**DEVELOPMENT BANK OF
FEDERATION OF BOSNIA AND HERZEGOVINA**

Financial statements for the year
ended 31 December 2018 and
Independent auditor's report

This version of the report is a translation from the original, which was prepared in Bosnian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our financial reports and the accompanying audit report takes precedence over this translation.

Contents

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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 7 to 79 were authorised by the Management Board on 16 April 2019 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

Razvojna Banka FBiH
Igmanska 1
71000 Sarajevo
Bosna i Hercegovina

16 April 2019

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INDEPENDENT AUDITOR'S REPORT

To the owners of Development Bank of Federation of Bosnia and Herzegovina

Opinion

We have audited the financial statements of the Development Bank of Federation of Bosnia and Herzegovina (the "Bank"), which comprise the statement of financial position as at 31 December 2018, the statement of profit or loss, statement of comprehensive income, statement of changes in equity, and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

As described in Note 20 to the financial statements, the total court proceedings against the Bank amount to KM 2,685 thousand as at 31 December 2018. Of the total amount, KM 2,283 thousand is related to labour dispute proceedings of employees against the Bank, and KM 402 thousand is related to other proceedings. The Management of the Bank believes that it is not possible to estimate the outcome of the outstanding proceedings, hence provisions on this basis have not been created as at 31 December 2018.

Our opinion is not qualified in respect of these matters.

Key Audit Matters

1. Impairment of carrying value of loans and receivables

Key audit matter	How the key audit matter was addressed in the audit
The International Accounting Standards Board (IASB) issued IFRS 9 – "Financial Instruments" which replaces "IAS 39 – Financial Instruments" as of the date of its effectiveness on 1 January 2018. The key changes arising from adoption of IFRS 9 are that the Bank's credit losses are now based on expected losses rather than an incurred loss model, and the change in the classification and measurement of the Bank's financial assets and liabilities, which are detailed in Note 2 to the financial statements. As at 31 December 2018, the Bank's gross loans and receivables amount to KM 234,483 thousand and the related impairment allowances amount to KM 36,357. The policy for impairment of loans and receivables is presented in the accounting policies in Note 2 (f) to the financial statements. The Bank exercises significant judgement using subjective assumptions over both when and how much to record as loan impairment, and estimation of the amount of the impairment allowances for loans and receivables. Because loans and receivables form a major portion of the Bank's assets, and due to the significance of the judgments used in classifying loans and receivables into various stages stipulated in IFRS 9 and determining related impairment requirements, this audit area is considered a key audit risk. Key areas of judgment included: • The interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Bank's expected credit loss model. • The identification of exposures with a significant deterioration in credit quality. • Assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward looking macroeconomic factors (e.g. unemployment rates, interest rates, gross domestic product growth, property prices). • The need to apply additional overlays to reflect current or future external factors that are not appropriately captured by the expected credit loss model.	With respect to classification and measurement of financial assets and financial liabilities, our audit procedures comprised the following: • We read the Bank's IFRS 9 based classification and measurement of financial assets and financial liabilities policy and compared it with the requirements of IFRS 9; • We obtained an understanding and checked the Bank's business model assessment and the test on the contractual cash flows, which give rise to cash flows that are "solely payments of principal and interest" [SPPI test]; and • We checked the appropriateness of the opening balance adjustments. With respect to impairment methodology, our audit procedures comprised the following: • We read the Bank's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9; • We gained understanding of the Bank's key credit processes comprising granting and monitoring, and tested operating effectiveness of key controls over these processes; • We assessed the design and tested the operating effectiveness of relevant controls over the: a. Data used to determine the impairment reserve, including transactional data captured at loan origination, ongoing internal credit quality assessments, storage of date and interfaces to the expected credit loss model. b. Expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy. • For exposures determined to be individually impaired, we tested a sample of loans and receivables and examined management's estimate of future cash flows, assessed their reasonableness and checked the resultant impairment calculations; and • For provision against exposures classified as Stage 1 and Stage 2, we obtained an understanding of the Bank's impairment methodology, assessed the reasonableness of the underlying assumptions and the sufficiency of the data used by the management.

Key audit matters (continued)

1. Impairment of carrying value of loans and receivables

Key audit matter	How the key audit matter was addressed in the audit
	• We checked the appropriateness of the determination of significant increase in credit risk and the resultant basis for classification of exposures into various stages; • For a sample of exposures, we checked the appropriateness of the Bank's staging; • We checked and understood the key data sources and assumptions for data used in the Expected Credit Loss (ECL) models used by the Bank to determine impairment allowances; • For forward looking assumptions used by the Bank's management in its ECL calculations, we held discussions with management and corroborated the assumptions using publicly available information; • For a sample of exposures, we checked the appropriateness of determining Exposure at Default, including the consideration of prepayments and repayments in the cash flows and the resultant arithmetical calculations; • For Probability of Default (PD) used in the ECL calculations, we checked the Through the Cycle (TTC) PDs calculation and checked the appropriateness of development of PDs at a point in time (PIT); • We checked the calculation of the Loss Given Default (LGD) used by the Bank in the ECL calculations, including the appropriateness of the use of collateral and the resultant arithmetical calculations; • We checked the completeness of loans and receivables, off-balance sheet items, and other financial assets included in the ECL calculations as of 31 December 2018; We understood the theoretical soundness and tested the mathematical integrity of the models; • For data from external sources, we understood the process of choosing such data, its relevance for the Bank, and the controls and governance over such data; • Where relevant, we used information system specialists to gain comfort on data integrity; • We checked consistency of various inputs and assumptions used by the Bank's management to determine impairment provisions; and • We checked the appropriateness of the opening balance adjustments. We assessed the financial statement disclosures arising on adoption of IFRS 9 to determine if they were in accordance with the requirements of the Standard. Refer to the accounting policies, critical accounting estimates and judgements, disclosures of loans and receivables and credit risk management in Notes 2, 3, 14 and 25 to the financial statements.

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

The Management Board is responsible for the preparation and fair presentation of the accompanying financial statements in accordance with the International Financial Reporting Standards, and for such internal control as the Management Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the unconsolidated and consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank and the Group to cease to continue as a going concern.

Auditor's Responsibilities for the Audit of the Financial Statements (continued)

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is Sabina Softić.

Deloitte d.o.o.

Sead Bahtanović, director and licensed auditor

Deloitte d.o.o. Zmaja od Bosne 12c 71000 Sarajevo ID: 4200047380000

Sabina Softić, partner and licensed auditor

Zmaja od Bosne 12c

Sarajevo, Bosnia and Herzegovina

16 April 2019

(All amounts are expressed in thousand KM, unless otherwise stated)

	Notes	2018	2017
Interest income	4	8,963	8,528
Interest expense	5	(282)	(91)
Net interest income		**8,681**	**8,437**
Fee and commission income	6	1,629	1,665
Net fee and commission income		**1,629**	**1,665**
Other operating income	7	300	231
Operating income		**10,610**	**10,333**
Personnel expenses	8	(5,733)	(5,719)
Depreciation and amortisation		(426)	(467)
Administrative and other expenses	9	(1,681)	(1,556)
Operating expenses		**(7,840)**	**(7,742)**
Profit before impairment losses and provisions		**2,770**	**2,591**
Impairment losses and provisions	10	(2,263)	(2,463)
Profit before tax		**507**	**128**
Income tax	2(e)	-	-
Net profit for the year		**507**	**128**

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

	Notes	2018	2017
Net profit for the year		**507**	**128**
Other comprehensive income for the year		-	-
Total comprehensive income for the year		**507**	**128**

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

(All amounts are expressed in thousand KM, unless otherwise stated)

	Notes	31 December 2018	31 December 2017
Assets			
Cash and cash equivalents	11	107,731	89,797
Obligatory reserve with the Central Bank	12	13,496	13,619
Loans to and receivables from banks	13	-	-
Loans to and receivables from customers	14	198,126	194,889
Other assets	15	1,198	528
Property and equipment	16	4,319	4,619
Intangible assets	17	168	145
Total assets		**325,038**	**303,597**
Liabilities			
Current accounts and deposits from customers	18	142,116	116,783
Borrowings	19	1,866	2,282
Provisions	20	3,115	1,070
Other liabilities	21	9,029	7,418
Total liabilities		**156,126**	**127,553**
Equity			
Registered capital	22	163,615	163,615
Retained earnings		(2,760)	4,372
Regulatory reserves for credit losses		8,057	8,057
Total equity		**168,912**	**176,044**
Total liabilities and equity		**325,038**	**303,597**

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

(All amounts are expressed in thousand KM, unless otherwise stated)

	2018	2017
Operating activities		
Profit for the year	507	128
Adjustments for:		
Depreciation and amortisation	426	467
Impairment losses and provisions, net	2,263	2,463
Net interest income	(8,681)	(8,437)
	(5,485)	*(5,379)*
Changes in:		
Net decrease / (increase) in obligatory reserve with the Central Bank	123	(4,576)
Net increase in given loans and receivables	(9,298)	(14,638)
Net (increase) / decrease in other assets	(477)	227
Net decrease in current accounts and deposits from customers	25,333	26,346
Net decrease in other liabilities	(118)	(9,833)
	10,078	*(7,853)*
Interest received	8,714	8,867
Interest paid	(282)	(91)
Net cash from operating activities	**18,510**	**923**
Investing activities		
Purchase of property and equipment	(50)	(205)
Purchase of intangible assets	(105)	(6)
Net cash used in investing activities	**(155)**	**(211)**
Financial activities		
Repayment of borrowings	(416)	(753)
Net cash used in financial activities	**(416)**	**(753)**
Net increase / (decrease) in cash and cash equivalents	**17,934**	**(41)**
Cash and cash equivalents at the beginning of the year	**89,797**	**89,838**
Cash and cash equivalents at the end of the year	**107,731**	**89,797**

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

(All amounts are expressed in thousand KM, unless otherwise stated)

	Registered capital	Regulatory reserves for credit losses	Retained earnings	Total
As at 1 January 2017	**163,615**	**8,057**	**4,244**	**175,916**
Net profit for the year	-	-	128	128
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	*128*	*128*
As at 31 December 2017	**163,615**	**8,057**	**4,372**	**176,044**
Effect of IFRS 9 application Note 2)	-	-	(7 639)	(7,639)
Net profit for the year	-	-	507	507
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	*507*	*507*
As at 31 December 2018	**163,615**	**8,057**	**(2,760)**	**168,912**

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

(All amounts are expressed in thousand KM, unless otherwise stated)

1. GENERAL

History and incorporation

The Development Bank of Federation of Bosnia and Herzegovina (the "Bank") was established by the Law on the Development Bank of 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 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 FBiH), the Supervisory Board, the Management Board and the Audit Board.

As of 31 December 2018, the Bank had branch offices in Mostar, Bihać, Zenica, Orašje, Tuzla and Livno.

Principal activities of the Bank

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

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.

Management Bodies of the Bank

Supervisory Board:

Igor Živko	Chairman
Božo Vukoja	Member
Zvonko Landeka	Member
Asim Omanić	Member
Amir Avdić	Member
Edin Bandić	Member
Dino Hadžialić	Acting Member

Management Board:

Salko Selman	President of the Management Board
Marijan Oršolić	Vice President of the Management Board
Senija Bubić	Acting Executive Director for Operations Support (since 26 February 2018)
Mersiha Slipičević	Acting Executive Director for Risk Management (since 26 February 2018)
Dalibor Milinković	Acting Executive Director for Projects and Development (since 26 February 2018)

Audit Board:

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

Term of the Audit Board expired on 4 December 2018.

1. GENERAL (CONTINUED)

The Supervisory Board, as a control body, has a significant role in overseeing the Bank's operations and representing the owner's interests; together with the members of the Management Board of the Bank, the Supervisory Board is responsible for the preparation of financial statements in accordance with statutory provisions.

Assembly of the Bank

In April 2018, the Assembly of the Bank adopted the Decision on identifying the amount of profit of the Bank for 2016 and Decision on adoption of the operating plan and program of the Bank for 2017.

On its meeting held in July 2018, the Assembly of the Bank adopted the Report on operations of the Development Bank of FBiH with accompanying financial statements, internal and external audit reports, report on Supervisory Board and Audit Board operations for 2017. On the same meeting, the Assembly of the Bank adopted the Decision on the amount and allocation of profit for 2017, and the Decision on adoption of the operating plan and program of the Bank for 2018.

Supervisory Board

According to the Law on the Development Bank of FBiH, the Supervisory Board of the Bank consists of the Chairman and six members, which are appointed and dismissed by the Assembly. In addition, the aforementioned is defined by the Statute of the Development Bank of FBiH as well and by the adopted Rulebook on Functioning of the Supervisory Board of the Development Bank of FBiH (February 2010).

In April 2018, the seventh member of the Supervisory Board was appointed by the Assembly of the Bank, so the Supervisory Board operates in its full composition of total seven members (including the Chairman), which is in accordance with the stated Law, the Statute and the adopted Rulebook.

In May 2018, the Supervisory Board adopted the Financial statement of the Development Bank of FBiH and Independent auditor's report for 2017, as well as the Report on operations for the first quarter of 2018. On the same date, the new Rulebook with Internal organization and Organizational scheme and Workplace systematization of the Development Bank of FBiH was adopted.

Management Board of the Bank

Pursuant to the Law on the Development Bank of FBiH and the Statute of the Bank, the Management Board comprises the President of the Management Board, Vice President of the Management Board and executive directors, appointed and dismissed by the Supervisory Board.

According to the organizational scheme adopted in 2018, the Management Board of the Bank comprises: President, Vice President and functions of three executive directors – Executive Director for Operations Support, Executive Director for Risk Management, and Executive Director for Projects and Development.

Secretary of the Bank

The Bank has no Secretary of the Bank since 23 September 2017.

1. GENERAL (CONTINUED)

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 16 April 2019 for submission to the Supervisory Board.

b) Going concern

The financial statements have been prepared on a going concern basis, which means that the Bank will be able to realize its receivables and settle its liabilities in the ordinary course of business.

c) Basis of measurement

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

d) Functional and presentation currency

The financial statements are presented in Convertible Marks ("KM"), 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 2018 and 2018. This is expected to continue in the foreseeable future.

e) 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 they are revised and potentially in future periods if they affect them.

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 3.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

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) Operating lease payments

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 income tax.

f) Financial instruments

Recognition

Financial instruments comprise financial assets and financial liabilities. Financial assets and financial liabilities are recognized when the Bank becomes a party to a contract relating to a financial instrument.

Financial instruments are initially recognized at their fair value. Transaction costs that are directly attributable to the acquisition of financial assets or the formation of a financial liability (excluding financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the asset or financial liability at initial recognition.

Classification and measurement

The Bank classifies its financial instruments in the following categories: cash and cash equivalents and obligatory reserve with the CBBiH, loans and other receivables. The Bank classifies its financial liabilities in the following categories: irrevocably approved borrowings, contracted undrawn borrowings, issued guarantees and received loans.

Financial assets and other financial liabilities are initially recognized at fair value.

After initial recognition, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method, or at fair value through other comprehensive income (FVOCI), or at fair value through profit or loss (FVTPL).

	IFRS 9
Financial instruments – classification	**Measurement category**
Cash and cash equivalents	Amortized cost
Obligatory reserve at the CBBiH	Amortized cost
Loans and receivables from banks	Amortized cost
	Amortized cost
Loans and receivables from clients	FVTPL – fair value through profit or loss
Financial assets available for sale	FVOCI – fair value through other comprehensive income
Other financial assets	Amortized cost
Other financial liabilities	Amortized cost

Derecognition

IFRS 9 encompasses IAS 39 derecognition requirements for financial assets and financial liabilities with no substantial changes. There is a certain immaterial impact on the Bank based on adoption of new provisions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments (continued)

Derecognition (continued)

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 transfer rights to receive cash flows or when it commits to pay received cash flows to a third party under a "rights transfer" agreement, or (i) when it transfers substantially all the risks and rewards of ownership to another business entity or (ii) when substantially all risks and benefits of ownership are neither transferred nor retained, but control over assets is surrendered.

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.

Impairment of financial assets

Impairment of financial assets is recognized on the basis of the expected credit loss model for assets that are subsequently measured at amortized cost.

The Expected Credit Loss (ECL) model applies to debt instruments (such as bank deposits, loans, securities) recorded at amortized cost or at fair value, contractual assets and credit liabilities and financial guarantee contracts that are not measured at fair value through profit or loss.

Impairment losses for individual risks or portfolio risk provisions must be estimated for customers from all segments and all such exposure types have to be taken into account.

The underlying principle of the expected credit loss model is to reflect the deterioration or improvement of the credit quality of a financial instrument.

IFRS 9 expected credit loss model includes three stages, i.e. three levels of credit risk, whereby the financial asset moves through stages as it changes its credit quality.

	Stage 1 Healthy portfolio	Stage 2 Significant increase of credit risk	Stage 3 Problematic portfolio
Expected loss	In 12 month period	In the entire duration of the loan	In the entire duration of the loan
Criterion for grouping and determining risk levels	Overdue ≤30 days by IFRS counter FBA classification ≤B5% Client is not in default on any basis	Overdue ≥31 days ≤90 days by IFRS counter FBA classification >B5% Deterioration of client's position Client is not in default on any basis	Overdue >90 days by IFRS counter i.e. Client is in default on any basis

Impairment is done by applying the Internal loan and other financial assets impairment methodology in accordance with IFRS 9 ("Methodology").

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments (continued)

Impairment of financial assets (continued)

The amount of expected credit loss that is recognized depends on the degree of credit deterioration since the initial recognition of the instrument.

There are two basics for calculating:

- 12-month ECL, which is applied on a group basis in Stage 1, and refers to all items until there is a significant deterioration in credit quality
- Lifetime ECL, which is applied on a group basis in Stage 2, and on an individual basis in Stage 3, when there is a significant increase in credit risk.

The Bank for each reporting period, i.e. at the end of each month, estimates whether there has been a significant change (increase or decrease) of the credit risk from initial recognition and whether the credit impairment of each financial instrument is identified for each portfolio subject to estimation in order to determine whether the calculation of impairment is applied on a 12-month basis or lifetime basis for a financial instrument.

At the same time, the method of calculating interest income, which depends on the level of credit risk in which financial instrument is located, is also estimated.

For loans classified in Stages 1 and 2, interest is charged to gross book value, while in Stage 3 (the default status on any basis) interest is calculated off-balance sheet and recognized in revenue only after the payment has been made.

Impairment is carried out on a monthly basis, during the accounting periods and at the end of the year at the balance sheet date, and the impairment effects are reported on each placement individually in the statement of financial position and statement of profit and loss.

The Bank also accounts for allowances in accordance with the relevant regulations of the Banking Agency of Federation of Bosnia and Herzegovina ("Agency" or "FBA"). Relevant placements are classified into appropriate groups for the Agency's purposes in accordance with the above regulations depending on the dates overdue, the financial position of the debtors and collateral instruments and are booked in accordance with the required percentage of provisions. The general allowances in accordance with these regulations are also calculated at the rate of 2% on all exposures that are not specifically impaired.

Allowances calculated in the manner described in the previous paragraph ("FBA allowances") are not recognized in these financial statements of the Bank. If impairment for contingent losses calculated in accordance with the Agency's regulations are higher than the impairment losses calculated in accordance with IFRS requirements, the above difference is shown as a reconciliation when calculating capital adequacy.

Fair value measurement principle

Specific financial instruments

Cash and cash equivalents

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments (continued)

Specific financial instruments (continued)

Cash and cash equivalents (continued)

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

Obligatory reserve with the Central Bank

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

Loans and advances

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

Borrowings

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

Current accounts and deposits from customers

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

g) Property and equipment

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

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

Buildings	3%
Furniture and equipment:	
- Furniture and other office equipment	20%-33,33%
- Mobile phones	50%
Vehicles	20%
Leasehold improvements	20%

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g) Property and equipment (continued)

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.

j) Employee benefits

Short-term benefits

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j) Employee benefits

Short-term benefits (continued)

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

Long-term benefits: retirement severance payments

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

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

k) Provisions for liabilities and expenses

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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

l) Registered capital

Regulatory reserve for credit losses (continued)

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 on capital calculation for banks, adopted by the Agency in November 2017, replacing the Decision on Minimum Standards for Capital Management and Capital Hedging adopted in February 2013, the surplus of regulatory reserves is not shown as the movement of reserves within the capital, but is solely used when calculating capital adequacy. Therefore, the reserves shown in the financial statements as at and for the year ended 31 December 2012 remained unchanged until 31 December 2018.

On 8 November 2018, the Agency issued a Decision on conditions for incorporation of created reserves fro credit losses into regular core capital of a bank, according to which banks are allowed to make regulatory reserves for credit losses generated from profits transferred to equity or retained earnings and reserves.

The Supervisory Board of the Bank has received a Proposal of the Decision on inclusion of formed reserves for credit losses into the Bank's regular core capital for consideration and determination thereof, and submission to the Assembly of the Bank for adoption. Until the date of issuance of this report, the Bank's Assembly has not adopted the decision in question.

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 24.

o) Standards and interpretations effective in the current period

The following new amendments to the existing standards issued by the International Accounting Standards Board (IASB) are effective for the current reporting period:

- IFRS 15 "Revenue from Contracts with Customers" and further amendments (effective for annual periods beginning on or after 1 January 2018),

  IFRS 15 "Revenue from Contracts with Customers" – the standard is effect for annual periods beginning on or after 1 January 2018. IFRS 15 establishes a five-step model that applies to revenue from contracts with customers with limited exceptions. Based on the conducted analysis no significant impact was detected by adopting IFRS 15 in current economic and financial volumes on the financial statements of the Bank.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

o) Standards and interpretations effective in the current period (continued)

- Amendments to IFRS 2 "Share-based Payment" – Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),
- Amendments to IAS 40 "Investment Property" – Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018).

The adoption of these standards, amendments and interpretations has not led to any material changes in the Bank's accounting policies.

p) Standards and interpretation in issue not yet adopted

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

- Amendments to IFRS 9 "Financial Instruments" – Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),
- IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019),

IFRS 16: "Leases" (effective for annual periods beginning on or after 1 January 2019) – IFRS 16 establishes principles for recognition, measurement, presentation and disclosure of leases for both contractual parties, i.e. the buyer ("lessee") and supplier ("lessor"). The Standard requires lessees to account for all leases under a single balance sheet model in a similar way to financing leases in accordance with IAS 17, with certain exceptions. The lessor's accounting remains largely unchanged.

The Standard defines a unified model for lease accounting at lessees, prescribes the obligation of the lessee to present assets and liabilities on all leases, except for leases for a period of 12 months or less or a low lease value. Lessors will still classify leases into operating or finance leases, with IFRS 16 introducing an approach that is not substantially different from the one in the previous IAS 17.

Upon commencement of the lease, the lessee recognizes the right to use property and the lease liability. The right to use property is measured for the first time in the amount of the lease liability that is increased for any direct costs of the lessee. It is also possible to calculate adjustments based on lease incentives, payments at the time or prior to the beginning of the lease, and the obligation to bring the lease object into original condition and similar.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

p) Standards and interpretation in issue not yet adopted (continued)

According to the cost method, the right to use property is measured at cost less depreciation, i.e. accumulated amortization. The lease liability is initially measured at the amount of the present value of the lease payments over the lease period determined by the lease rate if it is currently possible to determine it. Conversely, the lessee is obliged to apply an incremental charge rate.

Variable lease payments related to an index or rate used for initial measurement of a lease liability are initially measured using that index or the rate at the beginning of the lease. Amounts that are expected to be paid by the lessee are also included in the guarantee for the remainder of the value.

Variable lease payments that are not included in the measurement of the lease liability are recognized in profit or loss for the period in which the event or condition is triggered as a trigger, except for costs that are included in the carrying amount of another asset under another standard.

The lease liability is later measured in such a way as to include changes:

- lease periods (using the adjusted rate for the current value);
- estimates related to the purchase option (using the adjusted discount rate to the present value);
- the amounts expected to be payable on the basis of the guarantees for the outstanding value (using the same, i.e. unchanged default rate), i.e.
- future lease payments resulting from the change in the index or the rate used to determine the amount of these payments (using the same, unchanged, floating rate to present value).

The re-measurement results are calculated as the adjustment of assets with the right to use. Lease changes may also be a trigger for re-measuring lease commitments, except for changes that need to be accounted for as separate leases.

According to the conducted assessment, the Group reviewed the lease contracts and calculated the effects of the first application of the classification of contracts under IFRS 16. The total estimated effect of the right to use assets is KM 35 thousand or 0.2% of the total assets of the Bank, and it results in increase of total assets and total liabilities of the Bank in the stated amount.

- Amendments to IAS 28 "Investments in Associates and Joint Ventures" – Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 19 "Employee Benefits" – Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 19 "Employee Benefits" – Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019),
- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021),

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

p) Standards and interpretation in issue not yet adopted (continued)

- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" – Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),
- Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)" resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after 1 January 2019),
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019).
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019).

The Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Bank anticipates that the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments

In accordance with the Decision on the Issuance and Application of International Financial Reporting Standards ("Official Gazette of the Federation of BiH", no. 55/17), application of the International Financial Reporting Standards (IFRS) 9 – "Financial Instruments" is obligatory in preparation of financial statements which refer to periods beginning on or after 1 January 2018.

Since 1 January 2018, the Bank has applied IFRS 9 – "Financial Instruments", and has not restated comparative data for 2017, as the Standard allows. Accordingly, the current period from 1 January to 31 December 2018 is based on IFRS 9 and the results for 2017 and for the period from 1 January to December 31, 2017 are based on the International Accounting Standard (IAS) 39 "Financial Instruments: Recognition and Measurement", and IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", thus comparative data for 2017 are not comparable to the information presented in 2018.

IFRS 9 requirements for impairment are based on the expected credit loss model and replace the current IAS 39 model of incurred losses.

The effects of applying IFRS 9 are charged to retained earnings and reserves as at 1 January 2018 and amount to KM 7,639 thousand.

The Bank has adopted a new Internal Methodology for impairment of loans and other financial assets in accordance with IFRS 9 (no. 4067-II / 18 of 8 May 2018), which defines the general principles and processes of classification and measurement of financial instruments and establishes clear methods and processes for impairment of loans and other financial assets at the Bank.

Balance items subject to measurement are valued using the amortization cost method. Outstanding items that are subject to measurement are: guarantees, letters of credit, unused amounts of revolving loans, unused contracted credits. The so-called "Other assets" are also subject to classification, consisting of various receivables from legal and natural persons that are not subject to credit-guarantee transactions.

Impairment calculations for loans and other financial assets are carried out on a monthly basis.

Financial assets

Recognition

Financial assets are initially recognized at fair value, at the moment of acquisition or approval.

Business models

All financial assets are grouped into business models that indicate the way of managing a group of financial assets as a whole in order to achieve a certain business objective and define the way in which financial assets are expected to generate cash flows.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Business models (continued)

The Management of the Bank has chosen a business model that aims to hold assets solely for the purpose of collecting contractual cash flows, which combines all the financial assets held for the purpose of charging the contracted cash flows throughout the life of the financial instrument.

The business model for keeping assets for collection passes the SPPI test (Solely Payments of Principal and Interest, the "SPPI test"), and the following financial assets are allocated to this model:

- cash and cash on bank transaction account,
- current account and obligatory reserve with the CBBH
- loans
- other receivables (other assets)

The underlying risk in this business model is credit risk.

SPPI test

The SPPI test is a test of contractual cash flows from the aspect of paying only principal and interest on the outstanding principal amount, one of the criteria for classifying financial assets in a particular category of measurement. The SPPI test is conducted to determine whether the interest on the outstanding principal reflects only the time value of money, or includes credit risk, other basic lending risks, lending costs and profit margins.

SPPI test is performed:

- for each financial asset, allocated to a business model whose purpose is to hold a financial asset for the purpose of collecting contractual cash flows,
- for each financial asset in cases where the original asset is significantly modified and therefore recognized as new asset
- when introducing new credit products to determine in advance the eligibility of the credit conditions considered in relation to the need to subsequently monitor the value of any financial assets that would arise from them.

Classification of financial assets

The Bank classifies its financial assets on the basis of allocation to the business model and the SPPI test as assets subsequently measured at amortization cost if both conditions are met:

- financial assets are allocated to a business model whose purpose is to hold assets for the payment of contractual cash flows and
- the SPPI test is satisfied – for financial assets, cash flows are defined which represent only the payment of principal and interest on the outstanding principal amount.

The classification depends on the purpose for which the financial asset has been acquired. The Management determines the classification of financial assets at initial recognition and reviews this classification at each reporting date.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Reclassification of financial assets

In case of change in the business model of financial asset management, a reclassification will be made of all financial assets affected by the reclassification. Reclassification will take place prospectively, from the date of the reclassification, i.e. from the first day of the next accounting period, whereby not modifying previously recognized profit, loss or interest.

Impairment of financial assets

Impairment of financial assets is recognized on the basis of the expected credit loss model for assets that are subsequently measured at amortized cost.

Impairment is carried out on a monthly basis, during the accounting periods and at the end of the year at the balance sheet date, and the impairment effects are reported on each placement individually in the statement of financial position and statement of profit and loss.

IFRS 9 model of expected credit loss includes three stages, i.e. three levels of credit risk, whereby the financial asset moves through stages as it changes its credit quality.

Impairment is carried out using the Internal Methodology for impairment of loans and other financial assets in accordance with IFRS 9 ("Methodology").

On the date of first application of IFRS 9, the asset is allocated in three stages or three levels of credit risk:

- Stage 1 – financial assets without significant credit risk (the client is not in default status, it is overdue by the IFRS counter less than or equal to 30 days and the FBA risk rating is less than or equal to B 5%)
- Stage 2 – The client is not in default status, it is overdue by the IFRS counter more than or equal to 31 days and less than or equal to 90 days, and the FBA risk classification is greater than B5%, deteriorating the client's position.
- Stage 3 – The client is in default status on any basis, it is overdue by the IFRS counter more than 90 days

At the following reporting dates, all financial assets are allocated according to the identified significant increase in credit risk and credit rating criteria in 3 stages:

Stage 1 –financial instruments with low credit risk are allocated to this level, namely exposure to Bosnia and Herzegovina, Entities and Brčko District, and to lower levels (cantons, cities, municipalities) and exposure to the Central Bank of Bosnia and Herzegovina.

Client's financial instruments are not considered as low credit risk instruments only because of the value of the collateral instruments because they are not considered as instruments of low credit risk without such collateral.

Starting from default status as the sole criterion, the Bank distinguishes two different approaches to impairment:

- individual and
- group.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Impairment of financial assets (continued)

For financial instruments of customers allocated to Stage 1, impairment losses are calculated on a group basis in the amount of 12-month expected credit losses.

Stage 2 – clients' financial instruments with significant increase of credit risk are allocated to this risk level.

For clients' financial instruments in Stage 2, impairment losses are calculated on a group basis in the amount of lifetime expected credit losses.

Stage 3 – clients' financial instruments in default status – include clients with objective evidence of impairment of the financial instrument.

For clients' financial instruments in Stage 3, impairment losses are calculated on an individual basis in the amount of lifetime expected credit losses.

Exposure to the Central Bank of Bosnia and Herzegovina and other banks in the country and abroad is multiplied by the annual PD published by some of the credit rating agencies (e.g. Moody's) or, if not available, by expertly determined PD of 1% and an expertly established LGD value of 0.45.

As for other receivables (other assets) it is not practicable to estimate credit risk and expected credit losses, the Bank has decided to apply a matrix to determine impairment, with fixed rates of impairment depending on the number of days overdue or maturity overdue.

Details of the Methodology are listed in Note 25. Financial risk management, Note 25.1. Credit risk.

Derecognition and contract modification

IFRS 9 includes the requirements of IAS 39 for derecognition of financial assets and financial liabilities without any substantive changes. There is a certain immaterial significant impact on the Bank on the basis of adopting new provisions.

Financial assets are derecognised when:

- The contractual rights to receive cash flows expire; or
- The Bank transfers the right to receive cash flows or undertakes to pay the received cash flows to a third party through a "transfer of rights" agreement;
- or (i) any significant risks and rewards of ownership of the property have been transferred or (ii) significant risks and rewards associated with ownership of assets have been neither transferred or retained, but control over assets has been transferred.

Contractual changes arising as a result of negotiations with the debtor can lead to two types of modification of the initially contracted cash flows.

Modification of financial assets

Modification of a financial asset is any change in the contractual provisions that results in the conversion of contracted cash flows.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Modification of financial assets (continued)

In the event that the modification is not significant, the amendment to the contractual provisions does not result in derecognition of the financial asset but a new gross carrying amount is determined as the present value of the modified contractual cash flows discounted at the original effective interest rate (EIR).

In this case, the difference between the original gross carrying amount before the modification and gross carrying amount determined on the basis of modified cash flows after the change is recognized in profit or loss as income or loss.

In the event that the modification of a financial asset is significant, the financial asset is derecognised prior to the modification and the modified financial asset is re-recognized as a "new" financial asset and a new EIR is established. The date of initial recognition shall be deemed to be the date of modification of the contractual provisions. Impairment on re-recognized financial assets is recognized in the amount of expected credit losses for lifetime credit losses.

If it is determined that the modified financial asset at initial recognition is individually impaired for credit losses, in that case the financial asset is recognized as purchased or originated credit-impaired financial assets (POCI assets), and the same is determined by the EIR adjusted for the credit risk.

Purchased or originated credit-impaired financial assets (POCI assets)

POCI assets are financial assets where, at initial recognition, there is objective evidence of individual impairment for credit losses because credit risk is created or issued, or property purchased at a discount of at least 5%.

At initial recognition, expected credit losses are included in the fair value of the asset, so the impairment allowances are equal to zero.

At the reporting date only cumulative changes in expected credit losses that arise after initial recognition of POCI assets are recognized as allowances for impairment of POCI assets,.

For the purposes of calculating impairment, lifetime credit losses are recognized.

(All amounts are expressed in thousand KM, unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Classification and measurement of financial instruments

	IAS 39		IFRS 9	
	Measurement category	**Net amount 31 December 2017**	**Measurement category**	**Net amount 1 January 2018**
		000 KM		**000 KM**
Cash and cash equivalents	amortized cost	89,797	amortized cost	89,393
Obligatory reserve at the Central Bank of BiH	amortized cost	13,619	amortized cost	13,558
Loans and receivables from banks	amortized cost	-	amortized cost	-
Loans and receivables from customers	amortized cost	194,889	amortized cost	189,113
Financial assets available for sale	FVOCI (available for sale)	10	FVOCI	10
Other assets	amortized cost	518	amortized cost	513
Other liabilities	amortized cost	12,644	amortized cost	11,251

(All amounts are expressed in thousand KM, unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Positions in the Statement of financial position

Reclassifications	**Balance as at 31 December 2017 (IAS 39)**	**Reclassification**	**Subsequent measurement**	**Balance as at 1 January 2018 (IFRS 9)**
Cash and cash equivalents				
Opening balance under IAS 39	89,797			
Re-measurement under IFRS 9 (Note 11)			(404)	
Closing balance under IFRS 9				89,393
Obligatory reserve at the Central Bank of BiH				
Opening balance under IAS 39	13,619			
Re-measurement under IFRS 9 (Note 12)			(61)	
Closing balance under IFRS 9				13,558
Loans and receivables from banks				
Opening balance under IAS 39	1,534			
Re-measurement under IFRS 9			-	
Closing balance under IFRS 9				1,534
Loans and receivables from clients				
Opening balance under IAS 39	194,889			
Re-measurement under IFRS 9 (Note 14)			(5,776)	
Closing balance under IFRS 9				189,113
Financial assets available for sale				
Opening balance under IAS 39	10			
Re-measurement under IFRS 9			-	
Closing balance under IFRS 9 (FVOCI)				10
Other assets				
Opening balance under IAS 39	518			
Re-measurement under IFRS 9 (Note 15)			(5)	
Closing balance under IFRS 9				513

(All amounts are expressed in thousand KM, unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Presentation of impairment positions

	Provisions under IAS 39 (balance as at 31 December 2017) in KM 000	Reclassification	Subsequent measurement (balance as at 1 January 2018) in KM 000	Provisions under IFRS 9
Cash and cash equivalents	-	-	404	404
Obligatory reserve at the Central Bank of BiH	-	-	61	61
Loans and receivables from banks	1,534	-	1,534	-
Loans and receivables from clients	30,600		36,376	5,776
Financial assets available for sale (FVOCI)	1,412		1,412	-
Impairment of other assets	119	-	124	5
Provisions for liabilities and charges	339		1,732	1,393
Total	**34,004**	-	**41,643**	**7,639**

The Bank carried out the calculation of impairment of risk assets and provisions contingent liabilities (off-balance sheet) in accordance with IFRS 9 as at 1 January 2018, and reported a negative effect within the capital positions (in terms of unallocated profit and capital reserves, according to the Banking Agency of FBiH), in the amount of KM 7,639 thousand (on-balance KM 6,246 thousand and off-balance KM 1,396 thousand). The above-mentioned effect is expressed as the uncovered loss transferred from the previous years, i.e. the deductible item from the base capital, and decreased for the stated amount.

Below is an overview of the effects of applying IFRS 9 on individual balances and off-balance sheet items, on impairment or balance (for certain positions that are subject to impairment under IFRS 9).

(All amounts are expressed in thousand KM, unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Loans balance	Loans to banks	Long-term loans	Short-term loans	Regular interest	Penalty interest	Fees	**Total**
As at 31 December 2017	**1,407**	**223,273**	**1,142**	**990**	**208**	**3**	**227,023**
As at 31 December 2018	**1,407**	**223,273**	**1,142**	**990**	**208**	**3**	**227,023**

Impairment	Loans to banks	Long-term loans	Short-term loans	Regular interest	Penalty interest	Fees	**Total**
As at 31 December 2017	**1,407**	**29,638**	**593**	**347**	**147**	**2**	**32,134**
Effect of IFRS 9 application (Note 14)	-	5,737	4	29	6	-	**5,776**
As at 31 December 2018	**1,407**	**35,375**	**597**	**376**	**153**	**2**	**37,910**

As at 1 January 2018, by application of IFRS 9, impairment of total loans (including loan principal, interest and fees) was increased by KM 5,776 thousand compared to the impairment allowance in IAS 39.

(All amounts are expressed in thousand KM, unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Balance of cash and cash equivalents and obligatory reserve at the CBBH	Cash and cash equivalents	Obligatory reserve at the CBBiH	Total
As at 31 December 2017	89,797	13,619	**103,416**
As at 1 January 2018	**89,797**	**13,619**	**103,416**

Impairment	Cash and cash equivalents	Obligatory reserve at the CBBiH	Total
As at 31 December 2017	-	-	-
Effect of IFRS 9 application (Note 15)	404	61	**465**
As at 1 January 2018	**404**	**61**	**465**

By applying IFRS 9 as at 1 January 2018, impairment of cash and cash equivalents and obligatory reserve at the CBBiH amounts to KM 465 thousand. These financial assets did not have any impairment under IAS 39.

Balance of other assets	Acquired assets available for sale	Other assets	total
As at 31 December 2017	1,422	637	**2,059**
As at 1 January 2018	**1,422**	**637**	**2,059**

Impairment	Acquired assets available for sale	Other assets	total
As at 31 December 2017	1,412	119	**1,531**
Effect of IFRS 9 application (Note 15)	-	5	**5**
As at 1 January 2018	**1,412**	**124**	**1,536**

By applying IFRS 9, impairment of other assets was increased for KM 5 thousand compared to impairment under IAS 39.

(All amounts are expressed in thousand KM, unless otherwise stated)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1. Changes of accounting policies due to application of IFRS 9 Financial Instruments (continued)

Financial assets (continued)

Off-balance sheet	**Guarantees**	**Approved undrawn loans**	**Total**
As at 31 December 2017	10,893	2,090	**12,983**
As at 1 January 2018	**10,893**	**2,090**	**12,983**

Impairment	**Guarantees**	**Approved undrawn loans**	**Total**
As at 31 December 2017	218	121	**339**
Effect of IFRS 9 application (Note 20)	1,380	13	**1,393**
As at 1 January 2018	**1,598**	**134**	**1,732**

By applying IFRS 9, impairment of off-balance sheet items was increased for KM 1,393 thousand compared to impairment under IAS 37.

Total effect of IFRS 9 application, including balance on-balance and off-balance exposures, amounts to KM 7,639 thousand.

3. 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.

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 13 and 14) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 20).

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

Summary of impairment allowances	**Note**	**31 December 2018 '000 KM**	**31 December 2017 '000 KM**
Impairment allowance for balance sheet exposures, including cash and other assets	11,12,13, 14,15	39,010	33,665
Provisions for off-balance sheet exposures	20	2,337	339
		41,347	**34,004**

(All amounts are expressed in thousand KM, unless otherwise stated)

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

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

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 2018 are calculated in accordance with the new methodology (as explained in Note 2 l).

Summary of impairment allowances	**31 December 2018**	**31 December 2017**
Provisions for balance-sheet exposure (Agency)	46,743	42,857
Provisions for off-balance–sheet exposure (Agency)	1,318	1,491
	48,061	**44,348**
Impairment allowances under IFRS	41,347	34,004
Negative difference between provisions for balance-sheet exposure (Agency) and impairment allowance in accordance with IFRS	3,682	1,638
Positive difference between provisions for balance-sheet exposure (Agency) and impairment allowance in accordance with IFRS	10,396	11,982
Missing reserves	2,339	3,925

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 2 (f), 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 KM 10,396 thousand as at 31 December 2018 (31 December 2017: KM 11,982 thousand). Out of this amount, KM 8,057 thousand has been recognized as a regulatory reserve for credit losses within equity as at 31 December 2018 (31 December 2017: KM 8,057 thousand). The remaining amount of KM 2,339 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.

On 8 November 2018, the Agency issued a Decision on conditions for incorporation of created reserves fro credit losses into regular core capital of a bank, according to which banks are allowed to make regulatory reserves for credit losses generated from profits transferred to equity or retained earnings and reserves.

Court proceedings

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

(All amounts are expressed in thousand KM, unless otherwise stated)

3. ZNAČAJNE RAČUNOVODSTVENE PROCJENE I KLJUČNI IZVORI PROCJENE NEIZVJESNOSTI (NASTAVAK)

2 *Court proceedings (continued)*

As indicated in Note 20, the Bank provisioned KM 34 thousand, which is the amount that the Management considered sufficient. Since the assessment is made for each case separately, it is not practicable to estimate the financial impact of changes in the assumptions based on which the Management estimates the need for provisions at the reporting date.

4. INTEREST INCOME

	2018	2017
Interest on loans to customers	8,963	8,528
	8,963	**8,528**

5. INTEREST EXPENSE

	2018	2017
Interest on borrowings and deposits	282	91
	282	**91**

6. FEE AND COMMISSION INCOME

	2018	2017
Fee income from agency activities	1,308	1,335
Fee income from guarantees and letters of credit	115	39
Fees from other transactions	206	291
	1,629	**1,665**

7. OTHER OPERATING INCOME

	2018	2017
Income from sale of acquired real estate	176	119
Donations	46	46
Other	78	66
	300	**231**

8. PERSONNEL EXPENSES

	2018	2017
Net salaries	2,502	2,385
Taxes and contributions	1,866	1,794
Other	1,365	1,540
	5,733	**5,719**

Personnel expenses include KM 1,034 thousand (2017: KM 994 thousand) of defined pension contributions paid into the State pension fund. Contributions are calculated as percentage of the gross salary paid. The average number of employees during the year ended 31 December 2018 was 117 (2017: 121).

(All amounts are expressed in thousand KM, unless otherwise stated)

9. ADMINISTRATIVE AND OTHER EXPENSES

	2018	2017
Memberships and charges	223	223
Maintenance	205	175
Supervisory Board and Audit Board remunerations	186	179
Energy	131	129
Telecommunications	125	126
Services	101	72
Bank fees	100	271
Materials	97	93
Advertising, entertainment, sponsorship	68	79
Rent	50	46
Insurance	16	17
Other expenses	379	146
	1,681	**1,556**

10. IMPAIRMENT LOSSES AND PROVISIONS, NET

	2018	2017
Loans to clients (Note 14)	2,256	2,005
Provisions for employee benefits (Note 20)	238	242
Impairment of cash and cash equivalents (Note 11)	83	-
Impairment of acquired assets (Note 15)	(910)	149
Impairment of other assets (Note 15)	(9)	108
Additional / (income from release of) impairment allowance for contingent liabilities and court proceedings (Note 20)	605	(41)
	2,263	**2,463**

11. CASH AND CASH EQUIVALENTS

	31 December 2018	31 December 2017
Current accounts with the Central Bank of Bosnia and Herzegovina	96,069	76,309
Current accounts with other banks in foreign and domestic currency	12,137	13,472
Cash in hand	12	16
	108,218	**89,797**
Effect of IFRS 9 application (Note 2)	(404)	-
Impairment of cash and cash equivalents (Note 10)	(83)	-
	107,731	**89,797**

Cash and current accourts with other banks include KM 8,431 thousand (2017: KM 6,469 thousand) of funds managed for and on behalf of third parties (Note 24).

(All amounts are expressed in thousand KM, unless otherwise stated)

12. OBLIGATORY RESERVE WITH THE CENTRAL BANK

	31 December 2018	31 December 2017
Obligatory reserve with the Central Bank of Bosnia and Herzegovina	13,557	13,619
	13,557	**13,619**
Effect of IFRS 9 application (Note 2)	(61)	-
Net obligatory reserve with the Central Bank	**13,496**	**13,619**

During the reporting period the Bank has maintained the prescribed mandatory reserves with the Central Bank (CBBiH), by applying a 10% rate on all deposits.

For the amount of obligatory reserve and liquidity funds held with the Central Bank of Bosnia and Herzegovina (CBBiH), no interest was accounted on above mentioned amounts by the CBBiH in 2018.

Calculated impairment of the obligatory reserve at the CBBiH, as effect of IFRS 9 application, amounts to KM 61 thousand.

13. LOANS AND RECEIVABLES FROM BANKS

	31 December 2018	31 December 2017
Loans to banks	1,488	1,534
Less: impairment allowance	(1,488)	(1,534)
Total net loans to banks	-	-

Loans and advances to banks include interest receivable in the amount of KM 125 thousand (31 December 2017: KM 127 thousand). IFRS 9 application did not have effect on loans to banks.

Movement in gross exposure

	Bank			
	Stage 1	**Stage 2**	**Stage 3**	**total**
Gross carrying amount as at 1 January 2018	-	-	**1,534**	**1,534**
New financing	-	-	-	-
Derecognized assets (excluding write-offs)	-	-	-	-
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Repaid assets	-	-	-	-
Write-offs	-	-	(46)	(46)
FX adjustments	-	-	-	-
Other changes	-	-	-	-
As at 31 December 2018	-	-	**1,488**	**1,488**

(All amounts are expressed in thousand KM, unless otherwise stated)

13. LOANS AND RECEIVABLES FROM BANKS (CONTINUED)

Loans and receivables from banks (continued)

Movement in impairment allowance

	Bank			
	Stage 1	Stage 2	Stage 3	Total
Allowance for expected credit losses as at 1 January 2018	-	-	**1,534**	**1,534**
Derecognized assets (excluding write-offs)	-	-	-	-
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Impairment allowances (Note 10)	-	-	-	-
Write-offs	-	-	(46)	(46)
Other changes	-	-	-	-
As at 31 December 2018	-	-	**1,488**	**1,488**

14. LOANS AND RECEIVABLES FROM CLIENTS

	31 December 2018	31 December 2017
Short-term loans:		
Corporate	6,466	1,161
Retail	166	-
Current portion of long-term loans	28,590	25,471
	35,222	***26,632***
Long-term loans (excluding current portion):		
Corporate	194,758	193,948
Retail	4,503	4,909
	199,261	***198,857***
	234,483	**225,489**
Less: impairment allowance	(36,357)	(30,600)
	198,126	**194,889**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

Loans to customers include interest receivables, which comprise of unpaid due interest and fees, and accrued interest in the amount of KM 783 thousand (31 December 2017: KM 1,073 thousand) and are presented net of deferred fees in the amount of KM 854 thousand (31 December 2017: KM 1,072 thousand).

Changes in impairment allowance can be presented as follows:

	31 December 2018	31 December 2017
Balance at the beginning of the year	30,600	28,729
Effect of IFRS 9 application (Note 2)	5,776	-
Net changes in impairment allowance (Note 10)	2,256	2,005
Write-offs	(2,275)	(134)
Balance at the end of the year	**36,357**	**30,600**

Analysis of gross amount of loans by industry:

	31 December 2018	31 December 2017
Corporate loans		
Manufacturing	67,280	78,436
Real estate and rental business, etc.	47,002	56,899
Trade	29,003	24,879
Construction	14,392	12,443
Public administration and defence	38,656	10,632
Agriculture	9,193	10,165
Hospitality	1,802	4,326
Transportation, storage and communication	1,305	1,259
Other	20,359	20,937
	228,992	***219,976***
Retail loans		
Entrepreneurship	5,341	5,337
Housing loans	150	176
	5,491	***5,513***
	234,483	**225,489**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

Gross exposure

	31 December 2018					31 December 2017
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Total**
Internal rating level						
Performing						
Low risk	152,145	-	-	-	152,145	144,508
Medium risk	-	9,962	-	-	9,962	7,792
High risk	-	-	-	-	-	-
Non-performing						
Default	-	-	51,926	20,450	72,376	73,189
Total	**152,145**	**9,962**	**51,926**	**20,450**	**234,483**	**225,489**

Movement in gross exposure

	Bank				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Gross carrying amount as at 31 December 2017	**144,508**	**7,792**	**54,231**	**18,958**	**225,489**
IFRS 9 effect	(10,410)	10,658	(248)	-	-
Gross carrying amount as at 1 January 2018	134,098	18,450	53,983	18,958	**225,489**
New financing	50,792	6,083	4,205	1,709	62,789
Derecognized assets (excluding write-offs)	(9,225)	(3,115)	(4,843)	-	(17,183)
Transfers to Stage 1	4,939	(4,939)	-	-	-
Transfers to Stage 2	(1,024)	1,174	(150)	-	-
Transfers to Stage 3	(1,390)	(5,650)	7,040	-	-
Transfers to POCI	-	-	(593)	593	-
Repaid assets	(26,045)	(2,041)	(5,441)	(810)	(34,337)
Write-offs	-	-	(2,275)	-	(2,275)
As at 31 December 2018	**152,145**	**9,962**	**51,926**	**20,450**	**234,483**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

Movement in impairment allowance

	Stage 1	Stage 2	Stage 3	POCI	Total
Allowance for expected credit losses as at 31 December 2017	**3,261**	**804**	**22,486**	**4,049**	**30,600**
IFRS 9 application effect	(49)	1,981	3,388	456	5,776
Allowance for expected credit losses as at 1 January 2018	**3,212**	**2,785**	**25,874**	**4,505**	**36,376**
New financing	1,449	478	676	440	3,043
Derecognized assets (excluding write-offs)	(275)	(79)	(1,528)	-	(1,882)
Transfers to Stage 1	792	(792)	-	-	-
Transfers to Stage 2	(58)	85	(27)	-	-
Transfers to Stage 3	(121)	(1,086)	1,207	-	-
Transfers to POCI	-	-	(383)	383	-
(Decrease) / increase from balance change	(1,155)	34	2,216	-	1,095
Impairment (Note 10)	*632*	*(1,360)*	*2,161*	*823*	*2,256*
Write-offs	-	-	(2,275)	-	(2,275)
Other changes	-	-	-	-	-
As at 31 December 2018	**3,844**	**1,425**	**25,760**	**5,328**	**36,357**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

a) Corporate – credit quality

Gross exposure

	31 December 2018					31 December 2017
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Total**
Internal rating level						
Performing						
Low risk	112,313	-	-	-	112,313	132,646
Medium risk	-	9,823	-	-	9,823	7,751
High risk	-	-	-	-	-	-
Non-performing						
Default	-	-	47,789	20,450	68,239	69,577
Total	**112,313**	**9,823**	**47,789**	**20,450**	**190,375**	**209,974**

Movement in gross exposure

	Bank				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Gross carrying amount as at 31 December 2017	132,646	7,751	50,619	18,958	**209,974**
IFRS 9 effect	(10,070)	10,301	-231	-	-
Gross carrying amount as at 1 January 2018	122,576	18,052	50,388	18,958	**209,974**
New financing	15,664	5,954	4,039	1,709	**27,366**
Derecognized assets (excluding write-offs)	(8,178)	(3,113)	(4,815)	-	**(16,106)**
Transfers to Stage 1	4,768	(4,768)	-	-	-
Transfers to Stage 2	(934)	1,084	(150)	-	-
Transfers to Stage 3	(977)	(5,394)	6,371	-	-
Transfers to POCI	-	-	(593)	593	-
Repaid assets	(20,606)	(1,992)	(5,176)	(810)	**(28,584)**
Write-offs	-	-	(2,275)	-	**(2,275)**
As at 31 December 2018	**112,313**	**9,823**	**47,789**	**20,450**	**190,375**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

a) Corporate – credit quality (continued)

Movement in impairment allowance

	Stage 1	Stage 2	Stage 3	POCI	Total
Allowance for expected credit losses as at 31 December 2017	**3,013**	**790**	**21,800**	**4,049**	**29,652**
IFRS 9 application effect	(48)	1,946	3,264	456	5,618
Allowance for expected credit losses as at 1 January 2018	**2,965**	**2,736**	**25,064**	**4,505**	**35,270**
New financing	733	470	606	440	2,249
Derecognized assets (excluding write-offs)	(254)	(79)	(1,524)	-	(1,857)
Transfers to Stage 1	778	(778)	-	-	-
Transfers to Stage 2	(43)	70	(27)	-	-
Transfers to Stage 3	(59)	(1,062)	1,121	-	-
Transfers to POCI	-	-	(383)	383	-
(Decrease) / increase from balance change	(1,114)	44	1,895	-	825
Impairment (Note 10)	*41*	*(1,335)*	*1,688*	*823*	*1,217*
Write-offs	-	-	(2,275)	-	(2,275)
As at 31 December 2018	**3,006**	**1,401**	**24,477**	**5,328**	**34,212**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

b) State and public sector – credit quality

Bank	**31 December 2018**				**31 December 2017**
Gross exposure	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Total**
Internal rating level					
Performing					
Low risk	38,617	-	-	38,617	10,002
Medium risk	-	-	-	-	-
High risk	-	-	-	-	-
Non-performing					
Default	-	-	-	-	-
Total	**38,617**	**-**	**-**	**38,617**	**10,002**

Movement in gross exposure	**Bank**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 1 January 2018	**10,002**	**-**	**-**	**10,002**
New financing	34,749	-	-	34,749
Derecognized assets (excluding write-offs)	(960)	-	-	(960)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Repaid assets	(5,174)	-	-	(5,174)
Write-offs	-	-	-	-
Other changes	-	-	-	-
As at 31 December 2018	**38,617**	**-**	**-**	**38,617**

Movement in impairment allowance

	Bank			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Allowance for expected credit losses as at 1 January 2018	**200**	**-**	**-**	**200**
New financing	697	-	-	697
Derecognized assets (excluding write-offs)	(19)	-	-	(19)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
(Decrease) / increase from balance change	(104)	-	-	(104)
Impairment (Note 10)	*574*	-	-	*574*
Write-offs	-	-	-	-
Other changes	-	-	-	-
As at 31 December 2018	**774**	**-**	**-**	**774**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

c) Retail – credit quality

Bank		**31 December 2018**			**31 December 2017**
Gross exposure	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Total**
Internal rating level					
Performing					
Low risk	1,215	-	-	1,215	1,860
Medium risk	-	139	-	139	41
High risk	-	-	-	-	-
Non-performing					
Default	-	-	4,137	4,137	3,612
Total	**1,215**	**139**	**4,137**	**5,491**	**5,513**

Movement in gross exposure

	Bank			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 31 December 2017	**1.860**	**41**	**3.612**	**5.513**
IFRS 9 effect	(340)	357	(17)	-
Gross carrying amount as at 1 January 2018	**1.520**	**398**	**3.595**	**5.513**
New financing	379	129	166	674
Derecognized assets (excluding write-offs)	(87)	(2)	(28)	(117)
Transfers to Stage 1	171	(171)	-	-
Transfers to Stage 2	(90)	90	-	-
Transfers to Stage 3	(413)	(256)	669	-
Repaid assets	(265)	(49)	(265)	(579)
Write-offs	-	-	-	-
Other changes	-	-	-	-
As at 31 December 2018	**1.215**	**139**	**4.137**	**5.491**

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

c) Retail – credit quality (continued)

Movement in impairment allowance

	Bank			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Allowance for expected credit losses as at 31 December 2017	**48**	**14**	**686**	**748**
IFRS 9 application effect	(1)	35	124	158
Allowance for expected credit losses as at 1 January 2018	**47**	**49**	**810**	**906**
New financing	19	8	70	97
Derecognized assets (excluding write-offs)	(2)	-	(4)	(6)
Transfers to Stage 1	14	(14)	-	-
Transfers to Stage 2	(15)	15	-	-
Transfers to Stage 3	(62)	(24)	86	-
(Decrease) / increase from balance change	63	(10)	321	374
Impairment (Note 10)	*17*	*(25)*	*473*	*465*
Write-offs	-	-	-	-
Other changes	-	-	-	-
As at 31 December 2018	**64**	**24**	**1,283**	**1,371**

Weighted average annual nominal and effective interest rates as at 31 December 2018 and 31 December 2017 were as follows:

	31 December 2018		31 December 2017	
Corporate loans	Nominal i.r.	Effective i.r.	Nominal i.r.	Effective i.r.
Corporate	3.63%	3.89%	4.02%	4.35%
Retail	3.34%	3.60%	3.41%	3.67%

(All amounts are expressed in thousand KM, unless otherwise stated)

15. OTHER ASSETS

	31 December 2018	31 December 2017
Acquired assets	1,615	1,422
Other assets	200	637
Total impairment of other assets	(617)	(1,531)
Total other assets (net)	**1,198**	**528**

The impairment of other assets is mostly related to impairment of assets acquired for further sale.

Changes in impairment can be presented as follows:

	31 December 2018	31 December 2017
Balance at the beginning of the year	1,531	1,274
IFRS 9 application effect (Note 2)	5	-
Impairment of acquired assets (Note 10)	(910)	149
Impairment of other assets (Note 10)	(9)	108
Balance at the end of the year	**617**	**1,531**

(All amounts are expressed in thousand KM, unless otherwise stated)

16. PROPERTY AND EQUIPMENT

	Buildings	Vehicles	Furniture and equipment	Total
Cost				
As at 1 January 2017	**7,481**	**195**	**1,473**	**9,149**
Additions	2	-	203	205
Disposals and write-offs	-	-	(26)	(26)
As at 31 December 2017	**7,483**	**195**	**1,650**	**9,328**
Additions	-	-	50	50
Disposals and write-offs	-	-	(41)	(41)
As at 31 December 2018	**7,483**	**195**	**1,659**	**9,337**
Accumulated depreciation				
As at 1 January 2017	**2,927**	**81**	**1,330**	**4,338**
Charge for the year	224	29	144	397
Disposals and write-offs	-	-	(26)	(26)
As at 31 December 2017	**3,151**	**110**	**1,448**	**4,709**
Charge for the year	224	29	97	350
Disposals and write-offs	-	-	(41)	(41)
As at 31 December 2018	**3,375**	**139**	**1,504**	**5,018**
Net carrying amount				
As at 31 December 2018	**4,108**	**56**	**155**	**4,319**
As at 31 December 2017	**4,332**	**85**	**202**	**4,619**

(All amounts are expressed in thousand KM, unless otherwise stated)

17. INTANGIBLE ASSETS

	Leasehold improvements	Software	Total
Cost			
As at 1 January 2017	**6**	**940**	**946**
Additions	-	6	6
As at 31 December 2017	**6**	**946**	**952**
Additions	-	105	105
Disposals and write-offs	(6)	-	(6)
As at 31 December 2018	**-**	**1,051**	**1,051**
Accumulated depreciation			
As at 1 January 2017	**-**	**737**	**737**
Charge for the year	-	70	70
As at 31 December 2017	**-**	**807**	**807**
Charge for the year	-	76	76
As at 31 December 2018	**-**	**883**	**883**
Net carrying amount			
As at 31 December 2018	**-**	**168**	**168**
As at 31 December 2017	**6**	**139**	**145**

(All amounts are expressed in thousand KM, unless otherwise stated)

18. CURRENT ACCOUNTS AND DEPOSITS FROM CUSTOMERS

	31 December 2018	31 December 2017
Demand deposits		
Private enterprises	3,756	5,223
Cantonal and municipality governments	33,244	757
Individuals and entrepreneurs	442	495
Public companies	256	286
Total demand deposits	***37,698***	***6,761***
Purpose deposits		
Government of Federation of Bosnia and Herzegovina	18,359	36,721
Government of Tuzla Canton	5,961	5,075
Public companies	25	185
Total purpose deposits	***24,345***	***41,981***
Term deposits		
In domestic currency		
Government of Federation of Bosnia and Herzegovina (guarantee deposit)	57,952	51,914
Federal Employment Agency	11,368	10,874
Government of Federation of Bosnia and Herzegovina	10,000	5,000
Private enterprises	522	22
	79,842	***67,810***
In foreign currency		
Government of Federation of Bosnia and Herzegovina – EUR	231	231
Total term deposits	***80,073***	***68,041***
Total deposits	**142,116**	**116,783**

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

19. BORROWINGS

	31 December 2018	31 December 2017
Government of Federation of Bosnia and Herzegovina – Saudi Fund loan for development, interest rate 2% p.a. with maturity date 31 August 2021	1,281	1,631
Government of Federation of Bosnia and Herzegovina – Belgian merchandise loan, interest free with maturity date 31 December 2027	585	651
	1,866	**2,282**

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.

(All amounts are expressed in thousand KM, unless otherwise stated)

20. PROVISIONS

	Retirement severance payments	Contingent liabilities	Court proceedings	Total
As at 1 January 2017	**496**	**380**	**34**	**910**
Increase (Note 10)	245	(41)	-	204
Decrease (Note 10)	(3)	-	-	(3)
Decrease due to payment	(41)	-	-	(41)
As at 31 December 2017	**697**	**339**	**34**	**1,070**
IFRS 9 application effect (Note 2)	-	1,393	-	1,393
Increase (Note 10)	259	605	-	864
Decrease (Note 10)	(21)	-	-	(21)
Decrease due to payment	(191)	-	-	(191)
As at 31 December 2018	**744**	**2,337**	**34**	**3,115**

As at 31 December 2018, the total value of claims initiated against the Bank amounted to KM 2,685 thousand. Out of this amount, KM 2,283 thousand relate to labour disputes and KM 402 thousand relate to other claims against the Bank.

For part of the labour 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 KM 34 thousand.

Given the differing court practices in making decision on labour disputes, the Management of the Bank has not been able to estimate the outcome of the outstanding proceedings, hence provisions have not been created, except for those mentioned above.

Management's estimate is that the Bank will not lose other proceedings against it.

Commitments and contingencies (Off balance sheet exposure) as at 31 December 2018 were as follows:

	31 December 2018	31 December 2017
Performance guarantees	18,232	10,362
Undrawn lending commitments	5,350	2,090
Advance and payment guarantees	-	531
	23,582	**12,983**

21. OTHER LIABILITIES

	31 December 2018	31 December 2017
Agency liabilities (Note 24)	8,431	6,469
Deferred income	330	786
Accrued expenses	102	61
Trade payables	71	63
Liabilities for interest on deposits	38	19
Other	57	20
	9,029	**7,418**

22. REGISTERED CAPITAL

	%	31 December 2018	%	31 December 2018
Government of 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 KM 400 million from the budget of the Federation in equal instalments in the period 2008-2011.

Up to 31 December 2018, the Government has not yet provided the capital injection according to the agreed dynamic and amounts.

23. RELATED PARTY TRANSACTIONS

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:

KM '000	Type of relation	31 December 2018		31 December 2017	
		Receivables	Liabilities	Receivables	Liabilities
Government of Federation of Bosnia and Herzegovina	Owner	-	89,750	-	96,658
Public institutions	Common owner	24	18,495	20	16,641
Companies in majority ownership of the Government of FBiH	Common owner	60,204	143	76,171	352
		60,228	**108,388**	**76,191**	**113,651**

KM '000	Type of relation	31 December 2018		31 December 2017	
		Receivables	Liabilities	Receivables	Liabilities
Government of Federation of Bosnia and Herzegovina	Owner	927	110	979	92
Public institutions	Common owner	382	-	355	-
Companies in majority ownership of the Government of FBiH	Common owner	4,797	3,005	3,894	1,577
		6,106	**3,115**	**5,228**	**1,669**

Remunerations of the Management and Supervisory Board

The remuneration of the members of the Management and Supervisory Board during the year ended 31 December 2018:

	2018	2017
Gross salaries and other benefits	667	572
Supervisory Board members' remunerations	150	142
Other benefits	46	65
	863	**779**

(All amounts are expressed in thousand KM, unless otherwise stated)

24. FUNDS MANAGED FOR AND ON BEHALF OF THIRD PARTIES

The Bank manages significant funds for and on behalf of the Government of Federation of Bosnia and Herzegovina (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, and Ministry of Environment and Tourism) 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 2018	31 December 2017
PLACEMENTS		
Funds placed per project:		
Water and gas supply	40,827	43,031
Manufacture and processing	41,469	42,435
Healthcare and education	38,320	38,167
Agriculture	36,355	36,307
Employment incentives	11,658	12,053
Road construction and transport	1,583	2,240
Forestry	352	352
Micro finance	-	-
Other	540	2,896
Total placed by projects:	***171,104***	***177,481***
Receivables for accrued interest and fees	9,400	8,769
Total	**180,504**	**186,250**
SOURCES		
Government of Federation of Bosnia and Herzegovina	167,191	171,712
Federal Employment Agency	11,658	12,053
Other	51	63
Total sources:	***178,900***	***183,828***
Liabilities for accrued interest and fees	10,035	8,891
Total	**188,935**	**192,719**
Current liabilities from funds managed for and on behalf of third parties (Notes 11 and 21)	**8,431**	**6,469**

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

25. FINANCIAL RISK MANAGEMENT

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

25.1 Credit risk

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

The credit risk is the most significant risk which the Bank faces in the course of its operations, and it is analyzed and monitored 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.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

Credit risk classification (internal rating)

Each exposure that is measured at amortized cost and at fair value are allocated to one of the following categories.

Credit risk level	**Exposure**	**Expected credit loss**
Credit risk level 1	Low credit risk level exposures	12-month ECL
Performing	Overdue less or equal to 30 days	group assessment
	FBA classification lower or equal to B 5%	
	Exposure in non-default status	
Credit risk level 2	Medium credit risk level exposures	Lifetime ECL
Underperforming	Overdue over 30 days and less or equal to 90 days	group assessment
	FBA classification greater than B5%	
	Significant increase of credit risk (increase of PD parameter; deterioration of debtor's financial indicators; non-compliance with contractual provisions; on special watch list for exposures)	
	Exposure in non-default status	
Credit risk level 3	High credit risk level exposures (non-performing)	Lifetime ECL
Non-performing	Overdue over 90 days	individual assessment
	Impairment individually assessed.	
	Exposure in default status	
Write-off	There is evidence that debtor has significant financial difficulties and there are no realistic recovery indicators	Exposure or exposures are written-off

Impairment and provisioning policies (applicable from 1 January 2018)

Beginning with 1 January 2018, in accordance with IFRS 9, the Bank applies an Expected Credit Loss (ECL) model for all debt instruments measured at amortized cost or at fair value.

Impairment losses for individual risk or portfolio risk are estimated for customers from all segments and for all types of exposures.

The Bank performs segmentation by group of clients (corporate, retail, financial institutions), level of risk (credit risk level 1, 2 or 3) and risk assessment method (group or individual).

For exposures and customers classified in Credit level 1 (Performing) group risk assessment method is applied and 12-month expected credit losses (12-month ECL) are calculated.

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

Credit risk classification (internal rating) (continued)

Impairment and provisioning policies (applicable from 1 January 2018) (continued)

For exposures and customers classified in Credit risk level 2 (Underperforming) group risk assessment method is applied and lifetime expected credit losses (lifetime ECL) are calculated.

For exposures and customers classified in Credit risk level 3 (Non-performing) group risk assessment method is applied and lifetime expected credit losses (lifetime ECL) are calculated.

Definition of default and recovery status

The default status is determined at client level and its total exposure to both legal entities and population.

Default status is identified if any of the following conditions are met: the client is overdue for more than 90 days in a material amount; for reprogrammed / restructured loans at the moment of recognition; when it is estimated that it is unlikely that the client (debtor) will fully comply with his obligations, regardless of the possibility of settlement from collateral; when the liquidation or bankruptcy of the client was initiated.

A three month recovery period was established for the client's recovery. Exception are rescheduled / restructured loans for which a six-month recovery period was established, that is, if the grace period is agreed, six months after the expiration of the grace period.

PD assessment process

PD represents the likelihood that an exposure will be in default status in the next 12 months or for the duration of the obligation.

For PD modelling, approach is based on TTC (Through-the-Cycle) migration matrices for exposures in homogeneous client groups.

For these exposures, risky homogeneous groups are defined on the basis of days overdue and status of reprogrammed / restructured exposures. Data modelling for the previous five-year period is used in PD modelling, and the movement of exposures overdue longer than 90 days in material amounts and reprogrammed / restructured exposures is analysed.

For exposures classified in Credit risk level 2, i.e. exposures where there has been a significant increase in credit risk from initial recognition, but which still have regular operations, IFRS 9 requires the PD parameter to be calculated for the entire life of the instrument.

For exposures classified in Credit risk level 1, a portion of the PD parameter is used for 12 months, based on 12 migration matrices for each homogeneous group.

Starting from the PD value at 12-month level to migration matrices, the cumulative and conditional probabilities of the PD parameter for the maturity of up to 5 years are calculated, which are used to calculate the marginal values of the PD parameter. The marginal value of the lifetime PD parameter is shifted to the macroeconomic value of expected future losses taking into account the movements of GDP. The value of lifetime PD depends on the remaining period until the maturity of the individual exposure.

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

Credit risk classification (internal rating) (continued)

Exposure at default (EAD)

Exposure at Default (EAD) is calculated as the total amount of credit exposure (on-balance and off-balance sheet), including the interest that is expected to be collected up to the end of the loan term, for which impairment allowances for credit losses are to be created and is calculated at the client level.

For exposures classified in Credit risk level 1 and matured exposures, EAD is equal to current exposure.

For undue exposures, lifetime EAD is calculated on the basis of the repayment plan, taking into account amounts and maturity periods, up to the maximum exposure maturity date.

Loss given default (LGD)

Loss given default (LGD) is estimated for all exposures according to homogeneous groups on the basis of transactions after the date of default and is expressed as a percentage. Each exposure is discounted at the date of default at the appropriate discount rate.

The estimate and calculation of the LGD parameter is based on the effective value of collateral that falls under each individual contract and based on the Cure Rate (CR) at the 12-month level and/or the lifetime of the instrument, depending on whether the level of credit risk is 1 or 2.

Grouping financial assets measured on a group basis

For the purpose of determining a significant increase in credit risk and recognition of group-based allowances, on the basis of common credit risk characteristics, homogeneous groups were formed by the type of client:

- legal entities
- population
- financial institutions

By applying the Internal Impairment Methodology, exposures to each of these homogeneous groups are classified according to the level of credit risk.

Credit risk is assessed at group level for all clients and exposures classified in credit risk levels 1 and 2.

For exposures classified in credit risk level 1, the expected credit loss is measured as a 12-month ECL.

For exposures classified into risk level 2 expected losses are measured as lifetime expected losses.

Grouping financial assets measured on an individual basis

For all exposures that are not classified in credit risk levels 1 and 2, the impairment loss, i.e. the expected credit loss, is accounted for on an individual basis for the entire lifetime of exposure at the client level and the associated individual exposures.

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

Credit risk classification (internal rating) (continued)

Grouping financial assets measured on an individual basis (continued)

All customer exposures that have entered the default status are assessed on an individual basis.

In an individual basis assessment, the Bank performs a separate analysis of the expected cash flows, i.e. the expected credit loss (ECL) represents a probability weighted credit loss estimate based on three potential scenarios, weighted by the likelihood of the occurrence of each scenario and their discounting to the present value of the impairment loss.

The Bank uses three (3) most probable cash flow assessment scenarios whose aggregate probability must be = 1.

The individual basis implies an analysis of the expected future cash flows by observable placement and the calculation of their present value.

Methodology for POCI

The Bank classifies as a POCI asset each individual item of assets that, when originated or purchased, carries an individual impairment loss for expected credit losses mark, which meets any of the following criteria:

- reprogrammed/restructured individual credit agreements for a period of 12 months prior to the date of application of IFRS 9 and thereafter
- individual exposures from previous line that did not recover in the recovery period defined for POCI assets
- new placements to clients who have placements with individual impairment in the portfolio (classified in Stage 3)
- items of assets purchased with economic loss (discount) of more than 5% of the net book value of the asset.

At initial recognition, the value of POCI assets is calculated using the EIR adjusted for credit risk.

Improved Credit Risk of POCI Assets (Returning to Stage 2)

Items POCI assets can be returned to Stage 2 (due to credit recovery or credit risk improvement).

For the transfer of POCI assets in Stage 2, a twelve-month period of recovery was established. POCI asset (loan) remain classified as POCI at least 12 months from the moment of classification, i.e. if a grace period was contracted for POCI asset (loan) at the moment of recognition, at least 12 months after the expiration of the grace period. Only after this recovery period, POCI assets (loans) can be classified in Stage 2 if not in the default status on another basis.

POCI assets (loans) can never be classified in Stage 1.

In the event that after the recovery and transition to Stage 2 there is a re-emergence of default status, exposure is classified in Stage 3.

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

Credit risk classification (internal rating) (continued)

Methodology for POCI (continued)

Accounting model of POCI asset treatment

POCI assets are measured at amortized cost.

At initial recognition, expected credit losses are included in the fair value of POCI assets, so the impairment allowances equal to zero.

At the reporting date, the Bank recognizes only cumulative changes in Lifetime credit losses through profit or loss (FVPL) as impairment allowances for POCI assets.

Favourable changes in expected credit losses (decrease) are recognized as impairment gains and if the lifetime expected credit losses are less than the expected credit losses that were initially recognized in the estimated cash flows and the negative changes (increase) are recognized as a cost.

Significant Increase of Credit Risk (SICR)

For the purpose of continuously determining increased credit risk, the risk changes for all the Bank's clients are monitored at least annually. According to the Methodology, all placements to a client for which an increased credit risk is determined for the next reporting date are classified in Stage 2 according to any of the following criteria:

- customer's delay in paying any significant overdue liabilities longer than 31 days by the IFRS counter, and shorter than 90 days
- the client is in financial difficulties but is not in the default status
- FBA classification is greater than B 5%

In addition, the criteria for assigning a client to Stage 2 may be as follows:

- non-compliance with contractual provisions
- loss of key customers or suppliers
- known information on future events
- and similar.

Exit from the status of increased credit risk is due to the lack of any criteria that have been classified by the client in the relevant status for its occurrence, and the verification of all indicators is carried out at least once a year, within the annual client monitoring.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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

	Maximum credit exposure			
	Net exposure	Contingent liabilities / guarantees	Total	Fair value of collateral
31 December 2018				
Cash and cash equivalents	107,731	-	107,731	-
Obligatory reserve with the Central Bank	13,496	-	13,496	-
Loans and receivables from clients	198,126	23,582	221,708	232,812
	319,353	**23,582**	**342,935**	**232,812**
31 December 2017				
Cash and cash equivalents	89,797	-	89,797	-
Obligatory reserve with the Central Bank	13,619	-	13,619	-
Loans and receivables from clients	194,889	12,983	207,872	223,104
	298,305	**12,983**	**311,288**	**223,104**

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 2018 and 31 December 2017, 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 t me 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 15.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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. Wherever possible, the Bank's position improves by acquisition of additional collateral.

	31 December 2018	31 December 2017
Gross restructured loans	37,393	39,542
Less: impairment allowance	(13,089)	(9,188)
	24,304	**30,354**

25.1.1 Credit risk management and policy provisions and impairment

Classification of loans by credit risk level

For the purpose of credit monitoring and credit risk management, the Bank's credit portfolio is divided into the following groups:

- Loans with low credit risk (performing loans) – loans not impaired for 12-month expected losses, on group level;
- Loans with medium risk level (performing loans) – loans impaired for lifetime credit losses, on group level;
- Loans with high credit risk level (non-performing loans) – loans impaired for lifetime expected losses, on individual level, including POCI assets.

In 2017, the portfolio was divided into: a) Undue unimpaired loans (IBNR impairment), b) Due unimpaired loans (IBNR impairment) and c) Impaired loans.

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

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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

Classification of loans by credit risk level (continued)

	31 December 2018	31 December 2017
Banks		
Loans with high risk level	1,488	1,534
Gross exposure	**1,488**	**1,534**
Less: impairment allowance	(1,488)	(1,534)
Net exposure	-	-
Corporate		
Loans with low risk level (performing loans)	150,930	142,648
Loans with medium risk level (performing loans)	9,823	7,751
Loans with low risk level (non-performing loans)	47,789	69,577
Gross exposure	**208,542**	**219,976**
Less: impairment allowance	(29,658)	(29,852)
Net exposure	**178,884**	**190,124**
Gross exposure – POCI	**20,450**	n/a
Less: Impairment allowance	(5,328)	n/a
Net exposure	**194,006**	**190,124**
Retail		
Loans with low risk level (performing loans)	1,215	1,860
Loans with medium risk level (performing loans)	139	41
Loans with low risk level (non-performing loans)	4,137	3,612
Gross exposure	**5,491**	**5,513**
Less: impairment allowance	(1,371)	(748)
Net exposure	**4,120**	**4,765**
Total gross exposure	**235,971**	**227,023**
Portfolio impairment allowance (12-month ECL)	(3,844)	(4,065)
Portfolio impairment allowance (lifetime ECL)	(1,425)	N/p
Individual impairment allowances	(32,576)	(28,069)
Net exposure	**198,126**	**194,889**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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

Classification of loans by credit risk level (continued)

a) Loans with low credit risk level

The quality of the portfolio of loans to customers that have a low risk level and are impaired on portfolio level for 12-month ECL 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 with low risk level according to the type of loan user is as follows:

	Banks	Corporate	Retail	Total
31 December 2018				
Gross exposure	-	150,930	1,215	**152,145**
Impairment	-	(3,780)	(64)	**(3,844)**
Net	**-**	**147,150**	**1,151**	**148,301**
Impairment rate	-	*3%*	*5%*	*3%*
Exposure share in total loans	-	*72%*	*22%*	*64%*

	Banks	Corporate	Retail	Total
31 December 2018				
Gross exposure (undue loans)	-	142,648	1,860	**144,508**
Impairment (IBNR)	-	(3,697)	(61)	**(3,758)**
Net	**-**	**138,951**	**1,799**	**140,750**
Impairment rate	-	*3%*	*3%*	*3%*
Exposure share in total loans	-	*65%*	*34%*	*64%*

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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

Classification of loans by credit risk level (continued)

b) Loans with medium credit risk level

For loans to and receivables from customers between 31 and 90 days overdue, i.e. loans with medium risk level, gross exposure is impaired on portfolio level for lifetime ECL. The gross amount of loans to and receivables from customers with medium credit risk was as follows:

	Banks	Corporate	Retail	Total
31 December 2018				
Gross exposure	-	9,823	139	**9,962**
Impairment	-	(1,401)	(24)	**(1,425)**
Net	**-**	**8,422**	**115**	**8,537**
Impairment rate	-	*14%*	*17%*	*14%*
Exposure share in total loans	-	*5%*	*3%*	*4%*

	Banks	Corporate	Retail	Total
31 December 2018				
Gross exposure (due unimpaired loans)	-	7,751	41	**7,792**
Impairment (IBNR)	-	(306)	(1)	**(307)**
Net	**-**	**7,445**	**40**	**7,485**
Impairment rate	-	*4%*	*2%*	*4%*
Exposure share in total loans	-	*4%*	*1%*	*3%*

c) Loans with high credit risk level

The breakdown of the gross and net amount of the loans to customers that are impaired for lifetime ECL on individual level, 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	POCI	Total
31 December 2018					
Gross exposure	1,488	47,789	4,137	20,450	**73,864**
Impairment	(1,488)	(24,477)	(1,283)	(5,328)	**(32,576)**
Net	**-**	**23,312**	**2,854**	**15,122**	**41,288**
Impairment rate	*100%*	*51%*	*31%*	*26%*	*44%*
Exposure share in total loans	*100%*	*23%*	*75%*	*100%*	*31%*

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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

Classification of loans by credit risk level (continued)

c) Loans with high credit risk level (continued)

	Banks	Corporate	Retail	Total
Estimated value of collateral as at 31 December 2018				
Deposits	-	-	-	-
Mortgages	-	194,221	19,584	**213,805**
Total	**-**	**194,221**	**19,584**	**213,805**

	Banks	Corporate	Retail	Total
31 December 2017				
Gross exposure	1,534	69,577	3,612	**74,723**
Impairment	(1,534)	(25,849)	(686)	**(28,069)**
Net	**-**	**43,728**	**2,926**	**46,654**
Impairment rate	*100%*	*37%*	*19%*	*38%*
Exposure share in total loans	*100%*	*32%*	*66%*	*33%*

	Banks	Corporate	Retail	Total
Estimated value of collateral as at 31 December 2017				
Deposits	-	925	-	**925**
Mortgages	-	161,221	9,601	**170,822**
Total	**-**	**162,146**	**9,601**	**171,747**

Analysis by days overdue

Loans to clients of the Bank (in gross and net amount) by days overdue are presented in the table below:

	Banks	Corporate	Retail	Total
31 December 2018				
No delay	-	155,881	1,202	157,083
Overdue between 1 and 90 days	-	34,896	807	35,703
Overdue over 90 days	1,488	38,215	3,482	43,185
Total gross loans and receivables	**1,488**	**228,992**	**5,491**	**235,971**
Impairment (Stage 1 / Stage 2)	-	(5,181)	(88)	(5,269)
Impairment (Stage 3)	(1,488)	(29,805)	(1,283)	(32,576)
Impairment	**(1,488)**	**(34,986)**	**(1,371)**	**(37,845)**
Net loans and receivables	**-**	**194,006**	**4,120**	**198,126**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

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

Classification of loans by credit risk level (continued)

c) Loans with high credit risk level (continued)

	Banks	Corporate	Retail	Total
31 December 2018				
No delay	-	132,769	1,539	134,308
Overdue between 1 and 90 days	-	46,623	3,437	50,060
Overdue over 90 days	1,534	40,584	537	42,655
Total gross loans and receivables	**1,534**	**219,976**	**5,513**	**227,023**
Group impairment	-	(4,003)	(62)	(4,065)
Individual impairment	(1,534)	(25,849)	(686)	(28,069)
Impairment	**(1,534)**	**(29,852)**	**(748)**	**(32,134)**
Net loans and receivables	**-**	**190,124**	**4,765**	**194,889**

25.2 liquidity risk

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

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

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

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.2 Liquidity risk (continued)

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

31 December 2018	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 to 5 years**	**Over 5 years**	**Total**
Assets						
Cash and cash equivalents	107,731	-	-	-	-	**107,731**
Obligatory reserve with the Central Bank	13,496	-	-	-	-	**13,496**
Loans and receivables from clients	11,653	6,354	30,933	114,703	34,483	**198,126**
Other assets	85	-	1,113	-	-	**1,198**
Property, equipment and intangible assets	-	-	-	-	4,487	**4,487**
Total assets	**132,965**	**6,354**	**32,046**	**114,703**	**38,970**	**325,038**
Liabilities and equity						
Current accounts and deposits from customers	62,043	-	-	31,442	48,631	**142,116**
Borrowings	-	213	279	1,114	260	**1,866**
Provisions for liabilities and charges	534	-	165	2,043	373	**3,115**
Other liabilities	8,706	-	97	133	93	**9,029**
Registered capital and reserves	-	-	-	-	168,912	**168,912**
Total liabilities and equity	**71,283**	**213**	**541**	**34,732**	**218,269**	**325,038**
Liquidity gap	**61,682**	**6,141**	**31,505**	**79,971**	**(179,299)**	**-**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.2 Liquidity risk (continued)

31 December 2017	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	89,797	-	-	-	-	**89,797**
Obligatory reserve with the Central Bank	13,619	-	-	-	-	**13,619**
Loans and receivables from clients	13,397	8,114	29,729	115,922	27,727	**194,889**
Other assets	430	1	3	94	-	**528**
Property, equipment and intangible assets	-	-	-	-	4,764	**4,764**
Total assets	**117,243**	**8,115**	**29,732**	**116,016**	**32,491**	**303,597**
Liabilities and equity						
Current accounts and deposits from customers	48,742	-	-	26,420	41,621	**116,783**
Borrowings	-	204	269	1,483	326	**2,282**
Provisions for liabilities and charges	176	44	188	326	336	**1,070**
Other liabilities	7,034	1	127	212	44	**7,418**
Registered capital and reserves	-	-	-	-	176,044	**176,044**
Total liabilities and equity	**55,952**	**249**	**584**	**28,441**	**218,371**	**303,597**
Liquidity gap	**61,291**	**7,866**	**29,148**	**87,575**	**(185,880)**	**-**

25.3 Market risk

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

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

25.3.1 Foreign currency 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.

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.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.1 Foreign currency risk (continued)

The following table summarizes the Bank's exposure to foreign currency exchange rate risk at 31 December 2018 and 31 December 2017. The tables include the Bank's assets and liabilities at carrying amounts categorized by currency.

31 December 2018	KM	EUR	USD	Other currencies	Total
Assets					
Cash and cash equivalents	95,656	10,936	1,139	-	**107,731**
Obligatory reserve with the Central Bank	13,496	-	-	-	**13,496**
Loans and receivables from clients	198,108	-	18	-	**198,126**
Other assets	1,197	1	-	-	**1,198**
Property, equipment and intangible assets	4,487	-	-	-	**4,487**
Total assets	**312,944**	**10,937**	**1,157**	**-**	**325,038**
Liabilities and equity					
Current accounts and deposits from customers	141,499	568	49	-	**142,116**
Borrowings	-	585	1,281	-	**1,866**
Provisions for liabilities and charges	3,115	-	-	-	**3,115**
Other liabilities	9,028	1	-	-	**9,029**
Registered capital and reserves	168,912	-	-	-	**168,912**
Total liabilities and equity	**322,554**	**1,154**	**1,330**	**-**	**325,038**
Net foreign exchange position	**(9,610)**	**9,783**	**(173)**	**-**	**-**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.1 Foreign currency risk (continued)

31 December 2017	KM	EUR	USD	Other currencies	Total
Assets					
Cash and cash equivalents	76,331	11,685	1,781	-	**89,797**
Obligatory reserve with the Central Bank	13,619	-	-	-	**13,619**
Loans and receivables from clients	194,870	-	19	-	**194,889**
Other assets	527	1	-	-	**528**
Property, equipment and intangible assets	4,764	-	-	-	**4,764**
Total assets	**290,111**	**11,686**	**1,800**	**-**	**303,597**
Liabilities and equity					
Current accounts and deposits from customers	116,304	233	246	-	**116,783**
Borrowings	-	651	1,631	-	**2,282**
Provisions for liabilities and charges	1,070	-	-	-	**1,070**
Other liabilities	7,414	4	-	-	**7,418**
Registered capital and reserves	176,044	-	-	-	**176,044**
Total liabilities and equity	**300,832**	**888**	**1,877**	**-**	**303,597**
Net foreign exchange position	**(10,721)**	**10,798**	**(77)**	**-**	**-**

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 effect	
	31 December 2018	**31 December 2017**
Loss	(17)	(8)

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.2. Interest rate risk

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

The majority of loans to legal entities and individuals are initially contracted at fixed interest rates. These financial instruments are classified as instruments with fixed interest rates, and other such instruments with variable interest rates. The Bank does not pay interest on deposits, except for part of the guarantee deposit of the Government of FBiH KM 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".

As at 31 December 2018	Non-interest bearing	Less than 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total	Fixed interest rate	Effective interest rate
Assets									
Cash and cash equivalents	107,731	-	-	-	-	-	**107,731**	-	
Obligatory reserve with the Central Bank	13,496	-	-	-	-	-	**13,496**	-	
Loans and receivables from clients	-	11,653	6,354	30,933	114,703	34,483	**198,126**	197,884	3.87%
Other assets	1,198	-	-	-	-	-	**1,198**	-	
Property, equipment and intangible assets	4,487	-	-	-	-	-	**4,487**	-	
Total assets	**126,912**	**11,653**	**6,354**	**30,933**	**114,703**	**34,483**	**325,038**	**197,884**	
Liabilities and equity									
Current accounts and deposits from customers	132,116	-	-	-	-	10,000	**142,116**	10,000	1.00%
Borrowings	585	-	213	214	854	-	**1,866**	1,281	2.00%
Provisions for liabilities and charges	3,115	-	-	-	-	-	**3,115**	-	
Other liabilities	9,029	-	-	-	-	-	**9,029**	-	
Registered capital and reserves	168,912	-	-	-	-	-	**168,912**	-	
Total liabilities and equity	**313,757**	**-**	**213**	**214**	**854**	**10,000**	**325,038**	**11,281**	
Interest rate risk	**-**	**11,653**	**6,141**	**30,719**	**113,849**	**24,483**	**-**	**186,603**	

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.2. Interest rate risk (continued)

Interest rate sensitivity of assets and liabilities (continued)

As at 31 December 2017	Non-interest bearing	Less than 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total	Fixed interest rate	Effective interest rate
Assets									
Cash and cash equivalents	89,797	-	-	-	-	-	**89,797**	-	
Obligatory reserve with the Central Bank	13,619	-	-	-	-	-	**13,619**	-	
Loans and receivables from clients	-	13,397	8,114	29,729	115,922	27,727	**194,889**	194,263	4.31%
Other assets	528	-	-	-	-	-	**528**	-	
Property, equipment and intangible assets	4,764	-	-	-	-	-	**4,764**	-	
Total assets	**108,708**	**13,397**	**8,114**	**29,729**	**115,922**	**27,727**	**303,597**	**194,263**	
Liabilities and equity									
Current accounts and deposits from customers	111,783	-	-	-	-	5,000	**116,783**	5,000	1.00%
Borrowings	651	-	204	204	1,223	-	**2,282**	1,631	2.00%
Provisions for liabilities and charges	1,070	-	-	-	-	-	**1,070**	-	
Other liabilities	7,418	-	-	-	-	-	**7,418**	-	
Registered capital and reserves	176,044	-	-	-	-	-	**176,044**	-	
Total liabilities and equity	**296,966**	**-**	**204**	**204**	**1,223**	**5,000**	**303,597**	**6,631**	
Interest rate risk	**-**	**13,397**	**7,910**	**29,525**	**114,699**	**22,727**	**-**	**187,632**	

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.4. The estimation of fair values of financial assets and liabilities

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

Cash and cash equivalents

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

Loans to clients

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, which reflect the development component of the Bank. Since the bank has no commercial orientation nor set goals that are a rarity for other market participants, it is not practicable to calculate the fair value of loans to customers, nor would the information have particular added value, taking into account the above stated specificities.

Deposits from clients

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.

25.5. Capital management

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

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

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

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.5. Capital management (continued)

The Bank as at 31 December 2018 was in line with all regulatory capital requirements and in accordance with local regulations achieved a capital adequacy ratio of 91.8% (31 December 2017: 98.7%).

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 2018 and 31 December 2017, 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:

	2018 KM '000	2017 KM '000
Tier 1 Capital		
Share capital	163,615	163,615
Reserves	1,587	1,458
Intangible assets	(168)	(140)
Uncovered loss – IFRS 9	(7,639)	-
Total Tier 1 Capital	**157,395**	**164,933**
Tier 2 Capital		
General reserves – Agency regulations	1,940	1,314
Audited profit for the year	-	-
Total Tier 2 Capital	**1,940**	**1,314**
Adjustment for missing regulatory reserves	(2,339)	3,925)
Net Capital	**156,996**	**162,322**
Risk weighted assets (unaudited) *	156,435	149,434
Other weighted assets (unaudited) *	14,494	14,986
Total weighted risk assets	**170,929**	**164,420**
Capital adequacy ratio (%)	**91.8%**	**98.7%**

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

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.5. Capital management (continued)

In accordance with the regulations of the Agency, the Decision on minimum standards for managing bank capital and capital protection adopted on 30 May 2014 ("Official Gazette of BiH" No. 46/14), audited profit for the period are included in the calculation of regulatory capital as of the day when the Audited financial statements are issued and approved by the shareholders of the Bank. In accordance with regulatory requirements in force at the date of the report of 31 December 2017, 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 2018 was not included in the calculation of capital adequacy as at 31 December 2018.

26. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved by the Management Board on 16 April 2019.

Signed on behalf of the Management Board:

Salko Selman
President of the Management Board

RAZVOJNA BANKA FEDERACIJE BOSNE I HERCEGOVINE
RB FBiH
Sarajevo