Financial statements for the Year ended 31 December 2019 prepared in accordance with IFRS and Independent Auditor's Report

MF Banka a.d. Banja Luka

CONTENTS

Independent Auditor's Report

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

Opinion

We have audited the accompanying financial statements of MF Banka a.d. Banja Luka (hereinafter: the "Bank"), which comprise the statement of financial position as at 31 December 2019, the statement of profit and loss, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes on the financial statements, which include a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2019, and its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards (IFRS).

Basis for the opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of the utmost importance in our audit of the current financial statements. Those matters are processed in the context of the audit of the financial statements as a whole, as well as in forming of our opinion about them and we do not express specific opinion on those matters.

Key audit matters Adequacy of the allowance for impairment for credit losses	**Audit approach**
As stated in Note 17, the value of given loans is stated in the gross amount of BAM 340.004 thousand, that is in the net amount of BAM 312.760 thousand and the allowance for impairment of placed loans to customers in the amount of BAM 27.244 thousand (note 17). The adequacy of the allowance for impairment of credit losses has been chosen a key matter since it includes the assessment of the Bank in determining the allowance for impairment of credit losses. Since 1 January 2018, the Bank has been applying the International Financial Reporting Standard – IFRS 9, resulting in cost recognition of impairments of receivables per loans when losses are expected, not at the time they occur. The Bank adopted and applies the Methodology for calculating the allowance for impairment for expected credit losses in accordance with the requirements of IFRS 9 which is further described in Note 4.	Based on the risk assessment, we tested the costs of loan impairment and the application of the Methodology, as well as the assumptions used to develop the methodology. We evaluated and tested the design, the implementation and the operational efficiency of key controls for identifying the exposures with significant increase of the credit risk. We assessed and tested the criteria for Stages which include exposures with increased credit risk, from the moment of approval to the moment of reporting. Based on samples, we tested the calculation the Bank made for the impairment for loans that were devaluated on a group basis. Based on samples, we tested individually significant credit exposures in order to estimate the provision for credit losses where an individual allowance for impairment was made. We tested the criteria which were the basis for determining whether the impairment incurred and whether conditions existed for the calculation on an individual basis. For the tested sample, we confirmed the criteria used as basis for the individual allowance for impairment, ie we confirmed that the changes occurred with the debtor are adequately assessed. We considered the assumptions of the management, including the estimation of future cash flows, the value estimation of belonging collateral and the estimation of their recoverability. We evaluated the models used, the reasonableness of assumptions, as well as the completeness and accuracy of the data used by the Bank in order to estimate the allowance for impairment of loan values which have similar characteristics in terms of credit risk. Based on the performed audit procedures we are convinced that the Methodology applied by the Bank to assess the provisions for credit losses is adequate and consistent.

Responsibilities of the Management and the Supervisory Board for the financial statements

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

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

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

The Auditor's Responsibility for the Audit of Financial Statements

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

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

- Identify and evaluate the risks of misrepresentation of financial statements due to fraud or an error, formulate and perform audit procedures as an assessment to these risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not revealing a significant misstatement resulting from scams is greater than the risk of error because fraud may include secret agreements, counterfeiting, deliberate release, misrepresentation, or circumvention of internal controls;

- Establish an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the given circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control;

- Evaluate the appropriateness of the accounting policies used and the reasonableness of the accounting estimates and related disclosures created by the Management;

- Conclude on the appropriateness of using the accounting basis based on the timeless management of the Bank's operations and, based on the obtained audit evidence, we conclude whether there is significant uncertainty about events or circumstances that can give rise to a significant suspicion of the Bank's ability to continue operating as a going concern. If we conclude that there is significant uncertainty, we are required to pay attention to our audit report on related disclosures in financial statements or, if such disclosures are not appropriate, to modify our opinion. Our conclusions are based on audit evidence obtained until the date of our audit report. However, future events or conditions may cause the Bank to cease its business continuation as a going concern;

- Evaluate the overall presentation, structure and content of the financial statements, including disclosures, as well as reflect financial statements, core transactions and events in a manner that achieves fair presentation.

We communicate with the Supervisory Board, among other issues, the planned scope and timing of the audit, and significant audit findings, including the significant deficiencies in internal control that we identify during our audit.

We also provide the Supervisory Board the statement to adhere to the relevant ethical requirements regarding the independence and to share all of the relationships and other issues that can reasonably be expected to reflect on our independence, and, where applicable, the appropriate security measures.

From the matters addressed to the Supervisory Board, we determine those matters that were of the most importance in the audit of the current financial statements and, therefore, represent key audit matters. We present those matters in our auditor's report, unless the law or regulations exclude disclosure about the matter or when, in extremely rare circumstances, we decide that the issue should not be disclosed in our report because it can reasonably expected that the negative consequences of disclosure will outweigh the public interest in disclosing this issue.

Grant Thornton d.o.o. Banja Luka
Banja Luka, 15 April 2020

Aleksandar Džombić, PhD Managing Partner – Director Grant Thornton d.o.o. Banja Luka	Nevena Milinković Certified Auditor Grant Thornton d.o.o. Banja Luka

STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME
For the year ended 31 December 2019
(in BAM thousand)

	Note	Year ended 31 December 2019	Year ended 31 December 2018
Interest income	5	31.066	28.054
Interest expenses	6	(7.986)	(6.300)
Net interest income		23.080	21.754
Fee and commission income	7	6.229	5.068
Fee and commission expenses	8	(1.558)	(1.138)
Net fee and commission income		4.671	3.930
Other operating income	9	1.658	897
Other operating expenses	10	(15.685)	(13.188)
Foreign exchange (losses)/gains, net		30	31
Provisions for potential losses, net	11	(6.597)	(7.297)
Profit from operations before taxes		7.157	6.127
Income taxes	12	(1.202)	(901)
Net profit for the period		5.955	5.226
Other comprehensive income		502	-
Changes in the fair value of debt instruments that are measured at fair value through OSD		502	-
Total comprehensive income for the period		6.457	5.226
Earnings per share:			
- Basic earnings per share (in BAM)	25	12,60	11,15

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

The accompanying financial statements were adopted by the Bank's Management Board on 26 February 2020.

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

Bojan Luburić
President of the Management Board

MF banka
BANJA LUKA
AKCIONARSKO DRUŠTVO

Nikolina Vujkovac Pađen
Head of Accounting, Reporting, Financial Controlling and Credit Support

STATEMENT OF FINANCIAL POSITION
As at 31 December 2019
(in BAM thousand)

	Notes	31 December 2019	31 December 2018
ASSETS			
Cash and cash funds held with the Central Bank	13	101.442	109.920
Loans and receivables from banks	14	5.105	8.349
Placements with other banks	15	2.992	131
Securities	16	30.733	49
Loans to customers	17	312.760	274.880
Property and equipment	18	2.303	2.249
Intangible assets	18	278	236
Investment property	18.1	4.609	4.672
Business premises for rent	18.2	7.650	-
Other assets	19	5.887	2.747
Total assets		**473.759**	**403.233**
LIABILITIES AND EQUITY			
Liabilities			
Deposits due to banks	20	7.033	7.012
Deposits due to customers	20	362.011	312.430
Liabilities per loans	21	17.836	16.916
Subordinated debt	22	6.956	6.958
Other liabilities	23	12.006	4.074
Provisions for employee benefits and other contingent liabilities	11 a), b)	330	237
Total liabilities		406.172	347.627
Equity			
Share capital	24	51.141	46.841
Share premium		1.307	83
Equity reserves	24	1.002	238
Accumulated profit/(loss)		8.182	3.218
Profit of the current period		5.955	5.226
Total equity		67.587	55.606
Total liabilities and equity		**473.759**	**403.233**
Contingent liabilities and commitments	26	54.490	41.715

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

STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2019
(in BAM thousand)

	Share Capital	Share Premium	Equity Reserves	Accum-mulated profit/(loss)	Total
Balance 31 December 2017	46.841	83	25	4.803	51.752
Effect of IFRS 9 application	-	-	-	(1.372)	(1.372)
Balance 1 January 2018	**46.841**	**83**	**25**	**3.431**	**50.380**
Allocation of reserves to the accumulated profit	-	-	213	(213)	-
Total transactions with owners	-	-	*213*	*(213)*	-
Net profit of the current period	-	-	-	5.226	5.226
Total result of the accounting period	-	-	-	*5.226*	*5.226*
Balance 31 December 2018	**46.841**	**83**	**238**	**8.444**	**55.606**
New share issue	4.300	1.224	-	-	5.524
Allocation of reserves to the accumulated profit	-	-	262	(262)	-
Total transactions with owners	*4.300*	*1.224*	*262*	*(262)*	*5.524*
Net profit of the current period	-	-	-	5.955	5.955
Revaluation reserves based on securities	-	-	502	-	502
Total result of the accounting period	-	-	*502*	*5.955*	*6.457*
Balance 31 December 2019	**51.141**	**1.307**	**1.002**	**14.137**	**67.587**

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

STATEMENT OF CASH FLOWS
For the year ended 31 December 2019
(in BAM thousand)

	Year ended 31 December 2019	31 December 2018
Cash flows from operating activities:		
Interest receipts	29.643	27.727
Fee and commission receipts	6.828	3.994
Receipts from payments of depreciated receivables	(5.196)	514
Interest paid	(1.558)	(5.548)
Fee and commission paid	779	(379)
Payments to employees and suppliers	(13.697)	(11.790)
Net cash generated by operating activities	*16.799*	*14.518*
Changes in operating assets and liabilities:		
Net increase in loans due from customers	(47.284)	(37.395)
Loans to other banks	(2.869)	(131)
Income taxes paid	(1.160)	(775)
Net increase in bank deposits	21	7.012
Net increase in deposits due to customers	47.540	92.640
Net cash generated by / (used in) operating activities	*13.047*	*75.869*
Cash flows from investing activities:		
Purchase of intangible assets	(110)	(171)
Purchase of property and equipment	(687)	(1.243)
Purchase of other investments	(30.006)	(49)
Net cash (used in) investing activities	*(30.803)*	*(1.463)*
Cash flows from financing activities:		
Capital increase	5.525	-
Inflows from borrowings	3.131	3.010
Repayment of borrowings	(2.701)	(4.536)
Net cash (used in) / generated by financing activities	*5.955*	*(1.526)*
Net increase in cash and cash equivalents	(11.801)	72.880
Effects of change of exchange rate	29	31
Effects of change of **allowance for impairment**	50	(212)
Cash and cash equivalents, beginning of the year	118.269	45.570
Cash and cash equivalents, end of the year	106.547	118.269
Cash and cash equivalents comprise the following line items:		
- Cash and cash funds held with the Central Bank (Note 13)	101.442	109.920
- Loans and receivables due from banks (Note 14)	5.105	8.349
	106.547	**118.269**

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

1. BANK'S FOUNDATION AND BUSINESS POLICY

MF banka a.d. Banja Luka (hereinafter: the "Bank") was established on 12 June 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 dated on 11 May 2007, the Banking Agency of the Republic of Srpska (hereinafter: "BARS" or "Agency") issued an operating license to the Bank, and pursuant to Decision numbered 03-657-4/2007 dated on 12 July 2007, the Agency issued to the Bank a license to conduct international payment transactions.

At the Shareholder Assembly meeting held on 6 April 2010, the previous shareholders of the Bank enacted a Decision to sell 100% of the Bank's equity (Note 24), where after an Agreement on the Purchase and Sale of Capital was signed on 8 July 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 shareholders of the Bank, and the decision of the competent court in Banja Luka as of 26 November 2010, the Bank changed its name to 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's headquarter is in Banja Luka, Aleja Svetog Save street no. 61. As of 31 December 2019, the Bank has affiliates in Banja Luka, Prijedor, Bijeljina, Derventa, Doboj, Istočno Sarajevo, Brčko, Tuzla, Bihać, Cazin, Gradačac, Ilidža, Zenica and branch offices in Prnjavor, Teslić, Novi Grad, Zvornik, Pale, Laktaši, Gračanica, Živinice, Banja Luka, Novi Grad Sarajevo, Bugojno and Gradiška.

As of 31 December 2018, the Bank had 228 employees (31 December 2017: 213 employees).

The Management and Supervisory Boards of the Bank are: Assembly, Supervisory Board and Management Board. The members of the Supervisory Board are appointed by the Assembly of the Bank. The Bank is represented by the chairman of the Management Board.

The Bank formed Credit Boards and the Board for the Management of Assets and Liabilities as well as various Commissions.

As of 31 December 2019, the Management bodies of the Bank consist of:

Supervisory Board:
- Aleksandar Kremenović, chairman
- Mladen Bosnić, member
- Dželila Hadžović, member
- Freider Wohrmann, independent member
- Srećko Bogunović, independent member

Management Board until 01.02.2019:
- Sandra Lonco, chairman
- Bojan Luburić, member
- Dragan Đurić, member

Management Board from 01.02.2019:
- Bojan Luburić, chairman
- Sandra Lonco, member
- Dragan Đurić, member

Audit Board:
- Đurđica Dragojević, chairman
- Željko Pena, member
- Radmila Bjeljac, member
- Sanja Brkić, member
- Mira Cvijan, member

All members of the Audit Board are independent members.

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

2.1. Statement of Compliance

The accompanying financial statements represent the individual financial statements of the Bank compiled in accordance with the International Financial Reporting Standards („IFRS").

2.2. Basis of Measurement and Preparation of Financial Statements

The financial statements of the Bank have been prepared at cost (historical cost) principle, as explained in the accounting policies provided in the following passages.

Historical cost is generally based on the fair value of compensation paid in exchange for goods and received and given assets.

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 those characteristics of assets or liabilities that other market participants would also consider upon determining the price of assets or liabilities at the measurement date.

Upon preparation of the cash flow statements, the Bank used the direct method of reporting on the cash flows.

2.3. Functional and Presentation Currency

The amounts in the accompanying financial statements have been stated in Convertible Marks (BAM), being the official functional and reporting currency in Republic of Srpska and Bosnia and Herzegovina.

2.4. Going concern

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

2.5. Effects and Application of new and revised International Financial Reporting Standards („IFRS")

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

- IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019);
- IFRIC 23 interpretation: „ Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019);
- Amendments to IFRS 9 "Financial Instruments" – Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019);
- Amendments to IAS 28 "Investments in Associates and Joint Ventures –Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019);
- Annual improvement of IFRS - cycle 2015 – 2017 (effective for annual periods beginning on or after 1 January 2019);
- Amendments to IAS 19 "Employee Benefits" – Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019).

Applying these standards, amendments and interpretations has no significant impact on the Bank's financial statements in the current period, except for applying IFRS 16. More information on the effects of applying IFRS 16 is given below.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHODS (CONTINUED)

The impact of change as of 1 January 2019

The first application IFRS 16 resulted in recording usage rights of assets in the amount of BAM 7.970 thousand.
Effects of applying IFRS 16 on the statement of financial positionas at 1 January 2019:

STATEMENT OF FINANCIAL POSITION
(in BAM thousand)

	Note	31 December 2018	Initial recognition of IFRS 16	1 January 2019
ASSETS				
Cash and cash funds held with the Central Bank	13	109.920	-	109.920
Loans and receivables from banks	14	8.349	-	8.349
Investments to other banks	15	131	-	131
Securities	16	49	-	49
Loans to customers	17	274.880	-	274.880
Property and equipment	18	2.249	-	2.249
Intangible assets	18	236	-	236
Investment property	18.1	4.672	-	4.672
Business premises for rent	18.2	-	7.970	7.970
Calculated interest and other assets	19	2.747	-	2.747
Total assets		403.233	7.970	411.203
LIABILITIES AND EQUITY				
Deposits due to banks	20	7.012	-	7.012
Deposits due to customers	20	312.430	-	312.430
Liabilities per loans	21	16.916	-	16.916
Subordinated debt	22	6.958	-	6.958
Other liabilities	23	4.074	7.970	12.044
Provisions for employee benefits and other contingent liabilities	11b)	237	-	237
Total liabilities		347.627	7.970	355.597
Equity				
Share capital	24	46.841	-	46.841
Share premium		83	-	83
Equity reserves	24	238	-	238
Accumulated profit/(loss)		3.218	-	3.218
Profit of the current period		5.226	-	5.226
Total equity		55.606	-	55.606
Total liabilities and equity		403.233	7.970	411.203
Contingent liabilities and commitments	26	41.715	-	41.715

Summary of changes in accounting policies for leases under IFRS 16

IFRS 16 is applied from 1 January 2019, the Standard defines the initial recognition, measurement and disclosure of leases to both parties of a contract, that is, the buyer (the "lessee") and the supplier (the "lessor"). The key change made by IFRS 16 is the abolition of the division into financial and operational leases with the lessee, and the recognition of leases under the principle of "assets with usage right". The standard requires the lessee to recognize all assets with usage right as fixed assets and as liability in the balance sheet, unless the lease period is 12 months or shorter or if the asset is of negligible value, which aims to improve the financial reporting quality and comparability of the borrower's financial statements.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHODS (continued)

Summary of changes in accounting policies for leases under IFRS 16

At the beginning of the use of contract, the lessee should assess whether the contract, or part of the contract, represents a lease. The contract or part of the contract represents a lease if the contract regulates the assignment of the right to control the use of the identified asset in a given period in exchange for compensation. The control is assigned when the lessee is entitled to manage the use of the identified asset and to effect economic benefits by using this asset.

The Bank has defined a unique accounting model for all lease contracts. The changes effected the statement of financial position as well as the statement of profit and loss.

The Bank measured assets with usage rights based on the available data on the day of the initial application of IFRS 16. That is, the lease obligations will be recorded at the present value of the remaining lease payments, discounted at the incremental borrowing rate of the lessee with the date of the first application of the standard. The value of the leased property will be stated in the assets as the use right of the property within the position for fixed assets, while it will be stated as lease obligations in the liabilities.

According to IFRS 16 the lease expenses do not exist anymore as a position in the statement of profit and loss for long-term leases and leases of higher values, but the expenses of leased assets is recognized through: depreciation and amortization, interest rate for indebtedness and tax liabilities. Short-term leases (up to 12 months) and leases of low values are stated as leasing expenses in the statement of profit and loss.

In the statement of financial position, the Bank stated assets with usage right separately from other assets and lease obligations separately from other liabilities. In the statement of profit and loss, the Bank stated the interest expenses for lease obligations as financial expenses separately from expenses for depreciation and amortization of the given assets with usage right.

The effect of applying IFRS 16 as at 31 December 2019 amounts to BAM 158 thousand, interest expense on the lease liability amounts to BAM 373 thousand, depreciation and amortization expense of assets with usage right amounts to BAM 1.382 thousand, and the lease expense that is not subject to IFRS 16 amounts to BAM 373 thousand. Had the Bank continued to calculate the lease in accordance with IFRS 17, the lease expense as at 31 December would have been BAM 1.970 thousand (as at 31 December 2018: BAM 1.293 thousand).

Standards and interpretation in issue not yet adopted: existing Standards not yet applied

At the date of authorization of these financial statements, the following standards, amendments to existing standards and interpretation were in issue, but not yet effective and not previously adopted by the Bank:

- Changes to the provisions of the Conceptual Framework in IFRS (effective for annual periods beginning on or after 1 January 2020),
- Amendments to IFRS 3 „Business Combinations – Business definition" (effective for annual periods beginning on or after 1 January 2020);
- Amendments to IAS 1 „Presentation of Financial Statements" and IAS 8 „Accounting Policies, Changes in Accounting Estimates and Errors" – Amendments related to the Definition of Materiality (effective for annual periods beginning on or after 1 January 2020);
- IFRS 17: „Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021)
- Amendments to IFRS 9: „Financial Instruments" and IFRS 7: „ Financial Instruments: Disclosure – Interest Rate Benchmark Reform" (effective for annual periods beginning on or after 1 January 2022);
- Amendments to IAS 1 „Presentation of Financial Statements - Classification of Liabilities as Current or Non-Current" (effective for annual periods beginning on or after 1 January 2022).

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

3. SUMMARY OF SIGNIFICANT ACCOUTING POLICIES

3.1. Income and Expense from Interest and Fees

Interest income and expenses for all interest-bearing financial instruments, except for financial instruments classified as available for sale or carried at fair value through profit and loss, are stated at fair value of assets received or paid, and are presented as interest income or expenses, and fee and commission income or expenses in the statement of profit and loss and other comprehensive income.

Interest income is deferred and recognized using the effective interest method, which represents the rate that exactly discounts (reduces) the estimated future cash inflows over the expected life of financial instruments to the net carrying amount of such assets upon initial recognition.

Loan origination fees are deferred and amortized over the loan repayment period by applying the effective interest method and are presented within interest income.

Interest income is recognized exclusively based on performing loans and other investments where there are no problems in collection, i.e., based on 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.

3.2. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into Convertible Marks at the official exchange rates prevailing at the date of each transaction. Assets and liabilities denominated in foreign currencies are translated into Convertible Marks 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 Convertible Marks 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 expenses.

3.3. Property, Equipment and Intangible Assets

Property, 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:

	Rate (%)	**Useful Life (years)**
Buildings	1,3%	77
Automobiles	15,5%	6,5
Computer equipment	25%	4
Telephone switchboards	7%-10%	10-14,3
Furniture	10%-12,5%	8-10
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 necessary for them to operate in a manner intended by the Bank’s management.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.4. Investment property

Investment property is property the Bank as the owner or as user of financial lease holds for the purpose of profit earning from renting the property and/or for the purpose of capital increase, but not for the purpose of use for service provisions or for administrative purposes.

The initial recognition of the investment property is made at cost increased for related costs. The subsequent measurement of the investment property is made in the amount of the purchase value minus the total amount of calculated depreciation and amortization and accumulated impairment losses.

Depreciation and amortization are calculated equally at cost, using the following annual rates in order to completely write the assets off within their useful life:

	Rate (%)	Useful life (years)
Buildings	1,3%	77

3.5. Business premises for rent

The Bank has opted to apply IFRS 16 “Leases” from the effective date of its lease from 1 January 2019 using a cumulative catch-up approach.
At the beginning of the use of contract, the lessee should assess whether the contract, or part of the contract, represents a lease. The contract or part of the contract represents a lease if the contract regulates the assignment of the right to control the use of the identified asset in a given period in exchange for compensation. The control is assigned when the lessee is entitled to manage the use of the identified asset and to effect economic benefits by using this asset.
The Bank, as the lessee, uses the lease exemption in the case of short-term and leases for low value assets.
In accordance with IFRS 16, the Bank, as the lessee, recognizes the asset with usage right and the lease liability at the effective date of the lease. The start date of the lease is the date on which the lessor makes the underlying asset (that is, the lease asset) available to the lessee.
The Bank, as the lessee, recognizes the depreciation of the asset with usage right, the interest on the lease obligations and the tax liability as an expense of the period.
In calculating depreciation of an asset with usage right, the Bank uses the proportional method of calculation over the lease term.
As the interest rate on the lease obligations, the Bank applies an incremental borrowing rate, which is defined as the interest rate that the Bank, as the lessee, would have to borrow over a similar period and with similar guarantees to acquire funds needed to acquire an asset of similar value as an eligible asset in similar economic environment.

3.6. Impairment of Fixed Assets

At each statement of financial position date, the Bank’s management reviews the carrying amounts of the Bank’s equipment and intangible assets 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.

When an impairment loss is subsequently reversed, 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.

As of 31 December 2019, in the assessment of the Bank's management, there were no indications that the value of equipment, intangible assets and investment property had suffered impairment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7. Financial instruments

A financial instrument is considered to be any contract that creates a financial asset or a financial liability of the Bank, while creating a financial liability or a financial asset of third parties.

The classification of financial assets is as follows, respectively:

- it is measured at amortized cost if the following two conditions are met:

  a) financial assets are held within a business model aimed at holding financial assets in order to collect contractual cash flows.

  b) if the contractual terms of the financial assets generate cash flows at a specific date that are only principal and interest payments outstanding.

- it is measured at fair value through other comprehensive income if both of the following conditions are met:

  a) financial assets are held within a business model aimed at collecting contractual cash flows and selling the financial asset.
  b) contractual terms of financial assets generate cash flows at a specific date that are only principal and interest payments outstanding.

- it is measured at fair value through profit or loss unless measured at amortized cost or at fair value through other comprehensive income.

Financial liabilities are classified as liabilities at fair value through profit or loss or amortized cost. If they are held for trading, they are classified as liabilities at fair value through profit or loss.

Financial assets

Loans and receivables

Loans and receivables comprise placements with banks and placements with customers, with no intention of continuing to trade.
The Bank measures loans and receivables as financial assets at amortized cost if both of the following conditions are met:
a) financial assets are held within a business model aimed at holding financial assets in order to collect contractual cash flows.
b) if the contractual terms of the financial assets generate cash flows at a specific date that are only principal and interest payments outstanding.

Initial measurement of loans and receivables is carried at fair value. Subsequent valuation of loans and receivables is carried out using the amortized cost method using the effective interest rate.
The effective interest rate includes fees that are directly attributable to the loan and the placement.
At each balance sheet date, the Bank assesses the imparity, that is whether there is evidence that a loan / placement or group of loans / placements is impaired.
The criteria that the Bank uses to determine whether there is objective evidence of impairment include the following:

- delay in payment of contractual repayment of principal and interest,
- cash flow difficulties (decline in net profit ratios, sales revenue, capital adequacy),
- Not fulfilling contractual obligations,
- initiating bankruptcy proceedings,
- decrease in the value of collateral.

If any of the above evidence exists, the recoverable amount of the asset (value that can be recovered) must be estimated, and if it is less than the carrying amount of the asset, the impairment loss should be recognized in the income statement and the carrying amount of the asset written off to the lower recoverable amount.

In the case of loans and receivables, impairment arises if there is objective evidence that the total amount of payment determined by the contract in respect of the principal of the debt and interest will not be realized.
Impairment loss is the difference between the carrying amount of a loan and its estimated recoverable amount.
The recoverable amount is equal to the present value of expected future cash inflows per loan discounted at the effective interest rate.
Impairment is assessed individually, primarily for loans that are individually significant or on a group basis.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)
3.7. Financial instruments (continued)

Current period interest calculations for non-performing assets are treated with suspended interest, which means that further interest calculation is recorded in off-balance sheet records.
Impairment loss is recognized at the expense of the income statement. Amounts for which the loan / placement value is reduced by the loss are accounted for through the allowance account.
If the amount of the loss is reduced due to events occurring after its initial recognition, the reversal of the loss is made in favor of the income statement as a gain, but the reversal of the loss, that is the gain cannot be in excess of the amortized cost that would have been at the date of derecognition had the loss not been recognized.

The provisioning policy for loan loss is explained in detail in “Methodology for Valuation Impairment and Accounting for Provisions in accordance with IFRS 9” (Note 4).

Debt instruments at fair value through other comprehensive income

As financial assets measured at fair value through other comprehensive income, the Bank defines the category of debt instruments that are measured at fair value through other comprehensive income if the following conditions are met:

a) financial assets are held within a business model aimed at collecting contractual cash flows and selling the financial asset.

b) contractual terms of financial assets generate at a specific date cash flows that are only principal and interest payments outstanding.

Debt instruments at fair value through other comprehensive income are measured at fair value with recognition of gains and losses resulting from changes in fair value in other comprehensive income. Interest income and foreign exchange gains and losses are recognized in the income statement in the same way as financial assets carried at amortized cost. Upon derecognition, cumulative gains or losses recognized in other comprehensive income are reclassified from other comprehensive income to profit or loss.

Initial measurement is carried at fair value plus transaction costs directly attributable to their purchase / acquisition / issue.

Subsequent measurement is carried out at fair value. Fair value is determined in an active market (stock exchange) and represents the quoted price of the stock exchange on the day of the financial asset valuation or, in the absence of an active market, based on the Bank's best estimate of the fair value of those investments, using cash flow discounting methods or relying on the opinion of an independent expert.

Short - term changes in fair value are included in equity (increase and decrease).

If the Bank determines a long-term decline in the fair value of these assets, all cumulative losses recognized directly in equity are transferred from equity to profit or loss, even though the asset is not accounted for.

The Bank accepts trading dates as a method of calculating debt instruments that are measured at fair value through other comprehensive income.

Expected credit losses on debt instruments carried at fair value through other comprehensive income do not reduce the carrying amount of financial assets in the balance sheet. An amount equal to the provision that would arise if the assets were measured at amortized cost is recognized in other comprehensive income as the accumulated impairment loss with related recognition in the income statement. The accumulated amount recognized in other comprehensive income is reclassified to profit or loss after derecognition.

Financial Liabilities

Financial liabilities comprise long-term and short-term trade payables and other liabilities, that is, they represent financing instruments as a financial liability or as equity depending on the contractual terms.
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 payable, dividends, gains and losses on financial liabilities are recorded at the expense of financial expenses in the period to which they relate and are presented within other current liabilities.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7. Financial instruments (continued)

Impairment measurement and allowance for impairment

For impairment measurement, the Bank applies the concept of expected credit loss. At the end of each month, the Bank calculates and records allowance for impairment for credit losses in an amount equal to the expected credit losses, applying two methodologies, according to IFRS 9 and based on the methodology (Decision) of the Banking Agency of the Republic of Srpska.

3.8. Taxes and Contributions

Current Income Taxes

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.

3.9. 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10. Leases

The Bank as a Lessor
A lease is classified as a finance lease in all cases where the Bank is the lessor and when the lease, to the lessee, is transferred to the fullest extent all the risks and rewards of ownership of the assets. Every other lease is classified as an operating lease.

Operating lease income (rental income) is recognized using the straight-line method over the lease term. The indirect costs incurred in negotiating and contracting an operating lease are added to the carrying amount of the leased asset and are recognized on a pro rata basis over the lease term.

The Bank as a Lessee

The Bank, as a lessee, calculates the lease in accordance with IFRS 16, except in the case of short-term and leases with low value.
The Bank recognizes depreciation of the asset with usage right, interest on lease obligations, tax liability as an expense of the period, and in the case of short-term leases and leases with low value assets, the Bank recognizes the expense on a straight-line basis over the term of the lease.

3.7. Equity

Equity is not evaluated, but it is measured subsequently in the amount of paid funds based on share issues. Equity is divided to:

- Share capital,
- Share premium,
- Unallocated profit,
- Revaluation provisions,
- Legal provisions,
- Losses.

4. 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 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, Intangible Assets and Investments

The estimate of useful life of equipment, intangible assets and investments 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

The Methodology for Calculation of Expected Impairment Losses Allowance according to the request of IFRS 9 (hereinafter: „Methodology") which defines the methods and techniques used in MF Banka a.d. Banja Luka (hereinafter: the „Bank") aimed to calculate individual and collective allowance for impairment of Bank's balance sheet and off-balance sheet items, that is, all financial assets defined by the Standard.

The Methodology defines the criteria for determining the type of financial assets, criteria for receivables identification which need to be individually estimated as well as criteria for determining the receivables to be collectively estimated, and it is applied in the Bank systematically and consistently through time, by which it is enabled a timely establishment of the expected losses resulting in customers inability for liabilities settlement or significant increase in credit risk, all aimed to protect Bank's capital in the period of the loss identification and realization. The Methodology is based on the requests defined by the International Financial Reporting Standard (IFRS) 9.

Historic data used in the calculations are available for the last three years. Taking this into account, where applicable, the Methodology is based on rules and historic data, includes objective criteria of business in local market (use of real discount rate upon making estimates on the expected cash flows, collateral marketability and the time needed for realization, effective legal regulations and court practice in their implementation, current economic conditions and other relevant factors that influence the debtor's financial performance) and establishes the obligation of the Bank to estimate the current economic conditions in surroundings in which it is operating and to adjust the allowance for impairment related to the expectation on future information.

The methodology defines:
1) Type of financial assets, that is, is the asset purchased or credit decreased;
2) The stage of the financial assets;
3) Material significance limit for individual exposures;
4) Identification of exposures to be estimated/classified on an individual and group basis;
5) Individual allowance for impairment;
6) Group allowance for impairment.

4. SIGNIFICANT ACCOUNTING ESTIMATES (continued)

The Methodology includes the following:

1) identification of receivables classified on an individual and group basis, and criteria of receivables categorization into homogenous groups with similar characteristics (client type/segmentation, credit product type, receivables security instrument, accuracy in liability settlement, sector and geographic structure etc.);
2) determined methods and techniques for classification on individual and group basis, including way of estimating the expected time collection and percent of the value of receivables security instrument from which the payment will be collected (take into consideration all activation and collection costs), and factors used when determining time frame for loss estimation based on the data from previous periods;
3) analyses, estimates and other procedures used in calculation of allowance for impairment, that is, provisions, should be precisely explained and appropriately documented in writing;
4) providing the precise and up-to-date information to be considered when making estimates on receivables collection;
5) clearly determined organizational segments which have the authority on the said estimates and conditions under which it can be conducted, based on the prior experiences.

First, the Bank estimates whether there is an objective proof of impairment individually for financial assets considered individually significant, and individually or collectively for financial assets not considered as financially significant. If the Bank determines there are no objective evidence of individual impairment for the financial asset, whether significant or not, that asset is included in a group of assets with similar credit risk characteristics and the impairment is assessed in groups.

Based on the internal methodology for calculating the allowances for impairment, the exposure greater than BAM 50 thousand is considered as individually significant. The exposures of the Bank representing other receivables are subject of individual estimations due to the specific nature of each individual receivable. The procedure of impairment assessment is performed for all receivables defined in the internal methodology as materially significant. A materially significant amount is an amount greater than:

-1% of the Bank's individual receivable from the debtor – natural person, but not less than BAM 20, and
-2,5% of the Bank's individual receivable from the debtor – legal entity, but not less than BAM 500.

The estimation of individually significant investments is made for individually significant exposures (more than BAM 50 thousand) that are late more than 90 days regarding the settlement of obligations. Based on defined criteria, the risk management division finds candidates for individual assessment. After the examination of the candidates, the risk management division proposes candidates for whom the allowance for impairment on an individual basis will be calculated, while the remaining candidates will be „returned“ to the portfolio assessment and calculation of allowances for impairment.
This proposal of the risk management division is verified by the Bank's management/competent member of the risk management board.

The individual allowance for impairment is calculated as a difference between the total exposure and the sum of discounted cash flows from the regular payment and collateral realization for this client/exposure.

All loans/investments for which no individual allowance for impairment are subject to group assessment and calculation of allowance for impairment. Loans/investments are grouped into homogeneous groups with same or similar characteristics and subgroups depending on the number of days of delay, segment affiliation (and within MSME segment by product).

For all exposures which are subject to group calculation for allowance for impairment, the exposure is divided into a covered and uncovered part. The uncovered part of loans/investments is calculated as the difference between the total exposure and the value of recognized collateral. The internal methodology defines the recognized collateral values depending on the type of collateral.

The portfolio for allowance for impairment is calculated by applying % of the historical impairment for the uncovered exposure amount which is defined for this group/subgroup of investment obtained through migration of rating groups for the past three years.

4. SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Fair value

The Bank's business policy is to disclosure information on the fair value of assets and liabilities and equity for which official market information exist and when the fair value significantly varies from its carrying amount. In the Republic of Srpska, there is no sufficient market experience, nor stability or liquidity in the purchase and sale of receivables and other financial assets and liabilities and equity, since official market information are not available at all times. Therefore, the fair value cannot be reliably determined in the absence of an active market. The Bank's Management preforms a risk assessment even if it estimated that the asset value according to the business books will not be realized and an allowance for impairment is made. According to the Bank's management, the amounts in these financial statements reflect the value which is the most reliable and most useful for reporting purposes under the given circumstances.

Employee benefits

The Bank engages a certified actuary who, on behalf of the Bank, performs calculations of the present value of accumulated employee retirement benefits. In the process of calculating the present value of accumulated employee retirement benefits, the certifies actuary uses the following assumptions: projected salary growth, year of service for retirement, projected fluctuation of employees based on data on historical movement of employees in the previous period, officially published rates of mortality from the environment, as well as other conditions necessary for exercising the right to retirement benefits. According to the Bank's management, the amounts in these financial statements reflect the value which is the most reliable and most useful for reporting purposes under the given circumstances.

5. INTEREST INCOME

	(In BAM thousand) Period ended 31 December	
	2019	**2018**
Interest income from:		
Enterprises	16.947	13.999
Retail	13.794	14.020
Public sector	290	2
Non-profit organizations	7	11
Other	28	22
Total:	**31.066**	**28.054**

6. INTEREST EXPENSES

	(In BAM thousand) Period ended 31 December	
	2019	**2018**
Interest expenses from:		
Retail	6.252	4.363
Public sector	111	192
Non-banking financial institutions	636	757
Interest on subordinated debt	427	427
Interest on loans	278	299
Enterprises	148	133
Non-profit organizations	100	103
Banks and bank institutions	21	12
Other	13	14
Total:	**7.986**	**6.300**

7. FEE AND COMMISSION INCOME

(In BAM thousand)

	Period ended 31 December 2019	2018
Fee and commission income from domestic and foreign payment transactions	3.606	3.001
Income from foreign change operations	1.105	840
Fees and commissions per loans	825	729
Fees and commissions per off-balance operations	693	498
Total:	**6.229**	**5.068**

8. FEE AND COMMISSION EXPENSES

(In BAM thousand)

	Period ended 31 December 2019	2018
Fee and commission payable to the Central Bank for domestic payment transfers	657	435
Payment/credit card operation fees	553	374
Sale and purchase of currencies	180	172
Fee and commission expense from international payment transactions	79	50
Loan processing fees	12	17
Other fees and commissions	77	90
Total:	**1.558**	**1.138**

9. OTHER OPERATING INCOME

(In BAM thousand)

	Period ended 31 December 2019	2018
Collection of written-off suspended interest	788	540
Other income	870	357
Total:	**1.658**	**897**

10. OTHER OPERATING EXPENSES

(In BAM thousand)

	Period ended 31 December 2019	2018
Gross employee benefits	7.014	6.465
Remunerations to members of the Supervisory Board, Audit Committee, employees help	144	115
Professional education of employees	32	56
Materials and services	491	462
Business trips	56	38
Telecommunication and postage services	539	495
Equipment/software maintenance	532	620
Marketing and advertising	222	352
Rent	373	1.293
Membership fees	131	106
Representation	241	128
Assets' security services	789	559
Depreciation/Amortization	2.132	672
Taxes and contributions	240	202
Fees to the Banking Agency of the Republic of Srpska	346	316
Write-off of uncollectable receivables	370	46
Fees for third party engagements	56	48
Other	1.977	1.215
Total:	**15.685**	**13.188**

Gross employee benefits	**Period ended 31 December 2019**	**2018**
Net salaries	4.162	3.945
Taxes and contributions on salaries	2.852	2.520
Total gross employee benefits:	**7.014**	**6.465**

11. PROVISIONS FOR POTENTIAL LOSSES

a) Charged expenses

(In BAM thousand)

	Period ended 31 December 2019	2018
Cash assets and cash with other banks	(146)	(245)
Loans due from customers	(32.143)	(28.408)
Other assets	(734)	(519)
Employee benefits	(5)	(7)
Contingent liabilities and commitments	(955)	(699)
Total:	**(33.983)**	**(29.878)**

b) Reversal of provisions in favor of income

(In BAM thousand)

	Period ended 31 December 2019	2018
Cash assets and cash with other banks	196	56
Loans due from customers	25.531	21.629
Other assets	791	258
Employee benefits	-	3
Contingent liabilities and commitments	868	635
Total:	**27.386**	**22.581**
Net provisions	**(6.597)**	**(7.297)**

c) Movements during the period for long-term provisions for potential losses and commitments

(In BAM thousand)

	Cash assets and assets held at other banks	Loans due to customers	Other assets	Employee benefits	Contingent liabilities and commitments	Contingent liabilities and commitments – court proceedings	Total
Balance 1 January 2018	**23**	**22.252**	**767**	**26**	**136**	**7**	**23.211**
Provisions for the period	245	28.408	519	7	679	20	29.878
Reversal of provisions	(56)	(21.629)	(258)	(3)	(618)	(17)	(22.581)
Balance 31 December 2018	**212**	**29.031**	**1.028**	**30**	**197**	**10**	**30.508**
Balance stated 1 January 2019	**212**	**29.031**	**1.028**	**30**	**197**	**10**	**30.508**
Provisions for the period	146	32.143	649	5	881	74	33.898
Provision for the period based on securities through other comprehensive income	-	-	85	-	-	-	85
Reversal of provisions	(196)	(25.531)	(791)	-	(868)	-	(27.386)
Accounts receivable written off	-	(8.399)	-	-	-	-	(8.399)
Balance 31 December 2019	**162**	**27.244**	**971**	**35**	**210**	**84**	**28.706**

12. INCOME TAXES

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

(In BAM thousand)

	Period ended 31 December 2019	2018
Profit before taxes	7.157	6.127
Income tax calculated at the rate of 10%	715	613
Tax reduction for tax exempt income	(1.477)	(1.074)
Expenses not recognized for tax purposes – impairment of loans and other assets	1.797	1.248
Other expenses not recognized for tax purposes	82	114
Deferred tax assets	85	-
Total income tax	1.202	901
Income tax RS	778	659
Income tax realized in the branch office in Brčko District	50	52
Income tax realized in the branch offices in FBiH	374	190
Total income tax	1.202	901
Effective income tax rate	16,79%	14,71%

For the financial year 2019, the Bank paid monthly income tax advances for the Republic of Srpska, Brčko District and the Federation of Bosnia and Herzegovina in the amount of 1/12 of the calculated income tax for 2018.

Tax liabilities are stated in the Bank's tax returns and accepted as such but may be subject to control by the tax authorities for a period of five years after their acceptance. The Bank's management is not aware of any circumstances that could give rise to potential material liability in this regard or challenge the income tax returns.

13. CASH AND CASH FUNDS HELD WITH THE CENTRAL BANK

(In BAM thousand)

	31 December 2019	31 December 2018
Cash funds:		
- in BAM	6.312	5.158
- in foreign currencies	3.995	4.345
	10.307	**9.503**
Funds at the Central Bank of BiH in BAM:		
- Gyro account	51.826	66.712
- Foreign cash funds	1.010	677
	52.836	67.389
Gross value	**63.143**	**76.892**
Allowance for impairment of cash assets	(148)	(189)
Total:	**62.995**	**76.703**
Obligatory reserve	38.447	33.217
Total:	**101.442**	**109.920**

In accordance with the Decision of the Central Bank of Bosnia and Herzegovina on the determination and maintenance of obligatory reserves, the Bank is obliged to maintain and calculate the obligatory reserve for deposits (which form the basis for the calculation of required reserves) according to the balances at the end of each business day within ten calendar days which precede the maintenance period. The obligatory reserve rate applied by the Central Bank to the principal for the calculation of the obligatory reserves represents 10% of the sum of total deposits. The principal for calculating the obligatory reserves includes accrued interest, fees and commissions that are due.

14. LOANS AND RECEIVABLES FROM BANKS

(In BAM thousand)

	31 December 2019	31 December 2018
Loans and receivables due from banks:		
- domestic banks	4.174	5.166
- foreign banks	945	3.206
	5.119	**8.372**
Allowance for impairment of cash assets	(14)	(23)
Total:	**5.105**	**8.349**

15. PLACEMENTS WITH OTHER BANKS

(In BAM thousand)

	31 December 2019	31 December 2018
Placements with other banks:		
- short-term deposits in BAM	3.000	-
- long-term deposits in a foreign currency	-	133
	3.000	**133**
Allowance for impairment of placements with other banks	(8)	(2)
Total:	**2.992**	**131**

16. SECURITIES

(In BAM thousand)

	31 December 2019	31 December 2018
Securities - war damage stated at fair value through other comprehensive income	1.790	49
Securities – Republic of Srpska government bonds, stated at fair value through other comprehensive income	28.580	-
Accrued interest	363	-
Total:	**30.733**	**49**

Debt securities as at 31 December 2019 in the amount of BAM 30.370 thousand are classified as assets available-for-sale at fair value through other comprehensive income and are measured at fair value.

The following table provides an overview of debt securities classified at fair value through other comprehensive income by internal rating and impairment:

(In BAM thousand)

				31 December 2019
Securities	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities available-for-sale	30.733	-	-	30.733
Total:	30.733	-	-	30.733

Fair value movements in available-for-sale debt securities classified as other comprehensive income at expected loss levels:

16. SECURITIES (continued)

	Level 1	Level 2	Level 3	Total
Fair value as at 1 January 2019	49	-	-	49
Purchased principle instruments	30.006	-	-	30.006
Purchased interest instruments	14	-	-	14
Repaid principle instruments	(27)	-	-	(27)
Repaid interest instruments	(15)	-	-	(15)
Accrued interest	289	-	-	289
Change in fair value of principle	342	-	-	342
Change in fair value based on discount / premium depreciation	75	-	-	75
Fair value as at 31 December 2019	30.733	-	-	30.733

Movements in provisions for debt securities available-for-sale classified at fair value through other comprehensive income at expected loss levels:

	Level 1	Level 2	Level 3	Total
Value adjustment as at 1 January 2019	-	-	-	-
Provision during the year	86	-	-	86
Reversal during the year	(1)	-	-	(1)
Value adjustment as at 31 December 2019	85	-	-	85

17. LOANS TO CUSTOMERS

(In BAM thousand)

	31 December 2019	**31 December 2018**
Short-term loans in BAM	62.825	58.029
Short-term loans in foreign currencies	1	20
Long-term loans in BAM	194.190	170.622
Long-term loans in foreign currencies	116	-
Guarantees paid	446	79
Current portion of long-term loans	82.426	75.161
	340.004	**303.911**
Less: Impairment allowance of loans due from customers	(27.244)	(29.031)
Total:	**312.760**	**274.880**

During 2019, an accounting write-off of loans in the amount of BAM 8.399 thousand was carried out, ie the transfer of their balance sheet exposures after the Bank had recorded the expected credit losses in the amount of 100% of gross book value, and declared them fully due on off-balance sheet records, in accordance with the Decision on Credit Risk Management and Determination of Expected Credit Losses of the Banking Agency of the Republic of Srpska.

Until 31 December 2019, the Bank issued mostly long-term loans, an in smaller amount short-term loans, at annual interest rates ranging from 1,65 % to 15,5%. Loans with annual interest rate ranging from 1,65% to 6,49% are loans approved from the Investment and Development Bank of the Republic of Srpska, or are loans ensured/covered partially or fully with purpose-specific term deposits. As an insurance for approved loans, the Bank took deposits, pledge over movable and unmovable property, securities, administrative injunctions, bills of exchange and transfer orders. The organizational risk department of the Bank is continuously monitoring the market value of insurance instruments.

Most of the loans with a period of over one-year in local currency as of 31 December 2019 were issued to enterprises and population with an annual interest rate ranging from 6,49% do 14,50%, plus 6-month EURIBOR, for periods of 5 years up to the maximum of 10 years. The interest rate of 1,65% was approved to clients who had a 100% attributive term deposit held at the Bank as collateral, while the interest rates higher than 15,50 % relate to long-term loans assumed from MKD Mikrofin d.o.o. Banja Luka.

The largest portion of long-term investments approved to population included general consumer loans, housing loans, construction and adaptation loans, investments of individuals, while the loans given to legal entities include long-term loans intended for financing non-current assets, investments and permanent current assets.

The geographic concentration of loans approved to customers as included in the Bank’s loan portfolio mostly comprises customers domiciled in the regions of the City of Banja Luka (ca. 13,43 %) of the total portfolio, City of Bijeljina (ca. 6,59%) Laktaši (4,51%), City of Prijedor (ca. 4,31%), Brčko District (ca. 3,99%).

18. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

(In BAM thousand)

	Leasehold improve-ments	Buildings	Equipment	Equipment in the course of construc-tion	Total property and equipment	Intangible assets
Balance,1 January 2018	**526**	**4.834**	**3.200**	**8**	**8.568**	**1.050**
Acquisitions	361	-	813	69	1.243	171
Disposals	-	(4.834)	-	-	(4.834)	-
Balance, 31 December 2018	**887**	**-**	**4.013**	**77**	**4.977**	**1.221**
Acquisitions	172	-	515	-	687	110
Transfers from/to	-	-	77	(77)	-	-
Sale	-	-	(26)	-	(26)	-
Disposals	(54)	-	(108)	-	(162)	-
Balance, 31 December 2019	**1.005**	**-**	**4.471**	**-**	**5.476**	**1.331**
Depreciation						
Balance,1 January 2018	**251**	**99**	**1.928**	**-**	**2.278**	**925**
Transfer from/to	-	(99)			(99)	
Depreciation	100	42	449	-	591	60
Depreciation transfer from/to	-	(42)	-	-	(42)	-
Balance, 31 December 2018	**351**	**-**	**2.377**	**-**	**2.728**	**985**
Depreciation	151	-	468	-	619	68
Sale	-	-	(26)	-	(26)	-
Disposals	(52)	-	(96)	-	(148)	-
Balance, 31 December 2019	**450**	**-**	**2.723**	**-**	**3.173**	**1.053**
Balance, 31 December 2018	**536**	**-**	**1.636**	**77**	**2.249**	**236**
Balance, 31 December 2019	**555**	**-**	**1.748**	**-**	**2.303**	**278**

As at 31 December 2019, equipment and property are secured from general risks and the Bank is not charged and no pledge on property, equipment and intangible investments.

18.1. INVESTMENT PROPERTY

(In BAM thousand)

Investment property	
Cost	
Balance,1 January 2018	-
Transfer	4.834
Balance, 31 December 2018	**4.834**
Acquisition	-
Balance, 31 December 2019	**4.834**
Amortization	
Balance,1 January 2018	**-**
Transfer	141
Amortization	21
Balance, 31 December 2018	**162**
Amortization	63
Balance, 31 December 2019	**225**
Balance, 31 December 2018	**4.672**
Balance, 31 December 2019	**4.609**

18.1. INVESTMENT PROPERTY

The property in Vase Pelagića street no. 22 is in accordance with IAS 40 classified in investment property and is stated in the amount of BAM 4.834 thousand. Investment property shall be measured at cost method.

As at 31 December 2019, the court expert for constructions assessed the property and the estimated value amounts to BAM 4.655 thousand.

18.2. BUSINESS PREMISES FOR RENT

	(In BAM thousand)
Balance, 31 December 2018	-
Effects of IFRS 16 application	7.970
Balance as at 1 January 2019	**7.970**
New acquisitions	1.062
Depreciation	(1.382)
Balance, 31 December 2019	**7.650**

The following table shows the maturity analysis of the contractual undiscounted lease obligation:

	(In BAM thousand) 31 December 2019
Less than a year	1.547
From one to five years	4.450
More than five years	3.294
Total contractual lease obligations	**9.291**
Rental obligations included in note 23 as at 31 December 2019	**7.808**

Amounts recognized in the Bank's income statement and other comprehensive income:

	(In BAM thousand) Period ended 31 December 2019
Interest on lease obligations IFRS 16	373
Depreciation	1.382
Total	**1.755**

19. OTHER ASSETS

	31 December 2019	31 December 2018
		(In BAM thousand)
In BAM:		
- Funds obtained by collection of receivables	3.744	1.854
- Purchased receivables	1.635	437
- Accrued other expenses	239	223
- Fee and commission receivables	105	71
- Material inventories	88	29
- Given advances	47	50
- Receivables from accrued interest (factoring)	-	1
- Other receivables	779	970
In foreign currencies:		
- Accrued receivables for calculated expenses	32	44
- Advances in foreign currencies	33	11
- Other foreign currency receivables	61	85
	6.763	**3.775**
Minus: Allowance for impairment of accrued interest and other assets	(876)	(1.028)
Total:	**5.887**	**2.747**

20. DEPOSITS TO CUSTOMERS

(In BAM thousand)

	31 December 2019	31 December 2018
Demand deposits in BAM:		
- Government and state institutions	3.388	1.826
- Enterprises	13.028	11.974
- Banks and banking institutions	33	12
- Non-profit organizations	1.167	1.321
- Non-banking financial institutions	6.964	11.686
- Residents/non-residents	25.331	18.651
- Other	270	352
	50.181	**45.822**
Demand deposits in foreign currencies:		
- Enterprises	5.279	2.150
- Non-profit organizations	1.942	1.550
- Non-banking financial institutions	1.574	125
- Residents/non-residents	6.719	5.424
- Other	-	5
	15.514	**9.254**
Short-term deposits in BAM:		
- Banks and banking institutions	7.000	7.000
- Government and state institutions	500	1.622
- Enterprises	-	126
- Non-banking financial institutions	18.077	22.077
- Residents	620	377
- Other	82	51
	26.279	**31.253**
Short- term deposits in foreign currencies:		
- retail	777	245
	777	**245**
Long- term deposits in BAM:		
- Government and state institutions	950	10.558
- Enterprises	8.214	4.580
- Non-profit organizations	1.259	3.664
- Non-banking financial institutions	17.584	19.781
- Residents	92.881	69.397
- Other	500	641
	121.388	**108.621**
Long-term deposits in foreign currencies:		
- Enterprises	2.097	2.076
- Non-banking financial institutions	2.065	2.065
- Residents/non-residents	149.570	118.932
- Non-profit organizations	1.173	1.174
	154.905	**124.247**
Total:	**369.044**	**319.442**

20. DEPOSITS TO CUSTOMERS (continued)

Current maturity of long-term deposits

(In BAM thousand)

	31. December 2019	31 December 2018
Long-term portion of long-term deposits, in BAM		
- Government and state institutions	150	58
- Enterprises	3.784	3.171
- Non-profit organizations	2	1.051
- Non-banking financial institutions	7.354	10.161
- Residents	54.832	38.822
- Other	500	1
	66.622	**53.264**
Long-term portion of long-term deposits, in foreign currencies		
- Enterprises	2.097	903
- Non-banking financial institutions	1.565	500
- Residents	87.406	67.298
- Non-profit organizations	1.173	1
	92.241	**68.702**
Current maturity of long-term deposits, in BAM		
- Government and state institutions	800	10.500
- Enterprises	4.430	1.409
- Non-profit organizations	1.257	2.613
- Non-banking financial institutions	10.230	9.620
- Residents	38.049	30.575
- Other	-	640
	54.766	**55.357**
Current maturity of long-term deposits, in foreign currencies		
- Enterprises	-	1.173
- Non-banking financial institutions	500	1.565
- Residents	62.164	51.634
- Non-profit organizations	-	1.173
	62.664	**55.545**
Total long-term deposits in BAM:	**121.388**	**108.621**
Total long-term deposits in foreign currencies:	**154.905**	**124.247**

21. LIABILITIES PER LOANS

(In BAM thousand)

	31 December 2019	31 December 2018
In BAM:		
- „Fond za razvoj i zapošljavanje RS“	4.433	5.067
- „Fond stanovanja RS“	9.236	8.388
- „Fond za razvoj istočnog dijela RS“	4.144	3.461
Total in BAM:	**17.813**	**16.916**
Deferred interest liabilities in foreign currencies per long-term loans of non-residents	23	-
Total long-term portion of liabilities:	**17.836**	**16.916**
Current maturity:		
- IRB	2.320	2.039
Total current maturity of long-term liabilities:	**2.320**	**2.039**

21. LIABILITIES PER LOANS (CONTINUED)

As at 31 December 2019, the total liabilities balance based on loans from the funds managed by the Investment and Development Bank of the Republic of Srpska amounted to BAM 17.813 thousand (31 December 2018: BAM 16.916 thousand).

22. SUBORDINATED DEBT

(In BAM thousand)

	31 December 2019	**31 December 2018**
EFSE, Luxembourg	6.845	6.845
Deferred interest liabilities in foreign currency per long-term subordinated loans	111	113
Total:	**6.956**	**6.958**

In its Decision no. 03-1515-3/16 dated 7 October 2016, BARS approved of inclusion of subordinated debt into the Bank's supplementary capital in the amount of BAM 6.845 thousand.

Accordingly, on 13 October 2016, the Bank and EFSE, Luxembourg signed an agreement on subordinated debt amounting to BAM 6.845 thousand, for the period of 6 years, with one-off repayment at an interest rate of 6,2 % annually, intended for strengthening the Bank's total capital.

The loan amount was transferred to the Bank's foreign currency account on 21 October 2016.

As at 31 December 2019 the Bank was not in breach of any financial covenants as agreed with EFSE, Luxembourg.

23. OTHER LIABILITIES

(In BAM thousand)

	31 December 2019	**31 December 2018**
In BAM:		
- deferred income	2.519	2.304
- trade payables	211	357
- deferred expenses	52	--
- lease liabilities – IFRS 16 (note 18.2)	7.808	-
- other liabilities	1.349	1.219
In foreign currency:		
- trade payables	42	40
- other liabilities	25	154
Total:	**12.006**	**4.074**

24. EQUITY

Share capital

The share capital of the Bank was formed from the initial investments of shareholders and the subsequent capital increase. The Bank's share capital as of 31 December 2019 totaled BAM 51.141 thousand (as of 31 December 2018, it totaled BAM 46.841 thousand) and was comprised of 511.410 common shares with nominal value of BAM 100 per share.
In 2019, there was an increase in share capital and a change in the structure of shareholders, and according to the statement of the Central Registry of Securities of the Republic of Srpska, as at 31 December 2019, it was as follows:

	Number of shares	In thousands of BAM	%
MKD Mikrofin d.o.o., Banja Luka	404.981	40.498	79,19
Nederlandse Financierings - Maatschappij voor Ontwikkelingslanden N.V. (hereinafter: FMO). Holland	59.170	5.917	11,57
KfW, Germany	47.259	4.726	9,24
	511.410	51.141	100,00

As at 31 December 2018, the structure of the Bank's share capital was as follows:

	Number of shares	In thousands of BAM	%
MKD Mikrofin d.o.o., Banja Luka	366.956	36.696	78,34
Nederlandse Financierings - Maatschappij voor Ontwikkelingslanden N.V. (hereinafter: FMO). Holland	54.195	5.419	11,57
KfW, Germany	47.259	4.726	10,09
	468.410	46.841	100,00

Equity reserves

(In BAM thousand)

	31 December 2019	31 December 2018
Legal reserves	500	238
Revaluation reserves based on value changes in securities	417	-
Revaluation reserves based on provisions of securities IFRS 9	85	-
	1.002	**238**

Equity reserves in the amount of BAM 262 thousand (31 December 2018 in the amount of BAM 238 thousand) incurred from the issuing funds from profit to legal reserves pursuant to the Assembly's Decision no. NO-132/2019 dated 30 April 2019 and the Bank's the Assembly no. SK -7/2019 dated 20 June 2019.

25. EARNINGS PER SHARE

(In BAM thousand)

	31 December 2019	31 December 2018
Net profit of the period	5.955	5.226
Weighted average number of shares	472.533	468.410
Basic earnings per share (in BAM)	12,60	11,15

Given the fact that the Bank has no potentially diluting ordinary shares such as convertible debt and share options, diluted and basic earnings per share are identical.

26. CONTINGENT LIABILITIES AND COMMITMENTS

a) Payment guarantees, contract execution guarantees, and other irrevocable commitments

	31 December 2019	31 December 2018
Payment guarantees	11.473	10.564
Contract execution guarantees	21.320	12.518
Irrevocable commitments for undrawn loans	14.741	11.983
Unused overdrafts on accounts and credit cards	6.956	6.650
Total	**54.490**	**41.715**
Allowance for impairment	(210)	(197)
Total	**54.280**	**41.518**

b) Litigations

As at 31 December 2019, the Bank has initiated 1.136 litigations. The total portfolio value received on this basis in the Legal Affairs and Debt Collection Departments as of 31 December 2019 amounted to BAM 18.949 thousand (31 December 2018: BAM 13.914 thousand).

As at 31 December 2019, there were 11 litigations initiated against the Bank. Considering the nature of the dispute, the Committee on the assessment of the risk of loss in court proceedings against the Bank determines that the Bank's estimated performance in all of these litigations is over 50%, and in accordance with the Bank's Procedure performance evaluation and determination of provisions in proceedings pending against the "MF banka "a.d. Banja Luka, by Decision of the Management Board of the Bank no. UP-403/2019 dated 31 December 2019, the proposal of the Board was confirmed and provisions for litigation were made, which as of 31 December 2019 amount to BAM 84 thousand.

c) Regulatory Compliance

The Bank is obligated to reconcile the scope of its business operations with the legally prescribed ratios, that is to maintain the scope and structure of its investments in compliance with the accounting standards and regulations of the Republic of Srpska, established by the Banking Agency of the Republic of Srpska.

As at 31 December 2019, the Bank prepared and submitted its statements in compliance with accounting standards and regulations of the Republic of Srpska, established and by the Banking Agency of Republic of Srpska.

27. TRANSACTIONS WITH RELATED PARTIES

		(In BAM thousand)
Statement of financial position	**31 December 2019**	**31 December 2018**
Assets:		
Receivables based on placed loans:		
- Management, Management Board and Supervisory Board	538	298
- MKD Mikrofin d.o.o., Banja Luka (mother company)	-	1.000
- Drvex d.o.o., Laktaši	245	319
- Meridian a.d., Banja Luka	1.000	-
- Interest receivables	-	13
- Accrued interest	3	1
Assets, Total	**1.786**	**1.631**
Liabilities based on deposits:		
- Transaction accounts of the Management, Management Board and Supervisory Board	1.000	649
- Other related natural persons	1.331	369
- MKD Mikrofin d.o.o., Banja Luka (mother company)	3.528	5.129
- MF Software d.o.o., Banja Luka	115	134
- Mikrofin osiguranje a.d., Banja Luka	5.938	6.393
- Citizens' Association Mikrofin	615	690
- Other	325	120
	12.852	13.484
Other liabilities		
- Other liabilities	4	5
	4	5
Interest liabilities:		
-Mikrofin osiguranje a.d., Banja Luka	-	1
- Related natural persons	48	9
	48	10
Liabilities, total	**12.904**	**13.499**
Liabilities, net	**(11.118)**	**(11.868)**

27. TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

(In BAM thousand)

Profit and loss statement	**For the period ended 31 December 2019**	**31 December 2018**
Income		
Fee income from related parties:		
- MKD Mikrofin d.o.o., Banja Luka	575	545
- Mikrofin osiguranje a.d., Banja Luka	14	-
- MF SOFTWARE d.o.o., Banja Luka	1	1
- Drvex d.o.o., Laktaši	5	5
Rental income		
- MKD Mikrofin d.o.o., Banja Luka	523	232
- MF SOFTWARE d.o.o., Banja Luka	79	20
- Interest income from other related parties	28	45
Income, Total	**1.225**	**848**
Expenses		
Rental expenses		
- MKD Mikrofin d.o.o., Banja Luka	(29)	(29)
- Drvex d.o.o. Laktaši	(39)	(16)
- Mikrofin osiguranje a.d., Banja Luka	(51)	(51)
- MF SOFTWARE d.o.o., Banja Luka	(239)	(219)
Other expenses		
- MF SOFTWARE d.o.o., Banja Luka - license	(117)	(79)
- MF SOFTWARE d.o.o., Banja Luka - OS	(146)	-
- Mikrofin osiguranje a.d., Banja Luka - insurance	(249)	(184)
- Other expenses	(16)	-
Interest expenses:		
-Mikrofin osiguranje a.d., Banja Luka	(76)	(93)
-Citizens' Association Mikrofin, Banja Luka	(11)	(11)
-Bank's management	(11)	(4)
-Other related parties	(29)	(2)
-Remunerations to the members of the Bank's Management, Management Board and Supervisory Board	(1.183)	(893)
Expenses, Total	**(2.196)**	**(1.581)**
Expenses, net	**(971)**	**(733)**

28. TAX RISKS

Republic of Srpska and Bosnia and Herzegovina currently have several tax laws on regulating various taxes imposed by various governmental agencies. The applicable taxes include value added tax, income tax, taxes on wages (social taxes), among others. In addition, laws regulating these taxes were not enforced for a substantial period of time, contrary to similar legislation in more developed market economies. Moreover, the regulations defining the implementation of these laws are often unclear or non-existent. Hence, there is a limited number of cases, regrading tax legislation, which can be exemplified. There are, often, differences in opinions pertaining to legal interpretations of tax legislation among governmental ministries and organizations, thus creating uncertainties and conflict of interest.
Tax declarations, together with other legal compliance matters (e.g. customs and currency control matters) are subject to the review and investigation by a number of authorized agencies that are legally enabled to impose extremely severe fines and penalty interest charges.

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 determined with additional taxes, penalties and interests. In accordance with the Law on Tax Procedure of the Republic of Srpska, expiration period of the tax liability is defined at five years. This actually means that tax authorities could determine payment of non-settled liabilities in the period of five years from the occurrence of the liability. All these circumstances contribute to the fact that tax risks in the Republic of Srpska and Bosnia and Herzegovina are substantially more significant than those typically existing in countries with more developed tax systems.

29. THE CURRENT ECONOMIC SITUATION AND ITS EFFECT ON THE BANK'S BUSINESS

During 2019, the Bank was under certain impact of the global economic and financial crisis, as well as the significant decline of the economic activities in BiH. Even besides significant loan activities during 2019, the Bank did not have problems with liquidity.

Until now, the current financial crisis had a limited impact on the financial position and performances of the Bank, first of all because of the internal risk management policies and regulatory constraints, the Bank has taken several measures to prevent the impairment of risks on time, such as:

- review of policies and procedures for loan approvals, assessment of loan risks, and risk management.
- adjusting the offer of products and services to clients' needs and the structure of available resources.
- approval of loan restructuring in order to adjust the payments to the real resources of the client.
- re-evaluation of collateral when re-granting and restructuring of loans.

The Bank carefully monitors loan risks, liquidity risks, interest and foreign exchange risks on a regular basis. It is expected the liquidity of the Bank will be at a satisfactory level in the future period.

The economic situation in the country is likely to effect on the position of certain industries, as well as the ability of some clients to service their loan obligations, which may affect the Bank's provisions for losses based on impairments after 31 December 2018, and then on other segments for which the Bank's management is expected to provide assessments, including the value estimation of collateral and securities. The financial statements of the Bank contain significant accounting estimations related to losses after decreasing the value of assets. After 31 December 2019, the Bank will be concentrated on the managing its financial portfolio in accordance with the changes in the business environment.

30. FINANCIAL INSTRUMENTS

30.1. Financial risk management

The Bank is exposed to various types of financial risks based on its activities which include, among others, 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 established the risk management system in order to be able to identify, estimate and monitor risks it is 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 decisions by BARS.

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 as well as 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’s activities 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 all requests for risk-weighted products of the Bank (at the proposal of the Bank’s Credit Committee) in an individual amount greater than BAM 2.000.001. The Supervisory Board appoints members of the Bank’s Credit Committee and relieves them of duty.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.1. Financial risk management (continued)

The Management Board

The Management Board of the Bank is responsible for creation, development and timely submission of proposals to the Supervisory Board regarding implementation of programs, policies and procedures for risk identification, measurement, assessment and management.

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

The Credit Committee

Within the defined crediting policy of the Bank, the Bank's Credit Committee makes decisions on loans from BAM 200 thousand up to BAM 1 million of a single exposure, that is from BAM 300 thousand up to BAM 1,5 million of customer level or a group of related entities exposure. Decisions on loans below the aforesaid amounts falls under remit of Credit Committees of market sectors or Credit Committees of branch offices.

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 the total exposure regarding individuals in excess of BAM 20 thousand, and the total exposure regarding legal entities in excess of BAM 50 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 can exercise its 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.
In addition to regular reports, the Risk Management Department prepares in-depth analyzes of the quality of exposures and collateral coverage that will allow for a better understanding, acceptance and mitigation of credit risk.

The Treasury and Transaction Department

The Treasury and Transaction Department accomplishes its liquidity management role through the following activities:

- planning the inflow and outflow of cash on a daily basis,
- monitoring of business changes and balance of funds in the reserve account with the CBBH, in the accounts with correspondent banks abroad and in the country, as well as in cash in local and foreign currency in the treasury and in the cashiers of the Bank,
- obtaining missing funds or placing excess liquid assets in the financial markets,
- monitors large individual outflows / inflows of depositors' funds, monitors loan disbursements, all with the aim of maintaining foreign currency position, maturity structure and fulfillment of all due obligations on time,
- analysis of the structure and maturity of deposits by undertaking the activities of re-arranging the maturity of the matured deposits,
  maintains and allocates statutory reserve requirements as a minimum amount of funds allocated to the reserve account with the CBBH,
- prepares daily, monthly and six-month liquidity plans as a method of estimating future liquidity,
- internal and external reporting on liquidity developments.

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.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.1. Financial risk management (continued)

Loan Management Committee

The principal role of the Loan Management Committee is to oversee the quality of the Bank's assets, credit risk monitoring process and its efficiency, monitor collection processes within the Loan Restructuring and Legal Affairs Departments, and monitor the realization of these processes in conformity with the business goals of the Bank. The Committee's task is monitoring the credit process in all its phases, and in the event that a bottleneck is identified, prepare a proposal to the Management Board of the Bank for definition of measures, actions and responsibilities to eliminate such situations. In addition, its role is to coordinate and strategically direct the processes and activities among all the business functions of the Bank involved in the credit process in order to optimize the process in all its phases and achieve the targeted goals and amounts, along with the regular control related to such processes. This Committee is also competent to approve of the departures from the defined collection procedures and of the proposals for improvement of the loan portfolio quality.

Liquidity Committee

The Bank's Liquidity Committee, comprised of three members appointed by the Bank's Supervisory Board – a member of the Management Board, the Manager of the Treasury and Transactions Department and Manager of the Risk Management Department, has meetings at least once on a monthly basis. The Committee 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 Committee and Management Board.
The Committee 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 settle its current liabilities as these fall due.

Risk Management Committee

The Risk Management Committee is composed of the President of the Bank's Management Board, members of the Bank's Management Board, the Head of the Risk Management Sector and the Risk Management Control Function. The Committee meets once a month. The Commission continuously and systematically monitors all risks to which the Bank is or may be exposed in its operations by monitoring compliance of the Bank with the Bank's Risk Management and Risk Management Strategy, the Bank's Risk Management Policy and the Bank's Risk Tendency Statement.

30.2. Risk Management System and Mitigation Techniques

The most significant risks to which the Bank is exposed are credit risk, market risk, liquidity risk and operational risk.
In its business the Bank inevitably encounters various risk types which can produce adverse effects to the Bank's business. Bank's risk management system is comprised with the risk management strategy and policy, internal organizational structure of the bank, effective and efficient process of managing all the risk to which Bank is exposed or could be exposed in its business, adequate internal control system and the appropriate information system as well as adequate internal control estimate on capital adequacy.
In order to ensure an effective risk management and considering the need of minimizing conflicts of interests between risk transfer, limitation of risk levels and controls, as well as audit of the risk management system, a comprehensive risk management system of the Bank is established, according to the principle „3 lines of defense“. „First line of defense“ has the aim to: identify, estimate, mitigate, monitor and control risk in accordance with the risk limits determined in the second line of defense. „Second line of defense“ is aimed to compliance with the determined limitations and is not dependent on the first line of defense. “Third line of defense“ has the aim to independently estimate the compliance of the risk management system with internal and external requests.
In its business, the Bank's uses mitigation techniques in order to reduce credit risk related to the exposure or exposures the Bank has, and which includes material and immaterial credit security.
Material credit security is a credit risk mitigation technique according to which the decrease of credit risk by Bank's exposure comes from the Bank's right to, in instances of the counterparty's inability for liabilities settlement, or other credit events related to the counterparty, capitalize or transfer to its entity or appropriate or keep certain assets or amounts, or to decrease the amount of exposure to the amount representing the difference between the exposure amount and credit security amount.
Immaterial credit security is a credit risk mitigation technique according to which the decrease of credit risk by Bank's exposure results from the third party's obligation for payment of a certain amount in

instances of counterparty's inability for liabilities settlement or certain other credit events.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.2. Risk Management System and Mitigation Techniques (continued)

In its regular course of business, the Bank is specifically exposed to the following risks:

- Credit risk, including residual risk, risk of impairment of receivables, settlement/delivery risk, and the counterparty risk;
- Concentration risk, which specifically includes exposure risk to a single entity or group of related entities;
- Liquidity risk;
- Market risks (interest rate risk, foreign exchange risk and other);
- Operational risk;
- Bank's investment risk;
- Strategic risk;
- Bank's business compliance risk;
- Risk of money laundering and terrorism financing.

30.3. Allowance for impairment of receivables (IFRS 9 application – Financial instruments)

The application of IFRS 9 began on 1 January 2018 and since then the Bank has defined strategies, policies and procedures related to the Bank's business models, which are evidence for formally documenting existing business models, defining new ones and adapting them to IFRS 9.

The Supervisory Board of the Bank has adopted the Methodology for Calculation of Expected Impairment Losses Allowance according to the request of IFRS 9 (hereinafter: „Methodology“) which defines the methods and techniques used in MF Banka a.d. Banja Luka (hereinafter: the „Bank“) aimed to calculate individual and collective allowance for impairment of Bank's balance sheet and off-balance sheet items, that is, all financial assets defined by the Standard. Methodology defines the criteria for determining the type of financial assets, criteria for receivables identification which need to be individually estimated as well as criteria for determining the receivables to be collectively estimated, and it is applied in the Bank systematically and consistently through time, by which it is enabled a timely establishment of the expected losses resulting in customers inability for liabilities settlement or significant increase in credit risk, all aimed to protect Bank's capital in the period of the loss identification and realization. Methodology is based on the requests defined by the International Financial Reporting Standard (IFRS) 9. Methodology, based on rules and historic data, includes objective criteria of business in local market (use of real discount rate upon making estimates on the expected cash flows, collateral marketability and the time needed for realization, effective legal regulations and court practice in their implementation, current economic conditions and other relevant factors that influence the customer's financial performance) and establishes the obligation of the Bank to estimate the current economic conditions in surroundings in which it is operating and to adjust the allowance for impairment related to the expectation on future information.

The methodology defines:

1) Type of financial assets, that is, is the asset purchased or credit decreased;
2) The stage of the financial assets;
3) Material significance limit for individual exposures;
4) Identification of exposures to be estimated/classified on an individual and group basis;
5) Individual allowance for impairment;
6) Group allowance for impairment.

In addition to the aforementioned, the Methodology includes the following:

1) identification of receivables classified on an individual and group basis, and criteria of receivables categorization into homogenous groups with similar characteristics (client type/segmentation, credit product type, receivables security instrument, accuracy in liability settlement, sector and geographic structure etc.);
2) determined methods and techniques for classification on individual and group basis, including way of estimating the expected time collection and percent of the value of receivables security instrument from which the payment will be collected (take into consideration all activation and collection costs), and factors used when determining time frame for loss estimation based on the data from previous periods;
3) analyses, estimates and other procedures used in calculation of allowance for impairment, that is, provisions, should be precisely explained and appropriately documented in writing;
4) providing the precise and up-to-date information to be considered when making estimates on receivables collection;

5) clearly determined organizational segments which have the authority on the said estimates and conditions under which it can be conducted, based on the prior experiences.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.3. Allowance for impairment of receivables (IFRS 9 application – Financial instruments) (continued)

Given the fact that the regulation does not repeal the previous regulatory provisions relating to the classification of exposures and the calculation of provisions in accordance with the classification of exposures, they remain in force. The Bank is obliged to calculate provisions in accordance with the exposure classification and impairment at the same time in accordance with the internal impairment methodology. The methodological framework for the calculation of value adjustments is subject to further development and further improvements in subsequent periods, due to the current harmonization of the BARS with IFRS, improvements in the Bank's processes and changes in the IFRS itself.
The methodology is based on the final version of International Financial Reporting Standard 9: “Financial Instruments” adopted by the International Accounting Standards Board (IASB). Financial institutions are required to comply with the requirements of this Standard as of 01 January 2018.

The Methodology in accordance with IFRS 9 implies the following:

- Expected Loss Measurement Concept - The measurement of expected loss under IFRS 9 moves from the area of loss recognition to the area of expected loss, where different scenarios must be considered for loss expectation.
- Probability-Weighted Scenarios for Calculating Expected Loss - This means that in all stages of loss expectation, the probability-weighted scenarios of calculation in a minimum of two must be incorporated. multiple scenarios with associated probability. Therefore, for each exposure there is some (and even marginally low) probability of loss.
- Adequate modeling of risk parameters is necessary (EAD – exposure at default, PD – probability of default, LGD – loss given default, CCF – credit conversion factor) – IFRS 9 in addition to requiring more precise parameters to calculate expected losses that take into account PIT (point-in-time) parameters, as opposed to the currently defined IAS 39 (TTC - through the cycle).
- Necessary modeling of macroeconomic expectations - When determining risk parameters, it is also necessary to consider how the movement of macroeconomic variables influences the movement of risk parameters of the Bank.
- Criteria for the transition to phases - IFRS 9 given the determination that there is a Stage 2 in the future portfolio as well. the stage in which credit risk exposures are classified from the moment of approval to the moment of reporting, it is necessary for the Bank to define criteria on the basis of which it will recognize exposures with increased credit risk in all segments of impairment of financial instruments.
- Calculation of interest income on non-performing assets - the only source of interest income on non-performing assets is the so-called unwinding.
- POCI financial assets (purchased or originated credit-impaired financial assets) – a new asset category is defined for which there is a separate set of rules ie. an asset that already carries an impairment mark when approving or purchasing, an asset for which there is already an individual expected impairment.

Allowance for impairment under IFRS 9 is created for a financial asset within the scope of the standard that is classified in the relevant business models and area 1 of the standard.

According to the requests of the IFRS 9, the Bank, according to the reasonable expense and effort, estimates at which point of economic cycle it is currently in, regarding its exposure, and how macroeconomic changes, i.e. future information may impact the expected loss. Macroeconomic indicators may affect differently the risk parameters upon calculation of 12 months lifecycle losses but considering that the formula for allowance for impairment results from risk factors/parameters, with adjusting one risk parameter (PD) allowance for impairment will be adjusted for any expected future information.
Materially significant threshold is used in Methodology for the purpose of calculation of days delay in payment, which refers to the amount higher than:

- 1% of the Bank's individual receivables from the debtor, which is a natural person or farmer, and no less than BAM 20,00, and
- 2,5% of the Bank's individual receivables from the debtor, which is a legal entity or an entrepreneur, and no less than BAM 500,00.

Comparing to the IAS 39, the definition of the default status remains unchanged. A financial asset or a group of financial assets is considered impaired and impairment losses incurred, only if there is an objective proof of the impairment resulting in one or more previous events occurred after the initial recognition of the asset (a „loss event“) and the loss event (or events) have an impact on the future estimated cash flows of the financial asset or group of financial assets, which can be reliably estimated.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.03. Allowance for impairment of receivables (IFRS 9 application – Financial instruments) (continued)

First, the Bank estimates whether there is an objective proof of impairment individually for financial assets considered individually significant, and individually or collectively for financial assets not considered as financially significant. Non-significant individual exposures would be estimated individually when a specific risk related to the client/transaction (industry concentration, default status, rating category, credit type, customers risk bearing ability etc.) is defined. Objective proof of an impairment of financial asset or group of assets includes evident information brought to Bank's attention relating to the loss events described below:

- Debtor's delay is more than 90 days and it is a materially significant amount. Materially significant amount refers to the Bank's receivables as defined by the Methodology;
- The Bank considers unlikely that the borrower will settle its liability towards the Bank in full, with no regards to the collection possibility by activating the security instrument especially in respect of the following elements:
- Partial and total receivables write-off;
- Receivables restructuring due to deterioration of the borrower's financial capacity, with decrease in principal and interest amount, or fee or postponement of the maturity and
- Liquidation or bankruptcy of the debtor.

The Bank determines default status per client for all exposures. Based on the default status, and individual exposure significance, the Bank distinguishes different approaches to the impairment measurement (individual or collective estimate). For all materially significant clients for which the Bank determines there is objective proof of impairment, that is, that they are in the default status, they have specific provisions or are classified as POCI assets, the Bank will conduct an individual estimate on impairment.

According to the aforementioned, upon determining allowance for impairment in accordance with IFRS 9, the Bank has two approaches:

- Individual (separate) allowance for impairment – This type of allowance for impairment is calculated on an already stated exposures which are simultaneously individually materially significant (their exposure exceeds the individually defined significant limit) and which have objective proof of impairment.
- Portfolio (group) allowance for impairment – This type of allowance for impairment is calculated on all of the Bank's exposures for which there is no evidence of impairment.
- For each last day of the month, the Bank will determine both types of allowance for impairment. Methodology defines the criteria for allocation per stages for legal entities and individuals.

Calculation of allowance for impairment and provisions for losses, per individual materially significant exposures which have an identified objective proof of impairment, is conducted through the individual allowance for impairment. Individual allowance for impairment implies an estimate of expected credit losses and analysis of the expected future cash flows in several different scenarios of collections with certain probabilities for those scenarios and calculation of their present value. Individual allowance for impairment is calculated as a difference between the total client's balance exposure per loan (matured principal, non-matured principal, interest) and sum of net present value of estimated future cash flows (from regular repayment and activated security instruments) of the loan. For each individual transaction future cash flows are to be individually determined, separately for the principal and separately for the interest.

The calculation of value adjustments through the portfolio of value adjustments is made for the following types of exposures: for exposures that are not materially significant in Stage 3 and for all exposures in Stages 1 and 2. All investments to clients categorized by defined criteria for group allowance for impairment are further categorized into appropriate homogenous groups (HG). Basic criteria for grouping are the segments, whereby the largest, MSME segment, is divided in credit product groups: MSME-Current assets loan, MSME-Non-current assets and investment loan, MSME-Loans for entrepreneurs for all purposes, MSME-transferred loans and MSME-Others. Due to specific characteristics of the Overdraft, exposures regarding this credit product are separated into specific homogenous group at the level of Bank's portfolio (regardless of the segment). Through use, allowance for impairment will be formed per defined homogenous group. Every homogenous group will be monitored in regards of its movement, that is, migration of exposures from creditworthiness groups into a certain status according to the number of days delay in payment.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.3. Allowance for impairment of receivables (IFRS 9 application – Financial instruments) (continued)

Migrations from rating groups to a certain status, that is the second rating group will be monitored by taking the middle (weighted) cross-section value at the end of the individual quarters, going back through the data history for the defined period (minimum three years). Therefore, individual migrations will be determined first on defined cut-off dates (quarters), in a way that will monitor the movements of exposures / parties (by rating groups) that were active for one year until the cut-off date. Then, for each rating group, the resulting amounts that migrated across all cross-section dates will be summed by the sum of total exposures at all cross-section dates

Impairment measurement on group basis requests an estimate of the parameters on statistic basis with adjustments for future information. Risk parameters PD and LGD will be calculated for each homogenous group for the whole lifecycle, that is, with the highest maturity for the certain homogenous groups with the use of historic data and adjustments for expected future losses.

The Methodology defines the types of security instruments (collateral) and parameters related to collaterals, used upon calculation of allowance for impairment on individual and portfolio basis. With the use of defined parameters per individual types of collateral in the table, for the purpose of calculating individual allowance for impairment on the individually materially significant exposures securitized by these types of collateral, the result is expected cash flow discounted to the present value. Procedures and methods describing in detail the activities related to the security instruments (classification of security instruments, relevant value estimation methods, certified appraisers etc.) are defined by the Policy of acceptable security instruments.

30.4. Financial risks

In its regular course of business, the Bank is specifically exposed to the following risks:

- Credit risk, including residual risk, risk of impairment of receivables, settlement/delivery risk, and the counterparty risk;
- Concentration risk, which specifically includes exposure risk to a single entity or group of related entities;
- Liquidity risk;
- Market risks (interest rate risk, foreign exchange risk and other);
- Operational risk;
- Bank's investment risk;
- Strategic risk;
- Bank's business compliance risk;
- Risk of money laundering and terrorism financing.

30.5. 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, that is in loan origination activity. Credit risk is also present in off-balance sheet financial instruments such as guarantees and undrawn credit lines.

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 the customer’s 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;
- Exposure risks - risks that can arise from the Bank’s exposure toward a single entity, a group of related entities or Bank’s related parties.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.5. Credit risk (continued)

The Bank manages credit risk by implementing the crediting strategy focused on entrepreneurs and micro, small and medium enterprises (MSME) 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, Rulebook on Documenting Credit Activities and Credit Documentation Safekeeping, as well as Instruction Guide for Credit Analysis, clearly defines 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 their implementation. The aforesaid document prescribes all the forms used in loan processing and monitoring and the manner and forms for analyses of the borrowers' credit worthiness depending on the segment they belong to (COR and PUB, MSME 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 "Assessment", which includes the loan proposal as the basis for making a decision on loan approval. 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 are 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 MSME 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) define the manner of monitoring the existing loans and competences and responsibilities for performing collection activities. With the aforesaid Instructions Bank defines the daily and monthly monitoring of collection within certain steps of Non-Performing Loans 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 credit 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.

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 settle 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 homogenous groups in aspect of credit risk in accordance with the Bank's internal methodology for calculation of the impairment

allowance.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.5. Credit risk (continued)

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 considered.

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.
The Bank most commonly uses the following collaterals as security:

- bills of exchange,
- collection authorizations,
- statement of distrain (injunction),
- co-debtor,
- co-sureties,
- mortgages assigned over property,
- pledge liens assigned over movables,
- pledge liens assigned over securities,
- deposits/savings deposits,
- insurance policies,
- 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 are not considered to be NPL but are assets for special watch.

The Bank classifies the customers in accordance with its Methodology for calculating impairment allowance according to the number of days in arrears and data on migration of investments by credit worthiness groups and in accordance with the BARS Decision on the minimum standards for credit risk management and asset classification. Pursuant to this BARS Decision, all customers are classified into 5 categories: A, B, C, D and E.

NPL management is centralized and organized through the Division for Legal Affairs and Loan Restructuring. The Division was formed in April 2013 in order to ensure higher quality of NPL management.
This Division is competent for reprogramming and restructuring of all loans. When this Division has attempted and failed at all possibilities of collection, it proposes making a decision on initiation of legal proceedings to the Bank's Loan Management Committee/Credit Committee.

With the Instructions for collection and management of NPLs, the Bank explicitly prescribes the activities of assumption, monitoring and collection of NPLs for all market segments. The Legal Affairs Division has the authority over the loan when the following conditions are met:

1. Loans that are 90 and over 90 days past due with liability matured in excess of the amount of 1 annuity;
2. Clients 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 cards with repayment of 90 and over 90 days past due;
4. All types of guarantees where the Bank made the required payments and liabilities matured were not settled within 30 days from the Bank's payment date.

Clients meeting the above listed criteria are transferred to the Division for Legal Affairs and 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 debt servicing, legal proceedings are initiated.

30. FINANCIAL INSTRUMENTS (CONTINUED)

30.5. Credit risk (continued)

Transfer to the Division for Legal Affairs and Loan Restructuring is realized by generating a list of loans at the beginning of each month where, on the last day of the previous month, conditions were met for a transfer to the Division for Legal Affairs and Loan Restructuring. 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 delay categories defining the transfer (based on ownership and family relations), yet they affect the creditworthiness and possibility of loan repayment.
The market sector may propose delay in transferring a client to the Legal Affairs and Loan Restructuring Division maximum 30 days if there is an agreement with the client to make payment or rescheduling/reprogramming of obligations. If, within 30 days, the client fails to make the payment or his obligations are not rescheduled, the client falls under the jurisdiction of the Legal Affairs and Loan Restructuring Division. The decision to postpone the transfer to the Legal Affairs and Loan Restructuring Division is made by the Loan Management Committee after considering the proposals from the Market Sector.

Based on the client list, the cases are transferred from the affiliates / branches to the Legal Affairs and Restructuring Division, as well as the duties of the employee in the Legal Affairs and Loan Restructuring Division for the mentioned cases in the system. This borrowing activity in the system implies that in support, by the end of the 7th working day of the month, all back-up referents from the Legal Affairs and Loan Restructuring Sector (in the banking application) are assigned.

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

30.5.1 Overview of credit exposure as at 31 December 2019

(In BAM thousand)

LOAN BALANCE

	31.Jan	28.Feb	31.Mar	30.Apr	31.May	30.Jun	31.Jul	31.Aug	30.Sep	31.Oct	30.Nov	31.Dec
Other	-	-	-	29	183	-	-	1	-	-	-	-
Single adjustment	105.103	108.994	113.781	113.380	118.943	125.876	131.821	124.038	130.485	135.825	140.006	-
Stage 1	177.898	177.665	181.213	179.477	175.906	178.183	175.797	172.735	175.068	177.268	172.849	296.920
Stage 2	9.391	10.237	8.999	10.195	12.015	16.405	12.403	15.772	15.156	9.073	8.890	27.199
Stage 3	7.245	7.317	7.456	7.558	7.602	7.679	8.074	8.051	7.976	7.220	7.126	16.409
Total	**299.637**	**304.213**	**311.449**	**310.610**	**314.466**	**328.143**	**328.095**	**320.596**	**328.685**	**329.386**	**328.871**	**340.528**

INTEREST BALANCE

	31.Jan	28.Feb	31.Mar	30.Apr	31.May	30.Jun	31.Jul	31.Aug	30.Sep	31.Oct	30.Nov	31.Dec
Other	-	-	-	-	-	-	-	-	-	-	-	-
Single adjustment	1.355	1.304	1.371	1.414	1.499	1.483	1.457	1.068	1.517	1.571	1.317	-
Stage 1	1.139	1.052	1.176	1.147	1.129	1.174	1.153	187	1.125	1.160	1.100	1.803
Stage 2	101	105	92	119	123	98	121	59	138	96	90	219
Stage 3	338	345	346	352	357	357	367	409	370	377	314	634
Total	**2.933**	**2.806**	**2.985**	**3.032**	**3.108**	**3.112**	**3.098**	**1.723**	**3.150**	**3.204**	**2.821**	**2.656**

TOTAL EXPOSURE WITHOUT SUSPENDED INTEREST

	31.Jan	28.Feb	31.Mar	30.Apr	31.May	30.Jun	31.Jul	31.Aug	30.Sep	31.Oct	30.Nov	31.Dec
Other	9.455	8.518	9.108	9.665	10.476	10.227	10.453	10.647	11.594	13.295	12.488	11.124
Single adjustment	107.152	112.592	115.865	117.679	121.032	128.221	134.757	126.977	132.726	138.370	141.970	-
Stage 1	209.453	210.988	215.304	210.863	213.242	210.067	207.905	206.580	206.675	215.089	212.891	340.583
Stage 2	10.497	11.271	9.778	11.022	16.183	18.069	16.523	21.668	20.949	10.365	10.323	28.720
Stage 3	7.895	7.979	8.234	8.349	8.405	8.479	8.889	8.869	8.971	8.094	7.995	17.698
Total	**344.452**	**351.348**	**358.289**	**357.578**	**369.338**	**375.063**	**378.527**	**374.741**	**380.915**	**385.213**	**385.667**	**398.125**

TOTAL ALLOWANCE FOR IMPAIRMENT

	31.Jan	28.Feb	31.Mar	30.Apr	31.May	30.Jun	31.Jul	31.Aug	30.Sep	31.Oct	30.Nov	31.Dec
Other	76	83	83	83	83	83	83	83	83	83	83	49
Single adjustment	22.521	22.681	23.809	24.381	24.711	24.608	25.036	25.324	25.657	24.376	22.535	-
Stage 1	890	906	841	698	722	765	734	707	679	670	626	9.401
Stage 2	991	1.145	1.006	791	969	1.020	1.046	1.305	1.226	661	615	5.532
Stage 3	5.613	5.686	5.647	5.061	5.285	5.371	5.492	5.568	5.531	4.517	4.522	12.782

Total	**30.091**	**30.501**	**31.386**	**31.014**	**31.770**	**31.847**	**32.391**	**32.987**	**33.176**	**30.307**	**28.381**	**27.764**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

30.5.1. Total exposure as at 31 December 2019

(In BAM thousand)

			Share in total exposure							
	Total exposure	**Loans due**	**%**	**Non-performing loans**	**%**	**Reprogrammed/ restructured loans**	**%**	**Interest**	**%**	**Advances**
Public sector	1.417	-	0,00	-	0,00	-	0,00	-	0,00	-
Corporate	38.819	1.400	3,61	1.622	4,18	45	0,12	1	0,00	26
MSME	273.904	13.124	4,79	12.918	4,72	3.140	1,15	127	0,05	693
Retail	83.985	2.430	2,89	3.158	3,76	1.195	1,42	50	0,06	485
Total	**398.125**	**16.954**	**4,26**	**17.698**	**4,45**	**4.380**	**1,10**	**178**	**0,04**	**1.204**

The following table shows the changes in the gross carrying amount of loans to customers as at 31 December 2019:

(In BAM thousand)

	Retail loans				**Corporate loans**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balance as at 01 January 2019	**82.835**	**2.134**	**6.906**	**91.875**	**189.304**	**10.434**	**14.290**	**214.027**
Transfer to Stage 1 (from 2 or 3)	1.561	(1.479)	(82)	-	2.852	(2.704)	(148)	**-**
Transfer to Stage 2 (from 1 or 3)	(540)	884	(344)	-	(5.220)	7.205	(1.985)	**-**
Transfer to Stage 3 (from 1 or 2)	(880)	(274)	1.154	-	(3.094)	(2.162)	5.256	**-**
New financial assets acquired or purchased	37.637	878	218	38.733	148.996	12.095	1.768	162.859
Total as at 31 December 2019	**85.555**	**2.582**	**4.997**	**93.134**	**213.169**	**24.834**	**12.047**	**250.050**

Gross book values include principal and interest. Unamortized deferred compensation is not included.

30.FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)
Maximum credit risk exposure
The following table shows changes in impairment of loans to customers:

Impairment of loans to customers

	Retail loans				Corporate loans			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance as at 01 January 2019	**1.211**	**497**	**5.415**	**7.123**	**8.003**	**1.769**	**12.596**	**22.369**
Transfer to Stage 1 (from 2 or 3)	149	(119)	(30)	-	203	(164)	(39)	-
Transfer to Stage 2 (from 1 or 3)	(92)	197	(105)	-	(886)	2.581	(1.695)	-
Transfer to Stage 3 (from 1 or 2)	(319)	(151)	470	-	(1.997)	(1.401)	3.398	-
New financial assets acquired or purchased	565	126	66	757	5.952	1.473	1.246	8.671
Total as at 31 December 2019	**1.249**	**586**	**3.294**	**5.129**	**8.112**	**4.926**	**9.147**	**22.185**

The gross carrying amount of the financial assets below represents the Bank's maximum exposure to credit risk.

Maximum exposure to credit risk before collateral and other credit collateral as at 31 December 2019 and 31 December 2018

FINANCIAL INSTRUMENTS

	31. December 2019			31. December 2018		
	Exposure before impairment	**Impairment**	**Net credit risk exposure**	**Exposure before impairment**	**Impairment**	**Net credit risk exposure**
A. Credit risk exposure related to balance sheet items						
Cash funds and funds with the Central bank	101.590	148	101.442	110.109	189	109.920
Funds with other banks	5.119	14	5.105	8.372	23	8.349
Placements to other banks	3.000	8	2.992	133	2	131
Loans to customers	340.004	27.244	312.760	303.911	29.031	274.880
Purchased receivables	1.635	47	1.588	437	1	436
Other assets	5.128	829	4.299	3.338	1.027	2.311
Securities available-for-sale	30.733	86	30.647	49	-	49
Total assets	**487.209**	**28.376**	**458.833**	**426.349**	**30.273**	**396.076**
Off-balance						
Unused credit obligations	21.697	185	21.512	18.633	150	18.483
Credit portfolio collateral	*200.125*	-	-	*167.636*	-	-
- Securities pledged as collateral	*1.499*	-	-	*741*	-	-
Total off-balance	**21.697**	**185**	**21.512**	**18.633**	**150**	**18.483**
Total credit exposure	**508.906**	**29.829**	**480.345**	**444.982**	**30.423**	**475.405**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

Measurement of expected credit losses

Financial risk management

Principle balance based on loans as at 31 December 2019

Homogeneous groups	Loan balance	Exposure	Recognized amount of collateral	Expected credit loss (ECL) without other assets
COR	20.141	23.461	11.549	5.056
MSME- Working capital loan	75.989	76.924	38.329	4.942
MSME- Loan for fixed assets and investments	88.475	89.565	68.022	6.222
MSME- Non-purpose loan for entrepreneurs	6.104	6.218	3.660	769
MSME- other	34.204	41.958	22.243	1.657
MSME- Transfer loan	78	87	-	83
Overdraft	25.034	30.770	7.860	1.723
PUB	1.421	1.449	53	43
Reprogram	14.825	15.058	9.555	5.195
Retail	74.256	76.189	35.839	2.044
TOTAL (Bank)	**340.528**	**361.679**	**197.110**	**27.733**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

Measurement of expected credit losses

SEGMENT	Overview of credit status by segment by maturity						
	<=30 days	31-60 days	61-90 days	91-180 days	181-365 days	Over 1 year	Total
Public Sector	-	-	-	106	-	1.266	1.372
Corporate	1.039	-	150	4.062	5.584	10.679	21.514
MSME	10.987	3.689	5.648	14.282	30.304	172.056	236.966
Retail	2.485	347	445	896	3.022	73.481	80.675
TOTAL Bank	**14.510**	**4.037**	**6.243**	**19.346**	**38.911**	**257.482**	**340.528**

Overview of expected credit losses (ECL) per segments:

Segment	31.12.2018		31.12.2019	
	Expected credit loss (ECL)	% share	Expected credit loss (ECL)	% share
Public Sector	52	0,2%	40	0,1%
Corporate	7.227	24,3%	5.484	19,7%
MSME	18.697	63,0%	18.912	68,0%
Retail	3.712	12,5%	3.362	12,1%
TOTAL	**29.689**	**100,0%**	**27.798**	**100,0%**

Overview of loan balances by days of delay:

Days of delay	31.12.2018			31.12.2019		
	Loan balance	% share	PAR%	Loan balance	% share	PAR%
0 days	227.627	75,3%	0,0%	270.648	79,5%	0,0%
1-30 days	54.087	17,9%	17,9%	51.232	15,0%	15,0%
31-90 days	2.537	0,8%	0,8%	3.366	1,0%	1,0%
Over 90 days	18.230	6,0%	6,0%	15.282	4,5%	4,5%
TOTAL	**302.479**	**100,0%**	**24,7%**	**340.528**	**100,0%**	**20,5%**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

Loan collateral and other credit security (continued)

Collateral held for securing financial assets other than loans and advances depends on the nature of the instrument. The Bank's collateral acquisition policy did not change significantly during the reporting period and there was no significant change in the overall quality of the collateral held by the Bank from the previous period.

The total exposure of collateral and credit collateral analyzes is presented below as at 31 December 2019 and 31 December 2018:

(In BAM thousand)

	As at 31 December 2019	31 December 2018
Loans secured by special deposit	5.375	4.200
Loans secured by real estate	132.002	104.925
Loans secured by other collateral	202.627	194.786
Total:	**340.004**	**303.911**

	Loans to customers		
As at 31 December 2019	**Retail**	**Corporate**	**Total loans**
Residential, commercial or industrial property	35.640	104.687	140.327
Pledge	7.804	43.401	51.205
Financial asset	1.851	4.280	6.131
Other	85	2.359	2.444
Total	**45.380**	**154.727**	**200.107**

	Loans to customers		
As at 31 December 2018	**Retail**	**Corporate**	**Total loans**
Residential, commercial or industrial property	29.986	87.187	117.173
Pledge	7.895	36.489	44.384
Financial asset	1.952	2.706	4.658
Other	111	1.310	1.421
Total	**39.944**	**127.692**	**167.636**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

Exposure overview by segments and days of delay as at 31 December 2019

(In BAM thousand)

SEGMENT	**Days of delay**	**Loan balance**	**Total exposure**	**Adjustment**
Public Sector	0 days	1.372	1.417	40
	1-30 days	-	-	-
	31-90 days	-	-	-
	>90 days	-	-	-
Public Sector Total		**1.372**	**1.417**	**40**
Corporate	0 days	19.440	35.272	3.943
	1-30 days	716	2.097	179
	31-90 days	151	155	141
	>90 days	1.207	1.278	1.222
Corporate Total		**21.514**	**38.802**	**5.484**
MSME	0 days	184.217	218.119	6.037
	1-30 days	38.781	40.928	2.611
	31-90 days	2.207	2.300	680
	>90 days	11.760	12.588	9.584
MSME Total		**236.966**	**273.935**	**18.912**
Retail	0 days	65.618	68.263	1.011
	1-30 days	11.734	12.050	479
	31-90 days	1.007	1.096	185
	>90 days	2.315	2.561	1.687
Retail Total		**80.675**	**83.971**	**3.362**
TOTAL Bank as at 31 December 2019		**340.528**	**398.125**	**27.798**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

Employees of the Legal Affairs and Restructuring Division must receive a credit file from a credit officer within 15 days of the debit day. Act on items taken over as soon as possible. The Legal Affairs and Restructuring Division staff responsible for the client is obliged to continue to review the activities and measures taken at specific parties, through updating the strategies in the front application. Even if the loans are properly serviced, the Legal Affairs and Restructuring Division responsible for the client is required to regularly monitor the client.

Employees in the Legal Affairs and Restructuring Division have all the measures at their disposal in order to address delays that include aggressive collection, rescheduling of existing debt, restructuring the opening of new debt to the debtor or other participants.

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 it may overcome by applying the same control processes and procedures.
Monitoring and collection procedures applied to these exposures are identical to those applied to loans.

Collaterals and Other Forms of Security Instruments

The Bank demands security instruments for all types of 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 being approved as well as the assessed credit risk for each individual borrower.

The assessment and fair value of collateral are based on the value of security instruments estimated 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 upon reassessment of the loan impairment allowance adequacy. The Bank takes into account the value of collaterals upon reassessment of the loan impairment allowance adequacy.

30.5.1. Concentration risk

The Bank has internally defined minimum standards regarding concentration risk management by which the bank secures its business in terms of careful exposure to credit collection risk and risk of potential losses on issued loans, and all other investments as well as potential off-balance sheet liabilities.
In such way the Bank maintains business stability and determines the minimum standards of the highest allowed credit risk exposure of the Bank to a single client, borrower or other subject (or a group of related entities), as well as limits of high exposure.

According to the Article 106 of Law on Banks of RS high exposure of the bank is the exposure towards single entity or a group of related entities amounting or exceeding 10% of the recognized Bank’s capital. The Bank has adopted policies and procedures aimed to determine and monitor single and total exposure, maintain records, monitor and report on the said exposure, in accordance with Agency regulations.
Recognized capital of the Bank is equal to regulatory capital, which is a sum of a regular share capital and additional share capital after regulatory adjustments.

Bank’s exposure towards single entity or a group of related entities after applying the credit risk decrease method cannot exceed 25% of the Bank’s recognized capital. In accordance with Agency regulations, the highest allowed amount of credit receivables that is not secured with a collateral, towards single entity or group of related entities cannot exceed 15% of the Bank’s recognized capital. The total exposure of the bank toward its superior and subordinate entity and the related entities is limited by provisions of Article 107 of the Law on Banks.

The Bank’s share in other legal entities is defined by Article 111 of Law on Banks of RS: Prior to consent of the Agency, the Bank is not allowed to have direct or indirect

- share in a legal entity or subsidiary of that legal entity exceeding 5% of the recognized Bank capital or total net value of all Bank’s interest in other legal entities and subsidiaries of those legal entities exceeding 20% of the recognized Bank capital.
- the Bank’s share, direct or indirect, in one legal entity from financial sector cannot exceed 15%

of Bank's recognized capital.
- the Bank's interest in the legal entity not pertaining to financial sector cannot exceed 10% of Bank's recognized capital, nor 49% of the capital of that entity.
- Total interest in legal entities not pertaining to financial sector cannot exceed 25% of recognized Bank's capital, and total interest in legal entities pertaining to financial sector cannot exceed 50% of the Bank's recognized capital

Credit Risk Concentration per Industry Sector

The Bank has a diversified loan portfolio covering various industries: **In BAM thousand**

	31 December 2019	**In %**	**31 December 2018** *Corrected*	**In %**
Construction industry	25.751	7%	23.865	8%
Trade	65.523	19%	56.106	18%
Services, tourism and accommodation industry	16.159	5%	12.050	4%
Agriculture	9.215	3%	8.933	3%
Production, mining manufacturing industry	50.419	15%	43.419	14%
Transport, storage, postal services and telecommunications	26.665	8%	21.429	7%
Finance services	1.015	0%	2.183	1%
Property trade	3.163	1%	1.548	1%
Administration, other public services	-	0%	17	0%
Other (retail)	142.094	42%	134.361	44%
Total:	**340.004**	**100%**	**303.911**	**100%**

Credit Risk Concentration per loan type

The Bank regularly monitors and diversifies placed loans per loan type. **(In BAM thousand)**

	31 December 2019	**In %**	**31 December 2018** *Corrected*	**In %**
Loans per transactions accounts	25.242	7%	22.624	7%
Consumer loans	54.646	20%	59.502	20%
Working capital loans	115.218	31%	94.766	31%
Investment loans	130.910	38%	114.402	38%
Housing loans	13.557	4%	12.003	4%
Placements for payments made under guarantees	431	0%	614	0%
Total:	**340.004**	**100%**	**303.911**	**100%**

30. FINANCIAL INSTRUMENTS (continued)

30.5. Credit risk (continued)

30.5.1. Concentration risk (continued)

Loan quality and off-balance per BARS categories (portfolio quality)
In accordance with the Decision of BARS, the Bank classifies the placed loans according to the number of days of delay in repayment of the loan.

(In BAM thousand)

		Category				
31 December 2019	**A**	**B**	**C**	**D**	**E**	**Total**
Loans to clients						
- short-term	32.656	14.846	218	99	4	47.823
- long-term	202.639	67.892	3.972	1.817	412	276.732
- due	1.014	1.549	1.338	2.268	8.834	15.003
guarantees paid	14	-	244	170	18	446
Total loans	**236.323**	**84.287**	**5.772**	**4.354**	**9.268**	**340.004**
- off-balance	39.640	14.573	227	20	30	54.490
Total:	**275.963**	**96.860**	**5.999**	**4.374**	**9.298**	**394.494**

(In BAM thousand)

		Category				
31 December 2018	**A**	**B**	**C**	**D**	**E**	**Total**
Loans to clients						
- short-term	45.434	6.964	156	123	15	52.692
- long-term	183.181	42.901	4.110	2.107	624	232.923
- due	1.532	1.133	427	1.427	13.200	17.719
guarantees paid	-	-	-	3	574	577
Total loans	**230.147**	**50.998**	**4.693**	**3.660**	**14.413**	**303.911**
- off-balance	37.619	3.757	298	22	19	41.715
Total:	**266.351**	**54.755**	**4.991**	**3.682**	**14.432**	**343.757**

30.5.2. 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% of BAM devaluation, 30% collateral devaluation, and increase in allowance for impairment for customers with recorded defaults in settling their matured liabilities.

(In BAM thousand)

Portfolio as at 31 December 2019	**Total exposure**	**Total impairment exposure for the deposit amount**	**Discounted value of collateral**	**Allowance for impairment**	**Total deterioration**
Post test	477.472	471.340	180.106	32.062	31.397
Pre test	398.125	391.993	200.198	27.798	27.786
Difference	**79.347**	**79.347**	**(20.092)**	**4.264**	**3.611**

(In BAM thousand)

Portfolio as at 31 December 2019	**Total exposure**	**Total impairment exposure for the deposit amount**	**Discounted value of collateral**	**Allowance for impairment**	**Total deterioration**
Post test	417.065	412.407	151.945	33.294	33.073
Pre test	347.618	342.960	167.636	29.689	29.856

Difference	**69.447**	**69.447**	**(15.691)**	**3.605**	**3.217**

30. FINANCIAL INSTRUMENTS (continued)

30.6. 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 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).

30.6.1. 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 compliance 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 compliance 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 compliance 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 Management Board undertakes adequate aforesaid activities in order to maintain the foreign currency position within the permitted limits.

In planning activities that significantly influences 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 compliance of financial assets and financial liabilities.

30. FINANCIAL INSTRUMENTS (continued)

30.6. Market risk (continued)

30.6.1. Foreign exchange risk (continued)

The report on foreign currency balances, net, as of 31 December 2019, is presented in the table below:

(In BAM thousand)

	EUR	USD	CHF	GBP	Other	Total currencies	BAM	Total
Assets								
Cash and cash funds held with the Central Bank	4.580	63	149	5	205	5.002	96.440	101.442
Loans and receivables due from banks	4.492	349	47	29	6	4.923	182	5.105
Investments to other banks	-	-	-	-	-	-	2.992	2.992
Securities	30.373					30.373	360	30.733
Loans to customers	261.746	-	-	-	-	261.746	51.014	312.760
Property, equipment and intangible assets	-	-	-	-	-	-	7.190	7.190
Business premises for rent IFRS 16							7.650	7.650
Calculated other assets	116	-	-	-	-	116	5.771	5.887
	301.307	412	196	34	211	302.160	171.599	473.759
Liabilities								
	-	-	-	-	-	-	7.033	7.033
Deposits to customers	260.220	52	66	32	13	260.383	101.628	362.011
Liabilities per loans	17.813	-	-	-	-	17.813	23	17.836
Subordinated debt	6.956	-	-	-	-	6.956	-	6.956
Other liabilities	3.778	21	-	-	-	3.799	8.207	12.006
Provisions for employee retirement benefits and other contingent liabilities	-	-	-	-	-	-	330	330
	288.767	73	66	32	13	288.951	117.221	406.172
Net foreign currency position	**12.540**	**339**	**130**	**2**	**198**	**13.209**	**54.378**	**67.587**

The report on foreign currency balances, net, as of 31 December 2018, is presented in the table below:

(In BAM thousand)

	EUR	USD	CHF	GBP	Other	Total currencies	BAM	Total
Assets								
Cash and cash funds held with the Central Bank	4.620	97	89	3	212	5.021	104.899	109.920
Loans and receivables due from banks	7.851	341	72	26	5	8.295	54	8.349
Investments to other banks	131	-	-	-	-	131	-	131
Securities	49	-	-	-	-	49	-	49
Loans to customers	228.741	-	-	-	-	228.741	46.139	274.880
Property, equipment and intangible assets	-	-	-	-	-	-	7.157	7.157
Business premises for rent IFRS 16	131	-	-	-	-	131	2.616	2.747
Calculated other assets	241.523	438	161	29	217	242.368	160.865	403.233
Liabilities								
	-	-	-	-	-	-	7.012	7.012
Deposits to customers	216.297	59	82	4	12	216.454	95.976	312.430
Liabilities per loans	16.916	-	-	-	-	16.916	-	16.916
Subordinated debt	6.958	-	-	-	-	6.958	-	6.958
Other liabilities	186	10	-	-	-	196	3.878	4.074
Provisions for employee retirement benefits and other contingent liabilities	-	-	-	-	-	-	237	237
	240.357	69	82	4	12	240.524	107.103	347.627
Net foreign currency position	**1.166**	**369**	**79**	**25**	**205**	**1.844**	**53.762**	**55.606**

30. FINANCIAL INSTRUMENTS (continued)

30.6. Market risk (continued)

30.6.1. Foreign exchange risk (continued)

During 2019, 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.

30.6.2. 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 decided on the variable interest rate equal to 6-month EURIBOR rounded to the next decade above adjusted two times a year, on 30 June and 31 December. 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 risk 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.

If interest rates were higher or lower by 10% over the existing ones, and if other variables were kept constant, the Bank would have reduced / increased its net profit by BAM 9.537 thousand for the year ended 31 December 2019 (2018: decreased / increased profit by BAM 6.263 thousand).

30. FINANCIAL INSTRUMENTS (continued)

30.6. Market risk (continued)

30.6.2. Interest rate risk (continued)

The following table provides an overview of the annual interest rates applied to the most significant financial instruments:

	In foreign currency	In BAM thousand
Assets		
Obligatory reserve at the Central Bank	-	0,00%
Funds over the obligatory reserve	-	(0,50%)
Foreign currency accounts with foreign banks	0,50%	-
Loans to customers up to one year:		
- corporate	-	4,00%-14,00%
- retail	-	4,60% -15,50%
Loans to customers over one year:		
- corporate	-	4,10%-15,50%
- retail	8,49%	3,60%-15,5% +6M Euribor
Liabilities		
Demand deposits corporate	0,00%	0,00%-0,20%
Demand deposits retail	0,10%-0,80%	0,10%-0,80%
Short-term deposits:		
- corporate	0,50%-1,30%	0,50%-1,30%
- retail	0,50%-1,50%	0,50%-1,50%
Long-term deposits:		
- corporate	1,80%-2,20%	1,80%-2,20%
- retail	0,50%-3,60%	0,50%-3,60%
Loans:		
FSE	6,20%	-
„Fond za razvoj i zapošljavanje RS“	-	0,30%-1,80%
„Fond stanovanja RS“	-	0,30%-1,80%
„Fond za razvoj istočnog dijela RS“	-	0,30%-1,80%

Lower interest rates on loans over one year for natural persons of 3,6% and legal entities of 4,1% refer to loans made from IRB funds.

The Bank is exposed to various risks, which, through the effects of changes in interest rates on the market, affect its financial position and cash flows.

30. FINANCIAL INSTRUMENTS (continued)

30.6. Market risk (continued)

30.6.2. Interest rate risk (continued)

The table below shows the review of interest bearing and non-interest bearing assets and liabilities, as of 31 December 2019 and 31 December 2018:

(In BAM thousand)

31 December 2019

Monetary assets	**Interest bearing**	**Non-interest bearing**	**Total**
Cash and cash funds held with the Central bank	51.681	49.761	101.442
Cash and cash funds held with other banks	-	5.105	5.105
Loans to other banks	2.992	-	2.992
Securities	30.733	-	30.733
Loans to customers	312.760	-	312.760
Equipment, intangible assets and investment property	-	7.190	7.190
Business premises for rent IFRS 16	7.650	-	7.650
Interest, fee and other receivables	1.635	4.252	5.887
	407.451	66.308	473.759
Monetary liabilities			
Deposits of customers	334.093	34.951	369.044
Received loans	17.836	-	17.836
Subordinated debt	6.956	-	6.956
Other liabilities	-	12.006	12.006
Provisions for contingent losses	-	330	330
Total:	**358.885**	**47.287**	**406.172**

(In BAM thousand)
31 December 2018

Monetary assets	**Interest bearing**	**Non-interest bearing**	**Total**
Cash and cash funds held with the Central bank	66.500	43.420	109.920
Cash and cash funds held with other banks	-	8.349	8.349
Loans to other banks	-	131	131
Securities	49	-	49
Loans to customers	274.880	-	274.880
Equipment, intangible assets and investment property	-	7.157	7.157
Business premises for rent IFRS 16	523	2.224	2.747
	341.952	61.281	403.233
Monetary liabilities			
Deposits of customers	289.943	29.499	319.442
Received loans	16.916	-	16.916
Subordinated debt	6.958	-	6.958
Other liabilities	9	4.065	4.074
Provisions for contingent losses	-	237	237
Total:	**313.826**	**33.801**	**347.627**

30. FINANCIAL INSTRUMENTS (continued)

30.7. 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 development of its loan portfolio.

The Bank's liquidity management strategy is carried out by controlling the maturity matching of assets and sources of assets based on the realistic and precise projections of cash inflows and outflows, both recurring and non-recurring, for different maturity periods.

The strategy of asset liquidity risk management includes:

- Striving 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:

- Striving 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.

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 ALCO (the Asset and Liability Management Committee).

Responsible persons of the Bank:

- monitor the liquidity position and composition of asset and liability maturities,
- 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.

30. FINANCIAL INSTRUMENTS (continued)

30.7. Liquidity risk (continued)

(In BAM thousand)

31 December 2019	**Up to 1 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	101.442	-	-	-	101.442
Loans and receivables due from banks	5.105	-	-	-	5.105
Investments to other banks	-	-	2.992	-	2.992
Securities	30.733	-	-	-	30.733
Loans due from customers	14.247	22.012	97.274	179.227	312.760
Equipment, intangible assets and investment property	-	-	-	7.190	7.190
Business premises for rent	-	-	-	7.650	7.650
Other assets	5.003	276	579	29	5.887
Total assets	156.530	22.288	100.845	194.096	473.759
LIABILITIES					
Deposits	83.773	24.712	101.696	158.863	369.044
Liabilities per loans	194	380	1.746	15.516	17.836
Subordinated debt	-	111	-	6.845	6.956
Other liabilities	2.402	252	630	8.722	12.006
Provisions for contingent losses	-	-	-	330	330
Total liabilities	**86.369**	**25.455**	**104.072**	**190.276**	**406.172**
Liability gap	70.161	(3.167)	(3.227)	3.820	67.587

(In BAM thousand)

31 December 2018	**Up to 1 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	109.920	-	-	-	109.920
Loans and receivables due from banks	8.349	-	-	-	8.349
Investments to other banks	-	-	-	131	131
Securities	49	-	-	-	49
Loans due from customers	13.304	18.665	86.392	156.519	274.880
Equipment, intangible assets and investment property	-	-	-	7.157	7.157
Business premises for rent	2.489	228	-	30	2.747
Other assets	134.111	18.893	86.392	163.837	403.233
LIABILITIES					
Deposits	64.774	25.535	109.318	119.815	319.442
Liabilities per loans	50	361	1.628	14.877	16.916
Subordinated debt	-	-	-	6.958	6.958
Other liabilities	2.272	132	621	1.049	4.074
Provisions for contingent losses	-	-	-	237	237
Total liabilities	**67.096**	**26.028**	**111.567**	**142.936**	**347.627**
Liability gap	67.015	(7.135)	(25.175)	20.901	55.606

30. FINANCIAL INSTRUMENTS (continued)

30.8. 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 review 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.

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 includes the following activities:

- identification of the existing sources of operational risks and sources contingent on the introduction of new products, systems and 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 (MAKOR);
- 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 Management 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.

30.9. Capital management

Capital is a rare economic resource and capital management is one of the most important components of prudent, efficient and strategic planning and management of the Bank. The capital management policy includes ensuring and maintaining the quantity and quality of capital at least at the level of the minimum standards set out in the Decision on minimum standards for managing banks' capital and capital protection, that is, the minimum amount of initial capital and the minimum amount of net capital that the Bank must maintain may not be less than 15 million BAM. Pursuant to the Decision, the Bank's capital comprises the amounts of core (Tier 1), supplementary (Tier 2), and net capital represents the amount of capital less deductible items.

The Bank's policy for maintaining the quantity and quality of the capital 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 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 falls below 15%, the Bank undertakes 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.

30. FINANCIAL INSTRUMENTS (continued)

30.9. 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,
- planning the capital in terms of anticipating the Bank's future needs and requirements for capital.

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 in the prescribed form to BARS on a quarterly basis.

As of 31 December 2019, the Bank was in full compliance with all the prescribed capital adequacy indicators:

	As at 31 December 2019	31 December 2018
Core capital	61.354	46.926
Supplementary capital	7.285	8.147
Regulatory capital	**68.639**	**55.073**
Total amount of risk exposure	347.059	293.359
% capital adequacy	**17,68%**	**16,00%**
% regulatory capital adequacy	**19,78%**	**18,77%**

The regulation defines retained earnings in regulatory capital, and by the decision of the Shareholders' Assembly accumulated retained earnings in 2019 was allocated to retained earnings and legal reserves, which resulted in an increase in the capital adequacy ratio compared to 2018.
The increase in capital adequacy rates was also influenced by the Bank's capital increase during 2019.

31. Post-reporting date events

For the year ended 31 December 2019, the Bank made an estimate of the allowance of impairment of receivables as per IFRS 9 methodology in accordance with the Decision on Credit Risk Management and the Determination of Expected Credit Losses of the Banking Agency of the Republic of Srpska and in accordance with the requirements of the aforementioned decision, there was an increase on the allowance of impairment items in the amount of BAM 2.918 thousand. The application of that Decision shall commence on 1 January 2020 when the reconciliation was made.

Considering the expected impact and consequences of the Corona virus pandemic on the global economy, the Bank estimates that it will also have an impact on the Bank's operations. It is currently not possible to assess the impact of the spread of the Corona virus (COVID - 19) and its consequences on the Bank 's financial position and operations. In the coming period, the Bank will monitor and comply with all legal and regulatory decisions regarding the implementation of the measures resulting from the Corona virus pandemic (COVID - 19).

32. Foreign exchange rates

The official foreign exchange rates used in the translation of statement of financial position components as of 31 December 2019 and 31 December 2018 were as follows:

In BAM

	31 December 2019	31 December 2018
USD	1,7480	1,7076
CHF	1,7991	1,7421
EUR	1,9558	1,9558