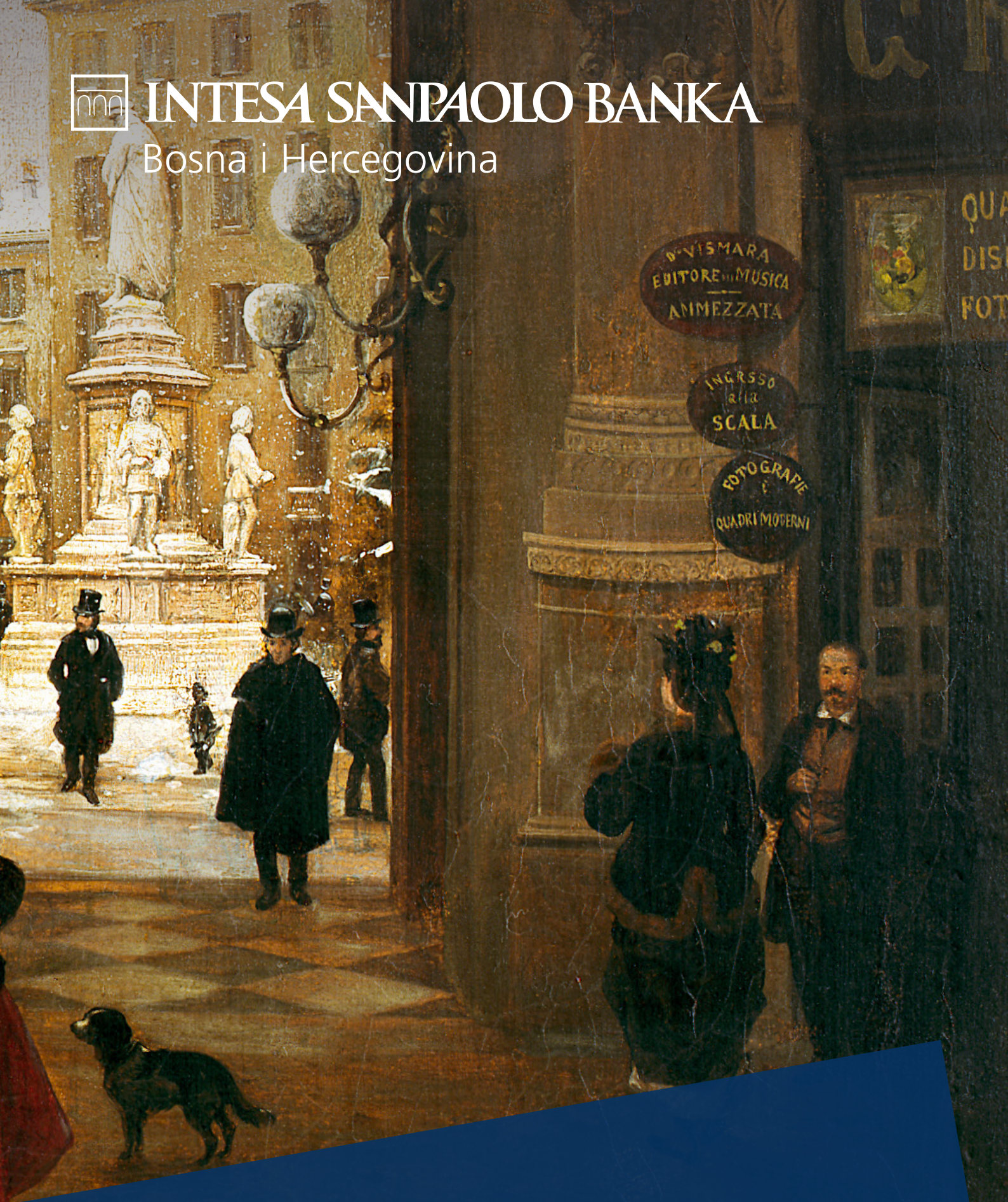




INTESA SANPAOLO BANKA

Bosna i Hercegovina



2018 Annual Report

GALLERIE D'ITALIA. THREE MUSEUM VENUES: AN ITALIAN CULTURAL NETWORK.

Through the Gallerie d'Italia, Intesa Sanpaolo intends to share its artistic and architectural heritage with the public at large: 1,000 works of art displayed in historic palazzi in three cities creating a unique museum network.

Set in an architectural context of great value, Gallerie d'Italia - Piazza Scala in Milan displays a selection of two hundred nineteenth-century works of the Lombard school of painting, coming from the art collections of Fondazione Cariplo and Intesa Sanpaolo, along with a collection representative of twentieth-century Italian art.

Gallerie d'Italia - Palazzo Leoni Montanari in Vicenza exhibits works of eighteenth-century Veneto art and a collection of Attic and Magna Graecia pottery. Moreover, one of the most important collections of Russian icons in the West is safeguarded here.

Gallerie d'Italia - Palazzo Zevallos Stigliano in Naples houses *The Martyrdom of Saint Ursula*, Caravaggio's last documented painting, as well as a collection of over one hundred and twenty artworks representative of Neapolitan artistic output from the early seventeenth century to the beginning of the twentieth century.

Cover photo:



ANGELO INGANNI (Brescia, 1807 - 1880)

**Piazza della Scala under the snow,
seen from the Gallery 1874**

oil on canvas, 65,5 x 55,5 cm

Intesa Sanpaolo Collection

Gallerie d'Italia - Piazza Scala, Milan

Angelo Inganni's vedute are fine works offering a valuable insight into the urban transformations that Milan experienced during the 19th century. In *Piazza della Scala under the snow, seen from the Gallery*, the artist depicts Teatro alla Scala before the square it faces was opened, which involved the demolition of a housing block next to the Palazzo Marino, and subsequently led to the construction of the Galleria Vittorio Emanuele II and the erection of the Leonardo da Vinci monument.

Despite the structural balance of the work, the resulting image - created with free and vibrant brushstrokes with no concern for defined outlines - seems somewhat random, almost like a snapshot of the path running between the snowy square and the Galleria.

The work is part of the permanent collection at the Gallerie d'Italia, Intesa Sanpaolo's museum complex located in Piazza Scala, Milan. The exhibition dedicated principally to 19th century art opens with Neoclassical works and continues through to the turn of the 20th century, with a century's worth of Italian paintings depicting historical events, battles of the Risorgimento (the Italian Unification), vedute and landscapes, as well as genre paintings and masterpieces of Symbolism.

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Report on Supervisory Board



On behalf of the Supervisory Board of Intesa Sanpaolo Banka d.d., Bosnia and Herzegovina (Bank), I am honoured to present you the business results of the Bank for the year 2018.

The Bank performs general banking business with retail and corporate clients offering all ranges of products and commercial services commonly traded in the industry at Bosnia and Herzegovina (BiH) level.

BiH economy is on a positive trend, with GDP growth of estimated 2.9% in 2018. Inflation was below 2% (estimated 1.4%) in 2018 which contributed positively to the stability of the banking system and the economy in general. The Central Bank of BiH runs a currency board regime, whereby the convertible mark (BAM) is pegged to the euro at a rate of BAM 1,95583 = EUR 1.

In 2018, total industrial production output advanced by 1.6%, i.e. slower vs in 2017, largely due to falling Manufacturing output of 1.1%, but also due to slower growth in Mining & quarrying. Real retail trade, meanwhile, rose by 8.2% in 2018, partly reflecting favourable labour market conditions and rising wages. Goods exports in 2018 advanced by 7.6%.

In such macro-economic scenario the Bank continues achieving extraordinary results and reached by the end of 2018 net profit in the amount of 36.3 million BAM. With the Banking industry recording loans' growth around 6% compared to 2017 (while customer deposits continue a stronger increase around 11% compared to 2017) coupled with continuous significant pressures on lending interest rates, the Bank's 2018 performance was sustained by a 11.7% increase of net loans to customers and increase of deposits by 3.9%.

A significant reduction of volume of Non-Performing Loans led to the decrease of the non-performing

to total loans ratio to values below 4%, what is significantly better than the market average. The Bank further strengthened its overall liquidity position, ready to sustain expected further expansion of credit. At the same time, the Bank's capital adequacy ratio continues improving reaching 15.7% at the end of 2018.

The Bank's cost/income ratio, an efficiency key measure, decreased during 2018 and equals 51.9%, while the return on average equity reached 13.2%. These are all very satisfactory figures consistently representing strong performance throughout the years.

The Bank in 2018 also implemented material investments to face the continuously increasing regulatory requirements of domestic and international supervisory authorities, to harmonize services and products for clients (and related supporting processes and IT systems) to the new parent group standards and to most advanced commercial best practises, increase the efficiency of internal operating processes by decreasing manual activities and strengthening quality of delivered data and information.

Strategic objectives of the Bank for 2019 are planned in coordination with Privredna banka Zagreb - progressing with multi-year plan of investments for the infrastructural and technological modernization of the Bank, organizational changes in terms of increase of the competitiveness of Bank's commercial offers to clients, improving support in decision-taking for faster reaction to market changes and continuous assessment of risk profile of Bank's assets.

On behalf of the Supervisory Board, I would like to express my gratitude and appreciation to all the employees of the Bank for their commitment and valued contribution. I would also like to thank the Management Board for its strong leadership and outstanding performance.

Report on the performed supervision in the year 2018

The Supervisory Board of the Bank carried out its activities in accordance with the Charter of the Bank and along with significant support by the Management Board and Audit Committee.

At the meetings held, the Bank's Supervisory Board considered, analyzed and discussed various general and internal acts of the Bank, including policies and procedures, prepared internally but also those Group ones from the Parent Company. The Supervisory Board put particular efforts and attention to analyzing and discussing Bank's

Report on Supervisory Board (continued)

financial reports and followed up internal and external auditors' activities, during the year.

Among the major issues and topics that the Supervisory Board discussed is the Capital Adequacy ratio and its components, both, the ones that are included in the official local CAR report and the ones that enter into consolidation CAR reports. Supervisory Board will continue to follow up with this issue, staying committed in respecting the local regulation about the capital adequacy ratio and advising Management Board on further actions.

The Supervisory Board also paid special attention to AML activities and reports, provided by the Compliance and AML Department.

As per local regulatory requirement, Supervisory Board also received and considered all information related to BCM and tests performed as well as to local regulatory requirements referring to reports on written complaints that the Bank received. The Supervisory Board assessed these Bank's activities successful.

During 2018, special attention was paid by the Board to the assessment of the adequacy of the internal control system of the Bank, in general and in specific operational areas, receiving information from the Management Board and Internal Auditing Department on potential and identified weaknesses and the progress in implementation of the necessary remedial actions.

The control functions of risk management and control functions of compliance submitted reports and information to the Supervisory Board for consideration, in order to ensure the effective establishment of a system of internal controls.

As per local regulatory requirement, Supervisory Board also received and considered information related to the assessment with reference to the efficiency of control functions in the Bank, including the appropriateness of proceedings. The Supervisory Board confirming assessment.

The Supervisory Board of the Bank, through adoption of Operational Reports and Report of independent External Auditors acknowledged work of the Management Board, assessing it as successful and compliant with laws, internal acts, decisions, policies, procedures and programs.

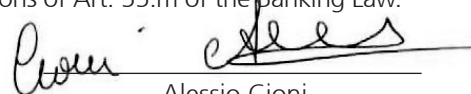
Significant involvement of the Supervisory Board of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina in all Bank's activities contributed to stability and maintenance a good position of the Bank in the market, thus, achieving good financial results.

Pursuant to the Decision on assessment of members of Bank's bodies by Banking Agency of the FBiH and its amendments, ("the Policy") the Nomination Committee performed necessary assessments in accordance with the Policy, confirming that all the assessed persons do satisfy the prescribed requirements and suitable for given positions in the Bank's Bodies.

In 2018 the Supervisory Board of the Bank performed duties in conformity with the law, the Bank's Articles of Association, and Rules of Procedure of the Supervisory Board of the Bank. In the course of 2018 the Supervisory Board held 16 meetings with either physical presence of members / video link or by letter. Meetings were held by letter in cases of utmost urgency or in the case when calling a meeting with physical presence of members was not possible for objective reasons. Four regular meetings that considered financial reports were held within the deadlines prescribed by law and the Articles of Association. In order to prepare the decisions that fall within its competence and supervise the implementation of the previously adopted decisions, the Supervisory Board of the Bank was provided with the assistance of the Audit Committee, which regularly reported on their work at the meetings of the Supervisory Board. In 2018, the Audit Committee held seven meetings where it discussed the processes within its competence.

In accordance with its legal responsibility, the Supervisory Board of the Bank has examined the Annual Financial Statements as at 31 December 2018 and the proposal for the Allocation of Net Profit for the period 01.07. – 31.12.2018 to Reserves, that were submitted by the Management Board of the Bank. The Supervisory Board made no remarks on the submitted reports. In that respect, the Supervisory Board established that the Annual Financial Statements were prepared in accordance with the balances recorded in the business books and that they impartially disclosed the assets and financial status of the Bank, which was also confirmed by the external auditor KPMG B-H d.o.o. za reviziju, the company that had audited the financial statements for 2018.

Since the Supervisory Board has given its consent regarding the Annual Financial Statements for 2018, the respective financial statements are considered to have been confirmed by the Management Board and by the Supervisory Board of Intesa Sanpaolo Banka Bosna i Hercegovina, pursuant to the provisions of Art. 55.m of the Banking Law.



Alessio Cioni
Chairman of the Supervisory Board

Management Board's report on Bank's operations



Pursuant to Article 40 of the Accounting Law ("FBIH Official Gazette" No 83/2009), the Management Board of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina presented its business results for 2018.

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina (hereinafter Intesa Sanpaolo Banka) was founded in Sarajevo in 2000 as UPI Bank d.d. Sarajevo. In 2006, the main shareholder became Intesa Sanpaolo Holding S.A Luxembourg with 94,92% ownership. In June 2007, the Bank completed the merge with LT Gospodarska Banka d.d. Sarajevo. In 2008, the Bank changed its name to Intesa Sanpaolo Banka d.d.

Within the investment reorganization under the auspices of Parent Company Intesa Sanpaolo Group from Italy, the sister Bank Privredna Banka Zagreb d.d. took over in July 2015 the majority ownership.

In the course of 2017, the Privredna Banka d.d. Zagreb took over the shares of the minority shareholders of the Bank, becoming the owner with 99,99% of shares.

Intesa Sanpaolo Banka was on the fifth position in Bosnia and Hercegovina in relation to share in the total assets, based on data of December 2018, with 44 branches in FBiH and 5 branches in RS, while the biggest portion of business activity (96% of total assets) is concentrated in FBiH, in which Intesa Sanpaolo Banka is on the third position in the total assets, loans and deposits, with respectable market participation of 9,4% in total assets, that is, 10,5% in loans and 8,8% in deposits.

Intesa Sanpaolo Banka offers the basic banking services to retail and corporate clients, offering the entire package of products and commercial services in the territory of Bosnia and Hercegovina.

The Bank maintains its business presence in the territory of BiH by its network of branches and ATMs, and by further development of relations with merchants and clients by spreading the POS network. The support to retail and corporate operations is reflected in spreading the products catalogue, and mostly in placing loans in the amount higher than 1,7 billion KM within 2018.

In 2018, the Bank achieved profit after taxation in the amount of 36,340 thousand KM, which represents growth of 46% in relation to the previous year.

The net interest margin recorded the annual growth of 6% as a result of significant increase of credit portfolio and decline of interest rates to sources of financing, that is, deposits of clients, banks and international financial organisations, which completely neutralized the effect of decline in interest rates to loans. The total operational income recorded growth of 6% thanks to the extraordinary increase of income from fees, which increased for 7% compared to the previous year.

Total assets increased for 10,3% and amounts to 2.060.820 thousand KM, with net loans in the amount of 1.428.689 thousand KM and client deposits in the amount of 1.290.085 thousand KM. On the level of the entire banking sector, the increase of credit portfolio was around 6%, while the increase of deposits was around 11%. The Bank kept the stable growth, and accomplished the increase of net credit portfolio in the amount of 11,7%, while the increase of client deposits was 3,9%.

In 2018, the significant growth of credit portfolio was recorded, in which granting loans to retail clients increased for 10,2%, while granting loans to corporate clients increased for 13,6%. Positive operations were confirmed also by the significant increase of total deposits, that is, increase of retail deposits of 5% and increase of corporate deposits for 3%. Position of the Bank from the aspect of liquidity is stable and safe, even in case of worsening of macro-economic conditions and increase of credit expansion.

The significant decrease of non-performing loans has lead to ratio of 4% of total loans compared to non-performing loans, which is much better than the market average.

At the same time, the capital adequacy of the Bank constantly increases and amounts to 15,7% as at 31.12.2018. Upon allocating profit for 2018 into Bank's reserves, once adopted by the General Shareholders

Management Board's report on Bank's operations (continued)

Meeting, the capital adequacy ratio will amount to 16,9%.

Cost and income ratio has been decreasing within 2018 and reached the level of 51,9%, while the return to capital amounted to 13,2%. Those are very satisfying indicators, which prove stable growth over the years.


Strategic goals of the Bank for 2019 were envisioned together with the Privredna Banka Zagreb, and the most significant ones are:

- Perennial significant investments into infrastructure and technological modernization of the Bank
- Organisational changes with goal of using new possibilities
- Continuous following of risk assets of the bank and introduction of new classification, evaluation and risk measuring rules
- Strategic goals of the Retail Division:
 1. Improvement of sale efficiency by introducing the special educational program and training with individual approach to employees
 2. FOR application: implementation of new application for teller operations in the entire network
 3. DIGICAL: improvement of digital projects.
 4. New products of life insurance
 5. Improvement of product catalogue
 6. Revising fee policies
 7. Increase of cross sale
 8. CRISP upgrade: Upgrade of existent CR-ISP application to the newest version and integration with Viber, SMS and Internet/mobile banking
- Strategic goals for Small Business:
 1. New module of services for SB segment
 2. Preapproved loans for existent clients and prospects
 3. Introduction of new package of products
- Strategic goals of Corporate and SME Segment:
 1. Upon increase of market share in loans with significant double digit increase in both the corporate and SME segment, the year of 2019 will have the same ambitions with focus on new clients

in SME and increase of share in corporate clients

- Strategic goals of other business segments in the Bank:
 1. Doubtful receivables: Offer of certain exit strategies for non-performing retail clients as one-time discounted arrangements
 2. Credit risk estimate: In the retail segment, defining criteria for activities of preapproved loans for small business and retail
 3. Risk management: Optimization of risk weighted assets by applying advanced tool for its calculation and simulation, and development and implementation of PD model for retail and corporate
 4. Chief Operating Officer:
 - Further development of Software and support interface
 - Launching the improved version of internet banking
 - Further consolidation of processing data and improved performance by moving internet banking server to PBZ
 - Further consolidation of licence management and improvement of process efficiency by applying MS Office Cloud solution
 - Development and upgrade of basic Software and Interface for support to new business projects and initiatives and for compliance with regulatory requests
 - Improvement of ATM service

Besides the aforementioned, the detailed explanations of Bank's policy related to financial risk management, exposure to price risk, FX risk, credit risks, capital and liquidity risk can be found in the Bank's Financial Report for 2018, which was revised by the external auditor KPMG B-H d.o.o and adopted by the Bank's Management Board at its session on 14.02.2019.



Almir Krkalić

President of the Management Board

Management Board's Report

The Management Board has pleasure in submitting its report for the year ended 31 December 2018.

Review of operations

The result for the year ended 31 December 2018 of the Bank is set out in the statement of profit or loss and other comprehensive income on page 11.

Supervisory Board, Management Board and Audit Committee

During the course of 2018 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board

Alessio Cioni	Chairman
Ivan Krolo	Vice-Chairman
Miroslav Halužan	Member
Gianluca Tiani	Member
Andrea Fazzorali	Member
Alden Bajgorić	Independent member from 29 August 2018
Massimo Lanza	Independent member from 29 August 2018
Gabriele Pace	Member until 29 August 2018
Alen Galavić	Member until 29 August 2018

During the course of 2018 and up to the date of this report, the Audit Committee comprised:

Audit Committee

Dražen Karakašić	Chairman
Petar Sopek	Member
Zoltan Mogyorosi	Member
Ana Jadrešić	Member from 16 May 2018
Jadranko Grbelja	Member from 16 May 2018
Mirella Klarić	Member until 15 May 2018
Andrea Tondo	Member until 15 May 2018

As of 31 December 2018, the Management Board comprised a President and three Members, who served during the year and up to the date of this report as follows:

Management Board

Almir Krkalić	President of the Management Board
Amir Termiz	Management Board Member and Head of Retail Division
Marko Filipčič	Management Board Member and Chief Financial Officer
Edin Izmirlija	Management Board Member and Head of Risk Management and Controlling Division

On behalf of the
Management Board


Almir Krkalić

President of the Management Board


Marko Filipčič

Member of the Management Board

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


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

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

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

The financial statements set out on pages 11 to 91 were authorised by the Management Board on 14 February 2019 for issue to the Supervisory Board, and are signed below to signify this, on behalf of the Bank, by:

For and on behalf of Management Board



Almir Krkalić
President of the Management Board



Marko Filipčič
Member of the Management Board

Independent Auditors' report to the shareholders

Opinion

We have audited the financial statements of Intesa Sanpaolo Banka d.d. BiH ("the Bank"), which comprise the statement of financial position as at 31 December 2018, and the statements of profit or loss and comprehensive income, cash flows and changes in equity for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the financial statements").

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2018 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in Federation of Bosnia and Herzegovina, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of loans and receivables from customers

As at 31 December 2018, gross loans and receivables amount to BAM 1,504 million, related impairment allowance amounts to BAM 75 million and impairment loss recognised in profit or loss amounts to BAM 4 million (31 December 2017: gross loans and receivables: BAM 1,342 million, impairment allowance: BAM 64 million and impairment loss recognised in profit or loss: BAM 8 million).

Refer to pages 17 to 18 (note 2 Basis of preparation Changes in accounting policies due to the application of IFRS 9 Financial instruments), pages 77 to 79 (note 22 (d) Transition to IFRS 9), and note 23 Loans and receivables from customers.

Key audit matter

Impairment allowances represent the Management Board's best estimate of the expected credit losses within the loans to other customers at the reporting date. We focused on this area as the determination of impairment allowances requires significant judgment from the Management Board over both the timing of recognition and the amounts of any such impairment.

Additionally, as at 1 January 2018, the Bank applied the new financial instruments standard, IFRS 9 Financial

How our audit addressed the matter

Our audit procedures in this area included, among others:

- Inspecting the Bank's new ECL impairment provisioning methodology and assessing its compliance with the relevant requirements of the new standard. As part of the above, we challenged the Management Board on whether the level of the methodology's sophistication is appropriate based on an assessment of the entity-level and portfolio-level factors;

Independent Auditors' report to the shareholders (continued)

Key audit matter (continued)

Instruments, whose impairment requirements are based on the expected credit loss (ECL) model rather than the incurred loss model, as previously used.

The new model uses a dual-measurement approach, under which the impairment allowance is measured as either 12-month expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk since initial recognition.

Following the initial application of the new standard, impairment allowances for performing exposures (Stage 1 and Stage 2 in the IFRS 9 hierarchy) and non-performing exposures (Stage 3) below BAM 150 thousand for retail and BAM 50 thousand for corporate exposures individually are determined by modelling techniques (together "collective impairment allowance"). Historical experience, identification of exposures with a significant deterioration in credit quality, forward-looking information and management judgment are incorporated into the model assumptions. For individual non-performing corporate exposures exceeding BAM 50 thousand and BAM 150 thousand for retail, the impairment assessment is based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. Related impairment allowances are determined on an individual basis by means of a discounted cash flows analysis

For the above reasons, impairment of loans to other customers was considered by us to be a significant risk in our audit, which required our increased attention. Accordingly, we considered the area to be our key audit matter.

How our audit addressed the matter (continued)

- Making relevant inquiries of the Bank's risk management and information technology (IT) personnel, and also inspecting conclusions of the Bank's external expert documentation to obtain an understanding of the provisioning process, IT applications used therein, key data sources and assumptions for data used in the ECL model. Also, assessing and testing of IT control environment for data security and access, assisted by our own IT specialists;
- Assessing and testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans, including, but not limited to, the controls relating to the identification of loss events and default, appropriateness of the classification of exposures into performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the impairment allowances;
- With respect of the impairment accounting under the new standard:
 1. Understanding the overall transition process activities and controls, including the process and controls over determining the impact as well as the underlying process activities that generated the related disclosures;
 2. Testing completeness and accuracy of input data used for establishing risk parameters (probability of default (PD), loss given default (LGD), exposure at default (EAD)) and obtaining explanations for exceptions where necessary;
 3. Obtaining the relevant forward looking information and macroeconomic forecasts used in the Bank's ECL assessment. Independently assessing the information by means of corroborating inquiries of the Management Board and inspecting publicly available information;
 4. Assessing whether the definition of default and the new standard's staging criteria were consistently applied. Also analyzing whether the definition of default applied for each segment/portfolio is appropriate based on the requirements of that standard;
 5. Performing an analysis of the ECL-based impairment allowances as at the standard's initial application date, by comparing them to those calculated in accordance with the previous standard, and assessing their reasonableness based on inquiries of the credit risk management personnel.

Independent Auditors' report to the shareholders (continued)

How our audit addressed the matter (continued)

For impairment allowances calculated individually:

- Selecting a sample of individual exposures, with focus on those with the greatest potential impact on the financial statements due to their magnitude and risk characteristics, as well as lower value items, which we independently assessed as high-risk, such as watchlisted, restructured or rescheduled exposures, loans to clients operating in higher risk industries, non-performing exposures with low provision coverage and loans with significant change in the provision coverage;
- For the sample selected, critically assessing, by reference to the underlying documentation (loan files) and through discussion with the loan officers and credit risk management personnel, the existence of any triggers for classification to Stage 2 or Stage 3;
- For those loans where triggers for classification in Stage 3 were identified, challenging key assumptions applied in the Management Board's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral values and realization period, and performing respective independent recalculations.
- In addition to testing of the underlying model, as described above, for collective impairment allowance, independently estimating the key ECL model parameters, as follows:
 1. EAD - by agreeing data on exposures (both balance and off balance sheet) back to source system and contractual data on a sample basis;
 2. PD - by independent back-testing of PDs derived by the Bank, by using more recent data;
 3. LGD – by independent back-testing of LGDs produced by the Bank's model by reference to date on defaults that occurred in the prior periods;

For exposures assessed on an individual and collective basis:

- Independently recalculating projected ECL, reconciling it with actual ECL recognized and inspecting any significant differences;
- Assessing the accuracy and completeness of the impairment-related financial statement disclosures, included, but not limited to, those associated with the initial application of the new standard.

Independent Auditors' report to the shareholders (continued)

Other Information

Management is responsible for the other information. The other information comprises the information included in the Management's Board report, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

Independent Auditors' report to the shareholders (continued)

Auditors' Responsibilities for the Audit of the Financial Statements (continued)

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.


From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Vedran Vukotić.

KPMG B-H d.o.o. za reviziju
Registered Auditors
Zmaja od Bosne 7-7A
71000 Sarajevo
Bosnia and Herzegovina

14 February 2019

On behalf of KPMG B-H d.o.o. za reviziju:


Manal Bećirbegović
Executive director




Vedran Vukotić
FBiH registered auditor
Licence number: 3090017124

Statement of profit or loss and other comprehensive income for the year ended 31 December

	Notes	2018	2017
Interest income	8	76.673	75.535
Interest expense	9	(12.118)	(14.736)
Net interest income		64.555	60.799
Fee and commission income	10	29.974	27.452
Fee and commission expense	11	(5.850)	(4.949)
Net fee and commission income		24.124	22.503
Net trading income	12	1.947	2.097
Other operating income/(expense)	13	(6.470)	(5.893)
Other operating expenses, net		(4.523)	(3.796)
Total operating income, net		84.156	79.506
Personnel expenses	14	(21.091)	(21.052)
Administrative expenses	15	(18.841)	(18.017)
Depreciation and amortisation		(3.768)	(3.941)
Operating expenses		(43.700)	(43.010)
Profit before impairment losses and other provisions and income tax		40.456	36.496
Net impairment gains/(losses) and other provisions	16	106	(8.358)
Profit before tax		40.562	28.138
Income tax expense	17	(4.222)	(3.228)
Net profit for the year		36.340	24.910

The accompanying notes form an integral part of these financial statements.

Statement of profit or loss and other comprehensive income for the year ended 31 December

	2018	2017
Profit for the year	36.340	24.910
Other comprehensive income for the year		
Items that may be reclassified subsequently to profit or loss		
<i>Fair value reserves (Financial assets at fair value through OCI)</i>		
Change in fair value, net of deferred tax	(132)	-
<i>Fair value reserves (Financial assets available for sale)</i>	-	(71)
Change in fair value, net of deferred tax		
Items that will not be reclassified to profit or loss		
<i>Revaluation of property (property classified as IAS 16)</i>		
Change in fair value, net of deferred tax	74	418
Other comprehensive income	(58)	347
Total comprehensive income for the year	36.282	25.257
Basic and diluted earnings per share (BAM)	18	55,63

The accompanying notes form an integral part of these financial statements.

Statement of financial position

	Notes	31 December 2018	31 December 2017
Assets			
Cash and cash equivalents	19	406.414	323.643
Reserves with Central Bank	20	172.979	147.453
Placements with other banks	21	21.594	14.636
Financial assets at fair value through other comprehensive income	22 a)	701	-
Financial assets available for sale	22 a)	-	65.952
Financial assets at fair value through profit or loss	22 b)	412	607
Loans and receivables from customers	23	1.428.689	1.278.696
Income tax prepayment		1.425	2.747
Deferred tax assets	32	255	178
Other assets	24	9.826	11.989
Property and equipment	25	12.943	14.577
Intangible assets	26	5.582	6.574
Total assets		2.060.820	1.867.052
Liabilities			
Due to banks and other financial institutions	27	456.407	323.036
Due to customers	28	1.290.085	1.241.700
Financial liabilities at fair value through profit or loss	22 c)	165	148
Subordinated debt	29	-	121
Other liabilities	30	33.430	27.988
Provisions for liabilities and charges	31	5.063	4.701
Deferred tax liabilities	32	50	42
Total liabilities		1.785.200	1.597.736
Equity			
Share capital	33	44.782	44.782
Share premium		57.415	57.415
Regulatory reserves for credit losses		18.286	18.286
Other reserves and fair value reserves		1.522	1.574
Retained earnings		153.615	147.259
Total equity		275.620	269.316
Total liabilities and equity		2.060.820	1.867.052

The accompanying notes form an integral part of these financial statements.

Statement of changes in shareholders' equity for the year ended 31 December 2018

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2018	44.782	57.415	18.286	980	594	147.259	269.316
First time adoption IFRS 9	-	-	-	-	2.781	(29.984)	(27.203)
Balance as at 1 January 2018 (remeasured)	44.782	57.415	18.286	980	3.375	117.275	242.113
Net profit for the year	-	-	-	-	-	36.340	36.340
Debt instruments at FVOCI – net change in fair value	-	-	-	-	(2.775)	-	(2.775)
Other comprehensive income							
Net loss from change in fair value of financial assets through other comprehensive income	-	-	-	-	(146)	-	(146)
Deferred tax assets	-	-	-	-	14	-	14
Net gain from change in fair value of property	-	-	-	-	82	-	82
Deferred tax liabilities	-	-	-	-	(8)	-	(8)
Total other comprehensive income	-	-	-	-	(58)	-	(58)
Total comprehensive income	-	-	-	-	(2.833)	36.340	33.507
Balance as at 31 December 2018	44.782	57.415	18.286	980	542	153.615	275.620

The accompanying notes form an integral part of these financial statements.

Statement of changes in shareholders' equity for the year ended 31 December 2017

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2017	44.782	57.415	18.286	980	247	138.349	260.059
Net profit for the year	-	-	-	-	-	24.910	24.910
Transactions with owners of the Bank							
Dividends	-	-	-	-	-	(16.000)	(16.000)
Other comprehensive income							
Net loss from change in fair value of financial assets available for sale	-	-	-	-	(79)	-	(79)
Deferred tax assets	-	-	-	-	8	-	8
Net gain from change in fair value of property	-	-	-	-	460	-	460
Deferred tax liabilities	-	-	-	-	(42)	-	(42)
Total other comprehensive income	-	-	-	-	347	-	347
Total comprehensive income	-	-	-	-	347	8.910	9.257
Balance as at 31 December 2017	44.782	57.415	18.286	980	594	147.259	269.316

The accompanying notes form an integral part of these financial statements.

Statement of cash flows

	Notes	31 December 2018	31 December 2017
Cash flows from operating activities			
Profit for the year		36.340	24.910
Adjustments for:			
- depreciation and amortisation	25, 26	3.768	3.941
- net impairment losses and provisions	16	(106)	8.358
- net change in provisions for liabilities and charges		615	(203)
- net interest income		(64.555)	(60.799)
- net change in fair value of financial assets and liabilities at fair value through profit or loss	12	(19)	(64)
- net gain / loss from disposal of property and equipment	13	(55)	55
- impairment of property and equipment	13	-	555
- impairment of assets held for sale	13	-	289
- income tax expense	17	4.222	3.228
		(19.790)	(19.730)
Changes in:			
- placements with other banks		(6.958)	32.571
- loans and receivables from customers		(180.129)	(93.734)
- other assets		1.861	(1.625)
- obligatory reserve with the Central Bank		(25.526)	103.852
- financial assets and liabilities at fair value through profit or loss		193	(259)
- due to banks		133.384	91.881
- due to customers		49.925	(24.149)
- other liabilities		5.450	1.810
- provisions for liabilities and charges		(253)	(336)
		(41.843)	90.281
Income tax paid		(2.977)	(3.717)
Interest received		77.247	75.155
Interest paid		(13.671)	(15.212)
Net cash from operating activities		18.756	146.507
Cash flows from investing activities			
Acquisition of property and equipment		(122)	(1.582)
Proceeds from the sale of property and equipment		28	147
Acquisition of intangible assets		(1.027)	(1.902)
Proceeds from financial assets at fair value through other comprehensive income		65.257	23.131
Net cash from investing activities		64.136	19.794

The accompanying notes form an integral part of these financial statements.

Statement of cash flows (continued)

	Notes	31 December 2018	31 December 2017
Cash flows from financing activities			
Dividends paid		-	(7.941)
Repayment of subordinated debt		(121)	(160)
Net cash flow used in financing activities		(121)	(8.101)
Net increase in cash and cash equivalents		82.771	158.200
Cash and cash equivalents at the beginning of the year	19	323.643	165.443
Cash and cash equivalents at the end of the year	19	406.414	323.643

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements

1. GENERAL

Incorporation and registered activities

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina ("the Bank") was registered in the Cantonal Court in Sarajevo on 20 October 2000. Its registered address is Obala Kulina Bana 9a in Sarajevo.

The Bank's main operations are as follows:

1. Accepting deposits from the public,
2. Granting short-term and long-term loans and guarantees to corporate customers, private individuals, local municipalities and other credit institutions,
3. Money market activities,
4. Performing local and international payments,
5. Foreign currency exchange and other banking-related activities,
6. Providing banking services through an extensive branch network in Bosnia and Herzegovina.

Notes to the financial statements (continued)

2. BASIS OF PREPARATION

Basis of accounting

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements were authorised by the Management Board on 14 February 2019 for submission to the Supervisory Board.

This is the first set of the Bank's annual financial statements in which IFRS 9 Financial Instruments have been applied. Changes to significant accounting policies are described in Note 3.

Functional and presentation currency

These financial statements are presented in thousands of convertible marks ('000 BAM) which is the functional currency of the Bank.

Use of estimates and judgments

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Results actually recorded upon settlement of transactions which were initially subject to estimates may eventually differ from those estimates.

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

Information on areas with significant uncertainty in the estimates and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in these financial statements are disclosed in Note 4.

Change in accounting policy and implementation of new accounting standard

The Bank has adopted the International Financial Reporting Standard (IFRS) 9 Financial Instruments since 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognized in the financial statements. The Bank did not early adopt IFRS 9 in previous periods.

As permitted by the standard, the Bank elected not to restate comparative figures for the year 2017. Any adjustments on the application of IFRS 9 are recognized in the opening retained earnings and other reserves of the current period.

Consequently, the Bank has applied the International Financial Reporting Standard 7 (revised due to the adoption of IFRS 9).

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition, classification and measurement of financial assets and financial liabilities, and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 Financial Instruments Disclosure.

Further details of the specific IFRS 9 accounting policies applied in the current period are described in Note 3 Summary of accounting policies resulting from the adoption of IFRS 9 Financial Instruments and Note 22(d) Transition to IFRS 9 of these financial statements.

The Bank has also initially adopted IFRS 15 from 1 January 2018. The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognized by the Bank. Accordingly, the impact on the comparative information is limited to new disclosure requirement. For additional disclosures related to IFRS 15 please see Note 3(t).

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES

Except for the changes abovementioned, the Bank has consistently applied the accounting policies as set out in Note 3 to all periods presented in these financial statements.

(a) Foreign currency transactions

Transactions in currencies other than Convertible Marks ("BAM") are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities are translated at the rates prevailing on the reporting date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Profits and losses arising on translation are included in the profit or loss statement for the period.

The Bank values its assets and liabilities at the middle rate of the Central Bank of Bosnia and Herzegovina valid at the reporting date. The principal rates of exchange set forth by the Central Bank and used in the preparation of the Bank's statement of financial position at the reporting dates were as follows:

31 December 2017	EUR 1= BAM 1,95583	USD 1 = BAM 1,63081
31 December 2018	EUR 1= BAM 1,95583	USD 1 = BAM 1,70755

(b) Net trading income

Net trading income comprises net gains and losses from foreign exchange trading, net gains and losses on financial instruments at fair value through profit or loss, and net gains and losses from the translation of monetary assets and liabilities denominated in foreign currency at the reporting date.

(c) Lease payments

Payments made under operating leases are recognised in the profit or loss statement on a straight-line basis over the term of the lease.

(d) Income tax expense

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

The amount of deferred tax is calculated using the balance sheet liability method whilst considering the temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and amounts used for income tax purposes. Deferred tax assets and liabilities are recognised using the tax rates that are expected to apply on taxable income in the period in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the reporting date.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(d) Income tax expense (continued)

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects at the reporting date to recover or settle the carrying amount of its assets and liabilities. Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the statement of financial position. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable future profits will be available against which the deferred tax assets can be utilized. At each reporting date the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets for indications of potential impairment.

(e) Property and equipment

Recognition and measurement

Equipment is stated at historical cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent cost is included in net book value or is accounted for as separate assets only if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day-to-day repairs and maintenance are recognised in the profit or loss statement as incurred.

Buildings are stated at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Increases in carrying amounts arising from revaluation, including currency translation differences, are recognised in the asset revaluation reserve, unless they offset previous decreases in the carrying amounts of the same asset, in which case, they are recognised in profit or loss. Decreases in carrying amounts that offset previous increases of the same asset are recognised against the asset revaluation reserve. All other decreases in carrying amounts are recognised as a loss in the statement of comprehensive income.

Gains and losses on disposal are determined by comparing proceeds with the carrying amount, and are included in the profit or loss statement as other income or operating expense.

Depreciation

Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Bank will obtain ownership by the end of the lease term. Land is not depreciated.

The depreciation rates used by the Bank are as follows:

	2017	2018
Computers	20%	20%
Furniture and equipment	10% - 15%	10% - 15%
Business premises	5%	5%
Leasehold improvements	20%	20%

Depreciation method and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(f) Intangible assets

Intangible assets are stated at cost less accumulated amortization and impairment losses. The cost includes all expenditure that is directly attributable to the acquisition of the items.

Amortization is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The amortization rates used by the Bank were applied consistently in 2017 and 2018:

Intangible assets – licenses	10% - 33,33%
Intangible assets – software	20%

Amortisation method and useful lives are reviewed and adjusted if appropriate at each reporting date.

(g) Assets repossessed from disbursement of loans

The Bank may recover assets that were originally received as collateral for the loan after exercising contractual rights or undertaking specific legal actions. When both of the following conditions are satisfied, the relevant assets shall be included in the Bank's balance sheet:

- The recovery activity has been completed
- The Bank has become owner of the asset

Classification and measurement of these assets depend on the scope for holding the property. More specifically, the asset may be classified according to IAS 16 (if the assets becomes instrumental), IAS 40 (if the property is held to earn rentals or for capital appreciation), IAS 2 (when the property has been acquired, in the ordinary course of business, exclusively with the intent to dispose of the asset in the reasonably short period of time). Classification under IFRS 5 is also possible when the conditions are met.

Following their initial recognition in the balance sheet at their fair value, the repossessed assets classified according to IAS 16, excluding property assets, shall be measured at cost (amortized and periodically tested for impairment). Repossessed property assets, such as functional property and valuable art collections (governed by IAS 16) and Investment property (governed by IAS 40) will be subsequently measured according to the revaluation model and fair value model respectively. Assets classified under IAS 2 shall be measured at the lower between cost and the net realizable value and shall not be amortized but only subject to the impairment test.

(h) Assets held for sale

Non-current assets are classified as held-for-sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use.

Such assets are generally measured at the lower of their carrying amount and fair value less costs to sell. Impairment losses on initial classification as held-for-sale and subsequent gains and losses on remeasurement are recognised in profit or loss.

Once classified as held-for-sale, intangible assets and property, plant and equipment are no longer amortised or depreciated, and any equity-accounted investee is no longer equity accounted.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(i) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the profit or loss statement.

The recoverable amount of other assets is the greater of their value in use and fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognised.

(j) Employee benefits

Short-term benefits

On behalf of its employees, the Bank pays pension and health insurance which is calculated on the gross salary paid as well as tax on salaries which are calculated on the net salary paid. The Bank pays the above contributions into the state pension and health funds according to statutory rates during the course of the year. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with local legislation. These expenses are recorded in the profit or loss statement in the period in which the salary expense is incurred.

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss statement as incurred.

Long-term employee benefits: retirement severance payments and early retirement bonuses

The Bank pays to its employees' retirement severance benefits upon retirement in an amount representing three times the average salary of the respective employee in the period of the last three months.

The obligation and costs of these benefits are determined by using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the estimated interest rate on government bonds.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(j) Employee benefits (continued)

Share-based payments

Employees of the Bank receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments issued by the ultimate parent company. The Bank accounts for share-based payments as a cash-settled transaction.

The fair value of the amount payable to employees in respect of the ultimate parent company shares to be given to the employees is recognised as an expense with a corresponding increase in liabilities over the period in which the employees unconditionally become entitled to payments. The liability is remeasured at each reporting date and at the settlement date. Any changes in the fair value of the liability are recognised as a personnel expense in the profit or loss statement.

(k) Provisions for liabilities and charges

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

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

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

(l) Equity

Issued share capital

Issued share capital comprises ordinary and preference shares and is stated in BAM at nominal value.

Regulatory reserve for credit losses

The regulatory reserve for credit losses represents the surplus of impairment allowances calculated in accordance with regulations as prescribed by the Agency over impairment allowances recognised in accordance with IFRS. The reserve is presented directly within equity (as a non-distributable reserve) and until 2012 any increase of the surplus was covered by transfers from retained earnings, after approval by shareholders.

Prior to 2012, the need for transfers from retained earnings to an earmarked reserve within equity (regulatory reserve for credit losses) was calculated for the whole credit-risk portfolio on a net basis, thereby taking into account both instances where application of Agency regulations would have resulted in a higher provision and instances where the application of Agency regulations would have resulted in a lower provision. However, from 2012, banks are required to calculate the requirement for regulatory reserves for credit losses taking into account only instances where higher provisions would have resulted from the application of the Agency rules. Retroactive application of this change in Agency rules is not required.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(l) Equity (continued)

Regulatory reserve for credit losses (continued)

Based on the Decision of Minimum Standards for Capital Management and Asset Classification issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. Accordingly, the balance of the regulatory reserve presented in the financial statements as of 31 December 2012 has been carried forward unchanged to 31 December 2018.

Retained earnings

Retained earnings represent the accumulation of net profits after appropriations to owners and other transfers, such as transfers to regulatory reserves as described above.

Fair value reserve

The fair value reserve comprises changes in fair value of financial assets available for sale, net of deferred tax.

Other reserves

Other reserves mainly relate to accumulated appropriations from retained earnings in accordance with the shareholder's decisions.

Dividends

Dividends on ordinary shares and preference shares are recognised as a liability until payment to beneficiaries in the period in which they are approved by the Bank's shareholders.

(m) Off-balance sheet commitments and contingent liabilities

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

(n) Managed funds for and on behalf of third parties

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

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(o) Segment reporting

A business segment is a distinguishable component of the Bank that is engaged in providing products or services, which is subject to risks and rewards that are different from those of other segments. A geographical segment is engaged in providing products or services within a particular economic environment distinguished from other segments engaged in providing products or services within other economic environments.

The Bank has identified 3 primary business segments: Retail, Corporate and Treasury. The primary segmental information is based on the Bank's internal reporting structure by business segment. Geographical concentration is not presented as the Bank's operations are concentrated in Bosnia and Herzegovina.

Policies applicable before 1 January 2018

(p) Interest income and expense

Interest income and expense are recognised in the profit or loss statement as they accrue using the effective interest rate method. The effective interest rate is the rate that discounts estimated future cash flows of financial assets or liabilities over the life of the financial instrument (or, if appropriate, a shorter period) to its net carrying value. In the calculation of effective interest rates the Bank estimates future cash flows considering all contractual terms, but not future credit losses.

Calculation of the effective interest rate includes all paid or received transaction costs, fees and points, which are an integral part of the effective interest rate. Transaction costs include all incremental costs incurred directly in connection with the issuance or acquisition of financial assets or financial liabilities.

Interest income and expense recognised in the profit or loss statement include interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest rate method.

(r) Fee and commission income and expense

Fee and commission income and expense that are integral part of the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Fee and commission income and expenses, reported as such, comprise mainly fees related to credit card transactions, the issuance of guarantees and letters of credit, domestic and foreign payment transactions and other services and are recognised in the profit or loss statement upon performance of the relevant service.

(s) Dividend income

Dividend income is recognised in the profit or loss statement when the right to receive income is established.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments

Recognition

Loans and receivables and other financial liabilities are recognised when advanced to borrowers or received from lenders (settlement date).

The Bank recognizes financial assets available for sale and financial assets and liabilities at fair value through profit or loss on the trade date which is the date when the Bank commits to purchase or sell the instruments.

Classification

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

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determined payments that are not quoted in an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with these receivable and include placements with and loans to other banks, loans and receivables from customers and balances with the Central Bank.

ii) Financial assets available for sale

Financial assets available for sale are non-derivatives that are either designated in this category or not classified into any of the other categories. Financial assets classified as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates or equity prices. Financial assets available for sale include equity and debt securities.

iii) Financial assets and financial liabilities at fair value through profit or loss

Financial assets and financial liabilities at fair value through profit or loss have two sub-categories: financial instruments held for trading (including derivatives) and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category only if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term for the purpose of short-term profit taking or designated as such by management at initial recognition.

The Bank designates financial assets and financial liabilities at fair value through profit or loss when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminated or significantly reduced an accounting mismatch which would otherwise have arisen; or
- the asset or liability contains an embedded derivative that significantly modified the cash flows that would otherwise be required under the contract.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments (continued)

iii) Financial assets and financial liabilities at fair value through profit or loss (continued)

Financial assets and financial liabilities at fair value through profit or loss include derivative financial instruments classified as financial instruments held for trading and equity instruments designated by management at fair value through profit or loss. Management has designated equity instruments at fair value through profit or loss because the designation eliminates or significantly reduces an accounting mismatch related to share-based payments, which would otherwise arise.

iv) Other financial liabilities

Other financial liabilities comprise all financial liabilities which are not at fair value through profit or loss and include amounts due to customers, due to banks and other financial institutions, and subordinated debt.

Initial and subsequent measurement

Loans and receivables are initially recognised at fair value. After initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment.

Financial assets available for sale are measured initially at their fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset. Subsequent to initial recognition financial assets available for sale are measured at fair value, except for equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, which are stated at cost less impairment.

Gains and losses from changes in the fair value of available-for-sale financial assets are recognised directly in other comprehensive income until derecognition or impairment, when the cumulative amount previously recognised in other comprehensive income is transferred to the profit or loss statement. Interest income calculated using the effective interest rate method is recognised in the profit or loss statement.

Foreign exchange gains and losses on available-for-sale equity instruments are part of the fair value of these instruments and are recognised in other comprehensive income. Dividend income on available-for-sale equity securities is recognised in profit or loss when the right to receive payment has been established.

Financial assets and liabilities at fair value through profit or loss are initially recognised at fair value. All transaction costs are immediately expensed. Subsequent measurement is also at fair value. Gains and losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the profit or loss statement.

Other financial liabilities are initially measured at fair value including transaction costs. Subsequent to initial recognition the Bank measures other financial liabilities at amortized cost using the effective interest rate.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments (continued)

Derecognition

The Bank derecognizes financial assets (in full or partially) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realized, surrendered or have expired.

The Bank derecognizes financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognizing that liability and will instantaneously recognize a new financial liability with new terms and conditions.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (Level 1 of the fair value hierarchy).

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs (Level 2 and Level 3 of the fair value hierarchy). The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or liability measured at fair value has a bid price and an ask price, the Bank measures assets and long positions at the bid price and liabilities and short positions at the ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustments of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand.

Notes to the financial statements

(continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments (continued)

Fair value measurement (continued)

Spot exchange transactions are always considered contributed instruments. Forward currency contracts are not contributed and are treated as financial derivatives pursuant to IAS 39.

The Bank recognizes transfers between levels of the fair value hierarchy as of the reporting period during which the change occurred.

Identification and measurement of impairment of financial assets

i) Financial assets carried at amortized cost

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) has (or have) an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

For financial assets carried at amortised cost, the Bank first assesses whether objective evidence of impairment exists individually, for financial assets that are individually significant, or collectively, for financial assets that are not individually significant. Those individually significant assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred) discounted at the original effective interest rate of financial assets valid at the time the asset become impaired. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit or loss statement.

For individually significant loans, the need for, and amount of impairment allowance is determined based on an assessment which includes the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of working capital and other financial support, the realisable value of collateral, and the timing of the expected cash flows.

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrences that cause impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses will be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss rate and the expected rate of recovery at each reporting date, to ensure accurate reporting.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments (continued)

Identification and measurement of impairment of financial assets (continued)

i) Financial assets carried at amortized cost (continued)

If in a subsequent period, the amount of the impairment loss decreases, and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the profit or loss statement.

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as a reversal of impairment losses in the profit or loss statement.

The Bank also calculates provisions in accordance with the relevant regulations of the Banking Agency of the Federation of Bosnia and Herzegovina ("the Agency" or "FBA"). In accordance with these regulations, the relevant placements are classified into appropriate risk groups, depending on the past due days, the financial position of the borrower and collateral; and are provided for at prescribed rates. A general provision is also calculated in accordance with these regulations at a rate of 2% on exposure not specifically impaired.

The provisions calculated on the basis of the preceding paragraph ("the FBA provisions") are not recognised in these financial statements of the Bank. However, if the FBA provisions are greater than the impairment allowance calculated in accordance with IFRS, the difference is presented as an appropriation within regulatory reserves for credit losses.

ii) Financial assets available for sale

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the investment below its acquisition cost is considered in determining whether the assets are impaired.

If any such evidence exists for financial assets available for sale, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the profit or loss statement, is removed from other comprehensive income and recognised in the profit or loss statement.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the profit or loss statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognised in other comprehensive income.

iii) Financial assets carried at cost

Financial assets carried at cost include equity securities classified as available for sale for which there is no reliable measure of fair value. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments (continued)

Identification and measurement of impairment of financial assets (continued)

iii) Financial assets carried at cost (continued)

An impairment loss is calculated as the difference between the carrying amount of the financial asset and the present value of expected future cash flows discounted by the current market interest rate for similar financial assets. Impairment losses on such instruments, recognised in the profit or loss statement, are not subsequently reversed through the profit or loss statement.

Specific financial instruments

i) Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to foreign exchange risks arising from operating, financing and investing activities. The Bank does not hold or issue derivative financial instruments for speculative trading purposes. All derivatives are classified as financial instruments at fair value through profit or loss. Hedge accounting is not applied.

Derivative financial instruments include foreign exchange forward contracts and are initially recognised and subsequently measured at their fair value in the statement of financial position. Fair values are obtained from discounted cash flow models.

All derivatives are classified as financial assets at fair value through profit or loss when their fair value is positive and as financial liabilities at fair value through profit or loss when it is negative.

ii) Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank and current accounts with other banks.

Cash and cash equivalents exclude the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank's day-to-day operations. The compulsory minimum reserve with the Central Bank is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

iii) Placements with banks and the obligatory reserve with the Central Bank

Placements with banks and the obligatory reserve with the Central Bank are classified as loans and receivables and are carried at amortized cost less impairment losses.

iv) Loans and receivables from customers

Loans to customers are presented at amortized cost net of impairment allowances to reflect the estimated recoverable amounts.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(u) Financial instruments (continued)

Specific financial instruments (continued)

v) Equity securities

Equity securities are classified as available for sale and carried at fair value, unless there is no reliable measure of the fair value, in which case equity securities are stated at cost, less impairment.

vi) Debt securities

Debt securities are classified as available-for-sale financial assets and carried at fair value.

vii) Borrowings and subordinated debt

Interest-bearing borrowings and subordinated debt are classified as other financial liabilities and are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortized cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the profit or loss statement over the period of the borrowings using the effective interest rate method.

viii) Current accounts and deposits from banks and customers

Current accounts and deposits are classified as other liabilities and initially measured at fair value plus transaction costs and subsequently stated at their amortized cost using the effective interest method.

Policies applicable from 1 January 2018

(v) Interest income and expense

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- (a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset
- (b) Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the expected credit loss provision).

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(w) Fee and commission income and expenses

Fee and commission income and expenses that are integral part of the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Fee and commission income and expenses, reported as such, comprise mainly fees related to credit card transactions, the issuance of guarantees and letters of credit, domestic and foreign payment transactions and other services and are recognised in the profit or loss statement upon performance of the relevant service.

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	Nature and timing of satisfaction of performance obligations, including significant payment terms	Revenue recognition under IFRS 15 (applicable from 1 January 2018)
Retail and corporate banking service	<p>The Bank provides banking services to retail and corporate customers, including account management, provision of overdraft facilities, foreign currency transactions, credit card and servicing fees.</p> <p>Fees for ongoing account management are charged to the customer's account on a monthly basis. The Bank sets the rates separately for retail and corporate banking customers in each jurisdiction on an annual basis.</p> <p>Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place.</p> <p>Servicing fees are charged on a monthly basis and are based on fixed rates reviewed annually by the Bank.</p>	<p>Revenue from account service and servicing fees is recognised over time as the services are provided.</p> <p>Revenue related to transactions is recognised at the point in time when the transaction takes place.</p>

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

(x) Net income from other financial instruments at fair value through profit or loss

Net income from other financial instruments at FVTPL relates to non-trading derivatives held for risk management purposes that do not form part of qualifying hedging relationships, financial assets and financial liabilities designated as at FVTPL and, from 01 January 2018, also non-trading assets mandatorily measured at FVTPL. The line item includes fair value changes, interest, dividends and foreign exchange differences.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(y) Dividend income

From 1 January 2018, dividends on equity instruments designated as at FVOCI that clearly represent a recovery of part of the cost of the investment are presented in OCI.

(z) Financial assets and financial liabilities

1. Recognition and initial measurement

The Bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

2. Classification and subsequent measurement

Financial assets

From 1 January 2018, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Financial assets measured at amortised cost
- Financial assets measured through other comprehensive income
- Financial assets at fair value through profit or loss

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables.

Classification and subsequent measurement of debt instruments depend on:

- (i) The purpose of managing financial assets (business model)
- (ii) The contractual characteristics of cash flows (Solely Payments of Principle and Interest, further "SPPI test" or "SPPI")

Based on these factors, the Bank classifies its debt instruments into one of the following three measurement categories:

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

2. Classification and subsequent measurement (continued)

- **Financial assets measured at amortized cost**

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVTPL, are measured at amortized cost. After initial recognition, the carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in Note 3(w)(6). Interest income from these financial assets is included in "Interest income" using the effective interest rate method.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables occur when the Bank grants cash to customers without the intent to trade these receivables and includes placements and loans to banks, given loans and receivables from customers and assets with the Central Bank.

- **Financial assets measured through other comprehensive income**

Fair value through other comprehensive income (FVOCI) financial assets, that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at fair value through other comprehensive income (FVOCI).

Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss.

When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss and recognised in "Net trading income". Interest income from these financial assets is included in "Interest income" using the effective interest rate method.

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

Financial assets at fair value through profit or loss have two sub-categories: financial instruments held for trading (including derivatives) and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category only if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term for the purpose of short-term profit taking or designated as such by management at initial recognition.

The Bank designates financial assets at fair value through profit or loss when:

- the assets are managed, evaluated and reported internally on a fair value basis;
- the designation eliminated or significantly reduced an accounting mismatch which would otherwise have arisen; or
- the asset contains an embedded derivative that significantly modified the cash flows that would otherwise be required under the contract.

Financial assets at fair value through profit or loss include derivative financial instruments classified as financial instruments held for trading and equity instruments designated by management at fair value through profit or loss.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

2. Classification and subsequent measurement (continued)

Purpose of managing financial assets (Business model)

The business model reflects how the Bank manages the assets in order to generate cash flows.

Business models of the Bank are:

- Business model whose objective is to hold assets for the collection of contractual cash flows - it includes all financial assets held for the purpose of collection of contractual cash flows over the lifetime of the financial instrument. For the purpose of classification in this business model, financial assets goes through the SPPI (Solely payment of principal and interest) test, and the following financial assets are allocated to this model:
 - Deposits with banks,
 - Loans,
 - Other receivables.

Credit risk is the underlying risk that is managed under this business model.

- Business model aimed to collect the contractual cash flows and sale of financial assets – it includes financial assets held for the purpose of collecting the agreed cash flows and sale of financial assets.

The following financial assets are allocated to the business model for collection and sale:

- Debt securities (pass SPPI test),
- Equity securities (fail SPPI test),

Liquidity risk is the underlying risk that is managed under this business model.

- The business model within which financial assets are measured at fair value through profit and loss - combines all financial assets that are not held under the two previously mentioned business models. Financial assets in this business model are managed in order to realize cash flows by selling assets and making short-term profits.

Contractual cash flow characteristics (SPPI)

Test of features of contractual cash flows from the point of view of solely payment of principal and interest (hereinafter: SPPI test) is one of the criteria for the classification of financial assets in an individual category of measurement. SPPI test is implemented for the purpose of establishing whether the interest rate on unsettled principle reflects the fee for time value of money, credit risk and other basic risks of borrowing, lending costs and profit margin.

The SPPI test is performed:

- for each financial asset, allocated to a business model whose purpose is to hold financial assets for the payment of contractual cash flows and a business model for the purpose of collecting contractual cash flows and selling financial asset on the date of its initial recognition,

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

2. Classification and subsequent measurement (continued)

Contractual cash flow characteristics (SPPI) (continued)

- for each financial asset in cases where the original asset has been significantly modified and therefore re-recognised as new assets,
- when introducing new models and/or loan programs to determine in advance the eligibility of the considered loan term and conditions in relation to the need to subsequently monitor the value of any financial assets that would arise from them.

• Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

The Bank subsequently measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Bank's right to receive payments is established.

Gains and losses on equity investments at FVTPL are included in the "Net trading income" line in the statement of profit or loss.

• Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL.

3. Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

3. Derecognition (continued)

Financial assets (continued)

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

4. Modifications of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

4. Modifications of financial assets and financial liabilities (continued)

Financial assets (continued)

If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method.

The Bank as at 31.12.2018 has no financial assets measured at amortised cost or FVOCI that were modified and the modification would not result in derecognition. All past modifications resulted in derecognitions of the original financial assets and recognitions of new financial assets.

Financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

5. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

6. Impairment

IFRS 9 outlines a "three-stage" model for impairment of financial assets based on changes in credit quality since initial recognition of financial assets.

Impairment of financial assets is recognized on the basis of the expected credit loss model (ECL) for assets subsequently measured at amortized cost and assets subsequently measured at fair value through other comprehensive income (other than equity instruments).

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

6. Impairment (continued)

IFRS 9 requires entities to enter the expected losses at the level of losses expected in the next 12 months (Stage 1) from the initial entry of the financial instrument. The time horizon for calculating the expected loss becomes the entire remaining life of the asset that is the subject of the valuation where the credit quality of the financial instrument has experienced a "significant" deterioration in relation to the initial measurement (Stage 2) or in case the asset is partially or fully non-performing (Stage 3). More specifically, the introduction of new impairment provisions includes:

- Allocation of performing financial assets at different levels of credit risk ("staging"), corresponding to value adjustments based on expected losses over the next 12 months (the so-called "Stage 1") or lifetime for the entire remaining duration of the instrument (the so-called "Stage 2"), in the presence of a significant increase in credit risk;
- Allocation of partially or fully non-performing financial assets in the so-called "Stage 3", always with value adjustments based on expected losses over the entire duration of the instrument;
- Inclusion of Expected Credit Losses ("ECL") in the calculation, as well as the expected future changes of the macroeconomic scenario.

The following table summarizes claims for impairment under IFRS 9:

	Stage 1	Stage 2	Stage 3
Deterioration in credit risk	Initial recognition (non-performing loans a origination are included in Stage 3)	Credit risk has increased significantly since initial recognition and is not considered "low"	Credit risk has increased to the point where it is considered that the value of the instrument is impaired.
Recognition of the provisioning in the balance sheet IFRS 9	12-month expected loss	Lifetime expected loss	Lifetime expected loss (as it was under IAS 39 but increased for Add-on)
Current classification	Performing	Performing	Non-performing
Current provision	Incurred loss	Incurred loss	Lifetime expected loss

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- *financial assets that are not credit-impaired at the reporting date*: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

6. Impairment (continued)

Measurement of ECL (continued)

- *financial assets that are credit-impaired at the reporting date*: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- *undrawn loan commitments*: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- *financial guarantee contracts*: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

See also Note 5.1.3.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in “impairment losses on financial instruments” in the statement of profit or loss and OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank’s procedures for recovery of amounts due.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(z) Financial assets and financial liabilities (continued)

6. Impairment (continued)

Write-off (continued)

The Bank wrote off a loan or an investment in debt security, either partially or in full, and any related allowance for impairment losses, when Bank's Credit determined that there was no realistic prospect of recovery.

7. Designation at fair value through profit or loss

Financial assets

At initial recognition, the Bank has designated certain financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, which would otherwise arise.

Before 1 January 2018, the Bank also designated certain financial assets as at FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

Financial liabilities

The Bank has designated certain financial liabilities as at FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Note 22 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class.

(aa) Loans and receivables from customers

"Loans and receivables" captions in the statement of financial position include:

- loans and receivables measured at amortised cost (see Note 23); they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

(ab) Investment securities

The "investment securities" caption in the statement of financial position includes:

- debt securities measured at FVOCI; and
- equity investment securities designated as at FVOCI.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(ab) Investment securities (continued)

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

(ac) Financial guarantees and loan commitments

'Financial guarantees' are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured as follows:

- from 1 January 2018: at the higher of the loss allowance determined in accordance with IFRS 9 (see Note 3(w)(6) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15; and
- before 1 January 2018: at the higher of the amount representing the initial fair value amortised over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

The Bank has issued no loan commitments that are measured at FVTPL.
For other loan commitments:

- from 1 January 2018: the Bank recognises a loss allowance
- before 1 January 2018: the Bank recognised a provision in accordance with IAS 37 if the contract was considered to be onerous.

Liabilities arising from financial guarantees and loan commitments are included within provisions.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

(ad) New standards and interpretations

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Bank has not early adopted them in preparing these financial statements.

Of those standards that are not yet effective, IFRS 16 is expected to have a significant impact on the Bank's financial statements in the period of initial application.

A. IFRS 16 Leases

The Bank is required to adopt IFRS 16 Leases from 1 January 2019. The Bank has assessed the estimated impact that the initial application of IFRS 16 will have on its financial statements, as described below.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

(i) Leases in which the Bank is a lessee

The Bank has completed an initial assessment of the potential impact on its financial statements.

The Bank will recognise new assets and liabilities for its operating leases of branch and office premises. The nature of expenses related to these leases will now change because IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities.

Previously, the Bank recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised.

As at 31 December 2018, the Bank's future minimum lease payments under non-cancellable operating leases amounted to BAM 11,192 thousand, on an undiscounted basis, which the Bank estimates it will recognize as additional lease liabilities and corresponding right-to-use asset.

(ii) Transition

The Bank plans to apply IFRS 16 initially on 1 January 2019, using a modified retrospective approach.

The Bank plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

Notes to the financial statements (continued)

3. SUMMARY OF ACCOUNTING POLICIES (CONTINUED)

B. Other standards

The following amended standards are not expected to have a significant impact on the Bank's financial statements.

- Annual Improvements to IFRS Standards 2015–2017 Cycle – various standards
- Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)
- Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)
- IFRIC 23 Uncertainty over Income Tax Treatments
- Amendments to References to Conceptual Framework in IFRS Standards
- IFRS 17 Insurance Contracts

Notes to the financial statements

(continued)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

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

(a) Impairment losses on loans and receivables

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the financial statements is included in the following notes.

- Applicable to 2018 only:
 - Note 3 (z) and Note 22 (d): classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding.
 - Note 5.1.2: establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 is included in the following notes.

- Applicable to 2018 only:
 - Note 5.1.4: impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information.
- Applicable to 2018 and 2017:
 - Note 6.1: determination of the fair value of financial instruments with significant unobservable inputs
 - Notes 3 (u) and 3 (z): impairment of financial instruments: key assumptions used in estimating recoverable cash flows

(b) Taxation

The Bank provides for tax liabilities in accordance with the tax laws of the Federation of Bosnia and Herzegovina. Tax returns are subject to the approval of the tax authorities which are entitled to carry out subsequent inspections of taxpayers' records.

Notes to the financial statements (continued)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

(c) Regulatory requirements

The Agency is entitled to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

In addition to impairment allowances calculated and recognised in accordance with IFRS, the Bank also calculates impairment losses in accordance with the Agency regulations for capital adequacy calculation purposes.

The following table summarizes impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2018 are calculated in accordance with the methodology, as explained in Note 3 (l):

Summary of impairment allowances	31 December 2018	31 December 2017
Provisions for total balance-sheet items (Agency)	97.939	96.986
Provisions for total off-balance-sheet items (Agency)	8.003	7.627
	105.942	104.613
Impairment allowances under IFRS (including Other assets impairment)	77.579	66.624
Excess at the year end	28.363	37.989

Prior to 2012, any increase in allowance in accordance with the Agency regulations over amounts recognised under IFRS were required to be transferred to regulatory reserves from profit or retained earnings, upon the decision of the General Assembly. However, as explained in Note 3(l), based on the Decision on Minimum Standards of Capital Management and Asset Classification issued by the Agency in February 2013 any further shortfall in regulatory provisions after 31 December 2012 will be adjusted as a deduction of regulatory capital in the capital adequacy calculation without any transfer of this shortfall from retained earnings to regulatory reserves for credit losses within equity.

As presented in the above table, total Agency provisions exceeded provisions recognised under IFRS by BAM 28,363 thousand as at 31 December 2018 (31 December 2017: BAM 37,989 thousand). Out of this amount, BAM 18,286 thousand has been recognised as a regulatory reserve for credit losses within equity as at 31 December 2018 (31 December 2017: BAM 18,286 thousand). The remaining amount of BAM 10,077 thousand (31 December 2017: 19,703), which represents the current year end shortfall, in line with the Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be recorded as a reduction of regulatory capital, for capital adequacy calculation.

(d) Litigation and claims

The total amount of litigations and claims amounts to BAM 12,915 thousand (2017: BAM 9,154 thousand).

The Bank performs an individual assessment of all court cases and creates provisions in accordance with the assessment. The assessment of risks and proposal for provisions for legal cases is performed by the Legal Affairs Department and Finance Division, and a decision on the creation of provisions is made by the Bank's management.

As stated in Note 31, the Bank provided BAM 2,016 thousand (2017: BAM 1,485 thousand), which management estimates as sufficient. Since the estimate is made considering the specifics of each individual case based on the likelihood and magnitude of an outflow of resources.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks: credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, and interest rate risk.

The Bank has established an integrated system of risk management by introducing a set of policies and procedures for analysis, evaluation, acceptance and risk management. Taking risk is core to the financial services business and the operational risks are an inevitable consequence of being in business.

The Management Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.

Risk management is carried out by the Risk Management Division whose main purpose is to support financial operations, coordinate access to domestic and international financial markets, and oversee and manage financial risk through internal risk reports including analysis by size and level of the risk.

5.1 CREDIT RISK

5.1.1 Risk limit control and mitigation policies

The Bank takes on exposure to credit risk which is the risk that the counterparty will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Such risks are monitored on a revolving basis and are subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest payment and capital repayment obligations and by changing the lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. 'Settlement risk' is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transaction, the Bank mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval/limit monitoring process described earlier. Acceptance of settlement risk on free-settlement trades requires transaction-specific or counterparty-specific approvals from Bank Risk.

The limits of credit risk are determined in relation to the Bank's regulatory capital.

According to the Bank's policy, decision-making on exposure to credit risk is centralized and concentrated on the Credit Committee. Decisions of the Credit Committees are made upon consideration of proposals provided by the Risk Management Department. The terms for approval of each corporate loan are determined individually depending on client type, the loan's purpose, estimated creditworthiness and current market situation. Conditions for collateral are also determined according to client creditworthiness analysis, type of credit risk exposure, term of the placement as well as the placement amount.

Off-balance-sheet credit instruments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letter of credits carry the same risk as loans and are secured with similar collateral as are loans.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.2. Maximum exposure to credit risk before collateral held or other credit enhancement

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt instruments (2018) and available-for-sale debt assets (2017). For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 3 (z).

	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
Placements with other banks at amortized cost					
Performing – Stage 1	21.595	-	-	21.595	147.453
Total Gross	21.595	-	-	21.595	147.453
Less: impairment allowance	(1)	-	-	(1)	-
Carrying amount	21.594	-	-	21.594	147.453
Loans and receivables from customers at amortized cost					
Performing – Stage 1	1.368.750	-	-	1.368.750	-
Performing – Stage 2	-	76.197	-	76.197	-
Past due impaired	-	-	12.684	12.684	-
unlikely to pay	-	-	44.195	44.195	-
doubtful	-	-	1.999	1.999	-
Total Gross	1.368.750	76.197	58.878	1.503.825	1.342.225
Less: impairment allowance	(18.750)	(11.930)	(44.456)	(75.136)	(63.529)
Carrying amount	1.350.000	64.267	14.422	1.428.689	1.278.696
Debt instruments at FVOCI					
Performing - Stage1	579	-	-	579	65.836
Total Gross	579	-	-	579	65.836
Loss allowance	-	-	-	-	-
Carrying amount	579	-	-	579	65.836
Contingent liabilities					
Stage 1	118.909	-	-	118.909	-
Stage 2	-	2.572	-	2.572	-
Stage 3	-	-	-	-	-
Total Gross	118.909	2.572	-	121.481	114.185
Less: impairment allowance	(110)	(118)	-	(228)	(616)
Carrying amount	118.799	2.454	-	121.253	113.569
Loan commitments					
Stage 1	219.454	-	-	219.454	-
Stage 2	-	6.828	-	6.828	-
Stage 3	-	-	-	522	-
Total Gross	219.454	6.828	522	226.804	203.963
Less: impairment allowance	(1.205)	(591)	(219)	(2.014)	(1.829)
Carrying amount	218.249	6.237	303	224.790	202.135

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.3. Collateral held and other credit enhancements

During the year the Bank obtains financial and non-financial assets by taking possession of collaterals it holds as security or calling on other credit enhancements, in case of failure by the debtors to repay their due amounts. Such process of foreclosure involves mainly real estate, equipment, vehicles and deposits. Repossessed items are presented as such in the statement of financial position once they meet the criteria for recognition according to IFRS and local law. The policy of the Bank is to sell repossessed assets; during the period of possession and pending their final sale to third parties, the assets can be temporarily used if they are functional to the Bank's standard operations, or leased operationally to third parties.

The Bank's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Bank since the prior period.

Residential mortgage lending

The following tables stratify credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in house price indices. For credit-impaired loans the value of collateral is based on the most recent appraisals.

	Note	31 December 2018	31 December 2017
LTV ratio			
Less than 50%		29.310	29.295
51–70%		53.827	42.240
71–90%		28.924	34.827
91–100%		6.743	10.160
More than 100%		-	365
Total	23	118.804	116.887

Credit-impaired loans	2018
Less than 50%	547
51–70%	557
More than 70%	1,038
Total	2,142

Assets obtained by taking possession of collateral

Details of financial and non-financial assets obtained by the Bank during the year by taking possession of collateral held as security against loans and advances and held at the year end are shown below.

	2018	2017
Property	971	3.300
Other	45	45
Total	1.016	3.345

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.4 Amounts arising from ECL

(i) Significant increase in credit risk (SICR)

The Bank considers a financial instrument to have experienced a significant increase in credit risk when one or more of the quantitative or qualitative criteria have been met. Criteria for determining a significant increase in credit risk are defined for the proper allocation of exposure in "Stage 1" or "Stage 2".

Elements that will be the main determinants which need to be considered for the purpose of assessing the "steps" between the various "stages" are the following:

- Default probability change in relation to the moment of initial entry of the financial instrument in the financial statements. It is therefore an assessment implemented by adopting the "relative" criterion, which is configured as the main criteria;
- Eventual presence of due amount which remains overdue over 30 days. In the event of such case the credit risk of such exposure is considered "significantly increased" and is classified to Stage 2;
- Existence of "forbearance" measures;
- Qualitative information on credit quality deterioration due to which the client is included in the monitoring list;
- Certain indicators of the internal credit risk monitoring system and early warning system

Determining whether the specific factor is relevant, as well as its significance in relation to other factors, depends on the type of products and characteristics of the financial instrument. Consequently, it is not possible to define a unique set of factors that determine whether there has been a significant increase in credit risk.

(ii) Definition of default

Staging criteria are selected in line with IFRS9, and based on risk parameters available in the Bank. Main indicators that are used are transaction classification, Days past due, Forbearance, PCEM (watch list) Indicator and/or Early Warning System (EWS) model for Small Business, SME and Large Corporate portfolios. Considering that, Stage 3 is equal to Non-performing status of the loan, the key element in Stage assignment is recognition of increasing credit risk of a financial instrument. Significant increase of credit risk could be highlighted by qualitative indicators as:

- Past Due days
- Forborne status
- Early warning signals and/or Proactive Credit Management watch list status of the customer

In addition, forbearance measures could represent a significant increase in credit risk since they consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments.

Stage assignment for Loans:

Loan exposures towards Legal entities:

Condition - business condition (event) for assignment of stage	Stage
Risk class is Past Due, Unlikely to pay or Doubtful	3
DPD >30 with materiality threshold over 5% at reporting date	2
Early warning system shows significant deterioration in credit risk (currently the Bank used local risk class = B, PCEM flag and EWS flag)	2
Contract is Forborne	2
Exposures with credit deterioration: Lifetime PD Comparison (used for Sovereign, PSE, Banks – not for others segments)	2

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.4 Amounts arising from ECL (continued)

(ii) Definition of default (continued)

Loan exposures towards Retail:

Condition - business condition (event) for assignment of stage	Stage
Risk class is Past Due, Unlikely to pay or Doubtful	3
DPD >30 with materiality threshold over 5% at reporting date	2
Early warning signals for retail exposures show significant deterioration in credit risk: - Bank used local risk class = B*** , - flag indicating that Customer has canceled Overdraft with due amount of principal	2
Contract is Forborne	2

(iii) Inclusion of forward looking element

Projection of Lifetime credit risk parameters under IFRS 9 requires inclusion of forward looking macroeconomic elements, in order to estimate future point-in-times risk drivers.

Inclusion of forward looking macroeconomic effect is based on EBA stress test coefficients. EBA stress test coefficients are used for creation of scenario for the three years, relative to the starting point of every bank. Stress test coefficient are multipliers for risk parameters: PD, LGD and LR-Loss rate. This step includes calculation of PD conditioned by EBA Stress Test coefficients. Since EBA releases only Baseline and Adverse coefficients, Best scenario coefficients have to be estimated in order to include add-on component into Lifetime PD.

(iv) Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 3(w).

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Bank renegotiates loans to customers in financial difficulties (referred to as "forbearance activities") to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.4 Amounts arising from ECL (continued)

(iv) Modified financial assets (continued)

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank Credit Committee regularly reviews reports on forbearance activities.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired (see Note 3(w)(6)). A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to Stage 1.

(v) Expected Credit Loss Measurement

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. In general, the Bank calculates ECL using three main components: a probability of default ("PD"); a loss given default ("LGD"); and the exposure at default ("EAD").

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities.

(vi) Loss allowance

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument. Comparative amounts for 2017 represent the allowance account for credit losses and reflect the measurement basis under IAS 39.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.4 Amounts arising from ECL (continued)

(vi) Loss allowance (continued)

Loans and advances to customers at amortised cost

	2018			Total	2017		Total
	Stage 1	Stage 2	Stage 3		Individual	Collective	
Balance at 1 January	5.629	902	56.998	63.529	53.395	31.124	84.519
First time adoption of IFRS 9	12.131	12.829	742	25.702	-	-	-
Transfer to stage 1	21.839	(15.510)	(6.329)	-	-	-	-
Transfer to stage 2	(1.424)	2.672	(1.248)	-	-	-	-
Transfer to stage 3	(236)	(5.229)	5.465	-	-	-	-
Net remeasurement of loss allowance	(21.747)	13.665	13.921	5.839	3.890	4.141	8.031
New financial assets originated or purchased	10.837	6.987	2.717	20.541	-	-	-
Financial assets that have been derecognised	(8.265)	(4.382)	(9.615)	(22.262)	-	-	-
Write off-s	(1)	-	(17.442)	(17.443)	(25.041)	(2.412)	(27.453)
Unwind the discount	-	-	(372)	(372)	(1.597)	-	(1.597)
Foreign exchange and other movement	(13)	(4)	(381)	(398)	1.075	(1.046)	29
Balance at 31 December	18.750	11.930	44.456	75.136	31.722	31.807	63.529

5.1.5 Impaired financial assets – Comparative information under IAS 39

a) Loans to customers that are neither past due nor impaired

The quality of the portfolio of loans to customers that are neither past due nor impaired can be assessed through the internal standard monitoring system. Loans to customers are regularly monitored and systematically reviewed in order to identify any irregularities or warning signals. These loans are subject to constant monitoring with the aim of taking timely action based on improvement/deterioration of the client's risk profile.

An overview of gross exposure of loans to customers that are neither past due nor impaired according to the business segment and the type of loan is as follows:

	Retail loans			Total	Corporate loans		Total
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	
31 December 2018							
Standard monitoring	403.416	171.011	54.536	628.963	497.974	293.663	791.637
31 December 2017							
Standard monitoring	365.579	148.341	51.310	565.230	406.152	269.437	675.589

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.5 Impaired financial assets – Comparative information under IAS 39 (continued)

b) Past due but not impaired loans

Loans to and receivables from customers less than 90 days overdue are not considered as impaired, unless other information is available to indicate the contrary. The gross amount of loans to and receivables from customers that were past due but not impaired was as follows:

		Past due days			
	Gross amount	Until 30 days	31 – 60 days	61 – 90 days	Over 90 days
31 December 2018					
Corporate loans					
- Large	-	-	-	-	-
- Other	775	450	-	325	-
	775	450	-	325	-
Retail loans					
- Consumer	14,236	11,633	2,092	388	123
- Housing	6,940	5,536	1,085	242	77
- Credit Cards and overdrafts	2.396	93	1,825	452	26
	23,572	17,262	5,002	1,082	226
Total	24,347	17,712	5,002	1,407	226

	Dani dospijeća				
	Bruto iznos	do 30 dana	31 – 60 dana	61 – 90 dana	Preko 90 dana
31 December 2017					
Corporate loans					
- Large	1.020	-	-	1.020	-
- Other	60	-	60	-	-
	1.080	-	60	1.020	-
Retail loans					
- Consumer	12.527	10.083	2.042	269	133
- Housing	8.668	7.269	1.233	110	56
- Credit Cards and overdrafts	2.394	202	1.759	409	24
	23.589	17.554	5.034	788	213
Total	24.669	17.554	5.094	1.808	213

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.5 Impaired financial assets – Comparative information under IAS 39 (continued)

c) Non-performing loans

The breakdown of the gross and net amount of the loans to customers that are impaired along with the estimated value of related collateral held by the Bank as security (presented up to the maximum amount of the related exposure), are as follows:

	Retail loans			Total	Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	Total
31 December 2018							
Gross exposure	26.282	5.762	3.301	35.345	2.411	21.122	23.533
Impairment	(19.193)	(2.020)	(2.424)	(23.637)	(2.411)	(18.408)	(20.819)
Net	7.089	3.742	877	11.708	-	2.714	2.714
Rate of impairment	73%	35%	73%	67%	100%	87%	88%
Estimated value of collateral							
Mortgage	46	3.739	-	3.785	-	2.059	2.059
Total	46	3.739	-	3.785	-	2.059	2.059
	Retail loans			Total	Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	Total
31 December 2017							
Gross exposure	24.209	7.559	3.360	35.128	10.320	31.289	41.609
Impairment	(19.681)	(2.345)	(2.821)	(24.847)	(7.724)	(24.428)	(32.152)
Net	4.528	5.214	539	10.281	2.596	6.861	9.457
Rate of impairment	81%	31%	84%	71%	75%	78%	77%
Estimated value of collateral							
Mortgage	354	5.151	-	5.505	2.175	7.099	9.274
Total	354	5.151	-	5.505	2.175	7.099	9.274

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.6. Credit risk management and policies for impairment and provisions

The Bank accounts for counterparty risks arising from the loan portfolio by making allowances for impaired loans. At each reporting date, the Bank checks the existence of objective evidence of impairment of financial assets, as previously explained in Note 3.

Loans and receivables with renegotiated terms

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

The Bank renegotiates loans to customers in financial difficulties to maximise collection opportunities and minimise the risk of default (rescheduling). Rescheduling is mainly performed in response to initial deterioration of the clients' financial position or for the prevention of further deterioration of the clients' financial position. The revised terms usually include extending the maturity, changing the timing of interest payments and when possible obtaining additional instruments of collateral. Following the restructuring the loans remain graded as restructured until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash-flows and there are no other indicators of impairment. Gross carrying amount of loans with renegotiated terms amount to BAM 6,552 thousand for corporate loans and BAM 9,626 thousand for retail loans as at 31 December 2018 (2017: BAM 19,005 thousand for corporate and BAM 4,745 for retail loans.)

For the purpose of credit monitoring and the management of credit risk, the Bank divides its credit portfolio into the following groups:

- Performing loans – loans that are neither past due nor impaired
- Past due but unimpaired loans
- Non-performing loans for which impairment has been recognised

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.1 CREDIT RISK (CONTINUED)

5.1.7. Concentration of credit risk per geographic location

Geographic risk is highly concentrated on the state of Bosnia and Herzegovina. Geographic risk concentrations on net amounts of balance sheet exposure are as follows:

	Bosnia and Herzegovina	EU countries	Non-EU countries	Total
As at 31 December 2018				
Current accounts with the Central Bank and other banks	311.125	57.876	2.932	371.933
Reserves with the Central Bank	172.979	-	-	172.979
Placements with other banks	-	21.594	-	21.594
Financial assets at FVOCI	632	69	-	701
Loans and receivables from customers	1.428.689	-	-	1.428.689
Income tax prepayment	1.425	-	-	1.425
Other assets (without fixed assets)	6.444	2.640	-	9.084
	1.921.294	82.179	2.932	2.006.405

	Bosnia and Herzegovina	EU countries	Non-EU countries	Total
As at 31 December 2017				
Current accounts with the Central Bank and other banks	193.366	95.205	5.614	294.185
Obligatory reserves with the Central Bank	147.453	-	-	147.453
Placements with other banks	-	14.636	-	14.636
Debt securities available for sale	65.836	-	-	65.836
Loans and receivables from customers	1.278.696	-	-	1.278.696
Income tax prepayment	2.747	-	-	2.747
Other assets (without fixed assets)	6.480	3.070	-	9.550
	1.694.578	112.911	5.614	1.813.103

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.2 LIQUIDITY RISK MANAGEMENT

Liquidity risk is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank maintains its liquidity profiles in accordance with regulations laid down by the Banking Agency.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash-settled derivatives. The Bank 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 Bank 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 following tables show the remaining contractual maturities of the Bank's assets and liabilities as at 31 December 2018 and 31 December 2017, except for financial assets at fair value through other comprehensive income which have been classified in accordance with their secondary liquidity characteristic as maturing within one month and obligatory reserves which have been classified in the maturity period within one month. Other items of assets and liabilities that have no contractual maturities are classified as having a remaining maturity of over 5 years.

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2018						
Assets						
Cash and cash equivalents	406.414	-	-	-	-	406.414
Reserves with the Central Bank	172.979	-	-	-	-	172.979
Placements with other banks	21.594	-	-	-	-	21.594
Financial assets at fair value through other comprehensive income	-	-	579	-	122	701
Financial assets at fair value through profit or loss	2	247	-	-	163	412
Loans and receivables from customers	71.627	106.602	345.298	626.737	278.425	1.428.689
Income tax prepayment and other assets	11.506	-	-	-	-	11.506
Property and equipment and intangible assets	-	-	-	-	18.525	18.525
Total assets	684.122	106.849	345.877	626.737	297.235	2.060.820
Liabilities and equity						
Due to banks and other financial institutions	35.204	148.659	174.632	74.746	23.166	456.407
Due to customers	718.325	41.351	181.038	330.617	18.754	1.290.085
Financial liabilities at fair value through profit or loss	2	163	-	-	-	165
Other liabilities and deferred tax	33.287	-	-	-	193	33.480
Provision for liabilities and charges	-	-	-	-	5.063	5.063
Share capital and reserves	-	-	-	-	275.620	275.620
Total liabilities and equity	786.818	190.173	355.670	405.363	322.796	2.060.820
Maturity gap	(102.696)	(83.324)	(9.793)	221.374	(25.561)	-

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.2 LIQUIDITY RISK MANAGEMENT (CONTINUED)

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2017						
Assets						
Cash and cash equivalents	323.643	-	-	-	-	323.643
Reserves with the Central Bank	147.453	-	-	-	-	147.453
Placements with other banks	14.636	-	-	-	-	14.636
Financial assets available for sale	65.836	-	-	-	116	65.952
Financial assets at fair value through profit or loss	-	181	-	-	426	607
Loans and receivables from customers	94.563	95.170	324.356	538.868	225.739	1.278.696
Income tax prepayment and other assets	14.914	-	-	-	-	14.914
Property and equipment and intangible assets	-	-	-	-	21.151	21.151
Total assets	661.045	95.351	324.356	538.868	247.432	1.867.052
Liabilities and equity						
Due to banks and other financial institutions	23.976	105.730	49.718	132.191	11.421	323.036
Due to customers	685.962	33.096	224.269	276.477	21.896	1.241.700
Financial liabilities at fair value through P&L	-	148	-	-	-	148
Subordinated debt	-	41	80	-	-	121
Other liabilities	27.916	-	-	-	114	28.030
Provisions for liabilities and charges	-	-	-	-	4.701	4.701
Share capital and reserve	-	-	-	-	269.316	269.316
Total liabilities and equity	737.854	139.015	274.067	408.668	307.448	1.867.052
Maturity gap	(76.809)	(43.664)	50.289	130.200	(60.016)	-

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.2 LIQUIDITY RISK MANAGEMENT (CONTINUED)

Future cash flows for interest bearing liabilities

The estimated future cash flows for the Bank's interest bearing liabilities, including expected interest as at 31 December 2018 and as at 31 December 2017 are shown in the following table:

	Total expected outflow					Total	Carrying value
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years		
31 December 2018							
Liabilities							
Due to banks and other financial institutions	24.842	130.583	165.204	115.784	24.272	460.685	456.407
Due to customers	718.322	42.533	184.868	343.588	19.278	1.308.589	1.290.085
Total expected outflow	743.164	173.116	350.072	459.372	43.550	1.769.274	1.746.492

	Total expected outflow					Total	Carrying value
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years		
31 December 2017							
Liabilities							
Due to banks and other financial institutions	21.272	107.598	51.970	134.330	11.515	326.685	323.036
Due to customers	688.540	32.788	227.616	286.291	22.568	1.257.803	1.241.700
Subordinated debt	-	41	81	-	-	122	121
Total expected outflow	709.812	140.427	279.667	420.621	34.083	1.584.610	1.564.857

The following table sets out the components of the Bank's liquidity reserves:

	2018	2017
Balance with central banks	310.292	193.366
Cash and balances with other banks	61.674	100.871
Other cash and cash equivalents	34.480	29.458
Total liquidity reserves	406.446	323.695

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK

The Bank is exposed to market risk which is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, foreign currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The Management Board sets limits and guidelines for monitoring and mitigating market risks which is regularly monitored by the Risk Management Department of the Bank.

5.3.1. Foreign exchange risk

Exposure to currency risk arises from credit, deposit-taking and trading activities and is controlled on a daily basis in accordance with legal and internal limits for each currency as well as in total amounts for assets and liabilities denominated in or linked to foreign currencies.

In order to manage foreign exchange rate risk more efficiently, the Bank monitors economic and other business changes in the environment in order to predict possible changes in foreign currency activities, exchange rates, and foreign currency risk.

Overall exposure to foreign exchange risks is monitored within Risk Management Department using techniques such as Value-at-Risk ("VaR") and stress testing.

FX Value-at-Risk is an individual, concise, statistical measurement of possible losses in the portfolio. VaR is a measurement of loss under normal movements of risk factors on the market. The likelihood of losses higher than VaR occurring is expected to be low.

The main model assumptions are:

- Being based on the historical methodology
- 99 percent as a confidence interval for Value-at-Risk computation
- One-day held period

The model covers foreign currency risk – valid for foreign currency transactions and positions denominated on foreign currencies; resulting from foreign currency rate volatility.

The model can compute VaR at different aggregation levels – from a single position to any sub-portfolio level. Therefore, the model allows a detailed analysis of risk profiles for the multi-level portfolio hierarchy and diversity effects occurring. Furthermore, VaR measurement can be expounded based on risk source (risk factors). These features of a more detailed risk monitoring system allow the determination of an efficient limit structure which can be compared through different organisational units.

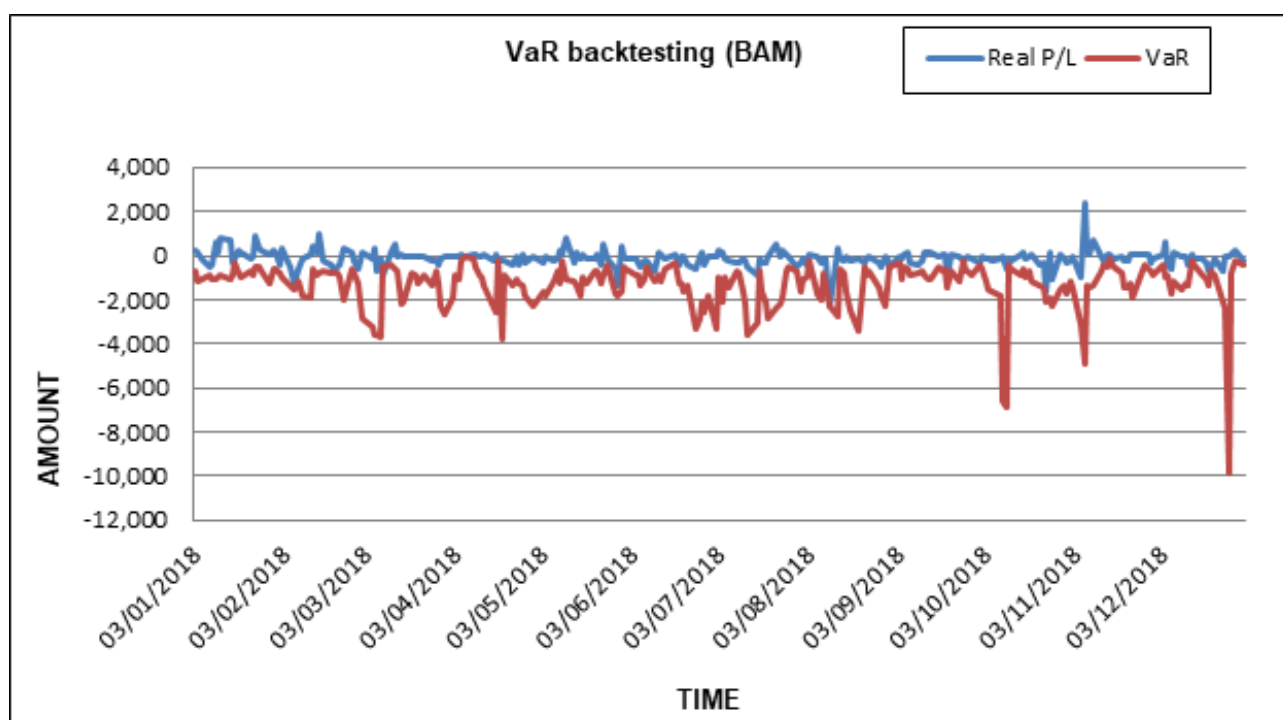
The quality of the implemented risk measurement model is constantly assessed. The Bank performs back-testing of the computed VaR measures with the actual gain and losses for the same period.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK (CONTINUED)

5.3.1. Valutni rizik (nastavak)



During 2018, the Bank improved the model for calculation of VaR in accordance with best practices and as a result, the Bank recorded 3 back-testing exceptions (results for 2017: 2 exceptions) when actual losses exceeded the daily VAR amount.

The Bank is exposed to foreign currency risk when there is no matching between assets and liabilities and off-balance sheet positions due to cash flows denominated in foreign currencies. Portfolio exposure to foreign currency risk arises from portfolio sensitivity to fluctuations in exchange rate values. The degree of foreign currency risk depends on the amount of open positions and the degree of potential change in foreign currency rates.

The Bank considers that it is not currently exposed to foreign currency risk related to EUR due to the fact that Convertible Mark is pegged to EURO (1 EUR = BAM 1.955830). Exposure is more prominent for USD and CHF. The Bank performs stress testing based on the assumption of a 10% increase or decrease in foreign currency rates against the relevant local currency. The sensitivity rate of 10% is used when reporting internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. Stress testing is performed on an annual basis. The results of the most recent test performed are presented here below:

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK (CONTINUED)

5.3.1. Foreign exchange risk (continued)

31 December 2018			
Currency	Open position (in BAM)	Stress Test	
		10% Move Up	10% Move Down
CHF	60.135	(6.014)	6.014
GBP	(3.667)	367	(367)
USD	(15.396)	1.540	(1.540)
HRK	(18.949)	1.895	(1.895)
CAD	11.784	1.178	(1.178)
SEK	5.468	(547)	547
Other	26.894	(2.689)	2.689
EUR	876.511	-	-

31 December 2017			
Currency	Open position (in BAM)	Stress Test	
		10% Move Up	10% Move Down
CHF	5.488	(549)	549
GBP	761	(76)	76
USD	(83.880)	8.388	(8.388)
HRK	8.766	(877)	877
CAD	3.934	(393)	393
SEK	5.941	(594)	594
Other	10.415	(1.042)	1.042
EUR	(30.401.288)	-	-

The analysis outlined above is based on the open foreign currency position of the Bank, which includes all asset and liability and off-balance-sheet positions.

If the currency position of a foreign currency is "long" (assets exceeding liabilities) and the exchange rate for this currency increases/(decreases) in relation to the BAM, the Bank will experience a foreign exchange gain/(loss).

If the currency position of a foreign currency is "short" (liabilities exceeding assets) and the exchange rate for this currency (increases)/decreases in relation to BAM, the Bank will experience a foreign exchange (loss)/gain.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank monitors its foreign exchange (FX) position for compliance with the regulatory requirements of the Banking Agency of the Federation of Bosnia and Herzegovina established in respect of limits on open positions. The Bank seeks to match assets and liabilities denominated in foreign currencies to avoid foreign currency exposures.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK (CONTINUED)

5.3.1. Foreign exchange risk (continued)

Foreign exchange position

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2018 and 31 December 2017. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by currency. The Bank has a number of agreements governed by a foreign currency clause. The BAM value of principal in such agreements is determined by the movement in foreign exchange rates. The principal balance of the related exposure is included in the table below in the column "EURO linked".

The Bank had the following significant currency positions:

31 December 2018	EURO	EURO linked	EURO total	USD	Other FX	BAM	Total
Assets							
Cash and cash equivalents	59.120	-	59.120	2.441	8.765	336.088	406.414
Reserves with the Central Bank	-	-	-	-	-	172.979	172.979
Placement with other banks	5	-	5	20,150	1,439	-	21,594
Financial assets at fair value through other comprehensive income	69	-	69	-	-	632	701
Financial assets at fair value through profit or loss	-	-	-	-	249	163	412
Loans and receivables from customers	3	865.194	865.197	-	-	563.492	1.428.689
Income tax prepayment	-	-	-	-	-	1.425	1.425
Deferred tax assets	-	-	-	-	-	255	255
Other asset	2.418	-	2.418	28	-	7.380	9.826
Property and equipment and intangible assets	-	-	-	-	-	18.525	18.525
Total assets	61.615	865.194	926.809	22.619	10.453	1.100.939	2.060.820
Liabilities and equity							
Due to banks and other financial Institutions	446.811	-	446.811	-	1.040	8.556	456.407
Due to customers	434.306	105.014	539.320	22.563	8.997	719.205	1.290.085
Financial liabilities at fair value through profit or loss	165	-	165	-	-	-	165
Subordinated debt	-	-	-	-	-	-	-
Other liabilities	3.149	-	3.149	44	10	30.227	33.430
Provision for liabilities and charges	-	-	-	-	-	5.063	5.063
Deferred tax liabilities	-	-	-	-	-	50	50
Share capital and reserves	-	-	-	-	-	275.620	275.620
Total liabilities and equity	884.431	105.014	989.445	22.607	10.047	1.038.721	2.060.820
Net foreign exchange position	(822.816)	760.180	(62.636)	12	406	62.218	-

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK (CONTINUED)

5.3.1. Foreign exchange risk (continued)

31 December 2017	EURO	EURO linked	EURO total	USD	Other FX	BAM	Total
Assets							
Cash and cash equivalents	88.948	-	88.948	5.487	13.453	215.755	323.643
Obligatory reserves with the Central Bank	-	-	-	-	-	147.453	147.453
Placements with other banks	9	-	9	14.627	-	-	14.636
Financial assets available for sale	64	-	64	-	-	65.888	65.952
Financial assets at fair value through profit or loss	426	-	426	-	-	181	607
Loans and receivables from customers	221	740.324	740.545	-	-	538.151	1.278.696
Income tax prepayment	-	-	-	-	-	2.747	2.747
Deferred tax assets	-	-	-	-	-	178	178
Other asset	2.432	-	2,432	35	-	9,522	11,989
Property and equipment and intangible assets	-	-	-	-	-	21,151	21,151
Total assets	92.100	740.324	832.424	20.149	13.453	1.001.026	1.867.052
Liabilities and equity							
Due to banks and other financial institutions	308.483	-	308.483	-	745	13.808	323.036
Due to customers	498.279	99.997	598.276	20.156	12.549	610.719	1.241.700
Financial liabilities at fair value through profit or loss	-	-	-	-	-	148	148
Subordinated debt	-	-	-	-	-	121	121
Other liabilities	2.008	-	2.008	32	101	25.847	27.988
Provision for liabilities and charges	-	-	-	-	-	4.701	4.701
Deferred tax liability	-	-	-	-	-	42	42
Share capital and reserves	-	-	-	-	-	269.316	269.316
Total liabilities and equity	808.770	99.997	908.767	20.188	13.395	924.702	1.867.052
Net foreign exchange position	(716.670)	640.327	(76.343)	(39)	58	76.324	-

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK (CONTINUED)

5.3.2. Interest rate risk

Interest rate risk is defined as the exposure of a Bank's financial condition to adverse movements in interest rates, referring to the banking book, meaning the set of on- and off-balance-sheet financial assets and liabilities which are part of the core lending and deposit collecting activities performed by the Bank.

The Bank is exposed to interest rate risk as the Bank borrows and lends funds at both fixed and floating interest rates. The risk is managed by the Bank by maintaining an appropriate mix between fixed and floating rate borrowings and lending.

Interest rate risk reflects the possibility of loss of profit and/or erosion of capital due to a change in interest rates. It relates to all products and balances that are sensitive to changes in interest rates. This risk comprises two components: income component and investment component.

The income component arises from a lack of harmonisation between the active and passive interest rates of the Bank (interest on placements is fixed, interest for liabilities is floating and vice versa).

The investment component is a consequence of the inverted relationship between price and interest rate fluctuations of securities.

The Bank strives to protect itself from interest rate risk by harmonizing the type of interest rate (fixed and floating), currency, related interest rate and the date of interest rate change for all products for which it concludes contracts (which are sensitive to interest rate changes). Any mismatch among the abovementioned elements results in exposure of the Bank to interest rate risk.

The adopted system operates at an analytical level commensurate to the complexity and risk of the banking book, and ensures that the risk profile can be examined from two separate, but complementary, perspectives:

- The economic value perspective, which considers the impact of changes in interest rates and related volatilities on the present value of all future cash flows;
- The earnings perspective, focused on analysing the impact that changes in interest rates and related volatilities generate on the net interest income and, therefore, on the related effects on interest margin.

The Bank uses the following methods to measure interest rate risks:

- Shift sensitivity of fair value;
- Shift sensitivity of the interest margin.

The shift sensitivity of fair value measures the changes in economic value of a financial portfolio resulting from a parallel shift in the discount curves. The total value of shift sensitivity is broken down by time bucket (bucket analysis), in order to identify the distribution of risk over the time axis. The operating limit currently in force for shift sensitivity of fair value (by +100 bp parallel shift of yield curves) amounts to BAM 5,867 / BAM -15,647 thousand (EUR 3,000 / EUR 8,000 thousand). The limit is set up by the Bank with the aim of keeping exposure within low levels which are compatible with self-imposed risk parameters.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.3. MARKET RISK (CONTINUED)

5.3.2. Interest rate risk (continued)

If changes in interest rates had been 100 basis points higher and all other variables were held constant at 31 December 2018, the effect, in terms of economic value of interest risk-sensitive balance-sheet portfolios, would have been BAM -9,631 thousand (31 December 2017: BAM -2,556 thousand).

In 2018 the Bank established the limit by time-buckets on the following way:

Shift Sensitivity Limit (+100 bp)

TOTAL	0-18 months	18 months - 5 years	above 5 years
BAM 5,867 thousand / BAM -15,647 thousand (3 mio EUR / -8 mio EUR)	+/- BAM 3,912 thousand (+/- 2 mio EUR)	BAM 5,867 thousand / BAM -7,823 thousand (3 mio EUR / -4 mio EUR)	BAM 5,867 thousand / BAM -9,779 thousand (3 mio EUR / -5 mio EUR)

The results of the analysis of the shift sensitivity of fair value are below the current operating limit and are presented in the table below:

Shift Sensitivity (+100b.p)	31 December 2018				31 December 2017			
	TOTAL	0-18 months	18 months - 5 years	over 5 years	TOTAL	0-18 months	18 months - 5 years	over 5 years
EUR	(4.632)	(111)	807	(5.328)	1.678	169	1.424	85
USD	220	55	160	5	76	27	49	-
CHF	13	8	5	-	13	6	7	-
BAM	(5.232)	(148)	(2.062)	(3.022)	(4.323)	(1.677)	(1.728)	(918)
Other currencies	1	1	-	-	3	2	1	-
Total	(9.630)	(195)	(1.090)	(8.345)	(2.553)	(1.473)	(247)	(833)

The sensitivity of the interest margin quantifies instead the short-term (twelve months) impact on the interest margin of a parallel, instantaneous and permanent shock in the interest rate curve. This measure highlights the effect of changes in interest rates on the portfolio being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a predictor of the future levels of the interest margin. The operating limit currently in force for shift sensitivity of interest margin (by -50 bp parallel shift of yield curves) amounts to BAM -4,890 thousand (EUR -2,500 thousand).

The result of shift sensitivity of the interest margin, if changes in interest rates market moving had been 100 basis points higher and all other variables were held constant at 31 December 2018 is an increase of BAM 1,234 thousand (31 December 2017: BAM 3,670 thousand), while if changes in interest rates market moving had been 100 basis points lower the result is decrease of BAM 2,422 thousand as of 31 December 2018 (31 December 2017: decrease of BAM 5,489 thousand). In addition, the Bank also prepares shift sensitivity of the interest margin based on the sensitivity range of +50/-50 bps. Increase by 50 bps of interest rates would increase the result for the year by BAM 1,234 thousand, while a decrease by 50 bps in interest rates would decrease result for the year by BAM 1,914 thousand as of 31 December 2018 (31 December 2017: BAM 1,863 thousand for +50 bps and decrease of BAM 2,597 thousand for -50 bps).

In order to measure the Bank's vulnerability under stressful market conditions the interest rate risk measurement system adopted by the Bank allows a meaningful evaluation of the effect of stressful market conditions on the Bank ("scenario analysis"), or rather abrupt changes in the general level of interest rates, changes in the relationships among key market rates (i.e. basis risk), changes in the slope and the shape of the yield curve (i.e. yield curve risk), changes in the liquidity of key financial markets or changes in the volatility of market rates.

Notes to the financial statements

(continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.4. CAPITAL MANAGEMENT

The Bank's objectives for capital management, which is a broader concept, in the opinion of the Management Board, than the 'equity' shown in the statement of financial position, are as follows:

- to comply with the capital requirements set by the regulators of the banking markets in the local environment;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital position to support the development of its business activities.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, employing techniques based on the guidelines developed by Banking Agency of Federation of Bosnia and Herzegovina for supervisory purposes. The required information is filed with the Agency on a quarterly basis.

The Bank's regulatory capital for monitoring adequacy according to the Agency's methodology consists of:

- Tier 1 Capital or Core Capital: share capital (net of the carrying value of treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; amount of revaluation reserves arising from the effects of changes in the fair value of assets and audited profit for the current period, upon approval and retention by the General Shareholders Assembly;
- Tier 2 Capital or Supplementary Capital: qualifying principal amounts of subordinated loan capital, collective impairment allowances in accordance with FBA regulation and Adjustment for shortfall in regulatory reserve.
- Deductible items.

Risk-weighted assets are measured by means of a hierarchy of weightings in accordance with FBA regulation classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance-sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.4. CAPITAL MANAGEMENT (CONTINUED)

The table below summarises the computation of regulatory capital and the capital adequacy ratio of the Bank as of 31 December 2018 and 31 December 2017, taken from the calculations submitted to the Agency in respect of those period-ends.

	31 December 2018	31 December 2017
Tier 1 capital		
Share capital	44.782	44.782
Share premium	57.415	57.415
Retained earnings and other reserves	134,858	122.963
Deferred tax assets	-	(178)
Intangible assets	(5.582)	(6.574)
Total qualifying Tier 1 Capital	231.473	218.408
Tier 2 capital		
General provisions – FBA regulations	17.081	19.238
Fair value reserves, positive	-	175
Adjustment for shortfall in regulatory reserve	(10.077)	(19.703)
Total qualifying Tier 2 Capital	7.004	(290)
Total regulatory capital	238.477	218.118
Capital requirements (*)		
Risk weighted assets	1.366.467	1.444.536
Operational risk	156.495	94.521
Total	1.522.962	1.539.057
Capital adequacy ratio	15,66%	14,17%

(*) Capital requirements stated above are calculated in accordance with FBA regulatory requirements.

Notes to the financial statements (continued)

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

5.4. CAPITAL MANAGEMENT (CONTINUED)

In accordance with the Agency regulations, Tier 1 capital does not include the balance on the regulatory reserve for credit losses (BAM 18,286 thousand at 31 December 2018) which is part of net equity in the statement of financial position. However, general provisions calculated in accordance with Agency rules (BAM 17,081 thousand at 31 December 2018) are included as Tier 2 capital.

In addition, an adjustment is made for the shortfall in regulatory reserves in respect of any additional requirements calculated at the reporting date (date of submission of the capital adequacy calculation to the Agency, which, in accordance with local regulations, is performed on a quarterly basis). For 2018 this amounted to BAM 10,077 thousand (2017: 19,703 thousand).

In accordance with the Agency regulations, the Decision on minimum standards for capital management of banks and capital protection dated 24 October 2018 (Official Gazette of the Federation of BiH 81/17), Article 6(3) audited profit for the year is included in the calculation of regulatory capital from the date when the audited financial statements for the period have been issued and approved by the General Shareholders Assembly. If current year profit would be included in Retained earnings, CAR would be 16.93% (15.79%).

Given the structure of Core and Supplementary capital, Core Capital ratio is almost equivalent to total CAR and reached 15.20% at the end of 2018 (minimum level: 9.0%). Leverage ratio reached 10.65% as of 31 December 2018 (regulatory limit: 6.0%).

Notes to the financial statements (continued)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair values using other valuation techniques.

6.1. VALUATION MODELS

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurement.

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premium used in estimating discount rates, bond and equity prices, foreign exchange rates, equity prices and expected price volatilities and correlations.

The objective of valuation techniques is to arrive at fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Bank determines the fair value of debt securities (treasury bills and bonds) using an internal valuation model which considers their remaining maturity and the latest available auction prices of equivalent instruments. The fair value of foreign currency forward derivatives is estimated using available market data for FX spot and cash curves of relevant currencies. Based on such inputs, forward points and forward rates are computed, which are then used for daily mark-to-market of outstanding deals.

The fair value of equity securities classified through other comprehensive income and at fair value through profit or loss traded on an active market is based on closing bid prices at the reporting date for these securities.

Notes to the financial statements (continued)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

6.2. FINANCIAL INSTRUMENTS AT FAIR VALUE – FAIR VALUE HIERARCHY

The following table analyses financial instruments measured at fair value at the reporting date distributed according to the fair value hierarchy. The amounts are based on the values recognised in the statement of financial position.

31 December 2018	Note	Level 1	Level 2	Level 3	Total
Financial assets at fair value through other comprehensive income 22 a)					
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina		-	579	-	579
Equity securities issued by non-resident legal entities		-	69	-	69
Equity securities issued by resident legal entities		-	52	-	52
Financial assets available at fair value through profit and loss 22 b)					
Equity shares		163	-	-	163
Derivatives held for trading – OTC product		-	249	-	249
Total		163	949	-	1,112
Financial liabilities available at fair value through profit and loss 22 c)					
Derivatives held for trading – OTC product		-	165	-	165
Total		-	165	-	165
31 December 2017					
	Bilješka	Nivo 1	Nivo 2	Nivo 3	Ukupno
Financial assets available for sale 22 a)					
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina		-	65.836	-	65.836
Equity securities issued by non-resident legal entities		-	64	-	64
Equity securities issued by resident legal entities		-	52	-	52
Financial assets available at fair value through profit and loss 22 b)					
Equity shares		426	-	-	426
Derivatives held for trading – OTC product		-	181	-	181
Total		426	66.133	-	66.559
Financial liabilities available at fair value through profit and loss 22 c)					
Derivatives held for trading – OTC product		-	148	-	148
Total		-	148	-	148

Notes to the financial statements (continued)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

6.3. FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised.

31 December 2018	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	34.480	371.934	406.414	406.414
Reserves with the Central Bank	-	-	172.979	172.979	172.979
Placements with other banks	-	21.594	-	21.594	21.594
Loans and receivables from customers	-	220.156	1.202.746	1.422.899	1.428.689
Total	-	276.227	1.747.659	2.023.886	2.029.676
Liabilities					
Due to banks and other financial institutions	-	266.860	178.485	445.345	456.407
Due to customers	-	766.146	523.646	1.289.792	1.290.085
Total	-	1.033.006	702.131	1.735.137	1.746.492
31 December 2017	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	29.458	294.185	323.643	323.643
Reserves with the Central Bank	-	-	147.453	147.453	147.453
Placements with other banks	-	14.636	-	14.636	14.636
Loans and receivables from customers	-	246.840	1.019.453	1.266.293	1.278.696
Total	-	290.934	1.461.091	1.752.025	1.764.428
Liabilities					
Due to banks and other financial institutions	-	134.055	187.628	321.683	323.036
Due to customers	-	712.827	530.565	1.243.392	1.241.700
Subordinated debt	-	-	122	122	121
Total	-	846.882	718.315	1.565.197	1.564.857

Notes to the financial statements (continued)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

6.3. FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE (CONTINUED)

In estimating the fair value of the Bank's financial instruments and in assigning the instruments to the relevant level of fair value hierarchy, the methods, assumptions and limitations described below apply in accordance with the approach revised at Intesa Sanpaolo Group.

Cash and cash equivalents

The carrying values of cash and balances with banks are generally deemed to approximate their fair value. Obligatory reserve with the Central Bank is classified as Level 3, as well as, on demand balances versus financial institutions in consideration of the fact that the setting of their exit price could include subjective valuations of the counterparty's credit risk difficult to quantify.

Placements with other banks

Placements with banks mostly represent overnight and short term deposits; hence there is no significant difference between the fair value of these deposits and their carrying value. Their classification to Level 2 of the fair value hierarchy depends on the absence, or low relevance, of non-observable parameters in setting their exit price.

Loans and receivables from customers, amounts due to customers, banks and other financial institutions

Fair value is estimated through discounted cash flow method in case of positions with residual medium-long term maturities, while it is approximated with the book value, net of collective impairment/individual adjustment in case of short-term loans, loans payable on demand or with an indefinite maturity for impaired loans.

For the purpose of division by fair value level, non performing/impaired assets are classified in Level 3, since the exit price is significantly influenced by the forecasts for losses determined by the credit officer based on future cash flow expectations and the related collection schedules. This entity specific assessment component outweighs other components (as, for example market interest rates), leading to attribution of Level 3 in the hierarchy.

Performing loans with original maturity equal or lower than 12 months, as well as short-term liabilities to customers and banks are classified into Level 2 of the fair value hierarchy, due to the absence or low relevance of non-observable parameters in setting their exit prices.

Medium-long term loans and liabilities with customers, banks and other financial institutions are classified into Level 3 of the fair value hierarchy, considering the relevance of entity specific assessment components in estimating the exit price.

Notes to the financial statements (continued)

7. OPERATING SEGMENTS

On a regular basis, the Bank's management analyses the overall results of the Bank with reference to the contributions by individually significant operating segments. Corporate, Retail and Treasury business lines have been identified as relevant operating segments, insofar as financial products managed by each of them and the respective counterparties with whom each segment enters into negotiation are specific for each segment and are not managed by / related to any of the others.

Even though lending and fund collection are actually performed by all operating segments, the financial characteristics of the loans, deposits and credit lines managed are specifically designed for each of them and are applicable only to counterparties related to each specific segment.

The financial results of each operating segment are recorded through a combined methodology of "direct" and "indirect" allocation of income and cost. Income is mainly directly allocated to the respective segment where it was generated, while costs are directly allocated whenever they are identified as immediately generated within the operating segment and are indirectly charged to the operating segments whenever they are sustained by central organisational units.

An internal transfer rate methodology is also applied for allocation of the cost of funding to the operating segments.

Profit or loss statement items in the tables presented below on segment information are in the format used for management reporting purposes.

Notes to the financial statements (continued)

7. OPERATING SEGMENTS (CONTINUED)

Segmental information for the year ending 31 December 2018

	Retail	Corporate	Treasury	Total
Interest income	49.934	26.175	564	76.673
Interest expense	(7.903)	(3.692)	(523)	(12.118)
Net interest income	42.031	22.483	41	64.555
Fee and commission income	21.483	8.128	363	29.974
Fee and commission expense	(5.035)	(793)	(22)	(5.850)
Net fee and commission income	16.448	7.335	341	24.124
Net profit of trading activities and foreign exchange	-	-	1.947	1.947
Other operating income/expense	(3.712)	(2.421)	(337)	(6.470)
Operating income/expense	(3.712)	(2.421)	1.610	(4.523)
Personnel expense	(15.886)	(4.594)	(611)	(21.091)
Other administrative expense	(14.485)	(3.540)	(816)	(18.841)
Depreciation expense	(3.259)	(452)	(57)	(3.768)
Operating expense	(33.630)	(8.586)	(1.484)	(43.700)
Profit before impairment losses, and other provisions and income tax	21.137	18.811	508	40.456
Reversal of Impairment / (Impairment losses) and provisions	(8.442)	5.727	2.821	106
PROFIT BEFORE INCOME TAX	12.695	24.538	3.329	40.562
Income tax	-	-	-	(4.222)
NET PROFIT FOR THE YEAR	-	-	-	36.340

Notes to the financial statements (continued)

7. OPERATING SEGMENTS (CONTINUED)

Segmental information as at 31 December 2018

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	34.480	-	371.934	406.414
Obligatory reserves with the Central Bank	-	-	172.979	172.979
Placements with other banks	-	-	21.594	21.594
Financial assets at fair value through other comprehensive income	-	-	701	701
Financial assets at fair value through profit or loss	-	-	412	412
Loans and receivables from customers	645.569	783.120	-	1.428.689
Other unallocated amounts	-	-	-	30.031
TOTAL ASSETS	680.049	783.120	567.620	2.060.820
Due to banks and other financial institutions	-	26.681	429.726	456.407
Due to customers	631.448	658.637	-	1.290.085
Financial liabilities at fair value through profit or loss	-	-	165	165
Other unallocated amounts	-	-	-	38.543
TOTAL LIABILITIES	631.448	685.318	429.891	1.785.200

Notes to the financial statements (continued)

7. OPERATING SEGMENTS (CONTINUED)

Segmental information for the year ending 31 December 2017

	Retail	Corporate	Treasury	Total
Interest income	48.911	25.671	953	75.535
Interest expense	(9.987)	(4.263)	(486)	(14.736)
Net interest income	38.924	21.408	467	60.799
Fee and commission income	19.428	7.738	286	27.452
Fee and commission expense	(4.159)	(756)	(34)	(4.949)
Net fee and commission income	15.269	6.982	252	22.503
Net profit of trading activities and foreign exchange	-	-	2.097	2.097
Other operating income/expense	(3.903)	(1.543)	(447)	(5.893)
Operating income/expense	(3.903)	(1.543)	1.650	(3.796)
Personnel expense	(15.726)	(4.723)	(603)	(21.052)
Other administrative expense	(14.228)	(3.153)	(636)	(18.017)
Depreciation expense	(3.419)	(455)	(67)	(3.941)
Operating expense	(33.373)	(8.331)	(1.306)	(43.010)
Profit before impairment losses, and other provisions and income tax	16.917	18.516	1.063	36.496
Impairment losses and provisions	(4.724)	(3.737)	103	(8.358)
PROFIT BEFORE INCOME TAX	12.193	14.779	1.166	28.138
Income tax	-	-	-	(3.228)
NET PROFIT FOR THE YEAR	-	-	-	24.910

Notes to the financial statements (continued)

7. OPERATING SEGMENTS (CONTINUED)

Segmental information as at 31 December 2017

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	29.458	-	294.185	323.643
Obligatory reserves with the Central Bank	-	-	147.453	147.453
Placements with other banks	-	-	14.636	14.636
Financial assets available for sale	-	-	65.952	65.952
Financial assets at fair value through profit or loss	-	-	607	607
Loans and receivables from customers	595.759	682.937	-	1.278.696
Other unallocated amounts	-	-	-	36.035
TOTAL ASSETS	625.217	682.937	522.833	1.867.022
Due to banks and other financial institutions	-	31.170	291.866	323.036
Due to customers	601.642	636.766	3.292	1.241.700
Financial liabilities at fair value through profit or loss	-	-	148	148
Subordinated debt	-	-	121	121
Other unallocated amounts	-	-	-	32.730
TOTAL LIABILITIES	601.642	667.936	295.427	1.597.735

Notes to the financial statements (continued)

8. INTEREST INCOME

	2018	2017
Retail clients	47.440	46.696
Corporate clients	28.621	27.839
Banks and other financial institutions	411	289
Interest on available-for-sale financial assets	-	711
Interest on financial assets through other comprehensive income	201	-
	76.673	75.535

9. INTEREST EXPENSE

	2018	2017
Retail clients	6.944	9.131
Corporate clients	3.204	3.674
Banks and other financial institutions	1.967	1.912
Other	3	19
	12.118	14.736

10. FEE AND COMMISSION INCOME

	2018	2017
Credit card business	9.005	8.007
Domestic payment transactions	5.556	5.017
Account service fee	4.250	4.114
Foreign payment transactions	3.204	3.207
Guarantees	2.225	1.945
Loans to clients	2.124	1.887
FX transactions	1.669	1.597
Agency services	79	85
Other	1.862	1.593
	29.974	27.452

Other fee and commission income includes ATM and mobile banking fees from retail customers.

Notes to the financial statements (continued)

11. FEE AND COMMISSION EXPENSE

	2018	2017
Credit card operations	4.458	3.659
Banks services	750	681
Domestic payment transactions	293	263
Other	349	346
	5.850	4.949

12. NET TRADING INCOME

	2018	2017
Net gains from foreign exchange spot trading	1.904	2.016
Net gains on equity securities	24	17
Net gains/losses on financial instruments at fair value through profit or loss	19	64
	1.947	2.097

13. OTHER OPERATING INCOME / (EXPENSE)

	2018	2017
Savings deposit insurance	(2,783)	(2.681)
Card intermediation expenses	(2,266)	(2.128)
Consultancy and the Federal Banking Agency expenses	(1,295)	(1.205)
Net charge to profit or loss statement (Note 24)	(664)	53
Other income / (expense)	(19)	(38)
Impairment of property and equipment (Note 25)	-	(555)
Provisions for assets held for sale (Note 24)	-	(289)
Income from claims settled by insurance companies and recharges from customers	502	1.005
(Loss) / Gain on sale and write off of property and equipment	55	(55)
	(6.470)	(5.893)

Notes to the financial statements (continued)

14. PERSONNEL EXPENSES

	2018	2017
Net salaries	13.546	13.501
Tax and contributions	7.121	7.117
Provisions for liabilities and charges (Note 31)	80	22
Other expenses	344	412
	21.091	21.052

Personnel expenses include BAM 3,511 thousand (31 December 2017: BAM 3,559 thousand) of defined pension contributions paid into the State pension plan. Contributions are calculated as percentage of the gross salary paid. The Bank had 562 employees as at 31 December 2018 (567 as at 31 December 2017).

15. ADMINISTRATIVE EXPENSES

	2018	2017
Maintenance expenses	4.355	4.321
Rent and other rent-related expense	3.880	3.728
Telecommunication and post expense	2.951	2.992
Security and transport costs	2.351	2.220
Consultancy expenses	933	1.030
Representation and marketing expense	874	828
Material expenses	838	861
Energy	743	763
Net of provisions for liabilities and charges (Note 31)	535	(225)
Other insurance charges	526	532
Other costs	855	967
	18.841	18.017

Notes to the financial statements (continued)

16. NET IMPAIRMENT LOSSES AND OTHER PROVISIONS

The charge to profit or loss statement in respect of impairment losses and provisions is analysed as follows:

Net impairment losses and provisions	2018	2017
- for cash and cash equivalents (Note 19)	(54)	-
- for loans to customers (Note 23)	4.118	8.031
- for other assets (Note 24)	231	66
- for off-balance sheet items (Note 31)	(1.626)	261
- for financial assets at fair value through other comprehensive income	(2.775)	-
	(106)	8.358

17. INCOME TAXES

	2018	2017
Current tax	4.299	3.136
Deferred tax (Note 32)	(77)	92
Total Income tax	4.222	3.228

Income tax recognised in the profit or loss statement comprises current tax.
Official corporate income tax rate is 10% (2017: 10%).

	2018	2017
Profit before income tax	40.562	28.137
Tax calculated at rate of 10%	4,056	2.814
Non-deductible expenses	167	415
Non-taxable income	(1)	(1)
Income tax expense	4.222	3.228
Average effective income tax rate	10,4%	11,5%

Notes to the financial statements (continued)

18. BASIC AND DILUTED EARNINGS PER SHARE

	2018	2017
Net profit (BAM'000)	36.340	24.910
Weighted average number of ordinary shares outstanding	447.760	447.760
Basic and diluted earnings per share (BAM)	81,16	55,63

19. CASH AND CASH EQUIVALENTS

	31 December 2018	31 December 2017
Current account with the Central Bank	310,292	193.366
Current accounts with other banks	61,674	100.871
Cash in hand in domestic currency	24,990	22.194
Cash in hand in foreign currency	9,490	7.264
	406,446	323.695
Less: impairment allowance	(32)	(52)
	406,414	323,643

20. RESERVES WITH THE CENTRAL BANK

	31 December 2018	31 December 2017
Obligatory reserve	172.979	147.453
	172.979	147.453

The minimum obligatory reserve as of 31 December 2018 and 31 December 2017 is calculated for 10% of all deposits, and is calculated on a daily basis, and updated every ten calendar days, in arrears.

Notes to the financial statements (continued)

21. PLACEMENTS WITH OTHER BANKS

	31 December 2018	31 December 2017
Placements with banks	21.594	14.636

As at 31 December 2018, the Bank had placement as follows:

Placement with bank:	Original currency	Original currency	BAM	Maturity	Interest rate
Erste Group Bank AG	USD	11.801.656	20.149.619	03.01.2019	2,00%
Intesa Sanpaolo S.p.A.	CAD	440.005	551.326	03.01.2019	0,40%
Intesa Sanpaolo S.p.A.	GBP	410.010	887.908	03.01.2019	0,90%
Intesa Sanpaolo S.p.A.	EUR	2.433	4.757	01.01.2019	-
			21.593.611		

22. FINANCIAL ASSETS AND LIABILITIES

a) Financial assets at fair value through other comprehensive income

	31 December 2018	31 December 2017
<i>Debt instruments</i>		
Bonds and Treasury bills issued by the Federation of Bosnia and Herzegovina	579	65.836
	579	65.836
<i>Equity instruments</i>		
Equity securities at fair value	122	116
	122	116
	701	65.952

Notes to the financial statements (continued)

22. FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

b) Financial assets at fair value through profit or loss

	31 December 2018	31 December 2017
Financial assets		
Equity shares designated at fair value through profit or loss	163	426
Derivatives held for trading	249	181
	412	607

Derivatives held for trading are represented by foreign currency swaps, details of which are presented in the table below:

	31 December 2018 Notional amount	31 December 2018 Fair value	31 December 2017 Notional amount	31 December 2017 Fair value
Financial assets				
<i>Derivatives classified as held for trading – OTC products</i>				
Forward foreign exchange contracts	9.353	249	8.238	181
	9.353	249	8.238	181

c) Financial liabilities at fair value through profit or loss

	31 December 2018	31 December 2017
Financial liabilities		
Derivatives held for trading	165	148
	165	148

Derivatives held for trading are represented by foreign currency swaps, of which are presented in the table below:

	31 December 2018 Notional amount	31 December 2018 Fair value	31 December 2017 Notional amount	31 December 2017 Fair value
Financial liabilities				
<i>Derivatives classified as held for trading – OTC products</i>				
Forward foreign exchange contracts	9.074	165	8.042	148
	9.074	165	8.042	148

Notes to the financial statements (continued)

22. FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

d) Transition to IFRS 9

Estimated impact of the adoption of IFRS 9 – First Time Adoption (“FTA”)

The new accounting standard IFRS 9, issued in July 2014 by the International Accounting Standards Board (IASB) and adopted by the European Commission, Regulation No. 2067/2016, as of 1 January 2018, replaced the existing IAS 39 that regulated the recognition and measurement of financial instruments.

Based on the above, the following impact for first-time adoption of IFRS 9 on net assets of the Bank as at 1 January 2018 arise:

- More income statement volatility. IFRS 9 raises the risk that more assets will have to be measured at fair value with changes in fair value recognized in profit and loss as they arise.
- Earlier recognition of impairment losses on receivables and loans, including trade receivables. The Bank will have to start providing for possible future credit losses in the very first reporting period a loan goes on the books – even if it is highly likely that the asset will be fully collectible.
- Significant new disclosure requirements—the more significantly impacted may need new systems and processes to collect the necessary data.

The Bank has adopted the requirements of IFRS 9 ‘Financial Instruments’ on 1 January 2018. The impact of transitioning to IFRS 9 at 1 January 2018 on the financial statements of the Bank was a decrease in net assets of BAM 27,203 thousand, arising from:

- a decrease of BAM 25,772 thousand from additional impairment allowances;
- an increase in provisions for liabilities and charges of BAM 1,431 thousand.

The Bank remains strongly capitalised following the adoption of IFRS 9. As at 31 December 2018 capital adequacy ratio amounts to 15,66% (minimum level: 12%), without current year profit being included. The impacts of adopting IFRS 9 is shown in the table below:

Notes to the financial statements (continued)

22. FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

d) Transition to IFRS 9 (continued)

ASSETS	Note	Carrying amount 31 December 2017 IAS 39	Reclassification	Remeasurements	Carrying amount 1 January 2018 IFRS 9
Cash and cash equivalents	19	323.643	-	(34)	323.609
Reserves with Central Bank	20	147.453	-	-	147.453
Placements with other banks	21	14.636	-	-	14.636
Financial assets through other comprehensive income	22 a)	65.952	-	-	65.952
Financial assets at fair value through profit and loss	22 b)	607	-	-	607
Loans and receivables from customers	23	1.278.696	-	(25.702)	1.252.994
Income tax prepayment		2.747	-	-	2.747
Deferred Tax assets		178	-	-	178
Other assets	24	11.989	-	(36)	11.953
Property and equipment	25	14.577	-	-	14.577
Intangible assets	26	6.574	-	-	6.574
TOTAL ASSETS		1.867.052		(25.772)	1.841.280
LIABILITIES					
Due to banks and other financial institutions	27	323.036	-	-	323.036
Due to customers	28	1.241.700	-	-	1.241.700
Financial liabilities at fair value through profit and loss	22 c)	148	-	-	148
Subordinated debt	29	121	-	-	121
Other liabilities	30	27.988	-	-	27.988
Provisions for liabilities and charges	31	4.701	-	1.431	6.132
Deferred Tax liabilities		42	-	-	42
TOTAL LIABILITIES		1.597.736		1.431	1.599.167
EQUITY					
Share capital	33	44.782	-	-	44.782
Share premium		57.415	-	-	57.415
Regulatory reserves for credit losses		18.286	-	-	18.286
Other and fair value reserves		1.574	-	2.781	4.355
Retained earnings		147.259	-	(29.984)	117.275
TOTAL EQUITY		269.316	-	(27.203)	242.113
TOTAL LIABILITIES AND EQUITY		1.867.052	-	(25.772)	1.841.280

Notes to the financial statements (continued)

22. FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

d) Transition to IFRS 9 (continued)

IMOVINA	Note	Original classification under IAS 39	New classification under IFRS 9	Remeasurement		Effects of IFRS 9 Changes
				Original carrying amount under IAS 39	New carrying amount under IFRS 9	
Cash and cash equivalents	19	Loans & Receivables	Amortised cost	323.643	323.643	(34)
Reserves with Central Bank	20	Loans & Receivables	Amortised cost	147.453	147.453	-
Placements with other banks	21	Loans & Receivables	Amortised cost	14.636	14.602	-
Financial assets available for sale	22 a)	Available for sale	Fair value through other comprehensive income	65.952	65.952	-
Financial assets at fair value through profit and loss	22 b)	Fair value through profit and loss	Fair value through profit and loss	607	607	-
Loans and receivables from customers	23	Loans & Receivables	Amortised cost	1.278.696	1.252.994	(25.702)
TOTAL ASSETS				1.830.987	1.805.251	(25.736)
Liabilities						
Due to banks and other financial institutions	27	Amortised cost	Amortised cost	323.036	-	323.036
Due to customers	28	Amortised cost	Amortised cost	1.241.700	-	1.241.700
Financial liabilities at fair value through profit or loss	22 c)	Fair value through profit and loss	Fair value through profit and loss	148	-	148
Subordinated debt	29	Amortised cost	Amortised cost	121	-	121
Provisions for liabilities and charges	31			4.701	6.163	1.431
TOTAL LIABILITIES				1.569.706	6.163	1.566.436

Notes to the financial statements (continued)

23. LOANS AND RECEIVABLES FROM CUSTOMERS

	31 December 2018	31 December 2017
Short-term loans		
<i>Corporate</i>		
- in BAM and BAM linked to foreign currency	241.869	277.501
- in foreign currency	1.415	1.328
<i>Retail</i>		
- in BAM and BAM linked to foreign currency	70.431	65.399
- in foreign currency	5	5
	313.720	344.233
Long-term loans		
<i>Corporate</i>		
-in BAM and BAM linked to foreign currency	572.244	438.714
-in foreign currency	417	735
<i>Retail</i>		
-in BAM and BAM linked to foreign currency	617.431	558.505
-in foreign currency	13	38
	1.190.105	997.992
Total loans	1.503.825	1.342.225
Less: impairment allowance	(75.136)	(63.529)
	1.428.689	1.278.696

Loans and receivables from customers are presented including accrued interest in the amount of BAM 5,609 thousand (2017: BAM 6,555 thousand), and net of up-front fees in the amount of BAM 10,493 thousand (2017: BAM 8,741 thousand).

As of 31 December 2018, the net amount of short-term and long-term loans in domestic currency includes loans disbursed and repayable in domestic currency index-linked to the BAM:EUR exchange rate in the amount of BAM 115,081 thousand and BAM 791,815 thousand, respectively (31 December 2017: BAM 82,712 thousand and BAM 698,562 thousand, respectively).

Movements in the provision for impairment of loans and receivables are summarised as follows:

	2018	2017
Balance as at 1 January	63.529	84.519
Impact of first time adoption – IFRS 9 (Note 4)	25,702	-
Net charge to profit or loss statement (Note 16)	4,118	8.031
Unwinding of discount	(372)	(1.597)
Transfers – other	(397)	29
Write-offs	(17,444)	(27.453)
Balance as at 31 December	75,136	63.529

Notes to the financial statements (continued)

23. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

Concentration of credit risk by industry:

Economic sector risk concentration in the gross amount of loans and receivables is as follows:

	31 December 2018	31 December 2017
Trade	257.724	288.076
Manufacturing, agriculture, forestry, mining and energy	269.778	200.278
Services, finance, sport, tourism	65.763	42.256
Construction industry	73.789	57.370
Administrative and other public institutions	64.052	57.126
Transport and telecommunications	48.650	54.181
Other	36.189	18.991
Citizens	687.880	623.947
	1.503.825	1.342.225

Notes to the financial statements (continued)

24. OTHER ASSETS

	31 December 2018	31 December 2017
Receivables from card operations	3.439	3.959
Prepaid expenses	2.065	1.919
Fees receivable	1.093	1.076
Assets held for sale	1.031	1.031
Assets acquired upon foreclosure of loans	1.016	3.345
Other assets	3.107	3.164
Total other assets	11.751	14.494
Less: impairment allowance	(1.925)	(2.505)
	9.826	11.989

The movement in the impairment allowance for other assets are summarised as follows:

	2018	2017
Balance as at 1 January	2505	2820
Impact of first time adoption – IFRS 9 (Note 4)	36	-
Net charge to profit or loss statement (Note 16)	231	66
Net charge to profit or loss statement - Assets acquired upon foreclosure of loans (Note 13)	664	(53)
Net charge to profit or loss statement - Assets held for sale (Note 13)	-	289
Transfers – other	(114)	(367)
Write-offs and sale of property	(1.397)	(250)
Balance as at 31 December	1.925	2.505

Notes to the financial statements (continued)

25. PROPERTY AND EQUIPMENT

	Land and buildings	Computers and other equipment	Assets in the course of construction	Leasehold improvements	Total
Cost					
At 1 January 2017	13.096	20.682	386	9.683	43.847
Additions	-	-	1.582	-	1.582
Disposals	(20)	(561)	-	-	(581)
Reclassification to Other asses	(1.363)	-	-	-	(1.363)
Other comprehensive income	418	-	-	-	418
Impairment of building	(555)	-	-	-	(555)
Transfers	-	1.273	(1.444)	171	-
At 31 December 2017	11.576	21.394	524	9.854	43.348
Additions	14	-	108	-	122
Disposals	-	(1.668)	-	-	(1.668)
Other comprehensive income	74	-	-	-	74
Transfers	-	486	(590)	104	-
At 31 December 2018	11.664	20.212	42	9.958	41.876
Accumulated depreciation					
At 1 January 2017	2.648	16.069	-	8.747	27.464
Charge for the year	535	1.276	-	259	2.070
Reclassification to Other asses	(332)	-	-	-	(332)
Disposals	(12)	(419)	-	-	(431)
At 31 December 2017	2.839	16.926	-	9.006	28.771
Charge for the year	320	1.185	-	249	1.754
Disposals	-	(1.592)	-	-	(1.592)
At 31 December 2018	3.159	16.519	-	9.255	28.933
Carrying Value					
At 31 December 2017	8.737	4.468	524	848	14.577
At 31 December 2018	8.505	3.693	42	703	12.943

Notes to the financial statements (continued)

26. INTANGIBLE ASSETS

	Software	Assets in the course of construction	Total
Cost			
At 1 January 2017	12.951	2.176	15.127
Additions	-	1.902	1.902
Disposals	(1.277)	-	(1.277)
Transfers	3.854	(3.854)	-
At 31 December 2017	15.528	224	15.752
Additions	-	1,027	1,027
Disposals	(575)	-	(575)
Transfers	552	(552)	-
At 31 December 2018	15,505	699	16,204
Amortisation			
At 1 January 2017	8.532	-	8.532
Charge for the year	1.871	-	1.871
Disposals	(1.225)	-	(1.225)
At 31 December 2017	9.178	-	9.178
Charge for the year	2.014	-	2.014
Disposals	(570)	-	(570)
At 31 December 2018	10.622	-	10.622
Carrying Value			
At 31 December 2017	6.350	224	6.574
At 31 December 2018	4.883	699	5.582

Notes to the financial statements (continued)

27. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	31 December 2018	31 December 2017
Due to banks		
Current accounts and term deposits		
Demand deposits		
-in BAM	3.556	6.008
-in foreign currencies	12.719	11.765
Term deposits		
-in BAM	5.000	7.800
-in foreign currencies	245.584	108.482
	266.859	134.055
Borrowings		
Long-term borrowings		
-foreign banks	162.867	157.812
	162.867	157.812
Total Due to Banks	429,726	291.867
Due to other financial institutions		
Long-term borrowings		
-in foreign currencies	26.681	31.169
Total borrowings from other financial institutions	26.681	31.169
Total Due to Banks and other financial institutions	456.407	323.036

Current accounts, deposits and borrowings from banks presented above include accrued interest in the amount of BAM 166 thousand (2017: BAM 145 thousand).

Borrowings from other financial institutions are presented including accrued interest in the amount of BAM 168 thousand (2017: BAM 202 thousand).

Notes to the financial statements (continued)

28. DUE TO CUSTOMERS

	31 December 2018	31 December 2017
Demand deposits:		
Retail clients:		
-in BAM	165.085	146.221
-in foreign currencies	71.938	65.364
Corporate clients:		
-in BAM	362.541	319.806
-in foreign currencies	94.464	136.581
Total demand deposits	694.028	667.972
Term deposits:		
Retail clients:		
-in BAM	133.916	115.988
-in foreign currencies	260.505	274.068
Corporate clients:		
-in BAM	162.678	128.702
-in foreign currencies	38.958	54.970
Total term deposits	596.057	573.728
Total Due to customers	1.290.085	1.241.700

Amounts due to customers are presented including accrued interest in the amount of BAM 6,402 thousand (2017: BAM 7,944 thousand).

29. SUBORDINATED DEBT

	31 December 2018	31 December 2017
Ministry of Finance of Bosnia and Herzegovina	-	121

With the approval of the Banking Agency of Federation of Bosnia and Herzegovina and in accordance with the provisions of the FBA Decision on Minimum Standards for Capital Management of banks and capital protection, the subordinated debt was included in Tier 2 capital in the calculation of capital adequacy in previous years.

Notes to the financial statements (continued)

30. OTHER LIABILITIES

	31 December 2018	31 December 2017
Liabilities to shareholders	8.194	8.194
Loan repayments before due dates	5.700	5.465
Credit card liabilities	3.299	3.463
Liabilities for employees' bonuses	2.450	2.136
Liabilities to vendors	1.813	1.667
Liabilities in respect of managed funds (Note 37)	3	86
Other liabilities	11.971	6.977
	33.430	27.988

31. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2018	31 December 2017
Provisions for off-balance-sheet credit risk	2.242	2.445
Provisions for legal proceedings	2.016	1.485
Provisions for retirement employee benefits	805	771
	5.063	4.701

Notes to the financial statements (continued)

31. PROVISIONS FOR LIABILITIES AND CHARGES

Movement in provisions for liabilities and charges for the year ended 31 December 2018 are summarized as follows:

	Provisions for legal proceedings (Note 15)	Provisions for retirement employee benefits (Note 14)	Provisions for off-balance-sheet credit risk (Note 16)	Total
Balance at 1 January 2017	1.975	782	2.222	4.979
Net charge/(benefit) to profit or loss statement	(225)	22	261	58
Reductions arising from payments	(265)	(33)	(38)	(336)
Balance at 31 December 2017	1.485	771	2.445	4.701
Balance at 1 January 2018	1.485	771	2.445	4.701
Impact of first time adoption-IFRS 9 (Note 22(d))	-	-	1.431	1.431
Net charge to profit or loss statement	535	80	(1.627)	(1.012)
Reductions arising from payments	(4)	(46)	(7)	(57)
Balance at 31 December 2018	2.016	805	2.242	5.063

The calculation of provisions for retirement benefits of BAM 528 thousand as of 31 December 2018 (2017: BAM 485 thousand) is performed by an independent actuary, applying a discount rate of 5% over the working life and average salary of each employee.

Provisions for unused days of vacation of BAM 276 thousand as of 31 December 2018 (2017: BAM 286 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

Notes to the financial statements (continued)

32. DEFERRED TAX BALANCES

The deferred tax liability relates to taxable temporary differences arising on fair value adjustments of financial assets through other comprehensive income. The effect of the fair value adjustment, net of relating tax is recognised in equity. Deferred tax assets relate to temporary differences arising on provisions that will be recognised for tax purposes in the moment of realization.

The movement of deferred tax balances is presented in the table below:

	Deferred tax liabilities	Deferred tax assets
As at 1 January 2017	-	229
<i>Recognised in other comprehensive income</i>		
Increase in deferred tax liabilities	42	-
Increase in deferred tax assets	-	8
<i>Recognised in profit or loss</i>		
Decrease in deferred tax assets for provisions for IAS 19 – retirements	-	(7)
Decrease in deferred tax assets for provisions for litigations	-	(56)
Increase in deferred tax assets for other provisions	-	4
As at 31 December 2017	42	178
As at 1 January 2018	42	178
<i>Recognised in other comprehensive income</i>		
Increase in deferred tax liabilities	8	-
Increase in deferred tax assets	-	14
<i>Recognised in profit or loss</i>		
Decrease in deferred tax assets for provisions for litigations	-	45
Increase in deferred tax assets for other provisions	-	18
As at 31 December 2018	50	255

Notes to the financial statements (continued)

33. SHARE CAPITAL

	31 December 2018 and 31 December 2017		Total
	Class ES Ordinary shares	Class EP Preference shares	
Number of shares	447.760	60	447.820
Pair value (BAM)	100	100	100
Total	44.776	6	44.782

Each registered ordinary share carries the right of one vote per share, while preference shares are non-voting.

Preference shareholders are entitled to receive dividends when declared, non-cumulatively, with priority rights over the ordinary shareholders in receipt of dividends.

The shareholding structure of the Bank as at 31 December 2018 is as follows:

Privredna banka Zagreb d.d.	99,99%
Other	0,01%

The shareholding structure of the Bank as at 31 December 2017 was as follows:

Privredna banka Zagreb d.d.	99,99%
Other	0,01%

In the year 2017 Privredna Banka Zagreb d.d. tookover the shares of minority shareholders of the Bank, ending the membership of certain minority shareholders. This way, PBZ stayed the majority shareholder with 99.99%, but increased its percentage equity in the Bank's share capital for 5.05%.

Notes to the financial statements (continued)

34. SHARE-BASED PAYMENTS

In 2012 the Bank purchased 78,028 equity shares representing an interest in the capital of Intesa Sanpaolo SpA (the ultimate majority shareholder of the Bank). The purchase is related to the application of the remuneration policy for the Bank's employees and was accounted for according to the provisions of IFRS 2 Share Base Payments as a cash-settled shared-based payment transaction, insofar the transaction occurred between entities belonging to the same group.

During 2018, part of the shares have been transferred to the beneficiaries (35,746). As of 31 December 2018 the Bank has 42,989 equity shares of Intesa Sanpaolo SpA left in its portfolio of financial assets at Fair Value through Profit and Loss (with fair value measured based on equity shares quotation on the Milan Stock Exchange). The residual shares will be assigned to beneficiaries when vesting conditions are met.

35. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Bank enters into credit related commitments which are recorded off-balance-sheet and primarily include guarantees, letters of credit and undrawn loan commitments.

	31 December 2018	31 December 2017
Contingent liabilities		
Performance guarantees	74.574	74.878
Payment guarantees	40.837	36.492
Letters of credit	6.070	2.815
Total contingent liabilities	121.481	114.185
Commitments		
Undrawn lending commitments	226.804	203.964
Total commitments	226.804	203.964
Total contingent liabilities and commitments	348.285	318.149

Notes to the financial statements (continued)

36. RELATED-PARTY TRANSACTIONS

The Bank is a member of the Intesa Sanpaolo S.p.A Group ("Intesa Sanpaolo Group"). The key shareholder of the Bank is Privredna banka Zagreb d.d. 99.99% (2017: Privredna banka Zagreb d.d. 99.99%) of the Bank's shares and the ultimate parent company is Intesa Sanpaolo S.p.A. The Bank considers that it has an immediate related-party relationship with its key shareholders and their subsidiaries; its associates; Supervisory Board members and Management Board members and other executive management ("key management personnel"); and close family members of key management personnel.

Related party transactions are part of the Bank's regular operations.

The overview of related party transactions as at 31 December 2018 and 31 December 2017 is presented below:

	31 December 2018	31 December 2017
Assets		
Receivables from key management personnel and their close family members	690	880
Bank accounts and loans – Intesa Sanpaolo Group	37.136	45.006
Financial assets at fair value through profit or loss – Intesa Sanpaolo Group	2	1
Other receivables – Intesa Sanpaolo Group	194	178
	38.022	46.065
Liabilities		
Deposits – key management personnel and their close family members	1.474	969
Borrowings and term deposits – Intesa Sanpaolo Group	244.779	107.967
Financial liabilities at fair value through profit or loss – Intesa Sanpaolo Group	163	145
Other liabilities – Intesa Sanpaolo Group	300	211
	246.716	109.292
Financial commitments and contingencies		
Financial Guarantees	7.970	7.670
Undrawn lending commitments – key management personnel and close family members	151	144
	8.121	7.814

Notes to the financial statements (continued)

36. RELATED-PARTY TRANSACTIONS (CONTINUED)

	2018	2017
Income		
Interest income – key management personnel and close family members	38	52
Interest income – Intesa Sanpaolo Group	163	105
Other Income – Intesa Sanpaolo Group	193	171
	394	328
Expenses		
Interest expense – key management personnel and close family members	18	56
Interest expense – Intesa Sanpaolo Group	39	6
Other expenses – Intesa Sanpaolo Group	2.154	1.846
	2.211	1.908

The remuneration of key management personnel was as follows:

	2018	2017
Net salaries for key management personnel	1.188	1.078
Taxes and contributions on net salaries	727	659
Bonuses to management	580	570
Compensation for Supervisory Board members	-	40
Other management benefits	137	147
	2.632	2.494

Notes to the financial statements (continued)

37. MANAGED FUNDS

The Bank manages assets on behalf of third parties. These assets are recorded separately from the Bank's assets.

	31 December 2018	31 December 2017
Liabilities		
Banks and insurance companies	64.817	40.498
Government organisations	7.970	8.416
Associations and Agencies	1.060	1.337
Other	428	523
Total	74.275	50.774
Assets		
Loans to companies	73.958	50.331
Loans to citizens	314	357
Total	74.272	50.688
Amounts due to original creditors – managed funds (Note 30)	3	86

