assets available for sale	152,133	12,780	-	164,913
Other assets	8,027	3	-	8,030
Total	**17,760,859**	**616,280**	**250,167**	**18,627,306**
Guarantees and commitments				
Issued guarantees in domestic currency	513	-	-	513
Issued guarantees in foreign currency	1,652,182	-	-	1,652,182
Issued bills of exchange	-	40,771	-	40,771
Open letters of credit in foreign currency	27,854	-	-	27,854
Undrawn loans	951,195	-	96,457	1,047,652
EIF - subscribed, not called up capital	-	29,298	-	29,298
Total	**2,631,744**	**70,069**	**96,457**	**2,798,270**
Total credit risk exposure	**20,392,603**	**686,349**	**346,624**	**21,425,576**

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):

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	8,314	1,975	14,367	24,656
Deposits with other banks	95,059	489,571	-	584,630
Loans to banks	10,483,266	-	40,267	10,523,533
Loans to other customers	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	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 industry, before and after considering collateral received, is as follows:

	Gross highest exposure	Net highest exposure	Gross highest exposure	Net highest exposure
	2008	2008	2007	2007
	HRK '000	HRK '000	HRK '000	HRK '000
Financial intermediation	13,481,454	332	12,138,610	39,715
Shipbuilding	1,856,788	116,558	2,635,806	276,746
Tourism	1,021,895	61,405	996,974	33,321
Water and electric supply and other infrastructure	1,722,559	1,278,183	1,895,873	1,412,621
Agriculture and food industry	694,640	135,082	631,742	164,922
Other industry	434,871	47,590	475,587	47,895
Private household with employees	336,304	18,045	316,508	37,036
Construction industry	347,825	214,806	445,590	252,846
Leather and textile industry	76,788	13,866	86,323	15,391
Health	21,889	14	19,244	-
Transport, warehousing and connections	795,023	15,113	956,215	16,543
Other	635,540	499,859	745,712	597,719
Total credit risk exposure	**21,425,576**	**2,400,853**	**21,344,184**	**2,894,755**

27. Risk management (continued)

27.2. Credit risk (continued)

Concentration of risk and highest credit risk exposure (continued)

The fair value of collateral in 2008 was HRK 19,024,723 thousand (2007: HRK 18,449,429 thousand), however in the total net highest exposure in 2008, the credit risk of HRK 1,848,019 thousand (2007: HRK 2,243,895 thousand) is not covered with ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 454,991 thousand (2007: HRK 649,032 thousand), from local (regional) authorities of HRK 157,192 thousand (2007: HRK 131,329 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally of HRK 250,087 thousand (2007: HRK 320,120 thousand), government funds of HRK 4,123 thousand (2007: HRK 7,698 thousand), government bonds of 151,971 thousand (2007: HRK 164,118 thousand), corporate bonds of HRK 0 thousand (2007: HRK 14,620 thousand) and government agency bonds of HRK 0 thousand (2007: HRK 39,161 thousand). In addition, an amount of HRK 829,655 thousand (2007: HRK 917,817 thousand) relates to receivables from a state-owned company (51 %).

Part of the placements with net exposure relates to placements provisionally and partially covered with collateral and the 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.

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 (%)	Historical default rate (%)	Total 2008	Total 2007
	2008	2007	HRK '000	HRK '000
A	0.75 %	0.82 %	19,064,951	19,213,293
B	7.54 %	7.24 %	2,360,625	2,130,697
C	60.66 %	55.11 %	-	194
Total			21,425,576	21,344,184

The 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 banks analyzed (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)

Impairment loss and provisions

The Bank forms provisions for identified losses in accordance with CNB regulations. Forming provisions is under the competence 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 the character of the 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 its 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 of 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 which are at least 80% covered by 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.

Loan Restructuring

In 2008 gross loans, before provision for impairment losses, that were restructured amounted to HRK 116,338 thousand (2007: HRK 24,022 thousand), and the value of the restructured loans after provision for impairment losses in 2008 amounted to HRK 63,679 thousand (2007: HRK 606 thousand).

Restructured loans to banks, before provision for impairment losses, account for 34% (2007: 0.3%) of total restructured loans or 60 % after provision for impairment losses (2007: 10%). In this case, commercial banks bear the default risk of the ultimate borrower.

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 the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows:

2008	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	14,017	-	-	14,017	-	-	-	-
Deposits with other banks	804,537	-	-	804,537	-	-	-	-
Loans to banks	11,236,569	751,139	-	11,987,708	-	332	-	332
Loans to other customers	4,465,649	1,182,452	-	5,648,101	1,731,726	131,373	-	1,863,099
Assets held to maturity	-	-	-	-	-	-	-	-
Assets available for sale	164,913	-	-	164,913	151,971	-	-	151,971
Other assets	8,013	17	-	8,030	761	17	-	778
Total	**16,693,698**	**1,933,608**	**-**	**18,627,306**	**1,884,458**	**131,722**	**-**	**2,016,180**
Guarantees and commitments								
Issued guarantees in domestic currency	513	-	-	513	-	-	-	-
Issued guarantees in foreign currency	1,460,980	191,202	-	1,652,182	3,417	191,202	-	194,619
Issued bills of exchange	40,771	-	-	40,771	-	-	-	-
Open letters of credit in foreign currency	27,854	-	-	27,854	-	-	-	-
Undrawn loans	811,837	235,815	-	1,047,652	127,904	62,150	-	190,054
EIF - subscribed, not called up capital	29,298	-	-	29,298	-	-	-	-
Total	**2,371,253**	**427,017**	**-**	**2,798,270**	**131,321**	**253,352**	**-**	**384,673**
Total credit risk exposure	**19,064,951**	**2,360,625**	**-**	**21,425,576**	**2,015,779**	**385,074**	**-**	**2,400,853**

In 2008, in the total net highest exposure, the amount of loans to other customers of HRK 1,696,019 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 454,991 thousand, local (regional) authorities of HRK 157,192 thousand, public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 250.087 thousand and the government fund of HRK 4.094 thousand. An additional amount of HRK 829,655 thousand relates to receivables from majority (51%) state-owned companies.

The amount of assets available for sale is not covered by ordinary collateral but it relates to government bonds of HRK 151,971 thousand.

Other assets of HRK 528 thousand are not covered by ordinary collateral but by receivables from government funds.

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 the positions of assets and guarantees and commitments by internal credit rating (continued):

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	24,656	-	-	24,656	-	-	-	-
Deposits with other banks	584,630	-	-	584,630	-	-	-	-
Loans to banks	9,928,561	594,972	-	10,523,533	-	554	-	554
Loans to other customers	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	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**

In 2007, in the total net highest exposure, the amount of loans to other customers of HRK 2,025,996 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 649,032 thousand, local (regional) authorities of HRK 131,329 thousand, public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 320,120 thousand and the government fund of HRK 7,698 thousand. An additional amount of HRK 917,817 thousand relates to receivables from 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 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 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:

2008	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	14,017	-	-	14,017
Deposits with other banks	804,537	-	-	804,537
Loans to banks	11,201,603	34,966	751,139	11,987,708
Loans to other customers	4,434,564	31,085	1,182,452	5,648,101
Assets held to maturity	-	-	-	-
Assets available for sale	164,913	-	-	164,913
Other assets	7,981	32	17	8,030
Total	**16,627,615**	**66,083**	**1,933,608**	**18,627,306**
Guarantees and commitments				
Issued guarantees in domestic currency	513	-	-	513
Issued guarantees in foreign currency	1,460,980	-	191,202	1,652,182
Issued bills of exchange	40,771	-	-	40,771
Open letters of credit in foreign currency	27,854	-	-	27,854
Undrawn loans	811,837	-	235,815	1,047,652
EIF - subscribed, not called up capital	29,298	-	-	29,298
Total	**2,371,253**	**-**	**427,017**	**2,798,270**
Total credit risk exposure	**18,998,868**	**66,083**	**2,360,625**	**21,425,576**

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):

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	24,656	-	-	24,656
Deposits with other banks	584,630	-	-	584,630
Loans to banks	9,868,816	59,745	594,972	10,523,533
Loans to other customers	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	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)

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

	Up to 2 days 2008	3 to 45 days 2008	46 to 90 days 2008	Over 90 days 2008	Total 2008	Up to 2 days 2007	3 to 45 days 2007	46 to 90 days 2007	Over 90 days 2007	Total 2007
	HRK '000	HRK '000	000 kuna	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS										
Loans to banks	24,806	10,073	81	6	34,966	29,894	29,661	46	144	59,745
Loans to other customers	28,214	374	84	2,413	31,085	90,747	753	122	184	91,806
Other assets	-	30	1	1	32	-	1	-	-	1
Total	**53,020**	**10,477**	**166**	**2,420**	**66,083**	**120,641**	**30,415**	**168**	**328**	**151,552**

From total due and not impaired loans to banks in 2008, an amount of HRK 14,850 thousand or 42 % relates to approved but not executed prolongations of revolving loans within the export credit financing programme. Out of this amount, HRK 10,050 thousand or 68 % was executed in January 2009.

Receivables that were 3 to 45 days overdue amounting to HRK 10,000 thousand, accounting for 99 % of this category of delays, was fully collected on 12 January 2009.

Out of total due and not impaired loans to others in 2008, an amount of HRK 28,214 thousand or 91 % relates to delays of two days. Part of these receivables of HRK 19,933 thousand or 64 % is covered by guarantees of the Republic of Croatia.

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 the stated receivables were collected until 16 January 2008.

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 form 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 estate/movables.
Standard and other collateral 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 a 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 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 collateral.

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 direct placements (continued)

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

- evaluation and verification of already appraised and 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 fund their due liabilities.

The basic principles for managing the Bank's liquidity are defined by the Liquidity Risk Management Procedures and decisions made by the Supervisory Board, the Managing Board and the ALCO.

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.

The Bank holds liquid assets of at least 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 a maturity of up to 90 days, highly liquid government bonds and marketable securities and domestic money market funds stakes.

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

The Bank monitors liquidity risk through scenario analysis and sensitivity analysis. Scenarios include cases of regular operations and significant changes in market conditions. The Bank has prescribed liquidity management limits in operations with commercial banks.

27. Risk management (continued)

27.3. Liquidity risk (continued)

The table below provides an analysis of the Bank's assets and liabilities as of 31 December 2008 placed into relevant maturity groupings based on the remaining period as at the balance sheet date related to the contractual maturity date, as follows:

2008	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	14,020	-	-	-	-	14,020
Deposits with other banks	804,537	-	15,300	-	-	819,837
Loans to banks	782,573	1,138,133	2,761,663	2,203,677	5,101,662	11,987,708
Loans to other customers	259,587	125,613	582,884	1,469,578	3,210,439	5,648,101
Assets held to maturity	-	-	-	-	-	-
Assets available for sale	162,466	2,447	-	-	-	164,913
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	66,091	66,091
Non-current assets held for sale	-	-	7,730	33,711	-	41,441
Other assets	8,735	600	267	1	-	9,603
TOTAL ASSETS (1)	**2,031,918**	**1,266,793**	**3,367,844**	**3,706,967**	**8,378,192**	**18,751,714**
LIABILITIES						
Deposits	417,963	20,762	292	-	-	439,017
Borrowings	-	78,471	1,378,765	2,275,934	1,286,951	5,020,121
Bonds payable	-	172,518	146,489	2,483,861	3,065,813	5,868,681
Other liabilities	181,322	84,522	166,437	338,655	369,119	1,140,055
Total liabilities	**599,285**	**356,273**	**1,691,983**	**5,098,450**	**4,721,883**	**12,467,874**
EQUITY						
Founder's capital	-	-	-	-	4,723,739	4,723,739
Retained earnings and reserves	-	-	-	-	1,378,526	1,378,526
Other reserves	-	-	-	-	(5,754)	(5,754)
Net profit for the year	-	-	-	-	174,906	174,906
Equity excluding Guarantee fund	**-**	**-**	**-**	**-**	**6,271,417**	**6,271,417**
Guarantee fund	-	-	-	-	12,423	12,423
Total equity including Guarantee fund	**-**	**-**	**-**	**-**	**6,283,840**	**6,283,840**
Total liabilities and total equity including Guarantee fund (2)	**599,285**	**356,273**	**1,691,983**	**5,098,450**	**11,005,723**	**18,751,714**
Net amount/liabilities (1) - (2)	**1,432,633**	**910,520**	**1,675,861**	**(1,391,483)**	**(2,627,531)**	**-**
Cumulative assets/liabilities, net	**1,432,633**	**2,343,153**	**4,019,014**	**2,627,531**	**-**	**-**

27. Risk management (continued)

27.3. Liquidity risk (continued)

The table below provides an analysis 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 (continued):

2007	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Tota
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks	24,660	-	-	-	-	24,660
Deposits with other banks	554,776	29,854	-	-	-	584,630
Loans to banks*	830,887	1,033,000	1,748,564	1,964,865	4,946,217	10,523,533
Loans to other customers	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
Non-current assets held for sale	-	-	16,806	28,716	4,745	50,267
Other assets	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
Equity excluding Guarantee fund	**-**	**-**	**-**	**-**	**5,766,394**	**5,766,394**
Guarantee fund	-	-	-	-	12,985	12,985
Total equity including Guarantee fund	**-**	**-**	**-**	**-**	**5,779,379**	**5,779,379**
Total liabilities and total equity including Guarantee fund (2)	**958,649**	**277,631**	**2,256,754**	**1,720,113**	**12,188,904**	**17,402,051**
Net amount/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 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 an 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:

2008	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	417,963	20,762	292	-	-	439,017
Borrowings	-	78,502	1,547,794	2,491,174	1,505,510	5,622,980
Bonds payable	-	107,120	431,669	2,921,832	3,782,006	7,242,627
Other liabilities	181,322	84,522	166,438	338,655	369,119	1,140,056
Total	**599,285**	**290,906**	**2,146,193**	**5,751,661**	**5,656,635**	**14,444,680**
2007						
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**

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 on the financial position. This technique is used throughout scenario analysis and sensitivity analysis in both a stressed and regular business environment.

HBOR does not hold financial instruments designated for short term profit taking in its portfolio.

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 level. From the funds that bear 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.

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 2008 and 2007 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 is 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 2008 and 2007 which may not be indicative for the positions in other periods.

2008	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	-	-	-	-	-	14,020	14,020
Deposits with other banks	804,437	-	-	-	-	15,400	819,837
Loans to banks	775,189	1,924,313	2,740,893	2,019,523	4,494,895	32,895	11,987,708
Loans to other customers	239,624	331,319	1,935,923	1,053,876	2,069,836	17,523	5,648,101
Assets held to maturity	-	-	-	-	-	-	-
Assets available for sale	162,466	-	-	-	-	2,447	164,913
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	66,091	66,091
Non-current assets held for sale	-	-	-	-	-	41,441	41,441
Other assets	-	-	-	-	-	9,603	9,603
TOTAL ASSETS (1)	**1,981,716**	**2,255,632**	**4,676,816**	**3,073,399**	**6,564,731**	**199,420**	**18,751,714**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest risk (continued)

2008	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	77,373	20,702	292	-	-	340,650	439,017
Borrowings	-	1,042,576	2,848,924	197,992	904,715	25,914	5,020,121
Bonds payable	-	-	146,488	2,483,861	3,065,813	172,519	5,868,681
Other liabilities	-	-	-	-	-	1,140,055	1,140,055
Total liabilities	**77,373**	**1,063,278**	**2,995,704**	**2,681,853**	**3,970,528**	**1,679,138**	**12,467,874**
EQUITY							
Founder's capital	-	-	-	-	-	4,723,739	4,723,739
Retained earnings and reserves	-	-	-	-	-	1,378,526	1,378,526
Other reserves	-	-	-	-	-	(5,754)	(5,754)
Net profit for the year	-	-	-	-	-	174,906	174,906
Equity excluding Guarantee fund	**-**	**-**	**-**	**-**	**-**	**6,271,417**	**6,271,417**
Guarantee fund	-	-	-	-	-	12,423	12,423
Total equity including Guarantee fund	**-**	**-**	**-**	**-**	**-**	**6,283,840**	**6,283,840**
Total liabilities and total equity including Guarantee fund (2)	**77,373**	**1,063,278**	**2,995,704**	**2,681,853**	**3,970,528**	**7,962,978**	**18,751,714**
Net amount/liabilities (1) - (2)	**1,904,343**	**1,192,354**	**1,681,112**	**391,546**	**2,594,203**	**(7,763,558)**	**-**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest 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
ASSETS							
Cash on hand and due from banks	-	-	-	-	-	24,660	24,660
Deposits with other banks	554,725	29,691	-	-	-	214	584,630
Loans to banks	824,494	1,798,787	1,731,734	1,801,388	4,340,527	26,603	10,523,533
Loans to other customers	121,441	521,589	2,184,833	1,015,411	2,041,166	48,291	5,932,731
Assets held to maturity	-	-	38,821	-	-	340	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
Non-current assets held for sale	-	-	-	-	-	50,267	50,267
Other assets	-	-	-	-	-	6,797	6,797
TOTAL ASSETS (1)	**1,689,279**	**2,350,067**	**3,955,388**	**2,816,799**	**6,381,693**	**208,825**	**17,402,051**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest 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							
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
Equity excluding Guarantee fund	**-**	**-**	**-**	**-**	**-**	**5,766,394**	**5,766,394**
Guarantee fund	-	-	-	-	-	12,985	12,985
Total equity including Guarantee fund	**-**	**-**	**-**	**-**	**-**	**5,779,379**	**5,779,379**
Total liabilities and total equity including Guarantee fund (2)	**26,790**	**1,278,324**	**2,276,009**	**480,717**	**5,548,039**	**7,792,172**	**17,402,051**
Net amount/liabilities (1) - (2)	**1,662,489**	**1,071,743**	**1,679,379**	**2,336,082**	**833,654**	**(7,583,347)**	**-**

27. Risk management (continued)

27.4. Market risk (continued)

27.4.1. Interest 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 44.9% for 2008 (2007: 22%) on the daily changes of the interest rates linked to EUR has been determined using the standard deviation method. Based on such determined volatility used in the sensitivity analysis for 2008, the hypothetical impact of changes of the interest rate linked to EUR by 45 basis points (2007: 25 basis points) has been analyzed.

Volatility of 120% for 2008 (2007: 49%) on the daily changes of the interest rates linked to USD has been determined using the standard deviation method. Based on such determined volatility used in the sensitivity analysis for 2008, the hypothetical impact of the changes of the interest rate linked to USD by 120 basis points (2007: 50 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 2008	Effect on profit and equity in 2008	Increase in b.p. in 2007	Effect on profit and equity in 2007
		HRK '000		HRK '000
EUR	+45	(3,395)	+25	(341)
USD	+120	300	+50	65

Currency	Decrease in b.p. in 2008	Effect on profit and equity in 2008	Decrease in b.p. in 2007	Effect on profit and equity in 2007
		HRK '000		HRK '000
EUR	-45	3,395	-25	341
USD	-120	(300)	-50	(65)

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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 prescribed 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 2008 and 31 December 2007 in HRK and foreign currencies can be shown as follows:

2008	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks	552	2,312	1,286	4,150	9,870	14,020
Deposits with other banks	52,553	732,191	-	784,744	35,093	819,837
Loans to banks	21,928	7,407,558	-	7,429,486	4,558,222	11,987,708
Loans to other customers	92,828	3,342,507	-	3,435,335	2,212,766	5,648,101
Assets held to maturity	-	-	-	-	-	-
Assets available for sale	-	141,489	-	141,489	23,424	164,913
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	66,091	66,091
Non-current assets held for sale	-	-	-	-	41,441	41,441
Other assets	-	2	3,156	3,158	6,445	9,603
TOTAL ASSETS (1)	**167,861**	**11,626,059**	**4,442**	**11,798,362**	**6,953,352***	**18,751,714**
LIABILITIES						
Deposits	149,182	29,775	3,833	182,790	256,227	439,017
Borrowings	-	5,020,121	-	5,020,121	-	5,020,121
Bonds payable	-	5,868,681	-	5,868,681	-	5,868,681
Other liabilities	6,919	33,974	-	40,893	1,099,162	1,140,055
Total liabilities	**156,101**	**10,952,551**	**3,833**	**11,112,485**	**1,355,389**	**12,467,874**
EQUITY						
Founder's capital	-	-	-	-	4,723,739	4,723,739
Retained earnings and reserves	-	-	-	-	1,378,526	1,378,526
Other reserves	-	-	-	-	(5,754)	(5,754)
Net profit for the year	-	-	-	-	174,906	174,906
Equity excluding Guarantee fund	**-**	**-**	**-**	**-**	**6,271,417**	**6,271,417**
Guarantee fund	-	12,423	-	12,423	-	12,423
Total equity including Guarantee fund	**-**	**12,423**	**-**	**12,423**	**6,271,417**	**6,283,840**
Total liabilities and total equity including Guarantee fund (2)	**156,101**	**10,964,974**	**3,833**	**11,124,908**	**7,626,806**	**18,751,714**
Net amount/liabilities (1) - (2)	**11,760**	**661,085**	**609**	**673,454**	**(673,454)**	**-**

* Amounts linked to a to one-way currency clause represent HRK 2,666,327 thousand.

27. Risk management (continued)

27.4. Market risk (continued)

27.4.2. Currency risk (continued)

Total assets and liabilities as of 31 December 2008 and 31 December 2007 in HRK and foreign currencies can be shown as follows (continued):

2007	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash on hand and due from banks	661	6,313	9,382	16,356	8,304	24,660
Deposits with other banks	158,897	396,093	-	554,990	29,640	584,630
Loans to banks	29,777	5,980,808	-	6,010,585	4,512,948	10,523,533
Loans to other customers	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
Non-current assets held for sale	-	-	-	-	50,267	50,267
Other assets	-	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						
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
Equity excluding Guarantee fund	**-**	**-**	**-**	**-**	**5,766,394**	**5,766,394**
Guarantee fund	-	12,985	-	12,985	-	12,985
Total equity including Guarantee fund	**-**	**12,985**	**-**	**12,985**	**5,766,394**	**5,779,379**
Total liabilities and total equity including Guarantee fund (2)	**391,412**	**9,776,496**	**9,519**	**10,177,427**	**7,224,624**	**17,402,051**
Net amount/liabilities (1) - (2)	**77,678**	**(201,077)**	**(137)**	**(123,536)**	**123,536**	**-**

* Amounts linked to a 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)

Sensitivity analysis

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 the 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 3.3% for 2008 (2007: 1.8%) on the monthly changes of the foreign exchange rate EUR/HRK have been determined using the standard deviation method. Based on such determined volatility and asset liability ratio in EUR as stated in this note within the sensitivity analysis in 2008, a rate of increase of 7.6% (2007: 5.5%) has been applied.

Volatility of 15.69% for 2007 (2007: 5.39%) on the monthly changes of the foreign exchange rate USD/HRK have been determined using the standard deviation method. Based on such determined volatility and asset liability ratio in USD as stated in this note within the sensitivity analysis in 2008, a rate of increase of 20% (2007: 7%) has been applied.

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

Currency	Change in currency rate in % 2008	Effect on profit and equity in 2008	Change in currency rate in % 2007	Effect on profit and equity in 2007
		HRK '000		HRK '000
EUR	+7.6	150,834	+5.5	81,020
USD	+20	2,352	+7	5,497
EUR	-7.6	(52,042)	-5.5	6,146
USD	-20	(2,352)	-7	(5,497)

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 management 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 ratio is performed in line with the regulations prescribed for the banks in the Republic of Croatia and does not differ from international banking practice.

	2008	2007
	HRK '000	HRK '000
Core capital - Tier 1	6,277,170	5,768,263
Supplementary capital - Tier 2	233,737	184,429
Total liable capital	**6,510,907**	**5,952,692**
Risk weighted assets	7,714,438	6,425,218
Capital requirements for currency risk	3,021,687	3,377,499
Total capital requirements	**10,736,125**	**9,802,717**
	%	%
Capital ratio (Tier 1)	**58.47**	**58.84**
Capital adequacy ratio	**60.64**	**60.73**
	HRK '000	HRK '000
	HRK '000	**HRK '000**
Liable capital needed for ensuring capital adequacy according to regulatory requirements	**1,073,613**	**980,272**

28. Capital management (continued)

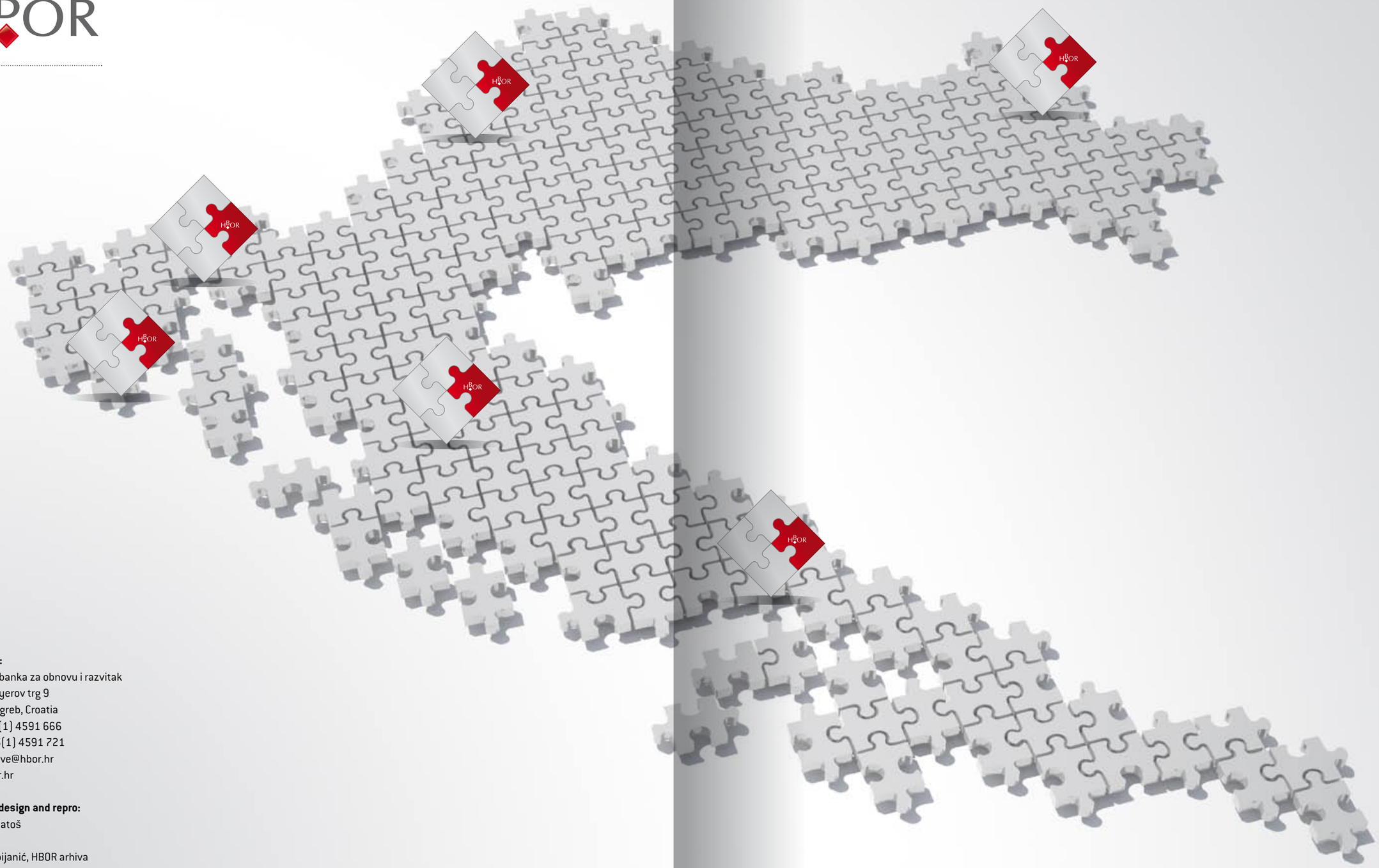
Minimum capital adequacy ratio at the end of both balance sheet dates was 10%. From the second half of 2009 and onwards, the regulatory minimum for the capital adequacy ratio is increased to 12%. Apart from the increase of the minimum ratio percentage, the new regulations require a change of methodology for the calculation of capital adequacy. The Bank doesn't expect any adverse effects on its capital adequacy as result of introduction of this new regulation.

29. Events after the balance sheet date

The Bank has signed a loan agreement on 24 March 2009 with European Investment Bank for the financing of small and medium size entrepreneurs, for environment protection and infrastructure projects in public and private sectors in total amount of EUR 250,000 thousand.

Furthermore, the Bank signed a sindicated term loan agreement on 31 March 2009 for general purpose in the amount of EUR 100.000 thousand.

On 25 March 2009 Supervisory Board reappointed the President of the Managing Board of the Bank for the period from 1 June 2009 up to 31 May 2014.



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