Development Bank of the

Federation of Bosnia and Herzegovina

Financial statements for the year ended 31 December 2016

Content

Management Board's Report

The Managements Board has the pleasure of submitting its report for the year ended 31 December 2016.

Review of operations

The result for the year ended 31 December 2016 of the Bank is set out in the income statement on page 6.

Supervisory Board

For the period starting from 1 January 2016 until 14 April 2016, the Supervisory Board comprised of:

Željko Karačić	Chairman
Fuad Kasumović	Member
Zvonko Landeka	Member
Ana Marija Boban	Member
Asim Omanić	Member
Amir Avdić	Member
Mustafa Mujezinović	Member until 14 January 2016

The above stated composition of the Supervisory Board was valid until 14 April 2016, and new Supervisory Board members were not appointed until 9 June 2016. By the decision No. 6736-I/16, the Assembly of the Bank appointed new members of the Supervisory Board on the same date, as set out below:

As at 31 December 2016, Supervisory Board comprised of:

Igor Živko	Chairman
Božo Vukoja	Member
Zvonko Landeka	Member
Asim Omanić	Member
Amir Avdić	Member
Semir Fejzić	Member
Mersiha Slipičević	Member

Management Board

During the course of 2016 and up to the date of this report, the Management Board comprised:

Salko Selman	President of the Management Board
Borislav Trlin	Vice-chairman of the Management Board until 26 July 2016
Marijan Oršolić	Vice-chairman of the Management Board since 26 July 2016

Management Board's Report (continued)

Audit Committee

During the course of 2016 and up to the date of this report, the Audit Committee comprised:

Drago Novaković	Chairman
Fatima Obhodžaš	Vice-Chairwoman
Haladin Salihović	Member
Dželmina Huremović	Member
Suada Isaković	Member

On behalf of the Management Board

Salko Selman
President of the Management Board

RAZVOJNA BANKA FEDERACIJE BOSNE I HERCEGOVINE
RB FBiH
Sarajevo

10 March 2017

Responsibilities of the Management and Supervisory Board 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 51 were authorised by the Management Board on 10 March 2017 for issuing to the Supervisory Board and are signed below to signify this:

On behalf of the Management Board

Salko Selman
President of the Management Board

RAZVOJNA BANKA FEDERACIJE BOSNE I HERCEGOVINE
RB FBiH
Sarajevo

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

10 March 2017

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 statement of financial position as at 31 December 2016, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising 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 Standards on Auditing applicable in the Federation of Bosnia and Herzegovina. 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 audit opinion.

This version of audit opinion 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.

KPMG

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 2016, 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
71 000 Sarajevo
Bosnia and Herzegovina

10 March 2017

This version of audit opinion 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.

Statement of profit or loss

For the year ended 31 December

	Note	2016 BAM'000	2015 BAM'000
Interest income	*5*	9,771	10,888
Interest expense	*6*	(100)	(109)
Net interest income		**9,671**	**10,779**
Fee and commission income	*7*	1,917	2,199
Net fee and commission income		**1,917**	**2,199**
Other operating income	*8*	364	700
Operating income		**11,952**	**13,678**
Personnel expenses	*9*	(4,964)	(4,919)
Depreciation and amortisation	*17,18*	(433)	(401)
Administrative and other expenses	*10*	(1,824)	(1,531)
Operating expenses		**(7,221)**	**(6,851)**
Profit before impairment losses and provisions		**4,731**	**6,827**
Impairment losses and provisions	*11*	(2,987)	(5,369)
Net profit for the year		**1,744**	**1,458**

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

Statement of other comprehensive income

For the year ended 31 December

	Note	2016	2015
		BAM '000	**BAM '000**
Net profit for the year		**1,744**	**1,458**
Other comprehensive income for the year		-	-
Total comprehensive income for the year		**1,744**	**1,458**

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

Statement of financial position

As at 31 December

	Note	**31 December 2016 BAM'000**	**31 December 2015 BAM'000**
Assets			
Cash and cash equivalents	*12*	89,838	66,197
Obligatory reserve with the Central Bank	*13*	9,043	4,628
Loans to banks	*14*	-	47
Loans to customers	*15*	182,256	212,675
Other assets	*16*	944	284
Property and equipment	*17*	4,811	5,023
Intangible assets	*18*	209	290
Total assets		**287,101**	**289,144**
Liabilities			
Current accounts and deposits from customers	*19*	90,437	103,833
Borrowings	*20*	3,035	3,466
Employee benefits	*21*	496	439
Provisions	*22*	414	394
Other liabilities	*23*	16,803	6,840
Total liabilities		**111,185**	**114,972**
Equity			
Registered capital	*24*	163,615	163,615
Retained earnings		4,244	2,500
Regulatory reserves for credit losses		8,057	8,057
Total equity		**175,916**	**174,172**
Total liabilities and equity		**287,101**	**289,144**

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

Statement of cash flows

For the year ended 31 December

	Note	2016 BAM'000	2015 BAM'000
Cash flow from operating activities			
Profit		1,744	1,458
Adjustments for:			
Depreciation and amortization	17,18	433	401
Impairment losses and provisions	11	2,987	5,369
Net interest income		(9,671)	(10,779)
		(4,507)	**(3,551)**
Changes in:			
- Obligatory reserve with the Central Bank		(4,415)	3,098
- Loans and receivables		27,712	(4,888)
- Other assets		(316)	1,099
- Current accounts and deposits from customers		(13,396)	17,380
- Other liabilities		10,175	(3,269)
Cash generated from operating activities		**15,253**	**9,869**
Interest received		9,062	10,635
Interest paid		(100)	(109)
Net cash from operating activities		**24,215**	**20,395**
Cash flow from investing activities			
Acquisition of property and equipment		(143)	(305)
Acquisition of intangible assets		-	(310)
Net cash used in investing activities		**(143)**	**(615)**
Cash flows from financing activities			
Repayment of loans and borrowings		(431)	(195)
Net cash from financing activities		**(431)**	**(195)**
Net increase in cash and cash equivalents		**23,641**	**19,585**
Cash and cash equivalents at the beginning of the year	12	**66,197**	**46,612**
Cash and cash equivalents at the end of the year	12	**89,838**	**66,197**

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

Statement of changes in equity

For the year ended 31 December

	Registered capital BAM '000	Regulatory reserves for credit losses BAM '000	Retained earnings BAM '000	Total BAM '000
Balance as at 1 January 2015	**163,615**	**8,057**	**1,042**	**172,714**
Net profit for the year	-	-	1,458	1,458
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	***1,458***	***1,458***
Balance as at 31 December 2015	**163,615**	**8,057**	**2,500**	**174,172**
Net profit for the year	-	-	1,744	1,744
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	***1,744***	***1,744***
Balance as at 31 December 2016	**163,615**	**8,057**	**4,244**	**175,916**

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 referred to as "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 in 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 2016 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 on 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 approvals 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 10 March 2017 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 ("CBBiH" or "Central Bank") implemented a currency board arrangement aligning BAM to EURO at an exchange rate of EUR 1: BAM 1.95583 throughout 2015 and 2016. 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 (continued)

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 where there is no objective evidence of individual impairment. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrences that cause impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses will be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss 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

a) 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.

b) Obligatory reserve with the Central Bank

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

c) 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.

d) 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.

e) 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%
Office equipment	20%-50%
Vehicles	20%
Leasehold improvements	20%

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, useful lives and net values 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

a) 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.

b) 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) Registered capital

Registered capital consists of 100% share of the Federation of BiH.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

l) Registered capital (continued)

a) 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 2016.

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 statement of financial position 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 25.

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 2016, 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, but has not completed it. 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. However, the Bank has not yet completed a preliminary assessment of the effects of the new standard until the date of these financial statements.

- 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.

- *Sale or Contribution of Assets Between an Investors and its Associate or Joint venture (Amendments to IFRS 10 and IAS 28)*
- *IFRS 16 Leases*
- *Classification and Measurement of Share-based payments (Amendments to IFRS 2)*
- *Recognition of Deferred tax assets for Unrealized losses (Amendments to IAS 12)*
- *Disclosure Initiative (Amendments to IAS 7)*

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 21).

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 and provisions	*Note*	**31 December 2016 BAM '000**	**31 December 2015 BAM '000**
Impairment allowances for statement of financial position exposures, including IBNR and other	*14, 15,16*	31,537	28,710
Provisions for off-balance sheet exposure	*22*	380	356
		31,917	**29,066**

As at 31 December 2016 and 31 December 2015, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognized were as follows:

	31 December 2016			**31 December 2015**		
	Loans to banks	**Loans to customers**	**Total**	**Loans to banks**	**Loans to customers**	**Total**
Gross exposure	1,534	55,507	**57,041**	1,534	36,343	**37,877**
Impairment allowance	(1,534)	(23,302)	**(24,836)**	(1,534)	(17,501)	**(19,035)**
Impairment rate	100%	42%	**44%**	100%	48%	**50%**

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 2016 amounted to BAM 5,427 thousand (2015: BAM 8,518 thousand) or 2.98% (2015: 4.0%) 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 2016 are calculated in accordance with the new methodology (as explained in Note 3 l):

Summary of impairment allowances	31 December 2016 BAM '000	31 December 2015 BAM '000
Provisions for balance-sheet exposure (Agency)	39,696	37,667
Provisions for off-balance–sheet exposure (Agency)	209	481
	39,905	**38,148**
Impairment allowances under IFRS	31,917	29,066
Negative difference between provisions for balance-sheet exposure (Agency) and impairment allowance in accordance with IFRS	2,728	2,974
Excess at period end	**10,716**	**12,056**

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 (l), 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 10,716 thousand as at 31 December 2016 (31 December 2015: BAM 12,056 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 2016 (31 December 2015: BAM 8,057 thousand). The remaining amount of BAM 2,659 thousand (2015: BAM 3,999 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 and is calculated only for regulatory reporting purposes.

Notes to financial statements (continued)

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

(c) Litigations

The Bank performs individual assessment of all court cases and on that basis determines the amount of provisions.

As indicated in Note 27, the Bank provided BAM 34 thousand, which is the amount that the Management considered sufficient. Since the assessment is made for each case separately, the Bank believes that the outcome of these cases will either be favourable for the Bank or their outcome is uncertain, taking into account the legal environment and the preliminary decisions of the relevant bodies which have in the past decided both in favour of the Bank and in favour of the claimant, as well as the fact that the cases are being revised and are under appeal.

5 Interest income

	2016 BAM '000	2015 BAM '000
Interest on loans to customers	9,771	10,886
Interest on loans to banks	-	2
	9,771	**10,888**

6 Interest expense

	2016 BAM '000	2015 BAM '000
Interest on borrowings and deposits	**100**	**109**

7 Fee and commission income

	2016 BAM '000	2015 BAM '000
Fee income from agency activities	1,503	1,554
Fees from other transactions	352	497
Fee income from guarantees and letters of credit	62	148
	1,917	**2,199**

Notes to financial statements (continued)

8 Other operating income

	2016 BAM '000	2015 BAM '000
Income from sale of acquired real estate	106	145
Donations	104	62
Foreign exchange rate gain	62	4
Income from written off interests and other fees	-	239
Other	92	250
	364	**700**

9 Personnel expenses

	2016 BAM '000	2015 BAM '000
Net salaries	2,197	2,121
Taxes and contributions	1,589	1,570
Other	1,178	1,228
	4,964	**4,919**

Personnel expenses include BAM 910 thousand (2015: BAM 930 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 2016 was 120 (2015: 126).

10 Administrative and other expenses

	2016 BAM '000	2015 BAM '000
Membership fees and taxes	327	249
Maintenance expenses	185	115
Advertising, representation and sponsorship	163	232
Telecommunication expenses	138	164
Energy costs	127	142
Supervisory Board fees	118	150
Bank fees	117	20
Services	98	90
Material costs	89	100
Audit costs	60	60
Rent	48	65
Audit Committee fees	37	37
Insurance	14	20
Water contributions fees	13	13
Other expenses	290	74
	1,824	**1,531**

Notes to financial statements (continued)

11 Impairment losses and provisions

Net impairment losses and provisions	2016 BAM '000	2015 BAM '000
- Loans to customers (Note 15)	2,753	4,027
- Acquired assets (Note 16)	107	1,156
- Employee benefits (Note 21)	98	113
- Provisions for liabilities and charges (Note 22)	20	75
- Other assets (Note 16)	9	1
- Loans to banks (Note 14)	-	(3)
	2,987	**5,369**

12 Cash and cash equivalents

	31 December 2016 BAM '000	31 December 2015 BAM '000
Current accounts with the Central Bank of Bosnia and Herzegovina	72,182	39,326
Current accounts with other banks in foreign and domestic currency	17,636	26,846
Cash in hand	20	25
	89,838	**66,197**

Cash and current accounts with other banks include BAM 15,731 thousand (2015: BAM 6,392 thousand) funds for and on behalf of third parties (Note 25).

13 Obligatory reserve with the Central Bank

	31 December 2016 BAM '000	31 December 2015 BAM '000
Obligatory reserve with the Central Bank of Bosnia and Herzegovina	**9,043**	**4,628**

During the reporting period the Bank has maintained the prescribed mandatory reserves with the Central Bank (CBB&H), by applying a 10% rate on short-term deposits and 7% on long-term deposits until 6 June 2016 and 10 % rate on all deposits since 1 July 2016.

For the amount of obligatory reserve and liquidity funds held with the Central Bank of Bosnia and Herzegovina (CBBH), during 2016 and 2015 no interest was accounted on above mentioned amounts by the CBBH.

Notes to financial statements (continued)

14 Loans to banks

	31 December 2016 '000 KM	31 December 2015 '000 KM
Loans to banks	1,534	1,581
Less: impairment allowance	(1,534)	(1,534)
Total net loans to banks	**-**	**47**

Loans and advances to banks include interest receivable in the amount of BAM 127 thousand (31 December 2015: BAM 127 thousand).

The movement in impairment allowance was as follows:

	31 December 2016 '000 KM	31 December 2015 '000 KM
Balance at the beginning of the year	1,534	1,537
Net changes in impairment allowance (Note 11)	-	(3)
Balance at the year end	**1,534**	**1,534**

Notes to financial statements (continued)

15 Loans to customers

	31 December 2016 BAM '000	31 December 2015 BAM '000
Short-term loans		
Corporate	1,239	5,703
Current portion of long-term loans	25,053	25,606
	26,292	**31,309**
Long-term loans (excluding current portion)		
Corporate	179,737	205,440
Retail	4,956	1,945
	184,693	**207,385**
	210,985	**238,694**
Less: Impairment allowance	(28,729)	(26,019)
	182,256	**212,675**

Loans to customers include interest receivables, which comprise of unpaid due interest and fees, and accrued interest in the amount of BAM 802 thousand (31 December 2015: BAM 1,075 thousand) and are presented net of deferred fees in the amount of BAM 969 thousand (31 December 2015: 1,549 thousand BAM).

Changes in impairment allowance can be presented as follows:

	31 December 2016 BAM '000	31 December 2015 BAM '000
Balance at the beginning of the year	26,019	22,055
Net changes in impairment allowance (Note 11)	13,342	12,227
(Decrease) due to collection (Note 11)	(10,589)	(8,200)
Derecognition	(43)	(63)
Balance at the year end	**28,729**	**26,019**

Notes to financial statements (continued)

15 Loans to customers (continued)

Analysis of gross amount of loans by industry:

Corporate loans	**31 December 2016 BAM '000**	**31 December 2015 BAM '000**
Manufacturing	78,760	83,896
Trade	29,745	32,052
Real estate and rental businesses	24,849	29,124
Public administration and defence	17,736	25,595
Construction	12,628	12,467
Agriculture	10,649	18,188
Hospitality industry	4,796	7,395
Transportation, storage and telecommunication	4,154	5,305
Other	22,068	21,991
	205,385	**236,013**
Retail loans		
Crafts	5,397	2,437
Housing loans	203	241
General consumption	-	3
	5,600	**2,681**
	210,985	**238,694**

Weighted-average nominal and effective interest rates as at 31 December 2016 and 31 December 2015 were as follows:

	31 December 2016		**31 December 2015**	
	Nominal i.r.	*Effective i.r.*	*Nominal i.r.*	*Effective i.r.*
Corporate	4.36%	4.78%	4.47%	4.91%
Retail	3.44%	3.72%	4.06%	4.47%

Notes to financial statements (continued)

16 Other assets

	31 December 2016 BAM '000	31 December 2015 BAM '000
Assets acquired for further sale	1,611	1,264
Other assets	607	176
Total impairment of other assets	(1,274)	(1,156)
Total other assets (net value)	**944**	**284**

The impairment of other assets is mostly related to impairment of assets acquired for further sale in the amount of BAM 1,262 thousand.

17 Property and equipment

	Buildings BAM '000	Vehicles BAM '000	Office Equipment BAM '000	Total BAM '000
Cost				
As at 1 January 2015	7,375	**557**	**1,573**	**9,505**
Additions	-	141	164	305
Disposals and write-offs	-	(502)	(125)	(627)
As at 31 December 2015	7,375	**196**	**1,612**	**9,183**
Additions	106	2	35	143
Disposals and write-offs	-	(3)	(162)	(165)
As at 31 December 2016	**7,481**	**195**	**1,485**	**9,161**
Accumulated depreciation/amortisation and impairment losses				
As at 1 January 2015	**2,483**	**549**	**1,426**	**4,458**
Charge for the year	222	8	99	329
Disposals and write-offs	-	(502)	(125)	(627)
As at 31 December 2015	**2,705**	**55**	**1,400**	**4,160**
Charge for the year	222	28	105	355
Disposals and write-offs	-	(2)	(163)	(165)
As at 31 December 2016	**2,927**	**81**	**1,342**	**4,350**
Carrying Value				
As at 31 December 2015	**4,670**	**141**	**212**	**5,023**
As at 31 December 2016	**4,554**	**114**	**143**	**4,811**

Notes to financial statements (continued)

18 Intangible assets

	Software BAM '000	Leasehold improvements BAM'000	Total BAM '000
Cost			
As at 1 January 2015	**630**	**18**	**648**
Additions	310	-	310
Disposals and write-offs	-	-	-
As at 31 December 2015	**940**	**18**	**958**
Additions	-	-	-
Disposals and write-offs	-	(12)	(12)
As at 31 December 2016	**940**	**6**	**946**
Accumulated depreciation/amortisation and impairment losses			
As at 1 January 2015	**591**	**5**	**596**
Charge for the year	71	1	72
Disposals and write-offs	-	-	-
As at 31 December 2015	**662**	**6**	**668**
Charge for the year	75	3	78
Disposals and write-offs	-	(9)	(9)
As at 31 December 2016	**737**	**-**	**737**
Carrying Value			
As at 31 December 2015	**278**	**12**	**290**
As at 31 December 2016	**203**	**6**	**209**

19 Current accounts and deposits from customers

Demand deposits	31 December 2016 BAM '000	31 December 2015 BAM '000
Public entities	6,822	21,244
Private entities	3,513	2,518
Cantonal and municipality governments	1,863	5,061
Individuals and crafts	126	20
Total demand deposits	**12,324**	**28,843**

Notes to financial statements (continued)

19 Current accounts and deposits from customers (continued)

	31 December 2016	31 December 2015
Purpose deposits	**BAM '000**	**BAM '000**
Government of Tuzla Canton	7,030	4,627
Government of FBiH	628	598
Public entities	-	1,404
Total purpose deposits	**7,658**	**6,629**
Term deposits		
In domestic currency		
Government of FBiH (guarantee deposit)	38,420	34,894
Federal Employment Agency	26,782	26,472
Government of FBiH	5,000	5,000
Government of FBiH – Saudi fund	-	1,764
Private entities	22	-
	70,224	**68,130**
In foreign currency		
Government of FBiH – EUR	231	231
Total term deposits	**70,455**	**68,361**
Total deposits	**90,437**	**103,833**

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)

20 Borrowings

	31 December 2016 BAM '000	31 December 2015 BAM '000
Government of the Federation of BiH – Saudi Fund loan for development, interest rate 2% p.a. with maturity date 31 August 2021	2,319	2,685
Government of the Federation of BiH – Belgian merchandise loan, interest free with maturity date 31 December 2027	716	781
	3,035	**3,466**

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.

21 Employee benefits liabilities

	Retirement provisions BAM '000
As at 1 January 2015	**643**
Increase in provisions (Note 11)	113
Reductions resulting from payments	(317)
As at 31 December 2015	**439**
Increase in provisions (Note 11)	115
(Decrease) in provisions (Note 11)	(17)
Reductions resulting from payments	(41)
As at 31 December 2016	**496**

In determining the liability for retirement provisions the basic assumptions the Bank has used is a discount rate of 6.0% (2015.: 6.0%) and the age of retirement of 65 years for men and women.

Notes to financial statements (continued)

22 Provisions

	Provisions for off-balance sheet items BAM '000	Provisions for litigations BAM '000	Total BAM '000
As at 1 January 2015	**260**	**59**	**319**
Increase in provisions (Note 11)	96	16	112
(Decrease) in provisions (Note 11)	-	(37)	(37)
Reductions resulting from payments	-	-	-
As at 31 December 2015	**356**	**38**	**394**
Increase in provisions (Note 11)	24	-	24
(Decrease) in provisions (Note 11)	-	(4)	(4)
Reductions resulting from payments	-	-	-
As at 31 December 2016	**380**	**34**	**414**

Provision for contingent off-balance sheet items and litigation

As at 31 December 2016, the total value of claims initiated against the Bank amounted to BAM 2,615 thousand. Out of this amount, BAM 2,213 thousand relate to labor disputes and BAM 402 thousand relate to other claims against the Bank.

For part of the labor disputes, 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, for this purpose the Bank formed provisions in the amount of BAM 34 thousand.

Given the uncertainty of different practices of the courts in making decisions on labor disputes and taking into account the legal arguments of the Bank and the claimants, the Management believes that the ultimate outcome of the remaining claims is uncertain.

Notes to financial statements (continued)

22 Provisions (continued)

Commitments and contingencies (Off balance sheet exposure) as at 31 December 2016 were as follows:

	31 December 2016	31 December 2015
	BAM '000	BAM '000
Undrawn lending commitments	5,355	4,908
Performance guarantees	850	7,348
Advance and payment guarantees	825	135
	7,030	**12,391**

23 Other liabilities

	31 December 2016	31 December 2015
	BAM '000	BAM '000
Agency liabilities (Note 26)	15,731	6,392
Other accruals	266	253
Liabilities toward suppliers	198	78
Accrued expenses	61	61
Funds provided based on decisions by the Government of FBiH	-	22
Accrued interest on deposits	19	19
Other liabilities	528	15
	16,803	**6,840**

24 Registered capital

	%	31 December 2016	%	31 December 2015
		BAM '000		BAM '000
Government of the Federation of Bosnia and Herzegovina	100	**163,615**	100	**163,615**

According to Article 3 of the Law on Development Bank of the Federation of Bosnia and Herzegovina, the capital was supposed to be increased for the amount of BAM 400 million from the budget of the Federation in equal instalments in the period 2008-2011.
Due to 31 December 2016, the government has not yet provided the capital injection described above.

Notes to Financial Statements (continued)

25 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 2016		31 December 2015	
		Exposure	Liabilities	Exposure	Liabilities
Government of the FBiH	Owner	-	60,356	17	46,906
Public institutions	Common owner	20	29,192	-	31,911
Companies in majority ownership of the Government of the FBiH	Common owner	37,160	6,712	57,080	20,190
		37.180	**96.260**	**57,097**	**99,007**

BAM '000	Type of relation	31 December 2016		31 December 2015	
		Income	Expenses	Income	Expenses
Government of the FBiH	Owner	1,154	100	1,217	108
Public institutions	Common owner	349	-	125	-
Companies in majority ownership of the Government of the FBiH	Common owner	2,437	505	4,141	1,355
		3,940	**605**	**5,483**	**1,463**

Remuneration of the Management and Supervisory Board

The remuneration of the members of the Management and Supervisory Board during the year ended 31 December 2016:

	2016	2015
	BAM '000	BAM '000
Gross salaries and other benefits	317	310
Severance for former Board members	-	212
Fees to the members of the Supervisory Board	118	150
	435	**672**

Notes to financial statements (continued)

26 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 2016	31 December 2015
PLACEMENTS	**BAM '000**	**BAM '000**
Funds placed per project:		
Water and gas supply	51,509	54,493
Healthcare and education	47,917	49,163
Manufacture and processing	43,145	39,883
Agriculture	36,391	36,290
Employment incentives	12,251	12,330
Road construction and transport	2,971	3,900
Micro finance	1,709	5,126
Forestry	352	352
Other	3,091	2,708
Total placed by projects:	**199,336**	**204,245**
Accrued interest and fees	7,981	7,854
Total	**207,317**	**212,099**
SOURCE OF FINANCING		
Government of the FBiH	201,030	197,275
Federal Employment Agency	12,251	12,330
Other	94	867
Total sources	**213,375**	**210,472**
Accrued interest and fees	9,673	8,019
Total	**223,048**	**218,491**
Current liabilities from funds managed for and on behalf of third parties (Note 23)	**15,731**	**6,392**

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

Notes to financial statements (continued)

27 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 risks.

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.

27.1. 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 on an 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.

In order to minimise 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)

27 Financial risk management (continued)

27.1. 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 2016				
Cash and cash equivalents	89,838	-	89,838	-
Obligatory reserve with the Central Bank	9,043	-	9,043	-
Loans and advances to customers	182,256	7,030	189,286	208,672
	281.137	**7.030**	**288.167**	**208.762**
31 December 2015				
Cash and cash equivalents	66,197	-	66,197	-
Obligatory reserve with the Central Bank	4,628	-	4,628	-
Loans and advances to banks	47	-	47	-
Loans and advances to customers	212,675	12,391	225,066	236,823
	283,547	**12,391**	**295,938**	**236,823**

For statement of financial position 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 2016 and 31 December 2015, 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)

27 Financial risk management (continued)

27.1. Credit risk (continued)

27.1.1 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.

	31 December 2016	31 December 2015
Gross restructured loans	46,570	51,344
Less: impairment	(9,547)	(6,256)
Net restructured loans	**37,023**	**45,088**

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:

Notes to financial statements (continued)

27 Financial risk management (continued)

27.1. Credit risk (continued)

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

	31 December 2016	31 December 2015
Banks		
Loans to customers that are neither past due nor impaired	-	47
Past due but not impaired loans	-	-
Non-performing loans (impaired loans)	1,534	1,534
Gross exposure	**1,534**	**1,581**
Less: impairment allowance	(1,534)	(1,534)
Net exposure	**-**	**47**
Corporate		
Loans to customers that are neither past due nor impaired	142,077	172,417
Past due but not impaired loans	8,771	28,434
Non-performing loans (impaired loans)	54,537	35,162
Gross exposure	**205,385**	**236,013**
Less: impairment allowance	(28,215)	(25,549)
Net exposure	**177,170**	**210,464**

Notes to financial statements (continued)

27 Financial risk management (continued)

27.1. Credit risk (continued)

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

	31 December 2016	31 December 2015
Retail		
Loans to customers that are neither past due nor impaired	4,579	1,400
Past due but not impaired loans	51	100
Non-performing loans (impaired loans)	970	1,181
Gross exposure	**5,600**	**2,681**
Less: impairment allowance	(514)	(470)
Net exposure	**5,086**	**2,211**
Total gross exposure	**212,519**	**240,275**
Portfolio impairment allowance (IBNR)	(5,427)	(8,518)
Specific impairment allowances	(24,836)	(19,035)
Net exposure	**182,256**	**212,722**

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	Corporates	Individuals	Total
31 December 2016				
Standard monitoring	-	142,077	4,579	**146,656**
31 December 2015				
Standard monitoring	47	172,417	1,400	**173,864**

Notes to financial statements (continued)

27 Financial risk management (continued)

27.1. Credit risk (continued)

27.1.1 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 2016					
Corporate	8,771	7,507	367	897	-
Retail	51	26	25	-	-
Total	**8,822**	**7,533**	**392**	**897**	**-**

		Past due days			
	Gross	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2015					
Corporate	28,434	20,486	5,210	2,738	-
Retail	100	38	9	50	3
Total	**28,534**	**20,524**	**5,219**	**2,788**	**3**

The significant decrease compared to 2015 is due to movement of a certain number of past due exposures but not impaired to impaired loans in 2016.

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	**Corporate**	**Retail**	**Total**
31 December 2016				
Gross exposure	1,534	54,537	970	**57,041**
Impairment	(1,534)	(22,976)	(326)	**(24,836)**
Net	-	**31,561**	**644**	**32,205**
Impairment rate	*100%*	*42%*	*34%*	***44%***
The exposure share in total loans	*100%*	*27%*	*17%*	***27%***

Notes to financial statements (continued)

27 Financial risk management (continued)

27.1. Credit risk (continued)

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

c) Non-performing loans (continued)

	Banks	Corporate	Retail	Total
Estimated value of the collateral as at 31 December 2016				
Deposits	-	-	-	-
Mortgages	-	119,875	3,893	**123,768**
Total	**-**	**119,875**	**3,893**	**123,768**

	Banks	Corporate	Retail	Total
31 December 2015				
Gross exposure	1,534	35,162	1,181	**37,877**
Impairment	(1,534)	(17,091)	(410)	**(19,035)**
Net	**-**	**18,071**	**771**	**18,842**
Impairment rate	*100%*	*49%*	*35%*	***50%***
The exposure share in total loans	*100%*	*15%*	*44%*	***16%***

	Banks	Corporate	Retail	Total
Estimated value of the collateral as at 31 December 2015				
Deposits	-	-	-	-
Mortgages	-	88,003	4,399	**92,402**
Total	**-**	**88,003**	**4,399**	**92,402**

Notes to financial statements (continued)

27 Financial risk management (continued)

27.2. 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. Obligatory reserve is presented, according to convention, in the category with maturity of up to one month, given that the calculations are performed on a monthly basis and that it cannot be withdrawn without a reduction in percentage of allocation or the relevant asset sources.

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

31 December 2016	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	89,838	-	-	-	-	**89,838**
Obligatory reserve with the Central Bank	9,043	-	-	-	-	**9,043**
Loans and advances to banks	-	-	-	-	-	**-**
Loans and advances to customers	11,480	6,956	36,364	109,009	18,447	**182,256**
Other assets	595	-	349	-	-	**944**
Property, equipment and intangible assets	-	-	-	-	5,020	**5,020**
Total Assets	**110,956**	**6,956**	**36,713**	**109,009**	**23,467**	**287,101**
Liabilities and equity						
Current accounts and deposits from customers	19,982	-	-	38,420	32,035	**90,437**
Borrowings	-	232	297	2,116	390	**3,035**
Provisions for liabilities and charges	400	11	57	162	280	**910**
Other liabilities	16,148	23	216	393	23	**16,803**
Registered capital and reserves	-	-	-	-	175,916	**175,916**
Total liabilities and equity	**36,530**	**266**	**570**	**41,091**	**208,644**	**287,101**
Liquidity gap	**74,426**	**6,690**	**36,143**	**67,918**	**(185,177)**	**-**

Notes to financial statements (continued)

27 Financial risk management (continued)

27.2. Liquidity risk (continued)

31 December 2015	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	66,197	-	-	-	-	**66,197**
Obligatory reserve with the Central Bank	4,628	-	-	-	-	**4,628**
Loans and advances to banks	9	19	19	-	-	**47**
Loans and advances to customers	14,087	7,379	35,240	126,479	29,490	**212,675**
Other assets	176	-	108	-	-	**284**
Property, equipment and intangible assets	-	-	-	-	5,313	**5,313**
Total assets	**85,097**	**7,398**	**35,367**	**126,479**	**34,803**	**289,144**
Liabilities and equity						
Current accounts and deposits from customers	35,472	120	119	6,524	61,598	**103,833**
Borrowings	-	224	224	2,050	968	**3,466**
Provisions for liabilities and charges	317	9	106	139	262	**833**
Other liabilities	6,678	-	89	55	18	**6,840**
Registered capital and reserves	-	-	-	-	174,172	**174,172**
Total liabilities and equity	**42,467**	**353**	**538**	**8,768**	**237,018**	**289,144**
Liquidity gap	**42,630**	**7,045**	**34,829**	**117,711**	**(202,215)**	**-**

27.3 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.

27.3.1 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)

27 Financial risk management (continued)

27.3 Market risk (continued)

27.3.1 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 2016 and 31 December 2015. The tables include the Bank's assets and liabilities at carrying amounts categorized by currency.

31 December 2016

	BAM BAM '000	EUR BAM '000	USD BAM '000	Other BAM '000	Total BAM '000
Assets					
Cash and cash equivalents	72,193	15,471	2,174	-	**89,838**
Obligatory reserve with the Central Bank	9,043	-	-	-	**9,043**
Loans and advances to banks	-	-	-	-	**-**
Loans and advances to customers	182,239	-	17	-	**182,256**
Other assets	579	1	-	-	**580**
Property, equipment and intangible assets	5,035	-	-	-	**5,035**
Assets held for sale	349	-	-	-	**349**
Total assets	**269,438**	**15,472**	**2,191**	**-**	**287,101**
Liabilities and equity					
Current accounts and deposits from customers	83,719	6,691	27	-	**90,437**
Borrowings	-	716	2,319	-	**3,035**
Other liabilities	15,913	181	-	-	**16,094**
Provisions for liabilities and charges	910	-	-	-	**910**
Other liabilities	709	-	-	-	**709**
Registered capital and reserves	175,916	-	-	-	**175,916**
Total liabilities and equity	**277,167**	**7,588**	**2,346**	**-**	**287,101**
Net foreign exchange position	**(7,729)**	**7,884**	**(155)**	**-**	**-**

Notes to financial statements (continued)

27 Financial risk management (continued)

27.3 Market risk (continued)

27.3.1 Foreign exchange risk (continued)

31 December 2015	BAM BAM '000	EUR BAM '000	USD BAM '000	Other BAM '000	Total BAM '000
Assets					
Cash and cash equivalents	39,351	7,442	19,404	-	**66,197**
Obligatory reserve with the Central Bank	4,628	-	-	-	**4,628**
Loans and advances to banks	47	-	-	-	**47**
Loans and advances to customers	212,660	-	15	-	**212,675**
Other assets	283	1	-	-	**284**
Property, equipment and intangible assets	5,313	-	-	-	**5,313**
Total assets	**262,282**	**7,443**	**19,419**	**-**	**289,144**
Liabilities and equity					
Current accounts and deposits from customers	83,305	3,707	16,821	-	**103,833**
Borrowings		781	2,685	-	**3,466**
Provisions for liabilities and charges	833	-	-	-	**833**
Other liabilities	6,833	7	-	-	**6,840**
Registered capital and reserves	174,172	-	-	-	**174,172**
Total liabilities and equity	**265,143**	**4,495**	**19,506**	**-**	**289,144**
Net foreign exchange position	**(2,861)**	**2,948**	**(87)**	**-**	**-**

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, but is exposed to changes of EUR in relation to other currencies.

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 2016	**31 December 2015**
	BAM '000	**BAM '000**
Loss	(16)	(9)

Notes to financial statements (continued)

27 Financial risk management (continued)

27.3 Market risk (continued)

27.3.2 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 BAM 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 2016	Non-interest bearing BAM '000	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	Fixed rate BAM '000	Effective rate
Assets									
Cash and cash equivalents	89,838	-	-	-	-	-	**89,838**	-	-
Obligatory reserve with the Central Bank	9,043	-	-	-	-	-	**9,043**	-	-
Loans and advances to banks	-	-	-	-	-	-	-	-	-
Loans and advances to customers	-	11,480	6,956	36,364	109,009	18,447	**182,256**	181,229	4.75%
Other assets	944	-	-	-	-	-	**944**	-	-
Property, equipment and intangible assets	5,020	-	-	-	-	-	**5,020**	-	-
Total assets	**104,845**	**11,480**	**6,956**	**36,364**	**109,009**	**18,447**	**287,101**	**181,229**	-
Liabilities and equity									
Current accounts and deposits from customers	85,437	-	-	-	-	5,000	**90,437**	5,000	1.00%
Borrowings	716	-	232	232	1,855	-	**3,035**	2,319	2.00%
Provisions for liabilities and charges	910	-	-	-	-	-	**910**	-	-
Other liabilities	16,803	-	-	-	-	-	**16,803**	-	-
Registered capital and reserves	175,916	-	-	-	-	-	**175,916**	-	-
Total liabilities and equity	**279,782**	**-**	**232**	**232**	**1,855**	**5,000**	**287,101**	**7,319**	-
Net foreign exchange position (interest risk)	**-**	**11,480**	**6,724**	**36,132**	**107,154**	**13,447**	**-**	**173,910**	-

Notes to financial statements (continued)

27 Financial risk management (continued)

27.3 Market risk (continued)

27.3.2 Interest rate risk (continued)

31 December 2015

	Non-interest bearing BAM '000	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	Fixed rate BAM '000	Effective rate
Assets									
Cash and cash equivalents	66,197	-	-	-	-	-	**66,197**	-	-
Obligatory reserve with the Central Bank	4,628	-	-	-	-	-	**4,628**	-	-
Loans and advances to banks	-	9	19	19	-	-	**47**	47	1.96%
Loans and advances to customers	-	14,087	7,379	35,240	126,479	29,490	**212,675**	211,682	4.87%
Other assets	284	-	-	-	-	-	**284**	-	-
Property, equipment and intangible assets	5,313	-	-	-	-	-	**5,313**	-	-
Total assets	**76,422**	**14,096**	**7,398**	**35,259**	**126,479**	**29,490**	**289,144**	**211,729**	-
Liabilities and equity									
Current accounts and deposits from customers	98,833	-	-	-	-	5,000	**103,833**	5,000	1.00%
Borrowings	781	-	224	224	1,790	447	**3,466**	2,685	2.00%
Provisions for liabilities and charges	833	-	-	-	-	-	**833**	-	-
Other liabilities	6,840	-	-	-	-	-	**6,840**	-	-
Registered capital and reserves	174,172	-	-	-	-	-	**174,172**	-	-
Total liabilities and equity	**281,459**	-	**224**	**224**	**1,790**	**5,447**	**289,144**	**7,685**	-
Net foreign exchange position (interest risk)	-	**14,096**	**7,174**	**35,035**	**124,689**	**24,043**	-	**204,044**	-

Based on the above stated data, a sensitivity analysis of interest rates on 31 December 2016 shows that, if interest rates had been 1% lower and all other variables held constant, the result for the year would be BAM 10 thousand lower (2015: 10 thousand). On the other hand, if there is an increase of 1% in the interest rates, it would increase the result for the same amount.

Sensitivity analysis of interest rate includes all assets and liabilities with variable interest rates and assumes that all short-term asset and liability items with fixed interest rates are reinvested at maturity. The Bank has only a small share of loans granted at variable interest rates, while all obligations are with fixed interest rates.

Notes to financial statements (continued)

27 Financial risk management (continued)

27.4 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 statement of financial position 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.

27.5 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 as at 31 December 2016 was in line with all regulatory capital requirements and in accordance with local regulations achieved a capital adequacy ratio of 96% (31 December 2015: 81.5%).

Notes to financial statements (continued)

27 Financial risk management (continued)

27.5 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
- Tier 2 capital or Capital or Supplementary Capital: general reserves to cover loan losses, the Bank's assets estimated as good assets 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 2016 and 31 December 2015, 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:

	2016 BAM '000	2015 BAM '000
Tier 1 capital		
Share capital	163,615	163,615
Reserves	1,458	-
Intangible assets	(203)	(278)
Total Tier 1 capital	**164,870**	**163,337**
Tier 2 capital		
General provision - Agency regulations	1,525	1,771
Audited profit for the year	-	-
Total Tier 2 capital	**1,525**	**1,771**
Adjustment for shortfall in regulatory reserve	(2,659)	(3,999)
Net Capital	**163,736**	**161,109**
Risk weighted Assets *	155,507	182,643
Other weighted Assets *	15,011	15,002
Total weighted risk	**170,518**	**197,645**
Capital adequacy ratio (%)	**96%**	**81.5%**

* The risk weighted asset amounts in the table above were calculated in accordance with FBA regulations

Notes to financial statements (continued)

27 Financial risk management (continued)

27.5 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 2016, 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 2016 was not included in the calculation of capital adequacy as at 31 December 2016.