**Komerční banka, a.s.**

# CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INDEPENDENT AUDITOR'S REPORT

**FOR THE YEAR ENDED 31 DECEMBER 2008**

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# INDEPENDENT AUDITOR'S REPORT FOR THE SHAREHOLDERS OF KOMERČNÍ BANKA, a.s.

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# INDEPENDENT AUDITOR'S REPORT

To the shareholders of Komerční Banka, a.s.

Having its registered office at: Praha 1, Na Příkopě 33 čp. 969, PSČ 11407
Identification number: 453 17 054
Principal activities: Retail, corporate and investment banking services

We have audited the accompanying consolidated financial statements of Komerční Banka, a.s. and subsidiaries ("the Group"), which comprise the balance sheet as of 31 December 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## Statutory Body's Responsibility for the Financial Statements

The Statutory Body is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing and the related application guidelines issued by the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

In Prague on 26 February 2009

Deloitte

Audit firm:
Deloitte Audit s.r.o.
Certificate no. 79
Represented by:

Diana Rogerová

Diana Rogerová, authorised employee

Statutory auditor:

Diana Rogerová

Diana Rogerová, certificate no. 2045

# Consolidated Profit and Loss Statement

Year ended 31 December 2008

| | Note | **Year ended 31 December 2008** | Year ended 31 December 2007 |
|---|---|---|---|
| | | **CZKm** | CZKm |
| Interest income and similar income | 5 | 42,432 | 34,149 |
| Interest expense and similar expense | 5 | (21,410) | (15,470) |
| Income from dividends | 5 | 239 | 111 |
| **Net interest income and similar income** | | **21,261** | **18,790** |
| Net fees and commissions | 6 | 8,050 | 7,756 |
| Net profit on financial operations | 7 | 4,223 | 2,982 |
| Other income | 8 | 180 | 142 |
| **Net banking income** | | **33,714** | **29,670** |
| Personnel expenses | 9 | (6,320) | (5,914) |
| General administrative expenses | 10 | (6,606) | (6,241) |
| Depreciation, impairment and disposal of fixed assets | 11 | (1,581) | (1,474) |
| **Total operating expenses** | | **(14,507)** | **(13,629)** |
| **Profit before provision for loan and investment losses, other risk and income taxes** | | **19,207** | **16,041** |
| Provision for loan losses | 12 | (2,815) | (1,563) |
| Provisions for impairment of securities | 12 | (152) | 15 |
| Provisions for other risk expenses | 12 | (3) | 250 |
| **Cost of risk** | | **(2,970)** | **(1,298)** |
| Income from share of associated companies | 13 | 12 | 109 |
| Profit attributable to exclusion of companies from consolidation | 13 | 150 | 0 |
| Share of profit of pension scheme beneficiaries | | (142) | (524) |
| **Profit before income taxes** | | **16,257** | **14,328** |
| Income taxes | 14 | (3,024) | (3,103) |
| **Net profit** | | **13,233** | **11,225** |
| Profit attributable to the Bank's equity holders | | 13,161 | 11,188 |
| Minority profit | | 72 | 37 |
| **Earnings per share (in CZK)** | 16 | **348.70** | **295.74** |

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

# Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2008

| | Note | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|---|
| **Assets** | | | |
| Cash and current balances with central banks | 17 | 13,961 | 13,557 |
| Financial assets at fair value through profit or loss | 18 | 43,993 | 31,910 |
| Positive fair value of financial derivative transactions | 44 | 9,146 | 2,030 |
| Financial assets available for sale | 19 | 98,164 | 81,826 |
| Assets held for sale | 20 | 429 | 735 |
| Amounts due from banks | 21 | 146,098 | 201,091 |
| Loans and advances to customers | 22 | 364,040 | 304,938 |
| Investments held to maturity | 23 | 1,435 | 2,999 |
| Income taxes receivable | 14 | 6 | 4 |
| Deferred tax asset | 35 | 0 | 729 |
| Prepayments, accrued income and other assets | 24 | 6,167 | 7,000 |
| Investments in associates and unconsolidated subsidiaries | 25 | 550 | 493 |
| Intangible fixed assets | 26 | 3,504 | 2,954 |
| Tangible fixed assets | 27 | 8,000 | 8,002 |
| Goodwill | 28 | 3,551 | 3,551 |
| **Total assets** | | **699,044** | **661,819** |
| **Liabilities** | | | |
| Amounts due to central banks | | 1 | 10 |
| Financial liabilities at fair value through profit or loss | 29 | 20,155 | 7,723 |
| Negative fair value of financial derivative transactions | 44 | 5,244 | 2,746 |
| Amounts due to banks | 30 | 11,114 | 12,267 |
| Amounts due to customers | 31 | 554,570 | 540,229 |
| Securities issued | 32 | 24,128 | 27,917 |
| Income taxes payable | 14 | 186 | 226 |
| Deferred tax liability | 35 | 575 | 4 |
| Accruals and other liabilities | 33 | 12,075 | 12,348 |
| Provisions | 34 | 2,019 | 1,691 |
| Subordinated debt | 36 | 6,003 | 6,004 |
| **Total liabilities** | | **636,070** | **611,165** |
| **Shareholders' equity** | | | |
| Share capital | 37 | 19,005 | 19,005 |
| Share premium and reserves | | 42,837 | 30,589 |
| Minority equity | | 1,132 | 1,060 |
| **Total shareholders' equity** | | **62,974** | **50,654** |
| **Total liabilities and shareholders' equity** | | **699,044** | **661,819** |

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

These financial statements were approved by the Board of Directors on 26 February 2009.

**Signed on behalf of the Board of Directors:**

Laurent Goutard — Chairman of the Board of Directors and CEO

Peter Palečka — Member of the Board and Senior Executive Director

# Consolidated Statement of Changes in Shareholders' Equity

Year ended 31 December 2008

| | Share capital CZKm | Capital and reserve funds and undistributed profit* CZKm | Hedging instruments CZKm | Revalu-ation gains or losses CZKm | Revaluation of available-for-sale financial assets CZKm | Total CZKm | Minority interest CZKm | Total, including minority interest CZKm |
|---|---|---|---|---|---|---|---|---|
| **Balance at 31 December 2006** | **19,005** | **27,033** | **2,847** | **(57)** | **1,190** | **50,018** | **580** | **50,598** |
| **Acquisition adjustments in respect of Modrá pyramida Stavební spořitelna a.s.** | **0** | **(341)** | **0** | **0** | **0** | **(341)** | **0** | **(341)** |
| - Impact on retained earnings | 0 | (432) | 0 | 0 | 0 | (432) | 0 | (432) |
| - Impact on net profit for the period | 0 | 91 | 0 | 0 | 0 | 91 | 0 | 91 |
| **Adjusted balance at 1 January 2007** | **19,005** | **26,692** | **2,847** | **(57)** | **1,190** | **49,677** | **580** | **50,257** |
| Cash flow hedging | | | | | | | | |
| - net fair value, net of tax | 0 | 0 | (2,519) | 0 | 0 | (2,519) | 0 | (2,519) |
| - transfer to net profit, net of tax | 0 | 0 | (1,119) | 0 | 0 | (1,119) | 0 | (1,119) |
| FX differences on the revaluation of net assets from foreign investments | 0 | 0 | 0 | 26 | 0 | 26 | 0 | 26 |
| Gains or losses on available-for-sale financial assets, net of tax | 0 | 0 | 0 | 0 | (1,916) | (1,916) | 0 | (1,916) |
| Gains or losses on available-for-sale financial assets - associates, net of tax | 0 | (50) | 0 | 0 | 0 | (50) | 0 | (50) |
| Treasury shares, other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends | 0 | (5,693) | 0 | 0 | 0 | (5,693) | 0 | (5,693) |
| Increase in share capital – minority interest | 0 | 0 | 0 | 0 | 0 | 0 | 443 | 443 |
| Net profit for the period | 0 | 11,188 | 0 | 0 | 0 | 11,188 | 37 | 11,225 |
| **Balance at 31 December 2007** | **19,005** | **32,137** | **(791)** | **(31)** | **(726)** | **49,594** | **1,060** | **50,654** |
| Cash flow hedging | | | | | | | | |
| - net fair value, net of tax | 0 | 0 | 4,733 | 0 | 0 | 4,733 | 0 | 4,733 |
| - transfer to net profit, net of tax | 0 | 0 | (390) | 0 | 0 | (390) | 0 | (390) |
| FX differences on the revaluation of net assets from foreign investments | 0 | 0 | 0 | 35 | 0 | 35 | 0 | 35 |
| Gains or losses on available-for-sale financial assets, net of tax | 0 | 0 | 0 | 0 | 1,493 | 1,493 | 0 | 1,493 |
| Gains or losses on available-for-sale financial assets - associates, net of tax | 0 | 46 | 0 | 0 | 0 | 46 | 0 | 46 |
| Treasury shares, other | 0 | 2 | 0 | 0 | 0 | 2 | 0 | 2 |
| Dividends | 0 | (6,832) | 0 | 0 | 0 | (6,832) | 0 | (6,832) |
| Net profit for the period | 0 | 13,161 | 0 | 0 | 0 | 13,161 | 72 | 13,233 |
| **Balance at 31 December 2008** | **19,005** | **38,514** | **3,552** | **4** | **767** | **61,842** | **1,132** | **62,974** |

*Note:/* Capital and reserve funds and undistributed profit consist of statutory reserve funds, other funds created from profit, share premium, purchased treasury shares**, undistributed net profit from the period** and retained earnings **in the amount 20 791 CZKm***

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

# Consolidated Cash Flow Statement
Year ended 31 December 2008

| | **Year ended 31 December 2008 CZKm** | **Year ended 31 December 2008 CZKm** | Year ended 31 December 2007 CZKm | Year ended 31 December 2007 CZKm |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Interest receipts | 39,556 | | 31,094 | |
| Interest payments | (21,116) | | (15,123) | |
| Commission and fee receipts | 9,739 | | 9,275 | |
| Commission and fee payments | (1,701) | | (1,460) | |
| Net income from financial transactions | 4,547 | | 4,520 | |
| Other income receipts | 336 | | 249 | |
| Cash payments to employees and suppliers, and other payments | (12,689) | | (12,309) | |
| **Operating cash flow before changes in operating assets and operating liabilities** | **18,672** | | **16,246** | |
| Due from banks | 55,502 | | 7,868 | |
| Financial assets at fair value through profit or loss | (9,884) | | (21,660) | |
| Loans and advances to customers | (60,692) | | (53,685) | |
| Other assets | (4) | | (1,669) | |
| **Total (increase)/decrease in operating assets** | **(15,078)** | | **(69,146)** | |
| Amounts due to banks | (3,424) | | (2,825) | |
| Financial liabilities at fair value through profit or loss | 12,450 | | 7,711 | |
| Amounts due to customers | 13,934 | | 58,852 | |
| Other liabilities | 173 | | (631) | |
| **Total increase/(decrease) in operating liabilities** | **23,133** | | **63,107** | |
| Net cash flow from operating activities before taxes | 26,727 | | 10,207 | |
| Income taxes paid | (2,848) | | (2,685) | |
| **Net cash flows from operating activities** | | **23,879** | | 7,522 |
| **Cash flows from investing activities** | | | | |
| Dividends received | 185 | | 112 | |
| Maturity of investments held to maturity * | 1,634 | | 341 | |
| Purchase of financial assets available for sale | (22,274) | | (18,382) | |
| Sale of securities available for sale* | 8,639 | | 14,854 | |
| Purchase of tangible and intangible fixed assets | (2,225) | | (2,257) | |
| Sale of tangible and intangible fixed assets | 444 | | 206 | |
| **Net cash flow from investing activities** | | **(13,597)** | | (5,126) |
| **Cash flows from financing activities** | | | | |
| Paid dividends | (6,814) | | (5,678) | |
| Securities issued | 301 | | 3,654 | |
| Securities redeemed* | (5,236) | | (2,810) | |
| Increase in share capital – minority interest | 0 | | 443 | |
| **Net cash flow from financing activities** | | **(11,749)** | | (4 391) |
| **Net increase/(decrease) in cash and cash equivalents** | **(1,467)** | | (1,995) | |
| **Cash and cash equivalents at beginning of year** | 11,882 | | 13,877 | |
| **Cash and cash equivalents at end of year (see Note 38)** | | **10,415** | | 11,882 |

*Note: /* The amount also includes received and paid coupons.*

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

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## 1 Principal activities

The Financial Group of Komerční banka, a.s. (the 'Group') consists of Komerční banka, a.s. (the 'Bank') and 10 subsidiaries and associated undertakings. The parent company of the Group is the Bank which is incorporated in the Czech Republic as a joint stock company. The principal activities of the Bank are as follows:

I. Providing loans, advances and guarantees in Czech Crowns and foreign currencies;
II. Acceptance and placement of deposits in Czech Crowns and foreign currencies;
III. Providing current and term deposit accounts in Czech Crowns and foreign currencies;
IV. Providing banking services through an extensive branch network in the Czech Republic;
V. Treasury operations in the interbank market;
VI. Servicing foreign trade transactions; and
VII. Investment banking.

The Bank generates a substantial proportion of the Group's income and represents substantially all of the assets and liabilities of the Group.

The registered office address of the Bank is Na Příkopě 33/969, 114 07 Prague 1.

In addition to its operations in the Czech Republic, the Group has operations in Slovakia through its subsidiary Komerční banka Bratislava, a. s. and in Belgium through its subsidiary Bastion European Investment S. A.

The Bank's ordinary shares are publicly traded on the Prague Stock Exchange. Société Générale is the Bank's majority shareholder, holding 60.35 percent (2007: 60.35 percent) of the Bank's issued share capital.

The main activities of subsidiary companies of the Bank as of 31 December 2008

| Company's name | Direct holding % | Group holding % | Principal activity | Registered office |
|---|---|---|---|---|
| Penzijní fond Komerční banky, a. s. | 100.0 | 100.0 | Pension fund | Prague |
| Komerční banka Bratislava, a. s. | 100.0 | 100.0 | Banking services | Bratislava |
| Modrá pyramida stavební spořitelna, a. s. | 100.0 | 100.0 | Building society | Prague |
| Protos uzavřený investiční fond, a. s. | 100.0 | 100.0 | Investments | Prague |
| Factoring KB, a. s. | 100.0 | 100.0 | Factoring | Prague |
| ALL IN REAL ESTATE LEASING, a. s. | 100.0 | 100.0 | Support banking services | Prague |
| Bastion European Investment S. A. | 99.98 | 99.98 | Financial services | Brussels |
| ESSOX s. r. o. | 50.9 | 50.9 | Consumer loans, leases | České Budějovice |

The main activities of associated companies of the Bank as of 31 December 2008

| Company's name | Direct holding % | Group holding % | Principal activity | Registered office |
|---|---|---|---|---|
| Komerční pojišťovna, a. s. | 49.0 | 49.0 | Insurance | Prague |
| CBCB - Czech Banking Credit Bureau, a. s. | 20.0 | 20.0 | Data collection for credit risk assessments | Prague |

## *2 Events for the year ended 31 December 2008*

**Dividends declared in respect of the year ended 31 December 2007**

At the General Meeting of the Bank held on 29 April 2008, the shareholders approved a dividend for the year ended 31 December 2007 of CZK 180 per share before tax. The dividend was declared in the aggregate amount of CZK 6,832 million. An amount of CZK 508 million was allocated to the reserve fund and CZK 2,830 million was allocated to retained earnings.

**Changes in the Bank's Financial Group**

In May 2008, the Bank increased its equity investment in Penzijní fond Komerční banky, a.s. by CZK 300 million through the payment made over and above the share capital to other capital funds. In June 2008, the Bank decreased its equity investment in Bastion European Investments S.A. by EUR 3.6 million. For additional details of changes in the Bank's financial group, refer to Note 25.

**Uncertainty about the Impact of the Global Financial Crisis**

The Group might be influenced by the global financial and economic crisis. The Group might be exposed to increased risk mainly due to the high volatility and uncertainty regarding the valuation, possible impairment of assets, contingent liabilities and future development of the markets. Those potential risks may have an impact on the Group's financial statements in the future.

The presented consolidated financial statements for the year ended 31 December 2008 are based on the current best estimates and management of the Group believes that they present the truest and fairest view of the Group's financial results and financial position using all relevant and available information at the financial statements date.

## 3 Principal accounting policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below:

### (a) Basis of accounting

The consolidated statutory financial statements are prepared in accordance with and comply with International Financial Reporting Standards ('IFRS') as adopted by the European Union, applicable for consolidated financial statements effective for the year ended 31 December 2008. As of the date of issuance of these consolidated financial statements, IFRS as adopted by the European Union do not differ from IFRS, except for fair value hedge accounting under IAS 39 applied to interest rate hedging on a portfolio basis for banking deposits which has not been approved by the EU. In addition, the European Commission has not yet approved the following effective standards and interpretations, or their amendments:

- Revised IFRS 3 Business Combinations and related changes in IAS 27, 28 and 31;
- Revised IFRS 1 First-time Adoption of IFRS;
- Amendment to IAS 39 Eligible Hedged Items;
- New IFRIC 12 Service Concession Arrangements;
- New IFRIC 15 Agreements for the Construction of Real Estate;
- New IFRIC 16 Hedges of a Net Investment in a Foreign Operation;
- New IFRIC 17 Distributions of Non-cash Assets to Owners; and
- New IFRIC 18 Transfers of Assets from Customers.

The consolidated financial statements are prepared on the accrual basis of accounting whereby the effects of transactions and other events are recognised when they occur and are reported in the financial statements of the periods to which they relate, and on the going concern assumption. The consolidated financial statements include a balance sheet, a profit and loss statement, a statement of changes in shareholders' equity, a cash flow statement and notes to the financial statements containing accounting policies and explanatory disclosures.

The consolidated financial statements are largely prepared under the historical cost convention, as modified by the fair value remeasurement of available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss and all derivative contracts at the balance sheet date. Available-for-sale non-financial assets are stated at the lower of the amount before classification in this category and the estimated selling price less costs to sell. Assets that are not remeasured to fair value and suffered impairment are stated at the higher of net recoverable amount and value in use.

Assets and liabilities are not offset unless expressly permitted by IFRS.

The Bank maintains its books of account and regularly prepares the required statements in accordance with IFRS. The Bank also prepares consolidated financial statements under IFRS which show the consolidated results of the Group.

The reporting currency used in the consolidated financial statements is the Czech Crown (‘CZK’) with accuracy to CZK million.

### *(b) Basis of consolidation*

Subsidiary undertakings, which are those companies in which the Bank, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations, have been fully consolidated. Subsidiaries are consolidated from the date on which effective control is transferred to the Bank and are no longer consolidated from the date of disposal. All intercompany transactions have been eliminated.

Investments in unconsolidated subsidiaries are recognised in the consolidated balance sheet at cost less any provisions.

Investments in associated undertakings are accounted for using the equity method of accounting. These are undertakings in which the Bank has between 20 percent and 50 percent of the voting rights, and over which the Bank exercises significant influence, but which it does not control. Equity accounting involves recognising in the profit and loss statement the Group’s share of the associates’ profit or loss for the period. The Group’s interest in the associates is carried in the balance sheet at an amount that reflects its share of net assets of the associates and includes goodwill on acquisition.

### *(c) Use of estimates*

The presentation of unconsolidated financial statements in conformity with IFRS requires the Bank’s management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and their reported amounts of revenues and expenses during the reporting period. These estimates, which specifically relate to the determination of fair values of financial instruments, valuation of intangible assets, impairment of assets and provisions, are based on the information available at the balance sheet date. The current global economic crisis, its acceleration and market turbulence increase the risk that the actual results and outcomes may significant differ from these estimates. Key areas with a potential for significant differences between the actual results and the estimates principally include loan provisioning and fair values of securities.

Information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are disclosed in individual notes as appropriate.

### *(d) Dates of recognition and derecognition of financial instruments from the Group’s balance sheet*

All financial assets with normal delivery terms are recognised using settlement date accounting. The settlement (collection) date is the day on which the financial instrument is delivered (cash payment). When settlement date accounting is applied, the financial asset is recognised on the day of receipt of a financial instrument (sending of cash) and derecognised on the day of its provision (collection of cash). However, in case a portfolio of financial assets measured at fair value, the acquired financial asset is measured reflecting changes in its fair value from the purchase trade date to the sale trade date according to the categorisation into an individual portfolio, accrued interest on debt financial assets is recognised from the purchase settlement date to the sale settlement date.

All loans and receivables are recognised when funds are provided to customers. Loans and receivables are derecognised when fully repaid by the borrower. Assigned receivables are derecognised when payment is collected from the assignee, and receivables which the Group decided to write off are derecognised at the write-off date.

The Group remeasures derivative instruments at fair value from the trade date to the settlement date, that is, delivery of the last related cash flow.

The Group settles and derecognises financial liabilities at the date on which all related risks and costs attributable to the specific liability are transferred or settled.

### *(e) Foreign currency translation*

Transactions and balances are presented in the currency of the primary economic environment in which the Group operates (its functional currency). The Group's functional currency are Czech Crowns (CZK), Euro and Slovak Crowns. Transactions in currencies other than the Group's functional currencies (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions.

The presentation currency, in which the consolidated financial statements are prepared, is Czech Crowns.

At each balance sheet date:

(i) cash items denominated in foreign currencies are translated into CZK at the CNB's rate ruling at the financial statements date;
(ii) non-cash items denominated in foreign currencies, which are stated at historical cost, are translated into CZK at the CNs rate ruling at the transaction date; and
(iii) non-cash items denominated in foreign currencies, which are measured at fair value, are translated into CZK at the CNB's rate ruling at the date on which the fair value was determined.

Gains or losses arising from movements in exchange rates after the date of the transaction are recognised in '*Net profit/(loss) on financial operations*.' This does not apply to foreign exchange rate differences arising from the cost of equity financial assets available for sale, foreign exchange rate differences arising from the remeasurement of financial assets available for sale and foreign exchange rate differences from foreign currency non-derivative financial liabilities (current accounts, deposits) which the Group uses to hedge against currency risk of the net investments in foreign operations and anticipated asset purchase transactions. These foreign exchange rate difference are recognised in equity (refer to (h) Securities and (r) Derivative financial instruments and hedging).

### *(f) Cash and cash equivalents*

Cash comprises cash on hand and cash in the process of collection.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment purposes.

In preparing its cash flow statement for the period, the Group includes in cash and cash equivalents at the beginning and end of the period cash and balances with central banks and current amounts due from and to banks.

### *(g) Originated loans and provisions for loan impairment*

Loans originated by the Group by providing money directly to a borrower are categorised as loans originated by the Group and are stated at amortised cost in '*Loans and advances to customers*'.

The Group charges penalty interest to borrowers when a portion of the loan falls overdue. Pursuant to the Group's policies, penalty interest is not covered by the collateral set aside against the loan of the borrower. Default interest is not recognised as interest income on an accruals basis but on a cash basis when collected.

If there is any objective evidence that a loan may be impaired (deterioration of a debtor's financial health, payment default, etc), the amortised cost of the loan is reduced through a provision to its present estimated recoverable value. Estimated recoverable values are arrived at depending upon the classification of the client, taking into account collateral, if any, received by the Group. The recognition, use and release of provisions is accounted for on a monthly basis always by reference to the loan balances at the month-end. The provision is reduced if objective reasons for loan impairment cease to exist. In such cases, the original amount is reversed and a required provision is recognised. Provisions are used upon a sale or a write-off of the loan and released to income when the reasons for maintaining the provision cease to exist (for example, when the loan is repaid). The provisioning policy is set out in Note 44 ('Provisioning for receivables') to these financial statements.

The Group writes off loss loans when it can be reasonably anticipated that clients will be unable to fulfil their obligations to the Group in respect of these loans. Subsequent recoveries are credited to the profit and loss statement in '*Provision for loan losses*' if previously written off.

### *(h) Securities*

Securities held by the Group are categorised into portfolios in accordance with the Group's intent on the acquisition of the securities and pursuant to the Group's security investment strategy. The Group has allocated securities to the 'At fair value through profit or loss' portfolio, the 'Available for sale' portfolio, the 'Held to maturity' portfolio and the 'Loans and receivables' portfolio. All securities held by the Group are recognised at fair value which is typically equal to the cost reflecting direct transaction costs, if any, associated with the acquisition of securities.

The Group treats a security as quoted on an active market if the quoted market prices are readily and regularly available from the stock exchange, dealers, securities traders, industrial groups, valuation services or regulatory authorities and these prices represent current and regular market transactions under ordinary conditions.

All financial instruments included in the 'At fair value through profit or loss' and the 'Available for sale' portfolios are recognised at fair values. The fair value is established by reference to the price quoted on a market. In circumstances where appropriate market quotations are not readily available, do not exist, are deemed unreliable or are not immediately updated to reflect the movements in the underlying market parameters, the securities held by the Group are valued using the model of discounting future cash flows (valuation at the credit spread above the zero-risk yield curve). The parameters of the model are based on the credit spread of the relevant security and/or prices of comparable securities. Securities measured on the basis of the model are revalued at ruling market quotations at regular intervals. The length of this interval is derived from the volume of the measured securities in the portfolio. This revaluation is accompanied by the recalibration of the valuation model parameters.

The market price is determined on the basis of information published in the Reuters and Bloomberg information systems or directly from binding quotations obtained from market participants.

All purchases and sales of securities held for trading that require delivery within the time frame established by regulation or market convention (purchases and sales with standard settlement terms) are recognised as spot transactions.

All purchases and sales of securities that do not meet the ‘regular way’ settlement criterion in the securities marketplace concerned are treated as financial derivatives and are recognised on the face of the balance sheet upon settlement at fair value.

The cost of debt securities is gradually increased to reflect the accrued interest income using the effective interest rate method. Interest income which includes the accrued coupon adjusted for the accrued difference between the nominal value of the security and its cost is recognised from the purchase settlement date to the sale settlement date.

Dividend income arising from equity securities is recorded as the dividends are declared and is included as a receivable in the balance sheet line ‘*Prepayments, accrued income and other assets’* and in ‘*Income from dividends’* in the profit and loss statement. Upon receipt of the dividend, the receivable is offset against the collected cash.

Transactions with treasury shares that are settled on a gross basis by the delivery of treasury shares have a direct impact on the Group’s equity.

The Group assesses on a regular basis whether securities may be impaired, the only exception being securities at fair value through profit or loss. A financial asset is impaired if there is objective evidence of impairment or if its carrying amount is greater than its estimated recoverable amount. When an impairment of assets is identified, the Group recognises provisions through the profit and loss statement line ‘*Provision for impairment of securities’*.

**Financial assets at fair value through profit or loss**

Securities designated as ‘At fair value through profit or loss’ are securities held for trading (equity and debt securities, treasury bills, bills of exchange and participation certificates) acquired by the Group for the purpose of generating a profit from short-term fluctuations in prices. These securities are accounted for and stated at fair value which approximates the price quoted on recognised stock exchanges or any other public securities markets.

Unrealised gains and losses arising from the fair value remeasurement of securities as well as realised gains and losses are recognised as income in the profit and loss statement line ‘*Net profit/(loss) on financial operations.’*

**Available for sale financial assets**

Available for sale financial assets are those financial assets that are not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity investments. This portfolio comprises equity securities and debt securities, including asset backed securities, and participation certificates. Financial assets available for sale are accounted for and stated at fair value.

Accrued interest income is recognised through the profit and loss statement. Unrealised gains or losses from the fair value remeasurement of securities are included in the *'Revaluation of available-for-sale financial assets'* in equity until their sale, maturity or impairment. Fair value changes arising from changes in foreign exchange rates are presented in equity and changes in the amortised cost arising from changes in foreign exchange rates are included in the profit and loss statement.

In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/book value ratios refined to reflect the specific circumstances of the issuer and according to the principle of prudence. If equity securities cannot be measured using the methods referred to above or on any other valuation basis they are carried at cost.

The estimated recoverable amount of financial assets available for sale is equal to the current fair value of the assets. The estimated recoverable amount of equity and debt securities, for which the fair value cannot be reliably determined, is equal to the present value of the expected future cash flows discounted at the current market interest rate for similar financial instruments.

**Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(i) assets that the Group intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the Group upon initial recognition designates as at fair value through profit or loss;
(ii) assets that the Group upon initial recognition designates as available for sale; or
(iii) assets for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

These securities are measured on the same basis as investments held to maturity and are reported on the balance sheet together with amounts due from banks or customers, as appropriate.

**Investments held to maturity**

Investments held to maturity are financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intent and ability to hold to maturity. Held to maturity investments are carried at amortised cost using the effective interest rate method.

The estimated recoverable amount of investments held to maturity is equal to the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate.

### *(i) Assets held for sale*

An asset is classified as 'held for sale' under IFRS 5 if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. The asset must be available for immediate sale in its present condition, must be actively marketed for sale at a price that is reasonable in relation to its current fair value and its sale must be highly probable, that is, a plan to sell leading to the location of a buyer has been initiated. The sale of assets should be completed within one year from the date of classification of assets as 'held for sale'.

Non-current assets designated as 'Held for sale' are reported in the balance sheet line *'Assets held for sale'* and are no longer depreciated.
The Group recognises an impairment loss on assets held for sale if their selling price less costs to sell is lower than their carrying amount. Any subsequent increase in the selling price less costs to sell is recognised as a gain but not in excess of the cumulative impairment loss that has been recognised either in accordance with IFRS 5 or IAS 36.

### *(j) Tangible and intangible fixed assets*

Tangible and intangible fixed assets are stated at historical cost less accumulated depreciation together with accumulated impairment losses and increased by technical improvements. Fixed assets are depreciated indirectly through the accumulated depreciation charge. Depreciation is calculated on a straight line basis to write off the cost, net of provisions, in respect of tangible and intangible fixed assets and net of the estimated residual value in respect of cars held under finance lease (recognised in assets under IFRS) over their estimated useful economic lives and is reported in the profit and loss statement line 'Depreciation, impairment and disposal of fixed assets'. The residual value of cars held under finance leases is determined on the basis of the purchase price following the expiration of the lease set out in the lease contract.

The Bank specifically does not depreciate land, works of art, tangible and intangible fixed assets in the course of construction and technical improvements, unless they are brought into a condition fit for use.

The Bank has applied the component approach to buildings and their technical improvements that were acquired subsequent to 1 January 2005.

During the reporting periods, the Group used the following estimated useful economic lives in years:

| | **2008** | 2007 |
|---|---|---|
| Machinery and equipment | 4 | 4 |
| Information technology – notebooks, servers | 4 | 4 |
| Information technology – computers | 6 | 6 |
| Fixtures, fittings and equipment | 6 | 6 |
| Vehicles | 5 | 7 |
| ATMs and selected equipment of the Group | 8 | 8 |
| Energy machinery and equipment | 12/15 | 12/15 |
| Distribution equipment | 20 | 20 |
| Buildings and structures | 40 | 40 |
| Buildings and structures - selected components: | | |
| - Heating, air-conditioning, windows, doors | 20 | 20 |
| - Lift, electro-installation | 25 | 25 |
| - Roof, facade | 30 | 30 |
| - Net book value – building or technical improvements without selected components | 50 | 40 |
| Technical improvements on leasehold assets, including historic buildings | According to the lease term | According to the lease term |
| Intangible results of development activities (assets generated internally as part of internal projects) | According to the useful life, typically 4 | According to the useful life, typically 4 |
| Right of use – software | 4 | 4 |
| Other rights of use | According to contract | According to contract |

In accordance with IAS 38, the Group adds to the cost of intangible assets generated internally as part of internal projects external expenses and internal personnel costs incurred in developing intangible fixed assets. The Group does not capitalise expenses incurred in research.

The Group periodically tests its assets for indications of impairment, such as a change in their utilisation or worsened economic conditions. Where the indications of impairment are identified and the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount. The recoverable amount is the higher of net realisable value and value in use. Where assets are identified as being surplus to the Group's requirements, management of the Group determines a provision for asset impairment by reference to the selling price based on expert valuation reports adjusted downwards for an estimate of associated sale costs. The associated sale costs include costs of expert valuation reports, legal and economic advisory, etc. which are estimated on the basis of the Group's historical experience, and real estate transfer tax in respect of real estate.

Repairs and renewals are charged directly to the profit and loss statement when the expenditure is incurred.

Goodwill arising on the acquisition of a subsidiary is the excess of the acquisition cost for the interest acquired by the Group over the net fair value of acquired assets, liabilities and contingent liabilities at the acquisition date. Goodwill is initially recognised at the cost of acquisition and subsequently at cost net of impairment write-downs.

The Group recognises goodwill in accordance with IFRS 3 which facilitates the accounting for a business combination using provisional values in circumstances where the fair values of identifiable assets, liabilities, contingent liabilities and the cost of the combination are determined only provisionally. Any adjustments to those provisional values must be recognised within twelve months of the acquisition date.

The Group tests goodwill for impairment on an annual basis or more frequently if there are indications that the goodwill may be impaired. If the recoverable value of the tested cash-generating unit (typically the acquired enterprise taken as a whole) is lower than its carrying amount, the Bank recognises an impairment of the cash-generating unit which is primarily allocated against the goodwill and subsequently against the value of other assets (against other impaired assets and/or pro-rata).

Upon the sale of a subsidiary, the appropriate goodwill balance is reflected in the profit or loss on the sale.

### *(k) Leases*

**Group as the Lessor**

When assets are held subject to a finance lease, the present value of the lease payments is recognised as '*Loans and advances to customers'*, assets are not recognised. The difference between the gross receivable and the present value of the receivable is recognised as deferred interest income. Lease income is recognised over the term of the lease reflecting a constant periodic rate of interest.

**Group as the Lessee**

Assets held under finance leases when substantially all the risks and rewards of ownership are transferred, are recognised as assets at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. These assets are depreciated over their useful lives.

Lease payments are apportioned between interest reported in finance charges (in '*Interest expense and similar expense*') and a reduction of the outstanding lease obligation. Finance charges are allocated over the lease term so as to achieve a constant rate of interest.

Payments made under operating leases are charged to expenses on a straight line basis over the term of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

### *(l) Provisions*

In accordance with IFRS, the Group recognises a provision when, and only when:

- It has a present obligation (legal or constructive) as a result of a past event;
- It is probable that the settlement of the obligation will cause an outflow of resources causing a decrease of economic benefits; and
- A reliable estimate can be made of the amount of the obligation. Provisions for legal disputes are estimated on the basis of the amount sought by the plaintiff, including accrued interest and fees.

In the normal course of business, the Group enters into credit related commitments which are recorded in off balance sheet accounts and primarily include guarantees, avals, uncovered letters of credit, irrevocable commitments to extend credit, undrawn loan commitments and approved overdraft loans.

Specific provisions are made for estimated losses on these commitments on the same basis as used in provisioning (refer to Note 44).

### *(m) Employment benefits*

The Group provides its employees with retirement benefits and disability benefits.

The employees are entitled to receive retirement or disability benefits if they are employed by the Group until their retirement age or if they are entitled to receive a disability pension but only if were employed with the Group for a minimum defined period.

Estimated benefit costs are recognised on an accruals basis through a provision over the employment term using an accounting methodology that is similar to that used in respect of defined benefit pension plans. In determining the parameters of the model, the Group refers to the most recent employee data (the length of employment with the Group, age, gender, average salary) and estimates made on the basis of monitored historical data about the Group's employees (expected reduction of the current staffing levels) and other estimates (the amount of bonuses, anticipated increase in salaries, estimated amount of social security and health insurance contributions, discount rate).

The Group additionally provides short-term benefits to its employees, such as contributions to retirement pension insurance and capital life insurance schemes. The Group recognises the costs of these contributions as incurred.

### *(n) Securities issued*

Securities issued by the Group are stated at amortised costs using the effective interest rate method. Interest expense arising on the issue of the Group's own securities is included in the profit and loss statement line '*Interest expense and similar expense*.'

In the event of the repurchase of its own debt securities, the Group derecognises these securities so as to reflect the economic substance of the transaction as a repayment of the Group's commitment and decreases its liabilities in the balance sheet line '*Securities issued*'. Gains and losses arising as a result of the repurchase of the Group's own debt securities are included in '*Net profit/(loss) on financial operations'.*

### *(o) Recognition of income and expense*

Interest income and expenses related to interest-bearing instruments are reported in the profit and loss statement in the period to which they relate on an accruals basis using the effective interest rate which is calculated, under IFRS, reflecting the fees paid by contractual parties, transaction costs and other discounts and premiums. Interest, fees and other expenses included in the calculation of the effective interest rate are recognised in '*Interest income and similar income'.*

Other fees and commissions are recognised in the period to which they relate on an accruals basis. Penalty interest is accounted for and included in interest income on a cash basis.

### *(p) Income taxation*

Taxation is calculated in accordance with the provisions of the relevant legislation of the Czech Republic and other jurisdictions in which the Group operates, based on the profit recognised in the profit and loss statement net of the effects of IFRS. Income taxation is included in the profit and loss statement, or equity if it relates to an item directly taken to equity.

Deferred income tax is provided, using the balance sheet liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values. Deferred income tax is determined using tax rates effective in the periods in which the temporary tax difference is expected to be realised. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the tax assets can be utilised.

Deferred tax related to cash flow hedges where fair value changes or financial assets available for sale are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the profit and loss statement together with the deferred gain or loss.

***(q) Repurchase agreements***

Under repurchase transactions ('repos'), the Group provides securities held in the 'At fair value through profit or loss' and 'Financial assets available for sale' portfolio as collateral. These securities are recorded as assets in the balance sheet line '*Financial assets at fair value through profit or loss*' and *'Financial assets available for sale'* and the corresponding liability arising from the received loan is included in '*Amounts due to banks*' or '*Amounts due to customers*' as appropriate.

Securities purchased under reverse repurchase agreements ('reverse repos') are recorded off balance sheet where they are remeasured to fair value. The corresponding receivable arising from the provided loan is recognised as an asset in the balance sheet line '*Due from banks*' or '*Loans and advances to customers*' as appropriate.

The Group's off balance sheet accounts also reflect securities obtained under reverse repos and provided as collateral at fair value. The corresponding liability arising from the received loan is included in '*Amounts due to banks*' or '*Amounts due to customers*' as appropriate.

The difference between the sale and repurchase price in respect of repo and reverse repo transactions is treated as interest and accrued evenly to expenses/income over the life of the repo agreement using the linear interest rate due to their short-term maturities.

In regard to the sale of a security acquired as collateral under a reverse repo transaction, the Group derecognises from off balance sheet account securities acquired under reverse repo transactions and recognises in the balance sheet an amount payable from a short sale which is remeasured to fair value. This payable is included in '*Financial liabilities at fair value through profit or loss*'.

***(r) Derivative financial instruments and hedging***

In the normal course of business, the Group enters into contracts for derivative financial instruments. At the conclusion of the financial derivative contract, the Group designates derivative instruments as either trading or hedging. The Group also acts as an intermediary provider of these instruments to certain clients.

The derivative financial instruments used by the Group as trading instruments include interest rate, currency and commodity forwards, swaps, securities based derivatives, emission allowances and options. The values of these instruments change pursuant to the fluctuations in interest rates, commodity prices, exchange rates, market values of securities and similar market parameters.

Derivative financial instruments are recognised at their fair value. Changes in the fair values of derivatives held for trading are directly included in the profit and loss statement line *'Net profit/(loss) on financial operations'* from the trade date to the settlement date. Fair values are obtained from quoted market prices, discounted cash flow models or options pricing models as appropriate. All derivatives are carried as assets in '*Financial assets at fair value through profit or loss*' when fair value is positive and as liabilities in '*Financial liabilities at fair value through profit or loss*' when fair value is negative.

Certain derivatives, such as the option for an earlier redemption of a bond, are embedded in other (host) financial instruments and are treated and accounted for as separate derivatives when: i) they as a separate instrument meet the definition of a derivative, ii) their risks and economic characteristics are not closely related to those of the host contract, and iii) the host contract is not carried at fair value with fair value changes reported in the profit and loss statement.

The Group uses certain derivative financial instruments to hedge against interest rate and foreign exchange rate risks to which it is exposed as a result of its financial market transactions. The Group designates a derivative as hedging only if the criteria set out in IFRS are met at the designation date.

The criteria for a derivative instrument to be accounted for as a hedge include:

(a) Compliance with the Group's risk management strategy;
(b) At the inception of the hedge, the hedging relationship is formally documented, the documentation identifies the hedged item and the hedging instrument, defines the risk that is being hedged and the approach to assessing whether the hedge is effective;
(c) The hedge is expected to be highly effective at inception and throughout the period; and
(d) Changes in the fair value or cash flows of the hedged item are almost fully offset by changes in the fair value or cash flows of the hedging instrument and the results are within a range of 80 percent to 125 percent.

Hedging derivatives are accounted for according to the type of a hedging relationship which can be either:

(i) a hedge of the fair value of a recognised asset or liability or a firm commitment (fair value hedge), or
(ii) a hedge of a future cashflow attributable to a recognised asset or liability or a forecasted transaction (cash flow hedge); or
(iii) a hedge of an investment in a foreign entity.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk, are recorded in the profit and loss statement along with the corresponding change in the fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective element of the hedge is charged directly to the profit and loss statement line '*Net profit/(loss) on financial operations*.' On this basis, the Group hedges the selected portfolios of foreign currency assets. The effectiveness of the hedge is regularly tested on a quarterly basis through prospective and retrospective tests.

If the hedge no longer meets the criteria for hedge accounting, an adjustment to the carrying value of a hedged interest-bearing financial instrument is amortised to profit or loss over the period to the maturity of the hedged item.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that prove to be highly effective in relation to hedged risk, are recognised in the '*Hedging instruments'* in shareholders' equity. Amounts deferred in equity are transferred to the profit and loss statement and classified as income or expense in the periods during which the hedged assets and liabilities affect the profit and loss statement. The ineffective element of the hedge is charged directly to the profit and loss statement line '*Net profit/(loss) on financial operations'*. On this basis, the Group hedges the interest rate risk and currency risk associated with selected portfolios of assets or liabilities or individual assets or liabilities. The effectiveness of the hedge is tested through prospective and retrospective tests performed at the end of each quarter.

The fair values of derivative instruments held for trading and hedging purposes are disclosed in Note 44.

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

***(s) Regulatory requirements***

The Bank is subject to the regulatory requirements of the Czech National Bank and other institutions. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off balance sheet commitments and provisioning to cover credit risk associated with the banks' clients, liquidity, interest rate and foreign currency position.

Similarly, other Group companies are subject to regulatory requirements specifically in relation to insurance, retirement benefit schemes and construction savings scheme.

***(t) Fiduciary activities***

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

***(u) Share capital and treasury stock***

Where the Group purchases its own share capital or obtains rights to purchase its share capital, the consideration paid including any attributable transaction costs is shown as a deduction from total shareholders' equity. Gains and losses on sales of own shares are recorded in equity.

***(v) Contingent assets and contingent liabilities***

In addition to transactions giving rise to the recognition of assets and liabilities in the balance sheet, the Group enters into transactions under which it generates contingent assets and liabilities. The Group maintains contingent assets and liabilities off balance sheet as off-balance sheet items. The Group monitors these transactions as they represent a substantial proportion of its activities and materially impact the level of risks to which the Group is exposed (they may increase or decrease other risks, for instance, by hedging on-balance sheet assets and liabilities).

Under IAS 37 a contingent liability is defined as a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. A contingent liability is also a present obligation where an outflow of resources embodying economic benefits will not be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. Contingent liabilities, for example, include irrevocable loan commitments, commitments arising from bank guarantees, bank acceptances, letters of credit, and warrants.

The Group recognises issued guarantees in accordance with IAS 39. The guarantee is initially recognised at fair value and subsequently at the higher of the value determined in accordance with IAS 37 or the amount originally reported and decreased by an accumulated accrual, if any, in accordance with IAS 18.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. Contingent asset is recognised and disclosed where an inflow of economic benefits is probable.

Off-balance sheet items also consist of interest rate and foreign currency instruments, including forwards, swaps, options and futures. For further disclosure on derivatives refer to part (r).

***(w) Segment reporting***

In accordance with IAS 14, the Group reports income and assets under business segments. The Group does not report geographical segments because the Group's income is primarily generated on the territory of the Czech Republic and the bulk of its assets are located in the Czech Republic.

A business segment is a distinguishable component of the Group that is engaged in providing a group of related services and that is subject to risks and returns that are different from those of other business segments. The Group reports the 'Universal banking' and 'Investment banking' segments.

***(x) Changes of accounting policies arising from the implementation of new or revised IFRSs and IASs effective from 1 January 2008 to 31 December 2008***

In October 2008, an amendment to *IAS 39 Financial Instruments: Recognition and Measurement* and *IFRS 7 Financial Instruments: Disclosures* relating to the reclassification of financial assets was published and became effective retrospectively as of 1 July 2008. This amendment facilitates, under extraordinary circumstances (e.g. in the period of a financial crisis) and subject to the fulfilment of specified criteria, the reclassification of non-derivative financial assets from the category of securities at fair value through profit or loss. In line with the amendment, it is also possible to reclassify financial assets from 'Financial assets available for sale' to 'Loans and receivables' subject to the fulfilment of specified criteria.

In the year ended 31 December 2008, the Group made no reclassifications between categories of financial assets.

The below interpretations are effective for periods beginning on or after 1 January 2008:

- IFRIC 11 IFRS 2 - Group and Treasury Share Transactions (effective 1 March 2007);
- IFRIC 12 - Service Concession Arrangements (effective 1 January 2008);
- IFRIC 13 - Customer Loyalty Programmes (effective for accounting periods beginning on or after 1 July 2008);
- IFRIC 14 IAS 19 - The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction (effective 1 January 2008); and
- IFRIC 16 - Hedges of a Net Investment in a Foreign Operation (effective for accounting periods beginning on or after 1 October 2008).

These interpretations do not have a material impact on the accounting policies applied by the Group.

***Changes of accounting policies arising from the implementation of new IFRSs and revised IASs effective from 1 January 2009 or later***

The Group has undertaken a detailed analysis of the revised International Financial Reporting Standards in order to identify the relevant changes and their potential impact on its accounting policies. The Group anticipates that the application of these standards will not have a significant impact on the Group's profit or loss or equity.

In the current reporting period or in the year ended 31 December 2007, the following standards/amended standards became effective and are to be applied for annual periods beginning on or after 1 January 2009 or 1 July 2009:

- IFRS 1 First time Adoption of IFRS: restructured version of the standard which retains the substance of the previous version and only differs in the structure. In addition, an amended version of the standard was published. This version enables the valuation of investments in a subsidiary at their deemed cost.

- IFRS 2 Share-based Payment: the amendment to the standard relates to vesting conditions which are newly limited only to the condition of continuance of the employment and performance conditions, and specifies the accounting policy for the cancellation of a contract by the counterparty.

- IFRS 3 Business Combinations: an extensive amendment to the standard changes, among others, the accounting for costs relating to acquisitions, valuation of non-control interests or contingent considerations, etc. (effective for annual periods beginning on or after 1 July 2009).

- IFRS 8 Operating Segments: this new standard replaced IAS 14 Segment Reporting. Under IFRS 8, segments are required to be identified based on internal reports (rather than industry or geography) and may newly include as a segment a component of an entity that largely supplies its products or services internally, i.e. to other operating segments of the entity.

- IAS 1 Presentation of Financial Statements: the amended standard requires the preparation of a statement of financial position also at the inception of the oldest comparative period when the entity retrospectively applies an accounting policy or makes a retrospective adjustment of the amount or classification of certain items of the financial statements. The standard also requires an entity to separately present transactions with owners (e.g. dividends) and other transactions (e.g. resulting from revaluation of assets, cash flow hedges, etc) in equity. For this reason, a Statement of Comprehensive Income is introduced, comprising the existing income statement as well as information about unrealised gains and losses recognised in equity. The revised standard also refers to a 'balance sheet' as a 'statement of financial position'.

- IAS 23 Borrowing Costs: the amended standard eliminates the option to select between the benchmark treatment (recognition of all borrowing costs as an expense) and the allowed alternative treatment (capitalisation of borrowing costs attributable to the acquisition, construction or production of a qualifying asset) and requires that borrowing costs attributable to the acquisition, construction or production of a qualifying asset (fixed asset) to be capitalised as part of the cost.

- IAS 27 Consolidated and Separate Financial Statements: The amendment to the standard involves accounting for received first dividends after the acquisition of an investment and determining the cost upon the inclusion of a newly formed parent company in the consolidation group.

- IAS 27 Consolidated and Separate Financial Statements, IAS 28 Investments in Associates and IAS 31 Financial Reporting of Interests in Joint Ventures: the amendment to the standards relates to the amendment to IFRS 3 and predominantly involves a step-by-step acquisition, allocation of the profit or loss to a non-controlling interest, loss of control, or significant influence or joint venture (effective for the period beginning on or after 1 July 2009).

- IAS 32 Financial Instruments: Disclosure and Presentation: the amended standard defines a puttable financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. An exception was additionally added whereby an instrument meeting the ‘financial liability’ definition is classified as an equity instrument if it meets all the requirements and criteria for equity instruments.

- IAS 39 Financial Instruments: Recognition and Measurement: the amended standard relates to hedged items and assessment of the effectiveness of the hedging of purchased options. The entity may designate as a hedged item both all changes in its cash flows or fair value and only their changes over/below the specified amount or another variable (one-side risk). In respect of the purchased option, its intrinsic rather than time value then reflects the one-side risk. The amendment also stipulates that the hedged risk or its hedged part must be a separately identifiable component of the financial instrument and changes in the cash flows or fair value of the financial instrument arising as a result of the change in the relevant risk must be reliably measurable (effective for the annual periods beginning on or after 1 July 2009).

The International Accounting Standards Board published the Annual Improvements which amend 20 standards in a total of 35 points with the primary objective of removing unintentional inconsistencies among individual standards or redundant or misleading references and improve the wording or update the obsolete terminology. Certain provisions of this complex amendment are effective for periods beginning on or after 1 January 2009, other provisions for periods beginning on or after 1 July 2009.

In addition, the following interpretations are effective for periods beginning on or after 1 January 2009:

- IFRIC 15 Agreements for the Construction of Real Estate;
- IFRIC 17 Distributions of Non-cash Assets to Owners; and
- IFRIC 18 Transfers of Assets from Customers.

These interpretations do not impact the accounting policies applied by the Group (IFRIC 17 does not relate to the distribution of non-cash assets which are controlled by the same party before and after the distribution and concurrently requires that all owners of the same class of shares are treated in the same manner).

***(y) Reclassification***

During the year ended 31 December 2008, the Group refined the presentation of certain items of its profit and loss statement and balance sheet to reflect the structure of the financial statements used by the parent company. The amounts and balances for 2007 were restated to reflect the presentation for the current period. The below tables include a reconciliation of individual categories.

Reconciliation of the profit and loss statement categories for the year ended 31 December:

| CZKm | 2007 Before reclassification | **2007 After reclassification** | Reference |
|---|---|---|---|
| Interest expense and similar expense | (15,475) | **(15,470)** | 1 |
| Income from dividends | 0 | **111** | 2 |
| Net fee and commission income | 9,283 | **7,756** | 3 |
| Net profit from financial operations | 1,566 | **2,982** | 2, 3 |
| Personnel expenses | (5,909) | **(5,914)** | 1 |
| General administrative expenses | (6,175) | **(6,241)** | 4, 5 |
| Provisions for loan losses | (1,651) | **(1,563)** | 4 |
| Provisions for other risks | 272 | **250** | 5 |

1. Incurred interest expenses of the accrued provision for retirement costs of CZK 5 million were reclassified from '*Interest expense and similar expense'* to *'Personnel expenses'.*
2. Received dividends on financial assets available for sale in the amount of CZK 111 million were reclassified from '*Net profit from financial operations'* to *'Income from dividends'.*
3. Net profit from exchange rate commissions (clean payments, payment card transactions) of CZK 1,527 million was reclassified from '*Net fee and commission income'* to *'Net profit from financial operations'.*
4. The costs of bonuses provided in respect of debt recovery in the amount of CZK 88 million were reclassified from *'Provisions for loan losses'* to *'General administrative expenses'.*
5. The release of the provision for a penalty of CZK 22 million was reclassified from *'Provisions for other risk expenses' to 'General administrative expenses'.*

Reconciliation of balance sheet categories as of 31 December:

| CZKm | 2007 Before reclassification | **2007 After reclassification** | Reference |
|---|---|---|---|
| Cash and current balances with central banks | 10,957 | **13,557** | 1 |
| Financial assets at fair value through profit or loss | 24,501 | **31,910** | 2 |
| Positive fair value of hedging financial derivative transactions | 9,439 | **2,030** | 2 |
| Amounts due from banks | 203,691 | **201,091** | 1 |
| Loans and advances to clients | 304,521 | **304,938** | 3, 4, 5 |
| Prepayments, accrued income and other assets | 7,417 | **7,000** | 3, 4, 5 |
| Amounts due to central banks | 0 | **10** | 6 |
| Financial liabilities at fair value through profit or loss | 0 | **7,723** | 8, 9 |
| Negative fair value of hedging financial derivative transactions | 8,621 | **2,746** | 9 |
| Amounts due to banks | 13,598 | **12,267** | 6, 7, 8 |
| Amounts due to customers | 540,756 | **540,229** | 7 |
| Accruals and other liabilities | 12,347 | **12,348** | 10 |
| Provisions | 1,692 | **1,691** | 10 |

1. Term placements with the Czech National Bank in the amount of CZK 2,600 million were reclassified from '*Amounts due from banks'* to *'Cash and current balances with central banks'.*
2. The category '*Positive fair value of financial derivative transactions*' was split into hedging derivatives and trading derivatives. Trading derivatives were included in '*Financial assets at fair value through profit or loss'* in the amount of CZK 7,409 million.
3. Receivables arising from trading on the Prague Energy Stock Exchange in the amount of CZK 417 million were reclassified from *'Prepayments, accrued income and other assets'* to '*Loans and advances to customers'.*
4. Other receivables from the non-credit process of CZK 9 million were reclassified from *'Loans and advances to customers'* to '*Prepayments, accrued income and other assets'.*
5. Provisions for other receivables from the non-credit process of CZK 9 million were reclassified from *'Loans and advances to customers'* to '*Prepayments, accrued income and other assets'.*
6. Amounts due to central banks of CZK 10 million were reclassified from '*Amounts due to banks'* to *'Amounts due to central banks'.*
7. Amounts due to cooperative savings banks of CZK 527 million were reclassified from '*Amounts due to customers'* to *'Amounts due to banks'.*
8. Payables from sold securities in the amount of CZK 1,848 million were reclassified from *'Amounts due to banks' to 'Financial liabilities at fair value through profit or loss'.*
9. The category '*Negative fair value of financial derivative transactions*' was split into hedging derivatives and trading derivatives. Trading derivatives were included in '*Financial liabilities at fair value through profit or loss'* in the amount of CZK 5,875 million.
10. The provision for real estate tax of CZK 1 million was reclassified from '*Provisions'* to *'Accruals and other liabilities.*

## 4 Source of income and expenses

Set out below is a business segment analysis:

| | Universal banking | | Investment banking | | Total | |
|---|---|---|---|---|---|---|
| | **2008** | 2007 | **2008** | 2007 | **2008** | 2007 |
| | **CZKm** | CZKm | **CZKm** | CZKm | **CZKm** | CZKm |
| External income | 29,041 | 19,011 | 4,673 | 10,659 | 33,714 | 29,670 |
| Income from other segments | 2,649 | 8,958 | (2,649) | (8,958) | 0 | 0 |
| **Total income** | **31,690** | 27,969 | **2,024** | 1,701 | **33,714** | 29,670 |
| External expenses | (14,394) | (13,468) | (113) | (161) | (14,507) | (13,629) |
| **Segment result** | **17,296** | 14,501 | **1,911** | 1,540 | **19,207** | 16,041 |
| Unallocated expenses | | | | | (2,950) | (1,713) |
| **Profit before taxation** | | | | | **16,257** | 14,328 |
| Taxation | | | | | (3,024) | (3,103) |
| **Profit** | | | | | **13,233** | 11,225 |
| Assets by segment | **527,904** | 445,398 | **170,584** | 215,195 | **698,488** | 660,593 |
| Investments in associates and unconsolidated subsidiaries | **550** | 493 | **0** | 0 | **550** | 493 |
| Unallocated assets | | | | | **6** | 733 |
| **Total consolidated assets** | | | | | **699,044** | 661,819 |
| Liabilities by segment | **464,420** | 395,244 | **170,889** | 215,691 | **635,309** | 610,935 |
| Unallocated liabilities | | | | | **761** | 230 |
| **Total consolidated liabilities** | | | | | **636,070** | 611,165 |
| Acquisition of assets | **2,135** | 2,243 | **15** | 9 | **2,150** | 2,252 |
| Depreciation and amortisation | **1,684** | 1,646 | **5** | 5 | **1,689** | 1,651 |

The release of provisions during the reporting period in the "*Investment banking*" segment amounted to CZK 1 million (2007: a recognition of CZK 1 million), other recognition and release of provisions related only to the '*Universal banking*' segment for all classes of impaired assets.

Subsidiaries that do not meet the criteria of IAS 14 for inclusion in a standalone segment are presented within universal banking.

The Group's income is primarily generated on the territory of the Czech Republic. The bulk of assets are located in the Czech Republic.

## 5 Net interest income

Net interest income comprises:

| | **2008** | 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Interest income and similar income | 42,432 | 34,149 |
| Interest expense and similar expense | (21,410) | (15,470) |
| Income from dividends on available-for-sale securities | 239 | 111 |
| **Net interest income and similar income** | **21,261** | 18,790 |
| Of which net interest income arising from | | |
| - Loans and advances | 27,714 | 23,623 |
| - Securities held to maturity | 62 | 117 |
| - Securities available for sale | 2,926 | 2,682 |
| - Financial liabilities at amortised cost | (10,202) | (9,224) |

'*Interest income and similar income*' includes interest on substandard, doubtful and loss loans of CZK 685 million (2007: CZK 590 million) due from customers and interest of CZK 7 million (2007: CZK 1 million) on securities that have suffered impairment.

'*Interest income and similar income*' also includes accrued interest income from hedging financial derivatives of CZK 10,315 million (2007: CZK 7,727 million) and '*Interest expense and similar expense*' from hedging financial derivatives of CZK 9,793 million (2007: CZK 6,246 million). '*Net interest income and similar income*' from these derivatives amounts to CZK 522 million (2007: CZK 1,481 million).

*'Income from dividends on available-for-sale securities'* includes dividends received from available-for-sale securities in the form of shares which amounted to CZK 54 million in the year ended 31 December 2008.

## 6 Net fees and commissions

Net fees and commissions comprise:

| | **Year ended 31 December 2008** | Year ended 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Fees and commission from transactions | 3,977 | 3,667 |
| Fees and commissions from loans and deposits | 3,083 | 3,009 |
| Other fees and commissions | 990 | 1,080 |
| **Total net fees and commissions** | **8,050** | 7,756 |

## *7 Net profit/(loss) on financial operations*

Net profit/(loss) on financial operations comprises:

| | **Year ended 31 December 2008** | Year ended 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Net realised gains/(losses) on securities held for trading | (6) | 5 |
| Net unrealised gains on securities held for trading | 1,148 | 401 |
| Net realised gains on securities available for sale | 340 | 206 |
| Net realised gains on own bonds | 0 | 18 |
| Net realised and unrealised gains on security derivatives | 110 | 28 |
| Net realised and unrealised gains on interest rate derivatives | (240) | 230 |
| Net realised and unrealised gains on trading commodity derivatives | 33 | 10 |
| Net realised and unrealised gains on foreign exchange financial derivatives, spot foreign exchange transactions, re-translation of foreign currency assets and liabilities and foreign exchange fees and commissions | 2,838 | 2,084 |
| **Total net profit on financial operations** | **4,223** | 2,982 |

In the year ended 31 December 2008, the line '*Net realised gains/(losses) on financial assets available for sale*' shows the net gain from the sale of the equity investment in Burza cenných papírů Praha, a.s. in the amount of CZK 485 million (refer to Note 19).

The line '*Net realised and unrealised gains/(losses) on foreign exchange financial derivatives, spot foreign exchange transactions, re-translation of foreign currency assets and liabilities and foreign exchange fees and commissions'* shows the aggregate re-translation of foreign currency assets and liabilities (with the exception of securities held for trading) which represented a net gain of CZK 1,573 million in 2008 (2007: a net loss of CZK 1,778 million) and net fees and commissions from clean and documentary payments and cash transactions with clients of the Group, in the amount of the difference between the exchange rate relating to the purchase/sale of the foreign currency determined by the Group and the official foreign exchange rate of the Czech National Bank used for the revaluation of transactions in foreign currencies.

A loss of CZK 408 million (2007: gain of CZK 208 million) on the fair value of interest rate swaps for foreign currency risk hedging is included in *'Net realised and unrealised gains/(losses) on interest rate derivatives'*. This amount matches the loss arising from the retranslation of hedged loan receivables reported in the same line.

A profit of CZK 12 million (2007: a loss of CZK 9 million) on the fair value of cross currency swaps for foreign currency risk hedging is included in '*Net realised and unrealised gains/(losses) on foreign exchange financial derivatives, spot foreign exchange transactions, re-translation of foreign currency assets and liabilities and foreign exchange fees and commissions'*. This amount matches the gain arising from the retranslation of hedged foreign currency assets reported in the same line.

## 8 Other income

The Group reports CZK 180 million (2007: CZK 142 million) in '*Other income*'. In the years ended 31 December 2008 and 2007, '*Other income*' predominantly included income arising from the leased assets.

## 9 Personnel expenses

Personnel expenses comprise:

| | **Year ended 31 December 2008** CZKm | Year ended 31 December 2007 CZKm |
|---|---|---|
| Wages, salaries and bonuses | 4,537 | 4,144 |
| Social costs | 1,783 | 1,770 |
| **Total personnel expenses** | **6,320** | 5,914 |
| Physical number of employees at the period-end | 8,905 | 8,613 |
| Average recalculated number of employees during the period | 8,804 | 8,534 |
| **Average cost per employee (CZK)** | **717,856** | 692,933 |

'*Social costs*' include costs of CZK 113 million (2007: CZK 104 million) paid by the Group to the employees' retirement pension insurance scheme and costs of CZK 43 million (2007: CZK 43 million) incurred in contributing to the employees' capital life insurance scheme.

'*Personnel expenses*' include expenses of CZK 74 million (2007: CZK nil) relating to provisioning for restructuring in relation to the project of the reorganisation and centralisation of the Bank's back office divisions (refer to Note 34).

## 10 General administrative expenses

General administrative expenses comprise:

| | **Year ended 31 December 2008** CZKm | Year ended 31 December 2007 CZKm |
|---|---|---|
| Insurance of deposits and transactions | 489 | 482 |
| Marketing and entertainment costs | 882 | 682 |
| Costs of sale and banking products | 1,321 | 1,372 |
| Staff costs | 365 | 308 |
| Property maintenance charges | 1,290 | 1,335 |
| IT support | 881 | 883 |
| Office equipment and other consumption | 109 | 105 |
| Telecommunications, post and other services | 326 | 308 |
| External advisory services | 699 | 550 |
| Other expenses | 244 | 216 |
| **Total general administrative expenses** | **6,606** | 6,241 |

'*Insurance of deposits and transactions*' shown as a component of '*General administrative expenses*' includes an estimated balance of payments to the Deposit Insurance Fund of CZK 406 million (2007: CZK 386 million).

'*General administrative expenses*' include expenses of CZK 58 million (2007: CZK nil) relating to provisioning for the restructuring in relation to the project of the reorganisation and centralisation of the Bank's back office divisions (refer to Note 34).

## 11 Depreciation, impairment and disposal of fixed assets

Depreciation, impairment and disposal of fixed assets comprise:

| | **Year ended 31 December 2008 CZKm** | Year ended 31 December 2007 CZKm |
|---|---|---|
| Depreciation of tangible and intangible fixed assets | 1,689 | 1,651 |
| Provisions for assets and net gain on the sale of assets | (108) | (177) |
| **Total depreciation, impairment and disposal of fixed assets** | **1,581** | 1,474 |

## 12 Cost of risk

**Provisions for loans and other credit commitments**

The movement in the provisions was as follows:

| | **2008 CZKm** | 2007 CZKm |
|---|---|---|
| Balance at 1 January | (10,384) | (9,086) |
| Provisioning for loan losses | (2,815) | (1,563) |
| Reallocation to other provisions | 0 | 14 |
| Impact of loans written off and transferred | 203 | (18) |
| Exchange rate differences attributable to provisions | (146) | 269 |
| **Balance at 31 December** | **(13,142)** | (10,384) |

The balance of provisions as of 31 December 2008 and 2007 comprises:

| | **Year ended 31 December 2008 CZKm** | Year ended 31 December 2007 CZKm |
|---|---|---|
| Provisions for loans to customers (refer to Note 22) | (12,026) | (9,623) |
| Provisions for other loans to customers | (1) | (3) |
| Provisions for loans to financial institutions | (1) | 0 |
| Provisions for guarantees and other credit related commitments (refer to Note 34) | (1,114) | (758) |
| **Total** | **(13,142)** | (10,384) |

Provisions for securities

| | **Year ended 31 December 2008 CZKm** | Year ended 31 December 2007 CZKm |
|---|---|---|
| Balance at 1 January | 17 | 33 |
| Recognition of provisions | 152 | 0 |
| Release of provisions | 0 | (15) |
| Exchange rate difference | 0 | (1) |
| **Balance at 31 December** | **169** | 17 |

**Provisions for unconsolidated investments**

The balance of provisions for unconsolidated investments is reported in the balance sheet line '*Investments in associates and unconsolidated subsidiaries'* in the amount of CZK 35 million (2007: CZK 35 million).

**Provisions for other risk expenses**

The net recognition of '*Provisions for other risk expenses*' of CZK 3 million (2007: a net release of CZK 250 million) principally consists of the charge for provisions of CZK 65 million (2007: CZK 75 million) and the release and use of provisions of CZK 76 million (2007: CZK 539 million) for legal disputes, together with the costs incurred by the Group as a result of the outcome of legal disputes of CZK 12 million (2007: CZK 217 million), and the write-offs, recognition and use of provisions for receivables arising from internal transactions and supplier arrangements of CZK 4 million (2007: CZK 5 million). Additional information about the provisions for other risk expenses is provided in Note 34.

## 13 Profit/(loss) attributable to exclusion of companies from consolidation, income from share of associated undertakings

In May 2005, the Bank and Société Générale Asset Management S.A. (France) concluded a contract for the sale of 100 percent of the shares of Investiční kapitálová společnost Komerční banky, a.s. (hereinafter "IKS"). The selling price was payable in two instalments. The first portion of the price was paid immediately as of the transaction date in cash, the second portion of the price was due after the fulfilment of pre-agreed distribution targets for IKS products sold through the Bank's distribution network in 2005 to 2008. The Bank fulfilled the distribution targets. The gain of CZK 150 million is disclosed in the line *'Profit attributable to exclusion of companies from consolidation'.* In the year ended 31 December 2008, no companies were excluded from consolidation.

## 14 Income taxes

The principal components of the corporate income tax expense are as follows:

| | **Year ended 31 December 2008 CZKm** | Year ended 31 December 2007 CZKm |
|---|---|---|
| Tax payable – current year, reported in profit or loss | (2,912) | (2,877) |
| Tax paid – prior year | 1 | 35 |
| Deferred tax | (93) | (305) |
| Hedge of a deferred tax asset against foreign currency risk | (20) | 44 |
| **Total income taxes** | **(3,024)** | (3,103) |
| Tax payable - current year, reported in equity | **3** | 28 |
| **Total tax expense** | **(3,021)** | (3,075) |

The items explaining the difference between the theoretical and Group's effective tax rate are as follows:

| | **Year ended 31 December 2008 CZKm** | Year ended 31 December 2007 CZKm |
|---|---|---|
| **Profit before tax** | **16,257** | 14,328 |
| Theoretical tax calculated at a tax rate of 21% (2007: 24%) | 3,414 | 3,439 |
| Tax on pre-tax profit adjustments | (8) | (2) |
| Non-taxable income | (1,472) | (1,249) |
| Expenses not deductible for tax purposes | 1,099 | 908 |
| Use of tax losses carried forward | 0 | 0 |
| Tax allowance | (2) | (2) |
| Tax credit | (68) | (71) |
| Tax on a standalone tax base | 21 | 0 |
| Hedge of a deferred tax asset against foreign currency risk | 20 | (44) |
| Movement in deferred tax | 93 | 305 |
| Tax losses from consolidation | 27 | 0 |
| Impact of various tax rates of subsidiary undertakings | (96) | (123) |
| Tax effect of share of profits of associated undertakings | (3) | (23) |
| **Income tax expense** | **3,025** | 3,138 |
| Prior period tax expense | (1) | (35) |
| **Total income taxes** | **3,024** | 3,103 |
| Tax payable on securities reported in equity * | (3) | (28) |
| **Total income tax** | **3,021** | 3,075 |
| Effective tax rate | 18.60% | 21.66% |

* *This amount represents the tax payable on unrealised gains from the revaluation of securities available for sale which are revalued through equity under IFRS.*

Non-taxable income primarily includes dividends; gain on the sale of a subsidiary, tax exempt interest income and the release of non-tax deductible provisions and reserves. Expenses not deductible for tax purposes include the recognition of non-tax deductible reserves and provisions and non-tax deductible operating expenses. Tax on pre-tax profit adjustments primarily represents an adjustment of the IFRS result to CAS. Tax credit arises from interest income on bonds issued by EU states.

The corporate tax rate for the year ended 31 December 2008 is 21 percent (2007: 24 percent). The Group's tax liability is calculated based upon the accounting profit taking into account tax non-deductible expenses and tax exempt income or income subject to a final withholding tax rate.

Further information about deferred tax is presented in Note 35.

## 15 Distribution of profits/Allocation of losses

The Group generated a net profit of CZK 13,233 million for the year ended 31 December 2008. Distribution of profits for the year ended 31 December 2008 will be approved by the general meetings of the Group companies.

## 16 Earnings per share

Earnings per share of CZK 348.70 (2007: CZK 295.74 per share) have been calculated by dividing the net profit of CZK 13,233 million (2007: CZK 11,225 million) by the number of shares in issue, that is, 38,009,852, decreased to reflect the average number of treasury shares held by the Group during the period.

## 17 Cash and current balances with central banks

Cash and current balances with central banks comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Cash and cash equivalents | 7,791 | 7,223 |
| Balances with central banks | 6,170 | 6,334 |
| **Total cash and current balances with central banks** | **13,961** | 13,557 |

Balances with central banks represent obligatory minimum reserves and other deposits with central banks. The obligatory minimum reserves bear interest. The obligatory minimum reserves with the Czech National Bank bore interest at 2.25 percent and 3.50 percent as of 31 December 2008 and 2007, respectively. Obligatory minimum reserves with the National Bank of Slovakia bore interest at 1.50 percent and 1.50 percent as of 31 December 2008 and 2007, respectively.

## 18 Financial assets at fair value through profit or loss

As of 31 December 2008 and 2007, financial assets at fair value through profit or loss included securities and positive fair values of derivative financial instruments held for trading. Upon initial recognition, the Group has not designated any financial assets as at fair value through profit or loss.

| | **2008** | 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Securities | 25,801 | 24,501 |
| Derivative financial instruments | 18,192 | 7,409 |
| **Financial assets at fair value through profit or loss** | **43,993** | 31,910 |

For detailed information on derivative financial instruments included in the securities held for trading portfolio, refer to Note 44.

Trading securities comprise:

| | **31 December 2008 Fair value CZKm** | **31 December 2008 Cost CZKm** | 31 December 2007 Fair value CZKm | 31 December 2007 Cost CZKm |
|---|---|---|---|---|
| **Shares and participation certificates** | **3** | **3** | 74 | 74 |
| **Emission allowances** | **212** | **213** | 0 | 0 |
| Fixed income debt securities | 15,856 | 15,844 | 15,710 | 15,868 |
| Variable yield debt securities | 822 | 829 | 313 | 313 |
| Bills of exchange | 1,000 | 1,000 | 998 | 999 |
| Treasury bills | 7,908 | 7,904 | 7,406 | 7,414 |
| **Total debt securities** | **25,586** | **25,577** | 24,427 | 24,594 |
| **Total trading securities** | **25,801** | **25,793** | 24,501 | 24,668 |

** Acquisition cost for shares, participation certificates and emission allowances, amortised acquisition cost for debt securities*

The Group's portfolio of trading securities includes treasury bills issued by the Czech Finance Ministry at a fair value of CZK 7,908 million (2007: CZK 7,406 million).

As of 31 December 2008, the portfolio of trading securities includes securities at a fair value of CZK 16,893 million (2007: CZK 16,097 million) that are publicly traded on stock exchanges and securities at a fair value of CZK 8,908 million (2007: CZK 8,404 million) that are not publicly traded on stock exchanges (they are traded on the interbank market).

Trading shares and participation certificates at fair value comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| **Shares and participation certificates** | | |
| - Czech crowns | 3 | 74 |
| **Total trading shares and participation certificates** | **3** | 74 |

Trading shares and participation certificates at fair value, allocated by issuer, comprise:

| **Trading shares and participation certificates issued by:** | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| - Other entities in the Czech Republic | 0 | 71 |
| - Other foreign entities | 3 | 3 |
| **Total trading shares and participation certificates** | **3** | 74 |

Emission allowances held for trading at fair value comprise:

| Emission allowances | 31 December 2008 CZKm | 31 December 2007 CZKm |
|---|---|---|
| - Other currencies | 212 | 0 |
| **Total emission allowances held for trading** | **212** | 0 |

Emission allowances held for trading at fair value, allocated by issuer, comprise:

| Emission allowances held for trading issued by: | 31 December 2008 CZKm | 31 December 2007 CZKm |
|---|---|---|
| - Foreign state institutions | 212 | 0 |
| **Total emission allowances held for trading** | **212** | 0 |

Debt trading securities at fair value comprise:

| | 31 December 2008 CZKm | 31 December 2007 CZKm |
|---|---|---|
| **Variable yield debt securities** | | |
| - Czech crowns | 339 | 313 |
| - Other currencies | 483 | 0 |
| **Total variable yield debt securities** | **822** | 313 |
| **Fixed income debt securities (including bills of exchange and treasury bills)** | | |
| - Czech crowns | 22,807 | 22,834 |
| - Other currencies | 1,957 | 1,280 |
| **Total fixed income debt securities** | **24,764** | 24,114 |
| **Total trading debt securities** | **25,586** | 24,427 |

Debt trading securities at fair value, allocated by issuer, comprise:

| | 31 December 2008 CZKm | 31 December 2007 CZKm |
|---|---|---|
| **Debt trading securities issued by:** | | |
| - State institutions in the Czech Republic | 20,911 | 20,369 |
| - Foreign state institutions | 2,360 | 1,199 |
| - Financial institutions in the Czech Republic | 168 | 159 |
| - Foreign financial institutions | 458 | 382 |
| - Other entities in the Czech Republic | 1,579 | 1,988 |
| - Other foreign entities | 110 | 330 |
| **Total trading debt securities** | **25,586** | 24,427 |

Of the debt securities issued by state institutions in the Czech Republic, CZK 20,911 million (2007: CZK 19,518 million) represents securities eligible for refinancing with the Czech National Bank.

## *19 Financial assets available for sale*

Financial assets available for sale comprise:

| | **31 December 2008 Fair value CZKm** | **31 December 2008 Cost CZKm** | 31 December 2007 Fair value CZKm | 31 December 2007 Cost CZKm |
|---|---|---|---|---|
| **Shares and participation certificates** | **1,513** | **1,620** | 2,517 | 2,047 |
| Fixed income debt securities | 88,570 | 87,413 | 71,363 | 71,874 |
| Variable yield debt securities | 8,081 | 7,892 | 7,946 | 8,056 |
| **Total debt securities** | **96,651** | **95,305** | 79,309 | 79,930 |
| **Total financial assets available for sale** | **98,164** | **96,925** | 81,826 | 81,977 |

** Acquisition cost for shares and participation certificates, amortised acquisition cost for debt securities*

As of 31 December 2008, the available-for-sale portfolio includes securities at a fair value of CZK 83,173 million (2007: CZK 72,091 million) that are publicly traded on stock exchanges and securities at a fair value of CZK14,991 million (2007: CZK 9,735 million) that are not publicly traded.

In December 2008, the Bank and the group of selling shareholders of Burza cenných papírů Praha, a.s. (hereinafter "BCPP") sold the equity investment in BCPP to Wiener Borse AG (Vienna Stock Exchange). The sold equity investment of the Bank in BCPP amounted to 11.51 percent. The net gain from the sale for the Group amounted to CZK 485 million (refer to Note 7).

Shares and participation certificates available for sale at fair value comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| **Shares and participation certificates** | | |
| - Czech Crowns | 700 | 1,241 |
| - Other currencies | 813 | 1,276 |
| **Total shares and participation certificates available for sale** | **1,513** | 2,517 |

Shares and participation certificates available for sale at fair value, allocated by issuer, comprise:

| **Shares and participation certificates available for sale issued by:** | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| - Banks in the Czech Republic | 700 | 806 |
| - Foreign banks | 0 | 174 |
| - Non-banking entities in the Czech Republic | 0 | 230 |
| - Non-banking foreign entities | 813 | 1,307 |
| **Total shares and participation certificates available for sale** | **1,513** | 2,517 |

*'Shares and participation certificates available for sale issued by banks in the Czech Republic'* include the Group's 13 percent shareholding in Českomoravská záruční a rozvojová banka, a.s. Based on an analysis of regularly paid dividends and an estimate of probable future cash flows, the value of the investment was determined at CZK 640 million (2007: CZK 746 million) over the acquisition cost.

Debt securities available for sale at fair value comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Variable yield debt securities | | |
| - Czech Crowns | 7,980 | 7,755 |
| - Other currencies | 101 | 191 |
| **Total variable yield debt securities** | **8,081** | 7,946 |
| Fixed income debt securities | | |
| - Czech Crowns | 70,773 | 59,485 |
| - Other currencies | 17,797 | 11,878 |
| **Total fixed income debt securities** | **88,570** | 71,363 |
| **Total debt securities available for sale** | **96,651** | 79,309 |

Debt securities available for sale at fair value, allocated by issuer, comprise:

| **Debt securities available for sale issued by:** | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| - State institutions in the Czech Republic | 49,512 | 37,291 |
| - Foreign state institutions | 24,962 | 18,350 |
| - Financial institutions in the Czech Republic | 15,202 | 17,006 |
| - Foreign financial institutions | 3,738 | 4,054 |
| - Other entities in the Czech Republic | 1,032 | 1,292 |
| - Other foreign entities | 2,205 | 1,316 |
| **Total debt securities available for sale** | **96,651** | 79,309 |

Of the debt securities issued by state institutions in the Czech Republic, CZK 44,156 million (2007: CZK 37,064 million) represents securities eligible for refinancing with the Czech National Bank.

**Asset backed securities**

The Group maintains a portfolio of asset backed securities (ABS) denominated in USD which are carried as available for sale. The Group establishes the value of these securities using a simplified model which facilitates the discounting of anticipated future cash flows by using the most recent average CDO of credit spreads. The carrying value of these securities as of 31 December 2008, net of remeasurement, is CZK 102 million (2007: CZK 202 million).

In 2008, the Group's exposure to the ABS decreased primarily as a result of the decrease in the valuation of these securities of USD 4 million (i.e. CZK 81 million) and the redemption of the nominal values of these securities of USD 2 million (i.e. CZK 28 million).

**Other debt securities**

During the year ended 31 December 2008, the Group acquired Government bonds with a nominal value of CZK 13,800 million, EUR 236 million and USD 27 million (a total equivalent of CZK 20,667 million). During 2008, the Bank redeemed at maturity debt securities in the aggregate nominal volume of CZK 1,871 million and EUR 36 million (a total equivalent of CZK 2,827 million).

## 20 Assets held for sale

As of 31 December 2008, the Group reported assets held for sale at a carrying amount of CZK 429 million (2007: CZK 735 million) comprising buildings and land owned by the Group which management of the Group decided to sell as part of the plan to optimise the distribution network. These buildings are not depreciated. The difference between the amounts as of 31 December 2008 and 2007 arises from the sale of these assets and reclassification of buildings and land that do not meet the criteria for recognition as assets held for sale back to *'Tangible fixed assets'*, refer to Note 27. The impact on the profit and loss statement is immaterial.

## 21 Amounts due from banks

Balances due from banks comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Deposits with banks (current accounts) | 254 | 198 |
| Loans and advances to banks | 21,082 | 6,079 |
| Debt securities of banks acquired under initial offerings not designated for trading | 13,827 | 15,138 |
| Advances due from central banks (reverse repo transactions) | 94,882 | 120,073 |
| Term placements with other banks | 16,054 | 59,603 |
| **Total** | **146,099** | 201,091 |
| Provisions | (1) | 0 |
| **Total amounts due from banks** | **146,098** | 201,091 |

Advances due from central banks and other banks under reverse repurchase transactions are collateralised by treasury bills issued by central banks and other securities with fair value:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Treasury bills | 93,090 | 117,742 |
| Debt securities issued by state institutions | 15,490 | 2,747 |
| Debt securities issued by other institutions | 629 | 0 |
| Shares | 442 | 216 |
| **Total** | **109,651** | 120,705 |

**Securities acquired as loans and receivables**

As of 31 December 2008, the Group maintains in its portfolio bonds at an amortised cost of CZK 13,805 million (2007: CZK 15,138 million) and a nominal value of CZK 13,628 million (2007: CZK 14,925 million), of which CZK 11,513 million represents bonds issued by the parent company Société Générale S. A. (2007: CZK 13,515 million) which the Group acquired under initial offerings and normal market conditions in 2002 and 2006. The bond with the nominal value of CZK 8,000 million (2007: CZK 10,000 million) is denominated in CZK, bears fixed interest at 4.27 percent and will mature in 2012. During 2008, the Group partially repaid the nominal value of the bond in the amount of CZK 2,000 million. The bond with the nominal value of CZK 3,513 million (2007: CZK 3,515 million) is denominated in EUR, bears floating interest and will mature in 2026. The Group additionally carries in this portfolio three issues of securities placed by financial institutions with an aggregate nominal value of CZK 2,115 million (2007: CZK 1,410 million). During 2008, the Group purchased one issue of bonds issued by financial institutions with the nominal value of CZK 705 million.

## *22 Loans and advances to customers*

Loans and advances to customers comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Loans to customers | 371,421 | 312,661 |
| Bills of exchange | 748 | 851 |
| Forfaits | 1,804 | 985 |
| Other amounts due from customers | 2,094 | 67 |
| **Total gross loans and advances to customers** | **376,067** | 314,564 |
| Provisions for loans to customers | (12,026) | (9,623) |
| Provisions for other amounts due from customers | (1) | (3) |
| **Total loans and advances to customers, net** | **364,040** | 304,938 |

Loans and advances to customers include interest due of CZK 2,049 million (2007: CZK 1,555 million), of which CZK 1,228 million (2007: CZK 899 million) relates to overdue interest.

Loans provided to customers under reverse repurchase transactions as of 31 December 2008 amounting to CZK 2,079 million (2007: CZK 15 million) are collateralised by securities with fair values of CZK 2,306 million (2007: CZK 16 million).

The loan portfolio of the Group as of 31 December 2008 (excluding other amounts due from customers) comprises the following breakdown by classification:

| | **Gross receivable** | **Collateral applied** | **Net exposure** | **Provisions** | **Carrying value** | **Provisions** |
|---|---|---|---|---|---|---|
| | **CZKm** | **CZKm** | **CZKm** | **CZKm** | **CZKm** | **%** |
| Standard | 341,236 | 145,299 | 195,937 | 0 | 341,236 | 0% |
| Watch | 14,598 | 5,356 | 9,242 | 1,111 | 13,487 | 12% |
| Substandard | 5,250 | 1,429 | 3,821 | 973 | 4,277 | 25% |
| Doubtful | 1,903 | 441 | 1,462 | 790 | 1,113 | 54% |
| Loss | 10,986 | 455 | 10,531 | 9,152 | 1,834 | 87% |
| **Total** | **373,973** | **152,980** | **220,993** | **12,026** | **361,947** | |

The loan portfolio of the Group as of 31 December 2007 (excluding other amounts due from customers) comprises the following breakdown by classification:

| | Gross receivable CZKm | Collateral applied CZKm | Net exposure CZKm | Provisions CZKm | Carrying value CZKm | Provisions % |
|---|---|---|---|---|---|---|
| Standard | 288,010 | 128,577 | 159,433 | 0 | 288,010 | 0% |
| Watch | 13,705 | 5,607 | 8,098 | 793 | 12,912 | 10% |
| Substandard | 2,157 | 1,172 | 985 | 541 | 1,616 | 55% |
| Doubtful | 2,003 | 582 | 1,421 | 882 | 1,121 | 62% |
| Loss | 8,622 | 589 | 8,033 | 7,407 | 1,215 | 92% |
| **Total** | **314,497** | **136,527** | **177,970** | **9,623** | **304,874** | |

Loans classified as loss in the above table include amounts of CZK 6,291 million (2007: CZK 5,358 million), on which interest is not being accrued.

Set out below is the breakdown of loans by sector (net of other amounts due from customers):

| | **2008 CZKm** | 2007 CZKm |
|---|---|---|
| Food industry and agriculture | 16,397 | 16,111 |
| Metallurgy and metal processing | 8,146 | 8,116 |
| Automotive industry | 7,633 | 5,531 |
| Production of electric and electronic equipment | 3,011 | 2,531 |
| Electricity, gas and water industry | 7,790 | 5,163 |
| Construction industry | 9,889 | 10,402 |
| Wholesale | 30,567 | 27,005 |
| Insurance, banking | 31,303 | 28,319 |
| Real estate | 19,516 | 12,061 |
| Public administration | 11,919 | 10,757 |
| Commercial services | 14,756 | 11,861 |
| Other industry | 56,309 | 45,495 |
| Individuals | 156,737 | 131,145 |
| **Total loans to clients** | **373,973** | 314,497 |

The majority of loans were provided to entities on the territory of the Czech Republic.

Set out below is an analysis of types of collateral underlying on balance sheet loans and advances to customers:

| | **Total client loan collateral 31 December 2008** | **Discounted client loan collateral value 31 December 2008** | **Applied client loan collateral value 31 December 2008** | Total client loan collateral 31 December 2007 | Discounted client loan collateral value 31 December 2007 | Applied client loan collateral value 31 December 2007 |
|---|---|---|---|---|---|---|
| | **CZKm** | **CZKm** | **CZKm** | CZKm | CZKm | CZKm |
| Guarantees of state and governmental institutions | 3,428 | 2,829 | 2,594 | 4,091 | 3,262 | 2,945 |
| Bank guarantee | 21,045 | 20,630 | 19,473 | 19,058 | 18,307 | 16,576 |
| Guaranteed deposits | 737 | 732 | 453 | 2,607 | 2,606 | 2,382 |
| Issued debentures in pledge | 204 | 204 | 0 | 135 | 135 | 15 |
| Pledge of real estate | 240,358 | 145,986 | 101,050 | 189,244 | 119,294 | 87,256 |
| Pledge of movable assets | 7,794 | 1,697 | 1,551 | 7,136 | 1,101 | 1,044 |
| Guarantee by legal entity | 21,957 | 12,370 | 9,439 | 14,357 | 6,967 | 5,332 |
| Guarantee by individual (physical entity) | 11,291 | 1,256 | 1,172 | 44,357 | 7,467 | 7,382 |
| Pledge of receivables | 51,598 | 17,068 | 15,020 | 46,018 | 12,572 | 11,047 |
| Insurance of credit risk | 2,194 | 2,081 | 1,979 | 1,829 | 1,731 | 1,730 |
| Other | 5,021 | 818 | 249 | 24,469 | 5,033 | 818 |
| **Total nominal value of collateral** | **365,627** | **205,671** | **152,980** | 353,301 | 178,475 | 136,527 |

Pledges on industrial real-estate represent 12 percent of total pledges on real estate (2007: 13 percent).

**Loans and advances to customers - leasing**

| | **2008** | 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Due less than 1 year | 535 | 545 |
| Due from 1 to 5 years | 337 | 322 |
| Due over 5 years | 0 | 15 |
| **Total** | **872** | 882 |

Within the Group, ESSOX s.r.o. engages in providing lease services. Assets leased under lease arrangements primarily include used passenger and utility vehicles with an average lease instalment period of 63 months (2007: 43 months), new passenger and utility vehicles with an average lease instalment period of 68 months (2007: 56 months), technology with an average lease instalment period of 43 months (2007: 35 months) and consumer goods with an average lease instalment period of 10 months (2007: 12 months). As of 31 December 2008, future interest (the difference between the gross and net leasing investment) on lease contracts amounts to CZK 77 million (2007: CZK 75 million) and the provisions recognised against uncollectible lease receivables amount to CZK 336 million (2007: CZK 316 million).

**Trade finance losses**

During 1999, the Group incurred losses relating to loans, letters of credit and guarantees provided to a foreign client of the Group. As of 31 December 2008, on balance sheet loans to this client included an amount of CZK 1,352 million (2007: CZK 1,226 million) that was fully provided for. The year-on-year decrease in the balance between 2008 and 2007 arises from a foreign exchange rate difference.

The Group did not report any off balance sheet receivables from this client in 2008 and 2007. The Group is continuing to take action in all relevant jurisdictions to recover its funds.

## 23 Investments held to maturity

Investments held to maturity comprise:

| | **31 December 2008 Carrying value CZKm** | **31 December 2008 Cost* CZKm** | 31 December 2007 Carrying value CZKm | 31 December 2007 Cost CZKm |
|---|---|---|---|---|
| Fixed income debt securities | 1,435 | 1,435 | 2,999 | 2,998 |
| **Total investments held to maturity** | **1,435** | **1,435** | 2,999 | 2,998 |

** Amortised cost*

As of 31 December 2008, investments held to maturity include bonds of CZK 1,435 million (2007: CZK 2,999 million) that are publicly traded on stock exchanges.

Debt securities held to maturity comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Fixed income debt securities | | |
| - Czech Crowns | 0 | 1,368 |
| - Other currencies | 1,435 | 1,630 |
| **Total fixed income debt securities** | **1,435** | 2,999 |
| **Total debt securities held to maturity** | **1,435** | 2,999 |

Investments held to maturity, allocated by issuer, comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| **Debt securities held to maturity issued by:** | | |
| - State institutions in the Czech Republic | 0 | 1,369 |
| - Foreign state institutions | 1,435 | 1,630 |
| **Total debt securities held to maturity** | **1,435** | 2,999 |

Of the debt securities issued by state institutions in the Czech Republic, CZK nil (2007: CZK 1,385 million) represents securities eligible for refinancing central banks.

No purchase or sale within this portfolio took place during the year ended 31 December 2008. During 2008, debt securities in the total nominal amount of CZK 1,341 million and EUR 8 million (a total equivalent of CZK 1,556 million) were redeemed at maturity.

## 24 Prepayments, accrued income and other assets

Prepayments, accrued income and other assets comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Prepayments and accrued income | 788 | 735 |
| Settlement balances | 383 | 1,280 |
| Receivables from securities trading | 965 | 1,102 |
| Other assets | 4,031 | 3,883 |
| **Total prepayments, accrued income and other assets** | **6,167** | 7,000 |

In the year ended 31 December 2008, '*Other assets'* included receivables of CZK 2,086 million (2007: CZK 2,240 million) from the state budget including contributions to construction savings scheme and pension insurance policy holders.

## 25 Investments in associates and unconsolidated subsidiaries

Investments in associates and unconsolidated subsidiaries comprise:

| | **2008** | 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Investments in subsidiary undertakings | 4 | 4 |
| Investments in associated undertakings | 546 | 489 |
| **Total investments in subsidiaries and associates** | **550** | 493 |

| | **Group's ownership interest** | **31 December 2008** | **31 December 2008** | 31 December 2007 | 31 December 2007 |
|---|---|---|---|---|---|
| | **%** | **CZKm** | **CZKm** | CZKm | CZKm |
| **Subsidiaries** | | **Cost of investment** | **Net book value** | Cost of investment | Net book value |
| ALL IN REAL ESTATE LEASING, a. s. | 100.00 | 39 | 4 | 39 | 4 |
| **Total subsidiaries** | | **39** | **4** | 39 | 4 |
| **Associates** | | **Net book value** | **Share of net assets** | Net book value | Share of net assets |
| Komerční pojišťovna, a. s. | 49.00 | 482 | 546 | 483 | 489 |
| CBCB - Czech Banking Credit Bureau, a. s.* | 20.00 | 0 | 0 | 0 | 0 |
| **Total associates** | | **482** | **546** | 483 | 489 |
| **Investments in associates and unconsolidated subsidiaries** | | **521** | **550** | 522 | 493 |

*/* The cost and net book value of CBCB - Czech Banking Credit Bureau, a.s. is CZK 240 thousand.*

| Associates | 2008 Assets CZKm | 2008 Net operating income CZKm | 2008 Profit CZKm | 2007 Assets CZKm | 2007 Not operating income CZKm | 2007 Profit CZKm |
|---|---|---|---|---|---|---|
| Komerční pojišťovna, a. s. | 11,931 | 502 | 25 | 12,077 | 395 | 221 |
| CBCB - Czech Banking Credit Bureau, a. s. | 26 | 95 | 5 | 20 | 83 | 4 |

Additional information about the Bank's equity investments is presented in Notes 1 and 2.

## *26 Intangible fixed assets*

The movements in intangible fixed assets during the year ended 31 December 2008 are as follows:

| | Internally generated assets CZKm | Software CZKm | Other intangible assets CZKm | Assets under construction CZKm | Total CZKm |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| 31 December 2007 | 4,935 | 1,602 | 349 | 874 | 7,760 |
| Additions | 0 | 259 | 0 | 1,354 | 1,613 |
| Disposals/Transfers | 726 | 101 | 13 | (1,048) | (208) |
| **31 December 2008** | **5,661** | **1,962** | **362** | **1,180** | **9,165** |
| **Accumulated amortisation and provisions** | | | | | |
| 31 December 2007 | 3,345 | 1,102 | 326 | 33 | 4,806 |
| Additions | 630 | 248 | 20 | 0 | 898 |
| Disposals | 0 | (10) | 0 | 0 | (10) |
| Impairment charge | 0 | 0 | 0 | (33) | (33) |
| **31 December 2008** | **3,975** | **1,340** | **346** | **0** | **5,661** |
| **Net book value** | | | | | |
| 31 December 2007 | 1,590 | 500 | 23 | 841 | 2,954 |
| **31 December 2008** | **1,686** | **622** | **16** | **1,180** | **3,504** |

During the year ended 31 December 2008, the Group invested CZK 238 million (2007: CZK 161 million) in research and development through a charge to operating expenses.

## *27 Tangible fixed assets*

The movements in tangible fixed assets during the year ended 31 December 2008 are as follows:

| | **Land** | **Buildings** | **Fixtures, fittings and equipment** | **Assets under construction** | **Total** |
|---|---|---|---|---|---|
| | **CZKm** | **CZKm** | **CZKm** | **CZKm** | **CZKm** |
| **Cost** | | | | | |
| 31 December 2007 | 302 | 10,755 | 6,912 | 346 | 18,316 |
| Reallocation from assets held for sale | 0 | 76 | 0 | 0 | 76 |
| Additions | 9 | 278 | 461 | 796 | 1,544 |
| Disposals/Transfers | 0 | (154) | (1,243) | (723) | (2,120) |
| **31 December 2008** | **311** | **10,955** | **6,130** | **419** | **17,816** |
| **Accumulated depreciation and provisions** | | | | | |
| 31 December 2007 | **0** | **4,552** | **5,762** | **0** | **10,314** |
| Reallocation of accumulated depreciation of assets held for sale | 0 | 24 | 0 | 0 | 24 |
| Additions | 0 | 360 | 446 | 0 | 806 |
| Disposals | 0 | (67) | (1,234) | 0 | (1,301) |
| Impairment charge | 0 | (25) | (2) | 0 | (27) |
| **31 December 2008** | **0** | **4,844** | **4,972** | **0** | **9,816** |
| Net book value | | | | | |
| **31 December 2007** | 302 | 6,203 | 1,151 | 346 | 8,002 |
| **31 December 2008** | **311** | **6,111** | **1,158** | **419** | **8,000** |

As of 31 December 2008, the net book value of assets held by the Group under finance lease agreements was CZK 1 million (2007: CZK 5 million).

As of 31 December 2008, the Group recognised provisions against tangible assets of CZK 23 million (2007: CZK 50 million). These provisions primarily included provisions charged in respect of leasehold improvements.

## 28 Goodwill

The movements in goodwill during the year ended 31 December 2008 are as follows:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| **Opening balance** | 3,551 | 2,903 |
| Adjustment of acquisition accounting | 0 | 648 |
| 31 December 2007 adjusted balance | 0 | 3,551 |
| Additions | 0 | 0 |
| Disposals | 0 | 0 |
| **31 December 2008** | **3,551** | **3,551** |
| **Provisions** | | |
| 31 December 2007 | 0 | 0 |
| **31 December 2008** | **0** | **0** |
| **Net book value** | | |
| 31 December 2007 | 3,551 | 3,551 |
| **31 December 2008** | **3,551** | **3,551** |

The change in goodwill in 2007 represents its adjustment reflecting the adjustment of acquisition accounting under IFRS 3.

## 29 Financial liabilities at fair value through profit or loss

As of 31 December 2008 and 2007, financial liabilities at fair value through profit or loss include only liabilities arising from sold securities and negative fair values of financial derivative instruments held for trading. The Group identified no other financial liability as at fair value through profit or loss upon initial recognition.

| | **2008** | 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Sold securities | 947 | 1,848 |
| Derivative financial instruments | 19,208 | 5,875 |
| **Financial liabilities at fair value through profit or loss** | **20,155** | 7,723 |

For detailed information of financial derivative instruments included in the portfolio for trading, refer to Note 44.

## 30 Amounts due to banks

Amounts due to banks comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Current accounts | 3,799 | 1,863 |
| Other amounts due to banks | 7,315 | 10,404 |
| **Total amounts due to banks** | **11,114** | 12,267 |

The fair value of securities and treasury bills used as collateral for received repo loans from banks was CZK 419 million (2007: CZK 1,958 million).

## 31 Amounts due to customers

Amounts due to customers, by type of deposit, comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Current accounts | 293,997 | 299,874 |
| Savings accounts | 76,671 | 72,523 |
| Term deposits | 115,532 | 103,118 |
| Depository bills of exchange | 37,232 | 38,413 |
| Other payables to customers | 31,138 | 26,301 |
| **Total amounts due to customers** | **554,570** | 540,229 |

As of 31 December 2007 and 2008, the Group recorded no liabilities arising from repurchase loans from customers.

Amounts due to customers, by type of customer, comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Private companies | 193,106 | 191,291 |
| Other financial institutions, non-banking entities | 11,062 | 17,419 |
| Insurance companies | 7,990 | 6,031 |
| Public administration | 3,985 | 5,322 |
| Individuals | 242,520 | 228,132 |
| Individuals - businessmen | 26,064 | 25,937 |
| Government agencies | 55,322 | 50,103 |
| Other | 8,680 | 10,406 |
| Non-residents | 5,841 | 5,588 |
| **Total amounts due to customers** | **554,570** | 540,229 |

## 32 Securities issued

Securities issued comprise bonds of CZK 692 million (2007: CZK 466 million) and mortgage bonds of CZK 23,436 million (2007: CZK 27,451 million). Publicly tradable mortgage bonds are issued to fund the Group's mortgage activities.

Debt securities are repayable, according to remaining maturity, as follows:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| In less than one year | 3,630 | 3,789 |
| In one to two years | 0 | 3,632 |
| In two to four years | 0 | 0 |
| In five to ten years | 16,807 | 16,765 |
| Over ten years | 3,691 | 3,731 |
| **Total debt securities** | **24,128** | 27,917 |

During the year ended 31 December 2008, the Group repaid mortgage bond CZ0002000383 with the nominal volume of CZK 3,500 million, refer to the following table.

The debt securities detailed above include the following bonds and notes issued by the Group:

| Name | Interest rate | Currency | Issue date | Maturity date | 31 December 2008 CZKm | 31 December 2007 CZKm |
|---|---|---|---|---|---|---|
| Mortgage bonds of Komerční banka, a. s., CZ0002000268 | 5.5% | CZK | 21 Aug 2003 | 21 Aug 2009 | 3,630 | 3,702 |
| Mortgage bonds of Komerční banka, a. s., CZ0002000383 | 4.5% | CZK | 5 Aug 2004 | 5 Aug 2008 | 0 | 3,592 |
| Mortgage bonds of Komerční banka, a. s., CZ0002000565 | 3M PRIBID minus the higher of 10 bps or 10 % value of 3M PRIBID | CZK | 2 Aug 2005 | 3 Aug 2015 | 4,895 | 5,026 |
| Mortgage bonds of Komerční banka, a. s., CZ0002000664 | 4.4% | CZK | 21 Oct 2005 | 21 Oct 2015 | 10,290 | 10,358 |
| Mortgage bonds of Komerční banka, a. s., CZ0002000854 | 3.74% | EUR | 1 Sept 2006 | 1Sept 2016 | 930 | 1,035 |
| Bonds of Komerční banka, a. s., CZ0003701427 | 4.22% | CZK | 18 Dec 2007 | 1 Dec 2017 | 692 | 466 |
| Mortgage bonds of Komerční banka, a. s., CZ0002001753 | Rate of the interest swap sale in CZK for 10 years plus 150 bps | CZK | 21 Dec 2007 | 21 Dec 2037 | 3,691 | 3,738 |
| **Total debts** | | | | | **24,128** | 27,917 |

*Note: Six-month PRIBOR was 375 basis points as of 31 December 2008 (2007: 414 basis points).*

*Three-month PRIBID was 323 basis points as of 31 December 2008 (2007: 401 basis points).*

*The value of the interest rate swap CZK sale average for ten years as of 31 December 2008 was 327 bps (2007: 459 bps)*

## *33 Accruals and other liabilities*

Accruals and other liabilities comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Settlement balances and outstanding items | 82 | 146 |
| Payables from securities trading and issues of securities | 1,648 | 2,356 |
| Payables from payment transactions | 5,762 | 5,708 |
| Other liabilities | 3,660 | 3,260 |
| Accruals and deferred income | 923 | 878 |
| **Total accruals and other liabilities** | **12,075** | 12,348 |

*‘Other liabilities’* largely include liabilities arising from the supplies of goods and services and employee arrangements, including estimated balances.

Deferred income fees from banking guarantees is reported in *‘Accruals and deferred income’* in the amount of CZK 21 million (2007: CZK 21 million).

## 34 Provisions

Provisions comprise:

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Provisions for contracted commitments | 773 | 933 |
| Provisions for other credit commitments | 1,114 | 758 |
| Provision for restructuring | 132 | 0 |
| **Total provisions** | **2,019** | 1,691 |

In 2008, the Group recognised a provision for restructuring with respect to the project of reorganisation and centralisation of the Bank's back office divisions. The provision was recognised in the amount of estimated expenses for severance pay costs, advisory services and other expenses required to effect the restructuring according to the detailed plan of reorganisation. The recognition of the provision is posted to the profit and loss statement line "*Personnel costs*" and "*General administrative expenses*".

The provisions for other credit commitments are held to cover credit risks associated with issued credit commitments. The provisions for contracted commitments principally comprise the provisions for ongoing contracted contingent commitments, legal disputes, termination of rental agreements and the provision for jubilee bonuses.

Set out below is an analysis of the provision for other credit commitments:

| | **2008** | 2007 |
|---|---|---|
| | **CZKm** | CZKm |
| Provision for off balance sheet commitments | 934 | 621 |
| Provision for undrawn loan facilities | 180 | 137 |
| **Total** | **1,114** | 758 |

Movements in the provisions for contracted commitments are as follows:

| | 1 January 2008 | Additions | Disposals | Accrual | Foreign exchange difference | **31 December 2008** |
|---|---|---|---|---|---|---|
| | CZKm | CZKm | CZKm | CZKm | CZKm | CZKm |
| Provisions for retirement bonuses | 92 | 8 | 6 | 6 | 0 | 100 |
| Provisions for loyalty and jubilee bonuses | 2 | 0 | 0 | 0 | 0 | 2 |
| Other provisions for contracted commitments | 839 | 94 | 283 | 0 | 21 | 671 |
| **Total** | **933** | **102** | **289** | **6** | **21** | **773** |

As of 31 December 2008, the Group held a provision of CZK 2 million (2007: CZK 200 million) for the amount of future lease rental payments arising from the unutilised leased buildings which the Group intends to vacate. This provision is included in '*Other provisions for contracted commitments'.*

## 35 Deferred income taxes

Deferred tax is calculated from temporary differences between the tax bases and carrying values using tax rates effective in the periods in which the temporary tax difference is expected to be realised, that is 20 percent in 2009 and 19 percent starting from 2010.

Deferred income tax assets and liabilities are attributable to the following items:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Banking reserves and provisions | 282 | 255 |
| Provisions for non-banking receivables | 14 | 12 |
| Provisions for assets | 89 | 132 |
| Non-banking reserves | 127 | 125 |
| Depreciation | (341) | (316) |
| Leases | (2) | 2 |
| Revaluation of hedging derivatives - equity impact | (885) | 211 |
| Revaluation of available-for-sale financial assets - equity impact | (45) | 46 |
| Adjustments of the fair values of the building and deposits of Modrá pyramida stavební spořitelna, a.s. | 0 | 170 |
| Other temporary differences | 186 | 88 |
| **Net deferred tax asset/(liability)** | **(575)** | 725 |

Deferred tax recognised in the financial statements:

| | **2008 CZKm** | 2007 CZKm |
|---|---|---|
| **Balance at the beginning of the period** | **725** | (472) |
| Movement in net deferred tax liability - profit and loss impact | (93) | (305) |
| Movement in net deferred tax liability - equity impact | (1,207) | 1,502 |
| **Balance at the end of the period** | **(575)** | 725 |

The changes in tax rates had no significant impact on the deferred tax in 2008. The impact of changes in tax rates represented a reduction of the deferred tax asset of CZK 93 million in 2007.

## 36 Subordinated debt

As of 31 December 2008 the Group had subordinated debt of CZK 6,003 million (2007: CZK 6,004 million). The nominal value of the subordinated debt received by the Group at the end of 2006 is CZK 6,000 million. The subordinated debt was issued by the parent company of the Bank, Société Générale S. A. The subordinated debt carries a floating rate linked to one-month PRIBOR and has 10-year maturity until with the Group’s option for early repayment after five years and thereafter as of any interest payment date. Interest payments are made on a monthly basis.

## 37 Share capital

The Bank’s share capital, legally registered in the Register of Companies on 11 February 2000, amounts to CZK 19,005 million and consists of 38,009,852 ordinary shares with a nominal value of CZK 500 each (ISIN: CZ0008019106).

Set out below is a summary of the entities that hold more than 3 percent of the Bank's issued share capital as of 31 December 2008:

| **Name of the entity** | **Registered office** | **Ownership percentage** |
|---|---|---|
| SOCIETE GENERALE S. A. | 29 Bld Haussmann, Paris | 60.35 |
| STATE STREET BANK & TRUST COMPANY | Frenklin Street 225, Boston | 9.13 |
| NORTRUST NOMINEES LIMITED | 50 Bank St. Canary Wharf, London | 5.33 |

Société Générale S. A., being the only entity with a qualified holding in the Bank, is a French joint stock company incorporated by a Deed approved through the issuance of a Decree on 4 May 1864, and is licensed as a bank. Under the legislative and regulatory provisions relating to credit institutions, notably the articles of the Monetary and Financial Code, the Company is subject to commercial laws, in particular Articles 210-1 and the following of the French Commercial Code, as well as current by-laws.

As of 31 December 2008, the Group held 54,000 treasury shares at a cost of CZK 150 million (2007: 54,000 treasury shares at a cost of CZK 150 million).

**Capital Management**

The Group manages its capital with the objective of maintaining a strong capital base to support its business activities and to meet capital regulatory requirements in the current period and going forward. As part of the capital planning process, the Group takes into account both internal and external factors which are reflected in the corresponding internal targets expressed in targeted Tier 1 values and the capital adequacy ratio. The Group's capital level planning process is based on a regular capital structure analysis and a forecast which takes into account future capital requirements generated by increasing business volumes and future risks as expected by the Group. This analysis principally leads to adjustments of the level of the Group's dividend pay-out, identification of future capital needs and maintenance of a balanced capital composition.

The Group's capital principally consists of the following balances: share capital, reserve funds, undistributed profit and subordinated debt.

The Czech National Bank, as the local regulatory authority, oversees the Group's compliance with the capital adequacy ratio both on a stand-alone and consolidated basis. The Group's regulatory capital is divided into Tier 1 and Tier 2. The capital components are subject to various limits; for example, subordinated debt may not exceed 50 percent of the Tier 1 capital.

The ruling banking regulation, known as Basel II, is based on the three-pillar concept. The first pillar is devoted to the description and quantification of credit, operational and market risks and was implemented under the direct supervision of the regulator. The second pillar allows banks to apply their own approach to risks, but concurrently requires coverage of all types of risks to which the Bank is exposed. The third pillar focuses on reporting requirements with the aim of providing the market with better information on the Bank.

As part of the first pillar of Basel II, the Group began to use the following approaches starting from 2008:

- Special approach to the calculation of capital requirements relating to credit risks based on internal rating (Internal Rating Based Advanced Approach); and
- Special approach to the calculation of the capital requirement to the operational risk (Advanced Measurement Approach).

Under the second pillar of Basel II which requires the creation of the system for the internal evaluation of the capital adequacy in relation to the risk profile (internally determined capital system), the Group determined and formalised this system and outlined the relating capital adequacy strategy. The system is based on the Pillar 1 Plus method when mitigation factors are determined for risks not covered by the first pillar either of qualitative nature, e.g. in the form of control processes, or quantitative nature with an impact on the future income of the Group or directly on the additional capital requirement. The risks already described in the first pillar are actually assessed in the second pillar. In addition, the Group analyses impacts of stress testing on all risks over a specific time period. For stress testing purposes, the Group developed a set of macroeconomic "Global Economic Scenarios" which facilitates the evaluation of the impacts of the scenario in a comprehensive manner across all risks to which the Group is exposed and thus mutual integration the impact of individual risks. The Group prepared the Information on the Internally Determined Capital System and submitted it to the Czech National Bank for the first time in the year ended 31 December 2008.

## *38 Composition of cash and cash equivalents as reported in the cash flow statement*

| | **31 December 2008 CZKm** | 31 December 2007 CZKm | **Change in the year CZKm** |
|---|---|---|---|
| Cash and balances with central banks | 13,961 | 13,557 | 404 |
| Amounts due from banks – current accounts | 254 | 198 | 56 |
| Amounts due to central banks | (1) | (10) | 9 |
| Amounts due to banks - current accounts | (3,799) | (1,863) | (1,936) |
| **Total** | **10,415** | 11,882 | **(1,467)** |

## *39 Acquisition/disposal of subsidiary companies*

In May 2005, the Bank and Société Générale Asset Management S.A. (France) concluded a contract for the sale of 100 percent of shares of Investiční kapitálová společnost Komerční banky, a.s. (hereinafter "IKS"). The selling price was payable in two instalments. The first portion of the price was paid immediately as of the transaction date in cash, the second portion of the price was due after the fulfilment of pre-agreed distribution targets for IKS products sold through the Group's distribution network in 2005 to 2008. The Group fulfilled the distribution targets. The gain of CZK 150 million is disclosed in the line *'Profit/(loss) attributable to exclusion of companies from consolidation'*, refer to Note 12. No companies were excluded from consolidation in the year ended 31 December 2008.

## 40 Commitments and contingent liabilities

**Legal disputes**

The Group conducted a review of legal proceedings outstanding against it as of 31 December 2008. Pursuant to the review of significant litigation matters in terms of the risk of losses and litigated amounts, the Group has recorded a provision of CZK 146 million (2007: CZK 198 million) for these legal disputes, refer to Note 34. The Group has also recorded an accrual of CZK 354 million (2007: CZK 298 million) for costs associated with a potential payment of interest on the pursued claims.

As of 31 December 2008, the Group assessed lawsuits filed against other entities. The Group has been notified that certain parties against which it is taking legal action may file counterclaims against it. The Group will contest any such claims and, taking into consideration the opinion of its internal and external legal counsel, believes that any asserted claims made will not materially affect its financial position. No provision has been made in respect of these matters.

**Commitments arising from the issuance of guarantees**

Commitments from guarantees represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties. These assurances carry the same credit risk as loans and therefore the Group makes provisions against these instruments on the same basis as is applicable to loans.

**Capital commitments**

As of 31 December 2008, the Group had capital commitments of CZK 387 million (2007: CZK 128 million) in respect of current capital investment projects.

**Commitments arising from the issuance of letters of credit**

Documentary letters of credit are written irrevocable undertakings by the Group on behalf of a customer (mandatory) authorising a third party (beneficiary) to draw drafts on the Group up to a stipulated amount under specific terms and conditions. The condition for opening a letter of credit is its collateralisation, that is, no uncollateralised letter of credit can be opened. The Group records provisions against these instruments on the same basis as is applicable to loans.

**Commitments to extend credit, undrawn loan commitments, unutilised overdrafts and approved overdraft loans**

Principal off balance sheet exposures include unutilised overdrafts under framework agreements to provide financial services, approved overdraft loans, undrawn loan commitments, issued commitments to extend credit and unutilised facilities. The primary purpose of commitments to extend credit and overdraft loans is to ensure that funds are available to a customer as required. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans or guarantees. Commitments to extend credit or guarantees issued by the Group which are contingent upon customers maintaining specific credit standards (including the condition that a customer's solvency does not deteriorate) are revocable commitments. The Group does not recognise a provision for revocable commitments. Irrevocable commitments represent undrawn portions of authorised loans and approved overdraft facilities because they result from contractual terms and conditions in the credit agreements (that is, their use is not contingent upon the customers maintaining other specific credit standards). The Group recognises a provision for irrevocable commitments as and when required (according to a customer's solvency).

Financial commitments and contingencies comprise:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Non-payment guarantees including commitments to issued non-payment guarantees | 32,438 | 25,772 |
| Payment guarantees including commitments to issued payment guarantees | 9,483 | 9,690 |
| Received bills of exchange/acceptances and endorsements of bills of exchange | 68 | 75 |
| Committed facilities and unutilised overdrafts | 37,472 | 28,261 |
| Undrawn credit commitments | 62,271 | 51,395 |
| Unutilised overdrafts and approved overdraft loans | 46,028 | 53,373 |
| Unutilised discount facilities | 62 | 146 |
| Unutilised limits under Framework agreements to provide financial services | 43,755 | 45,494 |
| Letters of credit uncovered | 1,097 | 1,074 |
| Stand by letters of credit uncovered | 687 | 719 |
| Confirmed letters of credit | 276 | 67 |
| Letters of credit covered | 139 | 80 |
| **Total contingent revocable and irrevocable commitments** | **233,776** | 216,146 |

The Group provides a variety of credit facilities to its largest clients. Of the Group's committed facilities and guarantees, CZK 39,131 million (2007: CZK 38,703 million) is revocable.

The risk associated with off balance sheet credit commitments and contingent liabilities is assessed similarly as for loans to customers, taking into account the financial position and activities of the entity to which the Group issued the guarantee and taking into account the collateral obtained. As of 31 December 2008, the Group recorded provisions for these risks amounting to CZK 1,114 million (2007: CZK 758 million) - for further information see Note 34.

Set out below is the breakdown of financial commitments and contingencies by sector:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Food industry and agriculture | 6,455 | 6,838 |
| Metallurgy and metal processing | 5,936 | 4,872 |
| Automotive industry | 4,837 | 6,212 |
| Production of electric and electronic equipment | 3,980 | 4,851 |
| Electricity, gas and water industry | 22,620 | 19,011 |
| Construction industry | 43,663 | 35,888 |
| Wholesale | 22,585 | 21,998 |
| Insurance, banking | 15,657 | 13,146 |
| Real estate | 5,140 | 4,921 |
| Public administration | 11,674 | 10,216 |
| Commercial services | 16,836 | 14,733 |
| Other industry | 50,875 | 51,070 |
| Individuals | 23,518 | 22,390 |
| **Contingent liabilities** | **233,776** | 216,146 |

The majority of commitments and contingencies originate on the territory of the Czech Republic.

## *41 Related parties*

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party on making financial or operational decisions. As of 31 December 2008, the Group was controlled by Société Générale which owns 60.35 percent of the Bank's issued share capital.

A number of banking transactions are entered into with related parties in the normal course of business. These specifically include loans, deposits, derivative transactions and other types of transactions. These transactions were carried out on commercial terms and at market rates.

**Amounts due to and from the Group companies**

As of 31 December 2008, the Group had loans outstanding of CZK nil (2007: CZK 4 million) and deposits of CZK 181 million (2007: 369 million) to the associate, Komerční pojišťovna, a.s. Other amounts due, amounts owed, income and expenses with the Group were immaterial in 2008 and 2007.

**Amounts due to and from the Société Générale Group entities**

Principal balances due from the Société Générale Group entities include:

| Company | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| ALD Automotive Czech Republic, s. s r. o. | 2,725 | 1,596 |
| ESSOX SK s.r.o. | 100 | 98 |
| Investiční kapitálová společnost KB, a.s. | 12 | 0 |
| SG Consumer Finance d.o.o. | 1,151 | 1,151 |
| SG Equipment Finance Czech Republic, s. s r.o. | 8,763 | 6,724 |
| SG Express bank | 2 | 0 |
| SG Zurich | 9 | 0 |
| SG London | 0 | 352 |
| SG New York | 4 | 0 |
| SG Private Banking /Suisse/ S.A. | 2 | 0 |
| SG Vostok | 53 | 0 |
| SGA Société Générale Acceptance N. V. | 3,636 | 3,707 |
| SGBT Luxemburg | 138 | 1 |
| Société Générale Paris | 29,022 | 13,006 |
| **Total** | **45,617** | 26,635 |

Principal balances owed to the Société Générale Group entities include:

| Company | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| ALD Automotive Czech Republic, s. s r. o. | 1 | 0 |
| ESSOX SK s.r.o. | 0 | 9 |
| General bank of Greece SA | 1 | 0 |
| IKS Money Market Plus Fond | 551 | 0 |
| Investiční kapitálová společnost KB, a.s. | 266 | 89 |
| Romanian bank for development | 1 | 0 |
| SG Amsterodam | 4 | 0 |
| SG Consumer Finance d.o.o. | 3 | 7 |
| SG Cyprus LTD | 25 | 19 |
| SG Equipment Finance Czech Republic, s. s r.o. | 1,854 | 2,031 |
| SG New York | 7 | 0 |
| SG Private Banking /Suisse/ S.A. | 36 | 1 |
| SG Zurich | 1 | 0 |
| SGBT Luxemburg | 257 | 0 |
| Société Générale Paris | 18,204 | 10,662 |
| Société Générale Warsaw | 3 | 169 |
| Splitska Banka | 1 | 0 |
| **Total** | **21,215** | 12,987 |

Amounts due to and from the Société Générale Group entities principally comprise balances of current and overdraft accounts, nostro and loro accounts, issued loans, interbank market loans and placements, and debt securities acquired under initial offerings not designated for trading (refer also to Note 21), issued bonds and subordinated debt (refer also to Note 36).

As of 31 December 2008, the Group also carried off balance sheet exposures to the Société Générale Group, of which off balance sheet notional assets and liabilities amounted to CZK 162,136 million (2007: CZK 141,827 million) and CZK 172,075 million (2007: CZK 149,264 million), respectively. These amounts principally relate to currency spots and forwards, interest rate forwards and swaps, options, commodity derivatives, emission allowances and guarantees for credit exposures.

As of 31 December 2008 and 2007, the Group also carried other amounts due to and from the Société Générale Group entities which are immaterial.

During the year ended 31 December 2007, the Group realised total income of CZK 15,127 million (2007: CZK 8,673 million) and total expenses of CZK 17,021 million (2007: CZK 8,844 million) with the Société Générale Group. Income includes interest income from debt securities issued by Société Générale Paris (refer also to Note 21), income from interbank deposits, fees from transactions with securities, interest income on hedging derivatives and a gain on trading derivatives. Expenses comprise expenses of interbank deposits and subordinated debt, loss from financial operations, interest expense on hedging derivatives and expenses related to the provision of management, consultancy and software services.

As of 31 December 2008 and 2007, the Group recorded no material expenses or income with other companies in the Société Générale Group.

**Remuneration and amounts due from the members of the Management and Supervisory Boards and Directors' Committee**

Remuneration paid to the members of the Management and Supervisory Boards during the years was as follows:

| | **31 December 2008 CZKm** | 31 December 2007 CZKm |
|---|---|---|
| Remuneration to the Management Board members* | 58 | 40 |
| Remuneration to the Supervisory Board members** | 5 | 4 |
| Remuneration to the Directors' Committee members*** | 85 | 82 |
| **Total** | **148** | **126** |

*Note:*

/* ***Remuneration to the Management Board members*** *includes amounts paid during the year ended 31 December 2008 to the current and former directors of the Bank under mandate and management contracts, net of bonuses for 2008 but including bonuses for 2007, figures for expatriate members of the Management Board include remuneration net of bonuses for 2008 and other compensations and benefits arising from expatriate relocation contracts. The remuneration also includes benefits arising to the Bank's employees under a collective bargaining agreement. The remuneration of expatriate members of the Management Board does not include accommodation related services.*

/** ***Remuneration to the Supervisory Board members*** *includes amounts paid during the year ended 31 December 2008 to the current and former members of the Supervisory Board, amounts for the Supervisory Board members elected by employees additionally include income paid to them under their employment arrangement with the Bank. The remuneration also includes benefits arising to the Bank's employees under a collective bargaining agreement.*

/*** ***Remuneration to the Directors' Committee members*** *represents the sum of compensation and benefits paid in 2008 under management contracts or under expatriate relocation contracts in respect of expatriates. This balance does not reflect any compensation provided to the Management Board members (as it is reflected in the remuneration to the Management Board members). All the Management Board members are members of the Directors' Committee. The remuneration also includes benefits arising to the Bank's employees under a collective bargaining agreement. In the event that an employee became a member of the Directors' Committee during 2008, the total balance reflects his/her aggregate annual remuneration.*

| | **31 December 2008** | 31 December 2007 |
|---|---|---|
| Number of the Management Board members | 6 | 5 |
| Number of the Supervisory Board members | 9 | 8 |
| Number of the Directors' Committee members* | 16 | 17 |

*Note: /* These figures include all members of the Management Board who are also members of the Directors' Committee.*

As of 31 December 2008, the Group recorded an estimated payable of CZK 13 million (2007: CZK 15 million) for Management Board bonuses.

In respect of loans and guarantees as of 31 December 2008, the Bank recorded loan receivables totalling CZK 6 million (2007: CZK 4 million) granted to the members of the Management Board, Directors' Committee and Supervisory Board. During 2008, draw-downs of CZK 3 million were made under the loans granted to the members of the Directors' Committee. Loan repayments made by the members of the Directors' Committee during 2008 amounted to CZK 1 million.

## 42 Movements in the revaluation of hedging instruments in the statement of changes in shareholders' equity

In accordance with IAS 39, certain derivatives were designated as hedges. The changes in fair values of cash flow hedges are recorded in a separate category of equity in the hedging reserve.

| | **2008**<br>**CZKm** | 2007<br>CZKm |
|---|---|---|
| Cash flow hedge fair value at 1 January | (1,002) | 3,745 |
| Deferred tax asset/(liability) at 1 January | 211 | (898) |
| **Balance at 1 January** | **(791)** | 2,847 |
| **Movements during the year** | | |
| Gains/losses from changes in fair value | 5,933 | (3,273) |
| Deferred income tax | (1,200) | 754 |
| | **4,733** | (2,519) |
| Transferred to interest income/expense | (494) | (1,474) |
| Deferred income tax | 104 | 355 |
| | **(390)** | (1,119) |
| Cash flow hedge fair value at 31 December | 4,437 | (1,002) |
| Deferred tax asset/(liability) at 31 December | (885) | 211 |
| **Balance at 31 December** | **3,552** | (791) |

## 43 Movements in the revaluation of available-for-sale financial assets in the statement of changes in equity

| | 2008 CZKm | 2007 CZKm |
|---|---|---|
| Reserve from fair-value revaluation at 1 January | (765) | 1,542 |
| Deferred tax asset/(liability)/income tax liability at 1 January | 39 | (352) |
| **Balance at 1 January** | **(726)** | **1,190** |
| **Movements during the year** | | |
| Gains/(losses) from changes in fair value | 1,476 | (2,451) |
| Deferred tax/income tax liability | (126) | 393 |
| | 1,350 | (2,058) |
| (Gains)/losses from the sale | 151 | 144 |
| Deferred tax/income tax liability | (8) | (2) |
| | 143 | 142 |
| Reserve from fair-value revaluation at 31 December | 862 | (765) |
| Deferred tax asset/(liability)/income tax liability/income tax liability at 31 December | (95) | 39 |
| **Balance at 31 December** | **767** | (726) |

## 44 Risk management and financial instruments

### *(A) Credit risk*

**Credit rating of borrowers**

Assessment of credit risk is based on quantitative and qualitative criteria, the output of which is rating. The Group uses several types of ratings, depending on the type and profile of the counterparty, and related transactions. As a result, specific ratings are assigned to the Group's clients, and also to specific clients' transactions. In relevant cases the same rating procedure is applied to respective guarantors and sub-debtors, which provides for a better assessment of the quality of accepted guarantees and collateral.

In 2008, the Group continued in the process of developing its rating models, predominantly with the aim of increasing the complexity of the assessed data, extending the use of advanced statistical methods and reflecting current trends in the development of the risk profile of individual client and product portfolios of the Group. Concurrently, the Group prepared a detailed analysis of procedures of providing and measuring loans reflecting the updated models together with the results of the stress testing with the aim of further optimising the benefit/risk ratio for the Group. Reflecting the intent to use statistical models in credit risk management to the maximum extent possible, the Group focused on the further development of models for provisioning requirements. During 2008, the Group started an extensive internal training focused on expanding the knowledge of new rating models, their impact on the evaluation of clients and transactions, measurement of capital adequacy of the Group, pricing and provisioning.

All rating models are monitored on a quarterly basis and back tested in order to ensure their adequacy. The Group takes corrective measures in respect of identified inconsistencies resulting from the setting of the model.

### a) Ratings for business clients and municipalities

For businessmen, corporate clients and municipalities, the Group uses the obligor rating with the aim of evaluating the probability of default of the counterparty and the Loss Given Default (LGD) rating to assess the quality of available guarantees and collateral and to evaluate the potential loss from counterparty transactions. Both these models are also used for regular updates of the Probability of Default (PD) of all client exposures reported in accordance with the Basel II requirements.

For large and mid-size clients, the obligor rating is the combination of the financial rating based predominantly on financial data and economic rating obtained through the evaluation of non-financial information relating to a particular client. In 2008, the Group predominantly focused on the monitoring and back testing of these models (models were updated in 2007). Concurrently, the Group proceeded to update a statistical model for the monthly automated monitoring of corporate clients (the early warning system). The update of the model will be implemented in the first quarter of 2009.

In the businessmen and small companies segment, the obligor rating is the combination of financial, non-financial, personal data and data on client behaviour in the Group. When clients are funded using simple products, the setting of the rating is alternatively limited to the evaluation of data on client behaviour in the Group (behavioural rating). Given the update of models referred to above in the latter half of 2007, the Group focused on the monitoring and back testing of these models in 2008.

In the municipalities segment, the obligor rating is based on the evaluation of financial data of clients and expert evaluation of their economic situation. During 2008, the Group proceeded to make a significant update of the model towards achieving an increased complexity of the automatically evaluated data. The Group prepared a model based on the combination of the financial rating resulting from the evaluation of financial statements of clients for the last four reporting periods and the economic rating based on the evaluation of non-financial information relating to a particular client. The new model will be implemented in the second quarter of 2009.

### b) Ratings for Banks and Sovereign

For banks and other financial institutions the Group uses a central economic rating model developed by Société Générale S.A. The model is based on variables in a qualitative questionnaire, including the quantitative financial criteria, and the country support questionnaire. Central models have also been developed for sovereigns and other financial institutions (namely insurance companies, brokers and funds).

### c) Ratings for individual clients

The Group uses two types of ratings with the aim of evaluating default risk for individuals: the application rating which results from the evaluation of personal data of clients, data on the behaviour in the Group and the data of clients from available external registers, and behavioural rating which is based on the evaluation of the information on the clients' behaviour in the Group. The application rating is primarily used for active applications of clients for funding, while the behavioural rating which includes the calculation of pre-approved limits for simple products with low exposure is used for active offers of funding for clients by the Group. Behavioural rating of clients is concurrently used for regular updates of the probability of default of all client exposures reported in accordance with the BASEL II requirements.

In 2008, the Group updated the behavioural model rating with the objective of increasing the complexity of the evaluated data to include data from subsidiaries and increasing the accuracy and potential of the simplified procedure of providing loans to clients with low risk profile. The updated model was also reflected in all models of application rating of which it is part. As in the previous year, the behavioural model was the key factor impacting the quality of retail lending.

In 2008, the Group focused on further developing the models for the Loss Given Default (LGD) calculation, specifically for the mortgage loans segment. The Group completed the transition to the fully statistical models with an increased prediction ability.

Pursuant to the updates of the rating and LGD models and the results of stress testing models, the Group initiated a thorough review of the process of pricing all loan products provided to individuals with the aim of eliminating potential loss production and prepare the retail segment of the Group for the anticipated worsening of the economic situation.

In order to further boost the synergies in the Group and to support the potential of the cross selling between the Group entities, the Group updated the model evaluating client behaviour data at Modrá pyramida stavební spořitelna a. s. The updated model further increased the acquisition potential of the Group through consumer loans and credit cards with pre-determined limits offered to persons who are not clients of the Group.

### *d) Credit registers*

During 2008, the Group significantly reassessed the policies for evaluating data from internal and external credit registers integrated in the process of client assessment and lending. The used three-grade scale for evaluating data from the credit registers was replaced by the five-grade scale which facilitates a more accurate identification of problematic applicants for loans and more efficient setting of the related approval policies. In 2008, the evaluation of data from loan registers was one of the most significant factors impacting the evaluation of the client's application for funding.

### *e) Credit fraud prevention*

During 2008, the Group streamlined its fraud prevention and credit fraud response processes. The coordination of these processes was centralised and responsibilities for their individual parts were clarified. The Group launched a large project with the aim of creating an automated system integrating algorithms for the verification of client data from applications for funding with publicly available registers, algorithms for signalling an increased risk of credit fraud and the centralised system of reporting and responding to credit fraud. The new system will be fully integrated with the key applications of the Group and will be used within the entire Group.

**Credit risk concentration**

Credit concentration risk is actively managed using standard tools (e.g. analysis, assessment, setting of internal limits, reporting and mitigation of the risk as appropriate). The Group aims not to take any excessive credit concentration risk. Procedures of credit concentration risk management cover individual counterparts as well as economically connected groups, countries and industry sectors. The system of internal limits is established such that the Group complies with regulatory limits set on concentration risk.

The Group's maximum credit exposure as of 31 December 2008:

| | Total exposure | | | Applied collateral | | |
|---|---|---|---|---|---|---|
| | On-balance sheet CZKm | Off-balance sheet* CZKm | **Total credit exposure CZKm** | On-balance sheet CZKm | Off-balance sheet* CZKm | **Total collateral CZKm** |
| **Balances with central banks** | **6,170** | **x** | **6,170** | **0** | **x** | **0** |
| **Financial assets at fair value through profit or loss** | **43,993** | **x** | **43,993** | **0** | **x** | **0** |
| **Positive fair value of hedging financial derivative transactions** | **9,146** | **x** | **9,146** | **0** | **x** | **0** |
| **Financial assets available for sale** | **98,164** | **x** | **98,164** | **0** | **x** | **0** |
| **Amounts due from banks** | **146,098** | **3,810** | **149,908** | **93,020** | **99** | **93,119** |
| **Loans and advances to customers** | **376,067** | **229,966** | **606,033** | **152,980** | **15,161** | **168,141** |
| Corporate clients** | 218,061 | 206,449 | **424,510** | 58,132 | 13,832 | **71,964** |
| Of which: top corporate clients | 103,862 | 122,644 | **226,506** | 34,462 | 9,143 | **43,605** |
| Individuals – non-businessmen | 155,912 | 23,517 | **179,429** | 94,848 | 1,329 | **96,177** |
| Of which: mortgage loans | 90,288 | 6,384 | **96,672** | 70,888 | 1,124 | **72,012** |
| consumer loans | 22,967 | 2,936 | **25,903** | 1,594 | 198 | **1,792** |
| Other amounts due from customers | 2,094 | x | **2,094** | 0 | x | **0** |
| **Investments held to maturity** | **1,435** | **x** | **1,435** | **0** | **x** | **0** |
| **Total** | **681,073** | **233,776** | **914,849** | **246,000** | **15,260** | **261,260** |

*Note: /* Undrawn amounts, commitments, guarantees, etc.*
*/** This item also includes loans provided to individuals – businessmen*

The maximum credit exposure is presented on a gross basis net of the impact of provisions.

The Group's maximum credit exposure as of 31 December 2007:

| | Total exposure | | | Applied collateral | | |
|---|---|---|---|---|---|---|
| | On-balance sheet CZKm | Off-balance sheet* CZKm | **Total credit exposure CZKm** | On-balance sheet CZKm | Off-balance sheet* CZKm | **Total collateral CZKm** |
| **Balances with central banks** | **6,334** | **1,335** | **7,669** | **0** | **x** | **0** |
| **Financial assets at fair value through profit or loss** | **31,910** | **x** | **31,910** | **0** | **x** | **0** |
| **Positive fair value of hedging financial derivative transactions** | **2,030** | **x** | **2,030** | **0** | **x** | **0** |
| **Financial assets available for sale** | **81,826** | **x** | **81,826** | **0** | **x** | **0** |
| **Amounts due from banks** | **201,091** | **4,714** | **205,805** | **121,141** | **7** | **121,148** |
| **Loans and advances to customers** | 314,564 | 210,097 | **524,661** | 136,527 | 15,665 | **152,192** |
| Corporate clients** | 183,911 | 187,682 | **371,593** | 50,418 | 14,598 | **65,016** |
| Of which: top corporate clients | 85,804 | 109,789 | **195,593** | 23,390 | 9,847 | **33,237** |
| Individuals – non-businessmen | 130,586 | 22,415 | **153,001** | 86,109 | 1,067 | **87,176** |
| Of which: mortgage loans | 74,957 | 6,677 | **81,634** | 55,535 | 972 | **56,507** |
| consumer loans | 19,584 | 1,875 | **21,459** | 1,868 | 92 | **1,960** |
| Other amounts due from customers | **67** | **x** | **67** | 0 | x | **0** |
| **Investments held to maturity** | **2,999** | **x** | **2,999** | **0** | **x** | **0** |
| **Total** | **640,754** | **216,146** | **856,900** | **257,668** | **15,672** | **273,340** |

*Note: /* Undrawn amounts, commitments, guarantees, etc.*
*/** This item also includes loans provided to individuals – businessmen*

The maximum credit exposure is presented on a gross basis net of the impact of provisions.

**Classification of receivables**

The Group classifies its receivables arising from financial activities into five categories according to Regulation of the Czech National Bank No. 123/2007. The classification reflects both quantitative criteria (payment discipline, financial statements) and qualitative criteria (e.g. in-depth client knowledge, behavioural scoring). In July 2008, the Group newly implemented the default sharing principle for co-debtors and guarantors in respect of the default receivables in the classification in accordance with the BASEL II principles.

The structure of the credit portfolio according to the classification is regularly reported to the Czech National Bank and investors.

**Characteristics of receivables that are not categorised**

Pursuant to the Regulation issued by the Czech National Bank, the Group does not classify other amounts due from customers. These amounts consist of non-credit receivables that principally originated from the system of payment, fraudulent withdrawals, bank cheques, receivables associated with purchases of securities on behalf of clients that have not been settled, and balances receivable that arise from business arrangements that do not represent financial activities, specifically amounts receivable arising from outstanding rental payments on non-residential premises, sale of real estate and prepayments made.

**Provisioning for receivables**

All significant impaired credit exposures (i.e. classified as Watch, Substandard, Doubtful or Loss according to CNB classification) are assessed individually and reviewed at least on a quarterly basis by three levels of Provisioning Committees or, whenever required, by recovery specialists. Provisions are established on the basis of the present value of estimated future cash-flows to the Group and after due consideration of all available information, including the estimated value of collateral and expected duration of the recovery process. The remaining exposures are provisioned based on statistical models. These models were developed based on the BASEL II principles using the LGD (Loss Given Default) database which is established in respect of historically observed losses for clients not individually assessed. This new model was implemented in August 2007. In 2008, the model for the calculation of provisions was updated.

As of 31 December 2008, the Group reported the following loans before due date and past due loans that were not provisioned:

| | **Loans before due date** | **Past due loans that were not provisioned** | | | | | | **Total** |
|---|---|---|---|---|---|---|---|---|
| | | 1 to 29 days | 30 to 59 days | 60 to 89 days | 90 days to 1 year | Over 1 year | **Total** | |
| | **CZKm** | CZKm | CZKm | CZKm | CZKm | CZKm | **CZKm** | **CZKm** |
| Standard | **360,314** | 8,060 | 412 | 326 | 177 | 0 | **8,975** | **369,289** |
| Watch | **11,350** | 291 | 207 | 79 | 0 | 0 | **577** | **11,927** |
| **Total** | **371,664** | **8,351** | **619** | **405** | **177** | **0** | **9,552** | **381,216** |

As of 31 December 2007, the Group reported the following loans before due date and past due loans that were not provisioned:

| | **Loans before due date** | **Past due loans that were not provisioned** | | | | | | **Total** |
|---|---|---|---|---|---|---|---|---|
| | | 1 to 29 days | 30 to 59 days | 60 to 89 days | 90 days to 1 year | Over 1 year | **Total** | |
| | **CZKm** | CZKm | CZKm | CZKm | CZKm | CZKm | **CZKm** | **CZKm** |
| Standard | **298,401** | 5,783 | 61 | 24 | 70 | 0 | 5,938 | **304,339** |
| Watch | **11,358** | 22 | 6 | 1 | 0 | 0 | **29** | **11,387** |
| **Total** | **309,759** | **5,805** | **67** | **25** | **70** | **0** | **5,967** | **315,726** |

Collateral used in respect of the past due loans that were not provisioned amounts to CZK 5,083 million (2007: CZK 4,688 million).

**Loan collateral**

The amount of the recognised value of collateral is set based on the Group's internal rules for collateral valuation and discounting. The methods used in defining values and discounts take into account all relevant risks, the expected cost of collateral realisation, length of realisation, the historical experience of the Group, as well as collateral eligibility according to the CNB regulation, bankruptcy/insolvency rules and other regulations. Specifically for all real estate collateral, which represents the most frequent type of collateral, the Group uses independent valuations performed or supervised by a dedicated specialised department.

In 2007, the Group fully implemented in its internal system the new rules for assessment of collateral eligibility according to CNB Regulation No.123/2007. The Group's compliance with the new rules was validated by the CNB as part of the validation of the IRBA Basel II approach in September 2007.

**Recovery of amounts due from borrowers**

In order to address the growing volume of the retail loans portfolio, the Group continues improving the efficiency of its pre-recovery and recovery processes. This also includes the intensified and enhanced use of external recovery channels which cover approximately 23 percent of total exposure of the portfolio in the recovery regime. Specific attention was paid to analysing and implementing the new insolvency legislation into the Group's recovery process. The new insolvency legislation significantly impacts credit activities in both corporate and retail client segments.

**Credit risk hedging instruments**

The Group has not entered into any credit derivative transactions to hedge or reallocate its credit exposures.

**Revocable contractual commitments**

The Group monitors revocable contractual commitments on the same basis as irrevocable commitments. The risk is identified on a client basis and is monitored monthly, but no provisions or reserves are created. As of 31 December 2008, the revocable commitments account for 17 percent (2007: 18 percent) of all the Group's revocable and irrevocable commitments.

**Credit risk of financial derivatives**

The daily measuring of counterparty risk generated by financial derivatives is based on two indicators: the Current Average Risk indicator (CAR), and the Credit Value at Risk indicator (CVaR). Both indicators calculate the cost associated with the replacement of a defaulting client of the Bank at current market conditions and take into consideration specific parameters such as the type of the derivative product, current market parameters, time-to-maturity and the nominal amount of the defaulted transaction, as well as the volatility of the underlying assets. Doing so, CAR measures the average of the Group's estimated potential exposures over the remaining life of the derivative instrument, while CVaR measures the Group's potential maximum exposure with a confidence level of 99 percent, and thus better reflects the maximum counterparty risk levels in case of adverse market scenarios.

As of 31 December 2008, the Group posted a credit exposure of CZK 31,021 million (2007: CZK 33,025 million) on financial derivative instruments (expressed in CVaR). This amount represents the gross replacement costs at market rates as of 31 December 2008 of all outstanding agreements. The netting agreement is taken into account where applicable.

### *(B) Market risk*

**Segmentation of the Group's financial operations**

For market risk management purposes, the Group has internally split its activities into two books: the Market Book and the Structural Book. The Market Book includes capital market transactions entered into by the Group's dealers for trading purposes or for accommodating customer needs. The Structural Book principally consists of business transactions (lending, acceptance of deposits, amounts due to and from customers), hedging transactions within the Structural Book and other transactions not included in the Market Book.

In order to measure market risks, the Group operates a system of limits that monitors its market positions.

**Products traded by the Group**

Products that are traded by the Group and can bear market risks include interbank loans and deposits, currency transactions (spots, swaps, forwards, options), interest rate instruments (interest rate swaps, FRAs, interest rate futures, interest rate options), corporate and governmental bonds, emission allowances as well as other specific products (e.g. bond futures, bills of exchange programmes, cash management for selected clients, etc.). Transactions with these products are concluded either for proprietary purposes, for accommodating the clients' requests or for hedging the Group's positions (e.g. interest rate swaps, FRAs and currency swaps). Certain structured derivative transactions for the clients have been designed to meet the clients' hedging needs. Related market risks are eliminated by the Group via back-to-back transactions concluded with the market.

**Market risk in the Market Book**

In order to measure market risks inherent in the activities of the Market Book, the Group uses the Value-at-Risk concept as an aggregate metric.

The VaR method ('historical simulation') has been used by the Group since 2003. This method reflects correlations between various financial markets and underlying instruments. It uses scenarios simulating one-day variations of the relevant market parameters over a period of time limited to the last 250 business days. The resulting 99 percent VaR indicator captures the loss that would be incurred after eliminating the top 1 percent most unfavourable occurrences. This loss is calculated as the average of the second and third largest potential losses, out of the 250 considered scenarios.

The validity of the Value-at-Risk is verified through a back-testing process which compares the Value-at-Risk results with actual trading results and hypothetical overnight results. Any excesses are analysed to ensure the 99 percent confidence level. The Value-at-Risk calculations and results are monitored by the Bank's management.

The Global Value-at-Risks for a one-day holding period with a confidence level of 99 percent were EUR 701,000 and EUR 991,000 as of 31 December 2008 and 2007, respectively. The average Global Value-at-Risks were EUR 960,000 and EUR 667,000 for the years ended 31 December 2008 and 2007, respectively.

In addition, the Group also performs stress tests that capture the events with a lower probability of occurrence than Value-at-Risk scenarios, and that measure on a daily basis potential losses relevant to all open positions generated by larger shocks. Several types of stress tests for foreign exchange, interest rate and equity exposures are used. They are developed either based on actual large shock events in the past (such as the bond crisis of 1998) or from a hypothetical crisis that could harm the positions.

Various specific metrics such as sensitivities, positions and holding periods are used to obtain a detailed picture of risks and strategies.

**Market risk in the Structural Book**

The Group manages foreign exchange risk so as to achieve minimum risk exposures. In order to achieve this, the foreign exchange position of the Structural Book is measured on a daily basis and subsequently hedged under established rules. For the purpose of hedging foreign exchange positions within the Structural Book, the Group uses standard currency instruments in the interbank market, such as currency spots and forwards.

Interest rate risk within the Structural Book is monitored and measured using a static gap analysis, sensitivity of interest income to a parallel shift of the yield curve, and Earnings at Risk ('EaR') for net interest income. The indicators are monitored separately for CZK, USD and EUR, and the sum of other foreign currencies. The EaR indicator shows the maximum departure of the planned net interest income over a one-year period attributable to the movements in interest rates with a 99 percent confidence level from the initial value. EaR is set using stochastic simulations of random scenarios of interest rate developments and a change in interest income relative to the initial value is established for each scenario. The calculation of EaR for net interest income involves a stress-testing approach to the interest rate risk within the Structural Book.

The indicator of sensitivity to a change in market interest rates shows a change in the Group's market value upon an instant, one-off and adverse parallel shift of the market yield curve of 1 percent p.a. It is determined as the present value of the costs of closing out the Group's open interest rate position after the adverse change of interest rates occurred. As of 31 December 2008, the interest rate risk sensitivity was CZK 460 million (2007: CZK 670 million). The Group is limited by this indicator and the level of the limit is determined to be approximately 2 percent of capital.

In order to hedge against interest rate risk within the Structural Book, the Group uses both standard derivative instruments available in the interbank market (such as FRAs and interest rate swaps) and appropriate investments in securities or a selection of interest rate parameters of other assets and liabilities.

### *(C) Financial derivatives*

The Group operates a system of market risk and counterparty limits which are designed to restrict inadequate exposures due to movements in market prices and counterparty concentrations. The Group also monitors adherence to all limits on a daily basis and follows up on any breaches of these limits and takes corrective action to reduce the risk exposure.

The following tables set out notional and fair values of financial derivative instruments categorised as held for trading and hedging.

Financial derivative instruments designated as held for trading:

| | **Notional value** | | Notional value | | **Fair value** | | Fair value | |
|---|---|---|---|---|---|---|---|---|
| | **2008 Assets CZKm** | **2008 Liabilities CZKm** | 2007 Assets CZKm | 2007 Liabilities CZKm | **2008 positive CZKm** | **2008 negative CZKm** | 2007 positive CZKm | 2007 negative CZKm |
| **Interest rate instruments** | | | | | | | | |
| Interest rate swaps | 331,111 | 331,111 | 295,511 | 295,511 | 5,657 | 6,295 | 1,906 | 1,927 |
| Interest rate forwards and futures* | 474,815 | 474,815 | 379,466 | 379,466 | 998 | 969 | 226 | 220 |
| Interest rate options | 1,772 | 1,772 | 2,753 | 2,753 | 5 | 5 | 7 | 7 |
| **Total interest rate instruments** | **807,698** | **807, 698** | 677,730 | 677,730 | **6,660** | **7,269** | 2,139 | 2,154 |
| **Foreign currency instruments** | | | | | | | | |
| Currency swaps | 119,498 | 120,595 | 99,416 | 98,882 | 2,700 | 3,793 | 1,811 | 1,245 |
| Cross currency swaps | 29,917 | 29,981 | 21,164 | 19,977 | 1,023 | 1,107 | 1,316 | 150 |
| Currency forwards | 32,731 | 32,163 | 21,197 | 21,479 | 1,090 | 590 | 328 | 618 |
| Purchased options | 52,455 | 51,535 | 39,635 | 39,773 | 3,661 | 0 | 1,106 | 0 |
| Sold options | 51,535 | 52,455 | 39,783 | 39,646 | 0 | 3,664 | 0 | 1,106 |
| **Total currency instruments** | **286,136** | **286,729** | 221,195 | 219,757 | **8,474** | **9,154** | 4,561 | 3,119 |
| **Other instruments** | | | | | | | | |
| Futures on debt securities* | 364 | 364 | 1,329 | 1,329 | 0 | 0 | 0 | 0 |
| Forwards on emission allowances | 13,510 | 13,494 | 6,519 | 6,433 | 1,921 | 1,656 | 433 | 330 |
| Equity forwards | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| Commodity forwards | 298 | 298 | 1,218 | 1,218 | 49 | 48 | 44 | 43 |
| Commodity swaps | 4,616 | 4,616 | 1,674 | 1,674 | 1,049 | 1,042 | 230 | 228 |
| Purchased commodity options | 564 | 564 | 24 | 24 | 39 | 0 | 2 | 0 |
| Sold commodity options | 564 | 564 | 24 | 24 | 0 | 39 | 0 | 2 |
| **Total other instruments** | **19,917** | **19,901** | 10,788 | 10,702 | **3,058** | **2,785** | 709 | 603 |
| **Total** | **1,113,751** | **1,114,328** | 909,713 | 908,189 | **18,192** | **19,208** | 7,409 | 5,876 |

*Note.: /* Fair values include only forwards, with regard to futures the Group places funds on a margin account which is used on a daily basis to settle fair value changes and receivables arising from these margin accounts are reported within other assets.*

Financial derivative instruments designated as held for trading at nominal values per remaining maturity:

| | Up to 1 year CZKm | 1 to 5 years CZKm | Over 5 years CZKm | Total CZKm |
|---|---|---|---|---|
| **Interest rate instruments** | | | | |
| Interest rate swaps | 101,776 | 167,963 | 61,372 | **331,111** |
| Interest rate forwards and futures* | 399,388 | 75,427 | 0 | **474,815** |
| Interest rate options | 0 | 1,772 | 0 | **1,772** |
| **Total interest rate instruments** | **501,164** | **245,162** | **61,372** | **807,698** |
| **Foreign currency instruments** | | | | |
| Currency swaps | 115,794 | 3,203 | 501 | **119,498** |
| Cross currency swaps | 1,804 | 25,439 | 2,674 | **29,917** |
| Currency forwards | 24,105 | 8,054 | 572 | **32,731** |
| Purchased options | 28,634 | 23,821 | 0 | **52,455** |
| Sold options | 28,225 | 23,310 | 0 | **51,535** |
| **Total currency instruments** | **198,562** | **83,827** | **3,747** | **286,136** |
| **Other instruments** | | | | |
| Futures on debt securities | 364 | 0 | 0 | **364** |
| Forwards on emission allowances | 4,800 | 8,710 | 0 | **13,510** |
| Equity forwards | 1 | 0 | 0 | **1** |
| Commodity forwards | 298 | 0 | 0 | **298** |
| Commodity swaps | 4,221 | 395 | 0 | **4,616** |
| Purchased commodity options | 321 | 243 | 0 | **564** |
| Sold commodity options | 267 | 297 | 0 | **564** |
| **Total other instruments** | **10,272** | **9,645** | **0** | **19,917** |
| **Total** | **709,998** | **338,634** | **65,119** | **1,113,751** |

*Note: The remaining maturity of forward rate agreements (FRA) and futures covers the period to the fixing date when off balance sheet exposures are reversed.*

Financial derivative instruments designated as hedging:

| | **Notional value** | | Notional value | | **Fair value** | | Fair value | |
|---|---|---|---|---|---|---|---|---|
| | **2008 Assets CZKm** | **2008 Liabilities CZKm** | 2007 Assets CZKm | 2007 Liabilities CZKm | **2008 positive CZKm** | **2008 negative CZKm** | 2007 positive CZKm | 2007 negative CZKm |
| Interest rate swaps for cash flow hedging | 263,035 | 263,035 | 224,073 | 224,073 | 9,146 | 4,990 | 1,830 | 2,742 |
| Interest rate swaps for fair value hedging | 3,737 | 3,737 | 3,515 | 3,515 | 0 | 212 | 200 | 0 |
| Currency swaps for fair value hedging | 619 | 661 | 1,230 | 1,234 | 0 | 43 | 0 | 3 |
| **Total** | **267,391** | **267,433** | 228,818 | 228,822 | **9,146** | **5,245** | 2,030 | 2,745 |

Remaining maturity of derivatives designated as hedging:

| | Up to 1 year CZKm | 1 to 5 years CZKm | Over 5 years CZKm | Total CZKm |
|---|---|---|---|---|
| Interest rate swaps for cash flow hedging | 38,879 | 132,377 | 91,779 | **263,035** |
| Interest rate swaps for fair value hedging | 0 | 0 | 3,737 | **3,737** |
| Currency swaps for fair value hedging | 619 | 0 | 0 | **619** |
| **Total** | **39,498** | **132,377** | **95,516** | **267,391** |

The Group treats as hedges only those contracts where it has the ability to demonstrate that all criteria for recognising the transactions as hedges set out in IAS 39 have been met.

During 2008, the Group recorded the following hedges:

(i) Interest rate risk hedge:

a. The fair value of a provided long-term loan is hedged by an interest rate swap;
b. Future cash flows of a portfolio of current assets traded on the interbank market are hedged by a portfolio of interest rate swaps (cash flows will materialise on an ongoing basis and will also affect the Group's profit and loss statement on an ongoing basis); and
c. Future cash flows of a portfolio of short-term liabilities traded on the interbank market and short-term client liabilities are hedged by a portfolio of interest rate swaps (cash flows will materialise on an ongoing basis and will also affect the Group's profit and loss statement on an ongoing basis).

(ii) Foreign exchange risk hedge:

a. In selected material cases, the Group hedges future cash flows of firm commitments arising from the Group's contractual obligations (e.g., contractual payments to third parties in a foreign currency), the hedging instrument includes foreign currency assets (e.g., securities); and
b. The Group hedges the fair value of a deferred tax asset, the amount of which is derived from a foreign currency asset and is therefore dependent upon foreign exchange rate developments, by selected foreign currency liabilities (e.g., short-term liabilities traded on the interbank market).

(iii) Hedge of an investment in a foreign subsidiary:

a. The foreign exchange risk associated with investments in subsidiaries is hedged by selected foreign currency liabilities (e.g., short-term liabilities traded on the interbank market and short-term client liabilities).

The Group does not report any instance of hedge accounting being applied to a highly probably forecasted transaction that is not longer anticipated to be effected.

Further information on hedges is provided in Notes 3, 5 and 7 to these financial statements.

### *(D) Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument therefore indicates to what extent it is exposed to interest rate risk.

The Group uses internal models for managing interest rate risk. The objective of these models is to describe the estimated economic behaviour of the Group's clients when market interest rates fluctuate. It is the policy of the Group's management to manage the exposure to fluctuations in net interest income arising from changes in interest rates through gap analysis of assets and liabilities in individual groups. Further information about interest rate risk management is provided in Section B of this note.

The table below provides information on the extent of the Group's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next repricing date. Those assets and liabilities that do not have contractual maturity or a repricing date were grouped in the 'undefined' category.

| Assets | Up to 3 months CZKm | 3 months to 1 year CZKm | 1 year to 5 years CZKm | Over 5 years CZKm | Undefined CZKm | Total CZKm |
|---|---|---|---|---|---|---|
| Cash and current balances with central banks | 3,537 | 0 | 0 | 0 | 10,424 | **13,961** |
| Financial assets at fair value through profit or loss | 8,462 | 12,065 | 4,895 | 379 | 18,192 | **43,993** |
| Positive fair values of hedging financial derivative transactions | 0 | 0 | 0 | 0 | 9,146 | **9,146** |
| Financial assets available for sale | 5,225 | 5,539 | 42,326 | 43,562 | 1,512 | **98,164** |
| Assets held for sale | 0 | 0 | 0 | 0 | 429 | **429** |
| Amounts due from banks | 126,170 | 12,416 | 6,458 | 1,054 | 0 | **146,098** |
| Loans and advances to customers | 161,117 | 54,297 | 111,038 | 37,588 | 0 | **364,040** |
| Investments held to maturity | 0 | 109 | 754 | 572 | 0 | **1,435** |
| Income taxes receivable | 0 | 6 | 0 | 0 | 0 | **6** |
| Prepayments, accrued income and other assets | 0 | 1,929 | 0 | 0 | 4,238 | **6,167** |
| Investments in subsidiaries and associates | 0 | 0 | 0 | 0 | 550 | **550** |
| Intangible fixed assets | 0 | 0 | 0 | 0 | 3,504 | **3,504** |
| Tangible fixed assets | 0 | 0 | 0 | 0 | 8,000 | **8,000** |
| Goodwill | 0 | 0 | 0 | 0 | 3,551 | **3,551** |
| **Total assets** | **304,526** | **86,361** | **165,471** | **83,155** | **59,531** | **699,044** |
| Amounts due to central banks | 1 | 0 | 0 | 0 | 0 | **1** |
| Financial liabilities through profit or loss | 947 | 0 | 0 | 0 | 19,208 | **20,155** |
| Negative fair values of hedging financial derivative transactions | 0 | 0 | 0 | 0 | 5,244 | **5,244** |
| Amounts due to banks | 10,728 | 386 | 0 | 0 | 0 | **11,114** |
| Amounts due to customers | 197,125 | 16,031 | 4,171 | 938 | 336,305 | **554,570** |
| Securities issued | 4,951 | 3,342 | 0 | 15,835 | 0 | **24,128** |
| Income tax | 0 | 16 | 0 | 0 | 170 | **186** |
| Deferred tax liability | 0 | 0 | 0 | 0 | 575 | **575** |
| Accruals and other liabilities | 743 | 0 | 0 | 0 | 11,332 | **12,075** |
| Provisions | 0 | 0 | 0 | 0 | 2,019 | **2,019** |
| Subordinated debt | 6,003 | 0 | 0 | 0 | 0 | **6,003** |
| **Total liabilities** | **220,498** | **19,775** | **4,171** | **16,773** | **374,853** | **636,070** |
| **On balance sheet interest rate sensitivity gap at 31 December 2008** | **84,028** | **66,586** | **161,300** | **66,382** | **(315,322)** | **62,974** |
| Derivatives* | 318,737 | 431,906 | 244,658 | 109,086 | 0 | **1,104,387** |
| **Total off balance sheet assets** | **318,737** | **431,906** | **244,658** | **109,086** | 0 | **1,104,387** |
| Derivatives* | 346,164 | 414,398 | 306,367 | 37,522 | 0 | **1,104,451** |
| Undrawn portion of loans ** | (3,703) | (2,829) | 6,667 | 1,436 | 0 | **1,571** |
| Undrawn portion of revolving loans ** | 740 | 478 | 158 | 547 | 0 | **1,923** |
| **Total off balance sheet liabilities** | **343,200** | **412,047** | **313,192** | **39,505** | **0** | **1,107,944** |
| **Net off balance sheet interest rate sensitivity gap at 31 December 2008** | **(24,463)** | **19,859** | **(68,534)** | **69,581** | **0** | **(3,557)** |
| **Cumulative interest rate sensitivity gap at 31 December 2008** | **59,565** | **146,010** | **238,776** | **374,739** | **59,417** | **0** |
| Total assets at 31 December 2007 | 347,081 | 67,682 | 128,752 | 75,690 | 42,614 | 661,819 |
| Total liabilities at 31 December 2007 | 155,287 | 61,472 | 11,760 | 20,734 | 361,912 | 611,165 |
| Net on balance sheet interest rate sensitivity gap at 31 December 2007 | 191,794 | 6,210 | 116,992 | 54,956 | (319,298) | 50,654 |
| Net off balance sheet interest rate sensitivity gap at 31 December 2007 | (39,811) | (5,828) | (16,768) | 64,146 | 0 | 1,739 |
| Cumulative interest rate sensitivity gap at 31 December 2007 | 151,983 | 152,365 | 252,589 | 371,691 | 52,393 | x |

*Note: /* Assets and liabilities arising from derivatives include interest rate swaps, interest rate forwards, interest rate options, interest rate futures and cross currency swaps.*

*/** Undrawn loans and revolving loans are reported on a net basis, that is, the Group reports both the expected drawings and repayments within one line. This line does not reflect commitments to extend loans with a fixed repayment schedule or commitments to provide a revolving loan since the interest rate has not been determined for such commitments.*

Average interest rates as of 31 December 2008 and 2007:

| | **2008** | | | 2007 | | |
|---|---|---|---|---|---|---|
| | **CZK** | **USD** | **EUR** | CZK | USD | EUR |
| **Assets** | | | | | | |
| Cash and balances with central banks | 0.42% | x | x | 2.15% | x | x |
| Treasury bills | 3.87% | x | x | 3.60% | x | x |
| Amounts due from banks | 2.61% | 2.21% | 3.20% | 3.66% | 5.32% | 4.45% |
| Loans and advances to customers | 5.21% | 1.76% | 5.32% | 4.76% | 5.41% | 5.01% |
| Interest earning securities | 4.27% | 6.07% | 3.27% | 5.07% | 4.99% | 3.83% |
| **Total assets** | **3.85%** | **3.20%** | **3.77%** | 3.94% | 5.18% | 4.11% |
| **Total interest earning assets** | **4.44%** | **3.47%** | **4.13%** | 4.38% | 5.28% | 4.54% |
| **Liabilities** | | | | | | |
| Amounts due to central banks and banks | 1.49% | 0.36% | 3.99% | 2.13% | 4.10% | 3.94% |
| Amounts due to customers | 1.09% | 1.23% | 1.78% | 1.05% | 2.59% | 2.10% |
| Debt securities | 4.36% | x | 3.72% | 3.62% | x | 3.74% |
| Subordinated debt | 3.76% | x | x | 3.73% | x | x |
| **Total liabilities** | **2.02%** | **0.97%** | **1.91%** | 1.29% | 2.27% | 2.24% |
| **Total interest bearing liabilities** | **1.39%** | **1.23%** | **2.04%** | 1.30% | 2.59% | 2.31% |
| **Off balance sheet – assets** | | | | | | |
| Derivatives (interest rate swaps, options, etc) | 4.05% | 3.31% | 3.68% | 3.85% | 5.02% | 4.29% |
| Undrawn portion of loans | 4.79% | 2.49% | 4.32% | 4.63% | x | 4.94% |
| Undrawn portion of revolving loans | 6.60% | 1.58% | 3.39% | 7.42% | 5.44% | 4.44% |
| **Total off balance sheet assets** | **4.38%** | **3.30%** | **3.66%** | 4.32% | 5.03% | 4.32% |
| **Off balance sheet liabilities** | | | | | | |
| Derivatives (interest rate swaps, options, etc) | 3.96% | 3.19% | 3.79% | 3.67% | 5.01% | 4.36% |
| Undrawn portion of loans | 4.79% | 2.49% | 4.32% | 4.63% | x | 4.94% |
| Undrawn portion of revolving loans | 6.60% | 1.58% | 3.39% | 7.42% | 5.44% | 4.44% |
| **Total off balance sheet liabilities** | **4.31%** | **3.17%** | **3.77%** | 4.18% | 5.01% | 4.38% |

*Note: The above table sets out the average interest rates for December 2008 and 2007 calculated as a weighted average for each asset and liability category.*

In the first half of 2008, the CZK interest rates of the money market remained approximately on the constant level of around 4 percent. The 2T REPO rate declared by the Czech National bank amounted to 3.75 percent in the first half of 2008. In the second half of 2008, the money market saw a significant change in market spreads which increased from 10 bp to 35 or even to 40 bp. The 2T REPO rate declared by the Czech National Bank continually decreased by 1.5 percent, and this decrease was not fully absorbed by the rates of the monetary market, their decrease did not exceed 100 bp. The interest rates of the derivative market remained on the same level in the first half of the year and decreased by more than 100 bp in the second half of the year.

The EUR rates of the monetary market in the first three quarters slightly increased by 100 bp. At the end of the year, they declined by 200 bp. The EUR interest rates of the derivative market slightly increased at the beginning of the year, but they also declined in the second half of the year and they were 100 bp below the level at the beginning of the year.

The USD interest rates of both monetary and derivative markets saw a significant decline in 2008. The rates of the monetary market decreased by 300 bp in average, when the monthly rate decreased by more than 400 bp below the level of 1 percent. The rates of the derivative market copied the decrease in the rates of the monetary market, but at a slower rate of the change.

Breakdown of financial assets and liabilities by their exposure to interest rate fluctuations:

| | **Fixed interest rate 2008 CZKm** | **Floating interest rate 2008 CZKm** | **No interest 2008 CZKm** | **Total 2008 CZKm** | Fixed interest rate 2007 CZKm | Floating interest rate 2007 CZKm | No interest 2007 CZKm | Total 2007 CZKm |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash and balances with central banks | 50 | 3,537 | 10,374 | **13,961** | 2,600 | 2,299 | 8,658 | 13,557 |
| Financial assets at fair value through profit or loss | 24,764 | 822 | 18,407 | **43,993** | 24,114 | 313 | 7,483 | 31,910 |
| Positive fair values of hedging financial derivative transactions | 0 | 0 | 9,146 | **9,146** | 0 | 0 | 2,030 | 2,030 |
| Financial assets available for sale | 88,570 | 8,081 | 1,513 | **98,164** | 71,365 | 7,945 | 2,516 | 81,826 |
| Amounts due from banks | 20,634 | 125,098 | 366 | **146,098** | 10,403 | 190,381 | 307 | 201,091 |
| Loans and advances to customer | 217,130 | 143,559 | 3,351 | **364,040** | 176,789 | 126,949 | 1,200 | 304,938 |
| Investments held to maturity | 1,435 | 0 | 0 | **1,435** | 2,999 | 0 | 0 | 2,999 |
| **Liabilities** | | | | | | | | |
| Amounts due to central banks | 1 | 0 | 0 | **1** | 10 | 0 | 0 | 10 |
| Financial liabilities at fair value through profit or loss | 0 | 0 | 20,155 | **20,155** | 0 | 0 | 7,723 | 7,723 |
| Negative fair values of hedging financial derivative transactions | 0 | 0 | 5,244 | **5,244** | 0 | 0 | 2,746 | 2,746 |
| Amounts due to banks | 3,900 | 6,968 | 246 | **11,114** | 5,888 | 6,076 | 303 | 12,267 |
| Amounts due to customers | 69,703 | 453,139* | 31,728 | **554,570** | 71,414 | 440,258 * | 28,557 | 540,229 |
| Securities issued | 15,542 | 8,586 | 0 | **24,128** | 22,646 | 5,271 | 0 | 27,917 |
| Subordinated debt | 0 | 6,003 | 0 | **6,003** | 0 | 6,004 | 0 | 6,004 |

*Note: Individual assets and liabilities are split into the categories of 'Fixed interest rate', 'Floating interest rate', and 'No interest' according to contractual parameters defining the interest rate set-up. For this purpose, the fixed interest rate is defined as a rate with a repricing period exceeding one year. Products having no parameter definition of their interest rate set-up are included in the 'No interest' category.*

** This item principally includes client deposits where the Group has the option to reset interest rates and hence they are not sensitive to interest rate changes.*

### *(E) Liquidity risk*

Liquidity risk is a measure of the extent to which the Group may be required to raise funds to meet its commitments associated with financial instruments.

Liquidity risk management is based upon the liquidity risk management system approved by the Group's Management Board. Liquidity is monitored on a group wide level, with the Market Book also having a stand-alone limit. The Group has established its liquidity risk management rules such that it maintains its liquidity profile in normal conditions (basic liquidity scenario) and in crisis conditions (crisis liquidity scenario). As such, the Group has defined a set of indicators for which binding limits are established.

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

The liquidity risk of the Group is managed as stipulated above (especially not based on the undiscounted cash flows), as such the information on undiscounted cash flows is not provided.

The table below provides an analysis of assets, liabilities and shareholders' equity into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date.

| Assets | On demand up to 7 days CZKm | Up to 3 months CZKm | 3 months to 1 year CZKm | 1 year to 5 years CZKm | Over 5 years CZKm | Maturity undefined CZKm | Total CZKm |
|---|---|---|---|---|---|---|---|
| Cash and current balances with central banks | 11,475 | 0 | 0 | 0 | 0 | 2,486 | **13,961** |
| Financial assets at fair value through profit or loss | 1,000 | 7,156 | 11,895 | 5,076 | 459 | 18,407 | **43,993** |
| Positive fair values of hedging financial derivative transactions | 0 | 0 | 0 | 0 | 0 | 9,146 | **9,146** |
| Financial assets available for sale | 46 | 4,594 | 3,547 | 41,898 | 46,567 | 1,512 | **98,164** |
| Assets held for sale | 0 | 0 | 429 | 0 | 0 | 0 | **429** |
| Amounts due from banks | 79,273 | 46,549 | 10,451 | 7,035 | 2,760 | 30 | **146,098** |
| Loans and advances to customers | 6,152 | 36,179 | 72,181 | 88,164 | 139,875 | 21,489 | **364,040** |
| Investments held to maturity | 0 | 0 | 109 | 754 | 572 | 0 | **1,435** |
| Income taxes receivable | 0 | 0 | 0 | 0 | 0 | 6 | **6** |
| Prepayments, accrued income and other assets | 1,364 | 150 | 1,928 | 0 | 0 | 2,725 | **6,167** |
| Investments in associates and unconsolidated subsidiaries | 0 | 0 | 0 | 0 | 0 | 550 | **550** |
| Intangible fixed assets | 0 | 0 | 0 | 0 | 0 | 3,504 | **3,504** |
| Tangible fixed assets | 0 | 0 | 0 | 0 | 0 | 8,000 | **8,000** |
| Goodwill | 0 | 0 | 0 | 0 | 0 | 3,551 | **3,551** |
| **Total assets** | **99,310** | **94,628** | **100,525** | **142,927** | **190,233** | **71,421** | **699,044** |
| **Liabilities** | | | | | | | |
| Amounts due to central banks | 1 | 0 | 0 | 0 | 0 | 0 | **1** |
| Financial assets at fair value through profit or loss | 947 | 0 | 0 | 0 | 0 | 19,208 | **20,155** |
| Negative fair values of hedging financial derivative transactions | 0 | 0 | 0 | 0 | 0 | 5,244 | **5,244** |
| Amounts due to banks | 5,897 | 449 | 143 | 1,338 | 3,287 | 0 | **11,114** |
| Amounts due to customers | 403,422 | 99,018 | 17,543 | 6,564 | 2,164 | 25,859 | **554,570** |
| Securities issued | 0 | 28 | 1,647 | 0 | 22,453 | 0 | **24,128** |
| Income tax | 0 | 9 | 177 | 0 | 0 | 0 | **186** |
| Deferred tax liability | 0 | 0 | 0 | 0 | 0 | 575 | **575** |
| Accruals and other liabilities | 9,660 | 1,526 | 0 | 0 | 0 | 889 | **12,075** |
| Provisions | 36 | 154 | 648 | 150 | 55 | 976 | **2,019** |
| Subordinated debt | 0 | 3 | 0 | 0 | 6,000 | 0 | **6,003** |
| Equity | 0 | 0 | 0 | 0 | 0 | 62,974 | **62,974** |
| **Total liabilities** | **419,963** | **101,187** | **20,158** | **8,052** | **33,959** | **115,725** | **699,044** |
| **On balance sheet liquidity gap at 31 December 2008** | **(320,653)** | **(6,559)** | **80,367** | **134,875** | **156,274** | **(44,304)** | |
| Off balance sheet assets * | 33,258 | 710,776 | 75,358 | 83,826 | 3,748 | 0 | **906,966** |
| Off balance sheet liabilities * | 40,146 | 786,148 | 197,344 | 122,804 | 8,616 | 19,287 | **1,174,245** |
| **Net off balance sheet liquidity gap at 31 December 2008** | **(6,888)** | **(75,372)** | **(121,986)** | **(38,978)** | **(4,868)** | **(19,287)** | **(267,279)** |
| Total assets at 31 December 2007 | 151,128 | 89,930 | 95,256 | 131,078 | 146,656 | 47,771 | 661,819 |
| Total liabilities at 31 December 2007 | 422,866 | 77,002 | 29,365 | 15,099 | 33,008 | 84,479 | 661,819 |
| Net on balance sheet liquidity gap at 31 December 2007 | (271,738) | 12,928 | 65,891 | 115,979 | 113,648 | (36,708) | 0 |
| Net off balance sheet liquidity gap at 31 December 2007 | (2,023) | (19,647) | (112,478) | (26,388) | (22,319) | (25,370) | (208,225) |

*Note: /* Off balance sheet assets and liabilities include amounts receivable and payable arising from FX spot, forward and option contracts and payables under guarantees, letters of credit and committed facilities.*

### *(F) Foreign exchange position*

The table below provides an analysis of the Group's main currency exposures. The remaining currencies are shown within 'Other currencies.' The Group monitors its foreign exchange position on a daily basis. For this purpose, the Group has a set of internal limits.

| | Czech crowns CZKm | Euros CZKm | US dollars CZKm | Slovak crowns CZKm | Other curren-cies CZKm | Total CZKm |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and current balances with central banks | 10,811 | 1,406 | 207 | 1,304 | 233 | **13,961** |
| Financial assets at fair value through profit or loss | 40,373 | 987 | 166 | 1,820 | 647 | **43,993** |
| Positive fair values of hedging financial derivative transactions | 8,763 | 249 | 133 | 0 | 1 | **9,146** |
| Financial assets available for sale | 79,453 | 15,949 | 2,762 | 0 | 0 | **98,164** |
| Assets held for sale | 429 | 0 | 0 | 0 | 0 | **429** |
| Amounts due from banks | 113,116 | 29,068 | 1,637 | 2,173 | 104 | **146,098** |
| Loans and advances to customers | 320,409 | 34,799 | 3,222 | 5,186 | 424 | **364,040** |
| Investments held to maturity | 0 | 1,218 | 199 | 18 | 0 | **1,435** |
| Income taxes receivable | 6 | 0 | 0 | 0 | 0 | **6** |
| Prepayments, accrued income and other assets | 5,190 | 904 | 11 | 5 | 57 | **6,167** |
| Investments in associates and unconsolidated subsidiaries | 550 | 0 | 0 | 0 | 0 | **550** |
| Intangible fixed assets | 3,501 | 0 | 0 | 3 | 0 | **3,504** |
| Tangible fixed assets | 7,965 | 0 | 0 | 35 | 0 | **8,000** |
| Goodwill | 3,551 | 0 | 0 | 0 | 0 | **3,551** |
| **Total assets** | **594,117** | **84,580** | **8,337** | **10,544** | **1,466** | **699,044** |
| **Liabilities** | | | | | | |
| Amounts due to central banks | 1 | 0 | 0 | 0 | 0 | **1** |
| Financial liabilities at fair value through profit or loss | 19,169 | 612 | 131 | 170 | 73 | **20,155** |
| Negative fair values of hedging financial derivative transactions | 4,201 | 731 | 306 | 6 | 0 | **5,244** |
| Amounts due to banks | 3,968 | 4,547 | 8 | 2,571 | 20 | **11,114** |
| Amounts due to customers | 503,703 | 39,702 | 7,687 | 2,531 | 947 | **554,570** |
| Securities issued | 23,197 | 931 | 0 | 0 | 0 | **24,128** |
| Income tax | 176 | 0 | 0 | 9 | 1 | **186** |
| Deferred tax liability | 574 | 0 | 0 | 1 | 0 | **575** |
| Accruals and other liabilities | 9,287 | 1,912 | 769 | 87 | 20 | **12,075** |
| Provisions | 1,035 | 192 | 760 | 31 | 1 | **2,019** |
| Subordinated debt | 6,003 | 0 | 0 | 0 | 0 | **6,003** |
| Equity | 58,506 | 3,669 | 0 | 799 | 0 | **62,974** |
| **Total liabilities** | **629,820** | **52,296** | **9,661** | **6,205** | **1,062** | **669,044** |
| **Net FX position at 31 December 2008** | **(35,703)** | **32,284** | **(1,324)** | **4,339** | **404** | **0** |
| Off balance sheet assets included in the FX position* | 1,126,710 | 188,094 | 54,279 | 12,777 | 3,561 | **1,385,421** |
| Off balance sheet liabilities included in the FX position * | 1,087,661 | 225,903 | 53,440 | 14,943 | 4,093 | **1,867,000** |
| **Net off balance sheet FX position** | **39,049** | **(37,809)** | **839** | **(2,166)** | **(533)** | **(620)** |
| **Total net FX position at 31 December 2008** | **3,346** | **(5,525)** | **(485)** | **2,173** | **(129)** | **(620)** |
| Total assets at 31 December 2007 | 571,285 | 64,475 | 15,678 | 7,473 | 2,908 | 661,819 |
| Total liabilities at 31 December 2007 | 596,682 | 49,264 | 8,470 | 5,046 | 2,357 | 661,819 |
| Net FX position at 31 December 2007 | (25,397) | 15,211 | 7,208 | 2,427 | 551 | 0 |
| Off balance sheet net FX position at 31 December 2007 | 30,116 | (17,763) | (7,516) | (2,787) | (530) | 1,520 |
| Total net FX position at 31 December 2007 | 4,719 | (2,552) | (308) | (360) | 21 | 1,520 |

*Note: /* Off balance sheet assets and liabilities include amounts receivable and payable arising from spot, forward and option transactions.*

### (G) Operational risk

In 2008, pursuant to the approval of the Advanced Measurement Approach (AMA) by the Czech National Bank, the Operational Risk Management Department of the Group increased the efficiency of management of related risks and determined the principle of interconnection of individual management instruments, i.e. collection of data, risk control self assessment, scenario analysis and key risk indicators. The acquired knowledge is assessed on a regular basis and provided to the management of the Group for establishing the global operational risk management strategy.

Among others, the Group extended its activities in operational risks to include the definition of controls under 'Permanent Supervision' which serve as a basis for reviewing the adequacy of the functioning of the established operational risk management tools.

### (H) Legal risk

The Group regularly monitors and evaluates legal disputes filed against it. In order to cover all contingent liabilities arising from legal disputes, the Group establishes a provision equal to the claimed amount in respect of all litigation where it is named as a defendant and where the likelihood of payment has been estimated to exceed 50 percent. The Group also manages its legal risk through the assessment of legal risks involved in the contracts to which the Group is a party.

### (I) Estimated fair value of assets and liabilities of the Group

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

In estimating the fair value of the Group's financial instruments, the following methods and assumptions were used.

### (a) Cash and balances with central banks

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

### (b) Amounts due from banks

The estimated fair value of amounts due from banks that mature in 180 days or less approximates their carrying amounts. The fair value of other amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis, the fair value of loss loan is equal to the appraised value of the underlying collateral.

### *(c) Loans and advances to customers*

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

### *(d) Investments held to maturity*

Fair values of securities carried in the 'Held to maturity' portfolio are estimated based on discounted cash flow models using the interest rate currently offered at the balance sheet date.

### *(e) Amounts owed to central banks, banks and customers*

The fair value of deposits repayable on demand represents the carrying value of amounts repayable on demand at the balance sheet date. The carrying amount of term deposits at variable interest rates approximates their fair values at the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using market interest rates. For products without contractually determined maturity (e.g. construction savings scheme deposits, deposits of pension insurance policy holders), the Group uses the principle of matching carrying and fair values. Amounts due to banks and customers at fixed interest rates represent only a fraction of the total carrying value and hence the fair value of total amounts due to banks and customers approximates the carrying values at the balance sheet date.

### *(f) Debt securities issued*

The fair value of debt securities issued by the Group is based upon quoted market prices. Where no market prices are available, the fair value is equal to an estimate made by the Group.

The following table summarises the carrying values and fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value:

| | **2008 Carrying value CZKm** | **2008 Fair value CZKm** | 2007 Carrying value CZKm | 2007 Fair value CZKm |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and current balances with central banks | 13,961 | 13,961 | 13,557 | 13,557 |
| Amounts due from banks | 146,098 | 146,897 | 201,091 | 200,911 |
| Loans and advances to customers | 364,040 | 371,270 | 304,938 | 310,040 |
| Investments held to maturity | 1,435 | 1,460 | 2,999 | 2,958 |
| **Financial liabilities** | | | | |
| Amounts due to central banks and banks | 11,115 | 11,816 | 12,277 | 11,742 |
| Amounts due to customers | 554,570 | 554,471 | 540,229 | 540,132 |
| Securities issued | 24,128 | 25,183 | 27,917 | 26,992 |
| Subordinated debt | 6,003 | 6,003 | 6,004 | 6,003 |

## 45 Assets under management

As of 31 December 2008, the Group managed client assets in the amount of CZK 928 million (2007: CZK 2,852 million), of which no assets were from the Bank’s subsidiaries. The Group is transferring asset management services to other trustees.

## 46 Post balance sheet events

In January 2009, the Board of Directors of the Bank approved the intention to transform Komerční banka Bratislava, a. s. from a subsidiary to a foreign branch with the effective date of 1 January 2009.

The financial situation of one significant the Group's client strongly deteriorated after the balance sheet date with the important negative impact on the recoverability of the net receivable owed by that client.