MF BANKA A.D. BANJA LUKA

Financial Statements
Year Ended December 31, 2014 and
Independent Auditors' Report

CONTENTS

Deloitte.

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements (page 2 to 49) of MF banka a.d., Banja Luka (hereinafter the "Bank"), which comprise the statement of financial position as of December 31, 2014 and the related statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of MF banka a.d., Banja Luka as at December 31, 2014, and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards.

Deloitte doo

Deloitte d.o.o.,
Banja Luka

March 10, 2015

STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2014
(Thousands of BAM)

	Note	Year Ended December 31, 2014	Year Ended December 31, 2013
Interest income	5	15,053	10,507
Interest expenses	6	(6,541)	(4,178)
Net interest income		8,512	6,329
Fee and commission income	7	2,020	1,360
Fee and commission expenses	8	(600)	(469)
Net fee and commission income		1,420	891
Other operating income	9	557	315
Other operating expenses	10	(8,419)	(6,844)
Foreign exchange gains/(losses), net		81	(17)
Provisions for potential losses, net	11	(1,404)	(348)
Profit from operations before taxes		747	326
Income taxes	12	(53)	(31)
Net profit for the year		694	295
Other comprehensive income		-	-
Total comprehensive income for the year		694	295
Earnings per share			
- Basic earnings per share (in BAM)	24	2.61	1.13

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

These financial statements were adopted by the Bank's Board of Directors on February 23, 2015.

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

Sandra Lonco
Director

Marina Grabovica
Head of Accounting, Financial
Controlling and Back Office

STATEMENT OF FINANCIAL POSITION
As of December 31, 2014
(Thousands of BAM)

	Note	December 31, 2014	December 31, 2013
ASSETS			
Cash and balances held with the Central Bank	13	44,944	34,748
Due from other banks	14	2,393	5,150
Loans and advances to customers	15	148,653	109,076
Equipment	16	1,732	1,430
Intangible assets	16	236	325
Interest accrued and other assets	17	2,537	1,000
Total assets		200,495	151,729
LIABILITIES AND EQUITY			
Liabilities			
Deposits due to banks	18	5,300	5,000
Deposits due to customers	19	122,595	77,424
Borrowings	20	41,305	42,590
Subordinated debt	21	3,912	3,912
Other liabilities	22	3,759	2,029
Provisions for employee retirement benefits and other contingent liabilities	11b)	247	91
Total liabilities		177,118	131,046
Equity			
Issued capital	23	28,000	26,000
Equity reserves	23	795	795
Accumulated losses		(5,418)	(6,112)
Total equity		23,377	20,683
Total liabilities and equity		200,495	151,729
Contingent liabilities and commitments	25	11,504	9,976

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

STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2014
(Thousands of BAM)

	Issued capital	Equity Reserves	Accumulated Losses	Total
Balance, January 1, 2013	26,000	-	(5,614)	20,386
Profit for the year	-	-	295	295
Allocation of capital reserves as per amended regulations	-	795	(795)	-
Other increases (rounding adjustment)	-	-	2	2
Balance, December 31, 2013	26,000	795	(6,112)	20,683
Capital increase – new share issue (Note 23)	2,000	-	-	2,000
Profit for the year	-	-	694	694
Balance, December 31, 2014	28,000	795	(5,418)	23,377

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

STATEMENT OF CASH FLOWS
Year Ended December 31, 2014
(Thousands of BAM)

	Year Ended December 31, 2014	Year Ended December 31, 2013
Cash flows from operating activities		
Interest receipts	15,068	10,087
Interest paid	(5,248)	(3,727)
Fee and commission receipts	1,976	1,801
Fee and commission paid	(600)	(149)
Payments to employees and suppliers	(8,001)	(5,865)
Net cash generated by operating activities before changes in operating assets and liabilities	3,195	2,147
Changes in operating assets and liabilities		
Net increase in loans to customers	(41,147)	(26,724)
Income taxes paid	(34)	(37)
Net increase in customer deposits	45,490	26,377
Net cash generated by operating activities	7,504	1,763
Cash flows from investing activities		
Purchase of intangible assets	(1)	(88)
Purchase of property and equipment	(757)	(622)
Net cash used in investing activities	(758)	(710)
Cash flows from financing activities		
Capital increase	2,000	-
Inflows from borrowings	12,743	28,400
Repayment of borrowings	(14,028)	(7,366)
Receipts and payments per non-recurring items	(98)	(59)
Net cash (used in)/generated by financing activities	(617)	20,975
Net increase in cash and cash equivalents	7,363	22,028
Effects of the changes in foreign exchange rates	81	(3)
Cash and cash equivalents, beginning of year	39,899	17,874
Cash and cash equivalents, end of year	47,343	39,899
Cash and cash equivalents comprise the following line items:		
- Cash and balances held with the Central Bank	44,944	34,748
- Deposits held with other banks	2,399	5,151
	47,343	39,899

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

1. BANK'S FOUNDATION AND BUSINESS POLICY

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

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

At the Shareholder Assembly meeting held on April 6, 2010, the previous owners of the Bank enacted a Decision to sell 100% of the Bank's equity (Note 21), whereafter an Agreement on the Purchase and Sale of Capital was signed on July 8, 2010 based on which the Bank's major shareholder became MKD Mikrofin d.o.o., Banja Luka, and as of that date this entity also assumed the management and control over the Bank.

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

In the Republic of Srpska, the Bank is licensed to perform banking activities that include payment transfers, credit and deposit operations in the country and abroad, and as in accordance with the Republic of Srpska banking legislation, the Bank.

The Bank is headquartered in Banja Luka, at no. 22 Vase Pelagića Street. At December 31, 2014 the Bank had a central office and branch offices Borik and Centar in Banja Luka and branch offices in Laktaši, Gradiška, Derventa, Brčko, Bijeljina, Doboj, Prijedor, East Sarajevo, Zvornik, Novi Grad, Teslić, Prnjavor, Pale, Tuzla, Bihać and Cazin.

As of December 31, 2014 the Bank had 171 employees (December 31, 2013: 136 employees).

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

2.1. Basis of preparation and presentation of the financial statements

The accompanying financial statements are the annual stand-alone financial statements of the Bank, prepared in accordance with the International Financial Reporting Standards (IFRS).

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

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

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

The Central Bank of Bosnia and Herzegovina (the "Central Bank") applies the foreign exchange policy based on the Currency Board principle whereby BAM is pegged to EUR at the rate of BAM 1 = EUR 0.51129, which was used for the years 2014 and 2013.

In preparing the cash flow statement for the year ended December 31, 2014, the Bank used direct cash flow reporting method.

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

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

2.2. Application and Impact of the new and revised IFRS

Standards and Interpretations Effective in the Current Period

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

- Amendments to IFRS 10 “Consolidated Financial Statements,” IFRS 12 “Disclosure of Interests in Other Entities” and IAS 27 “Separate Financial Statements” – Investment Entities (effective for annual periods beginning on or after January 1, 2014);
- Amendments to IAS 32 “Financial Instruments: Presentation” – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2014);
- Amendments to IAS 36 “Impairment of Assets” – Disclosure of Recoverable Amount for Non-Financial Assets (effective for annual periods beginning on or after January 1, 2014);
- Amendments to IAS 39 “Financial Instruments:” Recognition and Measurement - Novation of Derivatives and Continuation of Hedge Accounting (effective for annual periods beginning on or after January 1, 2014); and
- IFRIC 21 “Levies” (effective for annual periods beginning on or after 1 January 2014).

Adoption of these standards, revisions and interpretations has not resulted in significant changes in the accounting policies of the Bank.

Standards and Interpretations in Issue not yet in Effect

At the date of authorization of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- IFRS 9 (revised in 2010)“Financial Instruments” (effective for annual periods beginning on or after January 1, 2018);
- IFRS 14 “Regulatory Deferral Accounts” (effective for annual periods beginning on or after January 1, 2016);
- IFRS 15 “Revenue from Contracts with Customers” (effective for annual periods beginning on or after January 1, 2017);
- Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures” – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IFRS 10 “Consolidated Financial Statements,” IFRS 12 “Disclosure of Interests in Other Entities” and IAS 28 “Investments in Associates and Joint Ventures” – Investment Entities: Applying the Consolidation Exception (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IFRS 11 “Joint Arrangements” – Accounting for Acquisition of an Interest in a Joint Operation (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IAS 1 “Presentation of Financial Statements” – Disclosure Initiative (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IAS 16 “Property, Plant and Equipment” and IAS 38 “Intangible Assets” – Clarification of Acceptable Methods of Depreciation and Amortization (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IAS 16 “Property, Plant and Equipment” and IAS 41 “Agriculture” – Agriculture: Bearer Plants (effective for annual periods beginning on or after January 1, 2016);
- Amendments to IAS 19 “Employee Benefits” – Defined Benefit Plans: Employee Contributions (effective for annual periods beginning on or after January 1, 2014);
- IAS 27 “Separate Financial Statements” – *Equity Method in Separate Financial Statements* (effective for annual periods beginning on or after January 1, 2016);
- Amendments resulting from Annual Improvements 2010-2012 Cycle issued in December 2013 (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after July 1, 2014);

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

2.2. Application and Impact of the new and revised IFRS (continued)

Standards and Interpretations in Issue not yet in Effect (continued)

- Amendments resulting from Annual Improvements 2011-2013 Cycle issued in December 2013 (IFRS 1, IFRS 3, IFRS 13 and IAS 40) with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after July 1, 2014); and
- Amendments resulting from Annual Improvements 2012 – 2014 Cycle (IFRS 5, IFRS 7, IAS 19 and IAS 34), with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after January 1, 2016).

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

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

3.3. Equipment and Intangible Assets

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3. Equipment and Intangible Assets (continued)

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:

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

The Bank's management believes that the amortization and depreciation rates that have been applied realistically to 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.

3.4. Impairment of Assets

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

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

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

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

As of December 31, 2014, in the assessment of the Bank's management, there were no indications that the value of equipment and intangible assets had suffered impairment.

3.5. Financial Assets

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5. Financial Assets (continued)

Effective Interest Method

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

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

Financial Assets Available for Sale

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

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

Loans and Receivables

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

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

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

Cash and Cash Equivalents

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

Impairment of Financial Assets

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5. Financial Assets (continued)

Impairment of Financial Assets (continued)

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

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

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

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

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

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

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

Derecognition of Financial Assets

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

3.6. Financial Liabilities

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7. Taxes and Contributions

Current Income Tax

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

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

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

Deferred Income Taxes

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

Indirect Taxes and Contributions

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

3.8. Employee Benefits

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

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

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

3.9. Leases

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.9. Leases (continued)

The Bank as a Lessor

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

The Bank as a Lessee

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

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

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES

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

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

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

Estimated Useful Life of Equipment and Intangible Assets

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

Impairment of Assets

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

Allowance for Impairment of Receivables

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

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Allowance for Impairment of Receivables (continued)

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

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

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

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

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

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

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

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

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

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

According to the Bank’s internal methodology for impairment allowance calculation, individually significant exposure is considered to be each exposure in excess of BAM 10 thousand. Other exposures, i.e. other bank’s receivables are subject to individual assessment for impairment due to the specificity of each individual receivable. The procedure of impairment assessment is performed for all receivables defined as materially significant by the internally adopted methodology. Materially significant amounts are amounts above:

- 2.5% of the individual Bank’s receivable due from a private individual debtor, but not below BAM 50, and
- 2.5% of the individual Bank’s receivable due from a legal entity debtor, but not below BAM 150.

The Bank assesses whether a loan is individually significant for individually significant exposures (in excess of BAM 10 thousand) in default, i.e. those that are over 90 days past due.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Allowance for Impairment of Receivables (continued)

Based on the defined criteria the Risk Management Department finds loans eligible for individual assessment. After the review of such loans, the Risk Management Department proposes loans eligible for calculation of individual-level impairment allowance, and the remaining loans are referred to the portfolio-level assessment of impairment and calculation of impairment allowance.

The proposals made by the Risk Management Department are verified by the bank's Managing Board. For each individual calculation of impairment allowance a form named "Analysis of Impairment Evidence" is created and enclosed with the credit file of the borrower.

Individual impairment allowance is calculated as the difference between the total exposure and the sum of discounted cash flows (from regular repayment and collateral foreclosure) for the specific borrower/exposure. The Bank has defined the minimum amount of impairment allowance for individually assessed exposures without quality collateral as follows:

- for exposures with repayment from 90 to 180 days past due, impairment allowance amounts to minimum 20% of the exposure, and
- for exposures with repayment over 180 days past due, impairment allowance amounts to minimum 55% of the exposure.

All loans and advances that are not individually impaired are subject to group or portfolio-level assessment and calculation of impairment. Loans/borrowers are classified into homogenous groups with identical or similar characteristics and subgroups depending on the number of days the repayment is in arrears.

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

Portfolio-level impairment allowance is calculated as follows: an impairment allowance percentage defined for the specific group/subgroup of loans is applied to the unsecured portion of the exposure and multiplied with the average loss confirmation period (LCP).

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

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

Fair Value

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

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

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Employee Benefits

The Bank engaged an independent certified actuary to calculate the present value of accumulated employee entitlements to retirement benefits as of December 31, 2014 on behalf of the Bank. In the calculation of the present value of accumulated employee entitlements to retirement benefits, the certified actuary used the following assumptions: the projected salary growth rate of 4.5% annually, years of service necessary for retirement – 40 years for men and 35 years for women, projected employee turnover based on data on historical employee turnover in the prior period, officially published mortality rates in the region in the prior period, as well as other terms necessary to exercise rights to a retirement benefit. In As per the Bank's management, amounts expressed in the financial statements reflect the fair value which is most reliable and useful for the needs of the financial reporting under the current circumstances.

5. INTEREST INCOME

	Year Ended December 31, 2014	2013
Interest income from:		
- public sector	103	154
- retail customers	8,586	5,094
- corporate customers	6,256	5,184
- Central Bank	23	8
- non-profit organizations	26	15
- other	59	52
Total:	15,053	10,507

6. INTEREST EXPENSES

	Year Ended December 31, 2014	2013
Interest expenses:		
- interest on borrowings from banking institutions	2,419	1,532
- public sector	538	413
- retail customers	1,952	699
- banks	204	203
- non-banking finance institutions	1,055	1,175
- corporate customers	202	108
- non-profit organizations	133	9
- other	38	39
Total:	6,541	4,178

7. FEE AND COMMISSION INCOME

	Year Ended December 31, 2014	2013
Sale and purchase of currencies	451	376
Fee and commission income arising from domestic payment transactions	983	629
Other loan fees (early repayment, reminders)	414	238
Fees for off-balance sheet operations	172	117
Total:	2,020	1,360

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2014
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8. FEE AND COMMISSION EXPENSES

	Year Ended December 31, 2014	2013
Sale and purchase of currencies	87	81
Fee and commission payable to the Central Bank for domestic payment transfers	108	70
Fee and commission expense arising from international payment transactions	17	12
Payment/credit card operation fees	208	198
Loan processing fees	151	94
Other fees and commissions	29	14
Total:	600	469

9. OTHER OPERATING INCOME

	Year Ended December 31, 2014	2013
Collection of suspended interest written off	351	234
Other income	206	81
Total:	557	315

10. OTHER OPERATING EXPENSES

	Year Ended December 31, 2014	2013
Gross salaries and benefits	4,526	3,641
Remunerations to the Supervisory Board, Audit Committee	101	107
Professional trainings and education of employees	11	13
Cost of materials and services	305	243
Business trip expenses incurred in the country and abroad	22	26
Telecommunication and postage services	380	234
Equipment/software maintenance	310	278
Marketing and advertising	173	260
Rental costs	751	583
Membership fees	50	49
Entertainment	53	37
Security services	418	351
Depreciation and amortization charge	464	443
Taxes and contributions	150	87
Fees payable to the Banking Agency of RS	154	104
Losses on disposal and retirement of equipment and other similar costs	97	61
Fees for third party engagements	11	12
Other	443	315
Total:	8,419	6,844

11. PROVISIONS FOR POTENTIAL LOSSES

a) Provisions Included in Expenses, Net

	Year Ended December 31, 2014	2013
Assets held with other banks	(5)	(1)
Loans to customers	(1,059)	(380)
Interest receivables and other assets	(184)	35
Employee benefits	(80)	-
Contingent liabilities and commitments	(76)	(2)
Total:	(1,404)	(348)

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

11. PROVISIONS FOR POTENTIAL LOSSES (continued)

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

2014 and 2013

	Assets Held with Other Banks	Loans to Customers	Interest and Other Assets	Employee Benefits	Contingent Liabilities and Commitments	Total
Balance, January 1, 2013	-	2,610	83	22	67	2,782
Purchase of portfolio	-	149	-	-	-	149
Charge for the year	6	3,275	38	-	202	3,521
Reversal of provisions	(5)	(2,895)	(73)	-	(200)	(3,173)
Balance, December 31, 2013	1	3,139	48	22	69	3,279
Purchase of portfolio (Note 15)	-	448	-	-	-	448
Charge for the year	9	4,400	77	80	349	4,915
Reversal of provisions	(4)	(3,223)	(11)	-	(273)	(3,511)
Balance, December 31, 2014	6	4,764	114	102	145	5,131

12. INCOME TAXES

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

	Year Ended December 31, 2014	2013
Profit before taxes	747	326
Income tax at the statutory rate of 10%	75	33
Tax reduction for tax exempt income	(2)	(1)
Expenses not recognized for tax purposes – impairment of loans and other assets	97	35
Other expenses not recognized for tax purposes	4	2
Prior years' tax losses carried forward	(174)	(69)
Total income taxes payable in the Republic of Srpska	-	-
Total income taxes payable in the Brčko District	53	31
Total current income tax expense	53	31
Effective tax rate	7.10%	9.51%

Pursuant to Article 47 of the Rulebook on the Application of the Corporate Income Tax Law of the Republic of Srpska, for the financial year 2014, the Bank utilized its tax loss from 2009 and reduced the 2014 tax base by the amount of BAM 1,738 thousand. Given the fact that the tax loss was sufficient to cover the entire tax base, the Bank has no income tax liability payable for 2014 in the territory of the Republic of Srpska. In addition, and given that the Bank has a branch office operating in the territory of the Brčko District of Bosnia and Herzegovina, pursuant to the Corporate Income Tax Law of the Brčko District (Official Gazette of BH, no. 60/10, 57/11 and 33/12), the Bank is under obligation to calculate and pay income taxes on the profit realized in this territory. The Bank therefore calculated and paid income taxes in the amount of BAM 53 thousand for the year 2014 (2013: BAM 31 thousand).

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

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2014
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13. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	December 31, 2014	December 31, 2013
Cash on hand:		
- in BAM	1,992	1,852
- in foreign currencies	1,942	825
Balances with the Central Bank in BAM:		
- Obligatory reserve	9,975	6,495
- Gyro account	31,035	25,576
Total:	44,944	34,748

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 7% with over one year maturities. The basis for computing the obligatory reserve includes calculated interest, fees and commissions due and matured.

In accordance with the Decision on Determining and Maintaining Obligatory Reserves and Determining the Fee Payable on the Amount of Reserves (Official Gazette of RS, no. 74 dated August 22, 2014), the Central Bank of Bosnia and Herzegovina calculated and paid fees-interest on:

- the amount of the obligatory reserve – 70% of the rate determined based on the weighted average of the interest rates realized in the market by the Central Bank on deposits invested up to a month in the same period, or the minimum of 0;
- the amount in excess of the obligatory reserve – 90% of the rate determined based on the weighted average of the interest rates realized in the market by the Central Bank on deposits invested up to a month in the same period, or the minimum of 0.

From January 1, 2014 up to the new Decision effective date, the Central Bank of Bosnia and Herzegovina paid interest on the obligatory reserve balance at the rates ranging from 0.007% to 0.147%, and interest on the amounts in excess of the obligatory reserve balance at the rates ranging from 0.009% to 0.189%. from mid-September 2014 up to the end of 2014, the Central Bank paid no interest on these funds.

14. DUE FROM OTHER BANKS

	Interest Rates	December 31, 2014	December 31, 2013
Due from banks:			
- foreign banks	0% - 0.01%	1,851	4,660
- domestic banks		548	491
		2,399	5,151
Less: Impairment allowance		(6)	(1)
Total:		2,393	5,150

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2014
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15. LOANS AND ADVANCES TO CUSTOMERS

	December 31, 2014	December 31, 2013
Short-term loans	28,467	21,868
Long-term loans	85,266	63,847
Current portion of long-term loans	39,684	26,500
	153,417	112,215
Less: Impairment allowance of loans and advances to customers	(4,764)	(3,139)
Total:	148,653	109,076

The major portion of *short-term* loans in BAM was placed with domestic corporate and retail customers at annual interest rates ranging from 11% to 15.5%, whereas the minimum and maximum annual interest rates applied to such loans equaled 6.3% and 20% per annum, respectively. The annual interest rate of 6.3% was approved to the customers with a 100% earmarked term deposit placed with the Bank as collateral, while the interest rates higher than 15.5% refer to the short-term loans assumed from MKD Mikrofin d.o.o. Banja Luka. Short-term loans were securitized with bills of exchange, sureties and pledge liens assigned over movables and mortgages assigned over property.

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

Most *long-term* loans in BAM were extended to corporate and retail customers at annual interest rates ranging from 10% to 15.9%, for periods of maximum 10 years, with respective minimum and maximum interest rates of 3.5% and 20% annually. The minimum interest rate of 3.5% was approved to the customers with a 100% earmarked term deposit placed with the Bank as collateral, while the interest rates higher than 15.9% refer to the short-term loans assumed from MKD Mikrofin d.o.o. Banja Luka. The aforesaid loans were securitized mostly with high quality collaterals such as mortgages and pledge liens assigned over movables. In 2014 the Bank approved loans from the funds of the Investment and Development Bank of the Republic of Srpska ("IDB RS") for periods of over 10 and up to 20 years in accordance with the rules of IDB RS.

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

The geographical concentration of loans approved to customers as included in the Bank's loan portfolio mostly comprises customers domiciled in the Republic of Srpska.

Loans Purchased from MKD Mikrofin d.o.o., Banja Luka

As in prior years, in 2014 the Bank entered into 4 Agreements on Assignment/Assumption of Receivables for a Consideration whereby it assumed 3,328 loans from the related party MKD Mikrofin d.o.o., Banja Luka. The consideration at which the aforesaid loan portfolio was transferred equals the amount of net receivables as of the transaction date measured in accordance with the requirements of IAS 39 „"Financial Instruments: Recognition and Measurement" applying the internal methodology of MKD Mikrofin d.o.o., Banja Luka, so that from these transactions the Bank earned/incurred neither positive nor negative effects to be included in the statement of profit and loss.

The net carrying value of the receivables assumed per the aforesaid Agreements in 2014 totaled BAM 16,519 thousand. The summary of effects of the aforesaid loan portfolio purchase transactions in 2013 and 2014 is provided in the following table:

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2014
(All amounts expressed in thousands of BAM, unless otherwise stated)

15. LOANS AND ADVANCES TO CUSTOMERS (Continued)

Loans Purchased from MKD Mikrofin d.o.o., Banja Luka (Continued)

	Loans to Customers	Interest Accrued
The amount of receivables per loans in 2013	3,793	42
Less: Impairment allowance	(149)	-
Loan portfolio purchased in 2013	3,644	42
The amount of receivables per loans in 2014	16,771	196
Less: Impairment allowance	(445)	(3)
Loan portfolio purchased in 2014	16,326	193

16. EQUIPMENT AND INTANGIBLE ASSETS

						2014 and 2013	
	Leasehold Improve-ments	Equipment	Equipment in Progress	Total Equipment	Intangible Assets	Intangible Assets in Progress	Total Intangible Assets
Cost							
Balance, January 1, 2013	101	1,592	15	1,708	841	-	841
Additions	97	525	(9)	613	88	-	88
Disposals	(46)	(67)	-	(113)	-	-	-
Balance, December 31, 2013	152	2,050	6	2,208	929	-	929
Additions	138	619	-	757	1	-	1
Disposals	(12)	(231)	(5)	(248)	-	-	-
Balance, December 31, 2014	278	2,438	1	2,717	930	-	930
Accumulated Depreciation/Amortization							
Balance, January 1, 2013	19	538	-	557	439	-	439
Charge for the year	26	252	-	278	165	-	165
Disposals	(16)	(41)	-	(57)	-	-	-
Balance, December 31, 2013	29	749	-	778	604	-	604
Charge for the year	41	326	-	367	97	-	97
Disposals	(12)	(148)	-	(160)	(7)	-	(7)
Balance, December 31, 2014	58	927	-	985	694	-	694
Net Book Value:							
- at December 31, 2014	220	1,511	1	1,732	236	-	236
- at December 31, 2013	123	1,301	6	1,430	325	-	325

As of December 31, 2014, equipment was insured against general risks. The Bank had no encumbrances or pledges against its equipment.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2014
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17. ACCRUED INTEREST AND OTHER ASSETS

	December 31, 2014	December 31, 2013
In BAM:		
- matured interest receivables	34	31
- advances paid	5	2
- other receivables	227	148
- inventories of materials	105	53
- accrued interest receivables	765	482
- other prepaid expenses	119	107
- receivables from the Solidarity Fund of the Republic of Srpska	1,002	-
- other assets	102	-
In foreign currencies:		
- accrued receivables for calculated expenses	265	208
- foreign currency advances	11	11
- other foreign currency receivables	16	6
	2,651	1,048
Less: Allowance for impairment of accrued interest and other assets	(114)	(48)
Total:	2,537	1,000

Receivables due from the Republic of Srpska Solidarity Fund of BAM 1,002 thousand relate to the receivables from this Fund arising from the Agreement on Mutual Rights and Obligations executed between the Bank and the Solidarity Fund on July 21, 2014. The aforecited Agreement refers to the receivables due from the Fund in respect of the customers' settlement of borrowings and other liabilities due to the Bank by means of the electronic card "Reconstruction of Srpska" issued by the Republic of Srpska Solidarity Fund. These receivables further relate to the debt assumption agreements legal entities have with the Republic of Srpska Solidarity Fund for goods sold or services rendered, which were also paid with the aforesaid card. The Republic of Srpska Solidarity Fund is a legal entity founded by the RS Government after the huge flooding in the Republic of Srpska in 2014. The Republic of Srpska Solidarity Fund is competent for setup and maintenance of the Uniform Damage Register and for management and disposal of the assets dedicated to the reconstruction of the Republic of Srpska following the flooding.

18. DEPOSITS DUE TO BANKS

	December 31, 2014	December 31, 2013
Deposits placed by banks in BAM for up to 12 months	5,300	5,000
Total:	5,300	5,000

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2014
(All amounts expressed in thousands of BAM, unless otherwise stated)

19. DEPOSITS DUE TO CUSTOMERS

	December 31, 2014	December 31, 2013
Demand deposits in BAM:		
- Government and state institutions	1,124	691
- corporate customers	2,513	1,745
- non-banking financial institutions	6,104	7,956
- retail customers	6,230	3,691
- non-profit organizations	427	101
- other customers	138	126
	16,536	14,310
Demand deposits in foreign currencies:		
- corporate customers	826	292
- non-banking financial institutions	1,920	87
- non-profit organizations	738	1
- non-residents	83	9
- retail customers	2,384	1,058
	5,951	1,447
Short-term deposits in BAM:		
- Government and state institutions	-	1,000
- corporate customers	30	22
- non-banking financial institutions	18,829	16,319
- retail customers	36	152
- others	2	-
	18,897	17,493
Short-term deposits in foreign currencies:		
- non-profit organizations	1,580	-
- retail customers	88	186
	1,668	186
Long-term deposits in BAM:		
- non-banking financial institutions	9,005	4,000
- Government and state institutions	10,625	10,475
- corporate customers	2,951	2,502
- non-profit organizations	2,610	2,608
- retail customers	14,811	5,922
- other customers	850	900
	40,852	26,407
Long-term deposits in foreign currencies:		
- corporate customers	1,467	1,565
- retail customers	37,224	16,016
	38,691	17,581
Total:	122,595	77,424

Demand deposits of corporate entities and entrepreneurs in BAM and foreign currencies accrued interest at the rate of 0.1% to 2.52% annually, applying the conformity method.

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

Savings demand deposits – open savings in BAM and EUR accrued interest at the rates of 0.1% to 3.2% annually by applying the conformity method.

Short-term deposits of corporate entities and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 0.1% to 5.07% annually.

Short-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 0.5% to 5.5% annually.

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

19. DEPOSITS DUE TO CUSTOMERS (continued)

Long-term deposits of corporate customers and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 3% to 5% annually (certain earmarked deposits were placed as collaterals to securitize loan repayment and contractually defined as non-interest bearing).

Long-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 4% to 5.8% annually.

The Bank applies the conformity method to calculate the interest on term deposits, whereas it may apply the proportionate interest calculation method on deposits placed by other banks, in accordance with the contractually agreed terms.

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

20. BORROWINGS

	December 31, 2014	December 31, 2013
In BAM:		
- RS Development and Employment Fund	3,885	4,021
- RS Housing Fund	2,880	2,194
- Fund for Development of Eastern Region of RS	3,989	2,286
Total in BAM:	10,754	8,501
In foreign currencies:		
- EFSE I	3,912	6,521
- EFSE II	9,779	5,867
- EFSE III	3,262	-
- KfW	2,608	5,216
- EBRD	4,470	6,706
- ResponsAbility SICAV	6,520	9,779
Total in foreign currencies:	30,551	34,089
Total non-current portion:	**41,305**	**42,590**
Current portions:		
- EFSE	9,130	5,214
- KfW	2,608	2,608
- EBRD	2,235	2,235
- RESPONSABILITY	3,260	3,260
- IRB	1,018	673
Total current portion of log-term liabilities:	**18,251**	**13,990**

As of December 31, 2014, the total balance of funds received from the funds managed by the Investment and Development Bank of RS amounted to BAM 10,754 thousand.

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

20. BORROWINGS (continued)

In addition to the aforesaid, the Bank entered into loan agreements with foreign creditors at the following terms:

- EFSE, the Netherlands, as of May 21, 2012; loan amount: EUR 5 million; loan repayment period: 3.7 years with a one-year grace period; interest rate applied: EURIBOR or LIBOR plus maximum markup of 4.75%;
- EFSE, the Netherlands, as of June 26,.2013: loan amount: EUR 3 million, loan repayment period: 3 years with a one-year grace period; interest rate applied: EURIBOR or LIBOR plus maximum markup of 4.75%;
- EFSE, the Netherlands, as of March 18, 2014: loan amount: EUR 5 million, loan repayment period: 3 years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.5%;
- KfW, Germany: as of August 28, 2012 loan amount: EUR 4 million; loan repayment period: 3.4 years with a 10-month grace period; interest rate applied EURIBOR plus maximum markup of 4.5%;
- EBRD, UK: loan amount: EUR 4 million; loan repayment period: 3.4 years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.75%;
- ResponsAbility (Funds), Luxembourg, as of September 30, 2013, and December 16, 2013: respective loan amounts: EUR 2 million and EUR 3 million loan repayment period: 3 years; interest rate applied: 5.75%;
- IFC, as of September 30, 2014: loan amount: EUR 4 million; loan repayment period of years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.75%

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

Loan Agreement Covenants

Pursuant to the loan agreements entered into with 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, 2014, the Bank achieved the capital adequacy ratio of 13.88% (Note 30.6), and did not comply with the contractual commitment to maintain the capital adequacy ratio at the minimum of 15%. The non-compliance refers to the following creditors:

Creditor:	**December 31, 2014**
- EFSE	16,953
- KfW	2,608
- KfW (subordinated debt, Note 21.)	3,912
- RESPONSABILITY SICAV	6,520
	29,993

On March 10, 2015 after submission of its request, the Bank received a Waiver Letter from KfW Germany approving its non-compliance with the relevant financial covenant (disclosed in more detail in Note 31).

The Bank's other ratios and financial performance indicators defined by the loan agreements executed were within the contractually defined limit ranges.

The Bank's management estimated that the aforesaid non-compliance with the contractual provisions will have no adverse effects on the future relations with the Bank's creditors and that the creditors will not demand early loan repayment. However, in accordance with IAS 1 "Presentation of the financial Statements," and given that the Bank did not comply with certain loan agreement covenants that may result in declaring the entire long-term liabilities matured, the bank reclassified the aforesaid liabilities in the total amount of BAM 29,993 thousand from non-current (long-term) to current (short-term) liabilities with the maturity of up to a month due to the creditors as of December 31, 2014. In Note 30.4 these liabilities are presented as maturing within a month.

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

21. SUBORDINATED DEBT

	December 31, 2014	December 31, 2013
KfW, Germany	3,912	3,912
Total	3,912	3,912

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

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

22. OTHER LIABILITIES

	December 31, 2014	December 31, 2013
In BAM:		
- accrued interest liabilities	704	374
- trade payables	131	120
- other liabilities	197	155
- deferred income	1,176	810
In foreign currency:		
- trade payables	18	15
- accrued interest liabilities	1,525	544
- other liabilities	8	11
Total:	3,759	2,029

Deferred income in BAM totaling BAM 1,176 thousand as of December 31, 2014 mostly relates to the loan processing fees collected in advance from customers.

Accrued interest liabilities in foreign currencies amounting to BAM 1,525 thousand mostly refer to the accrued interest payable per retail customers' term deposits, and, in a smaller amount, to accrued interest for borrowings and subordinated debt as of December 31, 2014.

23. CAPITAL

Issued Capital

The share capital of the Bank was formed from the initial investments of shareholders and the subsequent capital increase - share subscriptions paid in cash. The Bank's share capital as of December 31, 2014 totaled BAM 28,000 thousand and was comprised of 280,000 shares with a par value of BAM 100 per share.

In September 2014 the Bank's capital was increased for BAM 2,000 thousand by the majority shareholder MKD Mikrofin d.o.o., Banja Luka, whereby the ownership structure of the Bank's capital was slightly changed and, according to the excerpt provided by the Central Registry of Securities of the Republic of Srpska as of December 31, 2014, was as follows:

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

23. CAPITAL (continued)

Issued Capital (continued)

	Share Count	BAM '000	%
MKD Mikrofin d.o.o., Banja Luka	278,000	27,800	99.29
DUIF Mikrofin invest d.o.o., Banja Luka on behalf and for the account of OIF Mikrofin plus a.d., Banja Luka	2,000	200	0.71
	280,000	28,000	100.00

Equity Reserves

Equity reserves totaling BAM 795 thousand as of December 31, 2014 were formed under the Instruction of the Banking Agency of the Republic of Srpska (BARS) at the end of 2013, which Instruction ordered the Bank to set aside the difference between reserves for credit losses as per regulatory requirements measured at a methodology other than IAS 39 requirements and the impairment allowances of assets made in accordance with IAS 39 for the period from January 1, 2010 through December 31, 2013 and present it within the line item of equity reserves in accordance with the Amendment to the Decision on the Minimum Standards for Credit Risk Management and Classification of Assets in Banks (Official Gazette of RS, no. 49/13 and 1/14).

24. EARNINGS PER SHARE

	Year Ended December 31, 2014	2013
Net profit for the year	694	295
Weighted average number of shares outstanding	266,301	260,000
Basic earnings per share (in BAM)	2.61	1.13

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

25. CONTINGENT LIABILITIES AND COMMITMENTS

a) Payment guarantees, performance bonds and other irrevocable commitments

	December 31, 2014	December 31, 2013
Payment guarantees	1,896	1,810
Performance bonds	2,455	1,386
Irrevocable commitments for undrawn loans	2,576	4,426
Unused account overdrafts and credit card facilities	4,577	2,354
Total:	11,504	9,976

The largest portion of irrevocable commitments for undrawn loans refers to the unused framework loans for financial monitoring amounting to BAM 1,730 thousand and unused revolving loans totaling BAM 443 thousand.

As of December 31, 2014 provisions for potential losses per off-balance sheet items totaled BAM 145 thousand (December 31, 2013: BAM 69 thousand, Note 11 b).

25. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

b) Litigation

As of December 31, 2014, the Bank was involved in 264 legal suits filed against debtors in attempts to collect matured receivables. The total value of claims sought in these proceedings aggregated to BAM 7,070 thousand. Provisions for potential losses in this respect were formed in the amount of BAM 2,685 thousand.

As of December 31, 2014, there were 2 legal suits filed against the Bank. Given the nature of these lawsuits, the Bank's management estimates that the Bank will incur no material losses upon the outcome thereof.

c) Regulatory Compliance

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

As of December 31, 2014 the Bank was in compliance with the accounting standards and regulations of the Republic of Srpska, established and controlled by the BARS per all the prescribed ratios.

NOTES TO THE FINANCIAL STATEMENTS
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26. RELATED PARTY TRANSACTIONS

Statement of Financial Position	December 31, 2014	December 31, 2013
Assets		
Receivables from loans to the Bank's management and employees	458	492
Total prepaid insurance expenses:		
- Mikrofin osiguranje a.d., Banja Luka	49	31
Total prepaid license fees:		
- MF Software d.o.o., Banja Luka	57	55
Interest accrued	2	2
Assets, total	566	580
Liabilities:		
Transaction accounts of the Bank's Supervisory Board members and management	744	436
Other related private individuals	1,810	1,743
	2,554	2,179
Trade payables:		
- MF Software d.o.o., Banja Luka	7	7
- MKD Mikrofin d.o.o., Banja Luka	5	13
- Profi nova a.d., Bijeljina	6	1
Other liabilities:		
- Other liabilities	3	5
	21	26
Interest payables:		
- Mikrofin osiguranje a.d., Banja Luka	97	104
- MKD Mikrofin d.o.o., Banja Luka	-	3
- OIF Mikrofin plus a.d., Banja Luka	1	2
- Citizens' Association Mikrofin	3	4
- Related private individuals	62	61
	163	174
Balance of deposits placed by related parties:		
- MKD Mikrofin d.o.o., Banja Luka	3,067	4,667
- DUIF Mikrofin Invest a.d., Banja Luka	58	11
- OIF Mikrofin plus a.d. Banja Luka	692	584
- MF Software d.o.o., Banja Luka	71	76
- Mikrofin osiguranje a.d., Banja Luka	5,186	4,229
- Citizens' Association Mikrofin	941	990
- Profi nova a.d., Bijeljina	4	49
- Others	7	8
	10,026	10,614
Liabilities, total	**12,764**	**12,993**
Liabilities, net	**(12,198)**	**(12,413)**

NOTES TO THE FINANCIAL STATEMENTS
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26. RELATED PARTY TRANSACTIONS (continued)

	Year Ended December 31,	
Statement of profit and loss	2014	2013
Income		
Interest income from related parties:		
- MKD Mikrofin d.o.o., Banja Luka	-	6
Fee and commission income from related parties:		
- MKD Mikrofin d.o.o., Banja Luka	251	308
- Mikrofin osiguranje a.d., Banja Luka	10	6
- MF SOFTWARE d.o.o., Banja Luka	1	1
- OIF Mikrofin plus a.d. Banja Luka	-	1
- Drvex d.o.o. Laktaši	5	4
Interest income from the members of the Bank's Supervisory Board and management	1	3
Interest income from other related parties	24	24
Income, total	**292**	**353**
Expenses		
Rental costs – MKD Mikrofin d.o.o., Banja Luka	(284)	(287)
Rental costs – Drveks d.o.o., Laktaši	(16)	(16)
Rental costs – Mikrofin osiguranje a.d.,Banja Luka	(26)	(1)
Software lease – MF SOFTWARE d.o.o., Banja Luka	(82)	(82)
Licenses – MF SOFTWARE d.o.o., Banja Luka	(55)	(45)
Insurance expenses – Mikrofin osiguranje a.d., Banja Luka	(120)	(60)
Interest expenses – related parties:		
- MKD Mikrofin d.o.o., Banja Luka	(4)	(3)
- Mikrofin osiguranje a.d., Banja Luka	(206)	(183)
- DUIF Mikrofin invest a.d., Banja Luka	(1)	-
- OIF Mikrofin plus	(25)	(12)
- Citizens' Association Mikrofin	(37)	(39)
- Profi nova a.d., Bijeljina	-	(2)
- Bank's management	(14)	(15)
- Other related parties	(92)	(56)
Remunerations to the members of the Supervisory Board and Bank's management	(214)	(177)
Other related parties	(11)	(12)
Expenses, total	**(1,187)**	**(990)**
Expenses, net	**(895)**	**(637)**

27. TAXATION RISKS

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

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

In August 2013, the Tax Administration of the Republic of Srpska conducted inspection of the Bank's calculation and payment of direct taxes for the period from August 2008 to August 2013. The inspection revealed no irregularities in the Bank's calculation and payment of direct taxes over the period under review.

28. CURRENT ECONOMIC SITUATION AND ITS IMPACT ON THE BANK

During 2014, 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 2014, the Bank did not face any significant liquidity problems despite the significant lending activity.

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

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

Floodings that hit the Republic of Srpska and Bosnia and Herzegovina in 2014 had no significant adverse effect on the Bank's operations. The Bank has rescheduled in a timely manner the loan repayment liabilities of the customers directly affected by the floods, executed the Agreement on Purchase of Receivables and Settlement of Liabilities vial electronic card “Reconstruction of Srpska“ with the RS Solidarity Fund, and thus considerably alleviated the adverse impact on the process of receivable collection and its portfolio quality.

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

The economic situation in the country will probably impact the position of certain industries and the ability of certain customers to discharge their liabilities per borrowings obtained from the Bank. This may consequently influence the amount of the Bank's provisions for impairment losses in 2015 and other areas that require estimates to be made by management, including the valuation of collaterals and of securities. The 2014 financial statements contain significant estimates with respect to impairment charges and asset and collateral valuation. The key priority of the Bank in 2015 will be attention to the management of the financial portfolio adjusting to the changing economic environment.

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

29. COMMITMENTS FOR LEASE OF BUSINESS PREMISES

The minimum operating lease liabilities for business premises recognized as expenses for the year ended December 31, 2014 amounted to BAM 751 thousand (2013: BAM 583 thousand).

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

	December 31, 2014	December 31, 2013
Within 1 year	6	18
From 1 to 5 years	1,282	1,460
Over 5 years	-	-
Total:	1,288	1,478

30. FINANCIAL INSTRUMENTS

30.1. Financial Risk Management

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

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

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

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

The Supervisory Board

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

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

The Supervisory Board is also in charge of large exposure risks (whether it be to a single entity or a group of related entities), and decides on approval of loan requests in excess of BAM 500 thousand of individual exposure and in excess of BAM 750 thousand of total exposure (to a single entity and a group of related entities, respectively).

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

The Managing Board

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

30. FINANCIAL INSTRUMENTS (continued)

30.1. Financial Risk Management (continued)

The Managing Board (continued)

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

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

The Credit Committee

Within the defined crediting policy of the Bank, the Bank's Credit Committee makes decisions on loans from BAM 150 thousand to BAM 500 thousand of exposure to a single entity and loans totaling between BAM 200 thousand to BAM 750 thousand of total exposure to a single entity or a group of related entities. Decisions on loans below the aforesaid amounts falls under remit of Credit Committees of branches or Heads of Branches.

The Risk Management Department

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

As a member of the Bank's Credit Committee, the Manager of the Risk Management Department 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 roles of the Loan Management Committee include monthly monitoring of the loan portfolio quality at the branch level, considering individual loan files with exposures of over BAM 150 thousand (mostly COR and PUB customers) and preparing proposals, conclusions and decisions. The competence of this Committee encompasses granting approvals of departures from the defined collection procedures.

Liquidity Commission

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

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

30. FINANCIAL INSTRUMENTS (continued)

30.1. Financial Risk Management (continued)

The Treasury and Transactions Department

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

- Planning cash inflows and outflows on a daily basis;
- Monitoring transactions and cash balances on the accounts of reserves held with the Central Bank, balances on the accounts held with domestic and foreign correspondent banks and balances of cash on hand in foreign and local currencies (Bank's vault) 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, undertaking re-contracting of maturities for deposits matured;
- Maintaining and allocating the obligatory legal reserve as the minimum amount of funds set aside on the account held with the Central Bank;
- Preparing daily, monthly and semi-annually liquidity plans as the method for estimating future liquidity;
- Reporting on liquidity movements both internally and externally.

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

30.2. Credit Risk

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

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

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

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

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

30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

The Bank's Credit Manual 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 the implementation thereof. The aforesaid document prescribes all the forms used in loan processing and monitoring and the manner and forms for analyses of the credit worthiness of borrowers depending on the segment they belong to (COR and PUB, SME and Retail segments). The bank approves loans in accordance with the defined procedure for loan approval based on the assessed credit worthiness of the borrowers and collaterals. The analysis of the borrower creditworthiness must be presented in the document named "Analysis," which includes the loan proposal as the basis for making a decision on loan approval. Such decisions are made based on the defined limits for individual exposures and total exposures per single entity or a group of related entities. There five levels of authority within the Bank for loan approval, the highest of which is the Bank's Supervisory Board and the lowest personal responsibility of the Branch Manager. Processing of loan requests for SME and Retail segments is decentralized and performed by the Bank's branches. Processing of loan requests from the receipt of up to the loan disbursement is performed through the application module adjusted to the requirements of the Front Office.

In April 2013, COR and PUB division was formed where processing of loan requests of corporate and public sector customers is centralized and loans are monitored and collected. This Division also supports documentary operations for SME.

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. The aforesaid Instructions define the daily and monthly monitoring of collection within certain steps of NPL management are performed.

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

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

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

Impairment Losses and Provisioning Policy

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

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

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

30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

Impairment Losses and Provisioning Policy (continued)

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

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

For the purpose of this type of impairment assessment, loans are classified into groups homogenous from the credit risk aspect in accordance with the bank's internal methodology for calculation of the impairment allowance.
Expected future cash flows for homogenous loan groups are determined based on the available historical data, mostly data on default in liability settlement, and cash flows that will certainly result from collateral foreclosure are also taken into account.

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:

- Bills of exchange,
- Collection authorizations,
- Statement of distraint (injunction),
- co-debtor,
- co-sureties,
- mortgages assigned over property,
- pledge liens assigned over movables,
- deposits/savings deposits,
- insurance policies.

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

Non-Performing Loans (NPL)

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

The Bank does not have an internal customer credit rating system. The Bank classifies the customers in accordance with its internal methodology for calculating impairment allowance according to the number of days in arrears and in accordance with the BARS Decision on the Minimum Standards for Credit Risk Management and Asset Classification. Pursuant to the aforecited BARS Decision, all borrowers are classified into 5 categories: A,B,C,D and E.

NPL management for SME and Retail customers is centralized within the Division for Loan Restructuring. The Division was formed in April 2013 in order to ensure higher quality NPL management for SME and Retail segment borrowers.

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

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30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

Non-Performing Loans (NPL)(continued)

Instructions for Collection and management of NPL explicitly prescribes the activities of assumption, monitoring and collection of NPL for all market segments. A SME and Retail segment loan is assumed by the Division for Loan Restructuring when either of the following two conditions is met:

- The borrower's total liabilities natures per loan exceed or are equal to 4 repayment installments or there was no repayment for the previous two months and the total debt amount is lower than the amount of 3 repayment installments; or
- The borrower failed to settle the liabilities due per approved account overdraft/revolving loan within 30 days from the maturity of the loan portion used.

The borrowers meeting one or the other of the above listed criteria are transferred under the remit of the Division for Loan Restructuring if it is possible to enable further regular debt servicing by the borrower through loan rescheduling/restructuring. 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 transfer of borrowers from the Front Office to the Loan Restructuring Division is made at the group of related entities level. In exceptional cases, the Division for Loan Restructuring may assume only a certain member of a group, which must be explained in detail, documented and approved by the Bank's competent body. 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.

After the transfer to the Loan Restructuring Division, the Loan Restructuring Officer becomes competent for a specific borrower/case until the final collection thereof or its transfer to the Legal Department. The Loan Restructuring Officer is obligated to propose to the Credit Committee the loan restructuring/rescheduling plan as soon as possible.

Restructured loan is a loan that has been refinanced, rescheduled or otherwise converted, i.e. a loan where, due to the borrower's deteriorated situation and ability to repay loan or inability to repay it under the initially defined terms, the previously contractually defined terms are subsequently changed to facilitate the borrower's debt servicing.

Loan Restructuring Officers propose approval of measures and incentives for the borrower's recovery such as: extension of repayment periods for the existing debts, rescheduling repayment liabilities, approving new loans to the main borrowers or other creditworthy co-debtors, decrease of the debt amounts through write-off of receivables, approval of additional grace periods, approval of different ways of repayment to suit the borrowers' ability to repay loans (balloon payment, unequal repayment installments) etc.

Loan Officers or Loan Restructuring Officers may at any time, upon estimating that all possibilities of NPL collection have been attempts and failed, propose instigation of legal proceedings against the borrowers. Decision on instigation of legal proceedings against the borrowers are made by the competent Credit Committee and such cases are transferred under the remit of the Legal Department after the respective loan agreements are terminated.

Loan Restructuring Officers are obligated to request the transfer to the Legal Department upon fulfillment of the following criteria:

- the borrowers total debt matured equals or exceeds the amount of 7 loan repayment installments; and
- the sum of the borrowers payments received in the previous 3 months is lower than a single repayment installment amount.

The Bank's Credit Committee decides on this transfer to the Legal Department. The Loan Restructuring Officer is obligated to continue maintaining the summary of activities and measures taken in order to collect the due receivables. In the event that liabilities are regularly serviced, the Loan Restructuring Officer will be responsible for regular quarterly monitoring.

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30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

Non-Performing Loans (NPL)(continued)

The Front Office Loan Officers may also propose rescheduling loans as a strategy (addressing collection issues) even before criteria are met for the loan transfer to the Loan Restructuring Division. This particularly relates to the restructuring of retail loans fulfilling the criteria from the BARS Decision on Temporary Measures for Rescheduling Loans of Retail and Corporate Borrowers. These are not NPL loans being rescheduled, but loans up to 90 days past due.

The Bank has set up a centralized and automated system for delivery of reminders to borrowers, which is in charge of administrative clerks for the first and second reminder, while delivery of the reminder before lawsuit filing, i.e. before loan agreement termination, is within the scope of competence of Loan Officers or Loan Restructuring Officers. After the transfer to the Legal Department, this department assumes competence over monitoring of the transferred loans/borrowers until full collection or write-off of debt.

On a weekly basis the Bank's Managing Board reviews the loan portfolio over 30 days past due per segment, particularly SME segment, and undertakes activities to maintain the portion of the loan portfolio over 30 days past due within the projected scale.

Credit Risk-Related Risks

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

Collaterals and Other Forms of Securitization

The Bank demand 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 approves as well as the assessed credit risk for each individual borrower.

The assessment and fair value of collateral are based on the value thereof 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.

	Year Ended December 31,	
	2014	**2013**
Loans securitized with earmarked deposits	1,402	1,243
Loans securitized with mortgages	64,359	44,312
Loans securitized with other collaterals	87,438	66,660
Total:	153,199	112,215

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30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

30.2.1. Concentration Risk

In order to improve credit risk management and control, the Bank has set up adequate and prudent limits relative to the Bank's capital in accordance with the BARS Decision on the Minimum Standards for Concentration Risk Management, as follows: total credit risk exposure of the Bank toward a single entity or a group of related entities must not exceed 40% of the Bank's core capital, this being the amount of the largest total credit risk exposure (LTCRE). The Bank may attain the LTCRE toward a single entity or a group of related entities only if the following structure and restrictions thereof are ensured:

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

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

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

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

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

As of December 31, 2014, the Bank was in full compliance with all the limits regarding risk concentration prescribed by BARS and agreed with creditors.

Risk Concentration per Borrower

As of December 31, 2014, the largest exposure to a single entity borrower, before considering collaterals, amounted to BAM 3,129 thousand or 2.04% of the total credit risk exposure (December 31, 2013: 3 BAM 3,469 thousand).

Credit Risk Concentration per Geographic Area

During 2014, the Bank's loan portfolio was concentrated on the territory of the Republic of Srpska, i.e. the City of Banja Luka , with noticeable decline of the City of Banja Luka's share in the portfolio from 33.83% in 2013 to 26.07% at the end of 2014. In 2014 the Bank opened branch offices in the territory of the federation of Bosnia and Herzegovina and expanded its lending activities into this geographic area.

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

30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

30.2.1. Concentration Risk (continued)

Credit Risk Concentration per Industry Sector

The Bank has diversified portfolio which encompasses various industries:

	December 31, 2014	In %	December 31, 2013	In %
Construction industry	12,379	8%	6,732	6%
Trade	23,317	15%	21,339	19%
Services, tourism, catering and accommodation industry	3,539	2%	1,801	2%
Agriculture	6,981	5%	5,747	5%
Mining and industry	17,214	11%	11,874	11%
Transport, storage, postal services and telecommunications	8,823	6%	7,387	7%
Finance services	287	0%	3,727	3%
Real estate trade	497	0%	744	1%
Administration, other public services	150	0%	1,561	1%
Other (retail customers)	80,230	53%	51,303	45%
Total	153,417	100%	112,215	100%

As of December 31, 2014 as compared to December 31, 2013, credit risk concentration decreased by 4% and 3% in the trade and finance sectors, respectively, and increased by 6% in the retail sector (private individuals and entrepreneurs, which includes private individuals and entrepreneurs, while the other industries mostly retained the same levels of concentration.

Credit Risk Concentration per Loan Type

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

	December 31, 2014	In %	December 31, 2013	In %
Loans per transaction accounts	16,288	11%	8,242	7%
Consumer loans	41,544	27%	32,931	29%
Working capital loans	21,261	14%	14,206	13%
Investment loans	55,256	36%	44,940	40%
Housing loans	6,889	4%	5,416	5%
Payments per guarantees called on	554	0%	-	0%
Other loans-purchased short-term investments-factoring	11,625	8%	6,480	6%
Total	153,417	100%	112,215	100%

As of December 31, 2014 as compared to December 31, 2013, credit risk concentration decreased by 4% in investment loans, and increased by 4% in loans per transaction accounts, while the other loan types mostly retained the same levels of concentration.

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30. FINANCIAL INSTRUMENTS (continued)

30.2. Credit Risk (continued)

30.2.1. 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 to customers according to the number of days they are in default (days past due).

	Category					
December 31, 2014	**A**	**B**	**C**	**D**	**E**	**Total**
Loans to customers						
- short-term	22,618	3,328	96	10	1	26,053
- long-term	99,717	16,264	3,084	1,292	188	120,545
- matured	1,012	259	233	2,526	2,235	6,265
- guarantees called on	-	-	-	554	-	554
Total loans	123,347	19,851	3,413	4,382	2,424	153,417
- off-balance sheet items	10,968	487	10	39	-	11,504
Total	134,315	20,338	3,423	4,421	2,424	164,921

30.2.2. Stress Test

In the course of credit risk assessment, the Bank applied the worst possible scenario of events for its portfolio. The Bank performed the stress test under the following assumptions: 30% BAM devaluation, 40% collateral devaluation, and increase in allowance for impairment for customers with recorded defaults in settling their matured liabilities.

Portfolio as at December 31, 2014	**Total Exposure**	**Total Exposure Net of Deposits**	**Discounted Collateral Value**	**Allowance for Impairment**	**Amount of Shortfall Reserves**	**Total Deterioration**
Before the test	167,688	166,088	122,173	5,029	5,881	10,910
After the test	203,865	202,265	100,549	7,420	6,374	13,794
Difference	36,177	36,177	(21,624)	2,391	493	2,884

30.3. Market Risk

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

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

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

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30. FINANCIAL INSTRUMENTS (continued)

30.3. Market Risk (continued)

30.3.1. Foreign Exchange Risk

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

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

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

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

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

The breakdown of foreign currency balances as of December 31, 2014, net is presented in the table below:

	EUR	USD	CHF	GBP	Other	Total FX	BAM	Total
Assets								
Cash and balances held with the Central Bank	1,763	36	15	1	127	1,942	43,002	44,944
Other financial assets	1,792	495	-	-	-	2,287	106	2,393
Loans and advances to customers	123,132		-	-	-	123,132	25,521	148,653
Equipment and intangible assets	-	-	-	-	-	-	1,968	1,968
Interest accrued and other assets	280	2	-	-	-	282	2,255	2,537
	126,967	533	15	1	127	127,643	72,852	200,495
Liabilities								
Deposits due to banks							5,300	5,300
Deposits due to customers	78,303	16	8	30	14	78,371	44,224	122,595
Borrowings	41,305	-	-	-	-	41,305	-	41,305
Subordinated debt	3,912	-	-	-	-	3,912	-	3,912
Other liabilities	1,539	5	-	-	7	1,551	2,208	3,759
Provisions for employee benefits and other contingencies	-	-	-	-	-	-	247	247
	125,059	21	8	30	21	125,139	51,979	177,118
Net foreign currency balance	1,908	512	7	(29)	106	2,504	20,873	23,377

30. FINANCIAL INSTRUMENTS (continued)

30.3. Market Risk (continued)

30.3.1. Foreign Exchange Risk

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

During 2014, the Bank maintained the open individual foreign currency position within limits permitted for EUR currency up to the maximum of +/- 30% of its core capital and for USD currency up to 3% of its core capital, while the total foreign currency position was within the permitted range

Foreign Currency Sensitivity Analysis

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

30.3.2. Interest Rate Risk

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

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

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

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

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

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

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

Interest Rate Sensitivity Analysis

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

Had interest rates been 10% higher/lower and all other variables were held constant, the Bank's profit for the year ended December 31, 2014 would have decreased/increased by BAM 661 thousand (2013: by BAM 420 thousand).

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30. FINANCIAL INSTRUMENTS (continued)

30.3. Market Risk (continued)

30.3.2. Interest Rate Risk (continued)

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

	FX	BAM
Assets		
Obligatory reserve with the Central Bank	-	0.00%-0.147%
Assets in excess of obligatory reserves	-	0.00% – 0.189%
Foreign currency accounts with foreign banks	0.00 - 0.01%	-
Short-term loans to customers:		
- corporate customers	-	6.60%-20%
- retail customers	-	6.30% -16%
Long-term loans to customers:		
- corporate customers	-	3.5% – 18%
- retail customers	-	3.6% – 20%
Liabilities		
Demand deposits of corporate customers	0.10%	0.10%-2.52%
Demand deposits of retail customers	0.00%-3.20%	0.50%-4.00%
Short-term deposits:		
- corporate customers	1.60%	0.10%-5.07%
- retail customers	1.75%-5.5%	0.10%-3.20%
Long-term deposits:		
- Government institutions		..60%-5.30%
- corporate customers	5.5%	3.40%-5.07%
- retail customers	4.30%-8.80%	4.00%-5.80%
Borrowings:		
EFSE I	4.929%-5.124%	
EFSE II	5.929%-5.124%	
EFSE II	4.687%-4.910%	
KfW	4.687%-4.910%	
EBRD	4.932%-5.177%	
RESPONSABILITY SICAV	5.75%	
RS Development and Employment Fund	-	1.20%-2.309%
RS Housing Fund	-	1.20%-2.40%
Fund for Development of Eastern Region of RS	-	1.50%-2.40%

The Bank is exposed to various risks which, through the effects of changes in the amounts of market interest rates, influence its financial position and cash flows. The table below shows the review of interest-bearing and non-interest bearing assets and liabilities as of December 31, 2014:

			December 31, 2014
Monetary assets	**Interest-Bearing**	**Non-Interest Bearing**	**Total**
Cash and balances held with the Central Bank	39,147	5,797	44,944
Due from other banks	2,125	268	2,393
Loans and advances to customers	148,653	-	148,653
Equipment and intangible assets	-	1,968	1,968
Interest accrued and other assets	32	2,505	2,537
Total assets	189,957	10,538	200,495
Monetary liabilities			
Deposits due to banks	5,300	-	5,300
Deposits due to customers	121,679	916	122,595
Borrowings	41,305	-	41,305
Subordinated debt	3,912	-	3,912
Other liabilities	-	3,759	3,759
Provisions for potential losses	-	247	247
Total liabilities	172,196	4,922	177,118

30. FINANCIAL INSTRUMENTS (continued)

30.4. Liquidity Risk

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

The strategy of liquidity risk management in the Bank is implemented by establishing control over maturity matching between assets and sources of assets, based on realistic and accurate projections of cash inflows and outflows, regular and extraordinary, over different time periods.

The strategy of asset liquidity risk management encompasses:

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

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

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

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

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

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

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

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

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

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30. FINANCIAL INSTRUMENTS (continued)

30.4. Liquidity Risk (continued)

As of December 31, 2014	Within a Month	From 1 to 3 Months	From 3 to 12 Months	Over 1 Year	Total
ASSETS					
Cash and balances held with the Central Bank	44,944	-	-	-	44,944
Due from other banks	2,393	-	-	-	2,393
Loans and advances to customers	10,551	10,346	49,245	78,511	148,653
Equipment and intangible assets	-	-	-	1,968	1,968
Interest accrued and other assets	1,471	337	670	59	2,537
Total assets	59,359	10,683	49,915	80,538	200,495
LIABILITIES					
Deposits due to banks	-	5,000	300	-	5,300
Deposits due to customers	25,665	7,984	47,884	41,062	122,595
Borrowings	26,153	148	3,033	11,971	41,305
Subordinated debt	3,912	-	-	-	3,912
Other liabilities	1,330	437	986	1,006	3,759
Provisions for potential losses	223	-	-	24	247
Total liabilities	57,283	13,569	52,203	54,063	177,118
Liability gap	2,076	(2,886)	(2,288)	26,475	23,377

30.5. Operational Risk

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

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

30. FINANCIAL INSTRUMENTS (continued)

30.5. Operational Risk (continued)

Operational risk management is performed through the following activities:

- Identification of the existing sources of operational risks and sources contingent on the introduction of new products, systems 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.

30.6. Capital Management

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

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

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

- In respect of the shareholder composition and profile, focus on shareholders from the banking sector and areas of micro crediting, financial investment, corporate shareholders and eventually private individuals;
- Policy of diverse equity instruments, particularly within the core and supplementary capital, and decrease or avoidance of the capital deductibles;
- In respect of the profit distribution, increase in the Bank's total capital in accordance with the effective regulations;
- In respect of the capital adequacy, when the capital adequacy ratio fall below 15%, the Bank 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.

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

30. FINANCIAL INSTRUMENTS (continued)

30.6. Capital Management (continued)

Procedures for continuous monitoring of the balances are implemented through:

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

At the end of 2014, the plan for capital adequacy maintenance was harmonized with the Decision on the Minimum Standards for Capital Management and Capital Protection of Banks, as well as with the overall action plans, taking into accounts the current condition and expected influences of the anticipated changes in the business operations and environment. The Bank is under obligation to maintain capital adequacy at the minimum of 12% and the management regularly monitors the adequacy indicators and submits a report thereon in the prescribed form to BARS on a quarterly basis.

As of December 31, 2014, the Bank was in full compliance with all the prescribed capital adequacy indicators:

	Year Ended December 31,	
	2014	**2013**
Core capital	22,385	20,028
Supplementary capital	6,667	6,169
Deductible items	(5,820)	(3,448)
Bank's net capital	**23,232**	**22,749**
Credit risk-weighted assets and off-balance sheet items	157,482	115,332
Weighted operational risk exposure	9,942	6,551
Total risk-weighted assets, off-balance sheet items and operational risk exposure	167,424	121,883
Capital adequacy ratio	**13.88%**	**18.66%**

31. EVENTS AFTER THE REPORTING PERIOD

(a) On February 1, 2015 new organizational structure of the Bank became effective and changes were made to the Bank's management, i.e. the composition of both and the Management and Supervisory Boards. The compositions of the Management and Supervisory Boards before and after the changes were as follows:

Management Board:

	Up to February 1, 2015	From February 1, 2015
Director (Chairman of the Management Board)	Srećko Bogunović	Sandra Lonco
Executive Director	Dragan Đurić	Dragan Đurić

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

31. EVENTS AFTER THE REPORTING PERIOD (continued)

Supervisory Board:

	Up to February 1, 2015	From February 1, 2015
Chairman	Aleksandar Kremenović	Aleksandar Kremenović
Member	Mladen Bosnić	Mladen Bosnić
Member	Velimir Zdjelar	Velimir Zdjelar
Member	Damir Trivić	Damir Trivić
Member	Brane Stupar	Srećko Bogunović

(b) At its session held on February 26, 2015 the Bank's Supervisory Board adopted the Plan for Capital Increase through New Share Issue, which is planned for April 2015. The capital increase shall be made by the majority shareholder MKD Mikrofin d.o.o. Banja Luka in the amount of BAM 4 million.

(c) On March 10, 2015 after submission of its request, the Bank received a Waiver Letter from KfW Germany approving its non-compliance with the relevant financial covenant (Notes 20 and 21). The aforesaid Waiver relates to the non-compliance with the contractually defined obligation of the Bank to maintain the capital adequacy ratio at a minimum of 15% as of December 31, 2014 (the Bank's capital adequacy ratio achieved was 13.88%). The creditor's Waiver Letter stipulates that the approval of non-compliance validity up to June 30, 2015.

Except for the aforesaid, until these financial statements issue date, there have been no other subsequent events that would require additional disclosures in or adjustments to the Bank's financial statements for 2014.

32. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of statement of financial position components denominated in foreign currencies into BAM as of December 31, 2014 and 2013 were as follows:

		In BAM
	December 31, 2014	**December 31, 2013**
USD	1.6084	1.4190
CHF	1.6260	1.5954
EUR	1.9558	1.9558