Development Bank of the Federation of Bosnia and Herzegovina

Financial statements for the year ended 31 December 2014

This version of the report is a translation from the original, which was prepared in the Bosnian language. In all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation.

Content

Management Board's Report

The Managements Board has pleasure in submitting its report for the year ended 31 December 2014.

Review of operations

The result for the year ended 31 December 2014 of the Bank is set out in the income statement on page 6.

Supervisory Board

During the course of 2014 and up to the date of this report, the Supervisory Board comprised of:

Petar Jurčić	Chairman until 28 April 2014
Aid Berbić	Member until 28 April 2014, Chairman since 15 July 2014
Senad Softić	Member until 28 April 2014
Samir Ćatović	Member until 28 April 2014
Ružica Ćurković	Member until 28 April 2014, Member since 15 July 2014
Ivica Musić	Member until 28 April 2014, Member since 15 July 2014
Dženan Đonlagić	Member until 28 April 2014
Ivica Knezović	Member since 15 July 2014
Sejfo Ušanović	Member since 15 July 2014
Amir Karalić	Member since 15 July 2014
Semir Fejzić	Member since 15 July 2014

Management Board

During the course of 2014 and up to the date of this report, the Management Board comprised:

Ramiz Džaferović	Director and President of the Management Board until 25 July 2014
Salko Selman	Director and President of the Management Board since 23 October 2014
	Vice-president of the Management Board until 25 July 2014
	Board since 25 July 2014 until 23 October 2014
Borislav Trlin	Vice-president of the Management Board since 23 October 2014
Dubravka Bošnjak	Executive Director until 25 July 2014
Belma Izmirlija	Executive Director until 25 July 2014

Management Board's Report (continued)

Audit Committee

During the course of 2014 and up to the date of this report, the Audit Committee comprised:

Dragan Prusina	Chairman until 31 July 2014
Advija Alihodžić	Vice-Chairwoman until 31 July 2014
Fatima Obhodžaš	Member until 31 July 2014
Dragan Kolobarić	Member until 31 July 2014
Meliha Bašić	Member until 31 July 2014
Drago Novaković	Chairman since 4 December 2014
Fatima Obhodžaš	Vice-Chairwoman since 4 December 2014
Haladin Salihović	Member since 4 December 2014
Dželmina Huremović	Member since 4 December 2014
Suada Isaković	Member since 4 December 2014

On behalf of the Management Board

Salko Selman
President of the Management Board

RAZVOJNA BANKA FEDERACIJE BOSNE I HERCEGOVINE
RB FBiH
Sarajevo

30 April 2015

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

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

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

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

The financial statements set out on pages 6 to 48 were authorised by the Management Board on 30 April 2015 for issue to the Supervisory Board and are signed below to signify this:

On behalf of the Management Board

RB FBiH
Sarajevo

Salko Selman
President of the Management Board

Development Bank of the FBiH
Igmanska 1
71000 Sarajevo
Bosnia and Herzegovina

30 April 2015

This version of the report is a translation from the original, which was prepared in the Bosnian language. In all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation.

Independent auditors' report to the owners of the Development Bank of the Federation of Bosnia and Herzegovina

We have audited the accompanying financial statements of the Development Bank of the Federation of Bosnia and Herzegovina ("the Bank"), which comprise the balance sheet as at 31 December 2014, the income statement and statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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Independent auditors' report to the owners of the Development Bank of the Federation of Bosnia and Herzegovina (continued)

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2014, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG B-H d.o.o. za reviziju
Registered Auditors
Zmaja od Bosne 7-7A/III
71 000 Sarajevo
Bosnia and Herzegovina

D.O.O. ZA REVIZIJU KPMG B-H 1 SARAJEVO

30 April 2015

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Income statement

For the year ended 31 December

	Note	2014 BAM'000	2013 BAM'000
Interest income	5	9,188	9,666
Interest expense	6	(106)	(114)
Net interest income		**9,082**	**9,552**
Fee and commission income	7	1,918	1,690
Net fee and commission income		**1,918**	**1,690**
Other operating income	8	263	489
Operating income		**11,263**	**11,731**
Personnel expenses	9	(5,175)	(5,375)
Depreciation and amortisation		(331)	(347)
Administrative and other expenses	10	(1,637)	(1,539)
Operating expenses		**(7,143)**	**(7,261)**
Profit before impairment losses and provisions		**4,120**	**4,470**
Impairment losses and provisions	11	(3,078)	(1,233)
NET PROFIT FOR THE YEAR		**1,042**	**3,237**

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

Statement of comprehensive income

For the year ended 31 December

	Note	2014	2013
		BAM '000	BAM '000
Net profit for the year		1,042	3,237
Other comprehensive income for the year		-	-
Total comprehensive income for the year		1,042	3,237

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

Balance sheet

As at 31 December

	Note	31. December 2014 BAM'000	31. December 2013 BAM'000
Assets			
Cash and cash equivalents	*12*	46,612	80,956
Obligatory reserve with the Central bank	*13*	7,726	3,988
Loans to banks	*14*	158	270
Loans to customers	*15*	211,700	174,366
Other assets	*16*	1,269	99
Property, equipment and intangible assets	*17*	5,099	5,377
Total assets		**272,564**	**265,056**
Liabilities			
Current accounts and deposits from customers	*18*	86,453	61,032
Borrowings	*19*	3,661	3,749
Provisions for liabilities and charges	*20*	962	745
Other liabilities	*21*	8,774	24,621
Total liabilities		**99,850**	**90,147**
Equity			
Owner's capital	*22*	163,615	153,000
Retained earnings		1,042	13,852
Regulatory reserves for credit losses		8,057	8,057
Total equity		**172,714**	**174,909**
Total liabilities and equity		**272,564**	**265,056**

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

Statement of cash flows

For the year ended 31 December

	Note	2014 BAM'000	2013 BAM'000
Cash flow from operating activities			
Profit for the period		1,042	3,237
Adjustments for:			
Depreciation and amortization		331	347
Impairment losses and provisions		3,078	1,233
Net interest income		(9,082)	(9,552)
		(4,631)	**(4.735)**
Changes in:			
- Obligatory reserve with the Central bank		(3,738)	223
- Loans and receivables		(40,034)	20,521
- Other assets		(20)	192
- Current accounts and deposits from customers		25,421	9,293
- Other liabilities		(16,723)	(437)
		(39,725)	**25,057**
Interest received		8,867	9,666
Interest paid		(106)	(114)
Net cash flow from operating activities		**(30,964)**	**34,609**
Investing Activities			
Purchase of property and equipment		(55)	(61)
Purchase of intangible assets		-	(8)
Payment of profits		(3,237)	-
Net cash flow from operating activities		**(3,292)**	**(69)**
Financing activities			
Repayment of loans and borrowings		(88)	(565)
Net cash flow from financing activities		**(88)**	**(565)**
Net increase in cash and cash equivalents		(34,344)	33,975
Cash and cash equivalents at the beginning of the year	*12*	80,956	46,981
Cash and cash equivalents at the end of the year	*12*	46,612	80,956

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

Statement of changes in equity

For the year ended 31 December

	Owner's capital BAM '000	Regulatory reserves for credit losses BAM '000	Retained earnings BAM '000	Total BAM '000
Balance as at 1 January 2013	**153,000**	**8,057**	**10,615**	**171,672**
Net profit for the year	-	-	**3,237**	**3,237**
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	**3,237**	**3,237**
Balance as at 31 December 2013	**153,000**	**8,057**	**13,852**	**174,909**
Transfer of retained earnings to Owner's capital	10,615	-	(10,615)	-
Payment of retained earnings for 2013	-	-	(3,237)	(3,237)
Net profit for the year	-	-	1,042	1,042
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	**1,042**	**1,042**
Balance as at 31 December 2014	**163,615**	**8,057**	**1,042**	**172,714**

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

Notes to financial statements

1 General

The Development Bank of the Federation of Bosnia and Herzegovina (hereafter "the Bank") was established by the Law on the Development Bank of the Federation of Bosnia and Herzegovina ("Official Gazette of Federation of Bosnia and Herzegovina", No. 37/08). The Bank is headquartered in Igmanska 1, Sarajevo. The Bank is 100%-ownership of the Federation of Bosnia and Herzegovina.

In compliance with the Law on the Development Bank and the Statute of the Bank, bodies of the Bank are: the Assembly (consisting of the Government of the FBiH), the Supervisory Board, the Management Board and the Audit Committee.

As of 31 December 2014 the Bank had branch offices in Mostar, Bihać, Zenica, Orašje, Tuzla and Livno.

The goals of the Bank are encouragement of economic development and overall social development and the encouragement of sustainable growth to the territory of the Federation of Bosnia and Herzegovina, relating to the financial and general social goals defined by the Law.

Corporate loan and guarantee approval are the key activities of the Bank either directly or through other banks, in order to support the local economy, regional development and employment, The Bank performs credit operations in the name and on behalf of the Bank (from capital, collected deposits and borrowings), as well as in the name and on behalf of the Federation of BiH, on which behalf it manages its domestic and foreign funds aimed for development projects, as well as receives cash deposits and takes loans, as a function of financing development projects.

2 Basis of preparation

a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board.

The Bank's financial statements were authorized for issue by the Management Board on 30 April 2015 for submission to the Supervisory Board.

b) Basis of measurement

These financial statements have been prepared on the historical or amortised cost basis.

c) Functional and presentation currency

The financial statements are presented in Convertible Marks ("BAM"), which is the functional currency of the Bank.

The Central Bank of Bosnia and Herzegovina ("CB BiH") implemented a currency board arrangement aligning BAM to EURO at an exchange rate of EUR 1: BAM 1.95583 throughout 2013 and 2014. This is expected to continue in the foreseeable future.

d) Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

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

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

Notes to financial statements (continued)

3 Significant accounting policies

The accounting policies set out below have been consistently applied for all periods presented in these financial statements.

a) Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange profits and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary assets and items that are measured in terms of historical cost in foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the reporting date.

b) Interest income and expense

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

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

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

c) Fee and commission income and expenses

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

Fee and commission income and expenses, reported as such, mainly comprise of fees related to agency activities, the issuance of guarantees and letters of credit and other services and are recognised in the income statement upon performance of the relevant service.

d) Lease payments

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

e) Income tax

According to Article 32 of the Law on Development Bank of the Federation of Bosnia and Herzegovina ("Official Gazette of Federation of Bosnia and Herzegovina, No. 37/08), the Bank is not subject to corporate profit tax.

f) Financial instruments

Recognition

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

Notes to financial statements (continued)

3 Significant accounting policies (continued)

f) Financial instruments (continued)

Classification

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

a) Loans and receivables

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

b) Other financial liabilities

Other financial liabilities comprise of all other financial liabilities, including current and deposit accounts and borrowings.

Initial and subsequent measurement

Loans and receivables and other financial liabilities are initially recognized at fair value. Loans and receivables and other financial liabilities are subsequently measured at amortized cost, using the effective interest rate method, less any impairment.

Derecognition

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

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

Identification and measurement of impairment of financial assets

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

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

Notes to financial statements (continued)

3 Significant accounting policies (continued)

f) Financial instruments (continued)

Identification and measurement of impairment of financial assets

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

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

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

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

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

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

Provisions calculated in the manner described in the previous paragraph ("FBA reserves") are not recognized in these financial statements of the Bank. If the impairment for potential losses calculated in accordance with the regulations of the Agency is greater the impairment calculated in accordance with the requirements of IFRS, this difference is presented as adjustments in the calculation of capital adequacy.

Fair values of financial assets and liabilities

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

Where available, fair value is measured using the quoted price in an active market. The market is considered active if the transaction for asset or liability occur with sufficient frequency and to the extent sufficient to provide information about prices on a regular basis (Level 1 fair value hierarchy).

Notes to financial statements (continued)

3 Significant accounting policies (continued)

f) Financial instruments (continued)

Fair values of financial assets and liabilities (continued)

In circumstances where the quoted market prices are not readily available, the Bank then uses valuation techniques that maximize the use of observable inputs (Level 2 and Level 3 fair value hierarchy) and minimize the use of unavailable input data. Selected valuation techniques include all factors that market participants would take into account when determining the price of the transaction.

Analysis of financial instruments that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 as follows:

- Level 1 - fair value derived from quoted prices in active markets
- Level 2 - fair value measurements derived from inputs other than quoted prices included in level 1;
- Level 3 - fair value derived from valuation techniques that are not based on observable market data.

Specific financial instruments

Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents comprise of cash, balances with the Central bank and current accounts with other banks.

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

Obligatory reserve with the Central Bank

Obligatory reserve with the Central Bank are classified as loans and receivables and measured at amortized cost less impairment losses.

Loans and advances

Loans and advances to banks and customers are presented at amortised cost net of impairment allowances to reflect the estimated recoverable amounts.

Borrowings

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

Current accounts and deposits from customers

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

Notes to financial statements (continued)

3 Significant accounting policies (continued)

g) Property and equipment

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

Depreciation is provided on all property and equipment except for land and assets in the course of construction on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The depreciation rates used by the Bank are as follows:

Buildings	3%
Furniture and equipment	20%
Motor vehicles	20%
Leasehold improvements	20%
Computers	33%

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

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

h) Intangible assets

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

Amortization is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The following estimated useful lives are used:

Software	20%

Amortization method and useful lives are reassessed, and adjusted if appropriate, at each reporting date.

i) Impairment of non-financial assets

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

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

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

Notes to financial statements (continued)

3 Significant accounting policies (continued)

j) Employee Benefits

Short-term benefits

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

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Long-term benefits: retirement severance payments

According to the local legislation the Bank pays to its employees retirement severance benefits upon retirement in an amount of six employee's salaries received in the last six months or six average salaries at the Federation of BiH level in the last six months, depending on what is more favourable for the employee.

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

k) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, 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, or as required by law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures.

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

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

l) Owner's capital

Owner's capital consists of one share of the Federation of BiH.

In accordance with the provisions of the Law on Development Bank of the Federation of Bosnia and Herzegovina, Article 3, the capital of the Bank should be increased by BAM 400 million from the budget of Government of the FBiH in equal instalments in the next four years, starting from 2008 to 2011.

Up to 31 December 2014 the Government of the FBiH has not made capital injection in the above stated contracted dynamics and amounts.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

l) Owner's capital (continued)

Regulatory reserve for credit losses

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

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

Based on the Decision issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. Therefore, the reserve shown in the financial statements as at and for the year ended 31 December 2012 remained unchanged until 31 December 2014.

m) Off-balance sheet commitments and contingent liabilities

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

n) Funds managed for and on behalf of third parties

The Bank manages significant funds for and on behalf of the Government of the FBiH (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, Ministry of Environment and Tourism and Ministry of Energy, Mining and Industry) and the Federal Employment Agency. Income and expenses from such operations are charged to the principal and the Bank does not bear any liabilities and risks. For these services, the Bank charges fees. For details refer to Note 24.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

o) Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements

A number of new standards, amendments to standards and interpretations issued by the International Accounting Standards Board ("IASB") and International Financial Reporting Interpretations Committee ("IFRIC") are not yet effective for annual periods beginning 1 January 2014, and have not been applied in preparing these financial statements.

- IFRS 9 (*Financial Instruments*) was published in July 2014, replacing the existing provisions of IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new model of the expected credit loss for calculating impairment of financial assets, and new general requirements for hedge accounting. It also elaborates the requirements for the recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual periods beginning on 1 or after 1 January 2018, with early adoption permitted.
  The Bank assesses the potential impact of the application of IFRS 9 on its financial statements. Given the nature of the Bank, it is expected that this standard will have a pervasive impact on the Bank's financial statements. In particular, it is expected that the calculation of the impairment of financial instruments based on the expected credit loss will result in an increase in the overall level of impairment.

- IFRS 15 (*Revenues from contracts with customers*) establishes a comprehensive framework to determine whether, how and when to recognize revenue. It replaces the existing guidelines on the recognition of revenue, including IAS 18 *Revenue*, IAS 11 *Accounting for construction contracts* and IFRIC 13 *Customer Loyalty Programmes*. IFRS 15 is effective for annual reporting periods beginning on 1 January 2017, with early adoption permitted.
  The Bank assesses the possible impact of adoption of IFRS 15 on its financial statements.

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

- *Plans for defined benefit: Employees' contributions (amendment to IAS 19)*
- *The annual improvements to IFRSs Cycle 2010-2012*
- *The annual improvements to IFRSs Cycle 2011-2013*
- *IFRS 14 Accounts regulatory prepayments*
- *Accounting for the acquisition of interests in joint arrangements (amendments to IFRS 11)*
- *Clarification of the eligible methods of depreciation (amendments to IAS 16 and IAS 38)*
- *Agriculture: Growing crops (amendments to IAS 16 and IAS 41)*
- *The equity method in the separate financial statements (amendment IAS 27)*
- *The sale or transfer of assets between investors and its associated entities or joint ventures (amendment of IFRS 10 and IAS 28)*
- *The annual improvements to IFRSs Cycle 2012 to 2014 - various standards.*

Notes to financial statements (continued)

4 Critical accounting judgements and key sources of estimation uncertainty

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

(a) Impairment losses on loans and receivables and provisions for off-balance-sheet exposure

The Bank monitors the creditworthiness of its customers on an ongoing basis. The need for impairment of the Bank's on and off-balance sheet exposure to credit risk is assessed on a monthly basis.

Impairment losses are made mainly against the carrying value of loans to banks and customers (as disclosed in Notes 14 and 15) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 20).

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Such evidence includes delinquency in payments or other indications of financial difficulty of borrowers and adverse changes in the economic conditions in which borrowers operate or in the value or enforceability of security, where these changes can be correlated with defaults.

Summary of impairment allowances	*Note*	**31 December 2014 BAM '000**	31 December 2013 BAM '000
Impairment allowances for balance sheet exposures, including IBNR and other assets	*14, 15*	23,594	21,430
Provisions for off-balance sheet exposure	*20*	260	300
		23,854	**21,730**

As at 31 December 2014 and 31 December 2013, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognized were as follows:

BAM '000	**31 December 2014**			**31 December 2013**		
	Loans to banks	**Loans to customers**	**Total**	**Loans to banks**	**Loans to customers**	**Total**
Gross exposure	1,534	30,671	**32,205**	1,533	35,831	**37,364**
Impairment allowance	(1,534)	(12,908)	**(14,442)**	(1,533)	(14,729)	**(16,262)**
Impairment rate	100%	42%	**45%**	100%	41%	**43%**

In addition to identified losses on impaired loans, as described above, the Bank also recognizes impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified ("IBNR"). The amount of IBNR as at 31 December 2014 amounted to BAM 9,150 thousand (2013: BAM 5,167 thousand) or 4.5% (2013: 3.3%) of loans and receivables.

Notes to financial statements (continued)

4 Critical accounting judgements and key sources of estimation uncertainty

(b) Regulatory requirements

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

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

The following table summarizes impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2014 are calculated in accordance with the new methodology, as explained in Note 3 (m):

Summary of impairment allowances	**31 December 2014**	31 December 2013
	BAM '000	BAM '000
Provisions for balance-sheet exposure (Agency)	**34,963**	33,061
Provisions for off-balance–sheet exposure (Agency)	**408**	497
	35,371	33,558
Impairment allowances under IFRS	**23,854**	21,730
Negative difference between provisions for balance-sheet exposure (Agency) and impairment allowance in accordance with IFRS	**3,550**	1,453
Excess at period end	**15,067**	13,281

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

As presented in the above table, total Agency provisions exceeded provisions recognized under IFRS by BAM 15,067 thousand as at 31 December 2014 (31 December 2013: BAM 13,281 thousand). Out of this amount, BAM 8,057 thousand has been recognized as a regulatory reserve for credit losses within equity as at 31 December 2014 (31 December 2013: BAM 8,057 thousand). The remaining amount of BAM 7,010 thousand, which represents the current year shortfall, in line with the new Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be recorded as a reduction of regulatory capital.

Notes to financial statements (continued)

4 Critical accounting judgements and key sources of estimation uncertainty (continued)

(c) Litigation

The Bank performs individual assessment of all court cases and on that basis determines the amount of provisions.
As indicated in Note 26, the Bank provided BAM 275 thousand, which is the amount that the Management considered sufficient. Since the assessment is made for each case separately, it is not practical to estimate the financial effect of changes in assumptions based on which Management assesses the need for provisions on the reporting date.

5 Interest income

	2014 BAM '000	2013 BAM '000
Interest on loans to customers	9,161	9,650
Interest on placements with Central Bank	23	10
Interest on loans to banks	4	6
	9,188	**9,666**

6 Interest expense

	2014 BAM '000	2013 BAM '000
Interest on borrowings and deposits	**106**	**114**

7 Fee and commission income

	2014 BAM '000	2013 BAM '000
Fee income from agency activities	1,391	1,271
Fee income from guarantees and letters of credit	219	176
Fees from other transactions	308	243
	1,918	**1,690**

Notes to financial statements (continued)

8 Other operating income

	2014 BAM '000	2013 BAM '000
Donations	72	132
Foreign exchange rate gain	28	80
Other	163	277
	263	**489**

9 Personnel expenses

	2014 BAM '000	2013 BAM '000
Net salaries	2,259	2,355
Taxes and contributions	1,658	1,739
Other	1,258	1,281
	5,175	**5,375**

Personnel expenses include BAM 964 thousand (2013: BAM 964 thousand) of defined pension contributions paid into the State pension plan. Contributions are calculated as percentage of the gross salary paid. The average number of employees during the year ended 31 December 2014 was 131 (2013: 135).

10 Administrative and other expenses

	2014 BAM '000	2013 BAM '000
Advertising, representation and sponsorship	253	310
Membership fees and taxes	215	205
Telecommunication expenses	168	176
Energy costs	143	155
Supervisory and Audit committee fees	139	124
Services	142	118
Maintenance expenses	93	106
Material costs	128	102
Rent	73	69
Insurance	45	31
Bank fees	16	16
Other expenses	222	127
	1,637	**1,539**

Notes to financial statements (continued)

11 Impairment losses and provisions

Net impairment losses and provisions	2014 BAM '000	2013 BAM '000
-loans to banks (Note 14)	(2)	(68)
-loans to customers (Note 15)	2,814	1,417
-other assets	1	(4)
-provisions for liabilities and charges (Note 20)	(40)	(10)
-employee benefits (Note 20)	305	(102)
	3,078	**1,233**

12 Cash and current accounts with other banks

	31 December 2014 BAM '000	31 December 2013 BAM '000
Current accounts with other banks in foreign currencies	43,096	50,368
Current accounts with the Central Bank of Bosnia and Herzegovina	3,488	30,551
Cash in hand	28	37
	46,612	**80,956**

Cash and current accounts with other banks include funds for and on behalf of third parties (Note 24).

13 Obligatory reserve with the Central bank

	31 December 2014 BAM '000	31 December 2013 BAM '000
Obligatory reserve with the Central Bank of Bosnia and Herzegovina	**7,726**	**3,988**

The minimum obligatory reserve is calculated by applying 10% on short-term deposits as at 31 December 2014 (2013: 10%) on the ten-day average balance of the Bank's total long-term deposits and borrowings.

Interest rates earned with the Central bank on the obligatory reserve for the 2014 and 2013 were in range from 0.0610% to 0.00% and from 0.0040% to 0.1280% respectively.

Notes to financial statements (continued)

14 Loans to banks

	31 December 2014 '000 KM	31 December 2013 '000 KM
Loans to banks	1,695	1,809
Less: impairment allowance	(1,537)	(1,539)
Total net loans to banks	**158**	**270**

Loans and advances to banks include interest receivable in the amount of 127 thousand BAM (31 December 2013: 127 thousand BAM).

The movement in impairment allowance was as follows:

	31 December 2014 '000 KM	31 December 2013 '000 KM
Balance at the beginning of the year	1,539	1,607
Net changes in impairment allowance (Note 11)	(2)	(68)
Balance at the year end	**1,537**	**1,539**

Notes to financial statements (continued)

15 Loans to customers

	31 December 2014 BAM '000	31 December 2013 BAM '000
Short-term loans		
Corporate	8,239	7,110
Retail	-	-
Current portion of long-term loans	24,566	21,070
	32,805	**28,180**
Long-term loans (excluding current portion)		
Corporate	198,725	163,412
Retail	2,225	2,664
	200,950	**166,076**
	233,755	***194,256***
Less: Impairment allowance	(22,055)	(19,890)
	211,700	**174,366**

Loans to customers include interest receivables, which comprise of unpaid due interest and fees, and accrued interest in the amount of 1,025 thousand BAM (31 December 2013: 884 thousand BAM) and are presented net of deferred fees in the amount of 1,399 thousand BAM (31 December 2013: 951 thousand BAM).

Changes in impairment allowance can be presented as follows:

	31 December 2014 BAM '000	31 December 2013 BAM '000
Balance at the beginning of the year	**19,890**	**18,493**
Net changes in impairment allowance (Note 11)	2,814	1,417
Write-offs	(649)	(20)
Balance at the year end	**22,055**	**19,890**

Notes to financial statements (continued)

15 Loans to customers (continued)

Analysis of gross amount of loans by industry:

	31 December 2014 BAM '000	31 December 2013 BAM '000
Corporate loans		
Manufacturing	87,562	82,270
Trade	28,870	26,671
Public administration and defense	29,818	21,725
Agriculture	19,374	21,395
Construction	12,349	14,260
Transportation, storage and telecommunication	8,155	7,376
Hospitality industry	6,263	3,702
Real estate and rental businesses	31,266	1,343
Other	7,078	11,951
	230,735	**190,693**
Retail loans		
General consumption	24	53
Housing loans	310	428
Crafts	2,686	3,082
	3,020	**3,563**
	233,755	**194,256**

Weighted-average nominal and effective interest rates as at 31 December 2014 and 31 December 2013 were as follows:

	31 December 2014		31 December 2013	
	Nominal i.r.	*Effective i.r.*	*Nominal i.r.*	*Effective i.r.*
Corporate	4.59%	5.05%	4.70%	5.21%
Retail	4.10%	4.56%	4.11%	4.62%

Notes to financial statements (continued)

16 Other assets

	31 December 2014 BAM '000	31 December 2013 BAM '000
Assets acquired upon foreclosure of loans	1,150	-
Other assets	119	99
	1,269	**99**

17 Property, equipment and intangible assets

	Buildings BAM '000	Vehicles BAM '000	Office Equipment BAM '000	Software BAM '000	Leasehold improve-ments BAM'000	Total BAM '000
Cost						
As at 1 January 2013	**7,375**	**557**	**1,963**	**622**	**15**	**10,532**
Additions	-	-	57	8	4	69
Disposals and write-offs	-	-	(31)	-	-	(31)
As at 31 December 2013	**7,375**	**557**	**1,989**	**630**	**19**	**10,570**
Additions	-	-	55	-	-	55
Disposals and write-offs	-	-	(471)	-	(1)	(472)
As at 31 December 2014	**7,375**	**557**	**1,573**	**630**	**18**	**10,153**
Accumulated depreciation/amortisation						
As at 1 January 2013	2,041	529	1,765	542	-	4,877
Charge for the year	221	10	88	26	2	347
Disposals and write-offs	-	-	(31)	-	-	(31)
As at 31 December 2013	**2,262**	**539**	**1,822**	**568**	**2**	**5,193**
Charge for the year	221	10	74	23	3	331
Disposals and write-offs	-	-	(470)	-	-	(470)
As at 31 December 2014	**2,483**	**549**	**1,426**	**591**	**5**	**5,054**
Carrying Value						
As at 31 December 2013	**5,113**	**18**	**167**	**62**	**17**	**5,377**
As at 31 December 2014	**4,892**	**8**	**147**	**39**	**13**	**5,099**

Notes to financial statements (continued)

18 Current accounts and deposits from customers

	31 December 2014 BAM '000	31 December 2013 BAM '000
Demand deposits		
Private entities	5,057	7,402
Public entities	7,992	3,118
Cantonal and municipality governments	9,576	1,660
Individuals and crafts	101	52
Total demand deposits	**22,726**	**12,232**
Purpose deposits		
Individuals and crafts	-	1
Private entities	-	-
Public entities	3	423
Government of Tuzla Canton	9,368	9,819
Government of FBiH	1,663	367
Total purpose deposits	**11,034**	**10,610**
Term deposits		
In domestic currency		
Federal Employment Agency	25,545	25,399
Government of FBiH (guarantee deposit)	20,153	5,500
Government of FBiH	5,000	5,000
Government of FBiH – Saudi fund	1,764	1,945
Private entities	-	115
	52,462	**37,959**
In foreign currency		
Government of FBiH – EUR	231	231
Total term deposits	**52,693**	**38,190**
Total deposits	**86,453**	**61,032**

The Bank does not pay interest on demand deposits, dedicated deposits and term deposits, except for one part of a guarantee deposit from the government of the FBiH in the amount of BAM 5,000 thousand (1% p.a.).

Notes to financial statements (continued)

19 Borrowings

	31 December 2014 BAM '000	31 December 2013 BAM '000
Government of the Federation of BiH – Saudi Fund loan for development, interest rate 2% p.a. with maturity date 31 August 2021	2,815	2,838
Government of the Federation of BiH – Belgian merchandise loan, interest free with maturity date 31 December 2027	846	911
	3,661	**3,749**

In accordance with the contract signed between the Bank and the Government of the FBiH, the Bank has assumed obligation to redeem part of the borrowings as contracted between the Government and the creditors.

20 Provisions for liabilities and charges

	Provisions for off-balance-sheet items BAM '000	Provisions for employee benefits BAM '000	Total BAM '000
As at 1 January 2013	**310**	**615**	**925**
Decrease in provisions (Note 11)	(10)	(102)	(112)
Reductions resulting from payments	-	(68)	(68)
As at 31 December 2013	**300**	**445**	**745**
Increase/(decrease) in provisions (Note 11)	(40)	30	(10)
Additional provisions for labor disputes (Note 11)	-	275	275
Reductions resulting from payments	-	(48)	(48)
As at 31 December 2014	**260**	**702**	**962**

Notes to financial statements (continued)

20 Provisions for liabilities and charges (continued)

Commitments and contingencies (Off-balance sheet exposure) as at 31 December 2014 were as follows:

	31 December 2014 BAM '000	31 December 2013 BAM '000
Performance guarantees	11,924	16,581
Advance and payment guarantees	-	200
Undrawn lending commitments	2,396	711
	14,320	**17,492**

21 Other liabilities

	31 December 2014 BAM '000	31 December 2013 BAM '000
Agency liabilities (Note 24)	6,829	21,495
Funds provided based on decisions by the Government of FBiH	1,488	2,620
Deferred income	321	296
Liabilities toward suppliers	57	57
Accrued expenses	36	40
Accrued interest on deposits	19	19
Other liabilities	24	94
	8,774	**24,621**

22 Owner's capital

	%	31 December 2014 BAM '000	%	31 December 2013 BAM '000
Government of the Federation of Bosnia and Herzegovina	100	**163,615**	100	**153,000**

By the decision of the Bank's Assembly dated 28 April 2014, the owner's capital of the Bank was increased by 10,615 thousand BAM, by transfer of a part of the retained earnings. There were no cash payments.

By the decision of the Bank's Assembly dated 27 June 2014, the entire amount of the Bank's profit for 2013 was distributed as help to the areas in the Federation of BiH which were struck by the natural disaster.

Notes to Financial Statements (continued)

23 Transactions with related parties

Related parties are entities which directly or indirectly, through on or more intermediaries, control the Bank or are under the Bank's control.

The major part of transactions with related parties comprise of transactions with the Government of the FBiH, the 100% owner of the Bank, and other companies and institutions that are in the Government of the FBiH's major ownership (over 51%).

As of 31 December, balances resulting from related party transactions include:

BAM '000	Type of relation	31 December 2014		31 December 2013	
		Exposure	Liabilities	Exposure	Liabilities
Government of the FBiH	Owner	16	31,692	14	27,363
Public institutions	Common owner	-	32,246	-	36,230
Companies in majority ownership of the Government of the FBiH	Common owner	53,088	9,474	28.897	5,515
		53,104	**73,412**	**28,911**	**69,108**

BAM '000	Type of relation	31 December 2014		31 December 2013	
		Income	Expenses	Income	Expenses
Government of the FBiH	Owner	1,101	106	1.152	114
Public institutions	Common owner	120	-	119	-
Companies in majority ownership of the Government of the FBiH	Common owner	4,244	2,676	2,089	1,417
		5,465	**2,782**	**3,360**	**1,531**

Remuneration of the Management and Supervisory Board

The remuneration of the members of the Management and Supervisory Board during the year ended 31 December 2014:

	2014	2013
	BAM '000	BAM '000
Gross salaries and other benefits	463	571
Other benefits	1	1
Fees to the members of the Supervisory Board	96	79
	560	**651**

Notes to financial statements (continued)

24 Funds managed for and on behalf of third parties

The Bank manages significant funds for and on behalf of the Government of the FBiH (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, Ministry of Environment and Tourism and Ministry of Energy, Mining and Industry) with the purpose of financing reconstruction projects and Federal Employment Agency projects aimed at financing employment incentives and upkeep of employment. Those assets are held separately from other Bank assets. The bank calculates and charges a fee for those services in accordance with a contract signed with the provider of assets.

	31 December 2014	31 December 2013
PLACEMENTS	**BAM '000**	**BAM '000**
Funds placed per project:		
Water and gas supply	53,736	51,973
Healthcare and education	47,320	39,350
Agriculture	36,229	36,388
Manufacture and processing	37,361	30,527
Road construction and transport	18,531	19,883
Micro finance	8,544	11,962
Employment incentives	11,805	11,874
Forestry	352	369
Other	3,004	2,294
Total placed by projects:	*216,882*	*204,620*
Accrued interest and fees	13,916	11,832
Total	**230,798**	**216.452**
SOURCE OF FINANCING		
Government of the FBiH	210,872	213,192
Federal Employment Agency	12,760	12,830
Other	79	93
Total sources	*223,711*	*226,115*
Accrued interest and fees	13,916	11,832
Total	**237,627**	**237,947**
Current liabilities from funds managed for and on behalf of third parties (Note 21)	**6,829**	**21,495**

Decrease in current liabilities from funds managed for and on behalf of third parties relates to the formation of a dedicated guarantee deposit by the Government of the FBiH (see Note 18).

The Bank does not bear the risk for these placements and charges a fee for its services.

Notes to financial statements (continued)

25 Financial risk management

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

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

Risk management is carried out by the Bank's departments in charge for individual risks under policies suggested by the Management Board, and approved by the Supervisory Board.

Risk steering and risk controlling processes are adjusted in a timely manner to reflect changes in the market environment.

This Note aims to provide information on Bank's exposure to all of the above stated risks, and its goals, policies and procedures aimed to measure and manage the risks, as well as to manage capital of the Bank.

25.1. Credit risk

The Bank is exposed to credit risk which is the risk that a counterparty will not be able to pay amounts in full when due, which will result in the Bank's financial loss.

The credit risk is the most significant risk which the Bank faces in the course of its operations, and it is analyzed and monitored by individual loan and client basis, as well as in relation to the whole portfolio.

To manage the level of credit risk, the Bank only deals with counterparties which are creditworthy and, if possible, obtains sufficient collateral.

The choice of appropriate securities of the credit exposures depends on:

- Creditworthiness of the client
- Risk of the financed project
- Estimated value of collateral.

With a view to minimising credit risk, the Bank applies the Decision on definition, evaluation and treatment of collateral for loan and potential placement security and secures its credit exposures by taking one or more of the following instruments:

- cash;
- bank and corporate guarantees;
- bills of exchange and unconditional guarantees, issued by the responsible authorities as defined in the Decision;
- mortgages over properties;
- pledge over business assets such as equipment, inventory and receivables.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1. Credit risk (continued)

The maximum exposure to credit risk without taking into account any collateral or other increased value

	The maximum credit exposure			
	Net exposure	**Contingent liabilities / guarantees**	**Total**	**Fair value of collateral**
31 December 2014				
Cash and cash equivalents	46,612	-	46,612	-
Obligatory reserve with the Central Bank	7,726	-	7,726	-
Loans and advances to banks	158	-	158	-
Loans and advances to creditors	211,700	14,320	226,020	233,321
	266,196	**14,320**	**280,516**	**233,321**
31 December 2013				
Cash and cash equivalents	80,956	-	80,956	-
Obligatory reserve with the Central Bank	3,988	-	3,988	-
Loans and advances to banks	270	-	270	-
Loans and advances to creditors	174,366	17,492	191,858	194,758
	259,580	**17,492**	**277,072**	**194,758**

For balance sheet items, the above exposures are based on net carrying amounts as shown in the statement of financial position. The table above represents the maximum credit risk exposure as at 31 December 2014 and 31 December 2013, without taking account of any collateral or other increase in value.

Estimated value of property that serves as collateral is determined by the value of the initial evaluation by independent evaluators / real estate agents at the time of loan approval, reduced by a fixed percentage, depending on the type of collateral and reduced proportionately to the extent that it also serves as collateral security for other credit exposure. In order to verify the adequacy of the impairment, the re-valuation of collateral is done in accordance with the principles and rules of the collateral management system, taking into consideration the volatility of the value of the collateral and the time required for its implementation, under the influence of local and global market conditions. Guarantees and promissory notes do not have the declared value in the table, although they are usually required as collateral.

During the year, the Bank, in positions of non-financial assets, has items acquired by taking possession of collateral that are used as collateral in credit exposure in the case of non-repayment of the debt by the debtor. This process of acquiring is mainly related to real estate, equipment, vehicles. The acquired assets are shown as such in the statement of financial position of the Bank at the time when the conditions are met for its acquisition in accordance with IFRS and local regulations. The Bank's policy is to sell the assets acquired in this way, and during the time of ownership of these assets until they are sold to third parties, the assets can be temporarily used for the operations of the Bank or to rent to third parties. The acquired assets are presented in Note 16.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1. Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment

Restructured loans

During the year, the Bank carried out the restructuring of certain loans to customers, with the aim of achieving better recoverability. Restructuring is usually done after the initial deterioration of the financial situation of the client or for the purpose of preventing further deterioration. After the restructuring, loans continue to be considered as performing loans until the appearance of clear signs of default. Wherever possible, the Bank's position improves by acquisition of additional collateral.
For the purpose of credit monitoring and credit risk management, the Bank's credit portfolio is divided into the following groups:

• Performing loans - unimpaired loans (including restructured loans)
• Past due loans that are not recognized as impaired
• Non-performing loans - impaired loans.

Analysis of the credit portfolio in accordance with the aforementioned categories is as follows:

	31 December 2014	31 December 2013
Banks		
Loans to customers that are neither past due nor impaired	161	276
Past due but not impaired loans	-	-
Non-performing loans (impaired loans)	1,534	1,533
Gross exposure	**1,695**	**1,809**
Less: impairment allowance	(1.537)	(1.539)
Net exposure	**158**	**270**
Corporate		
Loans to customers that are neither past due nor impaired	195,331	151,104
Past due but not impaired loans	5,958	4,770
Non-performing loans (impaired loans)	29,446	34,819
Gross exposure	**230,735**	**190,693**
Less: impairment allowance	(21,691)	(19,471)
Net exposure	209,044	171,222

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1. Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment (continued)

	31 December 2014	31 December 2013
Retail		
Loans to customers that are neither past due nor impaired	1,531	2,397
Past due but not impaired loans	264	154
Non-performing loans (impaired loans)	1,225	1,012
Gross exposure	**3,020**	**3,563**
Less: impairment allowance	(364)	(419)
Net exposure	**2,656**	**3,144**
Total gross exposure	**235,450**	**196,065**
Portfolio impairment allowance (IBNR)	(9,150)	(5,167)
Specific impairment allowances	(14,442)	(16,262)
Net exposure	**211,858**	**174,636**

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

The quality of the portfolio of loans to customers that are neither past due nor impaired can be assessed through the internal standard monitoring system. Loans to customers are regularly monitored and systematically reviewed in order to identify any irregularities or warning signs. These loans are subject to constant monitoring with the aim of taking timely action based on improvement / deterioration of client risk profile. An overview of gross exposure of loans to customers that are neither past due nor impaired according to the type of loan is as follows:

	Banks	Coporates	Individuals	Total
31 December 2014				
Standard monitoring	161	195,331	1,531	**197,023**
31 December 2013				
Standard monitoring	276	151,104	2,397	**153,777**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1 Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment (continued)

b) Past due but not impaired loans

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

		Past due days			
	Gross	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2014					
Banks	-	-	-	-	-
Coporate	5,958	2,041	2,739	1,178	-
Retail	264	181	75	-	8
Total	**6,222**	**2,222**	**2,814**	**1,178**	**8**

		Past due days			
	Gross	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2014					
Banks	-	-	-	-	-
Coporate	4,770	3,470	67	1,233	-
Retail	154	88	66	-	-
Total	**4,924**	**3,558**	**133**	**1,233**	**-**

c) *Non-performing loans*

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

	Banks	Coporate	Retail	**Total**
31 Decembar 2014				
Gross exposure	1,534	29,446	1,225	**32,205**
Impairment	(1,534)	(12,593)	(315)	**(14,442)**
Net	-	16,853	910	**17,763**
Impairment rate	*100%*	*43%*	*26%*	***45%***

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1. Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment (continued)

c) Non-performing loans (continued)

	Banks	Corporate	Retail	**Total**
31 Decembar 2013				
Gross exposure	1,533	34,819	1,012	**37,364**
Impairment	(1,533)	(14,385)	(344)	**(16,262)**
Net	-	20,434	668	**21,102**
Impairment rate	*100%*	*41%*	*34%*	***44%***

Notes to financial statements (continued)

25 Financial risk management (continued)

25.2. Liquidity risk

Liquidity risk arises in the funding of the Bank's activities and in the management of positions. Treating liquidity risk, the Bank consolidates its operations in accordance with the relevant decisions and internal policies aimed at maintenance of liquidity reserves, harmonization of assets and liabilities indicators and liquidity limits.

The Bank has limited access to sources of finance. Funds are raised through a limited number of instruments including deposits of FBiH Government and the Federal Employment Service, deposits of legal entities, borrowings and equity. This limits the flexibility of financing and represents a reliance on deposits and payments of capital by the Government of the Federation.

The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with different maturities. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals. Furthermore, the Bank holds a portfolio of liquid assets as part of its liquidity risk management strategy.

The table below shows the remaining contractual maturity of the Bank's assets and liabilities:

31 December 2014	Up to 1 month BAM'000	1 to 3 months BAM'000	3 months to 1 year BAM'000	1 to 5 years BAM'000	Over 5 years BAM'000	Total BAM'000
Assets						
Cash and cash equivalents	46,612	-	-	-	-	**46,612**
Obligatory reserve with the Central Bank	7,726	-	-	-	-	**7,726**
Loans and advances to banks	9	19	84	46	-	**158**
Loans and advances to customers	15,702	5,240	32,364	126,214	32,180	**211,700**
Other assets	119	-	-	1,150	-	**1,269**
Property, equipment and intangible assets		-	-	-	5,099	**5,099**
Total Assets	**70,168**	**5,259**	**32,448**	**127,410**	**37,279**	**272,564**
Liabilities and equity						
Current accounts and deposits from customers	33,760	110	2,417	18,683	31,483	**86,453**
Borrowings	-	201	266	1,869	1,325	**3,661**
Provisions for liabilities and charges	402	-	89	229	242	**962**
Other liabilities	8,774	-	-	-	-	**8,774**
Owner's capital and reserves	-	-	-	-	172,714	**172,714**
Total liabilities and equity	**42,936**	**311**	**2,772**	**20,781**	**205,764**	**272,564**
Interest rate gap	**27,232**	**4,948**	**29,676**	**106,629**	**(168,485)**	**-**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.2 Liquidity risk (continued)

31 December 2013	Up to 1 month BAM '000	1 to 3 months BAM '000	3 months to 1 year BAM '000	1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash and cash equivalents	80,956	-	-	-	-	**80,956**
Obligatory reserve with the Central Bank	3,988	-	-	-	-	**3,988**
Loans and advances to banks	9	19	84	158	-	**270**
Loans and advances to customers	13,884	6,055	40,409	102,260	11,758	**174,366**
Other assets	99	-	-	-	-	**99**
Property, equipment and intangible assets	-	-	-	-	5,377	**5,377**
Total assets	**98,936**	**6,074**	**40,493**	**102,418**	**17,135**	**265,056**
Liabilities and equity						
Current accounts and deposits from customers	22,841	99	98	753	37,241	**61,032**
Borrowings	-	177	243	1,679	1,650	**3,749**
Provisions for liabilities and charges	311	2	36	99	297	**745**
Other liabilities	22,128	2,493	-	-	-	**24,621**
Owner's capital and reserves	-	-	-	-	174,909	**174,909**
Total liabilities and equity	**45,280**	**2,771**	**377**	**2,531**	**214,097**	**265,056**
Liquidity gap	**53,656**	**3,303**	**40,116**	**99,887**	**(196,962)**	**-**

25.3 Market risk

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

The Management Board sets limits and guidelines for monitoring and mitigating of market risks, which is regularly monitored.

25.3.1 Foreign exchange risk

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

Treasury department is responsible for daily management of the Bank's currency position in accordance with legal and internal regulations.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.1 Foreign exchange risk (continued)

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

The following table summarizes the Bank's exposure to foreign currency exchange rate risk at 31 December 2014 and 31 December 2013. The tables include the Bank's assets and liabilities at carrying amounts categorized by currency.

31 December 2014

	BAM	EUR	USD	Other	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Assets					
Cash and cash equivalents	3,511	34,142	8,959	-	**46,612**
Obligatory reserve with the Central Bank	7,726	-	-	-	**7,726**
Loans and advances to banks	158	-	-	-	**158**
Loans and advances to customers	211,687	-	13	-	**211,700**
Other assets	1,268	1	-	-	**1,269**
Property, equipment and intangible assets	5,099	-	-	-	**5,099**
Total assets	**229,449**	**34,143**	**8,972**	-	**272,564**
Liabilities and equity					
Current accounts and deposits from customers	78,595	1,600	6,258	-	**86,453**
Borrowings	-	846	2,815	-	**3,661**
Provisions for liabilities and charges	962	-	-	-	**962**
Other liabilities	8,772	2	-	-	**8,774**
Owner's capital and reserves	172,714	-	-	-	**172,714**
Total liabilities and equity	**261,043**	**2,448**	**9,073**	-	**272,564**
Net foreign exchange position	**(31,594)**	**31,695**	**(101)**	-	-

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.1 Foreign exchange risk (continued)

31 December 2013

	BAM	EUR	USD	Other	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Assets					
Cash and cash equivalents	30,579	44,771	5,606	-	**80,956**
Obligatory reserve with the Central Bank	3,988	-	-	-	**3,988**
Loans and advances to banks	270	-	-	-	**270**
Loans and advances to customers	174,366	-	-	-	**174,366**
Other assets	98	1	-	-	**99**
Property, equipment and intangible assets	5,377	-	-	-	**5,377**
Total assets	**214,678**	**44,772**	**5,606**	-	**265,056**
Liabilities and equity					
Current accounts and deposits from customers	57,894	232	2,906	-	**61,032**
Borrowings	-	911	2,838	-	**3,749**
Provisions for liabilities and charges	745	-	-	-	**745**
Other liabilities	24,238	383	-	-	**24,621**
Owner's capital and reserves	174,909	-	-	-	**174,909**
Total liabilities and equity	**257,786**	**1,526**	**5,744**	-	**265,056**
Net foreign exchange position	**(43,108)**	**43,246**	**(138)**	-	-

Foreign currency sensitivity analysis

The Bank is mainly exposed to EUR and USD. Since Convertible Mark (BAM) is pegged to EUR, the Bank is not exposed to risk of change in the exchange rate of EUR.

The following table shows the Bank's sensitivity to a 10% increase and decrease in BAM against the USD. 10% is the sensitivity rate used for reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible changes in foreign exchange rates. The analysis includes only outstanding foreign currency denominated monetary items and represent an adjustment to their value at period end for an USD exchange rate movement of 10%. The sensitivity analysis includes external loans that are denominated in a currency other than the currency of the lender or the borrower. A positive number below indicates an increase in profit when BAM strengthens by 10% against the USD. For a 10% weakening of the BAM against the USD, there would be an equal but opposite impact on the profit.

	USD impact	
	31 December 2014	**31 December 2013**
Loss	(10)	(14)

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.2 Interest rate risk

The bank is subject to the risk of interest rate changes, the extent to which interest-bearing assets and liabilities mature or change rates at different times or in different amounts.

The majority of loans to legal entities and individuals are initially contracted at fixed interest rates. These financial instruments are classified as instruments with fixed interest rates, and other such instruments with variable interest rates. The Bank does not pay interest on deposits, except for part of the guarantee deposit of the Government of FBiH 5,000 thousand (1% per annum). Decision on establishing and changes in interest rates are made by the Supervisory Board at the proposal of the Board.

Interest rate sensitivity of assets and liabilities

The table below summarizes the Bank's exposure to interest rate risk at the end of the year. Assets and liabilities are presented in the table at book value, and are categorized by the earlier contractual maturity date. Those assets and liabilities that are not applicable interest rates are classified as "Non-interest bearing".

31 December 2014	Non-interest bearing	Up to 1 month	1 to 3 months	3 months to 1 year 1	1 to 5 years 5 years	Over 5 years	Total	Fixed rate
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Assets								
Cash and cash equivalents	28	46,584	-	-	-	-	**46,612**	-
Obligatory reserve with the Central Bank	-	7,726	-	-	-	-	**7,726**	-
Loans and advances to banks	-	9	19	84	46	-	**158**	158
Loans and advances to customers	-	15,702	5,240	32,619	126,080	32,059	**211,700**	209,854
Other assets	1,269	-	-	-	-	-	**1,269**	-
Property, equipment and intangible assets	5,099	-	-	-	-	-	**5,099**	-
Total assets	**6,396**	**70,021**	**5,259**	**32,703**	**126,126**	**32,059**	**272,564**	**210,012**
Liabilities and equity								
Current accounts and deposits from customers	81,453	-	-	-	-	5,000	**86,453**	5,000
Borrowings	846	-	201	201	1,609	804	**3,661**	2,815
Provisions for liabilities and charges	962	-	-	-	-	-	**962**	-
Other liabilities	8,774	-	-	-	-	-	**8,774**	-
Owner's capital and reserves	172,714	-	-	-	-	-	**172,714**	-
Total liabilities and equity	**264,749**	-	**201**	**201**	**1,609**	**5,804**	**272,564**	**7,815**
Net foreign exchange position	-	**70,021**	**5,058**	**32,502**	**124,517**	**26,255**	-	**202,197**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.2 Interest rate risk (continued)

31 December 2014	Non-interest bearing	Up to 1 month	1 to 3 months	3 months to 1 year 1	1 to 5 years 5 years	Over 5 years	Total	Fixed rate
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Assets								
Cash and cash equivalents	36	80,920	-	-	-	-	**80,956**	-
Obligatory reserve with the Central Bank	-	3,988	-	-	-	-	**3,988**	-
Loans and advances to banks	-	9	19	84	158	-	**270**	270
Loans and advances to customers	-	13,884	6,055	40,409	102,260	11,758	**174,366**	172,596
Other assets	99	-	-	-	-	-	**99**	-
Property, equipment and intangible assets	5,377	-	-	-	-	-	**5,377**	-
Total assets	**5,512**	**98,801**	**6,074**	**40,493**	**102,418**	**11,758**	**266,056**	**172,866**
Liabilities and equity								
Current accounts and deposits from customers	56,032	-	-	-	-	5,000	**61,032**	5,000
Borrowings	911	-	177	178	1,419	1,064	**3,749**	2,838
Provisions for liabilities and charges	745	-	-	-	-	-	**745**	-
Other liabilities	24,621	-	-	-	-	-	**24,621**	-
Owner's capital and reserves	174,909	-	-	-	-	-	**174,909**	-
Total liabilities and equity	**257,218**	**-**	**177**	**178**	**1,419**	**6,064**	**256,056**	**7,838**
Net foreign exchange position	**-**	**98,801**	**5,897**	**40,315**	**100,999**	**5,694**	**-**	**165,028**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.4 The estimation of fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length conditions. Where available, fair values are based on market prices. However, for a significant part of the Bank's financial instruments, there are no readily available market prices. In conditions when market prices are not readily available, fair value is estimated using discounted cash flows or other appropriate techniques pricing. Changes in the accompanying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates may not be realized in the sale of financial instruments in the current period, particularly taking into account the impact of the global financial crisis and the lack of a liquid market in Bosnia and Herzegovina.

Cash and cash equivalents

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

Loans to customers

Given the specificity of the Bank, a large amount of the total loan portfolio carries a fixed interest rate and long-term maturity and an interest rate below the market of the interest rate. It is not practicable to calculate the fair value of loans to customers.

Deposits from customers

For demand deposits and deposits with no defined maturities, fair value is the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. It is not practicable to calculate the fair value of fixed-maturity deposits.

Borrowings

Bank borrowings are interest-free or carry a low fixed interest rate. The fair value of borrowings with fixed interest rate is determined using a discounted future cash flows using interest rates currently offered for loans with similar terms and conditions to borrowers with similar credit worthiness. It is not practicable to calculate the fair value of borrowings.

25.5 Capital management

The Bank's objectives when managing capital, which is a broader concept of "share capital" of the statement of financial position, are:

• To comply with the capital requirements set by the regulators of the banking market in the domestic environment;
• To maintain a strong capital base to support business development.

The Bank's management regularly monitors capital adequacy and the use of regulatory capital on the basis of appropriate techniques that are based on the regulations of the Banking Agency of the Federation of Bosnia and Herzegovina.

The Bank is as at 31 December 2014 was in line with all regulatory capital requirements to and in accordance with local regulations achieve a capital adequacy ratio amounting to 75.4% (31 December 2013: 85.3%).

Notes to financial statements (continued)

25 Financial risk management (continued)

25.5 Capital management (continued)

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

- Tier 1 capital or Core Capital: share capital (net of the carrying value of treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; negative revaluation reserves arising from the revaluation of the fair value of assets and audited profit for the period adopted and distributed by shareholders Assembly (since 2014);
- Tier 2 capital or Capital or Supplementary Capital: general reserves to cover loan losses, the Bank's assets estimated as good assets and revised the profit for the period was adopted and distributed by the General Assembly (since 2014), and
- Deductible items.

Risk-weighted assets are measured by means of hierarchy of four weights classified according to the nature of the assets and reflecting an estimate of associated credit, market and other risks, taking into consideration all eligible collateral or guarantees. Similar treatment is adopted for off-balance sheet exposures, with certain adjustments made in order reflect the volatility of potential losses.

The table below shows the structure of regulatory capital and capital adequacy indicators at 31 December 2014 and 31 December 2013, in accordance with local regulations (information on risk weighted assets is not audited), taken from the accounts submitted to the Agency for the periods then ended:

	2014	2013
	BAM '000	BAM '000
Tier 1 capital		
Share capital	163,615	153,000
Reserves	-	10,615
Intangible assets	(39)	(62)
Total Tier 1 capital	**163,576**	**163,553**
Tier 2 capital		
General provision - Agency regulations	2,480	2,094
Audited profit for the year	-	3,237
Total Tier 2 capital	**2,480**	**5,331**
Adjustment for shortfall in regulatory reserve	(7.010)	(5.224)
Net Capital	**159.046**	**163.660**
Risk Weighted Assets (unaudited)	194,204	174,205
Other weighted Assets (unaudited)	16,810	17,651
Total weighted risk	211,014	191,856
Capital adequacy ratio (%)	**75.4%**	**85.3%**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.5 Capital management (continued)

In accordance with the regulations of the Agency, the Decision on minimum standards for managing bank capital and capital protection adopted on 30 May 2014 ("Official Gazette of BiH" No. 46/14), audited profit for the period are included in the calculation of regulatory capital as of the day when the Audited financial statements are issued and approved by the shareholders of the Bank. In accordance with regulatory requirements in force at the date of the report of 31 December 2013, profit for the period was included in the calculation of regulatory capital if the audited financial statements were approved and adopted by the Supervisory Board prior to submission of the report to the Banking Agency. In the above calculation, audited profit for 2013 was included in the calculation of capital adequacy as at 31 December 2013.

26 Potential liabilites

On 31 December 2014 the total value of claims initiated against the Bank amounted to BAM 3,610 thousand: BAM 3,117 thousand relate to labor disputes, and BAM 493 thousand to other disputes against the bank.

For part of the labor disputes in the amount of BAM 1,996 thousand, the Bank concluded extrajudicial settlements by which the employees waive their claims, and the Bank undertakes to pay the employee's attorneys' fees incurred. Accordingly the Bank formed provisions in the amount of BAM 59 thousand. The Management decided to form a provision regarding legal disputes in the amount of BAM 216 thousand therefore total formed provisions for labor disputes for which the Bank's management estimate that will be lost, including provisions for reimbursement of lawyers' costs under the concluded agreements on extrajudicial settlement, amounts to BAM 275 thousand.

Given the uncertainty of different practices of the courts in making decisions on labor disputes, the Management is not able to estimate the outcome of the remaining cases, and thus have not formed provisions, except as stated above.

Assessment of the Management, regarding other claims against the Bank, is that they will not be lost.