MF BANKA A.D. BANJA LUKA

Financial Statements
Year Ended December 31, 2016 and
Independent Auditors' Report

CONTENTS

Deloitte.

Deloitte d.o.o. Banja Luka
Braće Mažar i majke Marije 58 i 60
78000 Banja Luka
Republic of Srpska
Bosnia and Herzegovina

Tel: +387 (0)51 223 500
Fax: +387 (0)51 224 990
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Supervisory Board and Shareholders of MF banka a.d. Banja Luka

We have audited the accompanying financial statements (pages 2 to 47) of MF banka a.d. Banja Luka (hereinafter the "Bank"), which comprise the statement of financial position as of December 31, 2016 and the related statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of MF banka a.d. Banja Luka as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards.

Deloitte doo

Deloitte d.o.o.
Banja Luka

April 4, 2017

STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2016
(Thousands of BAM)

	Note	Year Ended December 31, 2016	Year Ended December 31, 2015
Interest income	5	23,345	19,357
Interest expenses	6	(7,297)	(7,624)
Net interest income		16,048	11,733
Fee and commission income	7	3,623	2,716
Fee and commission expenses	8	(653)	(671)
Net fee and commission income		2,970	2,045
Other operating income	9	613	514
Other operating expenses	10	(10,118)	(9,382)
Foreign exchange gains, net		19	44
Provisions for potential losses, net	11	(6,096)	(2,482)
Profit from operations before taxes		3,436	2,472
Income tax expenses	12	(475)	(246)
Net profit for the year		2,961	2,226
Other comprehensive income		-	-
Total comprehensive income for the year		2,961	2,226
Earnings per share			
- Basic earnings per share (in BAM)	24	7.25	7.12

Notes on the following pages form an integral part
of these financial statements.

These financial statements were adopted by the Bank's Management on March 6, 2017.

Signed on behalf of MF banka a.d. Banja Luka by:

Sandra Lonco

Managing Director

Enisa Bosnić

Head of Accounting and Reporting

STATEMENT OF FINANCIAL POSITION
As of December 31, 2016
(Thousands of BAM)

	Note	December 31, 2016	December 31, 2015
ASSETS			
Cash and cash funds held with the Central Bank	13	48,951	56,684
Loans and receivables due from banks	14	2,457	1,453
Loans and receivables due from customers	15	211,643	180,367
Property and equipment	16	6,114	1,564
Intangible assets	16	164	210
Interest accrued and other assets	17	2,280	1,590
Total assets		271,609	241,868
LIABILITIES AND EQUITY			
Deposits due to banks	18	-	1
Deposits due to customers	19	198,407	162,729
Borrowings	20	18,189	30,684
Subordinated debt	21	6,845	3,912
Other liabilities	22	6,619	5,975
Provisions for employee benefits and other contingent liabilities	11b)	144	123
Total liabilities		230,204	203,424
Equity			
Issued capital	23	40,841	40,841
Equity reserves	23	-	795
Retained earnings/(accumulated losses)	23	564	(3,192)
Total equity		41,405	38,444
Total liabilities and equity		271,609	241,868
Contingent liabilities and commitments	25	20,479	14,098

Notes on the following pages form an integral part
of these financial statements.

STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2016
(Thousands of BAM)

	Issued Capital	Equity Reserves	Accumulated Losses / Retained Earnings	Total
Balance, January 1, 2015	28,000	795	(5,418)	23,377
Profit for the year	-	-	2,226	2,226
Capital increase – new share issue	12,841	-	-	12.841
Balance, December 31, 2015	40,841	795	(3,192)	38,444
Loss absorption against reserves	-	(795)	795	-
Profit for the year	-	-	2,961	-
Balance, December 31, 2016	40,841	-	564	41,405

Notes on the following pages form an integral part
of these financial statements.

STATEMENT OF CASH FLOWS
Year Ended December 31, 2016
(Thousands of BAM)

	Year Ended December 31, 2016	Year Ended December 31, 2015
Cash flows from operating activities		
Interest receipts	23,350	19,427
Interest paid	(6,923)	(6,631)
Fee and commission receipts	2,883	2,385
Fee and commission paid	(258)	(156)
Payments to employees and suppliers	(9,056)	(6,737)
Net cash generated by operating activities before changes in operating assets and liabilities	9,996	8,288
Changes in operating assets and liabilities		
Net increase in loans and receivables due from customers	(37,282)	(34,403)
Net decrease in deposits due to banks	(1)	-
Income taxes paid	(423)	(73)
Net increase in deposits due to customers	35,641	35,059
Net cash generated by operating activities	7,931	8,871
Cash flows from investing activities		
Purchase of intangible assets	(57)	(63)
Purchase of property and equipment	(5,043)	(278)
Net cash used in investing activities	(5,100)	(341)
Cash flows from financing activities		
Capital increase	-	12,841
Inflows from borrowings	9,508	9,939
Repayment of borrowings	(19,070)	(20,560)
Net cash (used in)/generated by financing activities	(9,562)	2,220
Net (decrease)/increase in cash and cash equivalents	(6,731)	10,750
Effects of the changes in foreign exchange rates	2	44
Cash and cash equivalents, beginning of year	58,137	47,343
Cash and cash equivalents, end of year	51,408	58,137
Cash and cash equivalents comprise the following line items:		
- Cash and cash funds held with the Central Bank	48,951	56,684
- Loans and receivables due from banks	2,457	1,453
	51,408	58,137

Notes on the following pages form an integral part
of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2016
(All amounts expressed in thousands of BAM, unless otherwise stated)

1. BANK'S FOUNDATION AND BUSINESS POLICY

MF banka a.d. Banja Luka ((hereinafter the "Bank") was established on June 12, 2007 and named IEFK banka a.d. Banja Luka.

In the process of the Bank's registration, all requirements defined by the regulatory authorities with respect to the principal banking activities were fulfilled. In accordance with its Decision numbered 03-231-11/2007 of May 11, 2007, the Republic of Srpska Banking Agency (the "BARS" or "Agency") issued an operating license to the Bank, and pursuant to Decision numbered 03-657-4/2007 of July 12, 2007, the Agency issued to the Bank a license to conduct international payment transactions.

At the Shareholder Assembly meeting held on April 6, 2010, the previous owners of the Bank enacted a Decision to sell 100% of the Bank's equity (Note 23), whereafter an Agreement on the Purchase and Sale of Capital was signed on July 8, 2010 based on which the Bank's major shareholder became MKD Mikrofin d.o.o., Banja Luka, and as of that date this entity also assumed the management and control over the Bank.

Based on the decision enacted by the new owner of the Bank and the decision of the competent court in Banja Luka as of November 26, 2010, the Bank changed its name into MF banka a.d., Banja Luka.

In the Republic of Srpska, the Bank is licensed to perform banking activities that include payment transfers, crediting and depositary operations in the country and abroad, and as in accordance with the Republic of Srpska banking legislation, the Bank is obligated to operate on the principles of liquidity, solvency and profitability.

The Bank is headquartered in Banja Luka, at no. 22 Vase Pelagića Street. At December 31, 2016 the Bank had the central office Centar u Banja Luka and branch offices in Laktaši, Gradiška, Derventa, Brčko, Bijeljina, Doboj, Prijedor, East Sarajevo, Zvornik, Novi Grad, Teslić, Prnjavor, Pale, Tuzla, Bihać, Cazin, Gradačac and Živinice.

At December 31, 2016 the Bank had 195 employees (December 31, 2015: 182 employees).

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

2.1. Statement of Compliance

The accompanying financial statements represent annual financial statements of MF banka a.d. Banja Luka, prepared in accordance with the International Financial Reporting Standards (IFRS).

2.2. Application and Impact of the New and Revised IFRS

Initial Adoption of the New and Amendments to the Existing Standards Effective over the Current Period

The following new standards, amendments to the existing standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) have become effective over the current period:

- IFRS 14 "Regulatory Deferral Accounts" (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IAS 1 "Presentation of Financial Statements" – Disclosure Initiative (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IFRS 11 "Joint Arrangements" – Accounting for Acquisitions of Interests in Joint Operations (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosure of Interests in Other Entities" and IAS 28 "Investments in Associates and Joint Ventures" – Investment Entities: Applying the Consolidation Exception (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets" – Clarification of Acceptable Methods of Depreciation and Amortization (effective for annual periods beginning on or after January 1, 2016),
- Amendments to IAS 16 "Property, Plant and Equipment" and IAS 41 "Agriculture" – Agriculture: Bearer Plants (effective for annual periods beginning on or after January 1, 2016);

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2016
(All amounts expressed in thousands of BAM, unless otherwise stated)

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

2.2. Application and Impact of the New and Revised IFRS (Continued)

Initial Adoption of the New and Amendments to the Existing Standards Effective over the Current Period (Continued)

- Amendments to IAS 27 "Separate Financial Statements" – Equity Method in Separate Financial Statements (effective for annual periods beginning on or after January 1, 2016); and
- Amendments to various standards "Improvements to IFRSs (cycle 2012-2014)" resulting from the annual improvement project of IFRS (IFRS 5, IFRS 7, IAS 19 and IAS 34) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after January 1, 2016).

Adoption of these amendments to the existing standards has not led to any material changes in the Bank's accounting policies and financial statements.

New Standards and Amendments to the Existing Standards in Issue, not yet Adopted

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

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after January 1, 2018);
- IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after January 1, 2018);
- IFRS 16 "Leases" (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IFRS 2 "Share-Based Payment" – Classification and Measurement of Share-Based Payment Transactions (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 4 "Insurance contracts" – Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2018 where IFRS 9 "Financial Instruments" is applied for the first time);
- 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 was deferred indefinitely until the research project on the equity method has been concluded);
- Amendments to IAS 7 "Statement of Cash Flows" – Disclosure Initiative (effective for annual periods beginning on or after January 1, 2017);
- Amendments to IAS 12 "Income Taxes" – Recognition of Deferred Tax Assets for Unrealized Losses (effective for annual periods beginning on or after 1 July 2017).
- Amendments to IAS 40 "Investment Property" – Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018);
- Amendments to various standards "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 12 are to be applied for annual periods beginning on or after January 1, 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after January 1, 2018); and
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after January 1, 2018).

IFRS 9 "Financial Instruments"

IFRS 9 issued in November 2009 introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include:

a) impairment requirements for financial assets and
b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments.

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

2.2. Application and Impact of the New and Revised IFRS (Continued)

New Standards and Amendments to the Existing Standards in Issue, not yet Adopted (Continued)

The key requirements of IFRS 9 are:

- All recognized financial assets that are within the scope of IAS 39 "Financial Instruments: Recognition and Measurement" are required to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. Debt instruments that are held within a business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are generally measured at fair value through other comprehensive income. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election upon initial recognition to measure an equity investment (that is not held for trading) at fair value through other comprehensive income, with only dividend income generally recognized in profit or loss.

- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.

- In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model, as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognized.

- The new general hedge accounting requirements retain the three types of hedge accounting mechanisms currently available in IAS 39. Under IFRS 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required.

In 2016 the Bank initiated the project of IFRS 9 introduction. It is expected that in the upcoming period the project will entail the following:

- o a series of training sessions to introduce IFRS 9 and its requirements to the Bank's employees;
- o gap analysis of the current status and IFRS 9 requirements in the area of classification and measurement:
  - ▪ definition of business models, and
  - ▪ definition of characteristics of the contracted cash flows;
- o gap analysis of the current status and IFRS 9 requirements in the area of impairment;
- o analysis of the quantitative impact of IFRS 9 implementation on the financial statements;
- o preparation of functional specifications for an appropriate application solution, i.e., introduction of adequate software;
- o development of the impairment methodology according to the Bank's business models – development of the model for determining parameters for calculation of the expected credit losses under IFRS 9.

The quantitative effects of transition to IFRS 9 will be determined in 2017. Impact on impairment will depend on the defined methodology for calculation of the expected credit loss and application of different parameters based on the expected credit losses.

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

2.2. Application and Impact of the New and Revised IFRS (Continued)

New Standards and Amendments to the Existing Standards in Issue, not yet Adopted (Continued)

Management of the Bank is currently considering the impact of the above listed standards and interpretations on the Bank's financial statements.

2.3. Basis of Preparation and Presentation of the Financial Statements

The financial statements of the Bank have been prepared at cost (historical cost) principle except for certain financial instruments measured at fair value at the end of each reporting period, as explained in the accounting policies provided in the following passages.

Historical cost is generally based on the fair value of consideration paid in exchange for goods and services. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between the market participants at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. Upon estimating the fair value of assets or liabilities, the Bank takes into account characteristics of assets or liabilities that other market participants would also consider upon determining the price of assets or liabilities at the measurement date.

In preparing the statement of cash flows for the year ended December 31, 2016, the Bank used direct cash flow reporting method.

In the preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 3 to the financial statements.

2.4. Functional and Presentation Currency

Financial statements are stated in convertible marks ("BAM"), BAM being the Bank's functional currency. The amounts are rounded to the nearest thousand (if not otherwise stated).

The Central Bank of Bosnia and Herzegovina (the "Central Bank") implements the policy on FX rate in line with the principle of the Currency Board, according to which BAM is fix pegged to EUR at the rate of BAM 1 = EUR 0.51129, which was used for 2016 and 2015.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest Income and Expenses

Interest income and expenses are recognized in the statement of comprehensive income as they accrue for all interest-bearing instruments using the effective interest method, i.e. at the rate that discounts the estimated cash flows to their net present value over the respective contract term.

The effective interest rate is the rate that precisely discounts the estimated future cash disbursements or payments over the expected life of a financial instrument or, as appropriate, a shorter period, to the net carrying value of the financial asset or liability. When calculating the effective interest rate, the Bank estimates cash flows, taking into consideration all contractual terms related to the financial instrument, but not considering future credit losses.

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

Interest income is recognized exclusively for performing loans and other investments where there are no problems in collection, i.e., for loans and investments that do not represent bad (impaired) assets. Calculations of interest receivables from non-performing loans and other investments, i.e. loans and investments that represent bad (impaired) assets as there are problems in collection thereof, are recorded within off-balance sheet items and recognized as income only if collected.

(All amounts expressed in thousands of BAM, unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.2. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into BAM at the official exchange rates prevailing at the date of each transaction. Assets and liabilities denominated in foreign currencies are translated into BAM at the statement of financial position date by applying the official rates of exchange in effect on that date. Contingent liabilities denominated in foreign currencies are translated into BAM at the official exchange rates prevailing at the statement of financial position date. Foreign exchange gains or losses arising upon translation are credited or charged to the statement of comprehensive income.

3.3. Property, Equipment and Intangible Assets

Items of equipment and intangible assets are recorded at cost net of any accumulated depreciation and amortization, and any accumulated impairment losses. Cost represents the prices billed by suppliers, increased by all acquisition-related costs and all costs incurred in bringing the assets to the location and condition necessary for their intended use.

Depreciation and amortization are calculated on a straight-line basis at the following prescribed annual rates in order to write off the assets over their estimated useful lives (there were no changes to depreciation/amortization rates compared to the previous year):

	Depreciation / Amortization Rate	Useful Life (Years)
Computer equipment	25%	4
Automobiles	15.5%	6.5
Telephone switchboards	7% - 10%	10 – 14.3
Furniture	10% - 12.5%	8 - 10
Building properties	1.3%	77
Intangible assets	20%	5

The Bank's management believes that the amortization and depreciation rates applied realistically reflect the expected patterns of future consumption of economic benefits from equipment and intangible assets.

The depreciation and amortization of assets commence when the assets are available for use and placed at the location and in condition to operate in the manner intended by the Bank's management.

If the useful life of an item of equipment is under a year, the item is treated as tools or fixtures and is fully written-off once placed into use.

3.4. Impairment of Assets

At each statement of financial position date, the Bank's management reviews the carrying amounts of the Bank's tangibles in order to determine the indications of impairment loss. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. In cases where it is impossible to assess the recoverable amount of an individual asset, the Bank assesses the recoverable value of the cash generating unit to which the asset belongs.

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. For the purpose of assessing value in use, estimated future cash flows are discounted to the present value by applying the discount rate prior to taxation reflecting the present market estimate of time value of cash and risks specifically related to the asset in question.

If the estimated recoverable amount of an asset (or cash generating unit) is below its carrying value, the carrying amount of the asset (or cash generating unit) is reduced to its recoverable amount. An impairment loss is immediately recognized as an expense of the current period.

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Impairment of Assets (Continued)

As of December 31, 2016, in the assessment of the Bank's management, there were no indications that the value of equipment and intangible assets had suffered impairment.

3.5. Financial Assets

All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis, i.e. requiring delivery of assets within the time frame established by regulation or convention in the marketplace, and are initially measured at fair value including transaction costs. Financial assets are classified into the following specified categories: loans and receivables and financial assets available for sale. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective Interest Method

The effective interest method is a method of calculating the amortized cost of financial assets and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognized on an effective interest basis for debt instruments other than those financial assets classified as at fair value through profit and loss.

Financial Assets Available for Sale

Available-for-sale financial assets comprise investments in equity instruments of enterprises and other legal entities that are listed in an active market stated at fair value at the end of each reporting period. Investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost. Gains and losses arising from the changes in the fair value directly affect the equity, i.e. the investment revaluation reserves, except for impairment losses, interest calculated using the effective rate method and foreign exchange gains or losses on monetary assets, which are recognized in profit and loss. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

The fair value of available-for-sale monetary financial assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate prevailing at the statement of financial position date. The foreign exchange gains and losses that are recognized in profit or loss and other comprehensive income are determined based on the amortized cost of the monetary asset. Other foreign exchange gains and losses are recognized within equity.

Loans and Receivables

Loans and other receivables with fixed or determinable payments that are not quoted in an active market can be classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate.

For the purpose of determining amortized cost, i.e. fair value of loans in accordance with IAS/IFRS, the Bank uses contractually agreed effective interest rate that adjusts the net present value of future cash flows to the nominal value of the loan approved, net of principal repaid.

Loans are contractually agreed with a variable interest rate according to the Bank's business policy. The Bank receives as collaterals payment orders, guarantees, bills of exchange, mortgages assigned over property and pledge liens over movables, deposits and the like.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, monetary assets held with the Central Bank and balances on foreign currency accounts held with domestic and foreign banks and other deposits maturing within less than three months from the placement date.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Assets (Continued)

Impairment of Financial Assets

Financial assets, other than those at fair value through profit and loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For equity investments not quoted in an active market and classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, including redeemable securities classified as assets available for sale, and finance lease receivables, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as a default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables from loans approved, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Bank's past experience of collecting payments, an increase in the number of delayed payments past the maturity dates, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in statement of profit and loss.

Except for securities available for sale, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through statement of profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, impairment losses previously recognized in statement of profit or loss are not reversed through statement of profit or loss. Any increase in fair value subsequent to an impairment loss is recognized within equity.

Derecognition of Financial Assets

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and retains control over a financial asset, it continues recognize such an asset.

3.6. Financial Liabilities

Financial liabilities comprise long-term and short-term trade payables and other liabilities.

Financial liabilities are initially recognized at the amounts received. Subsequent to the initial recognition, financial liabilities are measured at the initially recognized amounts net of principal repayment and increased by capitalized interest less any write-off granted by the creditor. Financial liabilities are stated at amortized cost using the effective interest rate. Interest accrued on financial liabilities is charged to finance of the respective period and presented within other current liabilities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial Liabilities (Continued)

The Bank derecognizes financial liabilities when the Bank's obligations are discharged, cancelled or they have expired.

3.7. Taxes and Contributions

Current Income Tax

Current income tax relates to the amount payable in accordance with the Income Tax Law. Current income tax is payable at the rate of 10% applied to the tax base determined in the taxa balance and reported in the annual corporate income tax return, being the amount of profit before taxation net of income and expense adjustment effects pursuant to the tax regulations of the Republic of Srpska.

The tax regulations in the Republic of Srpska allow for the reduction of the tax base for the amounts used in capital expenditures, for restoration of own manufacturing activity and for the amounts of the payroll taxes and contributions for over 30 newly employed staff members at the end of the financial year.

The tax regulations in the Republic of Srpska do not envisage that any tax losses of the current period be used to recover taxes paid within a specific carryback period. However, current period tax losses stated in tax return may be used to reduce or eliminate taxes to be paid in future periods but only for duration of no longer than five ensuing years.

Deferred Income Taxes

Deferred income tax is determined using the balance sheet liability method, for temporary differences arising between the tax bases of assets and liabilities components, and their carrying values in the consolidated financial statements. The currently enacted tax rates at the statement of financial position date are used to determine the deferred income tax amount. Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for deductible temporary differences, and the tax effects of income tax losses and credits available for carry forward, to the extent that it is probable that future taxable profit will be available against which deferred tax assets may be utilized.

Indirect Taxes and Contributions

Indirect taxes and contributions include payroll contributions charged to the employer, property taxes, and various other taxes and contributions, included in other operating expenses.

3.8. Employee Benefits

In accordance with regulatory requirements, the Bank is obligated to pay contributions to government social security funds and pension funds that are calculated by applying specific, legally prescribed percentages. These obligations involve the payment of taxes and contributions on behalf of employees, by the employer, in an amount calculated in accordance with the statutory regulations. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to the applicable government funds. These taxes and contributions payable on behalf of the employees and employer are charged as expenses in the period in which they arise.

In accordance with the requirements of IAS 19 “Employee Benefits,” the Bank performs the actuarial valuation of provisions so as to determine the present value of accumulated employee retirement benefits. Upon retirement, the Bank’s employees become entitled to retirement benefits in an amount equal to three monthly salaries earned by the vesting employee.

Expenses of retirement benefits are determined using the projected unit credit method for actuarial valuation as of the reporting date.

3.9. Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Leases (Continued)

The Bank as a Lessor

Lease income from operating leases (rentals) is recognized in income on a straight-line basis over the lease term. Initial direct costs incurred by lessors in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as the lease income.

The Bank as a Lessee

Lease payments under an operating lease are recognized as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit. Contingent fees arising from operating leases are recognized as expenses in the periods in which they arise.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES

The presentation of the financial statements requires the Bank's management to make best estimates and reasonable assumptions that influence the assets and liabilities amounts, as well as the disclosure of contingent liabilities and receivables as of the date of preparation of the financial statements, and the income and expenses arising during the accounting period. These estimations and assumptions are based on information available to the management, as of the date of preparation of the financial statements. However, actual future amounts may depart from the estimates.

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

Basic assumptions relating to the future events and other significant sources of uncertainties in rendering an estimate as of the statement of financial position date, which bears the risk that may lead to significant restatement of the net book value of assets and liabilities in the ensuing financial year, were as follows:

Estimated Useful Life of Equipment and Intangible Assets

The estimate of useful life of equipment and intangible assets is founded on the historical experience with similar assets, as well as foreseen technical advancement and changes in economic and industrial factors. The adequacy of the estimated remaining useful life of fixed assets is analyzed annually, or in cases where there are indications of significant changes in certain assumptions.

Impairment of Assets

At each statement of financial position date, the Bank's management reviews the carrying amounts of the Bank's assets for the indications of impairment loss. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount.

Allowance for Impairment of Receivables

At each reporting date the bank assesses whether there is objective evidence that individual financial assets or groups of financial assets have suffered impairment. The Bank calculates the impairment of its receivables in accordance with IAS 39 "Financial Instruments: Recognition and Measurement" and IAS 37 "Provisions, Contingent Assets and Contingent Liabilities" as well as the regulations of the Banking Agency of the Republic of Srpska.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (Continued)

Allowance for Impairment of Receivables (Continued)

The management assesses that allowance for impairment of receivables in addition to the amount already recognized in the financial statements is not necessary.

At each month end, the Bank calculates impairment losses contingent on defaults and irrecoverability and provisions thereof by applying the following two methodologies:

1) methodology for calculation of the aforesaid provisions based on IAS 39 “Financial Instruments: Recognition and Measurement,” used for internal and external reporting purposes of the Bank, and
2) methodology for calculation of the aforesaid provisions prescribed by the BARS and used exclusively for reporting to the regulator (BARS).

According to IAS 39 “Financial Instruments: Recognition and Measurement,” the Bank reviews the loan portfolio in order to determine allowance for impairment and provisions on a monthly basis. When assessing whether impairment losses are to be recognized within statement of profit or loss, the Bank assesses whether there is information/evidence indicative of measurable decrease in the estimated future cash flows on a portfolio basis before such losses are identifiable on an individual basis.

Information that may indicate the losses on loans include customer creditworthiness, irregularity and defaults in settling liabilities, market and economic conditions on a local level conditioning defaults in settling liabilities and the like. Management’s assessments regarding the impairment in financial instruments within the loan portfolio included in the Bank’s portfolio by way of assessing future cash flows are based on actual historical losses incurred on financial assets with similar causes of impairment.

The Bank calculates impairment for all customers that are over 90 days in default with payments. The Bank recognizes impairment losses up to the amount of recoverable value of loans/investments measured at amortized cost.

Impairment loss is the difference between its present value (amortized cost) and its recoverable value. The recoverable value is the present value of expected cash inflows from assets, increased by the expected future inflows from collaterals, net of present value of collection charges.

Impairment losses are charged to the statement of profit and loss. The amounts of impairment losses on loans/ investments are reflected on the allowance account.

Where an impairment loss subsequently reverses due to events that emerged after its initial recognition, the reversal is credited to statement of profit and loss, but the amount of reversal may not exceed the amount of amortized cost that would have been determined and recognized as at the impairment reversal date had no impairment loss been previously recognized.

The Bank first assesses whether there is objective evidence of individual-level impairment for an individually significant asset or of group-level impairment for financial assets that are not individually significant. If the Bank determines that there is no objective evidence of individual-level impairment of a financial asset, whether it be significant or not, such an asset is included into a group of assets with similar credit risk characteristics and assessed for impairment collectively, i.e. on a group (portfolio) level.

According to the Bank’s internal methodology for impairment allowance calculation, individually significant exposure is considered to be each exposure in excess of BAM 50 thousand. Other exposures, i.e. other Bank’s receivables are subject to individual assessment for impairment due to the specificity of each individual receivable. The procedure of impairment assessment is performed for all receivables defined as materially significant by the internally adopted methodology. Materially significant amounts are amounts above:

- 2.5% of the individual Bank’s receivable due from a private individual debtor, but not below BAM 50, and
- 2.5% of the individual Bank’s receivable due from a legal entity debtor, but not below BAM 500.

The Bank assesses whether a loan is individually significant for individually significant exposures (in excess of BAM 50 thousand) in default, i.e. those that are over 90 days past due. Based on the defined criteria the Risk Management Department finds loans eligible for individual assessment. After the review of such loans, the Risk Management Department proposes loans eligible for calculation of individual-level impairment allowance, and the remaining loans are referred to the portfolio-level assessment of impairment and calculation of impairment allowance.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (Continued)

Allowance for Impairment of Receivables (Continued)

The proposals made by the Risk Management Department are verified by the bank's Managing Board.

Individual impairment allowance is calculated as the difference between the total exposure and the sum of discounted cash flows (from regular repayment and collateral foreclosure) for the specific borrower/exposure.

All loans and receivables that are not individually impaired are subject to group or portfolio-level assessment and calculation of impairment. Loans/borrowers are classified into homogenous groups with identical or similar characteristics and subgroups depending on the number of days the repayment is in arrears and segment they belong to (and within MSME segment – depending on the product).

For all exposures included in the portfolio-level calculation of impairment allowance the exposure is divided into the secured and unsecured portion. The unsecured portion of loans is calculated as the difference between the total exposure and the recognized value of collateral. The Bank's internal methodology defines the weights for recognized value of collaterals, depending on the collateral type.

Portfolio-level impairment allowance is calculated as follows: an impairment allowance percentage defined for the specific group/subgroup of loans (obtained based on the data on the past 3 years' migration among groups) is applied to the unsecured portion of the exposure.

Fair Value

It is the policy of the Bank to disclose the fair values of those asset and liability components for which published market information is readily available, and for which their fair value is materially different from the recorded amounts. In the Republic of Srpska, there is insufficient market experience, stability and liquidity for the purchase and sale of financial assets or liabilities for which quoted prices on an active market are not presently, readily available. Hence, fair value cannot be reliably determined. The Bank's management assesses its overall risk exposure, and in instances in which it estimates that the value of assets stated in its books may not have been realized, it recognizes a provision. As per the Bank's management, amounts expressed in the financial statements reflect the fair value which is most reliable and useful for the needs of the financial reporting under the current circumstances.

Employee Benefits

The Bank engaged an independent certified actuary to calculate the present value of accumulated employee entitlements to retirement benefits as of December 31, 2016 on behalf of the Bank. In the calculation of the present value of accumulated employee entitlements to retirement benefits, the certified actuary used the following assumptions: the projected salary growth rate of 4.5% annually, years of service necessary for retirement – 40 years for men and 35 years for women, projected employee turnover based on data on historical employee turnover in the prior period, officially published mortality rates in the region in the prior period, as well as other terms necessary to exercise rights to a retirement benefit. In As per the Bank's management, amounts expressed in the financial statements reflect the fair value which is most reliable and useful for the needs of the financial reporting under the current circumstances.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2016
(All amounts expressed in thousands of BAM, unless otherwise stated)

5. INTEREST INCOME

	Year Ended December 31, 2016	2015
Interest income from:		
- retail customers	13,166	11,501
- corporate customers	10,095	7,721
- non-profit organizations	21	24
- public sector	1	47
- other	62	64
Total:	23,345	19,357

6. INTEREST EXPENSES

	Year Ended December 31, 2016	2015
Interest expenses:		
- retail customers	4,768	3,510
- interest on borrowings from banking institutions	1,000	1,816
- non-banking finance institutions	971	1,434
- public sector	203	235
- non-profit organizations	121	152
- corporate customers	110	120
- interest on subordinated debt	86	278
- banks	-	49
- other	38	30
Total:	7,297	7,624

7. FEE AND COMMISSION INCOME

	Year Ended December 31, 2016	2015
Fee and commission income arising from domestic payment transactions	1,961	1,538
Sale and purchase of currencies	737	544
Other loan fees (early repayment, reminders)	623	440
Fees for off-balance sheet operations	302	194
Total:	3,623	2,716

8. FEE AND COMMISSION EXPENSES

	Year Ended December 31, 2016	2015
Payment/credit card operation fees	208	253
Fee and commission payable to the Central Bank for domestic payment transfers	168	115
Sale and purchase of currencies	101	89
Loan processing fees	93	140
Fee and commission expense arising from international payment transactions	24	20
Other fees and commissions	59	54
Total:	653	671

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9. OTHER OPERATING INCOME

	Year Ended December 31, 2016	2015
Collection of suspended interest written off	371	383
Other income	242	131
Total:	613	514

10. OTHER OPERATING EXPENSES

	Year Ended December 31, 2016	2015
Gross salaries and benefits	5,213	5,018
Remunerations to the Supervisory Board, Audit Committee	91	93
Professional trainings and education of employees	41	26
Rental costs	740	841
Depreciation and amortization charge	580	533
Telecommunication and postage services	485	468
Security services	412	418
Equipment/software maintenance	394	332
Cost of materials and services	324	289
Insurance premium payable to the Deposit Insurance Agency	312	229
Fees payable to the Banking Agency of RS	217	179
Taxes and contributions payable	165	167
Marketing and advertising	145	206
Business travel expenses incurred in the country and abroad	95	26
Membership fees	89	57
Entertainment	79	65
Losses on disposal and retirement of equipment and other similar costs	29	26
Fees for third party engagements	11	7
Other	696	402
Total:	10,118	9,382

11. PROVISIONS FOR POTENTIAL LOSSES

a) Provisions Included in Expenses, Net

	Year Ended December 31, 2016	2015
Provisions for:		
Assets held with other banks	-	6
Loans and receivables due from customers	(5,960)	(2,518)
Interest receivables accrued and other assets	(115)	(94)
Employee benefits	1	75
Contingent liabilities and commitments	(22)	49
Total:	(6,096)	(2,482)

NOTES TO THE FINANCIAL STATEMENTS
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11. PROVISIONS FOR POTENTIAL LOSSES (continue)

b) Movements for the Year on the Long-Term Provisions for Potential Losses and Commitments

						2016 and 2015
	Assets Held with Other Banks	Loans and Receivables due from Customers	Other Assets	Employee Benefits	Contingent Liabilities and Commitments	Total
Balance, January 1, 2015	6	4,766	112	102	145	5,131
Purchase of portfolio	-	101	-	-	-	101
Charge for the year	-	7,098	210	7	373	7,688
Reversal of provisions	(6)	(4,580)	(116)	(82)	(422)	(5,206)
Balance, December 31, 2015	-	7,385	206	27	96	7,714
Charge for the year	-	18,891	161	-	568	19,620
Reversal of provisions	-	(12,931)	(46)	(1)	(546)	(13,524)
Balance, December 31, 2016	-	13,345	321	26	118	13,810

12. INCOME TAXES

The income tax expense can be reconciled with the profit stated in the statement of profit and loss as follows:

	Year Ended December 31, 2016	2015
Profit before taxes	3,436	2,472
Income tax at the statutory rate of 10%	344	247
Tax reduction for tax exempt income	(624)	(1)
Expenses not recognized for tax purposes – impairment of loans and other assets	745	164
Other expenses not recognized for tax purposes	10	22
Prior years' tax losses carried forward	-	(186)
Total income taxes payable	475	246
Effective tax rate	13.81%	9.95%

Tax liabilities are included in the Bank's income tax returns and accepted as such, but they can be subject to tax authorities' inspections within five years from their acceptance. The Bank's management is not familiar with any circumstances that could lead to any material liability in this respect or challenging the prepared income tax returns.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2016
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13. CASH AND CASH FUNDS HELD WITH THE CENTRAL BANK

	December 31, 2016	December 31, 2015
Cash on hand:		
- in BAM	2,530	2,082
- in foreign currencies	2,225	3,553
Balances with the Central Bank in BAM:		
- Obligatory reserve	22,262	13,370
- Gyro account	21,934	37,679
Total:	48,951	56,684

Pursuant to the Decision of the Central Bank of Bosnia and Herzegovina regarding reserve requirements, the Bank has to calculate and maintain an obligatory reserve of the average balance of the Bank's total deposits (which serve as a basis for computing the obligatory reserve) according to the average balance found at the end of work days of ten calendar days preceding the projection. The obligatory reserve is calculated as the sum of 10% of the total deposits maturing within a year and total deposits with over one year maturities. The basis for computing the obligatory reserve includes calculated interest, fees and commissions due and matured.

A new Decision of the Central Bank of Bosnia and Herzegovina came in effect on July 1, 2016, which stipulates the obligation of the Central Bank to pay interest on the amounts in excess of the obligatory reserve at the rate of 0.02% p.a. to commercial banks.

14. LOANS AND RECEIVABLES DUE FROM BANKS

	Interest Rates	December 31, 2016	December 31, 2015
Loans and receivables due from banks:			
- foreign banks	0.0%-0.01%	1,523	938
- domestic banks		934	515
Total:		2,457	1,453

15. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

	December 31, 2016	December 31, 2015
Short-term loans	42,285	34,267
Long-term loans	122,176	103,561
Guarantees paid out in foreign currencies	62	54
Foreign currency long-term loans	-	981
Current portion of long-term loans	60,465	48,889
	224,988	187,752
Less: Impairment allowance of loans and receivables due from customers	(13,345)	(7,385)
Total:	211,643	180,367

In 2016 the major portion of short-term loans in BAM was placed with domestic corporate and retail customers at annual interest rates ranging from 2.0% to 15.5%. The annual interest rate of 2.0% was approved to the customers with a 100% earmarked term deposit placed with the Bank as collateral, while the minimum annual interest rate approved to retail customers equaled 5.5% for short-term loans. Short-term loans were securitized with bills of exchange, sureties and pledge liens assigned over movables and mortgages assigned over property.

NOTES TO THE FINANCIAL STATEMENTS
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15. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (continue)

The largest portion of short-term loans extended to retail customers relate to transaction account overdrafts and consumer loans, while the largest portion of the loans approved to corporate customers represent loans for working capital and liquidity maintenance.

Most long-term loans in BAM were extended to corporate and retail customers at annual interest rates ranging from 2.0% to 15.5% plus 6-month EURIBOR, for periods of 5 years (in most cases) up to the maximum of 10 years (in rare cases). The minimum interest rates of 2.0% and 2.5% were approved to the corporate and retail customers, respectively, with a 100% earmarked term deposit placed with the Bank as collateral. The aforesaid loans were securitized mostly with high quality collaterals such as mortgages and pledge liens assigned over movables. In 2016 the Bank approved loans from the funds of the Investment and Development Bank of the Republic of Srpska ("IDB RS") for periods of over 10 and up to 20 years in accordance with the rules of IDB RS.

The largest portion of long-term loans approved to retail customers included general consumer loans, housing loans for purchase and construction and adaptation of homes, while the corporate long-term loans were intended for financing capital expenditures, investments and working capital.

The geographic concentration of loans approved to customers as included in the Bank's loan portfolio mostly comprises customers domiciled in the City of Banja Luka (about 15.2% of the total portfolio), East Sarajevo region (about 8.4% of the total portfolio), Derventa region (6.9%), Prijedor region (about 5.9%), Brčko District (about 5.6%) and Bjeljina region (about 5.2%).

16. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

	Leasehold Improvements	Buildings	Equipment	Equipment in Progress	Total Equipment	Intangible Assets
Cost						
Balance, January 1, 2015	278		2,438	1	2,717	930
Additions	28		248	1	277	64
Retirement and disposals			(10)		(10)	-
Balance, December 31, 2015	**306**		**2,676**	**2**	**2,984**	**994**
Additions	8	4,834	202	(1)	5,043	57
Reclassification			6		6	(6)
Retirement and disposals			(114)		(114)	(34)
Balance, December 31, 2016	**314**	**4,834**	**2,770**	**1**	**7,919**	**1,011**
Accumulated Depreciation/Amortization						
Balance, January 1, 2015	58		927	-	985	694
Charge for the year	59		384	-	443	90
Retirement and disposals			(8)	-	(8)	
Balance, December 31, 2015	**117**		**1,303**	**-**	**1,420**	**784**
Charge for the year	60	36	386	-	482	98
Retirement and disposals	-		(97)	-	(97)	(35)
Balance, December 31, 2016	**177**	**36**	**1,592**	**-**	**1,805**	**847**
Net Book Value:						
- at December 31, 2015	**189**		**1,373**	**2**	**1,564**	**210**
- at December 31, 2016	**137**	**4,798**	**1,178**	**1**	**6,114**	**164**

As of December 31, 2016, the Bank's property and equipment were insured against general risks. The Bank had no encumbrances or pledges assigned over its property and equipment.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2016
(All amounts expressed in thousands of BAM, unless otherwise stated)

17. ACCRUED INTEREST AND OTHER ASSETS

	December 31, 2016	December 31, 2015
In BAM:		
- accrued interest receivables	1,054	888
- inventories of materials	548	143
- other receivables	403	325
- receivables from the Solidarity Fund of the Republic of Srpska	246	91
- other prepaid expenses	130	139
- fee and commission receivables	80	43
- advances paid	6	9
- other assets	-	1
In foreign currencies:		
- accrued receivables for calculated expenses	104	127
- accrued interest receivables	-	1
- foreign currency advances paid	11	11
- other foreign currency receivables	19	18
	2,601	1,796
Less: Impairment allowance of accrued interest and other assets	(321)	(206)
Total:	2,280	1,590

18. DEPOSITS DUE TO BANKS

	December 31, 2016	December 31, 2015
Foreign currency deposits placed by banks for up to 12 months	-	1
Total:	-	1

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2016
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19. DEPOSITS DUE TO CUSTOMERS

	December 31, 2016	December 31, 2015
Demand deposits in BAM:		
- Government and state institutions	95	1,424
- corporate customers	4,741	4,101
- non-banking financial institutions	9,859	10,408
- retail customers	11,713	7,856
- non-profit organizations	1,095	1,830
- non-residents	111	55
- other customers	163	65
	27,777	25,739
Demand deposits in foreign currencies:		
- banks	-	1
- corporate customers	678	349
- non-banking financial institutions	154	800
- non-profit organizations	173	73
- retail customers	3,621	2,008
- non-residents	525	1,387
- other customers	3	1
	5,154	4,619
Short-term deposits in BAM:		
- Government and state institutions	-	500
- corporate customers	900	-
- non-banking financial institutions	18,547	21,470
- retail customers	219	153
- other customers	30	-
	19,696	22,123
Short-term deposits in foreign currencies:		
- non-profit organizations		
- retail customers	382	145
	382	145
Long-term deposits in BAM:		
- non-banking financial institutions	17,088	7,045
- Government and state institutions	7,950	3,825
- corporate customers	1,417	1,491
- non-profit organizations	2,627	2,620
- retail customers	38,463	29,625
- non-residents	50	50
- other customers	700	800
	68,295	45,456
Long-term deposits in foreign currencies:		
- non-residents	134	256
- non-banking financial institutions	1,565	2,738
- corporate customers	2,427	1,547
- non-profit organizations	1,173	-
- retail customers	71,804	60,107
	77,103	64,648
Total:	198,407	162,730

Demand deposits of corporate entities and entrepreneurs in BAM and foreign currencies accrued interest at the rates between 0.0% and 1.5% annually, applying the compound interest method.

Interest on demand savings deposits of retail customers and transaction accounts in BAM, EUR and USD was calculated at the annual rate of 0.1% using the straight-line method. Retail demand deposits in other foreign currencies do not accrue interest.

Savings demand deposits – open savings in BAM and EUR accrued interest at the rate of 1.5% annually by applying the compound interest method.

Short-term deposits of corporate entities and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 0.0% to 5.07% annually.

(All amounts expressed in thousands of BAM, unless otherwise stated)

19. DEPOSITS DUE TO CUSTOMERS (Continued)

Short-term deposits of retail customers in BAM and EUR were placed at the annual interest rates from 0.6% do 1.8%.

Long-term deposits of corporate customers and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 2.8% to 3.8% annually (certain earmarked deposits were placed as collaterals to securitize loan repayment and contractually defined as non-interest bearing).

Long-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 3.0% to 4.2% annually.

The Bank applies the compound interest method on term deposits, whereas simple interest method calculation is applied to earmarked deposits, all in accordance with the specific contractually agreed terms.

Depending on the market conditions, and in cases of particular significance for the Bank, the management may enact specific decisions on the implementation of interest rates up to 1 percentage point higher than the interest rates defined by the Bank's internal bylaws.

20. BORROWINGS

	December 31, 2016	December 31, 2015
In BAM:		
- RS Development and Employment Fund	3,450	3,576
- RS Housing Fund	6,549	5,141
- Fund for Development of Eastern Region of RS	2,881	3,061
Total in BAM	12,880	11,778
In foreign currencies:		
- EFSE I	1,956	1,956
- EFSE II	-	5,867
- IFC	3,353	5,588
- EBRD	-	2,235
- ResponsAbility SICAV	-	3,260
Total in foreign currencies	5,309	18,906
Total non-current portion:	**18,189**	**30.684**
Current portion:		
- EFSE	1,956	5,867
- EBRD	-	2,235
- IFC	2,235	2,235
- RESPONSABILITY	-	3,260
- IRB	1,410	1,236
Total current portion of log-term liabilities:	**5,601**	**14,833**

As of December 31, 2016, the total balance received from the Funds managed by the Investment and Development Bank of RS amounted to BAM 12,880 thousand.

The Bank entered into loan agreements with foreign creditors at the following terms:

- EFSE, Netherlands, as of March 18, 2014: loan amount: EUR 5 million, loan repayment period: 3 years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.5%;
- IFC, as of September 30, 2014: loan amount: EUR 4 million; loan repayment period of 4 years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.75%.

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20. BORROWINGS (Continued)

The borrowed funds are intended for financing loans to customers for the following purposes: purchase of property, plant and equipment, financing working capital, investments, startup micro, small and medium-sized enterprises and entrepreneurs.

Loan Agreement Covenants

Pursuant to the loan agreements entered into with the above listed creditors, the Bank is obligated to comply with certain procedures and accounting records that adequately reflect the Bank's operations in accordance with IAS and IFRS and certain financial covenants.

As of December 31, 2016, the Bank achieved all the contractually stipulated ratios and was in full compliance with the loan covenants.

21. SUBORDINATED DEBT

	December 31, 2016	December 31, 2015
EFSE , Luxembourg	6,845	-
KfW, Germany	-	3,912
Total	6,845	3,912

On December 18, 2013, the Bank and KfW Germany executed an agreement on subordinated debt amounting to EUR 2 million for a period of 5 years, with one-off repayment at an interest rate of 7% annually intended for strengthening the Bank's total capital.

In its Decision issued on December 16, 2013, BARS approved of inclusion of subordinated debt into the Bank's supplementary capital. In addition the aforesaid Decision stipulates that, in the period of five years and beyond, the Bank may not repay the aforesaid subordinated debt if such repayment should decrease the Bank's capital below the prescribed limit. Furthermore, the Subordinated Loan Agreement executed with KfW also defines that no repayment of matured liabilities will be made thereunder if such repayment should compromise the minimum capital adequacy of the Bank or without the regulator's (BARS) prior approval.

In its Decision no. 03-125-1/16 dated February 4, 2016 BARS granted the Bank approval for transfer of financial assets from the subordinated debt amounting to BAM 3,912 thousand to a special account. These funds are intended solely for purchase of the Bank's shares by KfW. On April 15, 2016 the funds were transferred to such an account, from which KfW thereafter purchased the Bank's shares from MKD Mikrofin d.o.o. Banja Luka (Note 23).

Under Decision no. 03-1515-3/16 dated October 7, 2016 BARS approved inclusion of the subordinated debt in the Bank's supplementary capital in the amount of BAM 6,845 thousand.

On October 13, 2016, the Bank and EFSE, Luxembourg executed an agreement on a subordinated loan amounting to BAM 6,845 thousand, for a period of 6 years and lump sum repayment, at an interest rate of 6.2% p.a. The loan is intended for strengthening the Bank's total capital.

The creditor disbursed the loan funds, i.e. transferred the funds to the Bank's foreign currency account on October 21, 2016.

(All amounts expressed in thousands of BAM, unless otherwise stated)

22. OTHER LIABILITIES

	December 31, 2016	December 31, 2015
In BAM:		
- accrued interest liabilities	1,348	896
- trade payables	172	157
- other liabilities	671	515
- deferred income	1,852	1,595
In foreign currencies:		
- trade payables	18	32
- accrued interest liabilities	2,555	2,724
- other liabilities	3	56
Total:	6,619	5,975

Accrued interest liabilities in BAM amounting to BAM 1,348 thousand as of December 31, 2016 mostly refer to the accrued interest payable per term deposits (BAM 1,328 thousand) and, in a smaller amount, to accrued interest for borrowings (BAM 20 thousand).

Deferred income in BAM totaling BAM 1,852 thousand as of December 31, 2016 mostly relates to the loan processing fees collected in advance from customers.

Accrued interest liabilities in foreign currencies totaling BAM 2,555 thousand as of December 31, 2016 mostly refer to the accrued interest payable per retail customers' term deposits (BAM 2,431 thousand), and, in a smaller amount, to accrued interest for borrowings (BAM 38 thousand) and subordinated debt (BAM 86 thousand).

23. EQUITY

Issued (Share) Capital

The share capital of the Bank was formed from the initial investments of shareholders and the subsequent capital increase - share subscriptions paid in cash. The Bank's share capital as of December 31, 2016 totaled BAM 40,841 thousand and was comprised of 408,410 shares with the par value of BAM 100 per share.

In 2016 the ownership structure of the Bank's capital was changed and, according to the excerpt provided by the Central Registry of Securities of the Republic of Srpska as of December 31, 2016, was as follows:

	Share Count	BAM '000	%
MKD Mikrofin d.o.o. Banja Luka	313,892	31,389	76.86
FMO, Netherlands	47,259	4,726	11.57
KFW, Germany	47,259	4,726	11.57
	408,410	40,841	100.00

The ownership (shareholder) structure of the Bank as of December 31, 2015 was as follows:

	Share Count	BAM '000	%
MKD Mikrofin d.o.o. Banja Luka	406,410	40,641	99.51
DUIF Mikrofin invest d.o.o. Banja Luka on behalf and for the account of OIF Mikrofin plus a.d., Banja Luka	2,000	200	0.49
	408,410	40,841	100.00

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23. EQUITY (Continued)

Equity Reserves

Equity reserves totaling BAM 62 thousand as of December 31, 2016 were formed under the Instruction of the Banking Agency of the Republic of Srpska (BARS), which ordered the Bank to set aside and retain within this equity line item the amount of BAM 62 of shortfall reserves dating back to the 2010 opening balance, when the transition from the Bank's loan portfolio measurement in line with the regulatory requirements to the measurement methodology based on full application of IAS 39 took place.

Equity reserves totaling BAM 795 thousand were formed by allocations from profit and intended to cover the shortfall reserves for the period from 2010 to 2012. Under Decision of the Bank's Assembly no. SK-52/2016 dated June 20, 2016 these reserves were used to absorb prior years' losses.

24. EARNINGS PER SHARE

	Year Ended December 31, 2015	2015
Net profit for the year	2,961	2,226
Weighted average number of shares outstanding	408,410	312,813
Basic earnings per share (in BAM)	7.25	7.12

Given the fact that the Bank has no potentially diluting ordinary shares such as convertible debt and share options, the Bank does not calculate diluted earnings per share.

25. CONTINGENT LIABILITIES AND COMMITMENTS

a) Payment guarantees, performance bonds and other irrevocable commitments

	December 31, 2016	December 31, 2015
Payment guarantees	6,144	2,886
Performance bonds	4,835	3,350
Irrevocable commitments for undrawn loans	3,520	3,238
Unused account overdrafts and credit card facilities	5,980	4,624
Total	20,479	14,098

The largest portion of irrevocable commitments for undrawn loans refers to the unused framework loans for financial monitoring amounting to BAM 3.488 thousand revolving and unused revolving loans totaling BAM 1,239 thousand and unused overdrafts of BAM 4,740 thousand.

As of December 31, 2016 provisions for potential losses per off-balance sheet items totaled BAM 118 thousand (December 31, 2015: BAM 96 thousand, Note 11 b).

b) Litigation

As of December 31, 2016 the Bank was involved in 494 legal suits filed against its debtors in attempts to collect receivables matured. The total value claimed in these proceedings aggregated to BAM 10,718 thousand. Provisions for potential losses in this respect were formed in the amount of BAM 7,616 thousand.

As of December 31, 2016 there were six lawsuits filed against the Bank totaling BAM 100 thousand. Given the nature of these lawsuits, at the proposal of the Committee for Assessing the Risk of Litigation Losses, on December 27, 2016 the Bank's management decided to make provisions of BAM 2 thousand in this respect.

(All amounts expressed in thousands of BAM, unless otherwise stated)

25. CONTINGENT LIABILITIES AND COMMITMENTS (Continued)

c) Regulatory Compliance

The Bank is obligated to align the volume of its business operations with the legally prescribed adequacy and performance ratios, i.e. to maintain the scope and structure of its assets in compliance with the accounting standards and regulations of the Republic of Srpska, established and controlled by the Banking Agency of the Republic of Srpska.

As of December 31, 2016 the Bank was in full compliance with the accounting standards and regulations of the Republic of Srpska, established and controlled by the BARS per all the prescribed ratios.

26. RELATED PARTY TRANSACTIONS

	December 31, 2016	December 31, 2015
Statement of Financial Position		
Assets		
Loans and receivables		
- due from the Bank's management and employees	2	466
- Drvex d.o.o. Laktaši	338	-
Prepaid insurance costs:		
- Mikrofin osiguranje a.d. Banja Luka	2	56
Prepaid licenses:		
- MF Software d.o.o. Banja Luka	5	61
Interest accrued	1	2
Total assets	**348**	**585**
Liabilities:		
Transaction accounts		
- of the Bank's Supervisory Board members and management	792	859
- of other related private individuals (management's family members)	1,192	1,830
	1,984	2,689
Trade payables:		
- MF Software d.o.o. Banja Luka	14	24
- MKD Mikrofin d.o.o. Banja Luka	-	4
Other liabilities:		
- Drvex d.o.o. Laktaši	5	-
	19	28
Interest liabilities:		
- other related private individuals (management's family members)	73	141
	73	141
Balances of deposits placed by related parties:		
- MKD Mikrofin d.o.o. Banja Luka	3,741	1,624
- DUIF Mikrofin Invest a.d. Banja Luka	-	110
- OIF Mikrofin plus a.d. Banja Luka	-	680
- MF Software d.o.o. Banja Luka	72	99
- Mikrofin osiguranje a.d. Banja Luka	4,687	6,383
- Citizens' Association Mikrofin	827	890
- Zepter Fund	5,500	-
- Profi nova a.d. Bijeljina	-	40
- Drvex d.o.o. Laktaši	162	-
- Others	5	10
	14,994	9,836
Total liabilities	**17,070**	**12,684**
Liabilities, net	**(16,722)**	**(12,099)**

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Year Ended December 31, 2016
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26. RELATED PARTY TRANSACTIONS

	Year Ended December 31, 2016	2015
Statement of profit and loss		
Income		
Fee and commission income from related parties:		
- MKD Mikrofin d.o.o. Banja Luka	423	393
- Mikrofin osiguranje a.d. Banja Luka	15	10
- MF SOFTWARE d.o.o. Banja Luka		1
- OIF Mikrofin plus a.d. Banja Luka	1	-
- Other individuals	7	
- Others	1	
- Drvex d.o.o. Laktaši	5	5
Rental income	50	-
Interest income from other related parties	22	22
Total income	**524**	**431**
Expenses		
Rental costs – MKD Mikrofin d.o.o., Banja Luka	(117)	(241)
Rental costs – Drvex d.o.o., Laktaši	(16)	(16)
Rental costs – Mikrofin osiguranje a.d., Banja Luka	(51)	(51)
Software lease – MF SOFTWARE d.o.o., Banja Luka	(117)	(123)
License costs – MF SOFTWARE d.o.o., Banja Luka	(62)	(57)
Insurance expenses – Mikrofin osiguranje a.d., Banja Luka	(143)	(100)
Cost of office supplies	(3)	-
Fixed assets maintenance costs	(33)	-
Cost of intellectual services	(129)	-
Employee professional trainings	(1)	-
Interest expenses:		
- Mikrofin osiguranje a.d. Banja Luka	(167)	(210)
- DUIF Mikrofin Invest d.o.o. Banja Luka	-	(3)
- OIF Mikrofin plus a.d. Banja Luka	-	(15)
- Citizens' Association Mikrofin	(23)	(26)
- Management of the Bank	(23)	(25)
- Other related parties	(71)	(94)
- Zepter Fund	(207)	-
Remunerations to the members of the Supervisory Board and Bank's management	(250)	(304)
Total expenses	**(1,413)**	**(1,265)**
Expenses, net	**(889)**	**(834)**

27. TAXATION RISKS

The Republic of Srpska and Bosnia and Herzegovina currently have several tax laws in effect, as imposed by various governmental agencies. The applicable taxes include: a turnover tax, corporate tax, and payroll (social) taxes, among others. Following their introduction, the regulations governing these taxes were not enforced for substantial periods of time; in contrast to similar legislation in more developed market economies. Moreover, the regulations defining the implementation of these laws are often unclear or non-existent. Hence, few precedents with regard to tax issues have been established in the Republic of Srpska. Often, contrary opinions pertaining to legal interpretations exist both among, and within, governmental ministries and organizations, thusly creating uncertainties and areas of legal contention. Tax returns, together with other legal compliance matters (e.g., customs and currency control matters) are subject to the review and investigation by a number of authorities that are legally enabled to impose extremely severe fines, penalties and interest charges.

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27. TAXATION RISKS (Continued)

The interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Bank may not coincide with that of the management. As a result, transactions may be challenged by tax authorities and the Bank may be assessed additional taxes, penalties and interest, which can be significant. In accordance with the Law on Tax Authority of the Republic of Srpska, expiration period of the tax liability is five years. This practically means that tax authorities could determine payment of outstanding liabilities in the period of five years from the origination of the liability. The afore-described situation creates tax risks in the Republic of Srpska and Bosnia and Herzegovina that are substantially more significant than those typically existing in countries with more developed tax systems.

28. CURRENT ECONOMIC SITUATION AND ITS IMPACT ON THE BANK

During 2016, the Bank's operations were under the impact of the global economic and financial crisis and significantly reduced economic activity in Bosnia and Herzegovina. However, in the course of 2016, the Bank had no liquidity problems despite the significant lending activity.

So far, the ongoing financial crisis has had a limited impact on the financial position and performance of the Bank, mainly due to the internal risk management policies and regulatory restrictions. In a timely manner the Bank took a number of measures to prevent risk deterioration such as:

- revision of loan approval policies and procedures, credit risk assessment and risk management policies and procedures;
- adjustment of product and service mix to the needs of customers and to the structure of the available resources;
- approval of loan rescheduling in order to adjust repayment to the actual and realistic customers' sources of financing; and
- revaluation of collaterals upon loan reapproval and restructuring/rescheduling.

The Bank closely monitors the credit, liquidity, interest rate and foreign exchange risks on an ongoing basis. The management expects that the Bank's liquidity will be satisfactory in the forthcoming period as well.

The economic situation in the country will probably impact the position of certain industries and the ability of certain customers to discharge their liabilities per borrowings obtained from the Bank. This may consequently influence the amount of the Bank's provisions for impairment losses in 2017 and other areas that require estimates to be made by management, including the valuation of collaterals and of securities. The 2016 financial statements contain significant estimates with respect to impairment charges and asset and collateral valuation. The key priority of the Bank in 2017 will be attention to the management of the financial portfolio adjusting to the changing economic environment.

29. COMMITMENTS FOR LEASE OF BUSINESS PREMISES

The minimum operating lease liabilities for business premises recognized as expenses for the year ended December 31, 2016 amounted to BAM 740 thousand (2015: BAM 841 thousand).

The Bank's commitments arising from cancellable agreements on the lease of business premises were as follows:

	December 31, 2016	December 31, 2015
Within a year	34	168
From 1 to 5 years	623	970
Over 5 years	-	-
Total:	657	1,138

30. FINANCIAL INSTRUMENTS

30.1. Financial Risk Management

The Bank is exposed to various types of financial risks based on its activities which include, but are not limited to, analyzing, assessing, assuming a certain level of risk or combination of risks, as well as managing these risks. Assumption of risks is inherent in financial business, while operational risks accompany any business. The Bank aims to strike a balance between risks assumed and return on its investments, and to minimize potential adverse effects of these risks on the Bank's financial result.

The Bank's risk management policies are used to identify and analyze these risks, to establish adequate limitations and controls, to review risks and to observe the limitations set by the reliable and updated information systems. The Bank regularly reexamines its risk management policies and systems, making sure that these respond to the changes on the market, changes of products and new best practices.

The Bank has the risk management system in place in order to be able to identify, estimate and monitor risks it exposed to in its operations in a timely manner.

The organizational structure of risk management in the Bank is set up in accordance with the Law on Banks of the Republic of Srpska and effective BARS Decisions on the minimum standards for managing certain types of risks.

The Supervisory Board

The Bank's Supervisory Board is responsible for defining the Bank's overall risk management strategy and capital management strategy as well as risk management policy and for supervision of risks assumed by the Bank in its regular activities.

The Supervisory Board adopts the program, policies and procedures for risk identification, measurement assessment and management. The Supervisory Board is to ensure full compliance of the Bank with the defined strategy and adopted policies and procedures.

The Supervisory Board is also in charge of large exposure risks (whether it be to a single entity or a group of related entities), and decides on approval of loan requests in instances of the Bank's risk products (at the proposal of the Bank's Credit Committee) in excess of BAM 1,000 thousand for individual loans and in excess of BAM 1,500 of total exposure (to a single entity and a group of related entities, respectively).

The Supervisory Board appoints members of the Bank's Credit Committee and relieves them of duty.

The Bank's Managing Board

The Bank's Managing Board of the Bank is responsible for creation of proposals for developing programs, policies and procedures for risk identification, measurement, assessment and management and timely submission of such proposals to the Supervisory Board.

The Managing Board is also responsible for implementation of the defined risk management strategy and capital management strategy as well as the Bank's risk management policies.

The Managing Board oversees the work of all lower management levels within the Bank and controls the implementation of the adopted policies and procedures. The Managing Board monitors the trends and analyzes risk management at least quarterly and regularly informs the supervisory Board thereof. In instances certain activities are not in line with the defined strategy or policy, the Bank's Managing Board is obligated to notify the Supervisory Board thereof.

The Bank's Credit Committee

Within the defined crediting policy of the Bank, the Bank's Credit Committee makes decisions on loans from BAM 200 thousand to BAM 1,000 thousand of exposure to a single entity and loans totaling between BAM 300 thousand and BAM 1,500 thousand of total exposure to a single entity or a group of related entities. Decisions on loans below the aforesaid amounts falls under remit of Credit Committees of branches or Heads of Branches.

30. FINANCIAL INSTRUMENTS (Continued)

30.1. Financial Risk Management (Continued)

The Risk Management Department

The Risk Management Department plays key role in identification, measurement, assessment and management of risks assumed by the Bank in the regular course of business. The Risk Management Department is under obligation to express opinions in writing on all loan requests in excess of BAM 150 thousand. An opinion of the Risk Management Department is an integral part of the loan proposal, i.e. loan case to be discussed by the Credit Committee.

As a member of the Bank's Credit Committee, the Manager of the Risk Management Department and a member of the Managing Board in charge or risk management can exercise their veto power upon deciding on loans discussed by the Bank's Credit Committee. The Risk Management Department expresses an opinion on each new risk-generating credit product as well as other risk-generating areas.

The Asset and Liability Management Committee (ALCO)

The principal function of the Bank's Asset and Liability Management Committee (ALCO) is to identify, measure, and manage risks inherent in the Bank's balance and off-balance sheet items, primarily liquidity and interest rate risks by setting adequate risk limits and measures for elimination of adverse risk impact on profitability.

Loan Management Committee

The principal roles of the Loan Management Committee involve overseeing the quality of the Bank's loans, the process of monitoring end efficiency of the credit risk management, monitoring of loan collection by the Loan Restructuring division and Legal and Forced Collection Affairs and their achievement in line with the Bank's business goals. The Committee monitors the crediting process through all its phases so that in the event of a bottleneck identification it is able to prepare a proposal for the Banks' Managing Board for definition of measures, activities and responsible persons for elimination of such situations. In addition, the Loan Management Committee coordinates and strategically directs processes and activities among all functions within the Bank that are involved in the crediting process for organization of all the stages of the process in order to achieve all the objectives and planned targets through regular controls associated with such processes. The competence of this Committee encompasses granting approvals of departures from the defined collection procedures and providing proposals for improvement of the loan portfolio quality.

Liquidity Commission

The Bank's Liquidity Commission, comprised of three members appointed by the Bank's Supervisory Board – a member of the Managing Board, the Manager of the Treasury and Transactions Department and Manager of the Risk Management Department, has meetings at least on a monthly basis. The Commission monitors and assesses daily liquidity based on the liquidity plan as of the certain date, submitted by the Treasury and Transactions Department on a daily basis to the members of the Commission and Managing Board.

The Commission analyzes the liquidity plan and its realization on a monthly basis, proposes measures and defines tasks for liquidity maintenance so that the Bank can avoid the risk of adverse effects on its financial performance due to its inability to discharge its current liabilities as these fall due.

The Treasury and Transactions Department

The Bank's Treasury and Transactions Department manages current liquidity through the following activities:

- planning cash inflows and outflows on a daily basis;
- monitoring transactions and cash balances on the accounts of reserves held with the Central Bank, balances on the accounts held with domestic and foreign correspondent banks and balances of cash on hand in foreign and local currencies (Bank's vault cash) and cash offices of the Bank;
- obtaining the shortfall amounts of funds or investing surplus liquid funds in the financial markets;

30. FINANCIAL INSTRUMENTS (Continued)

30.1. Financial Risk Management (Continued)

The Treasury and Transactions Department (Continued)

- monitoring large individual inflows/outflows of funds of depositors and loan disbursements in order to maintain the foreign currency position, maturity matching and timely settlement of all liabilities matured;
- analyzing the structure and maturities of deposits, undertaking re-contracting of maturities for deposits matured;
- maintaining and allocating the obligatory legal reserve as the minimum amount of funds set aside on the account held with the Central Bank;
- preparing daily, monthly and semi-annually liquidity plans as the method for estimating future liquidity;
- reporting on liquidity movements both internally and externally.

The most significant risks to which the Bank is exposed are credit risk, market risk, liquidity risk and operational risk.

30.2. Credit Risk

The Bank assumes credit risk which relates to potential negative effects on the financial result of the Bank contingent on the failure of debtors to meet their liabilities towards the Bank. Credit risk is the most significant risk for the Bank's business operations, and the Bank manages its risk exposure being aware of its importance. The credit risk exposure occurs primarily based on crediting activities i.e. in loan origination activity. Credit risk is also present in off-balance sheet instruments such as guarantees and undrawn lines of credit.

Credit risk represents the risk of negative effects on the Bank's financial result and capital as a result of the customer's inability to settle its matured liabilities to the Bank. Credit risk entails:

- Default risk - the risk of loss that may arise if a debtor fails to settle liabilities toward the Bank;
- Downgrade risk - the risk of loss that may arise if a risk level of a debtor is downgraded (deterioration of in the customer credit rating) on the line items of assets that are recorded in the credit portfolio;
- Risk of change in the value of assets - the risk of loss that may arise on items of assets that are recorded in the credit portfolio in the event of a decline in their market value compared to the price at which assets were acquired;
- Counterparty exposure risks - risks that can arise from the Bank's exposure toward a single individual, a group of related parties or to entities that

The Bank manages credit risk by implementing the crediting strategy focused on entrepreneurs and SME and risk dispersion.

The Bank manages credit risk by approving standardized credit products in accordance with its crediting policy. Those products and their basic characteristics in terms of amount, maturity, interest rate, fee and obligatory collateral are defined in the bank's Credit Product Catalogue. The Risk Management Department is involved in definition of credit products and their evaluation from the aspect of risk. Decision-making levels defined by the Rules of Procedure for Credit Committees, are competent for decision making in instances of standard loan approval under standard terms, whereas any departure from the defined standards requires higher level decision making.

The Bank's Credit Manual, Rules on Documenting Crediting Activities and Storing Credit Files and the Instructions for Credit Analysis clearly define the manner of processing credit products, documentation required for certain market segments, steps of the crediting process and organizational units and individual operators responsible for the implementation thereof. The aforesaid document prescribes all the forms used in loan processing and monitoring and the manner and forms for analyses of the credit worthiness of borrowers depending on the segment they belong to (COR and PUB, SME and Retail segments). The Bank approves loans in accordance with the defined procedure for loan approval based on the assessed credit worthiness of the borrowers and collaterals. The analysis of the borrower creditworthiness must be presented in the document named "Analysis," which includes the loan proposal as the basis for making a decision on loan approval.

30. FINANCIAL INSTRUMENTS (Continued)

30.2. Credit Risk (Continued)

Such decisions are made based on the defined limits for individual exposures and total exposures per single entity or a group of related entities. There five levels of authority within the Bank for loan approval, the highest of which is the Bank's Supervisory Board and the lowest personal responsibility of the Branch Manager. Processing of loan requests for SME and Retail segments is decentralized and performed by the Bank's branches. Processing of loan requests from the receipt of up to the loan disbursement is performed through the application module adjusted to the requirements of the Front Office.

The Instructions for Collection and Management of Non-Performing Loans (NPL) and the Monitoring Policy define the manner of monitoring the existing loans and competences and responsibilities for performing collection activities. The aforesaid Instructions define the daily and monthly monitoring of collection within certain steps of NPL management are performed.

In order to ensure quality, systematic and orderly management of loan portfolio in default, the Bank's internal procedures prescribe the following two documents: "Irregular Repayment File" and "Collection Strategies." The "Irregular Repayment File" represents a report providing a summary of activities already undertaken and performed in respect of loans with repayment over 30 days past due and is maintained until the loan repayment is settled in full. Loan Officers are obligated to maintain the irregular repayment files and chronologically record all activities undertaken in order to collect the receivables. The maintenance of this form is supported by the software within the module used by the Front Office. "Collection Strategies" is a report presenting a dynamic overview of activities that will be undertaken in order to collect receivables, i.e. the agreed upon collection strategy.

Since the end of 2010, the Bank has had the Risk Management Department within its organization. This Department measures and controls risks and since November 2011, it has performed risk assessment and evaluation of the borrower creditworthiness and given opinions presented to the Credit Committee upon deciding on loan approval.

In changes to its organizational structure conducted in 2011, the Bank relieved the Loan Officers of loan accounting, loan disbursement and other loan administration tasks and formed a separate department for these jobs, thereby reducing the risk. Under the most recent organizational changes these jobs were referred to the Back Office.

Impairment Losses and Provisioning Policy

The Bank estimates the risk of potential losses due to deterioration of the borrower credit rating. Credit risk represents the risk of the borrowers' inability to discharge their liabilities when due, whether there be little probability of borrowers settling the liabilities from their primary sources or the repayment be over 90 days past due.

Impaired loans are those loans where objective evidence of impairment has been determined. Objective evidence of impairment includes events causing measurable decrease in the estimated future cash flows.

Individually impaired assets are those assets which were assessed for impairment on an individual level and for which the assessed impairment losses have been recognized. The amount of impairment loss is determined as the difference between the carrying value and the present value of the future cash flows.

The calculated amount of the impairment of balance sheet assets is charged to expenses and credited to the impairment allowance of those assets, while the calculated amount of the probable loss per off-balance sheet assets is charged to expenses and credited to the provisions for potential losses per off-balance sheet items.

Group-level or portfolio-level assessment for impairment is performed for loans that are not individually significant.

For the purpose of this type of impairment assessment, loans are classified into groups homogenous from the credit risk aspect in accordance with the bank's internal methodology for calculation of the impairment allowance.

Expected future cash flows for homogenous loan groups are determined based on the available historical data, mostly data on default in liability settlement, and cash flows that will certainly result from collateral foreclosure are also taken into account.

30. FINANCIAL INSTRUMENTS (Continued)

30.2. Credit Risk (Continued)

Collaterals

In accordance with the standard principles of crediting operations, the Bank requires collaterals for loan securitization to cover the risk of the borrower inability to meet the contractual obligations.

Collaterals the Bank most commonly obtains as instruments securitizing loans include:

- bills of exchange,
- collection authorizations,
- statement of distraint (injunction),
- co-debtor,
- co-sureties,
- mortgages assigned over property,
- pledge liens assigned over movables,
- pledge liens assigned over securities,
- deposits/savings deposits,
- insurance policies, and
- guarantees of the RS Guarantee Fund.

The Bank reserves the right to demand any other type of collateral it deems necessary.

Non-Performing Loans (NPLs)

Non-performing loans (NPLs) are loans with repayment over 90 days past due and materially significant default. According to the categorization, those are category C, D and E loans. Loans from category B and less than 90 days past due ate not considered to be NPL but are assets for special watch.

The Bank classifies the customers in accordance with its internal methodology for calculating impairment allowance according to the number of days in arrears and in accordance with the BARS Decision on the Minimum Standards for Credit Risk Management and Asset Classification. Pursuant to the aforecited BARS Decision, all borrowers are classified into 5 categories: A, B, C, D and E.

NPL management is centralized within the Division for Loan Restructuring. The Division was formed in April 2013 in order to ensure higher quality NPL management.

This Division is competent for rescheduling and restructuring all loans but the opinion expressed by the Risk Management Department is mandatory. When this Division has attempted and failed at all possibilities of collection, it proposes making a decision on instigation of legal proceedings to the Bank's Loan Management Committee/Credit Committee.

The Bank's Instructions for Collection and Management of NPLs explicitly prescribes the activities of assumption, monitoring and collection of NPLs for all market segments. A loan is assumed by the Division for Loan Restructuring when the following conditions are met:

1. Loans that are 90 and over 90 days past due with liability matured in excess of one repayment installment;
2. Borrowers that failed to settle their liabilities to the Bank within 30 days from the maturity of the entire account overdraft or revolving loan amount;
3. Credit card facilities with repayment of 90 and over 90 days past due;
4. All types of guarantees called on where the Bank made the required payments and liabilities matured were not settled within 30 days from the Bank's payment date.

The borrowers meeting the above listed criteria are transferred to the Division for Loan Restructuring if it is possible to enable further regular debt servicing by the borrower through loan rescheduling or restructuring. If there are no possibilities for resuming debt servicing on the part of the borrower, such a borrower is not transferred to the Loan Restructuring Division but to the Legal Department instead, where legal proceedings are instigated.

Borrowers are transferred from the Front Office to the Loan Restructuring Division upon Front Office creating a monthly list of borrowers where, on the last day of the previous month, conditions were met for this transfer.

30. FINANCIAL INSTRUMENTS (Continued)

30.2. Credit Risk (Continued)

Non-Performing Loans (NPLs) (Continued)

The list needs to include all the loan facilities of each borrower, and those of its related parties, even if they are not in the categories triggering the transfer (related through ownership and family relations), yet they affect the creditworthiness and possibility of loan repayment. The Front Office may propose delay in transferring a borrower to the Loan Restructuring Division for up to 30 days if there is an arrangement with the borrower that within these 30 days the payment will be made or repayment liabilities rescheduled. If within 30 days such a borrower fails to make the due payment or have the Bank reschedule the liabilities, the borrower will be transferred to the Loan Restructuring Division. Decisions on the delay of transfer of borrowers to the Loan Restructuring Division is made by the Loan Management Committee after considering the Front Office's proposals. The final and with branch offices reconciled list of the loans/borrowers to be transferred to the Loan Restructuring Division is prepared in 3 copies and signed by the Deputy CEO. A copy is submitted to the Loan Restructuring Division, another copy is intended for the Back Office, and the third is archived in the Front Office. This final list is delivered electronically to all heads of branch offices.

Based on the aforesaid list, loan files are transferred from branch offices to the Loan Restructuring Division and a Loan Restructuring Officer becomes competent for the loan files received within the system. This activity within the system entails that, at the end of the seventh day in each month, all the loan facilities included in the list are assigned a Backup Officer from the Loan Restructuring Division (within the banking application).

The Loan Restructuring (Backup) Officer must:

- receive the loan file from the Loan Officer within 15 days from the assignment date; and
- act on it as soon as possible.

The Backup Officer in charge of a borrower is obligated to maintain records of the activities and measures undertaken in respect of specific loan facilities through update of strategies in the front application. Even if the loans are regularly serviced, the Backup Officer is obligated to perform regular quarterly monitoring of the borrower.

Loan Restructuring Officers have at their disposal all the measures for addressing the default problems, which entail aggressive collection, current debt rescheduling, current debt restructuring, main debt restructuring by including other co-debtors, etc.

Credit Risk-Related Risks

The Bank issues guarantees to its customers whereupon it has contingent liabilities to make the payment in favor of third parties. In this manner the Bank is exposed to risks similar and related to credit risk, which may be overcome by applying the same control processes and procedures.

Monitoring and collection procedures applied to these exposures are identical to those applied to loans.

(All amounts expressed in thousands of BAM, unless otherwise stated)

30. FINANCIAL INSTRUMENTS (Continued)

30.2. Credit Risk (Continued)

Collaterals and Other Forms of Securitization

The Bank demands security instruments for majority of it loans. The amount and type of the security instrument demanded depends on the market segment a specific borrower belongs to and the type of credit product approved as well as the assessed credit risk for each individual borrower.

Assessment of the fair value of collaterals is based on the value of collateral appraised upon loan approval. In accordance with its business policy and internal procedures, the Bank determines the required fair value of the collateral as well as the manner and time of its revaluation.

The management monitors the market value of collaterals and demands additional security instruments in accordance with the relevant loan agreements executed with borrowers and if it deems them necessary. The Bank takes into account the value of collaterals upon reassessment of the loan impairment allowance adequacy.

	Year Ended December 31, 2016	2015
Loans securitized with earmarked deposits	2,435	1,515
Loans securitized with mortgages	81,686	80,760
Loans securitized with other collaterals	141,400	105,477
Total:	225,161	187,752

30.2.1. Concentration Risk

In order to improve credit risk management and control, the Bank has set up adequate and prudent limits relative to the Bank's capital in accordance with the BARS Decision on the Minimum Standards for Concentration Risk Management, as follows:

Total credit risk exposure of the Bank toward a single entity or a group of related entities must not exceed 40% of the Bank's core capital, this being the amount of the largest total credit risk exposure (LTCRE). The Bank may attain the LTCRE toward a single entity or a group of related entities only if the following structure and restrictions thereof are ensured:

- The Bank's credit risk exposure toward a single entity or a group of related entities unsecured by collateral must not exceed 5% of the Bank's core capital;
- The Bank's credit risk exposure toward a single entity or a group of related entities ranging from over 5% up to 25% of the Bank's core capital must be secured by collateral;
- The Bank's credit risk exposure toward a single entity or a group of related entities ranging from over 25% up to LTCRE must be secured by the quality marketable pledge lien the value of which, as determined by reliable and stable market prices, exceeds the amount of the exposure;
- The Bank's total credit risk exposure per contingent off-balance sheet liabilities toward a single entity or a group of related entities except for performance bonds, must not exceed 20% of the Bank's core capital.

The sum of the Bank's large exposures (Bank's large exposure = each total credit risk exposure toward a single entity or a group of related entities in excess of 15% of the Bank's core capital), including all LTCRE, must not be above 300% of the Bank's core capital.

The sum of the Bank's large exposures per contingent off-balance sheet liabilities toward a single entity or a group of related entities except for performance bonds, must not exceed 300% of the Bank's core capital.

The Bank's internal policies and procedures define the concentration limits per single entity or a group of related entities and Bank's related parties.

The Risk Management Department monitors and measures and, in collaboration with the Accounting, Controlling and Back Office, reports on the risks of exposure toward a single entity or a group of related entities and Bank's related parties.

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Year Ended December 31, 2016
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30. FINANCIAL INSTRUMENTS (Continued)

30.2. Credit Risk (Continued)

30.2.1. *Concentration Risk (Continued)*

As of December 31, 2016, the Bank was in full compliance with all the limits regarding risk concentration prescribed by BARS and agreed with creditors.

Risk Concentration per Borrower

As of December 31, 2016, the largest exposure to a single entity borrower, before considering collaterals, amounted to BAM 2,499 thousand or 1.11% of the total credit risk exposure (December 31, 2015: BAM 2,763 thousand).

Credit Risk Concentration per Geographic Area

During 2016, the Bank's loan portfolio was concentrated on the territory of the Republic of Srpska, i.e. the City of Banja Luka, with noticeable increase of the City of Banja Luka's share in the total loan portfolio from 19.07% in 2015 to 22.70% at the end of 2016.

Credit Risk Concentration per Industry Sector

The Bank has a diversified loan portfolio covering various industries:

	December 31, 2016	In %	December 31, 2015	In %
Construction industry	17,099	8%	12,155	6%
Trade	32,770	15%	27,540	15%
Services, tourism, catering and accommodation industry	6,738	3%	3,664	2%
Agriculture	8,033	4%	7,979	4%
Mining and manufacturing industry	29,233	13%	21,812	12%
Transport, storage, postal services and telecommunications	16,395	7%	10,911	6%
Finance services	746	0%	380	0%
Real estate trade	872	0%	691	0%
Administration, other public services	-		-	0%
Other (retail customers)	113,102	50%	102,620	55%
Total:	224,988	100%	187,752	100%

As of December 31, 2016 as compared to December 31, 2015, credit risk concentration increased by 2% in the construction industry and by 1% in the services, tourism, catering and accommodation industry, mining and manufacturing industry and in transport, storage, postal services and telecommunications, while at the same time it decreased by 5% in the retail sector (private individuals and entrepreneurs), while the other industries mostly retained the same levels of concentration.

NOTES TO THE FINANCIAL STATEMENTS
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30. FINANCIAL INSTRUMENTS (Continued)

30.2. Credit Risk (Continued)

30.2.1. *Concentration Risk (Continued)*

Credit Risk Concentration per Loan Type

The Bank regularly monitors and diversifies loans approved according to their purpose and type.

	December 31, 2016	In %	December 31, 2015	In %
Loans per transaction accounts	26,045	12%	19,744	11%
Consumer loans	66,080	29%	58,004	31%
Working capital loans	55,705	25%	37,343	20%
Investment loans	65,464	29%	57,918	31%
Housing loans	8,479	4%	7,373	4%
Payments per guarantees called on	555	0%	554	0%
Other loans – purchased short-term investments-factoring	2,660	1%	6,816	3%
Total	224,988	100%	187,752	100%

As of December 31, 2016 as compared to December 31, 2015, credit risk concentration decreased by 2% in consumer and investment loans and by 3% in other loans, while it rose by 2% in loans per transaction accounts and by 5% in working capital loans. The other loan types mostly retained the same levels of concentration.

Loan and Off-Balance Sheet Item Quality According to BARS Categories (Portfolio Quality)

Pursuant to the relevant BARS Decision, the Bank classifies loans due from customers according to the number of days past due.

	Category					
December 31, 2016	**A**	**B**	**C**	**D**	**E**	**Total**
Loans due from customers						
- short-term	36,143	2,434	256	22	6	38,861
- long-term	144,732	23,805	3,446	955	383	173,321
- matured	1,254	682	587	912	8,816	12,251
- guarantees called on	-	-	-	-	555	555
Total loans	182,129	26,921	4,289	1,889	9,760	224,988
- off-balance sheet items	18,869	1,525	5	7	73	20,479
Total	200,998	28,446	4,294	1,896	9,833	245,467

30.2.2. *Stress Test*

In the course of credit risk assessment, the Bank applied the worst possible scenario of events for its portfolio. The Bank performed the stress test under the following assumptions: 30% BAM devaluation, 30% collateral value decline, and increase in allowance for impairment for customers with recorded defaults in settling their matured liabilities.

Portfolio as at December 31, 2016	Total Exposure	Total Exposure Net of Deposits	Discounted Collateral Value	Allowance for Impairment	Amount of Shortfall Reserves	Total Deterioration
Before the test	248,409	246,168	185,124	13,727	8,945	22,672
After the test	300,445	298,204	170,000	15,663	9,845	25,508
Difference	52,036	52,036	(15,124)	1,936	900	2,836

30. FINANCIAL INSTRUMENTS (Continued)

30.3. Market Risk

The Bank assumes market risks which represent the risk that the fair value or future cash flows from financial instruments may oscillate due to changes in market values. Market risks occur in open positions exposed to risk based on maturities, interest rates, currencies and capital products exposed to general and special movements and changes related to the degree of market rate and price volatility (such as interest rates, credit margins, foreign exchange rates and prices of capital).

The Bank is exposed to foreign exchange (currency) risk and interest rate risk.

The market risk control system is implemented through the separation of the risk assuming function (Front Office) from the risk monitoring and management function and backup activities (Back Office).

30.3.1. Foreign Exchange Risk

Foreign exchange risk represents the Bank's exposure to the possible adverse effects of the changes in exchange rates causing the Bank to incur losses in local currency, where the level of foreign exchange risk represents the function of the amount and duration of the Bank's exposure to the possible changes in exchange rates and depends on the amount of Bank's foreign debt, extent of the foreign currency exposure of the balance sheet assets and off-balance sheet items as well as the matching of the currency cash flows of the Bank.

The strategy of the Bank, applied in foreign exchange risk management, is based on the maintenance of foreign currency position within the limits prescribed by the Law on Banks of the Republic of Srpska and Decision on the Minimum Standards for Currency Risk Management in Banks.

For the purpose of controlling and identifying foreign currency exposure, the Bank monitors daily balances and structure of foreign currency cash in the treasury, foreign currency assets and structure per currencies on the accounts with foreign banks, ensures the matching between the foreign currency positions in unstable currencies, includes in contracts currency clause for both balance sheet assets and liabilities and off-balance sheet items, in the form a symmetrical, i.e. two-directional currency clause, in order to protect the value of assets and liabilities irrespective of the rise or decline of the exchange rate of the currency the currency clause refers to against the local currency, so as to achieve currency match between the financial assets and financial liabilities.

The Treasury and Transactions Department monitors the foreign currency position on a daily basis and, in collaboration with the Front Office and Bank's Managing Board undertakes adequate aforesaid activities in order to maintain the foreign currency position within the permitted limits.

In planning activities that significantly influence the changes in the structure or maturities of the Bank's financial assets and/or financial liabilities, and thereby Bank's foreign currency position, the Treasury and Transactions Department makes projections of the foreign currency position in order to ensure timely activities for continuous maintenance of the currency matching of financial assets and financial liabilities.

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30. FINANCIAL INSTRUMENTS (Continued)

30.3. Market Risk (Continued)

30.3.1. Foreign Exchange Risk (Continued)

The breakdown of foreign currency balances as of December 31, 2016, net is presented in the table below:

	EUR	USD	CHF	GBP	Other	Total FX	BAM	Total
Assets								
Cash and cash funds held with the Central Bank	1,945	80	73	3	124	2,225	46,726	48,951
Loans and receivables due from banks	1,618	592	-	-	-	2,210	247	2,457
Loans and receivables due from customers	172,867		-	-	-	172,867	38.776	211,643
Property, equipment and intangible assets	-	-	-	-	-	-	6,278	6,278
Interest accrued and other assets	123		-	-	-	123	2,157	2,280
	176,553	672	73	3	124	177,425	94,184	271,609
Liabilities								
Deposits due to banks	-					-		-
Deposits due to customers	82,520	71	46		2	82,639	115,768	198,407
Borrowings	5,309	-	-	-	-	5,309	12,880	18,189
Subordinated debt	6,845	-	-	-	-	6,845	-	6,845
Other liabilities	2,570	7	-	-	-	2,577	4,042	6,619
Provisions for employee benefits and other contingencies	-	-	-	-	-	-	144	144
	97,244	78	46	-	2	97,370	132,834	230,204
Net foreign currency position	79,309	594	27	3	122	80,055	(38,650)	41,405

Loans extended to customers in BAM with currency clause index to EUR are presented as EUR-denominated loans.

During 2016, the Bank maintained the open individual foreign currency position within limits permitted for EUR currency up to the maximum of +/- 30% of its core capital and for USD currency up to +/-3% of its core capital, while the total foreign currency position was within the permitted range.

Foreign Currency Sensitivity Analysis

The Bank is mostly exposed to EUR. Since Convertible Mark (BAM) is pegged to EUR, the Bank is not exposed to risk of fluctuations in the EUR exchange rate.

30.3.2. Interest Rate Risk

The Bank is exposed to multiple risks, which influence its financial position and cash flows through the effects of changes in the amount of interest rate fluctuations on the market. Interest rate risk is the risk from adverse effect on the Bank's financial result and equity contingent on the changes in interest rates.

The basic objective of interest rate risk management is to minimize adverse effects of changes in interest rates.

Interest rates applied to loans depend on the volatility of market interest rates and their trends in the money market as well as on the business policies of the Bank.

Fixed interest rates were applied to the loans with repayment periods of up to 36 months, and variable to the loans with repayment periods of over 36 months. The exceptions are loans approved to corporate customers and public sector customers as well as housing loans where the variable interest rates are applied for all repayment periods. The Bank decide on the variable interest rate equal to 6-month EURIBOR rounded to the next decade above adjusted two times a year, on June 30 and December 31.

(All amounts expressed in thousands of BAM, unless otherwise stated)

30. FINANCIAL INSTRUMENTS (Continued)

30.3. Market Risk (Continued)

30.3.2. Interest Rate Risk (Continued)

Fixed interest rates are applied to deposits, and interest rates on foreign borrowings are variable and based on 6-month EURIBOR.

The basic principle of interest rate management is matching assets and liabilities per interest rate type (fixed or variable) and maturities or repricing dates.

The Bank's top management and Risk Management Department take care of optimization of the levels of profitability and interest rate risk exposure.

Interest Rate Sensitivity Analysis

The sensitivity analyses below have been determined based on the exposure to interest rates for instruments at the statement of financial position date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the statement of financial position date remained the same for the whole year. A 10% increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

Had interest rates been 10% higher/lower and all other variables held constant, the Bank's profit for the year ended December 31, 2016 would have decreased/increased by BAM 1,604 thousand (2015: decreased/increased by BAM 1,173 thousand).

The table below shows the review of the annual interest rates applied to most significant financial instruments:

	FX	BAM
Assets		
Obligatory reserve with the Central Bank	-	0.00%-0.000%
Assets in excess of obligatory reserves	-	0.20%
Foreign currency accounts with foreign banks	0.40%	-
Short-term loans due from customers:		
- corporate customers	-	2.00%-15.50%
- retail customers	-	5.50% -15.50%
Long-term loans due from customers:		
- corporate customers	-	2.00% – 15.50%
- retail customers	8.99%	2.50% – 15.50%
Liabilities		
Demand deposits of corporate customers	0.00%	0.00%-0.65%
Demand deposits of retail customers	0.10%-1.50%	0.10%-1.50%
Short-term deposits:		
- corporate customers	0.00%	0.50%-1.80%
- retail customers	1.10%-2.00%	1.70%-1.70%
Long-term deposits:		
- Government institutions		2.50%
- corporate customers	2.80%-3.80%	2.80%-3.80%
- retail customers	3.00%-4.20%	3.00%-4.20%
Borrowings:		
EFSE II	4.929%-5.124%	
IFC	4.75%	
RS Development and Employment Fund		1.20%-3.09%
RS Housing Fund	-	1.20%-2.40%
Fund for Development of Eastern Region of RS	-	1.50%-2.40%

(All amounts expressed in thousands of BAM, unless otherwise stated)

30. FINANCIAL INSTRUMENTS (Continued)

30.3. Market Risk (Continued)

30.3.2. Interest Rate Risk (Continued)

The Bank is exposed to various risks which, through the effects of changes in the amounts of market interest rates, influence its financial position and cash flows. The table below shows the review of interest-bearing and non-interest bearing assets and liabilities as of December 31, 2016:

		December 31, 2016	
Monetary assets	**Interest-Bearing**	**Non-Interest Bearing**	**Total**
Cash and cash funds held with the Central Bank	21,934	29,474	51,408
Loans and receivables due from banks			
Loans and receivables due from customers	224,988	-	224,988
Property, equipment and intangible assets	-	6,278	6,278
Interest accrued and other assets	1,187	1,093	2,280
Total:	248,109	36,845	284,954
Monetary liabilities			
Deposits due to banks	-	-	-
Deposits due to customers	183,295	15,112	198,407
Borrowings	18,189	-	18,189
Subordinated debt	6,845	-	6,845
Other liabilities	-	6,619	6,619
Provisions for employee benefits and other contingencies	-	144	144
Total:	208,329	21,875	230,204

30.4. Liquidity Risk

Liquidity risk is the risk which emerges when the Bank is unable to settle all liabilities when due and in full. The basic objective of liquidity management is to ensure that the Bank has resources obtainable at reasonable costs necessary to discharge all liabilities for expected and unexpected fluctuations in the statement of financial position. Additionally, the process of liquidity management in the Bank needs to ensure liquid resources sufficient to finance the projected volume of its loan portfolio.

The strategy of asset liquidity risk management encompasses:

- Strivings to keep within the line items of assets, liquid forms of assets easily exchanged on the market for cash at no loss in case of a liquidity crisis (the Bank's aim is to maintain sufficient available resources to discharge its contingent liabilities at any time);
- Diversification of investments per separate customers, per industries and per loan maturities.

The strategy of liability management in respect to liquidity comprises the following:

- Strivings to ensure deposit stability with increasing participation of long-term deposits,
- Maximum diversification of resources according to their maturity, stability, origin, market and instruments,
- Particular attention is paid to large deposits,
- Undertaking arrangements with domestic and foreign banks on mutual extension of interbank liquidity loans which makes it possible to invest liquidity surpluses at an adequate interest rate, i.e. in case of insufficient liquidity funds, these resources are available to the Bank at favorable terms.

Primary sources of funds are local deposits acquired by the Bank by applying adequate interest rate policy.

The adoption, comprehensiveness and implementation of the Liquidity Risk Management Program is the responsibility of Bank's Supervisory Board and its Management.

(All amounts expressed in thousands of BAM, unless otherwise stated)

30. FINANCIAL INSTRUMENTS (Continued)

30.4. Liquidity Risk (Continued)

Everyday monitoring of daily liquidity in the Bank is the responsibility of the Treasury and Transactions Department and Liquidity Commission; short-term liquidity is the responsibility of the Liquidity Commission; and long-term liquidity is the responsibility of the ALCO (the Asset and Liability Management Committee).

Responsible persons monitor the liquidity position and composition of asset and liability maturities and:

- perform operational management of liquid assets on daily basis,
- compare the positions with projected position so as to determine trends in the liquidity positions and undertake adjustment measures so the liquidity position and maturity gaps would be in compliance with the law and the limits set by the Bank's Supervisory Board.

The table below shows a GAP analysis of assets and liabilities according to respective maturity based on the outstanding period before the agreed due date by matching receivables and payables per maturity periods in accordance with BARS regulations.

December 31, 2016	Within a Month	From 1 to 3 Months	From 3 to 12 Months	Over 1 Year	Total
ASSETS					
Cash and cash funds held with the Central Bank	48,951	-	-	-	48,951
Loans and receivables due from banks	2,457	-	-	-	2,457
Loans and receivables due from customers	20,524	18,961	83,476	126,920	249,881
Property, equipment and intangible assets	-	-	-	6,278	6,278
Interest accrued and other assets	2,175	35	19	51	2,280
Total assets	74,107	18,996	83,495	133,249	309,847
LIABILITIES					
Deposits due to banks	-	-	-	-	-
Deposits due to customers	41,887	16,553	85,995	65,200	209,635
Borrowings	142	2,289	3,574	13,876	19,881
Subordinated debt	-	177	212	8,967	9,356
Other liabilities	1,123	890	2,696	1,910	6,619
Provisions for employee benefits and other contingencies	-	-	-	144	144
Total liabilities	43,152	19,909	92,477	90,097	245,635
Liability gap	30,955	(913)	(8,982)	43,152	64,212

30.5. Operational Risk

Operational risk management is an important part of the Bank's business as it minimizes adverse effects on the income and equity of the Bank. Operational risk management entails the following:

- Forming a network of operational risk custodians and reporters across departments and divisions, who are in charge of taking activities in the area of operational risk management;
- Maintaining records on harmful events occurrences;
- Operational risk identification and assessment within all processes and adoption of measures for risk minimization;
- Regular reporting on damages incurred and detailed review of risks identified per process;
- Monitoring of implementation of the proposed measures for the control of operational risks.

Operational risk is managed based on:

- Monitoring harmful events occurrence in the scope of operational risks;
- Risk identification per process within the Bank;
- Significant risk measurements;
- Continuous monitoring and control of operational risks;
- Forming the minimum amount of adequate capital.

30. FINANCIAL INSTRUMENTS (Continued)

30.5. Operational Risk (Continued)

Monitoring harmful events occurrence in the scope of operational risks results in the historical review of the scale and type of actually occurred operational risks and is performed in accordance with the Procedure and Instructions for Harmful Event Recording.

Operational risk management is performed through the following activities:

- Identification of the existing sources of operational risks and sources contingent on the introduction of new products, systems or activities;
- Operational risk measurement through accurate and timely risk estimates;
- Continuous control of operational risks ensuring the maintenance thereof up to the level acceptable for the Bank's risk profile, its reduction and minimization;
- Continuous monitoring of operational risks by analyzing amounts, changes and trends of the Bank's exposure thereto;
- Forming the minimum amount of capital for protection against incurring operational risk-based losses (MACOR);
- Clear definition of authority and responsibility lines in the process of operational risk assumption and management;
- Setting up a system to ensure that all Bank's employees become familiar with their respective obligations in the process of operational risk management;
- Setting up a system for regular reporting to the Supervisory Board and Managing Board on functioning of the operational risk management;
- Obligatory regular periodical review and obligation of the Supervisory Board to analyze and assess adequacy of the established system for operational risk management at least annually.

30.6. Capital Management

Capital represents a unique economic resource and capital management is one of the most important components of the Bank's prudent, efficient and strategic planning and management. The Bank's capital management policy includes providing and maintaining the quantity and quality of the capital at least at the level of the minimum standards prescribed by the BARS Decision on the Minimum Standards for Capital Management of Banks (the "Decision"), i.e., the minimum amount of the share capital and the minimum amount of the net capital that the Bank is under obligation to maintain cannot be below BAM 15 million. In accordance with the aforecited decision, the Bank's capital is comprised of the core capital (Tier 1), supplementary capital (Tier 2) and net capital is the capital less deductible items.

The Bank's core capital is comprised of share capital paid in cash and other reserves that do not refer to the asset quality assessment less the following deductible items: unabsorbed prior years' losses and intangible assets. The Bank's supplementary capital includes general reserves for absorption of credit losses per Bank's assets within category A – good assets, amount of subordinated debts (maximum 1/2 and 1/3 of the core capital as from December 31, 2015 and 2016, respectively) where the core capital totals at least 9% of the total risk-weighted assets. The deductible item is the amount of shortfall reserves for credit losses per regulatory requirement (which the Bank did not form).

The Bank's policies for maintaining the quantity and quality of the capita include the following:

- In respect of the shareholder composition and profile, focus on shareholders from the banking sector and areas of micro crediting, financial investment, corporate shareholders and eventually private individuals;
- Policy of diverse equity instruments, particularly within the core and supplementary capital, and decrease or avoidance of the capital deductibles;
- In respect of the profit distribution, increase in the Bank's total capital in accordance with the effective regulations;
- In respect of the capital adequacy, when the capital adequacy ratio fall below 15%, the Bank starts undertaking activities to improve capital adequacy by new share issues, increase of supplementary capital by setting as priorities restructuring of bad assets, write-off of liabilities and obtaining subordinated debts. All these activities are intended to prevent the capital adequacy ratio decline below the legally prescribed minimum of 12%.

(All amounts expressed in thousands of BAM, unless otherwise stated)

30. FINANCIAL INSTRUMENTS (Continued)

30.6. Capital Management (Continued)

Procedures for continuous monitoring of the balances are implemented through:

- Maintaining up-to-date accounting records;
- Monitoring capital balances per quantity, quality and structure;
- Monitoring and analyzing balance sheet items and off-balance sheet credit equivalents;
- Reporting on changes in capital and changes that could have material adverse effect on the capital adequacy;
- Proposing necessary measures to be taken in order to ensure the quantity and quality structure of capital; and
- Planning the capital in terms of anticipating the Bank's future needs and requirements for capital.

As of December 31, 2016, the plan for capital adequacy maintenance was harmonized with the Decision on the Minimum Standards for Capital Management and Capital Protection of Banks, as well as with the overall action plans, taking into accounts the current condition and expected influences of the anticipated changes in the business operations and environment. The Bank is under obligation to maintain capital adequacy at the minimum of 12% and the management regularly monitors the adequacy indicators and submits a report thereon in the prescribed form to BARS on a quarterly basis.

As of December 31, 2016, the Bank was in full compliance with all the prescribed capital adequacy indicators:

	Year Ended December 31, 2016	2015
Core capital	38,218	35,946
Supplementary capital	9.798	5,657
Deductible items	(8,874)	(8,689)
Bank's net capital	**39,142**	**32,914**
Credit risk-weighted assets and off-balance sheet items	226.446	190,169
Weighted operational risk exposure	18.558	13,512
Total risk-weighted assets, off-balance sheet items and operational risk exposure	245.004	203,681
Capital adequacy ratio	**16.00%**	**16.20%**

In accordance with BARS Decision on Classification of Balance Sheet assets and Off-balance Sheet Items according to Recoverability, the Bank is obligated to classify loans, advances and other balance sheet and off-balance sheet exposures into categories A, B, C, D and E in accordance with the estimate of their recoverability. Classification is performed based on the regularity in liability settlement on the part of the borrowers, financial position of the borrowers and collaterals. The estimated amount of provisions for potential losses is calculated by applying percentages prescribed by the aforecited BARS Decision.

The difference between allowance impairment amounts arrived at in accordance with IAS 39, determined in the aforedescribed manner and the estimated amount of provisions for potential losses per loans classified into categories pursuant to the BARS Decision represents the amount of shortfall reserves as per regulatory requirement, which is stated as an item deductible from capital.

(All amounts expressed in thousands of BAM, unless otherwise stated)

31. EVENTS AFTER THE REPORTING PERIOD

Until these financial statements issue date, there have been no subsequent events that would require additional disclosures in or adjustments to the Bank's financial statements for FY 2016.

32. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of statement of financial position components denominated in foreign currencies into BAM as of December 31, 2016 and 2015 were as follows:

	December 31, 2016	**In BAM December 31, 2015**
USD	1.8554	1.7900
CHF	1.8212	1.8086
EUR	1.9558	1.9558