Financial statements for the Year ended 31 December 2018 prepared in accordance with IFRS and Independent Auditor's Report

MF Banka a.d.

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 of December 31, 2018, as well as the statement of profit and loss, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ending on the stated date, including the summary of significant accounting policies and notes on the financial statements.

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

Basis for the opinion

We conducted our audit in accordance with the International Standards on Auditing (ISA). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants of the International Accounting Standards Board (IESBA Code) and we have fulfilled our ethical responsibilities in accordance with 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 15, the value of given loans is expressed in the gross amount of 304.042 thousands of BAM, or in the net amount of 274.085 thousands of BAM and the allowance for impairment of the loan value due to customers in the amount of 27.957 thousands of BAM (note 11). This is a key matter since it includes the assessment of the Bank in determining the allowance for impairment of credit losses of the Bank. Since January 1, 2018, the Bank has applied the International Financial Reporting Standard – IFRS 9, resulting in cost recognition of impairments of receivables for 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 of the Bank is responsible for the preparation and fair presentation of the financial statements in accordance with the Law on Accounting and Auditing of the Republic of Srpska and in accordance with the regulations of the Banking Agency of the Republic of Srpksa, and for those internal controls the Management determines are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. .

When preparing the financial statements, the Management is responsible for assessing the Bank's ability to continue operating as a going concern, disclosing, if applicable, matters related to going concern and using an accounting basis for going concern, unless the Management intends to liquidate the Company or suspend business, or have no realistic option except to do it .

The Supervisory Board is responsible for control of the Company's consolidated 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 audits, and important audit findings, including the significant disadvantages of internal controls that were discovered 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.

Banja Luka, April 10, 2019

Grant Thornton d.o.o. Banja Luka

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

STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME
For the year ended December 31, 2018
(in thousands of BAM)

	Note	Year ended December 31, 2018	Year ended December 31, 2018
Interest income	6	28.054	26.340
Interest expense	7	(6.300)	(6.486)
Net interest income		21.754	19.854
Fee and commission income	8	5.068	4.127
Fee and commission expenses	9	(1.138)	(848)
Net fee and commission income		3.930	3.279
Other operating income	10	897	569
Other operating expenses	11	(13.188)	(10.737)
Foreign exchange (losses)/gains, net		31	(53)
Provisions for potentail losses, net	12	(7.297)	(8.030)
Profit from operations before taxes		6.127	4.882
Income tax	13	(901)	(619)
Net profit for the period		5.226	4.263
Other comprehensive income		-	-
Total comprehensive income for the period		5.226	4.263
Earnings per share:			
- Basic earnings per share (in BAM)	24	11,50	10,00

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

The attached financial statements were adopted by the Bank's Management on February 22, 2019.

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

Bojan Luburić
President of the Management

Radana Štrkić
Head of Accounting, Reporting and Financial Controlling

STATEMENT OF FINANCIAL POSITION
As of December 31, 2018
(in thousands of BAM)

	Notes	December 31 2018	December 31 2017
ASSETS			
Cash and cash funds held with the Central Bank	14	109.920	43.698
Loans and receivables due from banks	15	8.349	1.872
Loans to other banks		131	-
Loans due from customers	16	274.880	243.898
Property and eqipment	17	2.249	6.290
Intangible assets	17	236	125
Investment property	17.1	4.672	-
Other assets	18	2.796	3.936
Total assets		**403.233**	**299.819**
LIABILITIES AND EQUITY			
Deposits due to customers	19	319.442	216.017
Borrowings	20	16.916	18.442
Subordinated debt	21	6.958	6.845
Other liabilities	22	4.074	6.594
Provisions for employee retirement benefits and other contingent liabilities	12b)	237	169
Total liabilites		347.627	248.067
Equity			
Share capital	23	46.841	46.841
Share premium		83	83
Equity reserves	23	238	25
Reserve shortfall for credit losses		-	62
Accumulated profit/(loss)		3.218	478
Net profit for the period		5.226	4.263
Total equity		55.606	51.752
Total liabilities and equity		**403.233**	**299.819**
Contigent liabilities and commitments	25	41.715	27.609

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

STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2018
(in thousands of BAM)

	Share Capital	Share Premium	Equity Reserves	Accum-mulated profit/(loss)	Total
Balance January 1, 2017	**40.841**	**-**	**-**	**565**	**41.406**
New share issue	6.000	83	-	-	6.083
Reserves formed out of accummulated profit	-	-	25	(25)	-
Net profit of the current period	-	-	-	4.263	4.263
Other comprehensive income	-	-	-	-	-
Total result for the period	-	-	-	4.263	4.263
Balance December 31, 2017	**46.841**	**83**	**25**	**4.803**	**51.752**
Effects of IFRS 9 application	-	-	-	(1.372)	(1.372)
Balance January 1, 2018	**46.841**	**83**	**25**	**3.431**	**50.380**
Reserves formed out of accummulated profit	-	-	213	(213)	-
Net profit of the current period	-	-	-	5.226	5.226
Other comprehensive income	-	-	-	-	-
Total result for the period	-	-	-	5.226	5.226
Balance December 31, 2018	**46.841**	**83**	**238**	**8.444**	**55.606**

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

STATEMENT OF CASH FLOWS
For the year ended December 31, 2018
(in thousands of BAM)

	Year ended December 31, 2018	December 31, 2017
Cash flows from operating activities:		
Interest receipts	27.727	26.341
Fee and commission receipts	3.994	3.337
Interest paid	514	-
Fee and commission paid	(5.548)	(7.047)
Receipts from payments of depreciated receivables	(379)	(243)
Payments to employees and suppliers	(11.790)	(11.186)
Net cash generated by operating activities before changes in operating assets and liabilities	14.518	11.202
Changes in operating assets and liabilities:		
Net increase in loans due from customers	(37.395)	(39.486)
Loans to other banks	(131)	-
Income taxes paid	(775)	(684)
Net increase in bank deposits	7.012	-
Net increase in deposits due to customers	92.640	17.542
Net cash generated by / (used in) operating activities	75.869	(11.426)
Cash flows from investing activities:		
Purchase of intangible assets	(171)	(39)
Purchase of property and equipment	(1.243)	(656)
Purchase of other investments	(49)	-
Net cash (used in) investing activities	(1.463)	(695)
Cash flows from financing activities:		
Capital increase	-	6.083
Inflows from borrowings	3.010	6.856
Repayment of borrowings	(4.536)	(6.603)
Net cash (used in) / generated by financing activities	(1.526)	6.336
Net increase in cash and cash equivalents	72.880	(5.785)
Net increase in cash and cash equivalents	31	(53)
Net increase in cash and cash equivalents	(212)	-
Cash and cash equivalents, beginning of the year	45.570	51.408
Cash and cash equivalents, end of the year	118.269	45.570
Cash and cash equivalents comprise the following line items:		
- Cash and cash funds held with the Central Bank	109.920	43.698
- Loans and receivables due from banks	8.349	1.872
	118.269	**45.570**

Napomene na narednim stranama čine sastavni dio ovih finansijskih izvještaja.

1. BANK'S FOUNDATION AND BUSINESS POLICY

MF banka a.d. Banja Luka (hereinafter: the "Bank") was established on June 12, 2007 and named IEFK BANKA A.D. BANJA LUKA.

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

At the Shareholder Assembly meeting held on April 6, 2010, the previous shareholders of the Bank enacted a Decision to sell 100% of the Bank's equity (Note 22), where after an Agreement on the Purchase and Sale of Capital was signed on July 8, 2010 based on which the Bank's major shareholder became MKD Mikrofin d.o.o., Banja Luka, and as of that date this entity also assumed the management and control over the Bank.

Based on the decision enacted by the new shareholders of the Bank, and the decision of the competent court in Banja Luka as of November 26, 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, at no. 61 Aleja Svetog Save street. As of December 2018, the Bank has branch offices in Banja Luka, Gradiška, Derventa, Brčko, Bijeljina, Doboj, Prijedor, Istočno Sarajevo, Tuzla, Bihać, Cazin, Gradačac, Ilidža, Laktaši, Zvornik, Novi Grad, Prnjavor, Teslić, Pale, Živinice, Gračanica and Novi Grad Sarajevo.

As of December 31, 2018 the Bank had 213 employees (December 31, 2017: 193 employees).

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

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

As of December 31, 2018, the Management of the Bank is comprised of:

Supervisory Board:

- Aleksandar Kremenović, president
- Mladen Bosnić, member
- Dželila Hadžović, member
- Freider Wohrmann, independent member
- Srećko Bogunović, independent member

Management Board:

- Sandra Lonco, president
- Dragan Đurić, member
- Bojan Luburić, member

1. BANK'S FOUNDATION AND BUSINESS POLICY (continued)

Audit Board:

- Đurđica Dragojević, president
- Željko Pena, member
- Radmila Bjeljac, member
- Sanja Brkić, member
- Mira Cvijan, member

All members of the Audit Board are independent member.

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.

The Bank prepared within the prescribed deadline the forms of financial statements as defined by the Rulebook on the contents and forms of financial statemens for banks and other organisations („Official Gazette of RS“ no. 62/16) as well as the Rulebook on the contets and forms of reports ond changes in equity („Official Gazette of RS“ no. 63/16).

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

(a) New Standards and amendments to existing Standards which are issued and applicable from January 1, 2018

- IFRS 9 “Financial Instruments” (effective for annual periods beginning on or after January 1, 2018),
- IFRS 15 “Revenue from Contracts with Customers” (effective for annual periods beginning on or after January 1, 2018),
- IFRIC interpretation 22: “Foreign Currency Transactions and Advance Consideration“ (effective for annual periods beginning on or after January 1, 2018),
- Amendments to IFRS 15: “ Revenue from Contracts with Customers“ (effective for annual periods beginning on or after January 1, 2018),
- Amendments to IFRS 2: „“Share-based payments“ – Classificationa and measurement of share-based payments (effective for annual periods beginning on or after January 1, 2018),
- Amendments to IFRS 4 “Insurance Contracts” – Application of IFRS 9 „Financial Instruments“ with IFRS 4 „Insurance Contracts” (effective for annual periods beginning on or after January 1, 2018) or when IFRS 9 „Financial Instruments“ is applied for the first time,
- Amendments to IAS 40: “Investment property” – Accouting treatment for investment propery (effective for annual periods beginning on or after January 1, 2018),
- The cycle of annual improvements IFRS 2014. – 2016. – Amendments of IFRS 1: „First-time Adoption of International Financial Reporting Standards“ and IFRS 28: „Investments in Associates and Joint Ventures“ (effective for annual periods beginning on or after January 1, 2018).

Applying these standards, amendments and interpretations has no significant impact on the Bank's financial statements for the current period, except for IFRS 9. More information on the effects of applying IFRS 9 is given below. Since January 1, 2018 the Bank applies the methodology for assessment of the allowance for impairment of receivables in accordance with IFRS 9 (see disclosures in note 3 – Changes in the accouting policies).

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

EFFECTS OF APPLICATION OF IFRS 9 AS OF JANUARY 1, 2018

The following table gives a review of the carrying amounts of financial assets in accordance with IAS 39 and IFRS 9, as well as the effects of application of IFRS 9 on categories of financial assets as of January 01, 2018.

Classification and measurement of financial assets

(U hiljadama BAM)

Financial assets	**Initial Classification according to IAS 39**	**New Classification according to IFRS 9**	**Carrying Amount according to IAS 39, as of December 31, 2017**	**Carrying Amount according to IFRS 9, as of January 1, 2018**	**Effects of IFRS 9 appli-cation**
Loans and receivables	Loans and receivables – at amortized cost	Financial assets at amortized cost	243.898	242.549	1.349
Financial assets	Loans and receivables – at amortized cost	Financial assets at amortized cost			23
Other financial assets	Loans and receivables – at amortized cost	Financial assets at amortized cost	45.570	45.547	23
Total:			**289.468**	**288.096**	**1.372**

New Standards and amendments to existing Standards that have not been applied yet

On the day of the approval of these financial statements, the following Standards and amendments to existing Standards and new interpretations were issued, but did not become effective:

- IFRS 16 “Leases” (effective for annual reporting periods beginning on or after 1 January 2019),
- IFRS 17 “Insurance Contracts“ (effective for annual reporting periods beginning on or after 1 January 2021)
- IFRIC 23: “Uncertainty over Income Tax Treatments” (effective for annual reporting periods beginning on or after 1 January 2019),
- Amendments to IFRS 9: “Financial Instrumenti - Prepayment Features with Negative Compensation (effective for annual reporting periods beginning on or after 1 January 2019),
- Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures” – Sales or participation in property between investors and joint entitity or joint venture (the date of entry into force is postponed for an indefinite period, while the research project of the capital method is established),
- The cycle of annual improvements of IFRS for 2015.-2017. – (effective for annual reporting periods beginning on or after 1 January 2019),
- Amendments to IAS 19: “Employee Benefits – Plan Amendmet, Curtailment or Settlement” (effective for annual reporting periods beginning on or after 1 January 2019),
- Amendments and curtailment to references to the conceptual framework in IFRS standards (effective for annual reporting periods beginning on or after 1 January 2020)
- Amendments of IFRS 3: “Business Combinations“ – Definition of a Business (effective for annual reporting periods beginning on or after 1 January 2020),

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

2.4. Effects and Application of new and revised International Financial Reporting Standards („IFRS“) and Internationa Accouting Standards („IAS”) (continued)

The Management of the Bank has chosen not to adopt these Standards, amendments and interpretations before they enter into force and become effective. IFRS 16 will be applied from January 1, 2019. The Bank foresees that the adoption of these Standards, amendments and interpretation will not have any significant effect, expect the effect ot IFRS 16 on the financial statements of the Bank.

Effects of the first application of IFRS 16 – Leases

IFRS 16 will be applied from or after January 1 2019, the Standard defines initial recognition, measurement and disclosure of leases for both parties of the contract, ie for the buyer („lessee“) and for the supplier („lessor“). The key change of IFRS 16 is the abolition of the devision into financial and opreational lease for the lessee, as well as the recognition of leases under the principle „property with usage rigths“. The standard requires the lessee to recognize all assets with usage rights as fixed assets and as liability in the balance sheet, except if the lease period is 12 months or less o if the asset has negligible values, which aims to improve the quality of financial reporting and the comparability of the financial statements of the lessee.

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.

From January 1, 2019, the Bank will define an unique accouting model for all lease contracts. The changes will effect the statement of financial position as well as the statement of profit and loss.
During the transition to IFRS 16, the following approaches can be selected:

1. A retroactive approach for applying IFRS 16 to each prior reporting period, for which the comparative data is corrected;
2. A cumulative catch-up approach for retroactively applying IFRS 16 with a cumulative effect recognized as correction on January 1, 2019, for which the comparative data is not corrected.

The Bank decieded to apply the second approach and the assets with use rights were evaluated 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 liabilites.

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

In the statement of financial position the Bank will state the property with use right seperately from other assets and lease obligations seperately from other liabilites. In the statement of profit and loss the Bank will state the the interes expenses for lease obligations as a financial cost seperately from the cost for depreciation and amortization of the given assets with use right. In the statement of cash flows the Bank will state cash payments for principal lease obligations within the financial activities, cash payments, and for oblgations on interests based on leases within financial and operational activities.

The first application of IFRS 16 resulted in recording the right to use funds in the amount of 7.969 thousand of BAM.

3. SUMMARY OF SIGNIFICANT ACCOUTING POLICIES

3.1. Income and Expense Recognition 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 the statement of comprehensive income.

3.3. Property, Equipment and Intangible Assets

Items of 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)
Computer equipment	25%	4
Automobiles	15,5%	6,5
Telephone switchboards	7%-10%	10-14,3
Buildings	1,3%	77
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 pupose 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 is calculated equally at cost, using the following annual rates in order to completely write the assets off within their usefule life:

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

3.5. 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 of the current period.

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

As of December 31, 2018, in the assessment of the Bank's management, there were no indications that the value of equipment and intangible assets had suffered impairment.

3.6. Financial Assets

Effective policies until January 1, 2018

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

Effective Interest Method

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6. Financial Assets (continued)

Effective policies until January 1, 2018

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

Financial Assets Available for Sale

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

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

Loans and Receivables

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

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

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

Cash and Cash Equivalents

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

Impairment of Financial Assets

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

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6. Financial Assets (continued)

Effective policies until January 1, 2018

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

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

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

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

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

Derecognition of Financial Assets

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

Allowance for Impairment of Receivables

At the end of each month, the Bank makes provisions for potential losses on defaults and irrecoverability receivables and applies two methodologies:

1. a methodology provided by the Banking Agency of the Republic of Srpska for reporting purposes to the regulator,
2. a methodology based on IAS 39 for internal and reporting purposes of the Bank.

According to IAS 39 „Financial Instruments: Recognition and measurement“, the Bank reviews the loan portfolio in order to assess the allowance for impairment and necessary provisions on a monthly basis. When determining whether losses from potential impairments of investments have to be stated in the statement of profit and loss, the Bank evaluates potential information/evidences which indicate a measureable impairment of estimatated future cash flows on the protfolio basis, before it is possible to identify such losses on the basis of the individual investment.

Information that may indicate losses of investments include: creditworthiness of the debtor, irregularity and delay in settling obligations, market and economic conditions at local level which condition delays in settling obligations and the like. The estimations of the management of the impairment of financial investments in the Bank's portfolio are based on actual losses from the past which are realised on financial assets with similar impairment patterns. In the process of classification, the Bank treats all entities within the group of connected entities based on the worst classification category. The Bank, according to the methodology for the claculation of the allowance for impairment, applies two approaches for calculating the impairment loss:

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6. Financial Assets (continued)

Effective policies until January 1, 2018

- the portfolio of allowance for impairment (provisions) – calculated for all exposures of the Bank with no evidences of impairment of receivables,
- individual allowance of impairment (provisions) – calculated for all exposures of the Bank that are indiviually significant at the same time (the exposure exceeds the individually defined limit) and have evidences of impairment of receivables.

An internally defined individual significant limit for conducting an individual evaluation is 50.000,00 BAM (the amount represents total balance and non-balance exposure) on the day of calculating the impairment loss, ie allowance for impairment. All investments with a higher amount are individually significant investments.

The Bank calculates the impairment loss for:

Investments with objective evidence of impairment identified using data on delays from the Bank's information system which are used for migration matrices for the last three years, simultaneously classifying them in relevant rating groups,
-investments in a so-called „default“ status, with delays in settling of obligations for more than 90 days,
- investments in rating groups with delays for less than 90 days for which the Bank recognizes the basis for impairment and if the amount for delays is materially significant (materially significant amount is an amount greater than 1% of the Bank's indiviual receivalbe from the debtor if it is a natural person, but not less than 20,00 BAM or 2,5% of the Bank's individual receivable from the debtor if it is a legal entity or entrepreneur, but not less than od 500,00 BAM).

The Bank recognizes the impairment loss to the amount of recoverable value of the loan/investment valued at depreciated cost. The impairment loss represents the difference between its present value (depreciated value) and recoverable value. The recoverable value represents the present value of expected cash flows from assets increased by the present value of expected cash flows from collateral and decreased by the present value of billing costs.

The recognition of the impairment loss is stated in the statement of profit and loss. Amounts with impaired values for loans/investments based on the impairment loss are stated in the account for allowances for impairment.

If the amount of impairment loss is decreased as a result of occuring events after its initial recognition, the abolition of the impairment is made in favor of the statement of profit and loss, but the abolition of the impairment cannot be greater than what the depreciated value would have been on the date of abolition if the impairment has not been recognized.

3.7. Financial Liabilities

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accouting policies regarding financial assets in accordance with IFRS 9 from January 1, 2018

Accounting policies described in the following passages were applied starting from January 1, 2018 based on the implementation of IFRS 9: "Financial Instruments". For everything else that is not mentioned in these passages, remains the same as for the period until January 1, 2018.

During 2018, the Bank has adopted Methodology for calculation of allowance for impairment for expected losses according to the requests of IFRS 9.
The Bank has conducted GAP Analysis on the effective loan contracts which showed that currently Bank uses only a 6 month EURIBOR as a variable component of the interest rate. The Bank has defined resetting of the variable component of the interest rate at certaing dates, as follows:

- Semi-annually with precisely determined dates – June 30 and December 31
- Semi-annually with precisely determined dates – March 31 and September 30.

The Bank considers that during the semi-annually resetting of 6 month interest rate, on certain dates, differences in the expected cash flows can be encountered, if the date of the contract conclusion does not match one of the dates on which the resetting is to be done. Impact of these differences in certain situations can be potentially materially significant from the aspect of loans in the given accounting period, for which in that case an analysis will be conducted which will take into consideration the historic trends of interest rates in the given period, purposed for prospective anticipation of the material effects of the said differences. It is estimated that current market movement of EURIBOR will not lead to materially significant discrepancies in the expected cash flows.

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. Mehodology defines the criteria for determining the type of financial assets, criteria for receivables identification which need to be individualy 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 Standars (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 collective basis;
5) Individual allowance impairment;
6) Collective allowance impairment.

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

i. 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);

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Summary of the Changes in Accounting Policies Regarding Financial Assets in Accordance With IFRS 9 (continued)

ii. determined methods and techniques for classification on individual and collective 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;
iii. analyses, estimates and other procedures used in calculation of allowance for impairment, that is, provisions, should be precisely explained and appropriately documented in writing;
iv. providing the precise and up-to-date information to be considered when making estimates on receivables collection;
v. 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.

IFRS 9 introduces several requests regarding recognition and measurement of financial assets, financial liabilities and contracts on purchase/sale of non-financial subjects. This standard replaces the IAS 39 – Financial Instruments: Recognition and Measurement. IASB intended to fully replace IAS 39 with IFRS 9, but as a response to the requests of financial instruments calculation improvement, replacement procedure was divided into three stages:

• Stage 1: Classification and Measurement of Financial Assets and Liabilities – according to which financial assets should be classified based on the business model and characteristics of the contractual cash flows.
• Stage 2: Value Decrease Methodology – according to which financial assets impairment refers to the expected credit losses.
• Stage 3: General Security Accounting – according to which the perceived shortfalls and inconsistencies of the model stated by IAS 39, are being improved.

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 indicatiors may affect differently the risk parameters upon calculation of 12 months lifecycle losses, but considering that the formula for allowance for impariment 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 borrower 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 borrower 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 objecitve proof of the impairment resulting in one or more previous events occured 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.

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. A non-significant individual exposures would be estimated individually when a specific risk related to the client/transaction (industry concentarion, default status, rating cateogory, 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:

- Borrower'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 posibility by activating the security instrument especially in respect of the following elements:

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Summary of the Changes in Accounting Policies Regarding Financial Assets in Accordance With IFRS 9 (continued)

- 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 borrower.

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 deterimining 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 (collective) 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 exppected 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.

Calculation of allowance for impairment through portfolio impairment is conducted for the following exposures: for immaterial exposures in stage 3 and total exposures in stages 1 and 2.

All clients investments categorized by defined criteria for collective allowance for impairment, are further categorized into appropriate homogenous groups. 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. Movemenet of each homogenous group will be monitored, migration of exposures from creditworthiness groups into a certain status according to the number of days delay in payment.

Migration of the creditworthiness groups to a certain status, that is another creditworthiness group will be monitored with consideration of middle (weighted) average amount at the and of the individual quarters, relating to the historic data for the defined period (minimum of three years). Therefore, first an individual migration on defined quarterly dates will be determined, so that the movement of exposures/lines (active one year up to the said date) per creditworthiness groups will be monitored. Furthermore, for each creditworthiness group amounts migrated on all of the quarterly dates will be summarized and divided with the sum of the total exposures of all of the quarterly dates.

Impairment measurement on collective basis requests an estimate of the parameters on statistic basis wih 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Summary of the Changes in Accounting Policies Regarding Financial Assets in Accordance With IFRS 9 (continued)

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. The difference between the carrying amount of the exposure and recognized amount of the collateral (estimated value adjusted with the percentages given in the table) represents the uncovered amount which serves as a basis for portfolio calculation of allowance for impairment. 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 invidivually materially significiant 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.

Allowance for impairment is applied to all of the Bank's credit exposures, such as:

a) Balance sheet items (exposures)

-Credits and other client exposures (interest, penalty interest, compensations regarding credit activities, compensation based on the undertaken irrevocable liabilities (guarantees and letters of credit), other compensations);
-Accrued interests and compensations;
-Trade receivables with and without a significant financing component;
-Other investments;
-Other assets and

b) Off-balance sheet items (exposures)

-irrevocable approved, yet unused credits and all other components which represent contigent liabilities of the Bank;
-Guarantees and letters of credit;
-Other off-balance sheet items which can produce payments by the Bank.

Method of calculation of allowance for impairment depends on the fact whether the exposure is treated as individually significant or not. The Bank has defined internally that the total client exposure (balance and off-balance exposure) is considered to be materially significant if, at the day of the allowance for impairment calculation, exceed the limit of BAM 50.000.

3.8. Taxes and Contributions

Current Income Tax

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

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

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

Deferred Income Tax

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

3.10. Leases

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

The Bank as a Lessor

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

The Bank as a Lessee

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

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

3.11. Equity

Equity is not assessed, 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 reserves,
- Legal reserves,
- 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 underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

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

Estimated Useful Life of Equipment, 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

Effective assessment until January 1, 2018

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

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

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

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

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

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

4. SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Allowance for Impairment of Receivables (continued)

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

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

The recognition of the impairment loss is stated in the statement of profit and loss. Amounts with impaired values for loans/investments based on the impairment loss are stated in the account for allowances for impairment.

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

Estimation applied from January 1, 2018

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 individualy 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 Standars (IFRS) 9

The 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) Impairment on indvidual basis;
6) Impairment on collective basis.

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;

4. SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Estimation applied from January 1, 2018

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 50.000 BAM is considered as indiviually significant. The exposures of the Bank representing other receivables are subject of individual estimations due to the specifici 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:

-2,5% of the Bank's individual receivables from the debtor – natural person, but no less than 50 BAM, and

-2,5% of the Bank's individual receivables from the debtor – legal entity, but no less than 500 BAM.

The estimation of individually significant investments is made for individually significant exposures (more than BAM 50 thousands) that are late more than 90 days regarding the settlement of obligations. Based on defined criteria, the risk management division finds candidates for indiviual 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 calcuated, while the remaining candidates will be „returned“ to the protfolio assessment and calculation of allowances for impairment.
This proposal of the risk management division is verfied by the Bank's management/competent mamber 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, Plasmani/klijenti razvrstani su u homogene grupe sa istim ili sličnim karakteristikama i podgrupe u zavisnosti od broja dana kašnjenja, belonging to segments (and within the 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 protfolio 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.

Fair value

The Bank's business policy is to disclosure information on the fair value of assets and liabilites 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 liabilites 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 realised 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.

4. SIGNIFICANT ACCOUNTING ESTIMATES (continued)

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. CORRECTION OF FINANCIAL STATEMENTS FOR 2017

The Bank has made certain reclassifications of the previously reported balance sheet as of December 31,2017, for the purpose of adequate presentation and comparability of certain items within the financial statements. The effects of the reclassification of the balance sheet for the business year 2017.

The effects of the reclassification of the balance sheet for the business year 2017

				(U hiljadama BAM)
	Notes	**December 31 2017.**	**reclassification +/-**	**Decembar 31 2017.** *Corrected*
ASSETS				
Cash and cash funds held with the Central Bank	13	43.698	-	43.698
Loans and receivables due from banks	14	1.872	-	1.872
Loans to other banks		-	-	-
Loans due to customers	15	243.898	1.174	245.072
Property and eqipment	16	6.415	-	6.415
Intangible assets	16		-	-
Investment property	16.1	-	-	-
Calculated interest and other assets	17	3.936	(1.174)	2.762
			-	
Total assets		**299.819**	**-**	**299.819**
LIABILITIES AND EQUITY				
Deposits due to banks	18	216.017	3.112	219.129
Deposits due to customers	19	18.442	4	18.446
Obaveze po kreditima	20	6.845	119	6.964
Subordinated debt	21	6.594	(3.235)	3.359
Other liabilities	11b)	169	-	169
				-
Total liabilites		248.067	-	248.067
				-
Equity				-
Share capital	22	46.841	-	46.841
Share premium		83	-	83
Equity reserves	22	25	-	25
Reserve shortfall for credit losses		62	-	62
Accumulated profit/(loss)		478	-	478
Profit of the current period		4.263	-	4.263
				-
Total equity		51.752	-	51.752
				-
Total liabilities and equity		**299.819**	**-**	**299.819**
Contigent liabilities and commitments	25	27.609	-	27.609

6. INTEREST INCOME

	(In thousands of BAM)	
	January 1 to December 31, 2018	**January 1 to December 31, 2017**
Interest income:		
Public sector	2	3
Retail	14.020	13.825
Corporate	13.999	12.468
Nonprofit organizations	11	16
Other	22	28
Total:	**28.054**	**26.340**

7. INTEREST EXPENSE

(In thousands of BAM)

	January 1 to December 31, 2018	January 1 to December 31, 2017
Interest expense:		
Public sector	192	197
Retail	4.363	4.154
Banks and depositary institutions	12	-
Non-banking financial institutions	757	972
Corporate	133	136
Nonprofit organizations	103	164
Other	14	25
Loan interests	299	409
Interests on subordinated debt	427	429
Total:	**6.300**	**6.486**

8. FEE AND COMMISSION INCOME

(In thousands of BAM)

	January 1 to December 31, 2018	January 1 to December 31, 2017
Fee and commission income from domestic and non-domestic payment transactions	3.001	2.417
Sale and purchase of currencies	840	770
Other loan fees	729	574
Fees for off-balance sheet operations	498	366
Total:	**5.068**	**4.127**

9. FEE AND COMMISSION EXPENSES

(In thousands of BAM)

	January 1 to December 31, 2018	January 1 to December 31, 2017
Sale and purchase of currencies	172	96
Fee and commission payable to the Central Bank for domestic payment transfers	435	328
Fee and commission expense from non-domestic payment transactions	50	34
Payment/credit card operation fees	374	266
Loan processing fees	17	42
Other fees and commissions	90	82
Total:	**1.138**	**848**

10. OTHER OPERATING INCOME

(In thousands of BAM)

	January 1 to December 31, 2018	January 1 to December 31, 2017
Collection of written-off suspended interest	540	352
Other income	357	217
Total:	**897**	**569**

11. OTHER OPERATING EXPENSES

(In thousands of BAM)

	January 1 to December 31, 2018	January 1 to December 31, 2017
Gross salaries and benefits	6.465	5.581
Remunerations to the Supervisory Board, Audit Committee, employees help	115	119
Professional education of employees	56	29
Cost of materials and services	462	339
Business trip expenses	38	34
Telecommunication and postage services	495	451
Equipment/software maintenance costs	620	548
Marketing and advertising	352	284
Rental costs	1.293	721
Membership fees	106	97
Representation Cost	128	88
Security services	559	416
Amortization costs	672	602
Taxes and contributions payable	202	179
BARS fees	316	227
Write-off of irrecoverable receivables	46	160
Fees for third party engagements	48	31
Other operating expenses	1.215	831
Total:	**13.188**	**10.737**

Gross salaries and benefits	**January 1 to December 31, 2018**	**January 1 to December 31, 2017**
Net salaries expenses	3.945	3.408
Salaries taxes and contributions	2.520	2.173
Total gross salaries and benefits:	**6.465**	**5.581**

12. PROVISIONS FOR POTENTIAL LOSSES

a) Provisions Charged to Expenses

(In thousands of BAM)

	January 1 to December 31, 2018	January 1 to December 31, 2017
Cash assests	(245)	-
Loans due from customers	(28.408)	(24.746)
Other assets	(519)	(523)
Employee benefits	(7)	(10)
Potential and contingent liabilities and commitments	(699)	(473)
Total:	**(29.878)**	**(25.752)**

12. PROVISIONS FOR POTENTIAL LOSSES (continued)

b) Provisions Charged to Incomes

	January 1 to December 31, 2018	January 1 to December 31, 2017
Cash assests	56	-
Loans due from customers	21.629	17.187
Other assets	258	77
Employee benefits	3	10
Potential and contingent liabilities and commitments	635	448
Total:	**22.581**	**17.722**
Net provisions:	**(7.297)**	**(8.030)**

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

(In thousands of BAM)

	Cash assets	Loans due from Customers	Other Assets	Employee Benefits	Contingent Liabilities and Commitments	Total
Balance, January, 2017	**-**	**13.345**	**321**	**26**	**118**	**13.810**
Provision for the period	-	24.746	523	10	473	25.752
Reversal of provisions	-	(17.187)	(77)	(10)	(448)	(17.722)
Balance, December 31, 2017	**-**	**20.904**	**767**	**26**	**143**	**21.840**
Effect of IFRS 9 application-allowance for impairment increase	23	3.888	-	-	-	3.911
Effect of IFRS 9 application-allowance for impairment decrease	-	(2.540)	-	-	-	(2.540)
Balance, January 1, 2018	**23**	**22.252**	**767**	**26**	**143**	**23.211**
Provision for the period	245	28.408	519	7	699	29.878
Reversal of provisions	(56)	(21.629)	(258)	(3)	(635)	22.581
Balance, December 31, 2018	**212**	**29.031**	**1.028**	**30**	**207**	**30.508**

13. INCOME TAX

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

(In thousands of BAM)	January 1 to December 31, 2018	January 1 to December 31, 2017
Profit before taxes	6.127	4.882
Income tax at the statutory rate of 10%	613	488
Tax reduction for tax exempt income	(1.074)	(789)
Expenses not recognized for tax purposes – impairment of loans and other assets	1.248	905
Other expenses not recognized for tax purposes	114	16
Deferred tax assets	-	(1)
Total income tax	901	619
Effective income tax rate	14,61%	12,70%

For previous 2018 year, the bank has been made payments of monthly tax advances for Republic of Srpska, Brcko District and Federation of Bosnia and Herzegovina in 1/12-level income tax for 2017. year.

Tax obligations are stated in the tax statements of the Bank, and are accepted as such. Prior years' obligations were controlled by tax authorities in the current year 2018.
None of the materialy significant deviations were noticed.

14. CASH AND CASH FUNDS HELD WITH THE CENTRAL BANK

In thousands of BAM)	December 31, 2018	December 31, 2017
Cash on hand:		
- in BAM	5.158	3.490
- in foreign currency	4.345	2.136
	9.503	**5.626**
Balances with the Central Bank in BAM:		
- Gyro account	66.712	13.572
- Foreign currency cash on hand	677	137
	67.389	13.709
Gross value	**76.892**	**19.335**
Allowance for impairment of cash assets	(189)	-
Total for the purposes of Statement of Cash Flows	**76.703**	**19.335**
Obligatory reserve	33.217	24.363
Total	**109.920**	**43.698**

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

15. LOANS AND RECEIVABLES DUE FROM BANKS

	(In thousands of BAM)	
	December 31, 2018	**December 31, 2017**
Loans and receivables due from banks:		
- domestic banks in BAM	5.166	754
- foreign banks	3.206	1.118
	8.372	**1.872**
Allowance for impairment of cash assets	(23)	-
Total:	**8.349**	**1.872**

16. LOANS DUE FROM CUSTOMERS

	(In thousands of BAM)	
	December 31, 2018	**December 31, 2017**
		Corrected
Short-term loans in BAM	58.029	47.372
Short-term loans in foreign currency	20	-
Long-term loans in BAM	170.622	144.854
Long-term loans in foreign currency	-	978
Guarantees paid	79	71
Current portion of long-term loans	75.161	72.701
	303.911	**265.976**
Less: Impairment allowance of loans due from customers	(29.031)	(20.904)
Total:	**274.880**	**245.072**

Until December 31, 2018 the Bank issued mostly long-term loans, an in smaller amount short-term loans, at annual interest rates ranging from 1.65 % to 14.5%. Loans with annual interest rate in range 1.65% - 6.49% are loans approved form the Republic of Srpska Investment and Development Bank, or are loans ensured/covered partialy 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 injuctions, transition orders. Organizational part of the Bank for risk is continuosly monitoring the market value of insurance instruments.

Most of the loans with a period of over one-year in local currency as of December 31, 2018 were issued to enterprises and population with an annual interest rate ranging from 1.65% to 15.50%, plus 6-month EURIBOR, for periods of 3 years up to the maximum of 15 years. Loans that was approved with deadline over 15 years up to the maximum of 25 years are related to loans approved from the Republic of Srpska Investment and Development Bank. The interest rate of 1.65% was approved to the clients who had a 100% earmarked term deposit placed with the Bank as collateral, while the interest rate higher than 15.50 % relates to the long-term loans underteken from MKD Mikrofin d.o.o. Banja Luka.

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

As of December 31, 2018, the geographic concentration of loans approved to customers as included in the Bank's loan portfolio mostly comprises customers domiciled in the City of Banja Luka (about 22,65%) of the total portfolio, Bijeljina Region (about 6,66%), Prijedor Region (about 5,66%), Istocno Sarajevo Region (about 5,54%) and Brcko District (about 5,03%).

As of December 31, 2017, the geographic concentration of loans approved to customers as included in the Bank's loan portfolio mostly comprises customers domiciled in the City of Banja Luka (about 15.72%) of the total portfolio, Istocno Sarajevo Region (about 10.18%), Derventa Region (5.97%), Bijeljina Region (about 6.70%), Brčko District (about 6.07%) and Prijedor Region (about 6.0%).

17. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

(In thousand of BAM)

	Investments in Borrowed Assets	Buildings	Equipment	Equipment in Progress	Total Property and Equipment	Total Intangible Assets
Cost						
Balance, January 1, 2017	**314**	**4.834**	**2.770**	**1**	**7.919**	**1.011**
Acquisitions in the period	223	-	502	7	732	39
Disposals	(11)	-	(72)	-	(83)	-
Balance, December 31, 2017	**526**	**4.834**	**3.200**	**8**	**8.568**	**1.050**
Acquisitions in the period	361	-	813	69	1.243	171
Transfer from-to	-	(4.834)	-	-	(4.834)	-
Balance, December 31, 2018	**887**	**-**	**4.013**	**77**	**4.977**	**1.221**
Allowance for impairment						
Balance, January 1, 2016.	**117**	**-**	**1.303**	**-**	**1.420**	**784**
Amortization/Depreciation	60	36	386	-	**482**	98
Disposals	-	-	(97)	-	**(97)**	(35)
Balance, December 31, 2016.	**177**	**36**	**1.592**	**-**	**1.805**	**847**
Amortization/Depreciation	64	63	398	-	**525**	78
Disposals	(7)	-	(45)	-	**(52)**	-
Balance, December 31, 2017.	**234**	**99**	**1.945**	**-**	**2.278**	**925**
Adjusting of book entries	17	-	(17)	-	**-**	-
Balance, December 31, 2017	**251**	**99**	**1.928**	**-**	**2.278**	**925**
Transfer from/to	**-**	**(99)**			(99)	
Amortization/Depreciation	100	42	449	-	591	60
Amortization/Depreciation transfer from/to	-	(42)	-	-	(42)	-
Balance, December 31, 2018	**351**	**-**	**2.377**	**-**	**2.728**	**985**
December 31, 2016	**137**	**4.798**	**1.178**	**1**	**6.114**	**164**
December 31, 2017	**292**	**4.735**	**1.255**	**8**	**6.290**	**125**
September, 30, 2018	**536**	**-**	**1.636**	**77**	**2.249**	**236**

As of December 31, 2018 equipment and buildings are insured against the usual risks and the Bank has no pledges on property, equipment and intangible assets.

17.1. INVESTMENT PROPERTY

(In thousand of BAM)

	Investment property
Cost	
Balance, December 31, 2017	**-**
Acquisitions in the period	-
Transfer from-to	4.834
Balance, December 31,2018	**4.834**
Allowance for impairment	
Balance, December 31, 2018	**-**
Transfer from/to	**141**
Amortization	21
Balance, December 31, 2018	**162**
December 31, 2017	**-**
September, 30, 2018	**4.672**

The property in Vase Pelagića street no. 22 is in accordance with IAS 40 re-classified in investment property, in the amount of BAM 4,834 thousand. Investment property shall be measured at cost method.

Considering the current supply and demand of property in Banja Luka, the fair value of subjected property is BAM 4,720 thousand.

18. ACCRUES INTEREST AND OTHER ASSETS

(In thousands of BAM)

	December 31, 2018	December 31, 2017
In BAM:		Corrected
- Inventories of materials	1.883	1.416
- Accrued receivables for calculated interests	1	1
- Purchased receivables	437	1.101
- Accrued other expenses	223	170
- Fee and commission receivables	71	65
- Bonds - reconciliation of war damages	49	-
- Given advances	50	6
- Other receivables	970	651
-Deferred tax assets	-	1
In foreign currency:		
- Accrued receivables for calculated expenses	44	60
- Other foreign currency receivables	85	47
- Advances in foreign currencies	11	11
	3.824	**3.529**
Less: Impairment allowance of accrued interest and other assets	(1.028)	(767)
Total:	**2.796**	**2.762**

19. DEPOSITS DUE TO CUSTOMERS

	December 31, 2018	December 31, 2017 Corrected
		(In thousands of BAM)
Demand deposits in BAM:		
- Government and state institutions	1.826	749
- Corporate customers	11.974	8.760
- Banks and banking institutions	12	-
- Nonprofit organizations	1.321	853
- Non-banking financial institutions	11.686	7.252
- Residents/non-residents	18.651	16.468
- Other customers	352	73
	45.822	**34.155**
Demand deposits in foreign currencies:		
- Corporate customers	2.150	1.387
- Nonprofit organizations	1.550	340
- Non-banking financial institutions	125	3.101
- Residents/non-residents	5.424	5.911
- Other	5	4
	9.254	**10.743**
Short-term deposits in BAM:		
- Corporate customers	7.000	-
- Government and state institutions	1.622	622
- Non-banking financial institutions	126	1.141
- Retail customers	22.077	25.387
- Other	377	216
	51	36
Short- term deposits in foreign currencies:	**31.253**	**27.402**
- Retail customers	245	265
	245	**265**
Long- term deposits in BAM:		
- Government and state institutions	10.558	7.258
- Corporate customers	4.580	1.412
- Non-profit organizations	3.664	3.663
- Non-banking financial institutions	19.781	17.948
- Retail customers	69.397	38.7362
- Other customers	641	650
	108.621	**69.667**
Long term deposits in foreign currencies:		
- Corporate customers	2.076	2.231
- Non-banking financial institutions	2.065	2.065
- Residents/ non-residents	118.932	71.428
- Non-profit organizations	1.174	1.173
	124.247	**76.897**
Total:	**319.442**	**219.129**

19. DEPOSITS DUE TO CUSTOMERS (continued)
Current Portion

	(In thousands of BAM)	
	December 31, 2018	**December 31, 2017** Corrected
Long- term deposits in BAM:		
- Government and state institutions	58	208
- Corporate customers	3.171	701
- Nonprofit organizations	1.051	3.229
- Non-banking financial institutions	10.161	6.580
- Retail customers	38.822	17.405
- Other customers	1	-
	53.264	**28.123**
Long term deposits in foreign currencies:		
- Corporate customers	903	1.173
- Non-banking financial institutions	500	2.065
- Residents/ non-residents	67.298	32.838
- Nonprofit organizations	1	1.173
	68.702	**37.249**
Current portion of long-term deposits in BAM:		
- Government and state institutions	10.500	7.050
- Corporate customers	1.409	711
- Nonprofit organizations	2.613	434
- Non-banking financial institutions	9.620	11.368
- Retail customers	30.575	21.331
- Other customers	640	650
	55.357	**41.544**
Current portion. of long-term deposits, in foreign currency:		
- enterprises	1.173	1.058
- non-banking financial institutions	1.565	-
- population	51.634	38.590
- non-profit organizations	1.173	-
	55.545	**39.648**
Total in BAM:	**108.621**	**69.667**
Total in foreign currency:	**124.247**	**76.897**

20. BORROWINGS

(In thousands of BAM)

	December 31, 2018	December 31, 2017
In BAM:		
- RS Development and Employment Fund	5.067	5.235
- RS Housing Fund	8.388	7.345
- Fund for Development of Eastern Region of RS	3.461	4.744
Total in BAM:	**16.916**	**17.324**
In foreign currency:		
- IFC	-	1.118
Total in foreign currency:	**-**	**1.118**
Total long-term portion:		
Current portions:		
-IFC	-	1.118
- IRB	2.039	1.947
Total current portion of long-term liabilities:	**2.039**	**3.065**

As of December 31, 2018, the total balance liabilities received based on loans from the funds managed by the Investment and Development Bank of RS amounted to BAM 16.916 thousand (as of December 31, 2017 BAM 17.324 thousand).

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

IFC, as of December 31, 2014: loan amount EUR 4 milion – loan repayment period: 4 years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.75%.

The borrowed funds are intended for financing of capital assets, financing working capital, investments, startup micro, small and medium-sized enterprises and entrepreneurs.
Pursuant to the loan agreements entered into with creditors, the Bank is obligated to comply with certain procedures and accounting records that adequately reflect the Bank's operations in accordance with IAS and IFRS and certain financial covenants

As of December 31, 2018, the Bank was not breaks any of the financial covenants agreed with the IFC. The loan was repaid in July, 2018.

21. SUBORDINATED DEBT

(In thousands of BAM)

	December 31, 2018	December 31, 2017
EFSE, Luksemburg	6,845	6,845
Accrued interest liabilities in foreign currency on long-term subordinated loans of non-residental enterprises	113	119
Total	**6,958**	**6.964**

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

On October 13, 2016 the Bank and EFSE, Luxembourg executed an agreement on 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 amount of the loan was transferred into foreign currency account of the Bank on the October 21, 2016.

As of December 31, 2018, the Bank was not in breach of any financial convenants agreed with EFSE, Luxembourg.

22. OTHER LIABILITIES

(In thousands of BAM)

	December 31, 2018	December 31, 2017
In BAM:		Corrected
- deferred income	2.304	2.015
- trade payables	357	451
- other liabilities	1.219	856
In foreign currency:		
- trade payables	40	22
- other liabilities	154	15
Total:	**4.074**	**3.359**

23. EQUITY

Share Capital

Share capital of the Bank was formed from the initial investments of shareholders and the subsequent capital increase - share subscriptions paid in cash. The Bank's share capital as of December 31, 2018 totaled BAM 46.841 thousand (as of December 31, 2017 it totaled BAM 46.841 thousand) and was comprised of 468.410 shares with the par value of BAM 100 per share.

According to the excerpt provided by the Central Registry of Securities of the Republic of Srpska the ownership structure of the Bank's share capital as of December 31, 2018 was as follows:

	Share Count	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: daljem tekstu: FMO), Netherlands	54.195	5.419	11,57
KfW, Germany	47.259	4.726	10,09
	468,410	46,841	100.00

The ownership structure of the Bank's share capital as of December 31, 2017 was as follows:

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MKD Mikrofin d.o.o. Banja Luka	366.956	36.696	78,34
Nederlandse Financierings - Maatschappij voor Ontwikkelingslanden N.V. (hereinafter: FMO), Netherlands	54.195	5.419	11,57
KfW, Germany	47.259	4.726	10,09
	468,410	46,841	100.00

Equity Reserves

Equity reserves totaling BAM 238 thousand were formed by allocations from profit in accordance with the Supervisory Board's Decesion number NO – 60/2017 April, 26, 2017 on legal reserves and Assembly's Decision number SK – 7/2018 June 13, 2017

24. EARNINGS PER SHARE

(In thousands of BAM)

	December 31, 2018	December 31, 2017
Net profit of the period	5.226	4.263
Weighted average number of shares outstanding	468.410	426.163
Basic and diluted earnings per share (in BAM)	11, 15	10,00

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.

25. CONTIGENT LIABILITIES AND COMMITMENTS

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

(In thousands of BAM)

	December 31, 2018	December 31, 2017
Payment guarantees	10.564	7.524
Contract execution guarantees	12.518	5.765
Irrevocable commitments for undrawn loans	11.983	8.453
Unused overdrafts on accounts and credit cards	6.650	5.867
Total	**41.715**	**27.609**

b) Litigations

As of December 31, 2018 the Bank was involved in 905 litigations. The total portofilo value received on this basis by Legal Affairs and Debt Collection Departments as of December 31, 2018 aggregated to BAM 13.914 thousand (As of December 31, 2017 aggregated to BAM 12.101 thousands).

As of December 31, 2018 there were nine litigations initiated against the Bank. Given the nature of these litigations, the Committee for Assessing the Risk of Litigation Losses in proceedings initiated against the Bank determines that the estimated success rate of the Bank in all of the litigations is above 50%, consequently the Bank made provisions in 2% of all initiated litigations. According to the Bank Management Decision number Up -314/2018 December 28, 2018 Board's proposal was confirmed. Provisions for litigations initiated against the Bank as of December 31, 2018 aggregated to BAM 10 thousands.

c) Regulatory Compliance

The Bank is obligated to reconcile the size of its business operations with the legally prescribed ratios, i.e. to maintain the size 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 of December 31, 2018 the Bank prepared and submitted its statements in compliance with accounting standards and regulations of Republic of Srpska, established and by the Banking Agency of Republic of Srpska.

26. RELATED PARTIES TRANSACTIONS

Statement of Financial Position	(In thousands of BAM) December 31, 2018	December 31, 2017
Assets:		
- Receivables based on loans given to the Bank management and employees	1.617	3.358
-Receivables based on interests	13	2
-Calculated interest	1	2
Total assets	**1.631**	**3.362**
Liabilities:		
- Transaction accounts of the Bank's Supervisory Board members and management	649	1.239
- Other related individuals	369	1.598
	1.018	2.837
Trade payables:		
- MF Software d.o.o. Banja Luka	-	88
- MKD Mikrofin d.o.o. Banja Luka (Parent company)	-	11
	-	99
Other liabilities:		
- Other liabilities:	5	4
	5	103
Interest liabilities:		
- Mikrofin osiguranje a.d. Banja Luka	1	9
- Citizens' Association Mikrofin	-	1
- Related individuals	9	90
	10	100
Related parties deposit balance:		
- MKD Mikrofin d.o.o. Banja Luka (Parent company)	5.129	6.288
- MF Software d.o.o. Banja Luka	134	78
- Mikrofin osiguranje a.d. Banja Luka	6.393	5.593
- Citizens' Association Mikrofin	690	758
- Zepter fond	-	2.500
- Others	120	143
	12.466	15.360
Total liabilities	**13.499**	**18.499**
Liabilities, net	**(11.868)**	**(15.137)**

26. RELATED PARTIES TRANSACTIONS (continued)

(In thousands of BAM)

Profit and loss statement	**Period Ended December 31, 2018**	**Period Ended December 31, 2017**
Income		
Income from fees from related parties:		
- MKD Mikrofin d.o.o. Banja Luka	545	379
- Mikrofin osiguranje a.d. Banja Luka	-	12
- MF SOFTWARE d.o.o. Banja Luka	1	1
- Drvex d.o.o. Laktaši	5	6
- Other	-	-
- Other individuals	-	15
Income from rent	232	86
Interest income from other related parties	45	53
Total income	**828**	**552**
Expenses		
Rental costs– MKD Mikrofin d.o.o. Banja Luka	(29)	(29)
Rental costs – Drvex d.o.o. Laktaši	(16)	(16)
Rental costs – Mikrofin osiguranje a.d. Banja Luka	(51)	(51)
Software lease- MF SOFTWARE d.o.o. Banja Luka	(219)	(115)
Licence costs - MF SOFTWARE d.o.o. Banja Luka	(79)	(66)
Insurance costs - Mikrofin osiguranje a.d. Banja Luka	(184)	(139)
Office stationery	-	-
Assets maintenance costs	-	(114)
Intelectual services	-	-
Professional development costs	-	-
Interest expenses, related parties:		
- Mikrofin osiguranje a.d. Banja Luka	(93)	(107)
- Citizens' Association Mikrofin	(11)	(18)
- Zepter fond	-	(106)
- Bank's Management	(4)	(18)
- Other related parties	(2)	(53)
- Zepter fond	-	-
Remunerations to the members of the Supervisory Board and Bank's management	(893)	(1.654)
Total expenses	**(1.581)**	**(2.486)**
Expenses, net	**(753)**	**(1.934)**

27. TAXATION 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 virtually 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.

28. CURRENT ECONOMIC SITUATION AND IT'S IMPACT ON THE BANK

During 2018 the Bank's operations were under the impact of the global economic and financial crisis and significantly reduced economic activity in Bosnia and Herzegovina. However, in the course of 2018 the Bank had no liquidity problems despite the significant lending activity.

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

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

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

The economic situation in the country will probably impact the position of certain industries and the ability of certain customers to discharge their liabilities per borrowings obtained from the Bank. This may consequently influence the amount of the Bank's provisions for impairment losses after 31 December 2018, and other areas that require estimates to be made by management, including the valuation of collaterals and of securities. The Bank's financial statements contain significant estimates with respect to impairment losses and asset and collateral valuation. The key priority of the Bank after 31 December 2018 will be attention to the management of the financial portfolio adjusting to the changing economic environment.

29. FINANCIAL INSTRUMENTS

29.1. 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 the risk management system in place 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 excess of BAM 2.000.001 of total exposure (to a single entity and a group of related entities). The Supervisory Board appoints members of the Bank's Credit Committee and relieves them of duty.

29. FINANCIAL INSTRUMENTS (continued)

29.1. Financial Risk Management (continued)

The Managing Board

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

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

The Credit Committee

The Bank's Credit Committee is obliged, within the framework of the determined credit policies of the Bank, to make decisions on placements of over BAM 200,000 BAM to BAM 1 million of individual exposures, ie over 300,000 BAM to 1,5 million BAM of exposure at the level of the client or groups of related parties. Decisions on loans below the aforesaid amounts falls under remit of Credit Committees of branches or Heads of Branches

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.

The Asset and Liability Management Committee (ALCO)

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

Loan Management Committee

The principal 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 bottle-neck is identified, prepare a proposal to the Managing 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.

29. FINANCIAL INSTRUMENTS (continued)

29.1. Financial Risk Management (continued)

Liquidity Commission

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

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

The Treasury and Transactions Department

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

- planning cash inflows and outflows on a daily basis;
- monitoring transactions and cash balances on the accounts of reserves held with the Central Bank, balances on the accounts held with domestic and foreign correspondent banks and balances of cash on hand in foreign and local currencies in Bank’s vault and cash offices of the Bank;
- obtaining the shortfall amounts of funds or investing surplus liquid funds in the financial markets;
- monitoring large individual inflows/outflows of funds of depositors and loan disbursements in order to maintain the foreign currency position, maturity match and timely settlement of all liabilities matured;
- analyzing the structure and maturities of deposits by undertaking re-contracting of maturities for deposits matured;
- maintaining and allocating the obligatory legal reserve as the minimum amount of funds set aside on the account held with the Central Bank;
- preparing daily, monthly and semi-annually liquidity plans as the method for estimating future liquidity;
- reporting on liquidity movements both internally and externally.

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

29.2. Risk Management System and Mitigation Techniques

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 manegement 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. A comprehensive risk management system is established, according to the principle „3 lines of defense“, purposed for enabling efficient risk management, considering the need for minimizing conflict of interest between risk undertaking, limiting the level of risk and control, as well as auditing the risk management system. „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 independetly estimate the compliance of the risk management system with internal and external requests.
In its business, the Bank's uses mitigation tecniques 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, capitalise 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 securiy 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 liabilitites settlement or certain other credit events.

29. FINANCIAL INSTRUMENTS (continued)

29.3. Impairment allowance of receivables (Implementation of IFRS 9 – Financial Instruments)

Implementation of IFRS 9 started from January 1, 2018 and since then the Bank has defined strategies, policies and procedures for business models of the Bank, which are proofs for formal documentation of current business models, defining the new ones and its adjustment 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. Mehodology defines the criteria for determining the type of financial assets, criteria for receivables identification which need to be individualy 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 Standars (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.

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) Impairment on indvidual basis;
6) Impairment on collective basis.

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

1) identification of receivables classified on an individual and collective 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 collective 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.

Taking into account the fact that the regulations do not repeal the previous regulatory provisions relating to the exposure classification and the calculation of the reservation in accordance with the exposure classification, they shall remain affective. The Bank is obliged to calculate the reserves in accordance with the exposure classification and the correction of the value according to the internal impairment methodology. The Methodological framework for calculating the impairment allowance is under further development and further improvements in subsequent periods, due to the current harmonization of BARS with IFRS, improvements in the Bank's processes as well as changes in the IFRS itself. The Methodology is based on the final version of the International Financial Reporting Standard 9: "Financial Instruments" adopted by the International Accounting Standards Board (IASB) Financial institutions are obliged to comply with the requirements of this standard from January 1, 2018. for their financial instruments.

29. FINANCIAL INSTRUMENTS (continued)

29.3. Impairment allowance of receivables (Implementation of IFRS 9 – Financial Instruments)

Since IFRS 9 changes existing IAS 39, mentioned key differences IFRS 9 compared to IAS 39 are:

• The Concept of measurement of expected losses – measurement of expected loss according to IFRS 9 exceeds from the area of detection of losses incurred in expected losses, whereby different scenarios must be taken into account in anticipation of losses.
• Probability of the weighted calculation scenarios of the expected loss – means that at all stages of losses expectation must be incorporated and the likelihood of weighted calculation scenarios in a minimum of two i.e. More scenarios with the corresponding probability. Therefore, for each exposure there is some (even marginally small) probability of the occurrence of loss.
• Adequate risk parameter modelling (EAD-exposures, PD-probability default, LGD-loss by default, CCF-credit conversion factor) – IFRS 9 In addition to requiring more precise parameters for calculating expected losses that are taken into account PIT (Point-in-time) parameters, opposite the currently defined IAS 39 (TTC – through the cycle).
• Necessary modelling of macroeconomic expectations – when determining risk parameters it is necessary to take into account how the movement of macroeconomic variables affects the movement of risk parameters of the Bank.
• The Criteria for the transition to the phase - IFRS 9 in view of the determination that in the part of the revenue portfolio there is a phase 2 i.e. The phase in which exposures are classified with an increased credit risk from the moment of approval until the time of reporting, it is necessary for the Bank to define the criteria on the basis of which it will identify exposures with increased credit risk in all segments Impairment of financial instruments.
• Calculation of interest income on non-quality assets – as well as according to IAS 39, the only source of interest income on non-quality assets is the so-called, unwinding.
• POCI Financial assets (purchased or originated credit impaired financial assets) – a new category of assets TA; Assets which, when approving or purchasing, already bear an impairment mark, an asset for which there is already an individual expected impairment.

Impairment allowance according to IFRS 9 is created for financial assets in the scope of standards classified in the relevant business models and areas 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 indormation may impact the expected loss. Macroeconomic indicatiors may affect differently the risk parameters upon calculation of 12 months lifecycle losses, but considering that the formula for allowance for impariment 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 borrower which is an individual or a farmer, and no less than BAM 20,00, and
• 2,5% of the Bank's individual receivables from the borrower 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 objecitve proof of the impairment resulting in one or more previous events occured 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.

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. A non-significant individual exposures would be estimated individually when a specific risk related to the client/transaction (industry concentarion, default status, rating cateogory, 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:

29. FINANCIAL INSTRUMENTS (continued)

29.3. Impairment allowance of receivables (Implementation of IFRS 9 – Financial Instruments)

- Borrower'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 posibility 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 borrower.

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 deterimining 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 (collective) 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 exppected 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.
Calculation of allowance for impairment through portfolio impairment is conducted for the following exposures: for immaterial exposures in stage 3 and total exposures in stages 1 and 2.

All clients investments categorized by defined criteria for group allowance for impairment, are further categorized into appropriate homogenous groups. 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.

Migration of the creditworthiness groups to a certain status, that is another creditworthiness group will be monitored with consideration of middle (weighted) average amount at the and of the individual quarters, relating to the historic data for the defined period (minimum of three years). Therefore, first an individual migration on defined quarterly dates will be determined, so that the movement of exposures/lines (active one year up to the said date) per creditworthiness groups will be monitored. Furthermore, for each creditworthiness group amounts migrated on all of the quarterly dates will be summarized and divided with the sum of the total exposures of all of the quarterly dates.

29. FINANCIAL INSTRUMENTS (continued)

29.3. Impairment allowance of receivables (Implementation of IFRS 9 – Financial Instruments)

Impairment measurement on group basis requests an estimate of the parameters on statistic basis wih 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.

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. The difference between the carrying amount of the exposure and recognized amount of the collateral (estimated value adjusted with the percentages given in the table) represents the uncovered amount which serves as a basis for portfolio calculation of allowance for impairment. 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 invidivually materially significiant 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.

29.4. Financial risks

In its regular course of business 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.

29.5. 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 i.e. 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;
- Counterparty 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.

The Bank manages credit risk by implementing the crediting strategy focused on entrepreneurs and micro, small and medium enterprises (MSME) and risk dispersion.

29. FINANCIAL INSTRUMENTS (continued)

29.5. Credit Risk (continued)

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.

29. FINANCIAL INSTRUMENTS (continued)

29.5. Credit Risk (continued)

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

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 Internal 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 the aforecited BARS Decision, all customers are classified into 5 categories: A, B, C, D and E.

NPL management is centralized within the Division for Loan Restructuring. The Division was formed in April 2013 in order to ensure higher quality of NPL management.
This Division has the authority for reprogramming and restructuring of all investments. When this Division uses all of the collection possibilities a proposal is sent to the Bank's Credit Committee to enact a decision on litigation initiation.

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.

Instructions for Collection and management of NPLs and Instruction for Handling Acts in Loan Restructuring Division explicitly prescribes the activities of assumption, monitoring and collection of NPLs for all market segments. Division for Loan Restructuring 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 2 annuities;
2. Borrowers that failed to settle their liabilities to the Bank within 30 days from the maturity of the entire account overdraft or revolving loan amount;
3. Credit cards with repayment of 90 and over 90 days past due, at the last day of the month, if the matured liabilities exceed 10% of the approved limit;
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.

29. FINANCIAL INSTRUMENTS (continued)

29.5. Credit Risk (continued)

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

Borrowers are transferred from the Front Office to the Loan Restructuring Division upon Front Office creating a monthly list of borrowers where, on the last day of the previous month, conditions were met for this transfer. The list needs to include all the loan facilities of each borrower, and those of its related parties, even if they are not in the categories triggering the transfer (related through ownership and family relations), yet they affect the creditworthiness and possibility of loan repayment. The Front Office may propose delay in transferring a borrower to the Loan Restructuring Division with a maximum of 30 days if there is an agreement with the client on making payment or reprogramming the client's liabilities. If in those 30 days the payment is not made or the liabilities are not reprogrammed, the client is transfered to the authority of Division for Loan Restructuring. The Decision on Transfer Delay to the Division of Loan Restructuring on this basis is made by Head of Front Office, who is obligated to deliver information on these matters to the Loan Management Committee.The final and with branch offices reconciled list of the loans/borrowers to be transferred to the Loan Restructuring Division is prepared in 3 copies and signed by the Head of the Front Office. A copy is submitted to the Loan Restructuring Division, another copy is intended for the Back Office and the third is archived in the Front Office. This final list is delivered electronically to all heads of branch offices. Based on the aforesaid list, loan files are transferred from branch offices to the Loan Restructuring Division and a Loan Restructuring Officer becomes competent for the loan files received within the system. This activity within the system entails that, at the end of the seventh day in each month, all the lines included in the list are assigned to a Backup Officer from the Loan Restructuring Division (within the banking application).

29. Financial Instruments (continued)

29.5. Credit Risk (continued)

State of Loan

	Jan 31	Feb 28	Mar 31	Apr 30	May 31	Jun 30	Jul 31	Aug 31	Sep 30	Oct 31	Nov 30	Dec 31
Other	-	-	-	-	-	-	-	-	(1)	-	35	-
Individual impairment	23.033	27.283	26.712	26.348	26.558	47.727	64.605	65.244	70.347	71.027	87.645	106.420
Stage 1	216.995	213.919	221.892	221.357	220.972	211.063	194.413	197.659	198.016	194.195	189.235	180.261
Stage 2	14.737	13.577	11.904	13.880	17.083	11.149	12.747	13.808	12.221	13.867	10.893	8.645
Stage 3	6.568	6.538	6.930	6.885	7.143	6.644	6.694	6.866	6.983	6.842	6.911	7.154
Total	261.333	261.317	267.438	268.470	271.756	276.583	278.459	283.577	287.567	285.931	294.684	302.480

TOTAL EXPOSURE WITHOUT SUSPENDED INTEREST

	Jan 31	Feb 28	Mar 31	Apr 30	May 31	Jun 30	Jul 31	Aug 31	Sep 30	Oct 31	Nov 30	Dec 31
Other	7.051	6.915	8.901	8.365	8.684	10.206	8.837	10.770	11.014	11.078	11.398	9.131
Individual impairment	24.068	28.377	27.857	27.495	27.821	49.317	69.551	66.782	72.326	72.577	89.275	109.283
Stage 1	237.642	235.588	241.696	244.756	246.173	235.346	220.105	229.535	226.841	224.956	220.512	212.003
Stage 2	15.628	14.585	13.250	14.861	18.170	12.340	14.150	15.237	13.155	15.928	12.934	9.404
Stage 3	7.124	7.115	7.610	7.548	7.804	7.308	7.390	7.505	7.641	7.505	7.573	7.797
Total	291.513	292.580	299.314	303.025	308.652	314.517	320.033	329.829	330.977	332.044	341.692	347.618

TOTAL IMPAIRMENT ALLOWANCE

	Jan 31	Feb 28	Mar 31	Apr 30	May 31	Jun 30	Jul 31	Aug 31	Sep 30	Oct 31	Nov 30	Dec 31
Other	7	8	61	111	111	60	68	68	68	79	85	83
Individual impairment	14.235	15.506	15.882	16.300	16.151	18.947	20.276	19.421	20.154	20.572	22.122	22.716
Stage 1	1.048	839	900	884	937	898	635	849	798	814	797	778
Stage 2	1.761	1.617	1.357	1.387	1.641	733	628	851	709	886	768	771
Stage 3	5.614	4.786	5.150	5.330	5.680	4.394	3.921	4.777	4.833	4.832	4.808	5.340
Total	22.665	22.756	23.350	24.012	24.520	25.032	25.528	25.966	26.562	27.183	28.580	29.688

In thousands (BAM)

The Review includes other balance and out-of-balance receivables based on the loans, i.e. impairment allowance value in the amount of BAM 657 thousands.

29. Financial Instruments (continued)

29.5. Credit Risk (continued)

Total exposure as of 31.12.2018.

		Participation in total exposure								
	Total exposure	Past due loans	%	Loans of low quality	%	Reprogrammed/ restructured loans	%	Interest	%	Advance payments
Public sector	1.818	1	0,04%	0	0,00%	0	0,00%	0	0,01%	0
Corporate loans	36.866	2.728	7,40%	3.837	10,41%	1.654	4,49%	129	0,35%	28
MSMI	234.651	13.086	5,58%	15.309	6,52%	12.661	5,40%	1.097	0,47%	469
Retail loans	74.282	2.369	3,19%	3.482	4,69%	4.787	6,44%	267	0,36%	478
Total	**347.618**	**18.184**	**16,21%**	**22.628**	**21,62%**	**4.787**	**16,33%**	**1.493**	**1,19%**	**975**

29. Financial Instruments (continued)

29.5. Credit Risk (continued)

Maximum exposure to loan risk

The gross carrying amount of the following financial asstets represents the Bank's maximum exposure to credit risk

Maximum exposure to loan risk before collateral and other loan securities as of December 31, 2018 and December 31, 2017

Financial instruments

	December 31, 2018			December 31, 2017		
	Exposure before impairment	**Impairment**	**Net exposure to credit risk**	**Exposure befor impairment**	**Impairment**	**Net exposure for credit risk**
A. Credit risk exposure relating to balance sheet items						
Cash and Cash Balances with Central Banks	110.109	174	109.935	43.698	20	43.678
Placements and Balances with the Banks	8.372	13	8.359	1.872	1	1.871
Available-for-sale Securities	50	-	50	-	-	-
Loans and receivables due from banks	-	-	-	-	-	-
Loans to customers	305.902	29.492	276.410	268.652	21.251	247.401
Other assets	133		133	-	-	-
Total assets	**424.566**	**29.679**	**394.887**	**314.222**	**21.272**	**292.950**
Off balance sheet items						
Undrawn credit commitments	18.633	150	18.483	14.320	98	14.222
Collaterals for loan portfolio	*167.636*	-	-	*133.122*	-	-
Securities pledged as collateral	*741*	-	-	*3.838*	-	-
Total off balance sheet	**18.633**	**150**	**18.483**	**14.320**	**98**	**14.222**
Total credit risk exposure	**443.199**	**29.829**	**413.370**	**328.542**	**21.370**	**307.172**

29. Financial Instruments (continued)
29.5. Credit Risk (continued)

Measurement of expected loan losses

The following table represents the changes of the gross carrying loan values due to customers as of December 31, 2018:

	Retail lending				Corporate lending			
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balance at 1 January 2018	**85.061**	**2.169**	**5.855**	**93.084**	**151.903**	**12.063**	**11.601**	**175.568**
Transfer to stage 1 (from 2 or 3)	262	-	-	-	1.527	-	-	**-**
Transfer to stage 2 (from 1 or 3)	-	316	-	-	-	2.638	-	**-**
Transfer to stage 3 (from 1 or 2)	-	-	1.282	-	-	-	978	**-**
Newly acquired or purchased financial assets	35.876	1.489	613	-	135.715	6.164	1.568	**-**
Gross Balance at 31 December 2018	**82.835**	**2.134**	**6.906**	**91.875**	**189.304**	**10.434**	**14.290**	**214.027**

The gross carrying values including principal and interest. Non-amortized deferred fee is not included

29. Financial Instruments (continued)

29.5. Credit Risk (continued)

The following table shows the changes in the impairment of loans to customers

Impairment of loans to customers

	Retail lending				Corporate lending			
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balance at 1 January 2018	**980**	**492**	**4.678**	**6.151**	**4.644**	**971**	**9.485**	**15.100**
Transfer to stage 1 (from 2 or 3)	8	-	-	-	20	-	-	-
Transfer to stage 2 (from 1 or 3)	-	35	-	-	-	160	-	-
Transfer to stage 3 (from 1 or 2)	-	-	624	-	-	-	322	-
New financial assets originated or purchased	635	371	355	1.361	4.672	1.159	1.222	7.053
Gross Balance at 31 December 2018	**1.211**	**497**	**5.415**	**7.123**	**8.003**	**1.769**	**12.596**	**22.369**

29.Financial Instruments (continued)

29.5. Credit Risk (continued)

Managing Financial Risks

Collateral held as security of financial assets, other than loans and advance payments, depends on the nature of the instrument.

The Bank's policy in regards to collateral acquisition did not change significantly during the reporting period and there was ni significant change in the overall quality of collateral held by the Bank in previous periods.

Below is the analysis of collateral and loan securities as of 31.12.2018. and 31.12.2017:

	Loans to customers		
31 December 2018	**Retail**	**Legal entities**	**Total loans**
	29.986	87.187	117.173
Residental, commercial and industrial Property	7.895	36.489	44.385
Financial assets	1.952	2.706	4.658
Other	111	1.310	1.420
Total	**39.944**	**127.692**	**167.636**

	Loans to customers		
31 December 2017	**Retail**	**Legal entities**	**Total loans**
	25.533	64.964	90.497
Residental, commercial and industrial Property	7.627	27.763	35.390
Financial assets	1.194	1.758	2.952
Other	1.092	3.191	4.283
Total	**35.446**	**97.676**	**133.122**

29. Financial Instruments (continued)

29.5 Credit Risk (continued)

The Loan Restructuring (Backup) Officer must receive the loan file from the Loan Officer within 15 days from the assignment date and act on it as soon as possible. The Backup Officer in charge of a client is obligated to maintain records of the activities and measures undertaken in respect of specific lines update of strategies in the front application. Loan Restructuring Officers have at their disposal all the measures for addressing the default problems, which entail aggressive collection, current debt rescheduling, current debt restructuring, main debt restructuring by including other co-debtors, etc.

Credit Risk-Related Risks

The Bank issues guarantees to its customers whereupon it has contingent liabilities to make the payment in favor of third parties. In this manner the Bank is exposed to risks similar and related to credit risk, which 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.

(In thousands of BAM)

	Period Ended	
	December 31, 2018	**December 31 2017**
		Corrected
Loans securitized with earmarked deposits	4.200	2.793
Loans securitized with mortgages	104.925	112.875
Loans securitized with other collaterals	194.786	150.875
Total:	**303.911**	**265.976**

29.5.1. 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.

29. Financial Instruments (continued)

29.5.1. Concentration Risk **(**continued)

Bank's exposure towards single entity or a group of related entities after applying the credit risk decrease method can not 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 can not exceed 5% of the Bank's recognized capital. Total exposure of the bank toward its superior and subordinate entity and the related entities is limited by provisions of this Article.

Bank's interest in other legal entities is defined by Article 111 of Law on Banks of RS:

- Prior to consent of the Agency, Bank is not allowed to have direct or indirect: interest in legal entity or subsidiary of that legal entity exceeding 5% of the eligible 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 eligible Bank capital.
- Bank's interest, direct or indirect, in one legal entity from financial sector can not exceed 15% of Bank's eligible capital.
- Bank's interest in the legal entity not pertaining to financial sector can not exceed 10% of Bank's eligible capital.
- Total interest in legal entities not pertaining to financial sector can not exceed 25% of eligible Bank's capital, and total interest in legal entities pertaining to financial sector can not exceed 50% of the Bank's eligible capital.

Credit Risk Concentration per Industry Sector

The Bank has a diversified loan portfolio covering various industries: **(In thousands of BAM)**

	December 31, 2018	**In %**	Corrected **December 31, 2017**	**In %**
Construction industry	23.865	8%	19.664	8%
Trade	56.106	18%	37.920	14%
Services, tourism and accommodation industry	12.050	4%	11.808	4%
Agriculture	8.933	3%	7.461	3%
Mining and manufacturing industry	43.419	14%	36.018	14%
Transport, storage, postal services and telecommunications	21.429	7%	18.214	7%
Finance services	2.183	1%	3.748	1%
Property trade	1.548	1%	2.249	1%
Administration, other public services	17	0%	-	
Other (population)	134.361	44%	128.894	48%
Total:	303.911	100%	265.976	100%

Credit Risk Concentration per Loan Type

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

(In thousands of BAM)

	December 31, 2018	**In %**	**December 31, 2017**	**In %**
Loans per transaction accounts	22.624	7%	24.903	10%
Consumer loans	59.502	20%	67.445	25%
Current assets loans	94.766	31%	70.651	27%
Investment loans	114.402	38%	90.322	34%
Housing loans	12.003	4%	10.761	4%
Guarantee payments	578	0%	575	-
Loans for payments made based on guarantees	36	0%	1.319	-
Total:	**303.911**	**100%**	**265.976**	**100%**

29. FINANCIAL INSTRUMENTS (continued)

29.5. Credit Risk (continued)

29.5.1. Concentration Risk (continued)

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

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

(In thousands of BAM)

December 31, 2018	A	B	C	D	E	Total
		Category				
Loans due to customers						
- short-term	45.434	6.964	156	123	15	52.692
- long-term	183.181	42.901	4.110	2.107	624	232.923
- matured	1.532	1.133	427	1.427	13.200	17.719
- guarantees called on	-	-	-	3	574	577
Total loans	230.147	50.998	4.693	3.660	14.413	303.911
- off-balance sheet items	37.139	3.757	298	22	19	41.235
Total:	267.286	54.755	4.991	3.682	14.432	345.146

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

(In thousands of BAM)

December 31, 2017	A	B	C	D	E	Total
		Category				
Loans due to customers						
- short-term	36.235	6.087	201	166	20	42.709
- long-term	157.649	43.831	3.625	1.432	1.162	207.699
- matured	952	1.232	511	838	11.460	14.993
- guarantees called on	-	17	-	-	558	575
Total loans	194.836	51.167	4.337	2.436	13.200	265.976
- off-balance sheet	24.564	2.772	70	73	11	27.490
Total:	**219.400**	**53.939**	**4.407**	**2.509**	**13.211**	**293.466**

29.5.2. 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 thousands of BAM)

Portfolio as of December 31, 2018	Total Exposure	Total Exposure Net of Deposits	Allocated Collateral Value	Allowance for Impairment	Amount of Shortfall Reserves	Total Deterioration
After the test	417.065	412.407	151.945	33.294	-	33.073
Before the test	347.618	342.960	167.636	29.689	-	29.856
Difference	**69.447**	**69.447**	**(15.691)**	**3.605**	**-**	**3.217**

(In thousands of BAM)

29. FINANCIAL INSTRUMENTS (continued)

29.5. Credit Risk (continued)

Portfolio as of December 31, 2017	Total Exposure	Total Exposure Net of Deposits	Allocated Collateral Value	Allowance for Impairment	Amount of Shortfall Reserves	Total Deterioration
After the test	358.259	355.253	240.058	25.448	-	30.316
Before the test	296.261	293.255	268.031	21.426	-	27.076
Difference	**61.998**	**61.998**	**(27.973)**	**4.022**	**-**	**3.240**

29.6. 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 (currency) risk and interest rate risk.

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

29.6.1. 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 Managing 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.

29. FINANCIAL INSTRUMENTS (continued)

29.6. Market Risk (continued)

29.6.1. Foreign Exchange Risk (continued)

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

(In thousands of BAM)

	EUR	USD	CHF	GBP	Ostalo	Total FX	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
Loans due from customers	131	-	-	-	-	131	-	131
Property, equipment and intangible assets	228.741	-	-	-	-	228.741	46.139	274.880
Investment property	-	-	-	-	-	-	7.157	7.157
Interest accrued and other assets	131	-	-	-	-	131	2.665	2.796
	241.474	438	161	29	217	242.319	160.914	403.233
Liabilities								
Deposits due to banks	-	-	-	-	-	-	7.012	7.012
Deposits due to customers	216.297	59	82	4	12	216.454	95.976	312.430
Loans	16.916	-	-	-	-	16.916	-	16.916
Subordinated debt	6.958	-	-	-	-	6.958	-	6.958
Other liabilities	186	10	-	-	-	196	3.878	4.074
rovisions for employee benefits and other contingencies	-	-	-	-	-	-	237	237
	240.357	69	82	4	12	240.524	107.103	347.627
Net foreign currency position	**1.117**	**369**	**79**	**25**	**205**	**1.795**	**53.811**	**55.606**

The report on foreign currency balances as of December 31, 2017 net, is presented in the table below:

(In thousands of BAM)

	EUR	USD	CHF	GBP	Ostalo	Total FX	BAM	Total
Assets								
Cash and cash funds held with the Central Bank	1.997	56	70	4	146	2.273	41.425	43.698
Loans and receivables due from banks	1329	326	85	23	60	1.823	49	1.872
Loans due from customers	199.415	-	-	-	-	199.415	44.483	245.072
Property, equipment and intangible assets	-	-	-	-	-	-	6.415	6.415
Interest accrued and other assets	108	-	-	-	-	108	3.828	2.762
	202.849	382	155	27	206	203.619	96.200	299.819
Liabilities								
Deposits due to customers	171.575	63	14	-	20	171.672	47.457	219.229
Loans	18.446	-	-	-	-	18.446	-	18.446
Subordinated debt	6.964	-	-	-	-	6.964	-	6.964
Other liabilities	29	7	-	-	-	36	3.323	3-359
Provisions for employee benefits and other contingencies	-	-	-	-	-	-	169	169
	197.014	70	14	-	20	197.118	50.949	248.067
Net foreign currency position	5.835	312	141	27	186	6.501	45.251	51.752

29. FINANCIAL INSTRUMENTS (continued)

29.6. Market Risk (continued)

29.6.1. Foreign Exchange Risk (continued)

During 2018, 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 +/- 20% 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.

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

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.

Had interest rates been 10% higher/lower and all other variables held constant, the Bank's profit for the nine-month period ended December 31, 2018 would have decreased/increased by BAM 6.263 thousand (December 31, 2017: decrease/increase by BAM 3.045 thousand).

29. FINANCIAL INSTRUMENTS (continued)

29.6. Market Risk (continued)

29.6.2. Interest Rate Risk (continued)

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

	Foreign currency	BAM
Assets		
Obligatory reserve with the Central Bank	-	0,00%
Assets in excess of obligatory reserves	-	(0,20%)
Foreign currency accounts with foreign banks	0,00%	-
Short-term loans due from customers:		
- corporate customers	-	6,49%-12,50%
- retail customers	-	6,50% -15,50%
Long-term loans due from customers:		
- corporate customers	-	5,40%-12,50% +6M Euribor
- retail customers	8,49%	6,5%-15,5% +6M Euribor
Liabilities		
Demand deposits of corporate customers	0,00%	0,00%-0,20%
Demand deposits of retail customers	0,10%-0,80%	0,10%-0,80%
Short- term deposits:		
- legal entities	0,50%-1,30%	0,50%-1,30%
- population	0,50%-1,50%	0,50%-1,50%
Long- term deposits:		
- state institutions	-	-
- corporate customers	1,80%-2,20%	1,80%-2,20%
- retail customers	0,50%-3,60%	0,50%-3,60%
Loans:		
FSE	6,20%	-
IFC	-	-
RS Development and Employment Fund	-	0,30%-1,80%
Housing Fund RS	-	0,30%-1,80%
Fund for Development of Eastern Region of RS	-	0,30%-1,80%

Lower interest rates for loans over one year for retail customers from 3,6% and corporate customers from 4,1% are related to loans approved by IRB RS.

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

29. FINANCIAL INSTRUMENTS (continued)

29.6. Market Risk (continued)

29.6.2. Interest Rate Risk (continued)

The table below shows the review of interest-bearing and non-interest bearing assets and liabilities as of December 31, 2018 and December 31, 2017:

(In thousands of BAM)
December 31, 2018

Assets	Interest-Bearing	Non- Interest-Bearing	Total
Cash and cash funds held with the Central Bank	66.712	43.397	110.109
Cash and cash funds held with other banks	-	8.372	8.372
Loans to other banks	-	131	131
Receivables based on interest, fees and other receivables	1.600	2.224	3.824
Loans due from customers	303.911	-	303.911
Equipment, intangible assets and investment property	-	7.157	7.157
Provisions for contingent losses	-	(30.273)	(30.273)
Total	**372.223**	**31.010**	**403.233**
Liabilities			
Deposits due to clients	289.943	29.499	319.442
Loans received	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**

(In thousands of BAM)
December 31, 2017

Assets	Interest-Bearing	Non- Interest-Bearing	Total
Cash and cash funds held with the Central Bank and other banks	13.572	31.998	45.570
Receivables based on interest, fees and other receivables	63	3.466	3.529
Equipment and intangible assets	-	6.415	6.415
Provisions for contingent losses		(21.671)	(21.671)
Given loans and deposits	264.778	1.198	265.976
Total:	**278.413**	**21.406**	**299.819**
Liabilities			
Deposits due to banks	193.690	25.439	219.129
Loans received	18.442	4	18.446
Subordinated debt	6.845	119	6.964
Other liabilities	-	3.359	3.359
Provisions for contingent losses	-	169	169
Total:	**218.977**	**28.090**	**248.067**

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.

29. FINANCIAL INSTRUMENTS (continued)

29.6. Market Risk (continued)

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

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

29. FINANCIAL INSTRUMENTS (continued)

29.6. Market Risk (continued)

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.

(In thousands of BAM)

December 31, 2018	**Within a Month**	**From 1 to 3 months**	**From 3 to 12 Months**	**Over 1 year**	**Total**
ASSETS					
Cash and cash funds held with the Central Bank	109.920	-	-	-	109.920
Cash and cash funds held with the other banks	8.349	-	-	-	8.349
Loans and receivables due from banks	-	-	-	131	131
Loans due from customers	13.304	18.665	86.392	156.519	274.880
Equipment, iintangible assets and ivestment property	-	-	-	7.157	7.157
Calculated interest and other assets	2.489	228	-	30	2.796
Total Assets	134.111	18.893	86.392	163.837	403.233
LIABILITIES					
Deposits	64.774	25.535	109.318	119.815	312.430
Loans received	50	361	1.628	14.877	16.916
Subordinated debt	-	-	-	6.958	6.958
Other liabilities	2.272	132	621	1.049	4.074
Provision 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

(In thousands of BAM)

December 31, 2017	**Within a Month**	**From 1 to 3 months**	**From 3 to 12 Months**	**Over 1 year**	**Total**
ASSETS					
Cash and cash funds held with the Central Bank	43.698	-	-	-	43.698
Cash and cash funds held with the other banks	1.872	-	-	-	1.872
Loans due from customers	10.797	18.691	79.146	136.438	245.072
Equipment, intangible assets and investment property	-	-	-	6.415	6.415
Calculated interest and other assets	2.395	319	4	44	2.762
Total Assets	**58.762**	**19.010**	**79.150**	**142.897**	**299.819**
LIABILITIES					
Deposits	53.164	20.880	81.760	63.325	219.129
Loans received	4	353	2.712	15.377	18.446
Subordinated debt	119	-	-	6.845	6.964
Other liabilities and provision for contingent losses	1.543	208	736	1.041	3.528
Total Liabilities	**54.830**	**21.441**	**85.208**	**86.588**	**248.067**
Liability gap	3.932	(2.431)	(6.058)	56.309	51.752

29. FINANCIAL INSTRUMENTS (continued)

29.8. 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 (MACOR);
- clear definition of authority and responsibility lines in the process of operational risk assumption and management;
- setting up a system to ensure that all Bank's employees become familiar with their respective obligations in the process of operational risk management;
- setting up a system for regular reporting to the Supervisory Board and Managing Board on functioning of the operational risk management;
- obligatory regular periodical review and obligation of the Supervisory Board to analyze and assess adequacy of the established system for operational risk management at least annually.

29.9. Capital Management

Capital represents a unique economic resource and capital management is one of the most important components of the Bank's prudent, efficient and strategic planning and management. The Bank's capital management policy includes providing and maintaining the quantity and quality of the capital at least at the level of the minimum standards prescribed, the minimum amount of the share capital and the minimum amount of the net capital that the Bank is under obligation to maintain cannot be below BAM 15 million.

The Bank's policies 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 eventually individuals;
- policy of diverse equity instruments, particularly within the core and supplementary capital, and decrease or avoidance of the capital deductibles;
- in respect of the profit distribution, increase in the Bank's total capital in accordance with the effective regulations;
- in respect of the capital adequacy, when the capital adequacy ratio fall below 15%, the Bank 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.

29. FINANCIAL INSTRUMENTS (continued)

29.9. Capital Management

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 December 31, 2018, the Bank was in full compliance with all the prescribed capital adequacy indicators:

(In thousands of BAM)

	Period Ended	
	December 31, 2018	**December 31, 2017**
Core capital	46.926	47.302
Supplementary capital	8.147	2.940
Regulatory capital	**55.073**	**50.242**
Weighted operational risk exposure	293.359	234.596
% core capital adequacy	**16,00%**	**20,16%**
% regulatory capital adequacy	**18,77%**	**21,42%**

The new regulation stipulates that the regulatory capital is recognized as retained earnings, and by the decision of the Shareholders Assembly, the net profit from the annual report for 2017 is allocated to cover the shortfall of reserves created as an effective implementation of IFRS 9 in the composition of the regulatory capital, which resulted in a reduction of regulatory capital adequacy ratio compared to the previous year.

30.EVENTS AFTER THE REPORTING PERIOD

Until these financial statements' issue date, there have been no other subsequent events that would require additional disclosures in or adjustments to the B*ank's financial statements for the nine-month period ended December 31, 2018.

31. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of statement of financial position components as of December 31, 2018 and December 31, 2017 were as follows:

In BAM

	December 31, 2018	**December 31, 2017**
USD	1,7076	1,6308
CHF	1,7421	1,6714
EUR	1,9558	1,9558