

UniCredit Bank a.d. Banja Luka
Financial Statements
Year Ended December 31, 2018 and
Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the Supervisory Board and Shareholders of UniCredit Bank a.d. Banja Luka

Opinion

We have audited the financial statements (pages 4 to 82) of UniCredit Bank a.d. Banja Luka (hereinafter: the "Bank"), which comprise the statement of financial position as at December 31, 2018, and the related statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of UniCredit Bank a.d. Banja Luka as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with the International Standards on Auditing (ISA). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

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 most significant in our audit of the financial statements for 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.

(Continued)

INDEPENDENT AUDITORS' REPORT

To the Supervisory Board and Shareholders of UniCredit Bank a.d. Banja Luka (Continued)

Key Audit Matters (Continued)

Key audit matter	Related audit procedure
<i>Expected credit losses for loans and provisions for guarantees</i>	
<p>Outstanding loans amounted to BAM 1,010,701 thousand, gross, at 31 December 2018 (BAM 972,325 thousand at 31 December 2017), and the total impairment allowance of loans amounted to BAM 73,327 thousand at 31 December 2018 (BAM 76,563 thousand at 31 December 2017).</p> <p>From 1 January 2018, the Bank has adopted IFRS 9, resulting in impairment charges being recognized when losses are expected rather than when they have been incurred. Management has disclosed information regarding the transitional effect of IFRS 9 in note 2.5. including the impact on shareholders' equity and income statement at 1 January 2018.</p> <p>Measurement of loan impairment charges for loans and provisions for guarantees in the scope of IFRS 9 is deemed a key audit matter as the determination of assumptions for expected credit losses is subjective due to the level of judgement applied by Management.</p> <p>The most significant judgements are:</p> <ul style="list-style-type: none"> • Assumptions used in the expected credit loss models to assess the credit risk related to the exposure and the expected future cash flows of the customer. • Timely identification of exposures with significant increase in credit risk and credit impaired exposures. • Valuation of collateral and assumptions of future cash flows on individually assessed credit-impaired exposures. <p>Management has provided further information about the loan impairment charges and provisions for guarantees in notes 2, 14, 15, 21, and 34.1 to the financial statements.</p>	<p>Based on our risk assessment and industry knowledge, we have examined the impairment charges for loans and provisions for guarantees and evaluated the methodology applied as well as the assumptions made according to the description of the key audit matter.</p> <p>Our examination included the following elements:</p> <ul style="list-style-type: none"> • Assessing of key controls over assumptions used in the expected credit loss models to assess the credit risk related to the exposure and the expected future cash flows of the customer. • Obtaining and substantively testing evidence to support the assumptions used in the expected credit loss models applied in stage allocation, assumptions applied to derive twelve-months and lifetime probabilities of default (PD) and methods applied to derive loss given default. • Assessing of key controls over timely identification of exposures with significant increase in credit risk and timely identification of credit impaired exposures. • Obtaining and substantively testing evidence of correctness and timely identification of exposures with significant increase in credit risk and timely identification of credit impaired exposures. • Obtaining and substantively testing evidence to support appropriate determination of assumptions for loan impairment charges and provisions for guarantees including valuation of collateral and assumptions of future cash flows on individually assessed credit impaired exposures. • Assessing the key developments of high risk portfolio compared to last year against industry standards and historical data. • Assessing the appropriateness of impact of the macro forecasts applied in the expected credit loss models. • Challenging the methodologies applied by using our industry knowledge and experience. • We involved our IT and credit risk experts in areas that required specific expertise. • Assessing the accuracy and completeness of the disclosures in the financial statements.

Responsibilities of Management and the Supervisory Board for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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.

The Supervisory Board is responsible for overseeing the Bank's financial reporting process.

(Continued)

INDEPENDENT AUDITORS' REPORT

To the Supervisory Board and Shareholders of UniCredit Bank a.d. Banja Luka (Continued)

Auditors' Responsibility 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 the International Standards on Auditing 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 the International Standards on Auditing, 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 control.
- 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 control.
- 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 auditor's 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 auditor's 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 in charge of governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

From the matters communicated to those in charge of governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore key audit matters. We describe those matters in our auditors' report unless an applicable law or a 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 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 Mr. Mirko Ilić, Certified Auditor.

Banja Luka, February 14, 2019



Mirko Ilić
Partner
Certified Auditor

On behalf of:
Deloitte d.o.o. Banja Luka
Braće Mažar i majke Marije 58 i 60, Banja Luka



Statement of Profit or Loss and Other Comprehensive Income


	Note	Year Ended December 31,	
		2018 BAM '000	2017 BAM '000
Interest income and similar income	6	60,590	61,717
Interest expenses and similar expenses	7	(9,047)	(10,995)
Net interest income		51,543	50,722
Fee and commission income	8	18,617	17,278
Fee and commission expenses	9	(2,991)	(2,966)
Net fee and commission income		15,626	14,312
Dividend and profit sharing income	10	10	48
Net foreign exchange gains upon translation of monetary assets and liabilities	11	1,743	1,515
Gains on investments		-	166
Total operating income		68,922	66,763
Personnel expenses	12	(16,747)	(16,039)
Property and equipment depreciation charge	22	(1,595)	(1,590)
Intangible assets amortization charge	23	(879)	(1,173)
Other administrative expenses	13	(12,984)	(12,631)
Total operating expenses		(32,205)	(31,433)
Profit before impairment and provisions		36,717	35,330
Net impairment losses/recoveries per credit risks	14	(5,797)	n/a
a) Financial assets at amortized cost		(4,702)	n/a
b) Financial assets at fair value through other comprehensive income		(1,095)	n/a
Net impairment losses/recoveries and provisions for credit risks (IAS 39)		n/a	(5,882)
a) Loans and receivables		n/a	(5,882)
b) Financial assets available for sale		n/a	-
Provisions for risks and expenses	15	(874)	(572)
a) Provisions for credit risks and guarantees		(514)	(122)
b) Provisions for employee retirement benefits		10	-
c) Provisions for litigations		(370)	(450)
Other operating income and expenses		(194)	(462)
Gains/losses on sales of property and equipment		513	22
Profit before tax		30,365	28,436
Income tax	16	(2,594)	(2,661)
Profit for the year		27,771	25,775


Statement of Profit or Loss and Other Comprehensive Income (Continued)

	Note	Year Ended December 31,	
		2018 BAM '000	2017 BAM '000
Profit for the year		27,771	25,775
Other comprehensive income, net of income tax <i>Items that may subsequently be reclassified to profit and loss:</i>			
- (Losses)/gains on the financial assets at fair value through other comprehensive income		650	n/a
Other comprehensive income, net of income tax <i>Items that may subsequently be reclassified to profit and loss:</i>			
- (Losses)/gains on the financial assets available for sale (IAS 39)		n/a	(133)
Total comprehensive income for the year		28,421	25,642
		BAM	BAM
Earnings per share	31	200.30	185.90

These financial statements were approved by the Bank's Management on January 30, 2019.

Signed on behalf of UniCredit Bank a.d. Banja Luka by:


 Gordan Peihar
 President of the Management Board




 Nevena Nikšić
 Member of the Management Board

Statement of Financial Position

As of

	Note	December 31, 2018 BAM'000	December 31, 2017 BAM'000
Assets			
Cash and cash equivalents	17	225,492	170,568
Financial assets held for trading		1	n/a
Financial assets at fair value through profit and loss (IAS 39)		n/a	10
Financial assets at fair value through other comprehensive income	18	197,265	n/a
Financial assets available for sale (IAS 39)		n/a	169,542
Financial assets at amortized cost		1,207,266	n/a
a) Obligatory reserve held with the Central Bank	19	125,877	n/a
b) Loans and receivables due from banks	20	144,015	n/a
c) Loans and receivables due from customers	21	937,374	n/a
Obligatory reserve held with the Central Bank (IAS 39)		n/a	116,002
Loans and receivables due from banks (IAS 39)		n/a	100,444
Loans and receivables due from customers (IAS 39)		n/a	895,762
Property and equipment	22	17,761	16,468
Intangible assets	23	8,115	5,887
Deferred tax assets	27	77	16
Other assets	24	6,254	5,997
Total assets		<u>1,662,231</u>	<u>1,480,696</u>
Liabilities			
Financial liabilities at amortized cost		1,422,320	n/a
a) Deposits and borrowings due to banks	25	415,669	n/a
b) Deposits and borrowings due to customers	26	1,006,651	n/a
Deposits and borrowings due to banks (IAS 39)		n/a	395,901
Deposits and borrowings due to customers (IAS 39)		n/a	863,628
Financial liabilities held for trading		-	n/a
Financial liabilities at fair value through profit and loss (IAS 39)		n/a	621
Tax liabilities		178	433
a) Current tax liabilities		178	417
b) Deferred tax liabilities	27	-	16
Other liabilities	28	17,737	15,329
Provisions for risks and expenses	29	3,321	3,662
a) Provisions for credit risk on commitments and financial guarantees given		1,032	1,596
b) Provisions for employee retirement benefits		252	263
c) Provisions for litigations		2,037	1,803
Total liabilities		<u>1,443,556</u>	<u>1,279,574</u>
Equity and reserves			
Share capital	30	97,055	97,055
Share premium		373	373
Legal reserves		9,706	9,706
Capital reserves		39,242	39,242
Regulatory reserves for credit losses		3,604	3,496
Fair value reserves		2,447	(114)
Retained earnings		38,477	25,589
Net profit for the year		27,771	25,775
Total equity and reserves		<u>218,675</u>	<u>201,122</u>
Total liabilities, equity and reserves		<u>1,662,231</u>	<u>1,480,696</u>

Statement of Changes in Equity

For the year

	Share capital BAM '000	Share premium BAM '000	Legal reserves BAM '000	Capital reserves BAM '000	Regulatory reserves for credit losses BAM '000	Fair value reserves BAM '000	Retained earnings BAM '000	Net profit for the year BAM '000	Total BAM '000
Balance as at January 1, 2017	97,055	373	9,706	28,050	3,496	19	25,588	22,383	186,670
Profit distribution	-	-	-	11,192	-	-	11,191	(22,383)	-
Dividend payment	-	-	-	-	-	-	(11,190)	-	(11,190)
Net profit for the year	-	-	-	-	-	-	-	25,775	25,775
Other comprehensive income									
Net loss/ gain from changes in fair value of financial assets through other comprehensive income	-	-	-	-	-	(133)	-	-	(133)
Balance as at December 31, 2017	97,055	373	9,706	39,242	3,496	(114)	25,589	25,775	201,122
IFRS 9 first-time adoption – opening balance									
as at January 1, 2018	-	-	-	-	108	1,911	-	-	2,019
Profit distribution	-	-	-	-	-	-	25,775	(25,775)	-
Dividend payment (Note 31)	-	-	-	-	-	-	(12,887)	-	(12,887)
Net profit for the year	-	-	-	-	-	-	-	27,771	27,771
Other comprehensive income									
Net loss/gain from changes in fair value of financial assets through other comprehensive income	-	-	-	-	-	(445)	-	-	(445)
Net loss/gain from provisions for credit risks on financial assets at fair value through other comprehensive income	-	-	-	-	-	1,095	-	-	1,095
Balance as at December 31, 2018	97,055	373	9,706	39,242	3,604	2,447	38,477	27,771	218,675

Translation of the Auditors' Report issued in the Serbian language
Notes set out on pages 9 to 82 form an integral part of these financial statements

Statement of Cash Flows
For the year

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Cash flows from operating activities		
Interest income and similar income	60,590	61,717
Interest expenses and similar expenses	(9,047)	(10,995)
Fee and commission income	18,617	17,278
Fee and commission expenses	(2,991)	(2,966)
Dividend and profit sharing income	10	48
Net foreign exchange gains upon translation of monetary assets and liabilities	1,743	1,515
Administrative operating expenses	(29,731)	(28,670)
Other inflows / (outflows)	319	(275)
1. Net cash generated by operating activities	39,510	37,652
Changes in operating assets and liabilities		
Changes in the financial assets at amortized cost		
Obligatory reserve held with the Central Bank	(9,875)	n/a
Loans and receivables due from banks	(43,571)	n/a
Loans and receivables due from customers	(45,205)	n/a
<i>Obligatory reserve held with the Central Bank (IAS 39)</i>	<i>n/a</i>	<i>(18,856)</i>
<i>Loans and receivables due from banks (IAS 39)</i>	<i>n/a</i>	<i>64,976</i>
<i>Loans and receivables due from customers (IAS 39)</i>	<i>n/a</i>	<i>(45,429)</i>
Changes in the financial liabilities at amortized cost		
Deposits and borrowings due to banks	19,768	n/a
Deposits and borrowings due to customers	143,023	n/a
<i>Deposits and borrowings due to banks (IAS 39)</i>	<i>n/a</i>	<i>(1,835)</i>
<i>Deposits and borrowings due to customers (IAS 39)</i>	<i>n/a</i>	<i>67,534</i>
Other assets	(906)	(3,286)
Other liabilities	812	(296)
2. Net changes in operating assets and liabilities	64,046	62,808
3. Net cash generated by operating activities before tax (1+2)	103,556	100,460
4. Income tax paid	(2,622)	(2,529)
5. Net cash generated by operating activities (3+4)	100,934	97,931
Cash flows from investing activities		
Tangible assets	(2,305)	(1,866)
Intangible assets	(3,107)	(2,494)
Financial assets at fair value through other comprehensive income	(27,723)	n/a
<i>Financial assets available for sale (IAS 39)</i>	<i>n/a</i>	<i>(13,647)</i>
Dividend payment	(12,875)	(11,171)
6. Net cash used in investing activities	(46,010)	(29,178)
7. Net increase in cash (5+6)	54,924	68,753
8. Cash and cash equivalents at the beginning of year	170,568	101,815
9. Cash and cash equivalents at the end of year (7+8)	225,492	170,568

Notes to the Financial Statements

1. THE REPORTING ENTITY

UniCredit Bank a.d. Banja Luka is a shareholding company registered in the Republic of Srpska for performance of payment transactions, credit and deposit and other banking operations in the country and abroad in accordance with the regulations of the Republic of Srpska.

History of the Bank is related to the beginning of the past century, i.e. to 1910 and establishment of the Monetary Institute which subsequently developed into the "Banka za trgovinu i obrt". In the following 60 years, numerous transformations and changes of names under which the Bank operated were made: in 1956, the "Sreska Komunalna Banka", in 1961, the "Komunalna Banka", and in 1966, the "Kreditna Banka". By the reform of the banking system in 1971, the "Kreditna Banka" was merged by the "Privredna Banka Sarajevo" as its branch, and in 1976 it obtained a high degree of autonomy and was registered as the "Osnovna Banka". Under the Decision of the Founder Assembly in December 1989 the Bank was spun off from the "Privredna Banka Sarajevo" system into an independent bank, under the name of "Banjalučka Banka d.d. Banja Luka". From June 1998, it continued its operations as a shareholding company under the name Banjalučka Banka a.d. Banja Luka.

In accordance with regulations on privatization of state-owned capital in the Republic of Srpska, in October 2000, shares of state-owned enterprises in the Bank were transferred to the management of the RS Ministry of Finance until the completion of the state-owned capital privatization process.

In early 2002, the Government of the Republic of Srpska sold the state-owned shares of the Bank to the company Verano Motors d.o.o. Belgrade. The first Shareholders' Meeting of the private Bank adopted a decision on the change of the name from Banjalučka Banka into Nova Banjalučka Banka a.d. Banja Luka.

Since the end of 2002, the Bank's shares have been quoted on the Stock Exchange. At the end of 2005, having purchased a package of shares (83.3% equity interest) on the Stock Exchange, Bank Austria Creditanstalt AG Vienna became the majority owner of the Bank, which also at the end of the same year became a member of UniCredit Group and changed name to UniCredit Bank Austria AG. By further purchases of shares and increase in share capital, UniCredit Bank Austria AG increased its equity interest to 98.4% of the Bank's total capital.

With the change in the ownership structure after the entry of Bank Austria as the majority shareholder, the Bank became a member of HVB Group, and after the change in the ownership structure of Bank Austria whose majority owner became UniCredit Bank Milan, the Bank became a member of UniCredit Group. In 2008, the name Nova Banjalučka Banka a.d. Banja Luka was changed, hence since June 1, 2008, the Bank has been operating under the name of UniCredit Bank a.d. Banja Luka.

During 2016, ownership of all banks in Central-Eastern Europe was transferred from UniCredit Bank Austria AG, as the Sub-holding, to UniCredit S.p.A. – Holding, Italy at the level of UniCredit Group.

As at December 31, 2018, the Bank consisted of the Head Office in Banja Luka (with the registered address at no. 7, Marije Bursać Street), 31 branch offices and 5 agencies (December 31, 2017: 32 branch offices and 5 agencies).

As at December 31, 2018, the Bank had 441 employees (2017: 431 employees).

The tax identification number of the Bank is 4400958880009, and its VAT code is 400958880009.

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION

2.1. Statement of Compliance

The accompanying financial statements represent annual financial statements of UniCredit Bank a.d. Banja Luka, prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.2. General Preparation Criteria

The annual financial statements include:

- Statement of Profit or Loss and Other Comprehensive Income (Income Statement),
- Statement of Financial Position (Balance Sheet),
- Statement of Changes in Equity,
- Statement of Cash Flows (compiled using the direct method), and
- Notes to the financial statements.

It should be noted that, as a result of the first-time adoption of the new accounting standard IFRS 9 and the election of UniCredit Group and the Bank not to amend the previous period's report, additional items were integrated in the financial statements in order to allow comparability with the previous period statements prepared in accordance with IAS 39.

The present financial statements have been prepared on the going concern basis, since the Bank's management bodies did not identify any symptoms in the capital and financial structures or any economic effects that could indicate uncertainty regarding the ability of the Bank to continue to operate profitably in the foreseeable future.

The adopted measurement criteria are in line with this assumption and the principles of accrual accounting, the relevance and significance of the accounting information, and prevalence of the economic substance over the legal form. Compliance with these criteria has not changed since the previous years, except for the changes described below, which relate to the introduction of new standards and interpretations.

According to IFRS, management has to make judgments, estimates and assumptions that affect the application of accounting principles and the amounts of assets and liabilities, reported income and expenses, as well as the disclosure of contingent assets and liabilities. Estimates and related assumptions are based on the historical experience and other factors that are considered reasonable under the given circumstances and have been used to estimate the carrying amount of assets and liabilities that are not readily available from other sources.

2.3. Functional Currency and Presentation Currency

These financial statements are stated in convertible marks (hereinafter: "BAM"), BAM being the Bank's functional currency. The data in tables and explanations are presented in thousands of convertible marks (BAM '000), unless otherwise stated.

The Central Bank of Bosnia and Herzegovina (hereinafter: the "Central Bank") implements the policy on FX rate in line with the principle of the Currency Board, according to which BAM is pegged to EUR at the rate of BAM 1 = EUR 0.511290, which was used for 2018 and 2017.

2.4. Subsidiaries, Joint Ventures and Associates

As of the reporting date, the Bank did not have:

- Subsidiaries, i.e. entities, including structured entities, over which it has direct or indirect control,
- Joint arrangements with other entities, which in accordance with the IFRS 11 include joint control, joint operations and joint ventures, or
- Associates.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS

Initial application of the new and amendments to the existing standards that came into effect

In 2018 the following new accounting standards, amendments, interpretations or revisions came into effect:

- IFRS 9 – Financial Instruments (effective for annual periods beginning on or after January 1, 2018);
- IFRS 15 – Revenue from Contracts with Customers (effective for annual periods beginning on or after January 1, 2018);
- IFRIC 22 – Foreign Currency Transactions and Advance Consideration (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IAS 40: Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018)
- Amendments to IFRS 2: Classification and Measurement of Share-Based Payment Transactions (effective for annual periods beginning on or after January 1, 2018);
- Annual Improvements of IFRS Standards 2014-2016 (effective for annual periods beginning on or after January 1, 2018)
- Amendments to IFRS 4: Applying IFRS 9 “Financial Instruments” with IFRS 4 “Insurance Contracts” (effective for period 2018)
- Clarifications to IFRS 15: Revenue from Contracts with Customers (effective for annual periods beginning on or after January 1, 2018).

The explanations related to the application of IFRS 9 and IFRS 15 are provided in the following paragraphs while the application of other standards did not have any significant effect on the Bank’s current financial and economic performance.

IFRS 16, effective starting from January 1, 2019 modifies the current set of international accounting principles and interpretations on leases and, in particular, IAS 17.

IFRS 16 introduces a new definition for leases and confirms the current distinction between the two types of leases (operating and finance) with reference to the accounting treatment to be applied by the lessor. With reference to the accounting treatment to be applied by the lessee, the new accounting standard sets, for all the leasing typologies, recognition as an asset, representing the right of use of the underlying asset and, at the same time, a liability reflecting the future payments of the lease contract.

At the initial recognition such an asset is measured based on the lease contract cash flows, which include, in addition to the present value of lease payments, any initial direct cost attributable to the lease and any other costs required for the dismantling/removing the underlying asset at the end of the contract. After the initial recognition, the right-of-use will be measured on the basis of the provisions set for tangible assets measured using the cost model (at cost less any accumulated depreciation and any accumulated impairment losses), the revaluation model or the fair value model set by IAS 16 or by IAS 40.

For the purpose of applying IFRS 16, the Bank has initiated activities aimed at ensuring compliance with these accounting principles, in particular in the part regarding the calculation of the right-of-use and liabilities for leasing, which represent the main differences in relation to the current accounting model required by IAS17.

The activities were aimed at identifying lease contracts and development of rules, principles and that will be used for the proper assessment of new assets and liabilities and the subsequent calculation of related economic effects.

Taking into account the number of lease agreements in the Bank, it is expected that the adoption of IFRS 16 will affect the increase in the amount of assets and liabilities arising from the recognition of rights-of-use and related lease liabilities, and hence risk weighted assets (RWA - Risk Weighted Asset) in accordance with regulatory regulations on newly recognized assets.

The initial recognition of assets at the time of the first application of IFRS 16 as of January 1, 2019, as stated above, according to the preliminary calculation, results in a decrease in the rate of the Common Equity Tier 1 Capital (CET 1) by 6 bps (or -0.06pp).

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS (Continued)

New Standards and amendments to the existing Standards in issue, but not yet effective

At the date of authorization of these financial statements the following standards, amendments to the existing standards and new interpretations were in issue but not yet effective:

- IFRS 17 “Insurance Contracts” (effective for annual periods beginning on or after January 1, 2021),
- IFRIC 23 “Uncertainty over Income Tax Treatments” (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IFRS 3 “Business Combinations” - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period),
- Amendments to IAS 1 “Presentation of Financial Statements” and IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors” - Definition of Material (effective for annual periods beginning on or after 1 January 2020),
- Amendments to References to the Conceptual Framework in IFRS Standards (effective for annual periods beginning on or after 1 January 2020),
- Amendments to IAS 28 “Investments in Associates and Joint Ventures” - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019),
- Amendments to various standards due to “Improvements to IFRSs (cycle 2015-2017)” resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (amendments should be effective for annual periods beginning on or after January 1, 2019),
- Amendments to IAS 19 “Employee Benefits” - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IFRS 9 “Financial Instruments” - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures” - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded);
- IFRS 16 “Leases” (effective for annual periods beginning on or after January 1, 2019);

The Bank’s management has elected not to adopt these new Standards, amendments to existing Standards and new interpretations in advance of their effective dates. The management anticipates that the adoption of these new Standards, amendments to existing Standards and new interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

Transition to IFRS 15 “Revenue from Contracts with Customers”, effective starting from January 1, 2018, has been endorsed by the European Union with Regulation EU 2016/1905 dated September 22, 2016 (published on October 29, 2016), modifies the current set of international accounting principles and interpretations on revenue recognition and, in particular, IAS 18.

IFRS 15 provides for:

- two approaches for revenue recognition (“at point in time” or “over time”);
- a new model for transaction analysis (“five-step model”) focused on the transfer of control; and
- a requirement for a more detailed disclosure to be included in the explanatory notes to the financial statements.

Applying the new accounting standard could have effect on:

- (i) reclassification between line items of the income statement used for presenting revenues,
- (ii) change in the timing recognition of such revenue, when the contract with the customer contains several performance obligations that must be accounted for separately under the accounting Standard,
- (iii) different measurements of the revenues so as to reflect their variability.

Based on the analysis performed, with the adoption of IFRS 15 there were no significant effects on the current economic and financial volumes.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS (Continued)

Transition to IFRS 9: "Financial Instruments"

Since January 1, 2018, the Bank with support by UniCredit Group (hereinafter: Group) has adopted and applied the accounting standard "IFRS9: Financial Instruments".

Adoption of standards is the result of a long-term project at the level of the Group, whose goal is to create risk reporting and monitoring methods, harmonized between legal entities of the Group, which ensure full compliance with the standard and update the management and monitoring process in light of the new rules.

This project was organized on the Bank level through specific work streams:

- "Classification and Measurement" work-stream, aimed at reviewing classification of the financial instruments according to new IFRS 9 criteria;
- "Impairment" work-stream, aimed at developing and implementing models and methodologies for impairment calculation.
- Together with the work-streams, specific activities have been conducted focused on adapting models and methods to specific characteristics of corporate and investment banking (CIB).

The entire project at the Group level is being developed with the active involvement of all the relevant structures of the banks, Supervisory Board and top management.

In relation to the new accounting standard, the following should be mentioned:

- Significant changes to classification and measurement of financial instruments compared to IAS 39 were introduced. In relation to loans and debt securities, the classification and subsequent measurement of these instruments is based on the "business model" and the characteristics of cash flows of financial instruments (SPPI criterion - solely payments of principal and interest).

Equity instruments are classified as financial instruments at fair value, with differences being recognized through profit or loss or in other comprehensive income. Unlike IAS 39 requirement for available for sale assets, IFRS 9 no longer requires the recognition of impairment losses and provides that in the case of the sale of instruments, gains and losses on disposal shall be reclassified to capital reserves rather than to profit or loss.

Finally, in relation to financial liabilities at fair value, the "own credit risk" accounting was modified, i.e. changes in the value of liabilities at fair value that result from the fluctuation of their creditworthiness. Under the new standard, these changes must be recognized in capital reserves rather than in the income statement in accordance with IAS 39, which eliminates the source of volatility of economic results.

- A new accounting model of impairment for credit exposures has been introduced based on (i) the "expected loss" approach that replaces existing based on recognition of "incurred losses" and (ii) the concept of "life" expected loss;
- Guidelines have been introduced to clarify when the financial instruments will be written off, stating that the write-off is an event of the accounting write-off;
- The rules that apply to "hedge accounting" have been amended in terms of determining the relationship of the hedge and verifying its effectiveness with the aim of ensuring greater consistency between accounting recognition of hedge and the underlying management explanation.

The Bank decided to use the option provided by the accounting standard to not restate comparative data from previous years, so the first application of the new standard is from January 1, 2018.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS (Continued)

Transition to IFRS 9: “Financial Instruments” (Continued)

The balance sheet of the Bank as at January 1, 2018 is shown below:

	January 1, 2018 BAM '000
Assets	
Cash and cash equivalents	170,131
Financial assets held for trading	10
Financial assets at fair value through other comprehensive income	169,542
Financial assets at amortized cost	1,113,596
a) <i>Obligatory reserve held with the Central Bank</i>	115,657
b) <i>Loans and receivables due from banks</i>	100,363
c) <i>Loans and receivables due from customers</i>	897,576
Property and equipment	16,468
Intangible assets	5,887
Deferred tax assets	16
Other assets	5,997
Total assets	1,481,647
Liabilities	
Financial liabilities at amortized cost	1,259,529
a) <i>Deposits and borrowings due to banks</i>	395,901
b) <i>Deposits and borrowings due to customers</i>	863,628
Financial liabilities held for trading	621
Tax liabilities	433
a) <i>Current tax liabilities</i>	417
b) <i>Deferred tax liabilities</i>	16
Other liabilities	15,329
Provisions for risks and expenses	2,594
a) <i>Provisions for credit risk on commitments and financial guarantees given</i>	528
b) <i>Provisions for severance pays</i>	263
c) <i>Provisions for litigations</i>	1,803
Total liabilities	1,278,506
Equity and reserves	
Share capital	97,055
Share premium	373
Legal reserve	9,706
Capital reserve	39,242
Regulatory reserves for credit losses	3,604
Fair value reserves	1,797
Retained earnings	25,589
Net profit for the year	25,775
Total equity and reserves	203,141
Total liabilities, equity and reserves	1,481,647

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS (Continued)

Transition to IFRS 9: "Financial Instruments" (Continued)

The effects of IFRS 9 application are as follows:

- total positive impact on the net capital in the amount of BAM 2,019 thousand;
- total positive effect on the Common Equity Tier 1 Capital ratio (CET1) is equal to 1.2 pp;
- decrease in impairment and loan loss provisions in the amount of BAM 108 thousand.

Specifically, the effects arose from:

- BAM 1,911 thousand represents positive revaluation reserves expressed in the item "reserves for loan losses on financial assets at fair value through other comprehensive income" referring to the accrued provision for credit risk on instruments classified on the item "financial assets at fair value through other comprehensive income" recognized directly in equity on " regulatory reserve for credit losses " item;
- Provisions for credit risk on commitments and financial guarantees given that represent provisions on off-balance sheet exposure to credit risk on undrawn loans, guarantees and other assumed contingent liabilities were reduced by BAM 1,068 thousand;
- Impairment on exposure to credit risk on assets held with the Central Bank and other banks was calculated in the amount of BAM 863 thousand, resulting in decrease of net exposure in that amount;
- At exposure to credit risk towards the customers there was write-back in the amount of BAM 1,814 thousand, which resulted in an increase in net exposure in this amount;
- net effect of change in impairment on exposures to banks and customers in the amount of BAM 951 thousand is recognized directly in equity under the item of "regulatory reserve for credit losses".

Reclassifications made on January 1, 2018

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS (Continued)

Transition to IFRS 9: "Financial Instruments" (Continued)

The following table summarizes the reclassifications made on the Balance Sheet (Assets and Liabilities) based on initial application of IFRS 9:

	December 31, 2017 BAM '000	Re- classification BAM '000	Changes in measur. BAM '000	January 1, 2018 BAM '000
Assets				
Cash and cash equivalents	170,568	-	(437)	170,131
Financial assets held for trading	n/a	10	-	10
Financial assets at fair value through profit and loss (IAS 39)	10	(10)	-	-
Financial assets at fair value through other comprehensive income	n/a	169,542	-	169,542
Financial assets available for sale (IAS 39)	169,542	(169,542)	-	-
Financial assets at amortized cost	n/a	-	-	1,113,596
a) Obligatory reserve held with the Central Bank	n/a	116,002	(345)	115,657
b) Loans and receivables due from banks	n/a	100,444	(81)	100,363
c) Loans and receivables due from customers	n/a	895,762	1,814	897,576
Obligatory reserve held with the Central Bank (IAS 39)	116,002	(116,002)	-	n/a
Loans and receivables due from banks (IAS 39)	100,444	(100,444)	-	n/a
Loans and receivables due from customers (IAS 39)	895,762	(895,762)	-	n/a
Property and equipment	16,468	-	-	16,468
Intangible assets	5,887	-	-	5,887
Deferred tax assets	16	-	-	16
Other assets	5,997	-	-	5,997
Total assets	1,480,696	-	951	1,481,647
Liabilities				
Financial liabilities at amortized cost	n/a	-	-	1,259,529
a) Deposits and borrowings due to banks	n/a	395,901	-	395,901
b) Deposits and borrowings due to customers	n/a	863,628	-	863,628
Deposits and borrowings due to banks (IAS 39)	395,901	(395,901)	-	n/a
Deposits and borrowings due to customers (IAS 39)	863,628	(863,628)	-	n/a
Financial liabilities held for trading	n/a	621	-	621
Financial liabilities at fair value through profit and loss (IAS 39)	621	(621)	-	n/a
Tax liabilities	433	-	-	433
a) Current tax liabilities	417	-	-	417
b) Deferred tax liabilities	16	-	-	16
Other liabilities	16,925	(1,596)	-	15,329
Provisions for risks and expenses	2,066	1,596	(1,068)	2,594
a) Provisions for credit losses and guarantees	1,596	1,596	(1,068)	528
b) Provisions for employee retirement benefits	263	-	-	263
c) Provisions for litigations	1,803	-	-	1,803
Total liabilities	1,279,574	-	(1,068)	1,278,506
Equity and reserves				
Share capital	97,055	-	-	97,055
Share premium	373	-	-	373
Legal reserves	9,706	-	-	9,706
Capital reserves	39,242	-	-	39,242
Regulatory reserves for credit losses	3,496	-	108	3,604
Fair value reserves	(114)	-	1,911	1,797
Retained earnings	25,589	-	-	25,589
Net profit for the year	25,775	-	-	25,775
Total equity and reserves	201,122	-	2,019	203,141
Total liabilities, equity and reserves	1,480,696	-	951	1,481,647
Off-balance exposure	204,800	-	1,068	204,800

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.5. Impact and Application of New and Revised IFRS (Continued)

Transition to IFRS 9: “Financial Instruments” (Continued)

The following table presents the reclassification of items by stages with the calculation of impairment and provisions on off-balance sheet date as of January 1, 2018 in accordance with IFRS 9 and impairment and provisions for those items under IAS 39 with transition effects.

Asset item line	Gross placements	Impairment and provisions	Total carrying value	Impairment and provisions	Total carrying value	Difference
	IAS 39		IAS 39	IFRS 9	IFRS 9	IFRS 9 - IAS 39
	BAM 000	BAM 000	BAM 000	BAM 000	BAM 000	BAM 000
Cash and cash equivalents	170,568	-	170,568	437	170,131	(437)
Phase 1	170,568	-	170,568	437	-	(437)
Phase 2	-	-	-	-	-	-
Phase 3	-	-	-	-	-	-
POCI	-	-	-	-	-	-
Financial assets held for trading	10	-	10	-	10	-
Phase 1	10	-	-	-	-	-
Phase 2	-	-	-	-	-	-
Phase 3	-	-	-	-	-	-
POCI	-	-	-	-	-	-
Financial assets at fair value through other comprehensive income	169,542	-	169,542	1,911	169,542	(1,911)
Phase 1	-	-	-	-	-	-
Phase 2	169,542	-	169,542	1,911	-	(1,911)
Phase 3	-	-	-	-	-	-
POCI	-	-	-	-	-	-
Financial assets at amortized cost						
Obligatory reserve held with the Central Bank	116,002	-	116,002	345	115,657	(345)
Phase 1	116,002	-	116,002	345	115,657	(345)
Phase 2	-	-	-	-	-	-
Phase 3	-	-	-	-	-	-
POCI	-	-	-	-	-	-
Loans and receivables due from banks	100,444	-	100,444	81	100,363	(81)
Phase 1	100,444	-	100,444	81	100,363	(81)
Phase 2	-	-	-	-	-	-
Phase 3	-	-	-	-	-	-
POCI	-	-	-	-	-	-
Loans and receivables due from customers	972,325	76,563	895,762	74,749	897,576	1,814
Phase 1	679,746	5,800	673,946	4,091	675,655	1,709
Phase 2	219,736	5,609	214,127	4,774	214,962	835
Phase 3	72,843	65,154	7,689	65,884	6,959	(730)
POCI	-	-	-	-	-	-
Other assets	7,370	1,373	5,997	1,373	5,997	-
Phase 1	6,106	109	5,997	109	5,997	-
Phase 2	-	-	-	-	-	-
Phase 3	1,264	1,264	-	1,264	-	-
POCI	-	-	-	-	-	-
Total	1,536,261	77,936	1,458,325	76,985	1,459,276	951
Off-balance exposure	204,800	1,596	204,800	528	204,800	1,068
Phase 1	174,652	1,063	174,652	311	174,652	752
Phase 2	29,975	432	29,975	133	29,975	299
Phase 3	173	101	173	84	173	17
POCI	-	-	-	-	-	-
Total with off-balance exp.	1,741,061	79,532	1,663,125	79,424	1,664,076	2,019

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. Classification and Measurement

As a result of the entry into force of the new accounting standard, the Bank has reclassified its financial assets and liabilities as of January 1, 2018 into the new envisaged categories.

With regard to this, it should be noted that this classification is based on the business model and characteristics of the contractual cash flows.

The analysis of the business models has been performed by mapping the Bank's business areas and by allocating a specific business model to each of them.

In this regard, a "hold-to-collect" or "hold-to-collect and sell" business models have been allocated to the business areas comprising the Bank's portfolio in accordance with the intention of holding and expected sales of financial instruments.

For the classification of financial assets into the new categories stipulated by IFRS 9, the analysis of the business models was complemented by the analysis of the contractual cash flows ("SPPI Test").

In this regard, the Bank has established processes to analyze the portfolio of debt securities and loans by which it assesses whether the features of their contractual cash flows allow their measurement at amortized cost ("hold-to-collect" portfolio) or at fair value through other comprehensive income ("hold-to-collect and sell" portfolio).

The analysis is performed both by contract and by defining specific clusters based on the features of transactions and using a specific tool developed by the Group (SPPI Tool) in order to analyze the features of the contracts against IFRS 9 requirements, or by using external data providers.

In applying the above rules, the financial assets and liabilities of the Bank are classified as follows.

a) Financial Assets Held for Trading

Financial asset is classified as held for trading if:

- it is acquired or generated principally for the purpose of selling or repurchasing it in the near term;
- it is part of the portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term;
- it is held for profit making;
- it is a derivative contract not defined by hedge accounting, including derivatives with a positive fair value embedded in financial liabilities other than those that are measured at fair value through profit or loss.

Like other financial instruments, financial assets held for trading are initially measured at fair value at settlement date, which is usually equal to the amount paid, excluding transaction costs and income, which are recognized in profit and loss account, if they can be directly attributed to financial assets. Trading book derivatives are recognized at the trading date.

After initial recognition, this financial asset is measured at fair value through profit and loss account.

A gain or loss arising from the sale or repurchase or change in the fair value of a financial asset held for trading is recognized in the profit and loss account under the item of "net gains on trading and foreign exchange gains on the translation of monetary assets and liabilities", including gains or losses from financial derivatives relating to financial assets and/or financial liabilities designated at fair value or other financial assets that are mandatorily held at fair value. If the fair value of a financial instrument falls below zero, which can be the case with derivative contracts, it is recognized on "financial liabilities held for trading" item.

These assets are measured similarly to the "financial assets held for trading" but gains and losses, whether realized or unrealized, are recognized within the item of "gains/(losses) on financial assets/liabilities at fair value through profit and loss".

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. Classification and Measurement (Continued)

b) Financial Assets at Fair Value through Other Comprehensive Income

Financial assets are classified at fair value through other comprehensive income if:

- They reflect the business model "hold-to-collect and sell";
- Their cash flows are solely payments of principal and interest.

This category also includes equity instruments not held for trading and for which the Bank applies the option allowed by the Standard for instrument measurement at fair value through other comprehensive income.

Upon initial recognition, on settlement date, financial assets are measured at fair value, which is usually equal to the consideration paid plus transaction costs and income that can be attributed directly to the instrument. After initial recognition, interest accrued on interest-bearing instruments is recorded in the profit and loss account under the criterion of amortized cost within the item of "interest income and similar income".

Gains and losses arising from changes in fair value are recognized in the statement of comprehensive income and reported in equity within the "fair value reserve" item. In case of disposal, accumulated gains and losses are recorded in the profit and loss on the item "gains (losses) on disposal and repurchase of financial asset at fair value through other comprehensive income".

In respect of equity instruments, gains and losses arising from changes in fair value are recognized in the statement of comprehensive income and reported in equity under "fair value reserve" item. In case of disposal, accumulated gains and losses are recorded under the "reserves" item.

In accordance with the provisions of IFRS 9, impairment losses on equity instruments are not recognized in the profit or loss statement. Only dividends are recognized in the profit or loss statement under the item "income from dividends and similar income".

c) Financial Assets at Amortized Cost

Financial assets are classified at amortized cost if:

- their business model is holding for collection and
- their cash flows are solely for payment of principal and interest.

Upon initial recognition, on settlement date, financial assets at amortized cost are measured at fair value, which is usually equal to the consideration paid plus transaction costs and income that can be attributed directly to the instrument. After initial recognition at fair value, these assets are measured at amortized cost that requires interest recognition on an accrual basis using the effective interest method during the life of the loan. Such interest is recognized within the item of "interest income and similar income". The carrying value of a financial asset at amortized cost is adjusted to take into account the impairment allowances/write-offs arising from the measurement process.

Impairment losses are recorded in the profit and loss under the "net impairment losses/recoveries on loans relating to the financial assets at amortized cost". In case of disposal, accumulated gains and losses are recorded in the profit and loss under the "gains (losses) on disposal and redemption of financial assets at amortized cost".

Amounts arising from adjusting the carrying amount of financial assets, gross cumulative write-offs, made to reflect changes in contractual cash flows that do not lead to discontinuation of accounting recognition, are recognized in profit and loss as gains / losses on contractual changes, yet such a line item does not include the effect of contractual change in the amount of expected loss recognized under the item "net impairment losses/recoveries on loans that relate to the item: "financial assets at amortized cost".

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. Classification and Measurement (Continued)

d) Financial Liabilities Measured at Amortized Cost

Financial liabilities measured at amortized cost include financial instruments (other than those held for trading or those that are designated at fair value) that represent different forms of financing by third parties. These financial liabilities are recognized at the settlement date initially at fair value that is usually received, less any transaction costs that can be directly attributed to the financial liability. Thereafter, these instruments are measured at amortized cost using the effective interest method. Such interest is recognized within the item of "interest expenses and similar expenses".

e) Financial Liabilities Held for Trading

Financial liabilities held for trading include derivatives not designated as hedging instruments. These liabilities are measured at fair value upon initial recognition and for the duration of the transaction.

A gain or loss arising from the sale or repurchase or change in the fair value of a financial liability held for trading is recognized in the profit and loss account under the item of "net gains (losses) on trading and foreign exchange gains/losses on the translation of monetary assets and liabilities".

f) Qualitative Information on Fair Value

Fair value disclosures are made in accordance with the requirements of IFRS 13. 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 in the principal at the measurement date (i.e., the exit price).

For financial instruments that are quoted in active markets, fair value is determined on the basis of official prices in the principal market the Bank operates in and has access to (mark to market).

A financial instrument is considered to be quoted on an active market if quoted prices are easily and regularly available from pricing services, distributors, brokers, pricing agencies or regulatory agencies, and these prices represent real and regular market transactions at the "arm's length" principle. If the published price quotation on an active market does not exist for a financial instrument as a whole, but for active markets for its components, fair value can be determined on the basis of relevant market prices for the component parts.

g) Fair Value Measurement Principles

Fair values of financial assets and financial liabilities traded in active markets are based on the quoted market prices. For all other financial instruments, the Bank determines fair values using fair value assessment (valuation) techniques.

Valuation techniques for fair value involve models of cash flow discounting to the net present value, comparison to the similar instruments with identifiable market prices and other valuation techniques. Assumptions and inputs used in valuation techniques include risk-free and reference interest rates, credit margins, prices of shares and bonds, FX rates, prices of indices and other variables and their correlations. The objective of the valuation techniques is to compute the fair value that best reflects the price of a financial instrument as at the reporting date, i.e., the price that would be determined by other market participants under the normal market conditions.

When calculating fair value, the Bank takes into account fair value hierarchy rules prescribed by IFRS 13, which reflect the significance of inputs used in the valuation process. Each instrument is assessed individually in detail. Levels of the fair value hierarchy are determined based on the lowest level of inputs relevant for determining the fair value of an instrument.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. Classification and Measurement (Continued)

h) Fair Value Assessment Models

Financial instruments carried at fair value are grouped in three levels of the fair value hierarchy under IFRS 13, as follows:

- Level 1 – instruments that are measured by means of active market quoted prices. Those are instruments whose fair value can be determined directly based on prices quoted in active liquid markets.
- Level 2 – instruments that are measured by means of valuation techniques using available market inputs. Those are instruments whose fair value is determined by comparison to similar instruments traded in active markets or where all inputs used in the measurement techniques are available in the market.
- Level 3 – instruments that are measured by means of valuation techniques using market data that are not available on the active market. Those are instruments whose fair value cannot be determined directly using available market information, and where somewhat different valuation techniques are used for the calculation of value.

i) Debt Securities

Debt securities are measured through a two-phase process dependent on the liquidity of the relevant market. Liquid instruments in active markets are measured at market value (mark to market) and are therefore classified into Level 1 of the fair value hierarchy. Instruments not traded in active markets are measured using models that make the most use of the relevant and available parameters, and the least use of the inputs unobservable in the market. Given the aforesaid, depending on the significance of unobservable inputs, bonds are classified in an appropriate level.

j) Offsetting of Financial Instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle, on a net principle, or realize the asset and settle the liability simultaneously.

Income and expenses are presented in the net amount only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as the Bank's trading activities.

2.7. Impairment

a) General part

Loans and debt securities classified as financial assets at amortized cost, financial assets at fair value through other comprehensive income and relevant off-balance sheet exposures are tested for impairment in accordance with IFRS 9.

For such purposes, these instruments are classified into Stage 1, Stage 2, or Stage 3 according to their absolute or relative credit quality compared to the initial payment.

Specifically:

- Stage 1: includes (i) newly approved or acquired credit exposures, (ii) exposures for which credit risk has not significantly increased since initial recognition, (iii) exposures with low credit risk;
- Stage 2: includes credit exposures that have a significant credit risk increase since initial recognition;
- Stage 3: includes impaired credit exposures.

For exposures in Stage 1, the impairment is equal to the expected loss that is calculated over a time horizon of up to one year.

For exposures in Stage 2, the impairment is equal to the expected loss that is calculated over a time horizon corresponding to the entire lifetime of the exposure.

For exposures in Stage 3, the impairment is calculated on a collective basis or on an individual basis, depending on the client's characteristics.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.7. Impairment (Continued)

a) General part (Continued)

In order to meet the requirements of the standards, the Group has developed specific models for calculating the expected loss on the basis of PD, LGD and EAD parameters used for regulatory purposes and adjusted to ensure consistency with the accounting regulations.

In this context, forward-looking information is included through the elaboration of specific scenarios. The stage allocation model is the key aspect of the new accounting model required for expected credit loss calculation, whose aim is transfer of credit exposures from Stage 1 to Stage 2. Stage 3 includes exposures at default.

At the Bank, the Stage allocation assessment includes a combination of relative and absolute triggers. Considering a low number of observations in the portfolio, the Bank uses only qualitative criteria in recognition of significant credit risk increase, such as:

- a) Forbearance status classification – results in an exposure automatically classified in Stage 2 at least within next 9 months (since the date of classification). After that period, if there are no other significant triggers of credit risk deterioration, the transaction may be returned into Stage 1.
- b) 30 days past due – if a transaction reaches 30 dpd, it should be classified as Stage 2.
- c) Restructuring status – all performing exposures transferred to the remit of the Special Credit Unit are automatically classified as Stage 2.
- d) Watch list classification.
- e) Manual adjustments – customers with recognized increasing credit risk but not classified using the main qualitative criteria.

When it comes to financial assets consisted of securities, in accordance with the Standard, the Bank classified them to Stage 2, since securities are classified as non-investment grade securities.

The impairment calculated for impaired (default status) assets includes forward-looking adjustments and multiple scenarios applicable to this class of assets.

The definition of default is aligned with the principles embedded in the Definition of Default Guidelines issued by European Banking Authority (EBA), where the aggregate borrower exposure is classified as a default exposure if only one of the transactions is in the default status (the so called “debtor approach”).

b) Parameters and risk definitions used for impairment calculation

As mentioned above, specific models have been developed for calculating the expected loss based on PD, LGD and EAD parameters and the effective interest rate:

- PD (Probability of Default), represents the likelihood of the occurrence of a credit exposure default event over a given time horizon;
- LGD (Loss Given Default), represents the percentage of estimated loss, and thus the expected recovery rate, at the date of the occurrence of credit exposure default;
- EAD (Exposure at Default) represents the measurement of exposure at the time of credit exposure non-payment;
- Effective interest rate is a discount rate that expresses the time value of money.

Furthermore, specific adjustments have been developed on probability of default (PD), loss given default (LGD) and exposure at default (EAD) parameters used in the expected credit loss (ECL) calculation. The new model has been developed for allocation of unimpaired assets to the so-called Stages, at the transaction level, between Stage 1 and Stage 2.

The main difference between the two Stages refers to the time horizon for which the expected credit loss is expected to be calculated. In fact, for Stage 1 transactions a one-year expected credit loss is applied, while a “lifetime” expected credit loss applies to Stage 2 transactions.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.7. Impairment (Continued)

b) Parameters and risk definitions used for impairment calculation (Continued)

The basic adjustments made to the credit parameters are the following:

- Inclusion of the “point-in-time” approach in the parameters’ calculation, instead of the “through-the-cycle” adjustment (TTC),
- Inclusion of forward-looking information (FLI), and
- credit parameters calculation considering the period of assets’ duration.

As for what concerns the lifetime PDs, the TTC PD curves, obtained by fitting the observed cumulative default rates, PDs have been further calibrated to reflect a point in time and forward-looking expectation about the portfolio default rates.

Recovery rate embedded in the TTC LGD has been adjusted to reflect the most recent recovery rate trend as well as expectation about a future trend and discounted at the effective interest rate or its best approximation.

The lifetime EAD has been obtained by extending the 1Y managerial model, including expectation about future drawing levels.

The expected credit loss derived from such adjusted parameters takes into consideration macroeconomic forecasts applying multiple scenarios so to offset the partial non linearity naturally embedded in the correlation between macroeconomic changes and the key components of expected loss. In this sense the Group has developed a so called “overlay factor” that should be directly applied on expected loss.

The same scenario is used by the Group in other risk relevant processes (EBA stress test and ICAAP). In those processes the Bank provides the necessary information in the required scope and regulated format.

c) Definition of default

The default definition is key for determining expected credit losses. The definition of default is used to measure the amount of expected credit losses and to determine whether the loss is based on a 12-month or a lifetime expected credit loss.

All exposures classified as default exposures are regarded as having objective evidence of impairment. According to the Basel III Standard, exposures are in the default status when they are over 90 days past due in liability settlement and/or the customer is unable to settle at least one of its credit liabilities in full without the Bank resorting to the collection measures.

For legal entities and private individuals’ exposures, the Bank determines the default status at the debtor level taking into account all the debtor’s exposures. Counting of the number of days past due in liability settlement commences when liabilities matured at the individual borrower level exceed the materiality threshold defined. Materiality threshold for legal entities equals the liabilities matured in the amount of 2.5% of the total exposure of the customer and BAM 500. Materiality threshold for individuals equals the liabilities matured in the amount of 1% of the total exposure of the customer and BAM 20.

d) Significant credit risk increase

The Bank monitors all financial assets subject to impairment request to estimate whether there has been a significant increase in credit risk from initial recognition. If there is a significant increase in credit risk, the Bank measures the loss based on a lifetime rather than a 12-month expected credit loss.

When assessing whether a credit risk on a financial instrument has significantly increased since its initial recognition, the Bank compares the risk of default arising on the financial instrument at the reporting date based on the remaining maturity of the instrument, with the risk of default foreseen for the remaining maturity as of the reporting date when the financial instrument was recognized for the first time. In making this assessment, the Bank also considers quantitative and qualitative information that is reasonable and evident, including historical experience and forward-looking information, available without undue expense or effort, based on the Bank’s historical experience and expert credit assessments, including FLI.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.7. Impairment (Continued)

e) Purchased or originated credit impaired assets – (POCI- Purchased or Originated Credit Impaired)

POCI financial asset is a financial asset that is credit impaired upon origination. The Standard defines the special rules for these items in terms of their valuation rules, recognition of loss provisions, recognition of interest income and the application of discount rates.

POCI assets include:

- Loans and debt securities purchased when they were already of impaired credit value,
- Loans disbursed to customers with already impaired credit value. Additionally, new financing is significant in relation to the total customer exposure.

Regarding the determination of new significant financing, the relative and absolute thresholds are applied. New financing is significant if the following criteria are met:

- it is at least 20% of total exposure in default of the borrower's liabilities or \geq BAM 100.000.

The Bank does not buy non-performing portfolios and does not have any materially significant exposure approved to clients with already impaired value (or clients with default status).

f) Write-offs

Loans and debt securities are written off if the Bank does not have reasonable expectations to recover financial assets (in whole or in part). This is the case where the Bank determines that the borrower does not have the funds or sources of income that would be able to generate enough cash flows to repay the amount that is subject to write-off. The write-off represents the event of derecognition. The Bank may apply the activities of forced collection on financial assets written off. Receipts arising from the Bank's forced collection activities will result in impairment gains.

g) Derecognition of financial assets

In the event of significant changes to the terms and conditions, the Bank ceases to recognize financial assets such as a credit to a client when the contractual terms have been changed to such extent that the contract becomes a new loan, where the difference is recognized in the gain or loss of derecognition but to the extent that impairment losses have not already been recorded. The newly recognized credit is classified as Stage 1 for ECL measurement purposes, unless new credit is POCI.

When assessing the derecognition of a loan to a client, the Bank shall, inter alia, consider the following factors: change in the currency of the loan, introduction of equity interest provisions, change of the other contracting party, or in the event that the amendment results in the instrument no longer meeting the SPPI test criteria.

If the change in the terms does not lead to a change in cash flows, the derecognition will not take place. Based on the change in cash flows discounted by the original EIR, the Bank records the gain or loss on the change, to the extent that the impairment loss is not already recorded.

In the event that there are no significant changes to the terms Financial asset (or its part or part of a group of similar financial assets) is derecognized when the right to receive cash flows from the financial asset expires or when virtually all of the risks and rewards associated with the ownership or control over property were transferred.

2.8. Presentation of Expected Credit Losses in the Statement of Financial Position

Expected credit losses are presented in the statement of financial position as follows:

- For financial assets measured at amortized cost: impairment allowance or impairment, as deduction from the gross carrying value of the asset;
- For debt instruments measured at fair value through other comprehensive income: not recognized as impairment, but as item of fair value reserves within equity,
- For liabilities under undrawn loans and contracts on financial sureties (guaranties, letters of credit and other guarantees): as provisions for risks and expenses within liabilities.

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.9. Regulatory Requirements Related to Impairment

In accordance with the local regulations, the Bank calculates provisions for credit risks according to the Banking Agency of the Republic of Srpska ("BARS") regulations. Loans, receivables and other exposure of the Bank are classified into categories prescribed by BARS depending on the expected recoverability determined based on the number of days past due, an assessment of the debtor's financial position and the quality of the collateral. The assessed amount of specific provisions for potential losses (regulatory reserve for credit losses) is calculated by applying percentages prescribed by BARS.

The percentages are prescribed depending on the category of financial assets as follows:

- Category A – Good assets 2%
- Category B – Special watch assets 5% -15%
- Category C – Substandard assets 16% - 40%
- Category D – Bad assets 41%- 60%
- Category E – Loss 100%

If general and special regulatory provisions for potential losses calculated in compliance with BARS regulations are higher than impairment allowances and provisions calculated in compliance with IFRS requirements and the opening balance of the regulatory reserves, such difference represents shortfall regulatory reserves for credit losses. When calculating the regulatory capital, the amount of the shortfall reserves for credit losses under regulatory requirements and classification criteria represents a deductible item, i.e., it is subject to regulatory adjustments.

The following table summarizes impairment and provisions in accordance with IFRS 9, IAS 39 and BARS regulations:

	IFRS 9 December 31, 2018 BAM '000	IAS 39 December 31, 2017 BAM '000
<i>Impairment</i>		
1. Cash and cash equivalents	-	-
2. Financial assets at amortized cost	74,796	n/a
a) Obligatory reserve held with the Central Bank	1,304	n/a
b) Loans and receivables due from banks	165	n/a
c) Loans and receivables due from customers	73,327	n/a
<i>Obligatory reserve held with the Central Bank (IAS39)</i>	n/a	-
<i>Loans and receivables due from banks (IAS 39)</i>	n/a	-
<i>Loans and receivables due from customers (IAS 39)</i>	n/a	76,563
3. Other assets	1,436	1,373
4. Provisions for credit risk on commitments and financial guarantees given	1,032	1,596
TOTAL (1+2+3)	77,264	79,532

Notes to the Financial Statements

2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.9. Regulatory Requirements Related to Impairment (Continued)

	BARS December 31, 2018 BAM '000	BARS December 31, 2017 BAM '000
Impairment		
Loans and receivables due from banks	13	89
Loans and receivables due from customers	71,654	73,120
Other assets	5,593	6,214
Provision for undrawn loans and guarantees	4,575	4,149
TOTAL	81,835	83,572
Shortfall regulatory reserves for credit losses:		
	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Impairment and provisions according to BARS	81,835	83,572
Impairment and provisions according to IFRS 9	(77,264)	(79,532)
Regulatory reserves	(3,604)	(3,496)
Shortfall regulatory reserves	967	544

Regulatory reserves in the amount of BAM 3,604 thousand include:

- The amount of BAM 3,496 thousand, representing a positive difference between the total calculated reserves and impairment allowance as per BARS methodology and provisions calculated under IAS 39 methodology at the time of the first application of IAS and IFRS in the Republic of Srpska (January 1, 2010).
- The amount of BAM 108 thousand, representing a positive difference between the total calculated impairment allowance and provisions according to IAS 39 methodology and those under IFRS 9 methodology (January 1, 2018).

2.10. Comparative Financial Information

In order to achieve consistency of presentation in the current reporting period in accordance with IFRS 9, certain reclassifications of items were made as at January 1, 2018, which had no impact on the Bank's financial performance and capital:

Statement of profit or loss and other comprehensive income:

- The expense of provisions for off-balance exposures in the amount of BAM 122 thousand was reclassified from the item of "net impairment losses/recoveries and provisions for credit risks" to the item of "provisions for risks and expenses".
- Negative interest income in the amount of BAM 252 thousand was reclassified from the "interest income and similar income" to the "interest expenses and similar expenses".
- Positive interest expenses in the amount of BAM 193 thousand were reclassified from the "interest expenses and similar expenses" to the "interest income and similar income".

Statement of financial position:

- Tangible assets acquired in lieu of debt collection in the amount of BAM 584 thousand were reclassified from the "other assets" (Note 24) to "tangible assets" (Note 22),
- Provisions for off-balance exposures in the amount of BAM 1,596 thousand were reclassified from the "other liabilities" to the "Provisions for credit risk on commitments and financial guarantees given" within "provisions for risks and expenses" (this item was also decreased as at January 1, 2018 by the amount of BAM 1,068 thousand as a result of the first-time adoption of IFRS 9).

Notes to the Financial Statements

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies described hereunder have been consistently applied to all the years included in these financial statements.

3.1. Interest Income and Expenses

Interest income and expenses are recognized in the statement of profit or loss for the accounting period to which they relate for all interest-bearing instruments by accrued interest principle applying the effective interest method. The effective interest rate is the rate that discounts the estimated future cash disbursements or payments over the expected life of a financial instrument or, as appropriate, a shorter period, to the net carrying value of the financial asset or liability. When calculating the effective interest rate, the Bank estimates cash flows, taking into consideration all contractual terms related to the financial instrument, but not considering future credit losses.

The calculation includes all fees and commissions paid or received by contractual parties, which are a constituent part of the effective interest rate, transaction costs and all other premiums and discounts. Such income and expenses are presented as interest income and expenses in the statement of comprehensive income.

Interest income and expenses recognized and declared in statement of profit or loss include:

- Interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest method, and
- Interest on financial assets at fair value through other total comprehensive income calculated using the effective interest method.

3.2. Fee and Commission Income and Expenses

Fees and commissions, which are constituent part of the effective interest rate on financial assets and financial liabilities, are included in interest income i.e. expenses.

Other fee and commission income, which mainly comprise fees related to credit card transactions, guarantees, loans, domestic and foreign payment transactions and other services and are recognized in the statement of profit or loss upon performance of the relevant service.

Other fee and commission expenses, primarily service and transaction fees are recognized as expenses upon receipt of the service.

3.3. Net Trading Gains and Losses and Foreign Exchange Gains and Losses on Translation of Monetary Assets and Liabilities

Net trading gains and losses and foreign exchange gains and losses arising on translation of monetary assets and liabilities include unrealized and realized trading and net foreign exchange (FX) gains and losses on derivative financial instruments, and gains and losses arising on translation of monetary assets and liabilities.

3.4. Foreign Currencies

Transactions in foreign currencies are translated into BAM at the exchange rate prevailing at the date of each transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into BAM at the foreign exchange rate effective at that date. Foreign exchange differences arising on translation are recognized in the statement of profit and loss, except in the case of FX gains and losses arising on non-monetary financial assets at fair value through other comprehensive income, which are recognized within equity. Non-monetary assets and liabilities denominated in foreign currencies measured at amortized cost are translated into BAM using the exchange rate effective at the date of the transaction and are not retranslated at the reporting date.

Notes to the Financial Statements

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Specific instruments

Cash and Cash Equivalents

Cash and cash equivalents include: cash, cheques in the process of collection and cash deposited on the account with the Central Bank in excess of the amount of the obligatory reserve.

Financial Guarantees and Loan Commitments

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are initially recognized at their fair value, which is amortized over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of its amortized amount and the present value of any expected payment (when a payment under the guarantee has become probable).

Loan commitments are firm commitments to approve loans under pre-specified terms and conditions.

3.6. Tangible Assets

Recognition and Measurement

Property and equipment are tangible assets that are held for use in the supply of services or for other administrative purposes.

Property and equipment are presented at historical or assumed cost less accumulated depreciation and impairment losses. The historical cost includes the costs directly related to the acquisition of assets.

Equipment is measured at cost less accumulated depreciation and impairment.

Subsequent Costs

Cost includes the invoiced amount of purchased assets increased by all costs incurred until the moment of placing the new assets into use. Subsequent costs are included in the book value of the asset or recognized as a separate asset, as appropriate, only when it is probable that the Bank will have future economic benefits from this asset and the value of this asset can be reliably measured. Repair and current maintenance costs are charged to the statement of profit or loss during the period in which they are incurred.

Depreciation

Depreciation is calculated for all assets, except land, works of art and assets under construction, on a straight-line basis in order to write-off the cost of assets over their estimated useful lives.

The residual value of assets and estimated useful lives are reviewed at each reporting date.

Gains or losses on the disposal of assets are determined as the difference between the sales/disposal proceeds and the net carrying value and are recorded within other operating income or other operating expenses.

Depreciation rates used for property and equipment are set out below:

	2018	2017
Buildings	2.0% - 5.0%	2.0% - 5.0%
Electronic systems	12.5% - 25.0%	12.5% - 25.0%
Office furniture and equipment	12.5% - 20.0%	12.5% - 20.0%
Other	12.5% - 25.0%	12.5% - 25.0%
Leasehold improvements	20.0%	20.0%

Notes to the Financial Statements

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Tangible Assets Acquired by Collateral Foreclosure

Tangible assets acquired by collateral foreclosure (property and equipment) in order to prevent losses from the crediting operations is recognized on the date of transfer of ownership of the property or the date of acquisition of control over the equipment, at the lower of the following two values:

- The net carrying value of receivables secured by collateral or
- The amount of settlement of the claims specified in the court decision, under which the collateral is being taken over.

3.8. Impairment of Non-Financial Assets

The net carrying value is reviewed once a year for property owned by the Bank in order to determine whether there are circumstances indicating impairment thereof. If the existence of such indications is established, the recoverable amount of the assets is estimated. An impairment loss is recognized in the statement of comprehensive income whenever the net carrying amount of an asset exceeds its recoverable amount.

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, taking into account depreciation charge, if no impairment loss had been recognized.

3.9. Intangible Assets

Intangible assets are measured at cost less accumulated amortization and impairment. Cost includes all costs directly attributable to the acquisition of the assets.

Intangible assets, with the exception of intangible assets in progress, are amortized on a straight-line basis over their estimated useful economic lives. Useful life is reviewed and adjusted, if necessary, at each reporting date.

Amortization rates used for intangible assets are set out below:

	<u>2018</u>	<u>2017</u>
Intangible assets – software and licenses	20.0%-25.0%	20.0%-25.0%

4. SIGNIFICANT ACCOUNTING ESTIMATES AND ASSESSMENT

4.1. Provisions for Risks and Expenses

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, if 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 for unidentified losses on off-balance-sheet credit risk exposures in accordance with regulations.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of future losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of different transactions, as well as other relevant facts. Provisions are released only for such expenditure in respect of which provisions were recognized at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

Notes to the Financial Statements

4. SIGNIFICANT ACCOUNTING ESTIMATES AND ASSESSMENT (Continued)

4.2. Equity

Share Capital

Share capital comprises common stock (ordinary) shares and is stated in BAM at nominal value.

Reserves from Profit

Reserves from profit were formed through the distribution of the net profits from prior years.

According to the Companies Act, upon distribution of profit as per the annual accounts, shareholding companies in the Republic of Srpska are required to allocate minimum 5% of their annual profit to reserves from profit until the amount of such reserves reaches the level of 10% of the company's shareholding capital.

Share Premium

Share premium represents the accumulated positive difference between the nominal value of the issued shares and the paid-in amount.

Fair Value Reserves

Reserves generated based on the fair value calculation include changes in fair value and reserves for credit risks of financial assets at fair value through other comprehensive income, net of deferred tax.

Dividends

Dividends on ordinary shares are recognized as a liability in the period in which they are approved by the Bank's shareholders.

Retained earnings or accumulated profit include retained and unallocated earnings that can be distributed in the ensuing period.

4.3. Commitments and Contingent Liabilities

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

4.4. Managed Funds for and on Behalf of Third Parties (Consignment)

The Bank manages funds for and on behalf of third parties. These funds do not constitute part of the Bank's assets, and, therefore, they are excluded from the statement of financial position. The Bank receives fee income for providing these services and does not bear any credit risk.

4.5. Segment Reporting

An operating segment represents portion of assets, liabilities and business activities (products and services) subject to risks and benefits different from those in other operating segments. A geographic segment generates products or services within a specific economic environment that are subject to risks and benefits different from those operating in other economic environments.

The Bank has identified three main segments: Corporate and Investment Banking, Retail and Other.

Basic information per segment is based on the internal reporting structure of operating segments. Segment results are measured by applying an internal funding price (Note 5).

Notes to the Financial Statements

4. SIGNIFICANT ACCOUNTING ESTIMATES AND ASSESSMENT (Continued)

4.6. Employee Benefits

Employee Salaries

Gross salary costs are recorded in the statement of profit or loss in the period when incurred. Gross salaries include net employee salaries/wages, personal income tax and payroll, i.e., social insurance contributions calculated as the prescribed percentages applicable to the gross salary amount. The aforesaid contributions are paid by the Bank to the mandatory social insurance funds.

Employee commuting allowances, meal allowances, annual leave allowance and other benefits to employees are paid in accordance with the local legislation. These costs are recognized in the statement of profit or loss in the period when incurred.

Jubilee Awards

The Bank pays out jubilee awards to its employees in accordance with the regulations of the Republic of Srpska. Jubilee awards are paid out in the amount of one average salary paid by the Bank in the month preceding the payment for the completion of 20 years of service, or two average salaries paid by the Bank for the completion of 30 years of service with the Bank.

Retirement Benefits

In accordance with internal regulations on salaries, the Bank pays retirement benefits to employees upon retirement in the amount of three average monthly net salaries of the vesting employee. Calculation of long-term provisions for employee retirement benefits is performed annually by a certified actuary using the projected unit credit method. The projected unit credit method takes into consideration each year of service with the Bank, where the sum of all the particular units is the final liability which is measured individually for each unit. Liabilities are measured at present values of estimated future cash flows discounted at an econometrically modelled interest rate, which is more adequate in the existing market conditions than the interest rate on Government long-term debt securities.

4.7. Dividend Income

Dividend income is recognized in the statement of profit or loss when the Bank's right to receive dividends has been established.

4.8. Earnings per Share

Earnings per share are calculated by dividing the profit or loss and other comprehensive income for the current period by the weighted average number of ordinary shares outstanding during the period.

4.9. Leases

Leases where the Bank as a lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. At the reporting date, the Bank had no finance leases. All other leases are classified as operating leases. Payments made under operating leases are recognized in the statement of profit or loss on a straight-line basis over the lease term.

As noted in section "Initial implementation of new and amendment to existing standards that came into effect", effective from January 1, 2019, lease payments will only be recognized for short-term leases and leases of small value, while the leases over one year and of higher value will be recognized as tangible assets.

Notes to the Financial Statements

4. SIGNIFICANT ACCOUNTING ESTIMATES AND ASSESSMENT (Continued)

4.10. Income Tax

Income tax is based on taxable profit for the year and comprises current and deferred taxes.

Current Income Tax

Current income tax is the amount calculated by applying the prescribed tax rate of 10% to the taxable income determined in the income tax return, which represents the amount of the profit before tax adjusted for the effects of income and expense adjustments and any adjustments to the tax payable for prior years, in accordance with the tax legislation of the Republic of Srpska.

Deferred Tax

Deferred tax is recognized taking into account the temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and the amounts used for tax calculation purposes. Deferred taxes are not recognized on temporary differences at initial recognition of assets and liabilities in a transaction other than a business combination and which does not affect accounting or taxable profit. The amount of deferred tax asset or liability is recognized using the tax rate that is expected to be applied to taxable profit for the period in which realization or settlement of the carrying values of the assets or liabilities is expected, based on the tax rates applicable at the reporting date.

Measurement of deferred tax liabilities and assets reflects the tax effects that would result from the manner in which the Bank expects, at the reporting date, to recover or settle the net carrying values of these assets and liabilities.

Deferred tax assets and liabilities are offset only if they relate to the same tax jurisdiction and if there is a legal right to offset current tax assets and liabilities. Deferred tax assets and liabilities are not discounted and are classified as long-term assets and/or liabilities in the statement of financial position.

Deferred tax assets are recognized only to the extent that it is probable that they could be utilized as tax relief. At each reporting date, the Bank reassesses unrecognized contingent deferred tax assets and tests the carrying values of the recognized deferred tax assets for impairment and is reduced to the extent that it is no more likely that the recognized tax assets can be utilized.

4.11. Regulatory Requirements

The Banking Agency of the Republic of Srpska (BARS) is authorized to perform regulatory inspection of the Banks' operations and can request adjustments to the carrying values of assets and liabilities in accordance with the relevant regulations.

During 2017 and 2018, BARS adopted a new Law on Banks and a series of bylaws aimed to harmonize the regulatory framework for banking operations in the Republic of Srpska with the regulatory framework of the European Union.

4.12. Litigations

The Bank performs an individual assessment of all court cases and makes provisions according to the assessment. The assessment is performed by a special Commission of three members, two of whom are employees of the Bank's Legal Affairs, and one is from the Human Resources. The managers of the Legal Affairs, Human Resources, Accounting and Reporting and Payment Systems and Account Administration verify proposals for provisions after the assessment, and the decision on creating the provisions is made by the Bank's Management Board.

At the reporting date, there were 45 legal suits instigated against the Bank, 20 of which included damage claims filed. According to the Decision of the Bank's Management Board, at the proposal of the Commission for risk assessment of liabilities for litigations against the Bank, for the suits that the Bank believes could be lost or significant costs may be incurred thereon, provisions were formed in the total amount of BAM 2,037 thousand, fully relating to provisions for other legal suits (2017: BAM 1,722 thousand and BAM 81 thousand for other legal suits and for labor suits, respectively) (Note 15 and 29).

Notes to the Financial Statements

5. SEGMENT REPORTING

Segments recognized for the purposes of segment reporting in accordance with UniCredit Group methodology comprise the following:

1. "Retail": private individuals, entrepreneurs, micro and small companies;
2. "Corporate and Investment Banking" (CIB): large and medium-sized companies and public sector;
3. "Other": capital and reserves, Assets and Liability Management, other centralized services and other assets and liabilities not associated with other segments.

Segment reports were prepared in accordance with internal Bank's management reports and additionally reconciled with the financial statements within these notes.

When measuring operating results, internal funding prices are applied based on specific prices of products and services reflecting currencies and maturities in accordance with the methodology of the Group.

Statement of profit or loss and other comprehensive income by segment

Year Ended December 31, 2018	Corporate and Investment Banking BAM '000	Retail BAM '000	Other BAM '000	Total by segment reports BAM '000	Adjustments BAM '000	Total by financial statements BAM '000
Net interest income	21,359	27,580	2,604	51,543	-	51,543
Net fee and commission income	3,858	12,273	(505)	15,626	-	15,626
Dividend and profit sharing income	-	-	10	10	-	10
Net foreign gains/losses on translation of monetary assets and liabilities	1,080	663	-	1,743	-	1,743
Gains on investments	-	-	-	-	-	-
Total operating income	26,297	40,516	2,109	68,922	-	68,922
Personnel expenses	(1,146)	(6,415)	(9,186)	(16,747)	-	(16,747)
Tangible assets amortization costs	(119)	(871)	(605)	(1,595)	-	(1,595)
Intangible assets amortization costs	(62)	(434)	(383)	(879)	-	(879)
Other administrative expenses	(1,299)	(5,988)	(4,056)	(11,343)	(1,641)	(12,984)
Indirect and other allocated expenses	(3,236)	(10,320)	13,556	-	-	-
Total operating expenses	(5,862)	(24,028)	(674)	(30,564)	(1,641)	(32,205)
Profit before impairment and provisions	20,435	16,488	1,435	38,358	(1,641)	36,717
Net loan impairment losses/recoveries	(1,113)	(3,488)	(607)	(5,208)	(589)	(5,797)
a) Financial assets at amortized cost	-	-	-	-	(4,702)	(4,702)
b) Financial assets at fair value through other comprehensive income	-	-	-	-	(1,095)	(1,095)
Provisions for risks and expenses	(1,158)	(979)	22	(2,115)	1,241	(874)
a) Provisions for credit risk on commitments and financial guarantees given	-	-	-	-	(514)	(514)
b) Provisions for retirement benefits	-	-	-	-	-	10
c) Provisions for litigations	-	-	-	-	-	(370)
Other operating income and expenses	-	-	(89)	(89)	(105)	(194)
Gains/losses on the sales of tangible assets	(744)	102	61	(581)	1,094	513
Profit before tax	17,420	12,123	822	30,365	-	30,365
Income tax expense	(1,488)	(1,036)	(70)	(2,594)	-	(2,594)
Profit for the year	15,932	11,087	752	27,771	-	27,771
Statement of other comprehensive income						
Profit for the year	15,932	11,087	752	27,771	-	27,771
Other comprehensive income, net of income taxes						
Items that can be subsequently reclassified to gains or losses:						
- (Losses)/gains on financial assets at fair value through other comprehensive income	-	-	650	650	-	650
Total comprehensive income for the year	15,932	11,087	1,402	28,421	-	28,421

Notes to the Financial Statements

5. SEGMENT REPORTING (Continued)

Statement of profit or loss and other comprehensive income by segment (Continued)

Year Ended December 31, 2017	Corporate and Investment Banking BAM '000	Retail BAM '000	Other BAM '000	Total by segment reports BAM '000	Adjustments BAM '000	Total by financial reports BAM '000
Net interest income	19,778	26,717	4,227	50,722	-	50,722
Net fee and commission income	3,968	10,855	(510)	14,313	(1)	14,312
Dividend and profit sharing income	-	-	48	48	-	48
Net foreign gains/losses on translation of monetary assets and liabilities	904	612	166	1,682	(167)	1,515
Other expenses*	9	8	(385)	(368)	368	-
(Losses)/ Gains on investment	-	-	-	-	166	166
Total operating income	24,659	38,192	3,546	66,397	366	66,763
Total operating expenses	(5,407)	(23,926)	(615)	(29,948)	(1,485)	(31,433)
Profit before impairment and provisions	19,252	14,266	2,931	36,449	(1,119)	35,330
Net impairment losses/ (gains) and provisions for credit risk	(2,403)	(3,601)	-	(6,004)	-	(6,004)
Provisions for risks and expenses	(825)	(1,174)	(31)	(2,030)	1,580	(450)
Impairment gains on property and equipment*	-	-	22	22	-	22
Other operating income and expenses	-	-	-	-	(462)	(462)
Profit before tax	16,024	9,491	2,922	28,437	(1)	28,436
Income tax expense	(1,500)	(888)	(274)	(2,662)	1	(2,661)
Profit for the year	14,524	8,603	2,648	25,775	-	25,775
Other comprehensive income, net of income tax	-	-	-	-	-	-
Changes in net value reserves, net of income tax	-	-	(133)	(133)	-	(133)
Total comprehensive income for the year	14,524	8,603	2,515	25,642	-	25,642

*Segment report line item

Income and results per segment presented in the tables above (for the years ended December 31, 2018 and 2017) represent income generated from products sold and services rendered to customers within these segments.

Accounting policies of the reporting segments are identical to the Bank's accounting policies described in Note 3. Segment profit represents the profit of each segment with included all allocated costs and revenues. The aforesaid is the criterion used for reporting to the managers in charge of key decision making for the purpose of allocating adequate resources to the segments and analysis of their results.

The Bank's revenues from its core services are disclosed in detail in Notes 6 and 8 to the financial statements.

Notes to the Financial Statements

5. SEGMENT REPORTING (Continued)

Statement of financial position

December 31, 2018	Corporate and Investment Banking BAM '000	Retail BAM '000	Other BAM '000	Total by segment reports BAM '000	Adjustments BAM '000	Total by financial statements BAM '000
Assets						
Cash and cash equivalents	-	-	225,492	225,492	-	225,492
Financial assets held for trading	-	-	1	1	-	1
Financial assets at fair value through other comprehensive income	187,564	-	9,702	197,266	(1)	197,265
Financial assets at amortized cost	460,289	477,085	269,892	1,207,266	-	1,207,266
a) Obligatory reserve with the Central Bank	-	-	125,877	125,877	-	125,877
b) Loans and receivables due from banks	-	-	144,015	144,015	-	144,015
c) Loans and receivables due from customers	460,289	477,085	-	937,374	-	937,374
Property and equipment	-	-	17,762	17,762	(1)	17,761
Intangible assets	-	-	8,115	8,115	-	8,115
Deferred tax assets	-	-	77	77	-	77
Other assets	-	-	6,254	6,254	-	6,254
Total assets	647,853	477,085	537,295	1,662,233	-	1,662,231
Liabilities						
Financial liabilities at amortized cost	532,184	474,467	415,669	1,422,320	-	1,422,320
a) Deposits and borrowings due to banks	-	-	415,669	415,669	-	415,669
b) Deposits and borrowings due to customers	532,184	474,467	-	1,006,651	-	1,006,651
Financial liabilities held for trading	-	-	-	-	-	-
Tax liabilities	-	-	178	178	-	178
a) Current tax liabilities	-	-	178	178	-	178
b) Deferred tax liabilities	-	-	-	-	-	-
Other liabilities	-	-	17,737	17,737	-	17,737
Provisions for liabilities and costs	-	-	3,321	3,321	-	3,321
a) Provisions for credit risk on commitments and financial guarantees given	-	-	1,032	1,032	-	1,032
b) Provisions for retirement benefits	-	-	252	252	-	252
c) Provisions for litigations	-	-	2,037	2,037	-	2,037
Total liabilities	532,184	474,467	436,905	1,443,556	-	1,443,556
Equity and reserves						
Share capital	-	-	97,055	97,055	-	97,055
Share premium	-	-	373	373	-	373
Legal reserves	-	-	9,706	9,706	-	9,706
Capital reserves	-	-	39,242	39,242	-	39,242
Regulatory reserves for credit losses	-	-	3,604	3,604	-	3,604
Fair value reserves	-	-	2,447	2,447	-	2,447
Retained earnings	-	-	38,477	38,477	-	38,477
Net profit for the year	15,932	11,087	752	27,771	-	27,771
Total equity and reserves	15,932	11,087	191,656	218,675	-	218,675
Total liabilities, equity and reserves	548,116	485,554	628,561	1,662,231	-	1,662,231

Notes to the Financial Statements

5. SEGMENT REPORTING (continued)

Statement of financial position

December 31, 2017	Corporate and Investment Banking BAM '000	Retail BAM '000	Other BAM '000	Total by segment reports BAM '000	Adjustments BAM '000	Total by financial statements BAM '000
Assets						
Cash and cash equivalents	-	-	170,568	170,568	-	170,568
Obligatory reserve with the Central Bank	-	-	116,002	116,002	-	116,002
Loans and receivables due from banks	-	-	100,444	100,444	-	100,444
Financial assets at fair value through other comprehensive income	152,892	-	16,650	169,542	-	169,542
Financial assets at fair value through profit and loss	-	-	10	10	-	10
Loans and receivables from customers	450,289	445,473	-	895,762	-	895,762
Property and equipment	-	-	16,468	16,468	-	16,468
Intangible assets	-	-	5,887	5,887	-	5,887
Other assets	-	-	5,997	5,997	-	5,997
Deferred tax assets	-	-	16	16	-	16
Total assets	603,181	445,473	432,042	1,480,696	-	1,480,696
Liabilities						
Deposits and borrowings due to banks	-	-	395,901	395,901	-	395,901
Deposits and borrowings due to customers	422,569	441,059	-	863,628	-	863,628
Financial liabilities at fair value through profit or loss	-	-	621	621	-	621
Other liabilities	-	-	15,329	15,329	-	15,329
Provisions for liabilities and costs	-	-	3,662	3,662	-	3,662
Current income tax liability	-	-	417	417	-	417
Deferred income tax liability	-	-	16	16	-	16
Total liabilities	422,569	441,059	415,946	1,279,574	-	1,279,574
Equity and reserves	-	-	175,347	175,347	-	175,347
Net profit for the year	14,524	8,603	2,648	25,775	-	25,775
Total equity and reserves	14,524	8,603	177,995	201,122	-	201,122
Total liabilities, equity and reserves	437,093	449,662	593,941	1,480,696	-	1,480,696

Notes to the Financial Statements

6. INTEREST INCOME AND SIMILAR INCOME

a) Breakdown by type of financial asset

	Debt securities			
	2018	Loans 2018	Total 2018	Total 2017
	BAM '000	BAM '000	BAM '000	BAM '000
1. Financial assets at fair value through other comprehensive income	8,837	-	8,837	n/a
<i>Financial assets available for sale (IAS 39)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>8,164</i>
2. Financial assets at amortized cost				
a) Obligatory reserve with the Central Bank	-	-	-	n/a
b) Loans and receivables due from banks	-	459	459	
c) Loans and receivables due from customers	-	51,294	51,294	
<i>Obligatory reserve with the Central Bank (IAS 39)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	
<i>Loans and receivables due from banks (IAS 39)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>283</i>
<i>Loans and receivables due from customers (IAS 39)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>53,270</i>
Total	8,837	51,753	60,590	61,717
<i>Of which: interest income on non-performing portfolio</i>	<i>-</i>	<i>487</i>	<i>487</i>	<i>1,006</i>

b) Breakdown by sectors:

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Private individuals	29,871	30,216
Companies and entrepreneurs	12,821	14,675
Banks	459	283
Public sector	17,439	16,543
	60,590	61,717

7. INTEREST EXPENSES AND SIMILAR EXPENSES

a) Breakdown by type of financial liabilities

	Deposits	Borrowings	Total 2018	Total 2017
	2018	2018		
	BAM '000	BAM '000	BAM '000	BAM '000
Financial liabilities at amortized cost				
a) Deposits and borrowings due to banks	2,317	350	2,667	n/a
b) Deposits and borrowings due to customers	5,525	855	6,380	n/a
<i>Deposits and borrowings due to banks (IAS 39)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>2,732</i>
<i>Deposits and borrowings due to customers (IAS 39)</i>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	<i>8,263</i>
Total	7,842	1,205	9,047	10,995

Notes to the Financial Statements

7. INTEREST EXPENSES AND SIMILAR EXPENSES (Continued)

b) Breakdown by sectors:

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Private individuals	2,915	3,809
Companies and entrepreneurs	1,491	2,156
Banks	2,667	2,732
Public sector	306	163
Other organizations	1,668	2,135
	9,047	10,995

8. FEE AND COMMISSION INCOME

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Domestic payment transactions	6,955	6,440
Foreign payment transactions	2,007	1,986
Payment of foreign pensions and remittances of individuals	1,780	1,703
Issuance of guarantees and other sureties	1,445	1,370
Card operations	2,102	1,833
Loan origination fees	2,537	1,846
Foreign exchange spot trading gains and cash operations	1,357	1,660
Other fees and commissions	434	440
	18,617	17,278

9. FEE AND COMMISSION EXPENSE

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Card operations	1,767	1,618
Domestic payment transactions	700	631
Foreign payment transactions	203	216
Cash operations	18	245
Loan origination/processing fees	96	104
Other fees and commissions	207	152
	2,991	2,966

10. DIVIDEND AND PROFIT SHARING INCOME

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Dividend income	10	48
	10	48

Notes to the Financial Statements

11. FOREIGN EXCHANGE GAINS UPON TRANSLATION OF MONETARY ASSETS AND LIABILITIES

	Year Ended December 31,	2017
	2018	2017
	BAM '000	BAM '000
Net foreign exchange gains upon translation of monetary assets and liabilities	1,743	1,515
	1,743	1,515

12. PERSONNEL EXPENSES

	Year Ended December 31,	2017
	2018	2017
	BAM '000	BAM '000
Fixed payments - gross salaries	13,116	13,365
Variable payments - bonuses	1,572	1,454
Other personnel costs	1,479	618
Severance pays and retirement benefits	394	489
Other costs (service contracts)	186	113
Total personnel expenses	16,747	16,039

Personnel expenses include contributions for pension and disability insurance paid in 2018 in the amount of BAM 2,898 thousand (2017: BAM 2,593 thousand).

13. OTHER ADMINISTRATIVE EXPENSES

	Year Ended December 31,	2017
	2018	2017
	BAM '000	BAM '000
Information & communication technology expenses	3,847	3,406
Sundry operating expenses	2,488	2,516
Real estate expenses	1,851	1,794
Consulting & professional services	1,755	1,631
Security and cash management	1,018	1,152
Advertising & marketing expenses	699	829
Back office expenses	500	550
Other personnel expenses	422	393
Indirect taxes and contributions	300	285
Loan origination and monitoring fees payable	104	75
	12,984	12,631

Notes to the Financial Statements

14. NET IMPAIRMENT LOSSES AND PROVISIONS FOR CREDIT RISK

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Financial assets at fair value through other comprehensive income	1,095	-
Loans and receivables due from banks	605	-
Loans and receivables due from customers (Note 21)	4,097	5,882
	5,797	5,882

15. PROVISIONS FOR RISKS AND EXPENSES

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Provisions for litigations and court expenses	370	450
Provisions for undrawn loans and guarantees	504	122
	874	572

16. INCOME TAX

Income tax charged to the statement of profit or loss comprises current and deferred taxes.

a) Income tax expense recognized within the statement of profit or loss

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Current income tax expense	2,622	2,645
Deferred income tax (benefit)/expense (Note 27)	(28)	16
Total	2,594	2,661

b) Reconciliation of the income tax expenses

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Profit before tax	30,365	28,436
Income tax at the rate of 10%	3,037	2,844
Decrease of the income tax for deductible income	(972)	(866)
Increase of the income tax for impairment losses on loans and other assets which are not deductible for tax purposes	369	503
Increase of the income tax for other expenses not deductible for tax purposes	160	180
Income tax expense	2,594	2,661
Average effective income tax rate	8.54%	9.36%

Notes to the Financial Statements

16. INCOME TAX (continued)

The effective tax regulations stipulate expenses and income recognized for the purpose of taxable income calculation as well as the amount of impairment losses on loans deductible for tax purposes to the maximum amount that is prescribed by the Banking Agency of the Republic of Srpska for B, C, D, and E categories.

Tax liabilities are recognized in accordance with the tax returns prepared by the Bank. However, the Bank may be subject to subsequent inspection by the tax authorities over a period of five years following the year for which the tax return was issued. The Bank's Management Board is not aware of any circumstances, which may give rise to a potential material liability in this respect.

17. CASH AND CASH EQUIVALENTS

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Cash in the local currency	20,105	18,022
Funds held with the Central Bank – gyro account	199,745	147,052
Cash in foreign currencies	5,642	5,494
	225,492	170,568

18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

a) Financial assets at fair value through other comprehensive income by type:

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
<i>Equity securities</i>		
Domestic insurance companies	8	8
Other domestic companies	101	101
Foreign companies	8	8
	117	117
Quoted	8	8
Unquoted	109	109
	117	117
<i>Debt securities</i>		
Securities of the Republic of Srpska	197,148	167,327
Treasury bills of the Republic of Srpska	-	2,098
	197,148	169,425
Quoted	197,148	169,425
Unquoted	-	-
	197,148	169,425
Total financial assets at fair value through other comprehensive income	197,265	169,542

Notes to the Financial Statements

18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (Continued)

b) Breakdown of the financial assets at fair value through other comprehensive income by level of fair value:

	Level 1 '000 BAM	Level 2 '000 BAM	Level 3 '000 BAM	Total '000 BAM
December 31, 2018				
Equity securities	-	-	117	117
Bonds of the Republic of Srpska	-	197,148	-	197,148
Treasury bills of the Republic of Srpska	-	-	-	-
Total	-	197,148	117	197,265
December 31, 2017				
Equity securities	-	-	117	117
Bonds of the Republic of Srpska	-	167,327	-	167,327
Treasury bills of the Republic of Srpska	-	2,098	-	2,098
Total	-	169,425	117	169,542

After collecting and analyzing detailed data on turnover and debt security prices on the market of the Republic of Srpska, it was decided on the level of UniCredit Group that debt securities in the Bank's portfolio ought to be kept within hierarchy level 2.

c) External rating of the debt securities

As for the external rating of debt securities, the external credit rating of the state of Bosnia and Herzegovina was applied, which, according to the Agency for Credit Rating Standard & Poor's was "B / stable", and according to Moody's Investors Service "B 3 / stable."

19. OBLIGATORY RESERVE WITH THE CENTRAL BANK

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Obligatory reserve with the Central Bank in domestic currency	127,181	116,002
Cash impairment	(1,304)	-
	125,877	116,002

The Central Bank of Bosnia and Herzegovina (the "Central Bank") has prescribed a method for calculating and maintaining obligatory reserves, as well as the amount and manner of payment of fees for the amount of obligatory reserve and on the amount of funds in excess of the obligatory reserve held on the account with the Central Bank.

The basis for the calculation of the obligatory reserve is the average amount of deposits and borrowed funds in BAM and foreign currencies (denominated in BAM, at the exchange rate of the Central Bank effective over the calculation period).

From July 1, 2016 on, the Decision on Determining and Maintaining Required Reserves and Defining the Fees Payable by the Central Bank to Banks on the Amount of Reserves, which was enacted by the Governing Board of the Central Bank has defined a unique required reserve rate of 10%, which is to be applied for the required reserve calculation. The basis for calculation of the obligatory reserve excludes deposits placed with the Bank by domestic banks and domestic banks in bankruptcy.

From July 1, 2016 on, the Central Bank did not calculate the fee on the amount of obligatory reserve funds. On the amount of funds in excess of the obligatory reserve it calculated the fee at the rate that is equal to 50% of the rate applied by the European Central Bank on deposits of commercial banks (Deposit Facility Rate).

In 2018 the Central Bank neither calculated nor paid any fees on obligatory reserve. In 2018, the Central Bank charged from banks fees payable for funds in excess of the obligatory reserve which equaled 0.2%.

Notes to the Financial Statements

20. LOANS AND RECEIVABLES DUE FROM BANKS

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Loans to foreign banks	128,171	97,389
Loans to domestic banks	16,009	3,055
Impairment	(165)	-
	144,015	100,444

Of loans and receivables due from banks totaling BAM 144,015 thousand as of December 31, 2018, the amount of BAM 18,840 thousand relates to loans and receivables from related banks (2017: BAM 28,699 thousand).

Within the loans and receivables from related banks, the amount of BAM 16,000 thousand refers to the funds placed as cash collateral (2017: BAM 3,000 thousand).

21. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

a) Breakdown by product

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Legal entities		
- in BAM	326,518	219,068
- in foreign currencies	58,192	80,479
- with foreign currency clause	150,403	229,254
Total gross	535,113	528,801
Impairment allowance of loans	(39,696)	(45,833)
	495,417	482,968
Private individuals		
- in BAM	180,827	164,253
- in foreign currencies	31	46
- with foreign currency clause	294,730	279,225
Total gross	475,588	443,524
Impairment allowance of loans	(33,631)	(30,730)
	441,957	412,794
Total gross loans	1,010,701	972,325
Total net loans	937,374	895,762

Notes to the Financial Statements

21. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

b) Movements on impairment allowance of loans and interest

	Loans Legalclients BAM '000	Loans Private individuals BAM '000	Interest Legal clients BAM '000	Interest Private individuals BAM '000	Total BAM '000
Balance at January 1, 2017	43,463	28,223	2,607	776	75,069
Net loss recognized in the statement of profit or loss (Note 14)	3,097	2,786	(2)	1	5,882
Write offs	(3,288)	(1,026)	(44)	(30)	(4,388)
Balance at December 31, 2017	43,272	29,983	2,561	747	76,563
First-time adoption of IFRS 9	(1,650)	(177)	9	4	(1,814)
Net loss recognized in the statement of profit or loss (Note 14)	713	3,384	(11)	11	4,097
Write-offs/transfers and rounding	(4,094)	(341)	(1,104)	20	(5,519)
Balance at December 31, 2018	38,241	32,849	1,455	782	73,327

22. TANGIBLE ASSETS

	Land and buildings BAM '000	Equipment and other assets BAM '000	Investmen ts in progress BAM '000	Foreclose d tangible assets BAM '000	Total tangible assets BAM '000
Cost					
Balance as at January 1, 2017	25,258	15,829	727	-	41 814
Additions	-	-	1,866	-	1,866
Transfers	308	423	(731)	-	-
Sales and write-offs	-	(968)	-	-	(968)
Balance as at December 31, 2017	25,566	15,284	1,862	-	42,712
Balance as at January 1, 2018	25,566	15,284	1,862	-	42,712
Additions	-	-	2,304	584	2,888
Transfers	772	1,842	(2,614)	-	-
Sales and write-offs	-	(406)	-	-	(406)
Balance as at December 31, 2018	26,338	16,720	1,552	584	45,194
Accumulated depreciation					
Balance as at January 1, 2017	12,487	13,135	-	-	25,622
Charge for the year	555	1,035	-	-	1,590
Sales and write-offs	-	(968)	-	-	(968)
Balance as at December 31, 2017	13,042	13,202	-	-	26,244
Balance as at January 1, 2018	13,042	13,202	-	-	26,244
Charge for the year	571	1,024	-	-	1,595
Sales and write-offs	-	(406)	-	-	(406)
Balance as at December 31, 2018	13,613	13,820	-	-	27,433
Net book value:					
Balance as at December 31, 2017	12,524	2,082	1,862	-	16,468
Balance as at December 31, 2018	12,725	2,900	1,552	584	17,761

Notes to the Financial Statements

22. TANGIBLE ASSETS (Continued)

The carrying value of non-depreciable land within the class of land and buildings amounted to BAM 3,159 thousand (2017: BAM 3,159 thousand).

Investments in progress in the amount of BAM 1,552 thousand as of December 31, 2018 (2017: BAM 1,862 thousand) relate to the equipment not yet placed into use.

During 2018 there were no mortgage or pledge liens instituted over the Bank's property and equipment.

The Bank tested property for impairment as of December 31, 2018, and, based on the impairment test results, concluded that there was no need for impairment.

23. INTANGIBLE ASSETS

	Software BAM '000	Other BAM '000	Investments in progress BAM '000	Total intangible assets BAM '000
Cost				
Balance as at January 1, 2017	17,065	4,340	2,978	24,383
Additions	-	-	2,494	2,494
Transfers	1,516	301	(1,817)	-
Sales and write-offs	(35)	(9)	-	(44)
Balance as at December 31, 2017	18,546	4,632	3,655	26,833
Balance as at January 1, 2018	18,546	4,632	3,655	26,833
Additions	-	-	3,108	3,108
Transfers	2,009	584	(2,593)	-
Sales and write-offs	-	-	-	-
Balance as at December 31, 2018	20,555	5,216	4,170	29,941
Accumulated amortization				
Balance as at January 1, 2017	15,699	4,118	-	19,817
Charge for the year	716	457	-	1,173
Sales and write-offs	(35)	(9)	-	(44)
Balance as at December 31, 2017	16,380	4,566	-	20,946
Balance as at January 1, 2018	16,380	4,566	-	20,946
Charge for the year	680	199	-	879
Sales and write-offs	-	1	-	1
Balance as at December 31, 2018	17,060	4,766	-	21,826
Net book value:				
Balance as at December 31, 2017	2,166	66	3,655	5,887
Balance as at December 31, 2018	3,495	450	4,170	8,115

Intangible assets – investments in progress amounting to BAM 4,170 thousand as of December 31, 2018 (2017: BAM 3,655 thousand) relate to the software and other intangible assets not yet placed into use.

As of December 31, 2018, the Bank had no internally generated intangible assets.

Notes to the Financial Statements

24. OTHER ASSETS

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Fee receivables in the local currency	192	198
Receivables for employee salary refunds	1,372	1,167
Receivables from card operations	3,135	3,379
Receivables per cheque payments	21	14
Leasehold improvements	843	287
Receivables from operating activities	1,050	1,050
Tangible assets acquired in lieu of debt collection	-	584
Other receivables	1,077	691
	(1,436)	(1,373)
Total other assets	6,254	5,997

Movements on impairment allowance for other assets:

	Total BAM '000
Balance as at January 1, 2017	525
Net gains recognized in the statement of profit or loss	451
Write-offs and transfers	397
Balance as at December 31, 2017	1,373
Net gains recognized in the statement of profit or loss	103
Write-offs, transfers and rounding	(40)
Balance as at December 31, 2018	1,436

25. DEPOSITS AND BORROWINGS DUE TO BANKS

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Demand deposits		
- in BAM	-	-
- in foreign currencies	1,520	310
	1,520	310
Term deposits		
- in BAM	15,570	18,001
- in foreign currencies	352,282	318,335
	367,852	336,336
Total deposits	369,372	336,646
Borrowings		
- in foreign currencies	46,297	59,255
	46,297	59,255
Total borrowings		
Total deposits and borrowings due to banks	415,669	395,901

Deposits and borrowings due to banks include the amount of BAM 367,852 thousand (2017: BAM 336,336 thousand), which pertains to the deposits and borrowings due to related parties.

Notes to the Financial Statements

26. DEPOSITS AND BORROWINGS DUE TO CUSTOMERS

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
LEGAL ENTITIES AND ENTREPRENEURS		
Demand deposits		
- in BAM	345,348	195,053
- in foreign currencies	58,059	63,974
	403,407	259,027
Term deposits		
- in BAM	28,498	51,886
- with foreign currency clause	105,162	98,480
- in foreign currencies	11,625	14,440
	145,285	164,806
Total deposits due to legal entities and entrepreneurs	548,692	423,833
PRIVATE INDIVIDUALS		
Demand deposits		
- in BAM	166,919	141,342
- with foreign currency clause	61	-
- in foreign currencies	100,942	98,580
	267,922	239,922
Term deposits		
- in BAM	49,050	47,311
- with foreign currency clause	41	41
- in foreign currencies	98,962	100,796
	148,053	148,148
Total deposits due to private individuals	415,975	388,070
TOTAL DEPOSITS	964,667	811,903
Borrowings due to customers		
- in BAM	-	-
- with foreign currency clause	35,945	42,657
- in foreign currencies	6,039	9,068
Total borrowings due to customers	41,984	51,725
Total deposits and borrowings due to customers	1,006,651	863,628

Notes to the Financial Statements

27. DEFERRED TAX ASSETS AND LIABILITIES

Net deferred tax assets

Deferred taxes are calculated for temporary differences according to the balance sheet liability method using the legally prescribed income tax rate of 10% (2017: 10%).

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Deferred tax assets		
Fair value reserve	65	16
Deferred tax assets based on differences in the depreciation method and different depreciation rates	12	-
Net deferred tax assets	77	16
Deferred tax liabilities		
Deferred tax liabilities based on differences in the depreciation method and different depreciation rates	-	(16)
Net deferred tax assets/ liabilities	77	-

Movements on deferred taxes

	Deferred tax assets BAM '000	Deferred tax liabilities BAM '000	Net deferred tax assets BAM '000
Balance as at January 1, 2017	-	(3)	(3)
(Decrease)/increase in deferred tax assets	-	(13)	(13)
(Decrease)/increase in deferred tax liabilities	16	-	16
Balance as at December 31, 2017	16	(16)	-
Balance as at January 1, 2018			
(Decrease)/increase in deferred tax assets	(16)	(49)	(65)
(Decrease)/increase in deferred tax liabilities	(12)	-	(12)
Balance as at December 31, 2018	(28)	(49)	(77)

Notes to the Financial Statements

28. OTHER LIABILITIES

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Liabilities to employees	4,323	2,623
Advances received for foreclosure of assets - NPL	23	112
Liabilities to suppliers – trade payables	3,824	1,916
Provisions for jubilee awards	202	200
Liabilities for realization of payment orders in the country	1,407	1,874
Liabilities for non-nominated deposits	661	678
Accruals and deferred income	560	820
Liabilities from card operations	1,706	1,725
Liabilities for insured unpaid deposits	2,223	2,504
VAT payable	704	417
Other liabilities	2,104	2,460
	17,737	15,329

29. PROVISIONS FOR LIABILITIES AND EXPENSES

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Provisions for retirement benefits	252	263
Provisions for litigations	2,037	1,803
Provisions for credit risk on commitments and financial guarantees given	1,032	1,596
	3,321	3,662

Movements of provisions for credit risks, contingent liabilities, quaranties

	Retirement benefits BAM '000	Litigations BAM '000	Contingent liabilities and quaranties BAM '000	Total BAM '000
Balance as at January 1, 2017	253	1,773	1,474	3,500
Net gains/(losses) recognized in the statement of profit or loss (Notes 12 and 15)	12	450	122	584
Provisions released during the period and transfers	(2)	(420)	-	(422)
Balance as at December 31, 2017	263	1,803	1,596	3,662
First-time adoption of IFRS 9	-	-	(1,068)	(1,068)
Net gains/(losses) recognized in the statement of profit or loss (Notes 12 and 15)	(11)	370	504	863
Provisions released during the period and transfers	-	(136)	-	(136)
Balance as at December 31, 2018	252	2,037	1,032	3,321

Notes to the Financial Statements

30. SHARE CAPITAL

	Ordinary shares BAM '000
Balance as at January 1, 2017	97,055
Changes	-
Balance as at December 31, 2017	97,055
Changes	-
Balance as at December 31, 2018	97,055
Nominal value per share (BAM)	700
Share count	138,650

As at December 31, 2018, the shareholders of the Bank comprised a single major and 66 minority shareholders; both domestic and foreign legal entities and individuals with the following equity interests:

	% of equity interest
UniCredit Bank S.p.A. Italy	98.46%
Minority shareholders	1.54%
	100.00%

As at December 31, 2018, members of the Bank's Supervisory Board, Audit Committee and Management Board were not in possession of any shares of the Bank.

All the Bank's shares were quoted on Banja Luka Stock Exchange. In 2018, the price per share on the last trading day amounted to BAM 1,201.00 (December 31, 2017: BAM 1,185.00).

31. EARNINGS PER SHARE

	2018	2017
Total number of shares	138,650	138,650
Weighted average number of shares outstanding	138,650	138,650
Total result (profit) in BAM '000	27,771	25,775
Earnings per share in BAM	200,30	185,90

In Q2 2018 the Bank paid dividend to the shareholders in the amount of BAM 12,887 thousand from the net profit realized in 2017. The total of 63 shareholders were entitled to dividend payment, and dividend per share amounted to BAM 92.95.

Notes to the Financial Statements

32. COMMITMENTS AND CONTIGENT LIABILITIES

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Payment guarantees:		
- in BAM	12,193	9,067
- in foreign currencies	<u>20,656</u>	<u>20,448</u>
Performance guarantees:		
- in BAM	44,967	43,383
- in foreign currencies	<u>26,432</u>	<u>21,611</u>
Contingent liabilities for undrawn loans and guarantees :		
- in BAM	115,031	105,213
- in foreign currencies	<u>1,615</u>	<u>957</u>
Letters of credit in foreign currencies	997	4,121
Other sureties	<u>-</u>	<u>-</u>
Total	<u>221,891</u>	<u>204,800</u>

As at December 31, 2018, Provisions for credit risk on commitments and financial guarantees given amounted to BAM 1,032 thousand (2017: BAM 1,596 thousand). Movements on these provisions are presented in Note 29.

33. TRANSACTIONS WITH RELATED PARTIES

In compliance with International Accounting Standard (IAS) 24, parties related to the Bank and the Bank's key management members are as follows:

IAS 24.19	Name	Description
IAS 24.19 (a),(b)	Parent company and entities with joint control or significant impact on the Bank	UniCredit Bank S.p.A. Italy
IAS 24.19 (c)	Subsidiaries and other entities within the same Group	Related banks and other legal entities within UniCredit Group
IAS 24.19 (c), (e)	Associates and joint ventures	The Bank did not have associates or joint ventures in 2018
IAS 24.19 (f)	Key management of the institution or its parent entity	Members of the Supervisory Board and Management Board; members of the Supervisory Board and Management Board of the parent entity, key Bank management personnel and persons related to the specified members
IAS 24.19 (g)	Other related parties	The Bank did not have other related parties in 2018

Notes to the Financial Statements

33. TRANSACTIONS WITH RELATED PARTIES (Continued)

Balances of assets and liabilities arising from transactions performed with members of UniCredit Group were as follows:

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Assets		
Foreign currency demand deposits:		
- UniCredit Bank Austria AG Vienna	1,435	13,140
- UniCredit Bank Serbia a.d. Beograd	92	3,981
- Zagrebačka Banka d.d. Zagreb	548	431
- UniCredit Bank AG Munich	626	1,892
- UniCredit S.p.A. Italy	137	6,251
- UniCredit Bank d.d. Mostar	2	4
	2,840	25,699
Term deposits:		
- UniCredit Bank d.d. Mostar	16,000	3,000
	16,000	3,000
Other receivables		
- UniCredit Bank AG Munich	34	-
- UniCredit S.p.A. Italy	414	202
- UniCredit Bank d.d. Mostar	2	2
- UniCredit Bank Serbia a.d. Beograd	273	238
	723	442
Financial assets for trading		
- UniCredit Bank AG Munich	-	8
Total assets	19,563	29,149
Liabilities		
Short-term deposits:		
- UniCredit Bank Austria AG Vienna	-	-
- UniCredit Bank d.d. Mostar	15,570	18,001
- UniCredit S.p.A. Italy	352,282	318,335
	367,852	336,336
Other liabilities		
- UniCredit Bank Austria AG Vienna	-	12
- UniCredit Bank d.d. Mostar	214	27
- UniCredit S.p.A. Italy	171	616
- UniCredit Services GmbH Austria	2,321	826
- Zagrebačka Banka d.d. Zagreb	323	105
- UniCredit Consumer Financing EAD Sofia	-	64
- UniCredit Bank Moscow AO	-	99
- UniCredit Bulbank AD Sofia	44	39
	3,073	1,788
Financial liabilities for trading		
- UniCredit Bank AG Munich	-	11
- UniCredit S.p.A. Italy	-	610
Total liabilities	370,925	338,745
Liabilities, net	(351,362)	(309,596)

Notes to the Financial Statements

33. TRANSACTIONS WITH RELATED PARTIES (Continued)

Income and expenses from related party transactions were as follows:

	Year Ended December 31,	
	2018	2017
	BAM '000	BAM '000
Items included in the statement of comprehensive income:		
Interest income:		
- UniCredit Bank Austria AG Vienna	-	(7)
- UniCredit Bank d.d. Mostar	92	51
- UniCredit Bank AG Munich	-	(1)
- UniCredit S.p.A. Italy	315	9
	407	52
Fee and commission income:		
- UniCredit Bank Austria AG Vienna	3	33
- UniCredit Bank AG Munich	2	1
- UniCredit S.p.A. Italy	22	5
	27	39
Interest expenses:		
- UniCredit Bank Austria AG Vienna	-	474
- UniCredit Bank d.d. Mostar	103	79
- UniCredit Bank Moscow AO	1,039	1,100
- UniCredit S.p.A. Italy	804	153
	1,946	1,806
Fee and commission expenses:		
- UniCredit Bank Austria AG Vienna	9	1
- UniCredit S.p.A. Italy	13	20
- Zagrebačka Banka d.d. Zagreb	321	231
- UniCredit Bank d.d. Mostar	-	3
- UniCredit Bank AG Munich	3	3
- UniCredit Services S.C.p.A Italy	88	85
	434	343
Operating expenses		
- UniCredit Services GmbH Austria	1,438	1,336
- UniCredit Bank d.d. Mostar	106	134
- Zagrebačka Banka d.d. Zagreb	11	11
- UniCredit S.p.A. Italy	149	201
- I-FABER S.p.A.	6	14
	1,710	1,696
Expenses, net	(3,656)	(3,754)

Notes to the Financial Statements

33. TRANSACTIONS WITH RELATED PARTIES (Continued)

Salaries and remunerations paid to the members of the Bank's Supervisory, Management Boards, and other key management personnel are presented below:

	Year Ended December 31,	
	2018	2017
	BAM'000	BAM'000
Supervisory Board	<u>46</u>	<u>7</u>
	46	7
Management Board		
<i>Short-term remuneration</i>		
Gross salaries disbursed in the current year for the current year	929	846
Bonuses disbursed in the current year for the previous year - gross	<u>149</u>	<u>99</u>
<i>Long-term remuneration</i>		
Insurance policies paid in the current year - gross	28	23
Disbursements in the current year for prior years - gross	<u>91</u>	<u>128</u>
Total Management Board	<u><u>1,197</u></u>	<u><u>1,096</u></u>
Other key management personnel		
<i>Short-term remuneration</i>		
Gross salaries disbursed in the current year for the current year	471	646
Bonuses disbursed in the current year for the previous year - gross	<u>97</u>	<u>81</u>
<i>Long-term remuneration</i>		
Insurance policies paid in the current year - gross	15	20
Disbursements in the current year for prior years - gross	<u>-</u>	<u>11</u>
Total other key management personnel	<u><u>583</u></u>	<u><u>758</u></u>

The Supervisory Board consists of 5 members, 2 of which are independent members, 2 are employed within the Group, and 1 is a former employee of the Group. The remunerations were paid only to those members that are not employed with the Group. Members of the Supervisory Board do not exercise the right to a variable remuneration in accordance with the Remuneration Policy.

Until April 30, 2018, the Bank's Management Board consisted of 3 members, whereas from May 1, 2018 there were 5 members.

Other key management personnel comprised of 8 employees of the Bank until April 30, 2018, whereas from May 1, 2018, the key management comprised 6 employees, and 2 members of the key management were appointed as members of the Bank Management Board (2017: 8 employees of the Bank).

The amount of salaries and remuneration disbursed to the members of the Management Board and key management includes the amount of BAM 329 thousand (2017: BAM 343 thousand) of contributions for pension and disability insurance with the prescribed amounts of contributions, payable to the mandatory pension funds at the prescribed rates.

Within the regular transactions, transactions with related parties are performed under fair market terms, which are deemed to be arm's length transactions, and our estimate is that the Bank bears no risk in respect of transfer prices.

Notes to the Financial Statements

33. TRANSACTIONS WITH RELATED PARTIES (Continued)

Loans and deposits, and income and expenses per loans and deposits of the members of the Bank's Supervisory Board, Management Board and other key management personnel and their related parties were as follows:

	2018	2017
	BAM '000	BAM '000
Supervisory Board:		
- Loans as at December 31	-	-
- <i>Interest income for the year</i>	-	1
- Deposits as at December 31	33	33
- <i>Interest expense for the year</i>	1	1
Management Board:		
- Loans as at December 31	76	21
- <i>Interest income for the year</i>	4	2
- Deposits as at December 31	400	58
- <i>Interest expense for the year</i>	11	-
Other key management:		
- Loans as at December 31	122	222
- <i>Interest income for the year</i>	6	11
- Deposits as at December 31	384	188
- <i>Interest expense for the year</i>	9	5
Total key management		
- Loans as at December 31	198	243
- <i>Interest income for the year</i>	10	14
- Deposits as at December 31	817	279
- <i>Interest expense for the year</i>	21	6

34. RISK MANAGEMENT

The Bank's management of risks assumed in operating activities is conducted through a system of strategies, policies, programs, work procedures and defined limits, which are continuously upgraded in accordance with changes in legislation, changes in business activities based on market trends and development of new products, as well as through the adoption of risk management standards of Group. The Group has in place a comprehensive risk management system based on defined risk appetite, risk strategies and operating policies and procedures and set risk limits.

The Supervisory Board and Management Board of the Bank prescribe overall risk management principles and adopt risk strategies covering this area. The Risk Management Board considers, and reports to the Supervisory Board, on the strategy implementation, adequacy and manner of implementation of the adopted policies and other risk management procedures, as well as adequacy and reliability of the overall risk management system.

In accordance with the Group's policies, the Bank has implemented a standard approach to credit risk according to the Basel III Accord, through an IT platform, which is aligned with the requirements of these standards.

Risk management is within the competence of the Chief Risk Officer and is organized into the following organizational units:

- Underwriting,
- Credit Risk Monitoring and Special Credit Management, and
- Strategic, Market and Operational Risk Management.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

Within the Special Credit Management there are two departments: Corporate Special Credit Management and Retail Special Credit Management. Within Strategic, Market and Operational Risk Management, there are also two departments: Credit Risk Control and Basel II and Market and Operational Risk Management. The function of collateral management, policies and procedures is the function that operates within the Strategic, Market and Operational Risk Management.

The most significant types of risks the Bank is exposed to are:

- Credit risk
- Market risk and
- Operational risk.

34.1. Credit Risk

The Bank is exposed to credit risk, which can be defined as the possibility that a borrower may fail to perform the liabilities defined in the respective loan agreements, resulting in a financial loss for the Bank. Assumption of credit risk is managed in accordance with the specific rules and principles defined by the Group for areas of credit strategies, policies, modelling, risk concentration, new product introduction, monitoring and reporting. Credit risk exposure is managed in accordance with the Bank's strategies and policies in force, as well as other internal bylaws prescribed by the Supervisory Board and the Management Board. Credit risk strategies define the main strategic goals, and determine the limits of credit risk assumption within business operations with all customer segments.

General principles and rules of credit risk management have been established by the Group through a General crediting policy, which the Bank applies in its business operations in accordance with the requirements of the local regulator, Group standards and best practices. General rules and principles have been defined in more detail by specified special crediting policies.

a) Credit Risk Measurement

The following factors are taken into account in credit risk measurement: risk of loss resulting from insolvency of the borrower and risk of loss resulting from a change in the customer risk rating. Factors that are also taken into account are overall credit risk exposure including the balance sheet and off-balance-sheet items of the Bank and the quality and value of collaterals.

Credit risk is measured at the level of individual borrower/transaction and at the level of the total portfolio.

With the support of the Group, the Bank is developing and establishing both a system of credit risk measurement on the portfolio basis applying the Basel III basic parameters of credit risk for calculation of expected loss from the loan portfolio, and the calculation of the internal capital requirements to cover potential losses due to the credit risk on the basis of calculation of loan value at risk (VaR). As the measure of economic/internal capital, loan VaR is also the basic input for defining crediting strategies, analysis of credit limits and risk concentration.

The established system of reporting analyzes the main triggers and components of credit risk and their dynamics in order to undertake corrective activities if necessary and on time. Reports contain the information about changes in the size and quality of the loan portfolio at the customer segment level and for the Bank.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit risk (Continued)

b) Risk Control Policies

The Bank manages, limits and controls credit risk concentrations, wherever such risk concentrations have been identified, particularly with regard to specific clients and/or groups of clients, and industry sectors.

The Bank sets the credit risk level, which it assumes by setting limits for the amount of risk accepted in relation to one borrower or group of borrowers, or industry segments. Such risks are monitored on a regular quarterly basis via a report to the Credit Committee of the Bank on credit risk concentration per industry and compliance with the adopted industry strategy. Additionally, through regular monthly Report for the Credit Committee, the Risk Management reports to the Credit Committee on defined limits on the Bank level.

The Credit Committee, Management Board and the Supervisory Board of the Bank are regularly informed of all significant changes in the value and quality of the portfolio.

Credit risk is also managed through the regular analysis of the ability of borrowers and potential borrowers to settle liabilities for principal repayment and interest payment, and change in credit limits where necessary.

In order to minimize the risks from lending activities, the Bank has set up a system with policies for definition, assessment and treatment of collaterals serving as security for collection of receivables, where it demands acceptable collaterals for collection of its receivables. An acceptable collateral is a pledge over an asset which has a known active market and stable price, whose value is satisfactory relative to the Bank's receivables and which is sufficient to protect the Bank from possible loss of principal, interest, fees and collection costs.

34.1.1. Maximum exposure to credit risk for on and off-balance sheet items

	December 31, 2018 BAM '000	December 31, 2018 BAM '000
Balance sheet assets		
Cash and cash equivalents (Note 17)	225,492	170,568
Financial assets held for trading	1	n/a
Financial assets at fair value through profit and loss (IAS 39)	n/a	10
Financial assets at fair value through other comprehensive income (Note 18)	197,265	n/a
Financial assets available for sale (IAS 39)	n/a	169,542
Financial assets at amortized cost	1,207,266	n/a
<i>a) Obligatory reserve with the Central Bank (Note 19)</i>	125,877	n/a
<i>b) Loans and receivables due from banks (Note 20)</i>	144,015	n/a
<i>c) Loans and receivables due from customers (Note 21)</i>	937,374	n/a
<i>Obligatory reserve with the Central Bank (IAS 39)</i>	n/a	116,002
<i>Loans and receivables due from banks (IAS 39)</i>	n/a	100,444
<i>Loans and receivables due from customers (IAS 39)</i>	n/a	895,762
Tangible Assets (Note 22)	17,761	16,468
Other assets (Note 24)	6,254	5,997
Total balance sheet items exposed to credit risk	1,654,039	1,474,793
Off-balance sheet items		
Guarantees and other sureties	105,245	98,630
Approved overdraft, framework loans and guarantees	116,646	106,170
Total off-balance-sheet exposure to credit risk	221,891	204,800
Balance as at December 31	1,875,930	1,681,493

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit risk (Continued)

34.1.1. Maximum exposure to credit risk for on and off-balance sheet items (Continued)

The Bank obtains collaterals securitizing loans and receivables in the form of mortgages assigned over real estate, and other forms of security over the assets and guarantees. Initial appraisals of the value of collaterals, or real estate, are performed already upon loan approval, i.e., they are an integral part of the process of customer loan request approval.

Revaluations are performed in accordance with the principles and rules of the collateral management system. For the purpose of alignment with the Group's techniques for credit risk mitigation, the Bank has implemented functional automatic monitoring of the expired insurance policies for real estate and introduced adjusting factors in cases of currency mismatch of collaterals and loans. The adjusting factors are not applied if the collateral is an item of property or movable assets with the value stated in EUR/BAM currency during the effectiveness of the Currency Board regime. Collaterals are not obtained for loans and receivables due from banks and financial assets available for sale.

In view of the impact of the general financial and economic crisis, there is considerable uncertainty related to the fair market value of such collaterals, along with the time needed to realize the sale thereof.

34.1.2. Credit risk management and policies for impairment and provisions

Impairment

At each reporting date, the Bank checks the existence of objective evidence of impairment of financial assets, as previously explained in Note 2.7.

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

- Stages 1 and 2 - Performing loans and
- Stage 3- Non-performing loans.

For the purpose of determining impairment of loans and receivables, the Bank distinguishes two approaches:

- Loans assessed on an individual basis,
- Loans assessed on a portfolio basis.

Loans assessed on an individual basis

Individually significant loans are assessed on an individual basis in order to determine the existence of objective evidence of impairment. Factors that can influence the ability and readiness of each individual debtor to fulfil their obligations toward the Bank, are as follows:

- failure to settle or delay in payment of interest or principal;
- failure to comply with the contractual terms and conditions;
- instigation of bankruptcy proceedings;
- any specific information about business difficulties (e.g., reflected in the insufficient liquidity of the borrower);
- significant changes in the customer's market environment; and
- global economic situation.

Loans assessed on a portfolio basis

In order to assess the impairment of loans that are not individually significant, such loans are grouped based on the similar credit risk characteristics. The Bank has segmented the loan portfolio into the risk groups based on the credit rating for legal entities and based on the number of days past due for private individuals and, accordingly, applying credit risk parameters (probability of default, loss given default, amount that the Bank requires in instances of non-performance of obligations) determined by Basel III and in conformity with IFRS requirements, it impairs loans.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit risk (Continued)

34.1.2. Credit risk management and policies for impairment and provisions (Continued)

Breakdown of the loan portfolio according to the above listed categories is provided below:

Financial assets at amortized cost – Loans and receivables due from customers	December 31, 2018 BAM '000			December 31, 2017 BAM '000		
	Loans	Impairment	%	Loans	Impairment	%
Stage 1 and 2						
- Legal entities' loans	496,409	3,651	0,7%	n/a	n/a	n/a
- Private individuals' loans	445,923	7,112	1,6%	n/a	n/a	n/a
	942,332	10,763	1,1%	n/a	n/a	n/a
Stage 3						
- Legal entities' loans	38,705	36,045	93,1%	n/a	n/a	n/a
- Private individuals' loans	29,664	26,519	89,4%	n/a	n/a	n/a
	68,369	62,564	91,5%	n/a	n/a	n/a
Total loans	1,010,701	73,327	7,3%	n/a	n/a	n/a
Loans and receivables (IAS 39)						
Performing and past due loans not specifically impaired						
- Legal entities' loans	n/a	n/a	n/a	486,757	6,247	1,3%
- Private individuals' loans	n/a	n/a	n/a	412,726	5,164	1,3%
	n/a	n/a	n/a	899,483	11,411	1,3%
Non-performing loans						
- Legal entities' loans	n/a	n/a	n/a	42,078	39,586	94,1%
- Private individuals' loans	n/a	n/a	n/a	30,764	25,566	83,1%
	n/a	n/a	n/a	72,842	65,152	89,4%
Total loans	n/a	n/a	n/a	972,325	76,563	7,9%

Provision coverage of the non-performing portfolio amounts to 91.5% (2017: 89.4%).

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit Risk (Continued)

34.1.2. Credit risk management and policies for impairment and provisions (Continued)

The table below presents the breakdown of gross and net loans and receivables due from customers:

Financial assets at amortized cost – Loans and receivables due from customers	December 31, 2018. '000 BAM	December 31, 2017. '000 BAM
Legal entities		
Stage 1 and 2: Performing undue loans	493,533	n/a
Stage 1 and 2: Performing due loans	2,876	n/a
Stage 3: Non-performing loans	38,704	n/a
Gross exposure (Stage 1, 2 and 3)	535,113	n/a
Impairment (Stage 1, 2 and 3)	(39,696)	n/a
Net exposure (Stage 1, 2 and 3)	495,417	n/a
Private individuals		
Stage 1 and 2: Performing undue loans	445,803	n/a
Stage 1 and 2: Performing due loans	125	n/a
Stage 3: Non-performing loans	29,660	n/a
Gross exposure (Stage 1, 2 and 3)	475,588	n/a
Impairment (Stage 1, 2 and 3)	(33,631)	n/a
Net exposure (Stage 1, 2 and 3)	441,957	n/a
Total gross exposure (Legal entities and Private individuals)	1,010,701	n/a
Stage 1 and 2: Performing loans – impairment	(10,763)	n/a
Stage 3: Non-performing loans – impairment	(62,564)	n/a
Net exposure (Legal entities and Private individuals)	937,374	n/a
Loans and receivables (IAS 39)		
Legal entities		
Loans to customers that are neither due nor impaired	n/a	486,630
Past-due but not impaired loans	n/a	129
Non-performing loans (impaired loans)	n/a	42,042
Gross exposure	n/a	528,801
Less impairment allowance:		
- Portfolio (IBNR), individual and group impairment allowance	n/a	(45,833)
Net exposure	n/a	482,968
Private individuals		
Loans to customers that are neither due nor impaired	n/a	412,764
Past due but not impaired loans	n/a	81
Non-performing loans (impaired loans)	n/a	30,679
Gross exposure	n/a	443,524
Less impairment allowance:		
- Portfolio (IBNR), individual and group impairment allowance	n/a	(30,730)
Net exposure	n/a	412,794
Total gross exposure	n/a	972,325
Portfolio impairment allowance (IBNR)	n/a	(11,411)
Individual and group impairment allowance	n/a	(65,152)
Net exposure	n/a	895,762

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit Risk (Continued)

34.1.2. Credit risk management and policies for impairment and provisions (Continued)

a) Stages 1 and 2: Performing undue loans

The quality of the portfolio of undue loans to customers can be estimated 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 risk profile.

Breakdown of gross exposure of undue loans to customers according to the type of loan is as follows:

	Loans to private individuals				Loans to legal entities			
	Consumer loans	Housing loans	Credit card loans and approved account overdrafts	Total	Public and financial sector and international client loans	Domestic corporate client loans	Entrepreneurial loans	Total
December 31, 2018								
Stages 1 and 2								
Standard monitoring	325,983	94,851	24,969	445,803	315,960	143,106	34,467	493,533
<i>December 31, 2017</i>								
<i>IAS 39</i>								
Standard monitoring	301,369	86,663	24,732	412,764	321,909	133,069	31,652	486,630

b) Stages 1 and 2: Performing due loans

The gross amount of loans and receivables due from customers that were past due were as follows:

	Loans to private individuals				Loans to legal entities			
	Consumer loans	Housing loans	Credit card loans and approved account overdrafts	Total	Public and financial sector and international client loans	Domestic corporate client loans	Entrepreneurial loans	Total
December 31, 2018								
Matured – Stages 1 and 2:								
- up to 30 dpd	76	-	-	76	153	1,239	1	1,393
- 30 - 60 dpd	20	-	-	20	-	1,483	-	1,483
- 60 - 90 dpd	29	-	-	29	-	-	-	-
- over 90 dpd	-	-	-	-	-	-	-	-
Total	125			125	153	2,722	1	2,876
Collateral value	-	-	-	-	-	915	-	915
<i>December 31, 2017</i>								
<i>Matured: IAS 39</i>								
- up to 30 dpd	52	-	-	52	31	44	54	129
- 30 - 60 dpd	22	-	-	22	-	-	-	-
- 60 - 90 dpd	7	-	-	7	-	-	-	-
- over 90 dpd	-	-	-	-	-	-	-	-
Total	81			81	31	44	54	129
Collateral value	-	-	-	-	-	-	-	-

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit Risk (Continued)

34.1.2. Credit risk management and policies for impairment and provisions (Continued)

c) Stage 3: Non-performing loans

The classification of non-performing loans to customers, together with the allocated value of associated collateral instruments, is as follows:

	Loans to private individuals				Loans to legal entities			
	Consumer loans BAM '000	Housing loans BAM '000	Credit card loans and approved overdrafts BAM'000	Total BAM'000	Large BAM'000	Medium BAM'000	Small BAM'000	Total BAM'000
December 31, 2018								
Non-performing loans-Stage 3	23,151	3,993	2,516	29,660	5,844	17,905	14,955	38,704
Collateral value	820	2,098	-	2,918	1,810	4,186	1,263	7,259
<i>December 31, 2018</i>								
<i>Non-performing loans – IAS 39</i>	<i>23,322</i>	<i>4,881</i>	<i>2,476</i>	<i>30,679</i>	<i>3,041</i>	<i>21,096</i>	<i>17,905</i>	<i>42,042</i>
<i>Collateral value</i>	<i>891</i>	<i>1,942</i>	<i>-</i>	<i>2,833</i>	<i>104</i>	<i>4,927</i>	<i>2,257</i>	<i>7,288</i>

The data shown in the table above are presented in gross amounts.

As at December 31, 2018, assets acquired in lieu of debt collection per loans amounted to BAM 584 thousand (2017: BAM 584 thousand).

d) Restructured loans and receivables

During the year, the Bank restructured certain loans to customers in order to improve their ultimate recoverability. Restructuring is mainly performed in response to deterioration or for the prevention of further deterioration of the customer financial situation based on an analysis of the possibility of successful restructuring in order to remove difficulties in the client's operations within a defined time limit and return the client to the performing portfolio.

Restructured loans (exposure per all restructured loans irrespective of whether they belong to the remit of the Business Segments or Special Credit Management) amounted to a total of BAM 24,740 thousand as at December 31, 2018 (2017: BAM 25,068 thousand).

	December 31, 2018 BAM'000	December 31, 2017 BAM '000
Restructured loans	24,740	25,068
Loan portfolio - gross	1,010,701	972,325
Share of restructured loans in the gross loan portfolio	2.4%	2.6%

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit Risk (Continued)

34.1.3. Credit risk concentration

a) Geographic concentration of credit risk

Geographic credit risk concentration of the loan portfolio relates entirely to the corporate clients, individuals and other entities located in Bosnia and Herzegovina.

b) Concentration of credit risk by industry

Breakdown of the Bank's loan portfolio as at December 31, 2018 and December 31, 2017 per industry is provided in the table below:

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Legal entities		
Mining and energy	23,184	41,683
Agriculture	9,874	8,571
Construction industry	41,094	30,360
Processing industry	118,618	164,601
Trade	117,252	111,090
Services	2,020	1,277
Transport	27,587	7,750
Financial services	3,203	2,610
Public sector (central institutions)	95,962	90,125
Local self-government	91,931	66,043
Non-profit institutions	4,388	4,691
	535,113	528,801
Private individuals	475,588	443,524
Total gross loans	1,010,701	972,325
Impairment allowance	(73,327)	(76,563)
Total net loans	937,374	895,762

The structure of the loan portfolio is regularly monitored by the Risk Management in order to recognize potential events that could have a significant impact on the loan portfolio (usual risk factors) and, if needed, to mitigate the Bank's exposure to certain industry sectors.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.1. Credit Risk (Continued)

34.1.3. Credit risk concentration (Continued)

c) Large credit risk exposures

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Large credit risk exposures		
Number of clients with exposure over 10% of eligible capital	4	5
Balance and off-balance credit exposure - gross	102,258	175,465
Impairment and provision for off-balance credit exposure	(1,642)	(2,192)
Balance and off-balance credit exposure - net	100,616	173,273
	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Exposure to the Public Sector (Central Institutions)		
Balance and off-balance credit exposure - gross	143,318	90,694
Impairment and provision for off-balance credit exposure	(684)	(524)
Balance and off-balance credit exposure - net	142,634	90,170
Balance exposure - Securities	197,148	169,425

34.2. Liquidity Risk

Liquidity risk represents a risk that the Bank will not be able to settle its financial liabilities fully and without any delay. In this respect, the main target of the Bank, when managing liquidity risk as the central risk inherent in banking operations, is to align its business activities and ensure optimal liquidity in accordance with the minimum standards and limits prescribed by the Banking Agency of the Republic of Srpska, BH Central Bank and the Group.

The Bank has access to various sources of financing, which include different types of deposits of retail and corporate customers, banks (within and out of the Group), and lines of credit. The aforesaid sources enable flexibility of funding sources and limit the dependence on any single source, thus providing a high level of their own sustainability in possible crises.

The Bank has implemented the liquidity policies of the Group, by which methods and procedures of liquidity parameter analysis have been defined which cover managing and control of liquidity risk, both in terms of regular business and in crisis situations. In accordance with the Group guidelines, exposure to the liquidity risk is held at the level at which the Bank is able to fulfil its payment obligations on a regular basis, and in the crisis periods as well.

Regular business involves the usual daily activities for which it is usual for any phase from the Liquidity Policy in crisis situations not to be activated.

The most important activities are aimed at carrying out normal market transactions within the prescribed risk exposure limits in accordance with the defined financing plan, as well as decisions of the competent authorities and operational functions.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.2. Liquidity Risk (Continued)

These activities are mainly focused on managing short-term and long-term liquidity, managing the execution of the financing plan, regular monitoring and analysis of the results of the testing of the liquidity risk stress resistance as well as the consistent application of the principle of determining internal prices.

The risk of short-term liquidity is measured through operational buckets of maturities of up to one year, through net cash flows (inflows/outflows). Short-term liquidity limits the exposures to all currencies as well as the total exposure.

Structural liquidity measures seek to ensure an appropriate balance between assets and liabilities in the medium to long term (over a year), in order to ensure structural stability and limit the dependence on short-term and less stable financing.

The short-term liquidity stress testing measures whether the available liquidity reserves can ensure that the Bank endures a hypothetical shortage of short-term funds. The scenarios are based on the concept of maturity buckets of assets and their renewal. The relevant scenarios are defined in order to present possible events with a potentially negative impact on liquidity. Considering the nature of the liquidity stress test, as the tool for assessing different liquidity risks, the combined scenario is acceptable.

The Bank also adopted the Liquidity Management Policy in Emergency Situations consisting of the Liquidity Management Policy in Emergency Situations and the Emergency Action Plan.

The Bank is required to maintain liquidity within the ranges prescribed by the Banking Agency of the Republic of Srpska and the Central Bank of Bosnia and Herzegovina:

- Maintenance of the obligatory reserve
- Maintenance of ten-day and daily liquidity
- Maturity matching of financial assets and liabilities.

The following tables show the structure of the assets and liabilities at December 31, 2018 and December 31, 2017, which represents a breakdown of assets and liabilities by appropriate maturity buckets, based on the remaining period of agreed maturity, with the following exceptions:

1. Current and demand savings accounts and overdrafts per current accounts of legal entities and private individuals are mapped based on their estimated stability in compliance with BARS decisions and in accordance with the Group's standards;
2. Non-performing loans, other assets, equity and reserves are also mapped according to the Group's standard rules to the longest maturity term.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.2. Liquidity Risk (Continued)

December 31, 2018	Up to a month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash and cash equivalents	225,492	-	-	-	-	225,492
Financial assets held for trading	-	-	1	-	-	1
Financial assets at fair value through other comprehensive income	-	11,322	13,401	172,425	117	197,265
Financial assets at amortized cost						
a) Obligatory reserve with the Central Bank	125,877	-	-	-	-	125,877
b) Loans and receivables due from banks	128,015	-	-	-	16,000	144,015
c) Loans and receivables due from customers	65,565	41,329	158,167	435,911	236,402	937,374
Tangible assets	-	-	-	-	17,761	17,761
Intangible assets	-	-	-	-	8,115	8,115
Other assets	-	-	6,254	-	-	6,254
Deferred tax assets	-	-	77	-	-	77
Total assets	544,945	52,651	177,900	608,336	278,395	1,662,231
Liabilities, equity and reserves						
Financial liabilities at amortized cost						
a) Deposits and borrowings due to banks	148,831	47,099	158,434	41,446	19,859	415,669
b) Deposits and borrowings due to customers	181,722	72,999	202,547	307,641	241,742	1,006,651
Financial liabilities held for trading	-	-	-	-	-	-
Other liabilities	-	-	17,737	-	-	17,737
Provisions for risks and expenses	-	-	3,321	-	-	3,321
Income tax payable	-	178	-	-	-	178
Deferred tax liabilities	-	-	-	-	-	-
Equity and reserves	-	-	-	-	218,675	218,675
Total liabilities, equity and reserves	330,553	120,276	382,039	349,087	480,276	1,662,231
Liquidity gap	214,396	(67,625)	(204,139)	259,249	(201,881)	-

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.2. Liquidity Risk (Continued)

December 31, 2017	Up to a month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash and cash equivalents	170,568	-	-	-	-	170,568
Obligatory reserve with the Central bank	116,002	-	-	-	-	116,002
Loans and receivables due from banks	100,444	-	-	-	-	100,444
Financial assets at fair value through other comprehensive income	2,098	-	62,859	104,468	117	169,542
Financial assets at fair value through profit or loss	-	-	10	-	-	10
Loans and receivables due from customers	53,697	38,149	209,948	392,496	201,472	895,762
Property and equipment	-	-	-	-	16,468	16,468
Intangible assets	-	-	-	-	5,887	5,887
Other assets	-	-	5,997	-	-	5,997
Deferred tax assets	-	-	16	-	-	16
Total assets	442,809	38,149	278,830	496,964	223,944	1,480,696
Liabilities, equity and reserves						
Deposits and borrowings due to banks	117,890	35,205	132,418	81,605	28,783	395,901
Deposits and borrowings due to customers	130,426	88,301	174,753	239,489	230,659	863,628
Financial liabilities at fair value through profit and loss	-	-	-	-	621	621
Other liabilities	9,257	747	2,821	2,504	-	15,329
Provisions for liabilities and expenses	-	-	3,662	-	-	3,662
Income tax payable	-	417	-	-	-	417
Deferred tax liabilities	-	-	16	-	-	16
Equity and reserves	-	-	-	-	201,122	201,122
Total liabilities, equity and reserves	257,573	124,670	313,670	323,598	461,185	1,480,696
Liquidity gap	185,236	(86,521)	(34,840)	173,366	(237,241)	-

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management

Market risks arise from general and specific trends and changes of certain market variables (interest rates, prices of securities, exchange rate changes), which can affect the economic value the portfolio in the trading book and in the banking book. The Bank is exposed to market risks mainly because of items and business activities from the banking book.

Market risk exposure management includes the activities related to the operations of the Markets and Assets and Liabilities Management function, and it has been organized through a system of internal bylaws and the setting of defined limits and warning signals that are supervised on a daily basis. Market risk measuring is based on the VaR ("Value at Risk") methodology. VaR is the estimated potential overnight loss which occurs in the overall and in particular items of the balance sheet structure in a defined time period, based on numerous assumptions of changes in market conditions with a confidence level of 99%. The Group uses historic volatility simulation as an assessment model based on the last 500 daily return observations. VaR model quality is continuously monitored by back testing. Beside the VaR methodology, the Market Risk Management also uses open FX position limits and base point calculation as a supplement to the set VaR limits.

Factors, which are also of importance for assessment of the market risk impact on the Banks' portfolio, are stress-oriented warning levels and limits and the results are included in regular ALCO reports (reports presented to the Assets and Liabilities Management Committee of the Bank).

The Bank performs activities on market risk limit review closely cooperating with UniCredit Group. These activities are performed at least annually, and more frequently if necessary in accordance with business changes as a result of changes in legislation, development of business strategy goals as well as targeted risk profile.

The set of documents with rules for operations performed by the Markets and Market Risk Management is made in the form of a Financial Markets Rulebook and Market Risk Strategy. Only the permitted risk holders are enabled to enter into the risk-weighted items.

Overview of the Bank's aggregate VaR position:

	2018	2017
	BAM '000	BAM '000
- average for the period	768	647
- maximum for the period	1,291	712
- minimum for the period	452	559

In addition to implementing the Group market risk techniques, methods and measuring models, the Bank is continuously working on the improvement of the business processes and data quality.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.1. Currency Risk

Currency risk is the risk of a possible occurrence of adverse effects on the Bank's financial result and equity due to volatility in exchange rates. The exposure to foreign currency risk results from credit, deposit and trading activities and is controlled daily, according to legal and internal Group limits for particular currencies, and in total amount for all assets and liabilities denominated in foreign currencies or indexed to a foreign currency.

Currency risk management includes monitoring and control of individual items in foreign currencies and the total foreign exchange position of the Bank. The open position is determined on the basis of all on-balance and off-balance items. Foreign exchange risk limits restrict the maximum amount of open foreign currency position by currency. The Bank continuously monitors foreign exchange risk through the limits prescribed by local regulations and by the Group.

In accordance with the decision of the local regulator, which regulates the minimum standards for managing foreign currency risk, the Bank is required to maintain the relationship between assets and liabilities in each single currency so that its total open foreign currency position at the end of each working day does not exceed 30% of its recognized (regulatory) capital.

The Bank directs its business activities so as to minimize mismatch between items of assets and liabilities in foreign currencies or with a contracted currency clause, maintaining daily operations within the range of the set limits.

All sensitivities arising from items in or linked to foreign currencies are also covered by the general daily VaR limit, which among other risks, limits the maximum permitted loss of open positions in the foreign currencies.

	<u>2018</u>	<u>2017</u>
Currency risk ratios:		
- as at December 31	4.90%	15.31%
- maximum for the period - month of December	19.19%	21.47%
- minimum for the period - month of December	0.44%	0.27%

Due to the presence of the Currency Board (regime of the Central Bank of Bosnia and Herzegovina) according to which the rate of the national currency to the euro is fixed, it can be considered that the Bank is not exposed to the currency risk related to EUR/BAM exchange rate.

The Bank protects itself from exposure to currency risk in foreign currencies other than EUR by managing foreign currency position, within the Markets' strategy, in such a manner that the items opened through operations with customers are closed by opposite transactions, so that the open position of the Bank is reduced to the minimum.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.1. Currency Risk (Continued)

The analysis of assets and liabilities stated in foreign currency amounts, as at December 31, 2018 and December 31, 2017 is presented in the following table.

	EUR BAM'000	EUR - linked items BAM'000	USD BAM'000	Other currencies BAM'000	Total FX BAM'000	BAM BAM'000	Total BAM '000
December 31, 2018							
Assets							
Cash and cash equivalents	3,282	-	323	2,038	5,643	219,849	225,492
Financial assets for trading	-	-	-	-	-	1	1
Financial assets at fair value through other comprehensive income	66,520	126,389	-	-	192,909	4,356	197,265
Financial assets at amortized cost							
a) Obligatory reserve with the Central Bank	-	-	-	-	-	125,877	125,877
b) Loans and receivables due from banks	108,484	-	9,679	9,852	128,112	16,000	144,015
c) Loans and receivables due from customers	47,143	424,820	-	-	471,963	465,411	937,374
Property and equipment	-	-	-	-	-	17,761	17,761
Intangible assets	-	-	-	-	-	8,115	8,115
Other assets	171	-	54	997	1,222	5,032	6,254
Deferred tax assets	-	-	-	-	-	77	77
Total assets	225,600	551,209	10,056	12,887	799,849	862,479	1,662,231
Liabilities							
Financial liabilities at amortized cost							
a) Deposits and borrowings due to banks	400,099	-	-	-	400,099	15,570	415,669
b) Deposits and borrowings due to customers	254,685	141,236	10,049	10,892	416,862	589,789	1,006,651
Financial liabilities for trading	-	-	-	-	-	-	-
Other liabilities	865	-	6	-	871	16,866	17,737
Provisions for risks and expenses	331	1	-	-	332	2,989	3,321
Current income tax	-	-	-	-	-	178	178
Deferred tax liabilities	-	-	-	-	-	-	-
Total liabilities	655,980	141,237	10,055	10,892	818,164	625,392	1,443,556
Equity and reserves	1,523	1,468	-	-	2,991	215,684	218,675
Total liabilities, equity and reserves	657,503	142,705	10,055	10,892	821,155	841,076	1,662,231
Net foreign currency position	(431,903)	408,504	1	1,995	(21,306)	21,306	-

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.1. Currency Risk (Continued)

	EUR BAM'000	EUR linked items BAM'000	USD BAM'000	Other currencies BAM'000	Total FX BAM'000	BAM BAM'000	Total BAM'000
December 31, 2017							
Assets							
Cash and cash equivalents	3,115	-	341	2,038	5,494	165,074	170,568
Obligatory reserve with Central bank	-	-	-	-	-	116,002	116,002
Loans and receivables due from banks	71,594	-	16,332	9,513	97,439	3,005	100,444
Financial assets at fair value through other comprehensive income	-	103,301	-	-	103,301	66,241	169,542
Financial assets at fair value through profit and loss	-	-	-	-	-	10	10
Loans and receivables due from customers	67,429	490,128	-	-	557,557	338,205	895,762
Property and equipment	-	-	-	-	-	16,468	16,468
Intangible assets	-	-	-	-	-	5,887	5,887
Other assets	76	-	11	21	108	5,889	5,997
Deferred tax assets	-	-	-	-	-	16	16
Total assets	<u>142,214</u>	<u>593,429</u>	<u>16,684</u>	<u>11,572</u>	<u>763,899</u>	<u>716,797</u>	<u>1,480,696</u>
Liabilities							
Deposits and borrowings due to banks	377,900	-	-	-	377,900	18,001	395,901
Deposits and borrowings due to customers	257,462	141,185	18,342	11,392	428,381	435,247	863,628
Financial liabilities at fair value through profit and loss	-	-	-	-	-	621	621
Other liabilities	2,297	28	10	1	2,336	12,993	15,329
Provisions for liabilities and costs	1,112	-	-	-	1,112	2,550	3,662
Income tax payable	-	-	-	-	-	417	417
Deferred tax liability	-	-	-	-	-	16	16
Equity and reserves	3,496	-	-	-	3,496	197,626	201,122
Total liabilities, equity and reserves	<u>642,267</u>	<u>141,213</u>	<u>18,352</u>	<u>11,393</u>	<u>813,225</u>	<u>667,471</u>	<u>1,480,696</u>
Net foreign currency position	<u>(500,053)</u>	<u>452,216</u>	<u>(1,668)</u>	<u>179</u>	<u>(49,326)</u>	<u>49,326</u>	<u>-</u>

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.2. Interest Rate Risk

The Bank is exposed to a risk from interest rate fluctuations with an impact on the financial position of the Bank and its cash flows. The Bank's business operations are influenced by interest rates changes, to the extent that interest bearing assets and liabilities mature or their interest rates change at different times or in different amounts. Interest rate margins may grow as the result of those fluctuations, however, at the same time they may decrease and cause losses in the event of unexpected fluctuations.

The main sources of interest rate risk are as follows:

- repricing risk resulting from unfavorable changes in the fair value of assets and liabilities during the remaining period until the next interest rate change (items with fixed interest rate are classified according to the remaining maturity);
- risk of change in inclination and shape of the yield curve (yield curve risk);
- risk of different changes in lending and borrowing interest rates (basis risk) of instruments having identical maturities and denominated in identical currencies, where the interest rates are based on different reference rate types (e.g. EURIBOR vs. LIBOR); and
- optionality risk resulting from options, including embedded options in interest sensitive items (e.g. loans with early repayment possibility, deposits with early withdrawal possibility, and alike).

Exposure to the risk of interest rate changes is monitored by means of defined reports and in accordance with the Group guidelines.

Exposure to the interest rate risk will also be monitored in accordance with the requirements of the local regulator for significant currencies individually and for all other currencies in the aggregate by monitoring the changes in the economic value of the banking book for: items with a fixed interest rate, variable interest rate, a rate which changes according to the Bank's decision, total weighted position as well as the impact of interest rate risk on the net interest income.

The methodology used for risk assessment of interest rate changes is based on the gap analysis of time (maturity) differences. Differences between interest-bearing assets and liabilities in different time "buckets" show how two sides of the balance sheet may react differently to the change of interest rates:

- in case of a positive gap difference, the Bank is exposed to a risk of loss in the event that interest rates of given maturities for the relevant currency fall,
- in case of a negative gap difference, the Bank is exposed to a risk of loss in the event that interest rates of the given maturity for the relevant currency grow.

In accordance with the Group's requirements, interest rate risk is measured by calculating the change in the net present value of the portfolio in case of a fall in the reference rate curve by 0.01% (1 basis point) and it is limited by BPV limit (basis point value limit) as a sensitivity measure. BPV limits are defined in summary, per currency and per time buckets. Interest risk is also monitored through the specified VaR model.

Stress testing conducted by the Bank for interest rate risk category includes scenarios of various shocks on interest curves. Shocks include change in interest rate level (parallel shifts), curve rotations, change in curve inclination and peaks in specific segments of interest curves.

The review of the Bank's exposure to interest rate risk on December 31, 2018, and December 31, 2017 is shown in the following tables.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.2. Interest Rate Risk (Continued)

a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates

Earnings will also be affected by the maturity structure of the Bank's assets and liabilities.

	Up to a month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Non- interest bearing BAM '000	Total BAM '000	Fixed interest rate BAM '000
December 31, 2018								
Assets								
Cash and cash equivalents	199,744	-	-	-	-	25,748	225,492	-
Financial assets for trading	-	-	1	-	-	-	1	1
Financial assets at fair value through other comprehensive income	-	11,322	13,401	172,425	-	117	197,265	197,265
Financial assets at amortized cost								
a) Obligatory reserve with the Central Bank	-	-	-	-	-	125,877	125,877	-
b) Loans and receivables due from banks	128,015	16,000	-	-	-	-	144,015	128,097
c) Loans and receivables due from customers	229,390	226,052	351,825	84,429	45,678	-	937,374	191,506
Property and equipment	-	-	-	-	-	17,761	17,761	-
Intangible assets	-	-	-	-	-	8,115	8,115	-
Other assets	-	-	-	-	-	6,254	6,254	-
Deferred tax assets	-	-	-	-	-	77	77	-
Total assets	557,149	253,374	365,227	256,854	45,678	183,949	1,662,231	516,869
Liabilities								
Financial liabilities at amortized cost								
Deposits and borrowings due to banks	162,511	86,824	140,831	9,786	15,567	150	415,669	338,145
Deposits and borrowings due to customers	708,882	28,887	107,784	142,025	15,783	3,290	1,006,651	1,003,361
Financial liabilities for trading	-	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	17,737	17,737	-
Provisions for risks and expenses	-	-	-	-	-	3,321	3,321	-
Current tax liabilities	-	-	-	-	-	178	178	-
Deferred tax liabilities	-	-	-	-	-	-	-	-
Total liabilities	871,393	115,711	248,615	151,811	31,350	24,676	1,443,556	1,341,506
Equity and reserves	-	-	-	-	-	218,675	218,675	-
Total liabilities, equity and reserves	871,393	115,711	248,615	151,811	31,350	243,351	1,662,231	1,341,506
Interest rate mismatch	(314,244)	137,663	116,612	105,043	14,328	(59,402)	-	(824,637)

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.2. Interest Rate Risk (Continued)

a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates (continued)

	Up to a month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Non- interest bearing BAM '000	Total BAM '000	Fixed interest rate BAM '000
December 31, 2017								
Assets								
Cash and cash equivalents	129,775	-	-	-	-	40,793	170,568	-
Obligatory reserve with the Central Bank	-	-	-	-	-	116,002	116,002	-
Loans and receivables due from banks	55,403	45,041	-	-	-	-	100,444	45,039
Financial assets at fair value through other comprehensive income	2,098	-	62,859	104,468	-	117	169,542	169,425
Financial assets at fair value through profit and loss	-	-	-	10	-	-	10	10
Loans and receivables due from customers	148,935	277,835	371,240	86,852	10,900	-	895,762	63,318
Property and equipment	-	-	-	-	-	16,468	16,468	-
Intangible assets	-	-	-	-	-	5,887	5,887	-
Other assets	-	-	-	-	-	5,997	5,997	-
Deferred tax assets	-	-	-	-	-	16	16	-
Total assets	336,211	322,876	434,099	191,330	10,900	185,280	1,480,696	277,792
Liabilities								
Deposits and borrowings due to banks	-	221,244	147,051	27,381	-	225	395,901	283,132
Deposits and loans due to customers	521,637	66,119	164,151	106,181	100	5,440	863,628	806,582
Financial liabilities at fair value through profit and loss	-	-	-	-	-	621	621	-
Other liabilities	-	-	-	-	-	15,328	15,328	-
Provisions for liabilities and expenses	-	-	-	-	-	3,662	3,662	-
Income tax payable	-	-	-	-	-	417	417	-
Deferred tax liability	-	-	-	-	-	16	16	-
Equity and reserves	-	-	-	-	-	201,122	201,122	-
Total liabilities, equity and reserves	521,637	287,363	311,202	133,562	100	226,832	1,480,696	1,089,714
Interest rate mismatch	(185,426)	35,513	122,897	57,768	10,800	(41,552)	-	(811,922)

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.2. Interest Rate Risk (Continued)

a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates (continued)

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

	Up to a month BAM'000	From 1 to 3 months BAM'000	From 3 to 12 months BAM'000	From 1 to 5 years BAM'000	Over 5 years BAM'000	Total BAM'000
December 31, 2018						
Liabilities						
Transaction accounts and deposits of banks	8,567	240,918	140,831	9,786	15,567	415,669
Transaction accounts and deposits of customers	693,458	47,601	107,784	142,025	15,783	1,006,651
Other liabilities	17,737	-	-	-	-	17,737
Total liabilities	719,762	288,519	248,615	151,811	31,350	1,440,057
December 31, 2017						
Transaction accounts and deposits of banks	-	221,244	147,276	27,381	-	395,901
Transaction accounts and deposits of customers	541,234	115,962	107,185	99,241	6	863,628
Other liabilities	9,257	747	4,417	2,504	-	16,925
Total liabilities	550,491	337,953	258,878	129,126	6	1,276,454

b) Effective Interest Rates

The following table presents the effective interest rates calculated as the weighted average for the financial instruments in the reporting period:

	December 31, 2018 %	December 31, 2017 %
Funds in excess of the obligatory reserve held with the Central Bank	(0.20)	(0.20)
Loans and receivables due from banks	0.04	0.02
Loans and receivables due from customers	4.99	5.58
Financial assets at fair value through other comprehensive income	4.26	4.71
Deposits of banks	(0.39)	(0.16)
Deposits of customers	(0.65)	(0.99)

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.3. Market Risk Management (Continued)

34.3.3. Risk of Changes in Interest Rate Margin

Within market-risk-measuring techniques, the Bank measures the impact of interest rate margin changes in debt securities with fixed yield. The risk of change in debt securities price due to issuer credit risk change (margin perceived by the market) is measured and limited by CPV limit - basis point credit margin value limit (Credit Spread Point Value). This limit is similar to Basis Point Value (BPV) and limits the risk of change in the net present value of debt securities portfolio if the impact of interest margin change shifts by 0.01% (1 basis point). BPV limits the overall sensitivity of the Bank's items to changes in interest rates and CPV additionally limits investments in debt securities with regard to the volume and duration.

34.3.4. Interest Rate Risk in the Banking Book

Interest rate risk in the banking book is defined as the exposure of the Bank's financial position to undesirable changes in the movement of interest rates arising from assets and liabilities in the banking book.

The limitation system in accordance with the Group's rules is defined by classification of limits and warning levels depending on the type of limitation and the time required for corrective action in case of a limitation violation. The Bank's management and control of interest rate risk in the banking book is based on the analysis of metrics/indicators from two perspectives:

- economic value and
- earnings.

The main restrictions by means of which the Bank monitors exposure to risk from the perspective of the economic value are:

- BP01 sensitivity – Overall sensitivity and sensitivity per time (maturity) buckets– is calculated as a change in the present value of interest sensitive items arising from the current shock for 1 basis point at each step along the curve. The sum of all sensitivities per time buckets along the curve is BP01.
- EV supervisory standardized shocks – For regulatory reasons, in addition to BP01 metrics, the Group calculates the sensitivity of the economic value as a result of the standard shock due to a sudden parallel displacement of the yield curve by +/- 200 basis points. The impact of the economic sensitivity is measured in relation to Tier 1 capital.

From the perspective of earnings, the Bank monitors the risk exposure through the following limit:

- Sensitivity of the net interest income – The standard sensitivity of the net interest income is calculated based on the scenario of current parallel shocks at rates above the one-year time horizon and assuming a consistent balance and constant margin.

34.4. Operational Risk

The Bank's management and the Group are regularly informed and receive reports on the aforementioned processes and indicators which constitute the operational risk management system and the operational risk management system is aligned with the standards of the Group and local and international regulations.

Operational risk is a risk of adverse effects on the Bank's financial performance and equity due to omissions made by employees during their work, inadequate internal procedures and processes, inadequate management of the Bank's IT and other systems, as well as a result of externally caused unpredictable events including legal risk.

Losses arising from the following events can be considered as operational risk: internal or external fraud, employee relations and safety at work, customer complaints, fines and penalties for regulatory breaches, damage to material assets of the Bank, system interruptions and system malfunctions, process management.

In accordance with the Group methodology as well as regulations of the RS Banking Agency, the Bank has established and is continuously improving the operational risk management system. The system includes tools and mechanisms for continuous monitoring of damages that the Bank bears due to operational risks and its exposure to operational risks, the assessment of operational risks within processes and products, monitoring of the key risk indicators and defining the ways to avoid, control or transfer operational risks to third parties, as well as a reporting system.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.4. Operational Risk (Continued)

For operational risk loss data recording, recording and monitoring of risk indicators, the Bank uses Group's ARGO tool, whereas for reporting process and data analyses related to operational risks, the Bank uses Group's BO Tool (Business Object Tool).

Given that the Bank is exposed to operational risks in all its business activities and in order to raise awareness about the concept, significance of and responsibilities in process of operational risk management, the Bank has developed a system of electronic education for all its employees. Also, in cooperation with Human Resources, live trainings are organized for new Bank employees.

34.5. Reputation Risk

Taking into account significance of the reputation risk, which is defined as a risk of adverse effects on the Bank's financial performance (result) and equity due to loss of trust in the Bank's integrity triggered by unfavorable public opinion on the Bank's business practices or activities of the members of its bodies, irrespective of whether the grounds for such an opinion do or do not exist, the Bank manages the reputation risk by means the adopted and implemented special policies and procedures governing the area of the reputation risk management and acting with transactions in specific industries (nuclear energy, weapons industry, infrastructure water-dam, electricity production in coal-fired power plants, and mining sector), as well as by ongoing raising of the awareness of its employees of the significance of the reputation risk management using electronic and live trainings for all staff.

34.6. Capital Management

The Bank's objectives in capital management are:

- compliance with capital requirements set by regulators of banks and capital markets,
- maintenance of the Bank's ability to continue the business operations so that it could ensure return to shareholders and benefits for other stakeholders; and
- maintenance of a strong capital basis to support the development of its business activities.

At the beginning of 2017, the new Banking Law of RS entered into force, and during 2017 and 2018 BARS enacted a number of by-laws on the operation of banks. The aim of the new regulations is to harmonize the regulations governing the business of the banking sector in the Republic of Srpska with Basel II and Basel III Standards.

The new regulations have significantly changed the method of calculating the capital requirements for credit, market and operational risks, the method of calculating capital, as well as the amount of capital ratios that the banks are obligated to maintain continuously, including capital buffers.

The Bank monitors the prescribed ratios and other capital adequacy indicators in accordance with BARS regulations.

The minimum prescribed rates and ratios that banks must meet at all times are as follows:

- Common Equity Tier 1 Capital Ratio of 6.75%;
- Common Equity Tier 1 Capital of 9%; and
- the regulatory capital adequacy ratio of 12%.

For each of the above ratios an ongoing maintenance of the capital buffers of 2.5% for preservation of the capital is prescribed.

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.6. Capital Management (Continued)

In addition to the prescribed ratios, requirements are planned (still not prescribed) for other capital buffers, i.e. for the combined capital buffer representing the minimum ratio of the Common Equity Tier 1 Capital increased by the preservation of capital buffer and increased by the following buffers, depending on what is applicable, namely:

1. bank-specific countercyclical buffer;
2. buffer for a systemically important bank (prescribed in the range from 0% to 2%; it will be prescribed for each bank individually after BARS has ranked the banks according to the systemic importance); and
3. buffer for systemic risk.

The amount of regulatory core (T 1) and Common Equity Tier 1 Capital (CET 1), as well as their rates calculated in accordance with the BARS regulations are shown in the following table:

Line	Number	Item	December 31, 2018 BAM 000	December 31, 2017 BAM 000
010	1	REGULATORY CAPITAL	188,299	174,898
015	1.1	CORE CAPITAL	179,108	165,948
020	1.1.1	COMMON EQUITY TIER 1 CAPITAL	179,108	165,948
030	1.1.1.1	Equity instruments recognized as regular core capital	97,428	97,428
040	1.1.1.1.1	Paid-in equity instruments	97,055	97,055
060	1.1.1.1.3	Share issue premiums	373	373
130	1.1.1.2	Retained earnings	38,477	25,590
180	1.1.1.3	Other comprehensive income	2,448	(114)
200	1.1.1.4	Other reserves	48,947	48,947
340	1.1.1.11	(-) Other intangible assets	(8,115)	(5,887)
		(-) Deferred tax assets that are dependent on future profitability and do not arise from temporary differences minus related tax liabilities		
370	1.1.1.12		(77)	(16)
750	1.2	SUPPLEMENTARY CAPITAL	9,191	8,950
		General credit risk provisions in accordance with the standardized approach		
920	1.2.6		10,158	9,494
		Supplementary capital components or deductible items - other		
978	1.2.13		(967)	(544)
010	1	<i>Common Equity Tier 1 Capital ratio</i>	<i>18.78%</i>	<i>18.09%</i>
030	3	<i>Core capital ratio</i>	<i>18.78%</i>	<i>18.09%</i>
050	5	<i>Regulatory capital ratio</i>	<i>19.74%</i>	<i>19.07%</i>

Notes to the Financial Statements

34. RISK MANAGEMENT (Continued)

34.7. Taxation Risks

The Republic of Srpska and Bosnia and Herzegovina currently have several tax laws in effect, as imposed by various governmental agencies. The applicable taxes include: value added tax, corporate income tax and payroll (social) taxes, among others.

Following their introduction, the regulations governing these taxes were not enforced for substantial periods of time; in contrast to similar legislation in more developed market economies. Moreover, the regulations defining the implementation of these laws are often unclear or non-existent. Hence, few precedents with regard to tax issues have been established in the Republic of Srpska. Often, contrary opinions pertaining to legal interpretations exist both among, and within, governmental ministries and organizations thus creating uncertainties.

Tax returns, along with other areas governed by the law (e.g., customs and currency control matters) are subject to review and investigation by a number of authorities that are legally enabled to impose extremely severe fines, penalties and interest charges. The interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Bank may not coincide with that of the management. As a result, transactions may be challenged by tax authorities and the Bank may be assessed additional taxes, penalties and interest, which can be significant.

In accordance with the Law on Tax Procedure of the Tax Administration of the Republic of Srpska, expiration period of the tax liability is five years. This virtually means that tax authorities could determine payment of the outstanding liability in the period of five years from the origination of the liability. The afore-described situation creates tax risks in the Republic of Srpska and Bosnia and Herzegovina that are substantially more significant than those typically existing in countries with more developed tax systems.

35. FUNDS MANAGED ON BEHALF AND FOR THE ACCOUNT OF THIRD PARTIES

The Bank manages funds related to transactions for the account and on behalf of third parties; it records these transactions and funds off balance sheet, separated from its own assets. The Bank charges fees for managing funds on behalf of third parties. Income and expenses per these funds are posted as income or expenses of the owner or user.

Investments related to the funds managed on behalf of third parties are presented in the table below:

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Consignment investments	<u>236</u>	<u>362</u>

In 2018, the Bank did not earn revenues from fees for funds managed on behalf and for the account of third parties (2017: BAM 17 thousand).

Notes to the Financial Statements

36. LIABILITIES PER OPERATING LEASE AGREEMENTS

The Bank has commitments arising from operating lease contracts. The contracts are related to the lease of the Bank's branch premises and spaces for installation of ATMs.

The future minimum lease payments based on specified operating leases are as follows:

	December 31, 2018 BAM '000	December 31, 2017 BAM '000
Up to 1 year	619	583
From 1 to 5 years	1,129	738
Over 5 years	296	1
	2,044	1,322

As stated in Note 2.5, as of January 1, 2019, the Bank will record the liabilities under the operating lease agreements for over one-year lease terms and amounts above the defined minimum annual lease expense threshold as assets and liabilities in accordance with IFRS 16, and short-term liabilities on operating lease and small-value leases will continue to be booked as rental costs in accordance with the relevant contracts.

37. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value represents the amount for which an asset can be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. It can also be defined as the value at which it is possible to dispose of assets/liabilities, or the appraised value of the neutralization of the market risk arising from the assets/liabilities in the appropriate time-frame.

Assumptions used in assessing and measuring the fair values of financial instruments are based on application of centralized calculation developed at the Group level, which uses IFRS 13 as a unique source of guidelines to measure the fair value.

Financial instruments are considered as quoted on an active market if the quoted prices are easily and regularly available and if the prices represent actual and regular market transactions under common market terms.

All financial instruments are classified in accordance with classification criteria into three different hierarchy levels of fair values:

- Hierarchy Level 1: Fair value is determined on the basis of prices for identical assets or liabilities available as at the measurement date, i.e. if the financial instruments are present in an active market.
- Hierarchy Level 2: Fair value is determined based on a valuation model for which input data are obtained from an active market when it is not possible to use inputs used in assessment of Hierarchy Level 1.
- Hierarchy Level 3: Fair value is determined based on a valuation model for which input data are not present in an active market, i.e. when more significant adjustments are needed.

In its methodology, when determining hierarchy levels for performing loans and deposits of banks and customers, the Group uses the following additional criteria:

- Hierarchy Level 2: (risk-free rate, i.e., FV risk-free – adjusted rate for credit spread for the expected and unexpected loss, i.e., FV risk adjusted) / risk-free rate or FV risk-free ≤ 5%.
- Hierarchy Level 3: (risk-free rate, i.e., FV risk-free – adjusted rate for credit spread for expected and unexpected loss, i.e., FV risk adjusted) / risk-free rate or FV risk-free > 5%.

The Bank classifies non-performing loans (NPL) in accordance with the Group Instructions in such a manner that it equals their carrying and fair values. All assets and liabilities of the Bank are classified into hierarchy Level 2 and Level 3.

Notes to the Financial Statements

37. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (Continued)

The Bank classifies debt securities into Level 2 and the fair value adjustment is performed in accordance with the centralized calculation of the Group.

	December 31, 2018				December 31, 2017			
	Fair value	Carrying value	Variance		Fair value	Carrying value	Variance	
	BAM '000	BAM '000	BAM '000	%	BAM '000	BAM '000	BAM '000	%
Loans and receivables due from banks	269,892	269,892	-	0.00%	216,193	216,446	(253)	0.12%
Loans and receivables due from customers	984,782	937,374	47,408	5.06%	966,560	895,762	70,798	7.90%
Total	1,254,674	1,207,266	47,408	3.93%	1,182,753	1,112,208	70,545	6.34%
Deposits and borrowings due to banks	409,753	415,669	(5,916)	(1.42%)	387,951	395,901	(7,950)	(2.00%)
Deposits and borrowings due to customers	997,612	1,006,651	(9,039)	(0.90%)	862,752	863,628	(876)	(0.10%)
Total	1,407,365	1,442,320	(14,955)	(1.05%)	1,250,703	1,259,529	(8,826)	(0.70%)

Levels of fair value of the Bank's assets and liabilities in accordance with IFRS 13 are presented in the table below:

	December 31, 2018			December 31, 2017		
	Fair value levels			Fair value levels		
	Level 1 BAM '000	Level 2 BAM '000	Level 3 BAM '000	Level 1 BAM '000	Level 2 BAM '000	Level 3 BAM '000
Loans and receivables due from banks	-	-	269,892	-	2,470	213,723
Loans and receivables due from customers	-	418,626	566,156	-	109,221	857,339
Total	-	418,626	836,048	-	111,691	1,071,062
Deposits and borrowings due to banks	-	289,755	119,998	-	329,582	58,369
Deposits and borrowings due to customers	-	-	997,612	-	102,334	760,418
Total	-	289,755	1,117,610	-	431,916	818,787

38. EVENTS AFTER THE REPORTING PERIOD

After the reporting date, there have been no events that would require additional disclosures in or any adjustments to the financial statements (adjusting events) until the date of their issuance.

Notes to the Financial Statements

39. EXCHANGE RATES

The official exchange rates applied in translation of the statement of financial position components denominated in foreign currencies into BAM as at December 31, 2018 and 2017 for the following major currencies were:

	December 31, 2018	December 31, 2017
USD	1.707552	1.630810
CHF	1.742077	1.671364
EUR	1.955830	1.955830

40. ABBREVIATIONS

Bank – UniCredit Bank a.d. Banja Luka
 Group – UniCredit Group
 BARS – Banking Agency of Republic of Srpska
 RS – Republic of Srpska
 IAS – International Accounting Standards
 IFRS - International Financial Reporting Standards
 VAT – Value added Tax
 EU – European Union
 IFRIC – International Financial Reporting Interpretations Committee
 RWA – Risk Weighted Asset
 CET 1 – Common Equity Tier 1 Capital ratio
 SPPI – Solely Payments of Principal and Interest
 SE - Securities
 PD – Probability of Default
 LGD – Loss Given Default
 EAD – Exposure at Default
 TTC – Through The Cycle
 ECL – Expected Credit Loss
 FLI – Forward Looking Information
 EBA - European Banking Authority
 ICAAP – Internal Capital Adequacy Assessment Process
 POCI – Purchased or Originated Credit Impaired
 EIR – Effective Interest Rate
 IT – Information technology
 NPL – Non Performing Loans
 ALCO – Asset - Liability Committee
 VaR - Value at Risk
 BPV - Basis Point Value
 CPV – Credit Spread Point Value
 FV – Fair value
 EV – Economic value