Addiko Bank

Annual Report 2018

Addiko Bank a.d. Banja Luka
Bosnia and Herzegovina

Key data

in BAM thousand

Selected items of the Profit or Loss statement	YE18	YE17	Change (%)	YE16	Change (%)
					BAM thousand
Net banking income	37,634	33,867	11.1%	27,520	36.8%
Net interest income	25,244	21,844	15.6%	17,853	41.4%
Net fee and commission income	12,390	12,023	3.1%	9,667	28.2%
Other operating result	(789)	(4,240)	-81.4%	(2,188)	-63.9%
Operating expenses	(28,508)	(29,883)	-4.6%	(30,423)	-6.3%
Operating result before change in credit loss expense	**8,337**	**(256)**	>100%	**(5,091)**	>100%
Credit loss expenses on financial assets	(5,059)	4,724	>100%	(3,933)	28.6%
Tax on income	7	7	0.0%	9	-22.2%
Result after tax	**3,285**	**4,475**	-26.6%	**(9,015)**	>100%
Performance ratios	**YE18**	**YE17**	**Change(%)**	**YE16**	**Change(%)**
Net interest income/total av. assets	3.4%	3.1%	9.1%	2.4%	41.9%
Cost/income ratio	77.4%	100.9%	-23.3%	120.1%	-35.6%
Cost of risk ratio	0.3%	0.0%	>100%	1.6%	-84.1%
Selected items of the Statement of financial position	**YE18**	**YE17**	**Change (%)**	**YE16**	**Change (%)**
Loans and advances to customers	506,896	522,019	-2.9%	474,083	6.9%
Deposits of customers	540,245	459,381	17.6%	365,114	48.0%
Equity	154,461	151,546	1.9%	147,051	5.0%
Total assets	795,663	709,308	12.2%	715,806	11.2%
Risk-weighted assets	591,536	577,211	2.5%	527,076	12.2%
Balance sheet ratios	**YE18**	**YE17**	**Change(%)**	**YE16**	**Change(%)**
Loan to deposit ratio	93.8%	113.6%	-17.4%	129.9%	-27.8%
Non-performing exposure ratio	9.8%	13.8%	-29.3%	19.2%	-49.3%
NPL coverage ratio	84.3%	84.5%	-0.1%	76.0%	11.0%
Core tier 1 ratio	23.4%	13.6%	72.0%	15.1%	55.1%
Total capital ratio	24.5%	14.7%	66.9%	16.3%	50.3%

Contents:

Letter from the CEO

Our Addiko story began in mid-2016 with Advent International and EBRD taking over ownership of the loss-making Bank. 2016, and the following year, were years of radical changes in all segments, when we have transformed a loss making institution into a profitable and stable banking operation. We have changed the concept of doing business, organizational culture and organization.

Following this restructuring, year 2018 was somewhat different for us - it was a year of stable progress, showing strengthening and advancement in all aspects of our operations.

Our 2018 operations were profitable and successful as a consequence of our effort in all business areas. We grew in lending in our focus segments - consumer lending and small and medium enterprises. Although our loan book appears to be stable, this is a result of intensified lending in focus segments, while reducing legacy portfolio, dominantly CHF loans. We increased income by providing a stronger value proposition to our customers. Our brand shows significant increase of strength on the market and leads to customer numbers growth.

One of our legacy topics is level of non-performing loans driven dominantly by CHF loans. In 2018, our commitment to address this topic, resulted in 29% decline in non-performing loans. With above average market provisioning coverage of 84.3%, we find this legacy portfolio to have a minimal risk for the Bank, while being proud that our new loan books show excellent credit quality and performance.

At the same time, we worked on cost reductions. We are also proud that we achieved a reduction of the operating expense by 5% on a year-on-year rate, despite challenges of legacy costs and additional investments performed to grow the business and enhance the Bank's digital capabilities. We ended 2018 with a significant increase of capital adequacy and deposits, demonstrating trust of customers, allowing us to further increase our support to business environment and have strong base for expansion of our own operations in the coming years.

Although 2018 was not an easy year, we managed to face and address many challenges it brought. Besides business and regulatory challenges, we worked on our own internal improvements because we strongly believe we need to constantly be the better versions of ourselves, for benefit of our customers, employees and community in which we operate. We are entering a new business year by being better in operating according to our straightforward principles, with stronger skills of our employees in all areas, with improved digital tools and enhanced processes towards our customers.

Finally, I wish to express my gratitude for trust and support to our customers, employees, owners and regulators in this transitioning journey of Addiko. We are committed to continue our successful story in 2019. While being fully aware of the challenges of slow market growth, strong competition and new regulatory requirements, I strongly believe that we will have the persistence, knowledge and enthusiasm to continue this path.

Best regards,

Mario Ivanković

Management Board of Addiko Bank a.d.

Boštjan Pečenko,
Member of the
Management Board

Žaklina Dimitrijević,
Member of the Management Board

Mario Ivanković,
President of the
Management Board

Management Report

1. Overview of Addiko Bank

Addiko Bank a.d. Banja Luka is a part of an international financial group headquartered in Vienna, Austria which operates through six banks with its core business in Croatia, Slovenia, Bosnia and Herzegovina, Serbia and Montenegro. The Bank's strategy is focused on delivering core products and services relevant to Retail as well as Small and Medium Enterprises (SME) and Corporate customers.

The holding company AI Lake (Luxembourg) S.à r.l. is the direct parent company of Addiko Group and is indirectly owned by funds advised by Advent International, a global private equity investor and the European Bank for Reconstruction and Development (EBRD).

2. General economic conditions in 2018

Although the official figures on economic growth in 2018 are expected in the first half of this year, according to our estimates, in 2018 Bosnia and Herzegovina achieved GDP growth of 3%. Economic growth was primarily achieved under the influence of a strong private consumption, with an increase in exports and commercial construction activity. According to retail results, which accelerated its growth to 8.2% compared to last year, private consumption continued robust growth rates supported by positive shifts in the labor market (growth in the number of employees and accelerated growth of average wages - over 3% compared to last year), with the increase of foreign tourist nights (14.7% annually) as well as remittances from abroad.

Export growth in 2018 slowed down to 7.7% in relation to last year mainly due to lower demand from EU countries facing a slowdown in economic growth and a temporary drop in demand from Turkey in the middle of the year as one of the major trading partners of Bosnia and Herzegovina. With a solid growth of imports of 6.1% per annum, the coverage of imports by exports reached the level of 62%. At the same time, the growth of industrial production continued at a slower pace of 1.7% annually due to lower dynamics in production of capital goods, intermediate products and manufacturing industries.

Following a gradual acceleration during the second half of the year, driven by a rise in fuel prices, the consumer price index in 2018 increased by 1.4%, due to weaker inflationary pressures from food prices.

The competitiveness of the economy in 2018 did not make any progress compared to last year, and according to the results of the Global Competitiveness Survey conducted by the World Economic Forum in 2018, Bosnia and Herzegovina remained at the bottom of the ladder compared to the whole region. Despite the small improvements in liquidity resolution, Bosnia and Herzegovina still stands significantly worse in categories such as business start-up and electricity generation, in comparison with the competition.

The last parliamentary elections resulted in a politically fragmented parliament, where the inability to form a coalition also reflected on economic issues, and it will be equally difficult to reach a common agreement on key structural reforms. In addition to creating the preconditions for stronger growth in the incoming period, persistence on reforms is necessary primarily as a proof of the credibility of Bosnia and Herzegovina on its path to the EU, and for achieving a better country rating. In this respect, emphasis should be placed on administrative burdens and public sector reform in accordance with the guidelines adopted in the Strategic Framework for Public Administration Reform.

3. Significant events in YE2018

3.1. Organizational structure and Operating Model implementation

The implementation of the Operating Model continued during the 2018.

The operating model ensures a higher level of service quality across the six countries, increase operational stability and enabling full leveraging of investments at the Group level. Furthermore, it offers interesting perspectives for highly skilled staff and experts.

3.2. Digital transformation and building digital capabilities

Addiko Bank continued its digital efforts by launching two new key digital initiatives, namely a completely new group wide e-banking system for the Corporate and SME segment and API (application processing interface) for Retail segment.

The new e-banking system was launched after intensive feedback from Corporate/SME clients This platform was developed in an agile approach, leveraging the capabilities built in the group Digital Competence Center (DCC) in close cooperation with the customers and enables an easier handling of day to day tasks, allows customers to monitor their existing trade finance and loan products online and sets the stage for further convenient product initiatives coming to Addiko customers in the future.

On the other hand, APS developed for Retail segment, provides straightforward and efficient processing of consumer loans. With loan approval enabled within 30 minutes from customer walk in to the branch, APS supports Addiko's intention to provide a distinct level of services in its focus segment, which is consumer lending.

Creating new digital capabilities is one of the strategic focus points of the Bank. Addiko is investing a significant amount of resources in identifying innovative solutions that aim to solve specific customer problems. In pursuing this approach, Addiko is perceived as market leader in delivering convenient banking solutions to its customers in the countries of operation.

3.3. Continuous cost management and efficiency gains

With a continued focus in process optimization and establishing a lean, efficient, agile and integrated organization, a further consolidation of the existing IT applications and landscape was conducted during the first three quarters of 2018.

While carrying legacy cost infrastructure from period before ownership change and attempting to reduce it, Addiko is challenged to invest into digital development and branch channel network in the same time. We are proud that we achieved a reduction of the operating expense by 5% on a year-on-year rate, despite challenges of legacy costs and additional investments performed to grow the business and enhance the Bank's digital capabilities. This is a result of the commitment for ongoing cost improvement, which will continue and reduce the Cost-to-Income ratio (CIR) across the organization in the coming years.

3.4. Focus on improving customer experience

As part of its continuous focus on improving customer experience, Addiko Bank's net promoter score (NPS) platform started to operate in 2018, complementing the marketing NPS already live since 2017.

The possibility to survey customer experience after individual interactions with Addiko Bank will allow to measure critical moments of the customer journey. First results show promising customer satisfaction levels.

3.5. Review of the business strategy

After the successful implementation of its original business strategy (established following the change of ownership in July 2015) Addiko Bank has reviewed its strategy resulting in a refined scope.

The business strategy is grounded on the initially introduced "straightforward banking" approach providing simple, digital products and solutions for the daily banking needs of customers. As "Six countries - One winning team" Addiko Bank concentrates on "focus on essentials", on "deliver on efficiency" and on "communicate simplicity".

Based on this approach Addiko Bank reached its goal of transforming the business towards strategic core segments by focusing on Consumers and SMEs in the real economy. Furthermore, the Group continued its journey of building a distinctive operating model with digital capabilities.

Building on its successful initial strategy, Addiko will now take further steps to become a go-to-bank for selected products with operational excellence (cash loans, cards and payments), serving basic banking needs with the simplest, most convenient and fastest customer experience and focusing on transparent communication.

3.6. Branches

Our branches are still the most important distribution channel for our sales, so we are fully dedicated to increasing of client satisfaction during their visit to Addiko branches. We redecorated several branches making it more functional and modern, according to Addiko branding standards.

At year end 2018 Addiko Bank Banja Luka operates a total of 33 branches (2017: 34).

3.7. Financial performance in brief

After having delivered on the turnaround in 2017, Addiko continues its path towards achieving an appropriate return on equity and shows good progress by posting a YE18 profit after tax of BAM 3.3 million (YE17: BAM 4.5 million), which for a better understanding requires a comparison of operating result before changes in credit loss expense from BAM -0.3 million in 2017 to BAM +8.3 million in 2018).

This is the result of Addiko Bank's ongoing focus on changing the business composition predominantly from lower margin of legacy CHF loan portfolio and Public finance towards higher value-added Consumer and SME lending and is shown by the increased share of these two segments, while the overall loan book remained stable. The performance of market growth in the last 12 months, with regard to new disbursements clearly highlights that Addiko is delivering on its business strategy, and that it will continue to develop the focus business segments as key revenue generators in the coming year.

Net interest income on a reported basis increased by 15.6% to BAM 25.2 million (YE17: BAM 21.8 million) with NIM at 3.4% (+3.1 to YE17).

Despite the further reduction in average deposit pricing during 2018, customer deposits stayed stable at BAM 540 million (17.6% higher compared to BAM 459 million at YE17). The continuous improvements in the structure of customer deposits allows a slight reduction of excess liquidity while keeping very strong self-funding ratios (LTD Ratio: 2018: 93.8% (YE17: 113.64%)).

Net fee and commission income improved by 3.1% to BAM 12.4 million (YE17: BAM 12 million) as a consequence of new fee model and new product packages.

Other operating income is significantly driven by sale of repossessed real estate assets (BAM 0.8 million) and Income of release of provision for passive lawsuit (BAM 0.8 million).

Operating expenses were reduced to BAM 28.5 million (2017: BAM 29.9 million) as a result of higher productivity and tight cost management.

The performance in reduction of NPLs remains strong, driven by a focus on workout and collections leading to a 25% decline in non-performing loans to BAM 90.4 million (BAM 121.3 million at YE17). While having fairly high NPL ratio of 9.8%, it is important to stress that NPLs come dominantly from legacy portfolio, while new lending demonstrates excellent performance and quality in repayment. The legacy NPL portfolio strongly declined in 2018 (29%). The coverage is already above average market levels of 84.3% (YE17: 84.5%), thus having minimal risk for the bank and loan book.

3.8. Adoption of IFRS9

On 1 January 2018, the new accounting standard for financial instruments IFRS 9 took effect. This replaces IAS 39, which was the previous accounting standard for measurements and classification of financial instruments. The regulations set out in the new standard are primarily reflected in the loan loss provisions, as they apply to impairment losses on financial assets valued at amortized cost or at fair value recognized directly in equity. Under IFRS 9 the impairment requirements also apply to credit commitments and financial guarantees. The model used to determine impairment losses also changes, from a historically oriented model under IAS 39 (incurred losses) to a future oriented model under IFRS 9 (expected credit losses).

The new rules on valuation are by contrast of lesser significance. The adoption results in an adjustment to equity of BAM -0.5 million.

3.9. Increase in issued capital due to release of regulatory reserves

Addiko Bank Banja Luka maintained high regulatory reserves for credit losses from time of IAS 39 implementation. In 2018, with shift to IFRS 9, these regulatory reserves were no longer needed. As a result, Addiko Bank Banja Luka moved these reserves to core capital, into the position "other reserves" in the amount of BAM 56.8 million. This activity resulted in major strengthening of the regulatory capital in total amount of BAM 144.9 million and increased capital adequacy ratio to 24.5 % (YE17: 14.7%).

General Assembly adopted the decision to incorporate regulatory reserves in favor of Other reserves as part of Tier 1 capital in the amount of BAM 56.8 million which increased capital adequacy ratio to 24.5% (YE17: 14.7%).

3.10. General Data Protection Regulation (GDPR)

The new EU directive on personal data (GDPR), which has entered into force on 25 May 2018, implies that the rights of data subjects have been strengthened, and that data controllers and data processors are subject to new requirements when managing and handling personal data. Owing to the importance of this change in regulation, Addiko Group implemented well in advance a GDPR readiness program.

Considering the fact that our local legislation is not yet aligned with GDPR, it is only possible for Addiko Bank to comply with provisions that are not in contradiction to the local law on data protection.

4. Financial development of the Bank

4.1. Analysis of profit or loss statement

in BAM thousand

	YE18	YE17	Change (%)
Net banking income	37,634	33,867	11.1%
Net interest income	25,244	21,844	15.6%
Net fee and commission income	12,390	12,023	3.1%
Net result on financial instruments	91	86	5.8%
Other operating result	(880)	(4,326)	-79.7%
Operating income	36,845	29,627	24.4%
Operating expenses	(28,508)	(29,883)	-4.6%
Operating result before change in credit loss expense	8,337	(256)	>100%
Credit loss expenses on financial assets	(5,059)	4,724	>100%
Operating result before tax	3,278	4,468	-26.6%
Tax on income	7	7	0.0%
Result after tax	**3,285**	**4,475**	-26.6%

The year 2018 is marked by an improvement in the underlying development of the net interest income. The net interest income increased to BAM 25.2 million, compared to BAM 21.8 million in December 2017.

This positive development is supported by the strong growth in high margin consumer loans as well as lower interest rates for customer deposits as a consequence of our strategic repositioning within all markets. The adjusted net interest margin amounts to 335bp at YE18, compared to 307bp YE17. This progress is a result of a continuous shift from non-focus assets i.e. Mortgage, Large Corporates and Public Finance towards Consumer and SME lending as well as moving towards less costly funding. Net fee and commission income amounted to BAM 12.4 million (BAM 12 million in 2017), with the development mainly due to higher income from the card business, payment transactions and new product packages.

Personnel expenses and other administrative expenses declined from BAM 27.7 million in 2017 to BAM 26 million at the current reporting date. The reduction of BAM 1.7 million is mainly due to lower other administrative expenses. The decrease in administrative expenses is based on a strict cost management and monitoring throughout the whole Addiko Bank. The cost-income ratio decreased by 23% to 77% compared to 2017.

Depreciation and amortization of fixed assets increased to BAM 2.5 million, compared to BAM 2.2 million in the previous year. These increased costs are mainly a result of IT investments in new software solutions.

In total, operating income amounts to BAM 36.8 million (2017: BAM 29.6 million) while operating expenses sum up to BAM 28.5 million (2017: BAM 29.9 million). This resulted in an operating result in the amount of BAM 8.3 million which is significantly better compared to BAM 0.3 million in 2017.

Credit loss expenses amount to BAM 5 million due to implementation of new conservative rating models for private individuals unsecured segment and increase of probability of default within this.

4.2. Analysis of the statement of financial position

Addiko Bank adopted the requirements of IFRS 9 “Financial Instruments” on 1 January 2018. The classification, measurement and impairment requirements of IFRS 9 were applied retrospectively by adjusting the opening balance sheet at the date of the initial application. As permitted by IFRS 9, Addiko Bank has not restated comparative periods. Therefore, only the structure of the statement of financial position compared to YE17 was adjusted to the new requirements according to IFRS 9 and thus only limited comparability with the previous period’s figures is given.

in BAM thousand

	31.12.2018	31.12.2017	Change (%)
Assets			
Cash reserves	188,393	141,273	33.4%
Financial assets held for trading	-	-	-
Loans and receivables	509,678	524,232	-2.8%
Loans and advances to credit institutions	-	-	-
Loans and advances to customers	506,896	522,019	-2.9%
Other financial assets	2,782	2,213	25.7%
Investment securities*	55,128	2,258	>100%
Derivatives - Hedge accounting	-	-	-
Tangible assets	29,080	29,997	-3.1%
Intangible assets	5,874	4,438	32.4%
Tax assets	1,395	1,212	15.1%
Current tax assets	1,395	1,212	15.1%
Deferred tax assets	-	-	-
Other assets	5,570	5,353	4.1%
Non-current assets and disposal groups classified as held for sale	545	545	0.0%
Total assets	**795,663**	**709,308**	12.2%

Total assets of the Addiko Bank a.d. Banja Luka increased by BAM 86.4 million, from BAM 709.3 million to BAM 796.7 million.

Cash, cash balances at central banks increased by BAM 47 million to BAM 188 million (2017: BAM 141 million), while other demand deposits increased by BAM 28 million to BAM 45 million (2017: BAM 17 million).

Overall net receivables (gross receivables less credit risk provisions) decreased from BAM 522 million (2017) to BAM 507 million due to decrease Public and Medium loans.

Tangible assets decreased by BAM 0.9 million from BAM 30 million in 2017 to BAM 29.1 million.

Intangible assets increased by 1.4 million to BAM 5.9 million compared to year end 2017 (BAM 4.4 million) due to investments in digital transformation, development core banking software and improvement in card business.

Tax assets increased by BAM 0.2 million, from BAM 1.2 million in 2017 to BAM 1.4 million.

Other assets increased to BAM 5.6 million compared to BAM 5.4 million at the end of 2017.

in BAM thousand

	31.12.2018	31.12.2017	Change (%)
Equity and liabilities			
Financial liabilities held for trading	-	-	-
Financial liabilities measured at amortized cost	632,787	546,540	15.8%
Deposits of credit and other financial institutions	31,350	50,047	-37.4%
Deposits of customers	540,245	459,381	17.6%
Loan liabilities	52,512	28,300	85.6%
Other financial liabilities	8,680	8,812	-1.5%
Provisions	3,849	6,737	-42.9%
Tax liabilities	582	589	-1.2%
Current tax liabilities	-	-	-
Deferred tax liabilities	582	589	-1.2%
Other liabilities	3,984	3,896	2.2%
Equity	154,461	151,546	1.9%
Total equity and liabilities	**795,663**	**709,308**	12.2%

On the liabilities' side, deposits of customers increased by BAM 81 million to BAM 540 million in 2018 (2017: BAM 459 million). This development is mainly driven by increase in deposits from customers mostly private individuals and SMEs.

Provisions decreased from BAM 6.7 million at year end 2017 to BAM 3.8 million in 2018. Included are provisions for passive legal cases, which should further decrease as settlements and court achievements are developing very well.
The change in total equity comes from profit of 2018 and in the amount of BAM -0.5 million as result of implementation of IFRS 9. Retained losses decreased as a result of covering loss from reserves and profit from current year.

According to local regulation capital adequacy ratio is 24.5 % and it is significantly above the minimum prescribed 14.5% (12% + capital buffer 2.5%).

5. Analysis of non-financial key performance indicators

5.1. Human Resources management

The Human Resources (HR) strategy underpins the cultural transformation of Addiko Bank. The Operating Model enables employees at all levels to drive for results via team work and cross-boundary collaboration. Building strong HR processes in performance, recruitment, talent, learning and leadership development is needed to ensure agility in employee attitudes and capabilities.

The performance and talent management frameworks are key processes used to identify, develop, reward and recognize high performance and talented employees. The two processes support Addiko Bank's journey to build a great place to work, to become an employer of choice, to attract talents and to offer opportunities for employees to develop their careers.

In 2018, there were many areas of focus in Human Resources, with new training programs piloted to develop leadership capabilities. Standardizing HR processes was continued in the areas of recruitment, onboarding and personnel cost reporting. A new online platform was introduced, decreasing the administration and elevating digital recruitment. A key enabler of culture change was continuous internal communication and implementation of leadership standards for managers and desirable work-place behaviors (the Addiko "Values and Behaviors"). These were integrated into the Performance Management, Talent and Leadership Development programs and initiatives of 2018.

Several small-scale efficiency and rightsizing programs ended in 2018. At the year-end 2018, Addiko Bank Banja Luka had 372 employees (341.5 FTE). In the upcoming period the focus will be on elevating the cultural and business transformation of Addiko Bank ensuring that "Values and Behaviors" are integrated into daily performance. This will require effective HR metrics in place to ensure that the right employees hold key positions and that the Bank is developing critical skills needed to be an innovation leader and a digital disruptor in the countries where it operates.

6. Internal Control System for accounting procedures

Addiko Bank has an Internal Control System (ICS) for accounting procedures, in which suitable structures and processes are defined and implemented throughout the organization. The management in each organizational unit is responsible for implementing Bank-wide policies and procedures. Compliance with policies is monitored as part of the audits performed by internal and local internal auditors.

The ICS, as part of the Addiko Bank's risk management system, has the following general objectives:

- safeguarding the business and risk strategies as well as Addiko Bank policies
- effective and efficient use of all the resources in order to achieve the targeted commercial success
- ensuring reliable financial reporting
- supporting compliance with all relevant laws, rules and regulations

The particular objectives with regard to Addiko Bank accounting procedures are that the ICS ensures that all business transactions are recorded immediately, correctly and in a uniform way for accounting purposes. In addition, it should ensure that no errors or deliberate actions (fraud) prevent facts from adequately reflecting the organization's financial position and performance

The Internal Control System itself is not a static system but is continuously adapted to the changing environment. The implementation of the Internal Control System is fundamentally based on the integrity and ethical behavior of the employees. The Management Board and the leadership team actively and consciously embrace their role of leading by example.

7. Non-financial reporting

In line with the EU regulation Addiko Bank fully complies with the Directive 2014/95/EU and the rules on disclosure of non-financial and diversity information. The Bank operates and manages social and environmental related topics by continuously developing further its responsible approach to business. Accordingly, the Bank's non-financial report includes policies it implemented in relation to: environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery and diversity. The said non-financial report can be found as a part of the consolidated Addiko Group Annual Report.

8. Other disclosures

In relation to the required information in accordance with local Commercial law on events after the reporting date please refer to Note 34. With respect to the explanations on substantial financial and non-financial risk as well as the goals and methods of risk management please refer to the risk report. In addition, information on the use of financial instruments are presented in the note 3.8.

9. Research & Development

Addiko Bank does not conduct any R&D activities.

10. Outlook

In 2019 we expect a GDP growth of about 3.5%. It is important to emphasize that the intensification of economic growth in the incoming period implies faster resolution of the current political situation, necessary for opening the way to greater infrastructure investments, and continuation of strengthening of export potential.

We expect private consumption to retain the role of the main driver of growth, thanks to the steady increase in wages and employment, higher remittances, credit activity and steadily higher inflows from tourism.

Despite the slowdown in economic growth, we expect a solid demand from EU countries that, together with lifting the ban on imports of certain products in the EU and boosting energy capacity, should boost export growth. However, due to strong import-intensive domestic demand, the net contribution to economic growth will remain negative.

The acceleration of investments due to secured EBRD funding (EUR 700 million by 2020), stronger budget support and stronger FDI growth in the energy sector should also encourage faster economic growth.

ADDIKO BANK A.D. BANJA LUKA

Financial Statements Year Ended December 31, 2018 and
Independent Auditors' Report

Independent Auditor's Report

To the Supervisory Board and Shareholders of Addiko bank a.d. Banja Luka

Opinion

We have audited the accompanying financial statements (pages 12 to 105) of Addiko banka a.d. Banja Luka (hereinafter: the "Bank"), which comprise the statement of financial position as at December 31, 2018, and the related statement of profit or loss, statement of other comprehensive income, statement of changes in equity and reserves and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Addiko banka a.d. Banja Luka as at December 31, 2018, and its financial performance and changes in its cash flows for the year then ended, in accordance with the accounting regulations of the Republic of Srpska and regulations of the Banking Agency of the Republic of Srpska, governing the financial reporting of banks.

Basis for Opinion

We conducted our audit in accordance with the International Standards on Auditing (ISA) and the Law on Accounting and Auditing of the Republic of Srpska. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the ethical requirements relevant to our audit of the financial statements in the Republic of Srpska and we have fulfilled our other ethical responsibilities in accordance with those requirements.

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were most significant in our audit of the financial statements for the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

(Continued)

Key Audit Matters (Continued)

Key audit matter	Related audit procedure
Expected credit losses per loans and provisions for guarantees	
As of December 31, 2018, the Bank's loans and receivables due from customers totaled BAM 597,566 thousand (December 31, 2017: BAM 632,346 thousand), whereas the total impairment allowance amounted to BAM 89,106 thousand as of December 31, 2018 (December 31, 2017: BAM 108,568 thousand). As of January 1, 2018, the Bank adopted International Financial Reporting Standard (IFRS) 9, which resulted in recognition of the impairment costs per expected rather than incurred losses. The Bank's management disclosed information on the effects of transition to IFRS 9 in Note 2.4, including the effect on the Bank's capital as of January 1, 2018. Measurement of the impairment losses for loans and provisions per guarantees is deemed a key audit matter because definition of assumptions used in expected credit loss calculation is subjective due to the significant level of judgment used by the Bank's management. The most significant judgements refer to: • Assumptions used within the expected credit loss models applied in estimates of credit risk of the customer exposure and expected future cash flows; • Timely identification of exposures with a significant increase in credit risk and purchased or originated credit impaired (POCI) assets; and • Collateral valuation and assumptions of the future cash flows per individually assessed credit exposures. The Bank's management disclosed additional information on the impairment losses on loans and provisions for guarantees in Notes 2, 6.1, 14, 18 and 30 to the financial statements.	Based on our risk assessment and knowledge of the industry, we examined the Bank's impairment of loans and provisions per guarantees and assessed the methodology and assumptions used by the Bank in line with this key audit matter description. Our testing encompassed the following elements: • Evaluation of the key controls over the assumptions used in the expected credit loss models for assessing the credit risk of the customer exposure and expected future cash flows; • Obtaining and detailed testing of the evidence supporting the assumptions used in the expected credit loss models for staging, assumptions used to calculate 12-month and life-cycle probability of default (PD) parameters and methods applied in arriving at the loss given default (LGD) parameter; • Evaluation of the key controls over the timely identification of exposures with a significant credit risk increase and purchased or originated credit impaired (POCI) assets; • Obtaining and detailed testing of the evidence of the timely identification of exposures with a significant credit risk increase and purchased or originated credit impaired (POCI) assets; • Obtaining and detailed testing of the evidence supporting appropriate definition of assumptions on impairment losses on loans and provisions per guarantees, including collateral valuation and assumptions of the future cash flows per individually assessed credit exposures; • Estimates of the key trends in the Bank's previous year's high-risk portfolio against the industry standards and historical data; • Evaluation of adequacy of several different decisions made by the Bank's management against the macroeconomic forecasts used within the expected credit loss models; • Evaluation of the methodologies applied by the Bank using our knowledge of and experience with the industry; • We involved our IT experts and credit risk specialists in the work in areas that required specific expertise; • Evaluation of the accuracy and completeness of the disclosures made in the financial statements.

Responsibilities of Management and the Supervisory Board for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting regulations of the Republic of Srpska and regulations of the Banking Agency of the Republic of Srpska, governing the financial reporting of banks, 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.

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

(Continued)

Auditors' Responsibility for the Audit of the Financial Statements

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

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

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

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

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

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

The Engagement Partner on the audit resulting in this independent auditors' report is Mr. Mirko Ilić, Certified Auditor.

Banja Luka, March 20th, 2019

Mirko Ilić
Partner
Certified Auditor

DELOITTE d.o.o. 1 BANJA LUKA

(Thousands of BAM)

	Note	2018	2017 Restated
Statement of profit or loss			
Interest income calculated using the effective interest method	7.1	32,285	29,835
Other interest income	7.1	10	48
Interest expenses	7.2	(7,051)	(8,039)
Net interest income	7	**25,244**	**21,844**
Fee and commission income	8.1	14,983	13,936
Fee and commission expenses	8.2	(2,593)	(1,913)
Net fee and commission income	8	**12,390**	**12,023**
Net profit from financial instruments	9	91	86
Other operating income	10	2,819	3,562
Other operating expenses	11	(3,699)	(7,888)
Total operating income		**36,845**	**29,627**
Staff costs	12	(12,800)	(13,923)
Depreciation/amortization charge	21, 22	(2,522)	(2,176)
Other administrative costs	13	(13,186)	(13,784)
Total operating expenses		**(28,508)**	**(29,883)**
OPERATING PROFIT/(LOSS) BEFORE CREDIT RISK PROVISIONS		**8,337**	**(256)**
Provisions for potential losses, commitments and write-offs	14	(5,059)	4,724
PROFIT BEFORE TAXES		**3,278**	**4,468**
Income tax expense	15	**7**	**7**
NET PROFIT		**3,285**	**4,475**
Attributable to:			
the Bank's shareholders		**3,285**	**4,475**
Earnings per share (in BAM)	28	0.021	0.029

Notes on pages 21 to 104 form an integral part of these financial statements.

(Thousands of BAM)

	2018	2017
NET PROFIT FOR THE YEAR	**3,285**	**4,475**
Other comprehensive income		
Items that may subsequently be reclassified to the statement of profit or loss:		
Net gains on the fair value adjustment of financial assets available for sale (MRS 39) / financial assets at fair value through other comprehensive income (MSFI 9)	102	2
Items that cannot subsequently be reclassified to the statement of profit or loss:		
Losses on revaluation of property and equipment	-	(1)
Gains on changes in actuarial assumptions	3	18
Income tax on items of other comprehensive income that cannot be reclassified to profit or loss	-	1
Other comprehensive income, net	**105**	**20**
TOTAL POSITIVE COMPREHENSIVE INCOME	**3,390**	**4,495**

Notes on pages 21 to 104 form an integral part of these financial statements.

These financial statements were approved for issuance by Management of Addiko Bank a.d., Banja Luka on February 26, 2019.

Signed on behalf of the Bank by:

Mario Ivanković
Chairman of the Management Board

ADDIKO BANK AD
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BANJA LUKA

Žaklina Dimitrijević
Member of the Management Board

(Thousands of BAM)

	Note	2018	2017 Restated
ASSETS			
Cash and balances held with the Central bank	16	129,946	121,863
Balances held with other banks	17	58,447	19,410
Financial assets held for trading	19.2	-	-
Loans and receivables	18	509,678	524,232
Loans and receivables due from banks			
Loans and receivables due from customers	18.1	506,896	522,019
Other financial assets	18.2	2,782	2,213
Investments in securities	19.1	55,128	2,258
Equity investments	20		
Property and equipment	21	29,080	29,997
Land, buildings and equipment	21.1	26,679	27,609
Investment property	21.2	2,401	2,388
Intangible assets	22	5,874	4,438
Tax assets		1,395	1,212
Receivables for prepaid income taxes		1,395	1,212
Deferred tax assets	15 c)	-	-
Assets held for sale	23	545	545
Other assets	24	5,570	5,353
Total assets		**795,663**	**709,308**
LIABILITIES			
Financial liabilities held for trading		-	-
Financial liabilities at amortized cost	25	632,787	546,540
Deposits due to banks and financial institutions	25.1	31,350	50,047
Deposits due to customers	25.2	540,245	459,381
Borrowings	25.3	52,512	28,300
Other financial liabilities	25.4	8,680	8,812
Other provisions	29	3,849	6,737
Tax liabilities		582	589
Current tax liabilities		-	-
Deferred tax liabilities	15 c)	582	589
Other liabilities	26	3,984	3,896
Total liabilities		**641,202**	**557,762**
EQUITY			
Issued (share) capital	27	153,094	153,094
Regulatory reserves for credit losses	27	4,532	61,826
Other reserves from profit	27	56,819	-
Revaluation and fair value reserves		2,235	2,189
Accumulated losses		(62,219)	(65,563)
Total equity		**154,461**	**151,546**
Total liabilities and equity		**795,663**	**709,308**
Contingent liabilities and commitments	30	**114,429**	**126,097**

Notes on pages 21 to 104 form an integral part of these financial statements.

(Thousands of BAM)

	Share capital	Regulatory reserves for credit losses	Other reserves from profit	Revaluation and fair value reserves	Accumulated losses	Total
Balance as at 31 December 2016	**153,094**	**61,826**	**-**	**2,232**	**(70,101)**	**147,051**
Net profit for 2017	-	-	-	-	4,475	**4,475**
Other comprehensive income						
Items that may be reclassified to the income statement:						
Net gains on the fair value adjustment of securities available for sale	-	-	-	2	-	**2**
Items that ca not be reclassified to the profit or loss						
Revaluation of property and investment property	-	-	-	(70)	69	**(1)**
Gains on changes in actuarial assumptions	-	-	-	18	-	**18**
Net effect of changes in the deferred taxes	-	-	-	7	(6)	**1**
Total other comprehensive income	**-**	**-**	**-**	**(43)**	**63**	**20**
Total comprehensive income	**-**	**-**	**-**	**(43)**	**4,538**	**4,495**
Balance as at 31 December 2017	**153,094**	**61,826**	**-**	**2,189**	**(65,563)**	**151,546**

	Share capital	Regulatory reserves for credit losses	Other reserves from profit	Revaluation and fair value reserves	Accumulated losses	Total
Balance as at 31 December 2017	**153,094**	**61,826**	**-**	**2,189**	**(65,563)**	**151,546**
Transfers within reserves (note 27.)	-	(56,819)	56,819	-	-	**-**
IFRS 9 first-time adoption effect	-	(475)	-	-	-	**(475)**
Net profit for 2018	-	-	-	-	3,285	**3,285**
Other comprehensive income						
Items that may be reclassified to the income statement:						
Gains on the fair value adjustment of securities	-	-	-	102	-	**102**
Net effect of changes in the deferred taxes	-	-	-	-	-	**-**
Items that ca not be reclassified to the profit or loss						
Revaluation of property and investment property	-	-	-	(66)	66	**-**
Gains on changes in actuarial assumptions	-	-	-	3	-	**3**
Net effect of changes in the deferred taxes	-	-	-	7	(7)	**-**
Total other comprehensive income	**-**	**-**	**-**	**46**	**59**	**105**
Total comprehensive income	**-**	**-**	**-**	**46**	**3,344**	**3,390**
Balance as at 31 December 2017	**153,094**	**4,532**	**56,819**	**2,235**	**(62,219)**	**154,461**

Notes on pages 21 to 104 form an integral part of these financial statements.

(Thousands of BAM)

	Note	2018	2017
Cash flows from operating activities			
Interest, fees and commissions received		47,665	43,929
Interest paid		(9,317)	(8,581)
Collection of loans previously written off		163	3,204
Cash paid to employees and suppliers		(28,939)	(30,483)
Off-balance sheet contractual payments			
Receipts and payments on extraordinary items		508	(8,742)
Disbursement of loans extended to customers		7,439	(42,762)
Customer deposits		62,876	1,952
Income taxes paid		(183)	(6)
Net cash generated by/(used in) operating activities		**80,212**	**(41,489)**
Cash flows from investing activities			
Interest received		122	3,574
Dividend received		10	48
Investments in securities available for sale		(52,862)	63,097
Purchases of intangible assets		(3,060)	(1,573)
Purchases of tangible assets		(197)	(34)
Net cash (used in)/ generated by investing activities		**(55,987)**	**65,112**
Cash flows from financing activities			
Interest paid on borrowings		(1,076)	(1,396)
Increase in borrowings		30,426	-
Repayment of borrowings		(6,300)	(7,474)
Net cash generated by/(used in) by financing activities		**23,050**	**(8,870)**
Net increase in cash and cash equivalents		**47,275**	**14,753**
Cash and cash equivalents at beginning of year		**141,287**	**128,802**
Foreign exchange gains/(losses)		684	(2,268)
Cash and cash equivalents at end of year		**189,246**	**141,287**
Cash and cash equivalents comprise the following statement of financial position items:			
Cash and balances with the Central Bank	16	129,946	121,863
Balances held with other banks	17	58,447	19,410
Interest accrued and provisions		853	14
		189,246	**141,287**

Notes on pages 21 to 104 form an integral part of these financial statements.

(Thousands of BAM)

1. GENERAL INFORMATION

Addiko Bank a.d. Banja Luka (the “Bank”) is a legal successor of Kristal Banka a.d., Banja Luka which was initially registered as a separate legal entity as at September 30, 1992, and subsequently transformed into a shareholders’ company as at May 16, 1997. Prior to its establishment as an independent bank, the Bank operated as a main branch of Jugobanka Jubanka d.d., Sarajevo, a related party of Jugobanka d.d., Beograd.

Under Decision of the district Commercial court of Banja Luka (no. 057-0-Reg-16-002147) dated October 28, 2010, the Bank changed its name to the current legal name. The Bank’s owner is Addiko Bank AG, a member of Addiko Group, holding a 99.86% equity interest therein. More details on ownership structure of the Bank are provided in Note 31.

The Bank is licensed in the Republic of Srpska to perform banking operations related to payment transfers, credit and deposit activities in the country and abroad, and in accordance with the Republic of Srpska banking legislation, it is obligated to operate based on the principles of liquidity, solvency and profitability.

The Bank’s registered Head Office is located at no. 13, Aleja Svetog Save St., Banja Luka, Republic of Srpska. As of December 31, 2018, besides the Head Office located in Banja Luka, the Bank had 33 branch offices situated throughout Bosnia and Herzegovina (BH) (December 31, 2017: the Head Office located in Banja Luka and 34 branch offices).

Up to September 7, 2017 the Bank was the sole owner of Hypo Alpe Adria Leasing d.o.o. Banja Luka, when the liquidation procedure was instigated over Hypo Alpe-Adria-Leasing d.o.o. Banja Luka, which comprised the Group along with the Bank. On February 7, 2019, Decision on Closure of the Liquidation Procedure over Hypo Alpe Adria Leasing d.o.o. Banja Luka became effective.

As of December 31, 2018, the Bank had 372 employees (December 31, 2017: 390 employees).

Management of the Bank	
Executive Director from September 16, 2016 onward	Mario Ivanković
Member from September 16, 2016 onward	Boštjan Pečenko
Member from October 24, 2017 onward	Žaklina Dimitrijević
Supervisory Board of the Bank	
Chairman from December 30, 2015 onward	Hans-Hermann Anton Lotter
Deputy Chairman from March 7, 2017 onward	Biljana Rabitsch
Member from March 7, 2017 onward	Razvan Munteanu
Member from October 25, 2017 onward	Meliha Povlakić
Member from October 25, 2017 onward	Damir Karamehmedović
Audit Committee of the Bank	
President from May 29, 2015 onward	Đorđe Lazović
Member from May 29, 2015 onward	Siniša Radonjić
Member from May 29, 2015 to September 27, 2018	Ivan Trifunović
Member from May 29, 2015 to September 27, 2018	Marlene Schellander-Pinter
Member from September 28, 2018 onward	Jelena Mažuranić
Member from December 12, 2016 to September 27, 2018	Claudia Mayrhofer

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHOD

2.1. Statement of Compliance

The accompanying financial statements comprise annual financial statements of Addiko Bank a.d. Banja Luka (the "Bank") for 2018. these financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") in keeping with the Law on Accounting and Auditing or the Republic of Srpska and regulations of the Banking Agency of the Republic of Srpska governing the financial reporting of banks and finance lessors.

2.2. Basis of Measurement and Preparation of the Financial Statements

The accompanying financial statements of the Bank have been prepared on the historical cost basis unless otherwise stated in the summary of accounting policies hereunder.

Historical cost is generally based on the fair value of consideration paid in exchange for goods and services

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

In preparing the statement of cash flows for the year ended December 31, 2018, the Bank used direct cash flow reporting method.

2.3. Functional and Presentation Currency

Amounts in the accompanying financial statements are stated in thousands of convertible marks ("BAM"), BAM being the functional and official presentation currency in the Republic of Srpska and Bosnia and Herzegovina.

The Central Bank of Bosnia and Herzegovina (the "Central Bank") implements the policy on FX rate in line with the principle of the Currency Board, according to which BAM is fix pegged to EUR at the rate of BAM 1 = EUR 0.51129, which was used for 2018 and 2017.

2.4. Application and Impact of the New and Revised International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS")

The accompanying financial statements have been prepared in accordance with the International Accounting ("IAS") and International Financial Reporting Standards ("IFRS"), effective since January 1, 2009 and accounting regulations of the Republic of Srpska based on those standards as well as regulations of the Banking Agency of the Republic of Srpska governing financial reporting of banks and finance lessors.

Namely, in accordance with the provisions of the newly adopted Law on Accounting and Auditing of the Republic of Srpska (Official Gazette of RS no. 94/15), all legal entities situated on the territory of the Republic of Srpska are under an obligation to fully apply IAS, IFRS and the International Financial Reporting Standard for Small and Medium-Sized Entities ("IFRS for SMEs"), International Public Sector Accounting Standards ("IPSAS"), International Valuation Standards ("IVS"), International Standards for the Professional Practice of Internal Auditing, Conceptual Framework for Financial Reporting, Code of Ethics for Professional Accountants and the pronouncements, interpretations and guidelines of the International Accounting Standards Board ("IASB") and all pronouncements, interpretations and guidelines of the International Federation of Accountants ("IFAC").

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

2.4. Application and Impact of the New and Revised International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS") (Continued)

In addition, in accordance with the previously effective Law on Accounting and Auditing of the Republic of Srpska, on October 4, 2017, the Management Board of AAARS enacted "Decision on Determining and Issuing the Conceptual Framework for Financial Reporting and Basic Texts of the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS)".

Under the aforesaid Decision, translations of the Standards and interpretations issued by the International Accounting Standards Board ("IASB") up to December 31, 2014 are defined and published on AAARS website, which shall be effective in the Republic of Srpska and applicable to the financial statements prepared as of December 31, 2018.

In addition, the Banking Agency of the Republic of Srpska ("BARS"), as the regulator of the banking market in the Republic of Srpska, in its memo to the Association of Banks of Bosnia and Herzegovina no. 05-500-1572-3/17 dated October 16, 2017, ordered that additional three standards not yet officially translated in the Republic of Srpska or published on AAARS website, shall be applied:

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after January 1, 2018);
- IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after January 1, 2018); and
- IFRS 16 "Leases" (effective for annual periods beginning on or after January 1, 2019).

First-Time Adoption of New Standards and Amendments to the Existing Standards Effective for the Current Reporting Period

As of these financial statements' approval date, the following new standards and amendments to the existing standards were effective:

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after January 1, 2018);
- IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 2 "Share-based Payment" - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 4 "Insurance Contracts" - Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2018 or when IFRS 9 "Financial Instruments" is applied first time);
- Amendments to IAS 40 "Investment Property" - Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014-2016)" (effective for annual periods beginning on or after January 1, 2018); and
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after January 1, 2021).

The Bank's management analyzes the amendments to the standards and interpretations in effect as well as the newly adopted standards and interpretations issued after December 31, 2014, and, once the standards and interpretations relevant for the Bank have been determined, intends to implement those in preparation of the financial statements, if they are not in conflict with any of the regulations of Republic of Srpska and Bosnia and Herzegovina, after they have been officially translated and published in the Republic of Srpska.

For IFRS 9 and IFRS 15 explanations regarding their first-time adoption are provided hereunder, whereas the adoption of the other standards has had no material effects on the Bank's current economic and financial indicators.

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

2.4. Application and Impact of the New and Revised International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS") (Continued)

New Standards and Amendments to the Existing Standards Issued but not yet Effective

- IFRS 16 "Leases" (effective for annual periods beginning on or after January 1, 2019);
- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2021);
- Amendments to IFRS 3 "Business Combinations" - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period);
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded;
- Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" - Definition of Material (effective for annual periods beginning on or after 1 January 2020);
- Amendments to IAS 19 "Employee Benefits" - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019);
- Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)" resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (amendments should be effective for annual periods beginning on or after January 1, 2019);
- Amendments to References to the Conceptual Framework in IFRS Standards (effective for annual periods beginning on or after 1 January 2020); and
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after January 1, 2019).

It is the Bank's policy to adopt the new standards and amendments to the existing standards and apply them from their effective date. The Bank's management anticipates that the adoption of these standards, amendments to existing standards and new interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

2.4.1. Effects of First-Time Adoption of IFRS 16 - Leases

As from January 1, 2019, the Bank will be applying IFRS 16 – Leases. IFRS 16 is applicable to all leases, including subleases and sale and lease-back transactions, except the contracts on leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources, leases of biological assets, service concession arrangements and certain rights within the scope of IFRS 15 – Revenues from the Contracts with Customers and IAS 38 –Intangible Assets.

IFRS 16 defines the following exceptions from its application:

- short-term leases and small-value leases; and
- expedients (such as a single discount rate) for portfolios of leases with similar characteristics for both the lessees and lessors.

Short-term leases

Lessees may elect to account for lease payments within short-term lease arrangements as an expense on a straight-line basis over the lease term or another systematic basis. Short-term leases are those with a lease term of 12 months or less and containing no purchase options.

Leases with small-value underlying assets

Lessees may elect to treat as exceptions form recognition under IFRS 16 leases where the underlying asset has a low value when new. Although the standard itself does not specify the value threshold above which assets cannot be classified as small-value assets, it does provide some examples such as IT equipment or office equipment. Automobiles are not in the category of small-value assets.

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

2.4. Application and Impact of the New and Revised International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS") (Continued)

2.4.1. Effects of First-Time Adoption of IFRS 16 - Leases (Continued)

Definition of a lease

At the commencement of the lease contract, an entity is to assess whether the contract or a part thereof is a lease. A contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Control is conveyed where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use.

Under IFRS 16, a lease contract transfers the right of use of the identified asset to the lessee if the following two criteria are met:

- the lessee will obtain real economic benefits from the use of the asset during the period of usage (the lessee shall have the exclusive right of use of the asset; and
- the lessee will have the right to make decisions about how the asset will be used during the lease term.

Accounting for the lease

Following the commencement of the lease contract, IFRS 16 requires that lessees recognize all the leases within the balance sheet (statement of financial position). Accordingly:

- the lessee shall recognize depreciation of right-of-use assets during the lease term (mostly on a straight-line basis), along with the amortized cost of the lease liability; and
- the annual leasing costs should represent the depreciation charge of the right-of-use assets and interest on lease liabilities (the leasing costs will be dropping during the lease term due to lower interest on the decreasing principal amount).

Initial recognition and measurement of the right-of-use assets

At the inception of a lease (e.g., on a date when the lessor places certain assets to the disposition of the lessee), the lessee should recognize and measure the right-of-use assets using the cost method, as follows:

- an amount equal to the lease liability;
- plus any amounts prepaid by the lessee on the date or prior to the date of the lease commencement, less any discounts granted by the lessor;
- plus any direct lease costs (costs that would not have been incurred had there been no lease, e.g., lease commissions); and
- plus estimated costs of dismantling, removal and/or restoration of assets to the specified condition.

Initial recognition and measurement of the lease liability

At the inception of a lease, lessees recognize lease liabilities in the amount of the present value of the minimum future lease payments (discounted value).

IFRS 16 was issued in January 2016 and is effective for the reporting periods beginning on or after January 1, 2019.

First-time adoption impact

Based on the estimates made so far, upon initial measurement, the new standard application will result in increase in right-of-use assets about BAM 1,181 thousand and the lease liabilities (the aggregate principal amount) will increase by the same amount. In addition, the application of IFRS 16 will lead to reallocation of the previous leasing costs to the depreciation charge and costs of interest on the lease liabilities. The costs will be higher in the first years of the lease term, and they will decrease in the later periods in comparison to the previously effective IAS 17, due to the calculation of interest on the decreasing lease liability principal.

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

2.4. Application and Impact of the New and Revised International Financial Reporting Standards (“IFRS”) and International Accounting Standards (“IAS”) (Continued)

2.4.2. Effects of First-Time Adoption of IFRS 15 – Revenue from Contracts with Customers

New IFRS – Revenue from Contracts with Customers defines the timeframes and amounts for recognition of revenues from contracts with customers. The standard’s basic principle is that a reporting entity should recognize revenue in the amount of the consideration it expects to receive in exchange for transfer of goods and services to customers, when the contractual performance obligation has been fulfilled, i.e., control over the goods or services transferred to the customer. IFRS 15 is not applicable to the following types of contracts:

- leases within the scope of IAS 17;
- insurance contracts within the scope of IFRS 4;
- financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures;* and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Accordingly, the interest income and dividend income are no longer within the scope of the standard for revenue recognition. Instead, they are covered by IFRS 9 – *Financial Instruments* and IAS 39 – *Financial Instruments: Recognition and Measurement*. Since the Bank earns revenues primarily from the financial instruments that are excluded from the scope of IFRS 15, application of the standard will not result in significant changes within the Bank.

Adoption of IFRS 15 did not affect the time or amount of recognized income from fees and commissions from the contracts with customers and related assets. IFRS 15 supersedes clauses on current income recognition pf IAS 11, IAS 18 and the relating interpretations.

IFRS 15 is effective for period beginning on or after January 1, 2018.

2.5. Departures of the Local Regulations from the Requirements of IAS and IFRS

Although based on the International Financial Reporting Standards (“IFRS”), the statutory accounting requirements used for preparation of these financial statements differ in one significant aspect from IFRS, as stated below:

- Based on the Guidelines on the Treatment of Emergency Acquired Assets Received as Partial or Full Payment of Debts enacted by the Banking Agency of the Republic of Srpska (BARS), banks were obligated to sell such tangible assets held for sale within a year from the acquisition date, whereas as from the date after the expiry of the said deadline, the banks were under obligation to carry such assets in their books of account at the amount of BAM 1, which was a departure from IAS/IFRS (IAS 2 “Inventories“ and IFRS 5 “Non-Current Assets Held for Sale and Discontinued Operations“).The aforecited Guidelines were effective up to August 6, 2013, when the Banking Agency of the Republic of Srpska enacted Decision on cessation of effect of the Guidelines on the Treatment of Emergency Acquired Assets Received as Partial or Full Payment of Debts thereby abrogating the Guidelines, whereafter the Bank has recognized the such assets at cost. Following the initial recognition, the Bank carries such assets (properties) at the lower of cost/purchase price and net realizable value. According to the Bank’s estimates, the net realizable value of the assets acquired in lieu of debt collection, which were stated at technical value as of reporting date, amounted to BAM 274 thousand as of December 31, 2018(December 31, 2017: BAM 331 thousand).

Accordingly, the accompanying financial statements, which have been prepared in accordance with the statutory accounting requirements for banks of the Republic of Srpska are not equivalent to nor do they represent a set of financial statements in full compliance with IFRS.

(Thousands of BAM)

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

2.6. Reclassification

For better presentation and harmonization with the newly effective IAS and IFRS, the Bank applied a new financial reporting format and reclassified for that purpose certain line items of the statement of profit or loss for 2017.

2017 item reclassified	2017 reclassified	Reclassification	2017 previously stated	2017 item previously stated
Statement of profit or loss				*Statement of profit or loss*
Interest income	-	(29,835)	29,835	Interest income
Net banking income	**33,867**	-	-	
Interest income calculated using the effective interest method	29,835	29,835	-	
Other interest income	48	48	-	
Interest expenses	(8,039)	(66)	(7,973)	Interest expenses
Net interest income	**21,844**	**(18)**	**21,862**	**Net interest income**
Fee and commission income	13,936	(137)	14,073	Fee and commission income
Fee and commission expenses	(1,913)	(7)	(1,906)	Fee and commission expenses
Net fee and commission income	**12,023**	**(144)**	**12,167**	**Net fee and commission income**
	-	95	(95)	Net foreign exchange losses
	-	136	(136)	Net trading losses
Other operating income	-	(5,367)	5,367	Other operating income
Net profit from financial instruments	86	86	-	
Other operating income	3,562	3,562	-	
Other operating expenses	(7,888)	(7,888)	-	
Total operating income	**29,627**	**-**	**-**	
Staff costs	(13,923)	(67)	(13,856)	Staff costs
Depreciation/amortization charge	(2,176)	-	(2,176)	Depreciation/amortization charge
	-	668	(668)	Expenses per CHF incentives
	-	18,353	(18,353)	Other operating expenses
Other administrative costs	(13,784)	(13,784)	-	
	-	**-**	**4,112**	**PROFITBEFORE IMPAIRMENT LOSSES AND PROVISIONS**
Total operating expenses	**(29,883)**	-	-	
OPERATING PROFIT/(LOSS) BEFORE CREDIT RISK PROVISIONS	**(256)**	-	-	
Provisions for potential losses, commitments and write-offs	4,724	2,509	2,215	Provisions for potential losses, commitments and write-offs
	-	633	(633)	Provisions for other risks and contingent liabilities
	-	1,213	(1,213)	Impairment losses on property, equipment and intangible assets
	-	13	(13)	Losses on fair value adjustment of investment property
PROFIT BEFORE TAXES	**4,468**	**-**	**4,468**	**PROFIT BEFORE TAXES**
Income tax expense	**7**	**-**	**7**	Income tax expense
Net profit for the year	**4,475**	**-**	**4,475**	**Net profit for the year**

(Thousands of BAM)

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

2.6. Reclassification (Continued)

For better presentation and harmonization with the newly effective IAS and IFRS, the Bank applied a new financial reporting format and reclassified for that purpose certain line items of the statement of financial position as of December 31, 2017.

2017 item reclassified	2017 reclassified	Reclassification	2017 previously stated	2017 item previously stated
ASSETS				
Cash and balances held with the Central bank	121,863	-	121,863	Cash and balances held with the Central bank
Balances held with other banks	19,410	-	19,410	Balances held with other banks
Financial assets held for trading	-	-	-	
Loans and receivables	524,232	-	-	
Loans and receivables due from banks	-	-	-	
Loans and receivables due from customers	522,019	-	522,019	Loans and receivables due from customers
Other financial assets	2,213	2,213	-	
	-	-	-	Derivative financial assets
Investments in securities	2,258	2,258	-	
	-	(2,258)	2,258	Financial assets available for sale
Equity investments	-	-	-	
Property and equipment	29,997	-	-	
Land, buildings and equipment	27,609	-	27,609	Property and equipment
Investment property	2,388	2,388	-	
Intangible assets	4,438	-	4,438	Intangible assets
	-	(2,388)	2,388	Investment property
Tax assets	1,212	-	-	
Receivables for prepaid income taxes	1,212	-	1,212	Receivables for prepaid income taxes
Deferred tax assets	-	-	-	
	-	(1,891)	1,891	Other financial assets
Assets held for sale	545	-	545	Assets held for sale
Other assets	5,353	(322)	5,675	Other assets
Total assets	**709,308**	**-**	**709,308**	**Total assets**
LIABILITIES				
Financial liabilities held for trading	-	-	-	
Financial liabilities at amortized cost	546,540	-	-	
Deposits due to banks and financial institutions	50,047	-	50,047	Deposits due to banks and financial institutions
Deposits due to customers	459,381	-	459,381	Deposits due to customers
Borrowings	28,300	-	28,300	Borrowings
Other financial liabilities	8,812	8,812	-	
	-	-	-	Liabilities per derivative financial instruments
	-	(8,166)	8,166	Other financial liabilities
	-	(4,542)	4,542	Other liabilities
Other provisions	6,737	-	6,737	Other provisions
Tax liabilities	589	-	-	
Current tax liabilities	-	-	-	
Deferred tax liabilities	589	-	589	Deferred tax liabilities
Other liabilities	3,896	3,896		
Total liabilities	**557,762**	**-**	**557,762**	**Total liabilities**
EQUITY				**EQUITY**
Issued (share) capital	153,094	-	153,094	Issued (share) capital
Regulatory reserves for credit losses	61,826	-	61,826	Regulatory reserves for credit losses
Revaluation and fair value reserves	2,189	-	2,189	Revaluation reserves
Accumulated losses	(65,563)	-	(65,563)	Accumulated losses
Total equity	**151,546**	**-**	**151,546**	**Total equity**
Total liabilities and equity	**709,308**	**-**	**709,308**	**Total liabilities and equity**

(Thousands of BAM)

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

2.7. Effects of the First-Time Adoption of IFRS 9 9

The table below presents carrying value adjustments made as a result of the first-time adoption of IFSR 9 as of January 1, 2018:

	December 31, 2017	Derecognition of provisions under IAS 39 January 1, 2018	Inclusion of suspended interest January 1, 2018	Provisions under IFRS 9 January 1, 2018	January 1, 2018
ASSETS					
Cash and balances held with the Central bank	121,863	-	-	(968)	120,895
Balances held with other banks	19,410	15	-	(43)	19,382
Financial assets held for trading	-	-	-	-	-
Loans and receivables	524,232	110,955	1,106	(112,734)	523,559
Loans and receivables due from customers	522,019	108,568	1,106	(110,330)	521,363
Other financial assets	2,213	2,387	-	(2,404)	2,196
Investments in securities	2,258	-	-	-	2,258
Property and equipment	29,997	-	-	-	29,997
Intangible assets	4,438	-	-	-	4,438
Tax assets	1,212	-	-	-	1,212
Assets held for sale	545	-	-	-	545
Other assets	5,353	-	-	-	5,353
Total assets	**709,308**	**110,970**	**1,106**	**(113,745)**	**707,639**
LIABILITIES					
Financial liabilities held for trading	-	-	-	-	-
Financial liabilities at amortized cost	546,540	-	-	-	546,540
Other provisions	6,737	(2,546)	-	1,260	5,451
Tax liabilities	589	-	-	-	589
Other liabilities	3,896	-	-	-	3,896
Total liabilities	**557,762**	**(2,546)**	**-**	**1,260**	**556,476**
EQUITY					
Issued (share) capital	153,094	-	-	-	153,094
Regulatory reserves for credit losses	61,826	113,516	1,106	(115,097)	61,351
Other reserves from profit	-	-	-	-	-
Revaluation and fair value reserves	2,189	-	-	92	2,281
Accumulated losses	(65,563)	-	-	-	(65,563)
Total equity	**151,546**	**113,516**	**1,106**	**(115,005)**	**151,163**
Total liabilities and equity	**709,308**	**110,970**	**1,106**	**(113,745)**	**707,639**

Comments:

1) Provisions previously made under IAS 39 in the total amount of BAM 113,516 thousand were derecognized and transferred to equity;

2) Previously suspended interest in the total amount of BAM 1,106 thousand, net of internal write-offs, was included in the statement of financial positions, within equity. The gross amount of the previously suspended interest totaled BAM 19,516 thousand, while internal write-offs amounted to BAM 18,410 thousand;

3) The final balance of provisions under IFRS 9 amounted to BAM 115,097 thousand as of January 1, 2018;

4) The total effect on the regulatory reserves for credit losses was a decrease of BAM 475 thousand.

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

2.8. Going Concern

The accompanying financial statements have been prepared on a going concern basis, which entails that the Bank will continue to operate in the foreseeable future.

Throughout 2018 the Bank performed its operations in compliance with the effective legislation.

Upon calculation of the capital and capital adequacy ratios, the Bank implemented the new Law on Banks, where the Bank's regulatory capital ratio equaled 24.50%, and the regular core capital ratio was 23.42%. Based on the foregoing ratios, it is evident that the Bank had a solid capital position and that it meets the requirements and criteria for maintaining capital buffers.

During the year, the Bank's liquidity levels ranged within the limits prescribed by the Banking Agency of the Republic of Srpska. It should be noted that, after the milestone of 2017, in 2018 the Bank continued to operate profitably, with the net profit of BAM 3,285 thousand.

Given the Bank's solid capital position, and its focus on straightforward banking with attractive credit product mix, along with improvements in service digitalization, the Bank's management concluded that these financial statements may be prepared on a going concern basis, which entails that the Bank will continue to operate in the foreseeable future.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Basis of Consolidation

i. Business Combinations

Business combinations are accounted for using the acquisition method at the acquisition date, which is the date on which control is transferred to the Bank. The Bank controls an entity if it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In reassessing its conclusion on the existence of control, the Bank has taken into consideration the structured entities and entities with receivables classified as irrecoverable or partially recoverable, for which it reassessed whether the key decisions are made by the Bank and whether the Bank is exposed to variability of returns from those entities.

ii. Investments in Subsidiaries

Consolidated financial statements used to be prepared for the Bank/Group until December 31, 2017 and included consolidated financial statements of the Bank and entity Hypo-Alpe-Adria Leasing d.o.o., Banja Luka under the Bank's control (subsidiary) up to September 7, 2017, when the liquidation procedure was instigated, where by the Bank lost control over its subsidiary. The equity investment (interest) held in the subsidiary was stated at cost net of impairment allowance in the Bank's stand-alone financial statements. Accordingly, the Bank did not need to prepare the consolidated financial statements for FY 2018.

Subsidiaries are consolidated from the date when effective control is transferred to the Bank/Group and are no longer consolidated from the date of disposal. All intercompany transactions, balances and unrealized gains and losses on transactions between the entities within the Group have been eliminated in preparing the consolidated financial statements. Where necessary, the accounting policies used by the subsidiary have been changed to ensure consistency with the policies adopted by the Bank.

iii. Transactions Eliminated upon Consolidation

Intragroup balances and transactions, and unrealized income and expenses (except for foreign currency transaction gains or losses) arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealized losses are eliminated in the same way as unrealized gains, but only if there is no evidence of impairment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Interest Income and Expenses

Interest income and expenses are recognized in the statement of comprehensive income as they accrue for all interest-bearing instruments using the effective interest method. Interest income and expenses are accounted for on an accrual basis. The effective interest method is a method that calculates the costs of repayment of financial assets or financial liabilities and the costs of recognition of interest income or interest expense over a period. The effective interest rate is the rate that precisely discounts the estimated future cash disbursements or payments over the expected life of a financial instrument or, as appropriate, a shorter period, to the net carrying value of the financial asset or liability. When calculating the effective interest rate, the Bank estimates cash flows, taking into consideration all contractual terms related to the financial instrument (e.g. advance payments) but not considering future credit losses. The calculation includes all fees and commissions paid or received, which are a constituent part of the effective interest rate, transaction costs and all other premiums and discounts.

Interest income and expenses also include fee and commission income and expenses relating to loan origination and other differences between the initial carrying value of a financial instrument and its value at maturity, which are recognized using the effective interest rate.

3.3. Fee and Commission Income and Expenses

Fees and commissions are generally recognized on an accrual basis when due for collection i.e. when the relevant service has been rendered,

Such fees and commissions relate to domestic and foreign payment transactions, off-balance sheet operations (issuance of guarantees), broker-dealer operations and the like.

Fee and commission expenses relate to fees paid to the Central Bank of Bosnia and Herzegovina for the local payments operations, SWIFT costs, costs of payment card operations and other fees (Note 8).

3.4. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into the functional currency at official rates effective at the date of each transaction. Assets and liabilities denominated in foreign currencies on the statement of financial position date are translated into BAM by applying official rates of exchange effective on that date. Contingent liabilities denominated in foreign currencies are translated into BAM at official exchange rates effective at the statement of financial position date.

Foreign exchange effects arising from translation are credited or charged to the profit or loss statement. The Bank has no monetary securities denominated in foreign currencies.

Exchange rates used in these financial statements are official rates established by the Central Bank of Bosnia and Herzegovina (“CBBH”).

3.5. Employee Benefits

Short-Term Employee Benefits

Short-term benefits include employee salaries and benefits and all the related taxes and contributions payable to the Republic of Srpska social security and pension funds, calculated by applying the specific percentage rates which are stipulated by the relevant regulations. Short-term employee benefits are recognized as expenses in the period in which they are incurred.

Retirement Benefits and Annual Leave (Vacation) Entitlements

According to the Collective Bargaining Agreement of the Republic of Srpska financial organizations, employees are entitled to receive benefits upon retirement. The retirement benefit liability recognized in the statement of financial position represents the present value of the defined benefit liabilities as determined by actuarial calculations.

Provisions for retirement benefits and annual leave (vacation) entitlements are disclosed in the statement of financial position within “other liabilities.”

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5. Employee Benefits (Continued)

Retirement Benefits and Annual Leave (Vacation) Entitlements (Continued)

Retirement benefits provisions are based on actuarial reports and are used only for the purposes they are intended for. At each year-end, accuracy and adequacy of the amounts of provisions for retirement benefits and annual leave entitlements are assessed. In accordance with amendments to IAS 19, changes in retirement benefits are included in “staff costs” within the statement of profit or loss unless they relate to actuarial gains or losses. Otherwise, such changes are immediately recognized in other comprehensive income. Benefits falling due more than 12 months after the statement of financial position date are discounted to their present value.

3.6. Income Taxes

Current Income Tax

Current income tax relates to the amount calculated and paid in accordance with the Corporate Income Tax Law. Current income tax is payable at the rate of 10% applied to the tax base determined in the taxa statement 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 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 taxes are calculated on all temporary differences between tax base of assets and liabilities and their carrying amounts stated in financial statements of the Bank. Deferred tax liabilities are recognized for all taxable temporary differences between the tax base of assets and liabilities at the statement of financial position date and carrying values reported in the financial statements, which will result in future period taxable amounts.

Deferred tax assets are generally recognized for all deductible temporary differences, unused tax assets and unused tax losses to the extent that it is probable that taxable profits will be available against which those deductible temporary differences, unused tax credits and unused tax losses can be utilized.

Deferred tax assets are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences against profits earned.

3.7. Cash and Cash Equivalents

For purposes of the cash flow statement, cash on hand, balances on the accounts held with the Central Bank, foreign currency accounts with foreign and domestic banks and short-term deposits with maturities of up to 30 days held with foreign and domestic banks are all considered to be cash equivalents.

3.8. Financial Instruments

3.8.1. IFRS 9 - Financial Instruments – Business Model

Business Model

In order to classify financial assets in accordance with IFRS 9, the Bank needed to do the following two steps:

(i) assess the characteristics of the contractual cash flows of assets, i.e., perform the so-called SPPI test (whether the cash flows of an asset represent solely payments of principal and interest on the principal amount outstanding), and

(ii) assess the business model the assets are held within.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.1. IFRS 9 - Financial Instruments – Business Model (Continued)

Business Model (Continued)

By its business model, the Bank demonstrates in what manner it manages its financial assets in order to generate cash flows, in other words, whether it will generate the cash flows from collection of the instruments' contractual cash flows, by selling the financial assets or both. The model assessment is conducted based on the scenario the Bank can reasonably anticipate. This means that the assessment does not include the so-called "worst case scenario" or the "stress case scenario".

Taking into account analyses of the historical cash flow generation and anticipated sales for the future, the Bank has the following business models:

- **Held-to-Collect model,** which includes loans due from customers;
- **Held-to-Collect-and-Sale model**, which includes a portfolio of debt securities available for sale; and
- **Other business model,** which includes a trading securities' portfolio.

Under 9.4.1.1(a), financial assets are classified according to the business model for managing those assets except in cases to which paragraph IFRS 9.4.1.5 is applicable. The Bank assesses whether its financial assets meet the condition defined in paragraph IFRS 9.4.1.2(a) or paragraph IFRS 9.4.1.2A(a) based on the business model defined by the Bank's key management (as defined by IAS 24 – *Related Party Disclosures*).

A business model is determined at the level reflecting the manner in which groups of financial assets are jointly managed to achieve a certain business goal. The business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, there may be more than one business model for managing the financial instruments. Therefore, classification is determined at the reporting entity (Bank) level.

For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realize gains on the fair value changes. Similarly, an entity may decide that i tis appropriate to divide a portfolio of financial assets into sub-portfolios in order to present the level at which the entity manages its financial assets. This may be the case, for instance, when the entity creates or purchases a portfolio of mortgage loans and manages some of these loans in order to collect the contractual cash flows and the other loans are intended for sale.

The Bank shows by way of its business model the manner in which it manages its financial assets in order to generate cash flows, i.e., the business model demonstrates whether the Bank will generate the cash flows from (i) collection of the contractual cash flows, (ii) sales of the financial assets, or (iii) both these sources. This is why the business model assessment is not made based on the so-called "worst case scenario" or the "stress case scenario".

For example, the Bank expects to sell a certain portfolio of financial assets within the stress case scenario. Such a scenario does not affect the assessment of the Bank's business model for those particular assets if the Bank reasonably anticipates that such a scenario will not occur.

If the cash flows were realized in a manner different form the Bank's expectation as of the business model assessment date (e.g., more or less financial assets are sold than anticipated upon classification of those assets), that will not be the cause of the previous period misstatement in the Bank's financial statements (refer to IAS 8), or change the classification of the remaining financial assets within the business model (assets recognized by the Bank in prior periods and still held) on condition that, in assessing the business model, the Bank has taken into account of the relevant information available at the time of assessment. However, when the Bank assesses the business model for newly originated or purchased financial assets, it must consider the information on the historical cash flows along with all the other relevant information.

This means that there is no concept which is the same as that for treatment of the financial assets held to maturity under IAS 39. Rather, the manner of realizing the cash flows changes and it will affect classification of the new assets upon initial recognition in the future.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.1. IFRS 9 - Financial Instruments – Business Model (Continued)

Business Model (Continued)

The Bank's business model is a fact and not a mere representation. It may usually be monitored through the activities taken by the Bank to achieve the objective defined by the business model. The Bank assesses the business model for management of its financial assets based on the evaluation, based not only upon a single factor or activity but on all the relevant evidence available as of the model assessment date.

Held-to-Collect Model

The Bank manages financial assets held within the business model whose objective is to hold the assets in order to collect the contractual cash flows so as to generate cash flows from collection of particular contractual cash flows over the instrument's life. This means that the Bank manages the assets held in the portfolio to collect the contractual cash flows (rather than manage the overall turnover per such a portfolio by holding and selling the assets). Upon determining whether the cash flows will be generated from the collection of the contractual cash flows of the financial assets, the Bank considers the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. The sale activity is not to be considered in isolation since the business model cannot be determined solely based on the sales. Instead, the Bank needs to consider both the historical sale information as well as the expectations of the future sales as part of an overall assessment on how the Bank´s stated objective for managing the financial assets is achieved and how the cash flows are realized. However, the information on the historical sales need to be regarded within the context of the particular sale and conditions prevailing at that time, which are to be compared and contrasted to the current conditions.

Although the objective of the Bank's business model may be to hold financial assets in order to collect contractual cash flows, the Bank need not hold all of those instruments until maturity, so that the business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or is expected to occur in the future.

Although the objective of the Bank's business model may be to hold financial assets in order to collect contractual cash flows even if the Bank sells the financial assets, which may be:

- If there has been a **significant increase in the credit risk** of those assets. When determining whether the credit risk (i.e., risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider reasonable and supportable information, including forward-looking information. Irrespective of the frequency and volume of sales of financial assets due to significant increase in the credit risk of those assets, such sales are not deemed **inconsistent** with the business model whose objective is to hold financial assets to collect the contractual cash flows since it is the quality of the financial assets that is relevant to the Bank's ability to collect the contractual cash flows. An integral part of such a business model are activities of credit risk management aimed at minimizing potential credit losses due to the credit quality deterioration. An example of the sales due to a significant credit risk increase is a sale of financial assets because the assets no longer meet the credit quality criteria defined by the Bank's documented investment policy. However, if the Bank has no such policy in place, the Bank may otherwise present that the sale was made due to the increase in the credit risk.

- Sales for other reasons, such as **credit concentration risk management** (without an increase in the credit risk of financial assets), may also be consistent with the Bank's business model whose objective is to hold financial assets to collect the contractual cash flows. Such sales may particularly be consistent with the business model whose objective is to hold financial assets to collect the contractual cash flows if the sales are not frequent (even if the volume, i.e., amounts of such sales are significant) or if the value of an individual sale or of the aggregate sales is immaterial (even if the number of such sales is large).

  If multiple sales are made within the portfolio (the number of which is higher than the immaterial number) and if the value of such sales is higher than the immaterial value (individually or in the aggregate), the Bank needs to assess whether and how such sales are consistent with the objective to collect the contractual cash flows.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.1. IFRS 9 - Financial Instruments – Business Model (Continued)

Held-to-Collect Model (Continued)

For such an assessment, the information whether the sales are imposed on the Bank by a third party or the Bank has decided to sell the assets on its own is irrelevant. Increase in the frequency or value of the sales over the specific period is not necessarily inconsistent with the objective of holding the financial assets to collect the contractual cash flows if the Bank can provide a rationale for such sales and demonstrate why such sales do not mean a change of the business model.

- Further, a sale may be consistent with the objective of holding the financial assets to collect the contractual cash flows if the sale occurs **shortly before maturity of the financial assets** and if the gain on the sale approximate the amount of collection of the remaining cash flows.

Transferred Financial Assets not Derecognized

In various circumstances the Bank may sell financial assets yet such assets still remain within its statement of financial position, for example, in “repo” transactions, when the Bank sells debt securities and at the same time agrees to repurchase them at a fixed price. In such instances, the seller retains substantially all the risks and rewards of the ownership of such assets and does not derecognize the financial assets in accordance with the requirements of IFRS 9. For the purpose of the business model assessment, it is the accounting treatment rather than the legal form of the transaction that determines whether the entity has stopped holding the financial assets to collect the contractual cash flows.

Held-to-Collect-and-Sale Model

The Bank may manage financial assets within the business model whose objective achieved by both collection of the contractual cash flows and sales of the financial assets. In such a business model, the senior management has decided that the achievement of the business model objective requires both the collection of the contractual cash flows and sales of the financial assets. Various objectives may consistent with this type of the business model. For example, the objective may be to manage daily liquidity requirements, maintain a certain interest income profile or match the maturities of assets with the maturities of liabilities covered with those assets. In order to achieve such an objective, the Bank will collect the contractual cash flows and sell the financial assets.

Compared to the held-to-collect business model, this model normally entails higher frequency and value of the sales due to the fact that the sale of financial assets is an integral part of achieving the business model’s objective and not just a side effect.

However, there is no threshold for the frequency or value of sales that must be performed within this business model for both collection of the contractual cash flows and sales of the financial assets are elements of achieving the business model’s objective.

Other Business Model

Financial assets are measured at fair value through profit or loss (FVtPL) if not held within the business model whose objective is to collect the contractual cash flows or within the model whose objective is achieved by both collection of the contractual cash flows and sales of the financial assets (para. 5.7.5). The business model resulting in the measurement of the financial assets at FVtPL is a model in which the Bank manages the financial assets in order to generate the cash flows through the sales of assets. The Bank makes decision based on the fair value of assets and manages the assets in order to realize the fair value thereof. In such a case, the Bank’s goal is usually achieved through active sales and purchases. Although the Bank collects the contractual cash flows while holding the financial asset, the objective of this model is not achieved by both collecting the contractual cash flows and selling the assets, because the collection of the contractual cash flows is not an element of achieving the objective of the model but simply represents a side effect.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.1. IFRS 9 - Financial Instruments – Business Model (Continued)

Other Business Model (Continued)

Upon initial recognition, the Bank may make an irrevocable election to classify the instruments at FVtOCI, in order to present all subsequent changes in the fair value of investment in an equity instruments belonging to the scope of IFRS 9, which is not held for trading or is subject to a consideration recognized by the acquirer in a business combination to which IFRS 3 is applicable (para. 4.2.1A).

The portfolio of financial asset managed or resulting in assessment at fair value (as described in IFRS 9.4.2.2(b)) is held neither to collect the contractual cash flows nor to collect the contractual cash flows and sell the assets. Here the Bank is primarily focused on the information on fair value, which is used for assessment of the performance of the financial assets and decision making. In addition, the Bank's portfolio of financial assets meeting the criteria of definition of the financial assets held for trading, is held neither to collect the contractual cash flows nor to collect the contractual cash flows and sell the assets. In such portfolios, collection of the contractual cash flows is simply a side effect in achieving the business model's objective and that is why such portfolios must be measured at fair value through profit or loss.

3.8.2. IFRS 9 - Financial Instruments – Recognition

The Bank recognize,s loans and receivables and other financial liabilities at the date of occurrence, i.e., when disbursed to customers or received from the creditors.

Regular way purchases and sales of financial instruments are recognized on the trading date, i.e., the date when the Bank has become a party to the contractual terms of a particular instrument.

3.8.3. IFRS 9 - Financial Instruments – Classification

The Bank classifies its financial assets into the following categories;

- Financial assets subsequently measured at amortized cost (AC);
- Financial assets measured at fair value through other comprehensive income (FVtOCI); and
- Financial assets measured at fair value through profit or loss (FVtPL).

The Bank may, at initial recognition, **irrevocably** designate a financial asset that would otherwise have to be measured at amortized cost or fair value through other comprehensive income to be measured at fair value through profit or loss if doing so would eliminate or significantly reduce a measurement or recognition inconsistency ('accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.

In addition, the Bank may, at initial recognition, **irrevocably** designate certain investments in equity instruments as financial assets at FVtOCI.

Classification of the financial assets is made based on:

- The business model for management of the financial assets; and
- characteristics of the contractual cash flows of the instruments.

The Bank's management classifies financial assets upon initial recognition. As of December 31, 2018, the Bank had financial assets subsequently measured at amortized cost (AC) and financial assets measured at fair value through other comprehensive income (FVtOCI).

Financial Assets Measured at Amortized Cost (AC)

Financial assets measured at AC are financial assets that meet both of the following two criteria:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows (Held-to-Collect model); and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.3. IFRS 9 - Financial Instruments – Classification (Continued)

Financial Assets Measured at Amortized Cost (AC) (Continued)

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Financial Assets Measured at Fair Value through Other Comprehensive Income (FVtOCI)

Financial assets measured at FVtOCI are financial assets that meet both of the following two criteria:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

Financial Assets and Liabilities Measured at Fair Value through Profit or Loss (FVtPL)

In this category of instruments there are two sub-categories: financial assets held for trading (including derivatives) and those designated by management as carried at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term, for the purpose of short-term profit-taking, or if designated as such by management.

The Bank classifies financial assets and liabilities as financial instruments at fair value through profit or loss when:

- the assets and liabilities are managed, evaluated and reported internally at fair value;
- such designation eliminates or significantly reduces an accounting mismatch that would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance (default) risk.

The fair value of securities quoted in an active market are based on current bid prices. If the market for a financial asset (and the market of unlisted securities) is not active, the Group establishes fair value by valuation techniques. These involve the application of recent arm’s length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques.

3.8.4. IFRS 9 - Financial Instruments – Derecognition

The Bank derecognizes financial assets (in full or partially) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realized, ceded or have expired.

The Bank derecognizes financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognizing that liability and will instantaneously recognize a new financial liability with new terms.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.5. Impairment of Financial Assets

3.8.5.1. Financial Assets Measured at Amortized Cost

Under IFRS 9, impairment covers the following exposures (IFRS 9.5.5.1):

- financial assets that comprise debt instruments such as loans, debt securities, bank balances and deposits and trade receivables, which are measured at amortized cost (AC);
- financial assets measured at fair value through other comprehensive income (FVtOCI);
- Lease receivables within the scope of IAS 17;
- Contractual assets under IFRS 15;
- Borrowings other than those measured at fair value through profit or loss (FVtPL) under IFRS 9 (borrowings designated as FVtPL are excluded);
- Financial guarantee contracts other than those measured at fair value through profit or loss (FVtPL) under IFRS 9 (financial liabilities arising when the transfer of financial assets does not meet the derecognition criteria or when there is continuing involvement are excluded).

At each reporting date, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets has suffered impairment.

A financial asset or a group of financial assets is considered to be impaired and impairment losses are incurred only if there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event'), the estimated future cash flows of the financial asset or group of financial assets have been affected by the event or events, and that the amount of the loss incurred can be reliably estimated. The criteria that the Bank uses to determine that there is objective evidence of an impairment loss are described in its Credit Risk Provisioning Policy – Methodology for measurement of Impairment and Provisions.

For the assessment of the impairment allowances and provisions for credit losses, financial assets may be allocated to Stage 1, Stage 2, Stage 3) and POCI assets (purchased or originated credit impaired assets):

- Stage 1 – includes financial assets where no significant increase of credit risk has been identified since initial recognition or those with low credit risk level at the reporting date. For such assets, provisions based on the 12-month expected credit losses are recognized and interest income is calculated on the gross carrying value of the assets. 12-month expected credit losses (ECL) are expected credit losses arising from default that may occur within 12 months from the reporting date.

- Stage 2 – includes financial assets where a significant increase of credit risk has been identified since initial recognition (unless they have low credit risk level at the reporting date and this option is elected by the Bank), however, there is no objective evidence of impairment and those are not POCI assets. For such assets, provisions based on the lifetime expected credit losses are recognized but interest income is still calculated on the gross carrying value of the assets. Lifetime expected credit losses (ECL) are expected credit losses arising from all possible defaults over the maximum contractual term over which the Bank is exposed to credit risk. Such an expected credit loss is a default-risk-weighted average credit loss. The expected credit loss will be discounted at the reporting date using the effective interest rate or a rate approximating the effective interest rate.

- Stage 3 can be divided into:

  - Stage 3 ii – individual (special) risk provisions – individual imapirment: includes financial assets with objective evidence of impairment at the reporting date. For such assets, provisions based on the lifetime expected credit losses are recognized but interest income is calculated on the net carrying value of the assets.

  - Stage 3 ci – individual (special) risk provisions – collective imapirment: includes financial assets with objective evidence of impairment at the reporting date. For such assets, provisions based on the lifetime expected credit losses are recognized but interest income is calculated on the net carrying value of the assets.

- POCI assets –purchased or originated credit-impaired financial assets are financial assets whose value was impaired upon acquisition, i.e., at the time of purchase or origination, due to significant credit risk (IFRS 9.5.5.13). If a financial asset is deemed to be credit impaired at initial recognition, the Bank ought to recognize such asset as a POCI asset unless it is measured at FVtPL.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.5. Impairment of Financial Assets

3.8.5.1. Financial Assets Measured at Amortized Cost (Continued)

Loss identification period (LIP) is assessed by the management, separately for each portfolio type. This period generally ranges between 3 and 12 months. Exceptionally, it may exceed 12 months.

In accordance with IFRS, the Bank first assesses individually whether there is objective evidence of imapirment of individually significant financial assets and, either individually or collectively, of financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence of the impairment of financial assets carried at amortized cost, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

When a loan is irrecoverable it is written off by derecognition of both the relevant loan and the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

If a loan is written off without the Bank waiving the receivables due from the customer (the so-called internal or accounting write-off), the amount of the receivable written off is at the same time recorded on-balance, within the internal write-off adjustment accounts, and off-balance, within off-balance sheet items. The aforedescribed internal write-off of receivables represents a partial or full write-off when the Bank no longer reasonably expects recovery of the financial assets. The customer’s gross debt toward the Bank remains the same and is communicated to the customer as such, while the internal write-off represents an adjustment to the customer gross exposure and serves for the purposes of accounting and reporting under IFRS 9. internal write-offs are commonly performed for receivables allocated to Stage 3ii and Stage 3ci.

If an internally written-off receivable is subsequently recovered, it is recorded within income, as the recovery of the receivables previously written off.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognized (such as an improvement in the debtor’s credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the profit or loss as the income from reversal of impairment allowance/provision.

Whenever possible, the Bank seeks to restructure loans rather than foreclose collaterals securing loan repayment. If the terms of the financial assets are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, an assessment is made of whether the financial asset should be derecognized. If the cash flows of the renegotiated assets are substantially different, then the contractual rights to cash flows from the original financial assets are deemed to have expired. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. Rescheduled loans will be subject to individual or group-level assessment for impairment and provisioning using the original effective interest rate.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.5. Impairment of Financial Assets (Continued)

3.8.5.2. Financial Assets Measured at Fair Value through Other Comprehensive Income (FVtOCI)

At each reporting date, the Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. In case of securities classified as measured at FVtOCI, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for these financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value – is recognized in the statement of other comprehensive income.

If, in a subsequent period, the fair value of a debt instrument classified as at FVtOCI increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the profit or loss, the increase will be recognized within equity, under fair value reserves until such security is sold.

Interest on debt instruments and foreign exchange gains/losses are recognized directly in the profit or loss. Credit risk provisions for debt instruments are recognized within the statement of profit or loss and other comprehensive income, while their net carrying values remain equal to the fair values within assets, i.e., they are not decreased by the credit risk provisions.

Impairment of financial assets classified as measured at FVtOCI is made in the same manner as the impairment of financial assets measured at AC.

3.8.5.2. Estimation of Potential Losses for Financial Assets in Accordance with the Requirements of the Banking Agency of the Republic of Srpska

In accordance with the Decision of the Banking Agency of the Republic of Srpska on Classification of Assets and Off-Balance Sheet Items according to the Degree of Collectability, the Bank is required to classify loans, investments and other balance sheet and off-balance sheet risk exposures into categories A, B, C, D and E in accordance with the assessment of recoverability of loans and other investments based on regularity and timeliness in liability settlement on the part of the debtor, debtor's financial position and collaterals securitizing collection of receivables. The estimated amount of reserves for potential losses is calculated by applying the following percentages: 2% to loans classified as category A, 5% - 15% to the loans in category B, 16% - 40% to loans in category C, 41% - 60% to loans in category D and 100% to investments in category E.

The difference between impairment allowances determined in accordance with IFRS 9 and estimated provisions for potential losses on loans classified into categories, when negative, is presented as a deductible item in calculation of the capital adequacy.

3.8.6. Offsetting of the financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting regulations, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

3.8.7. Derivative Financial Instruments

Derivative financial instruments are initially recognized in the statement of financial position in accordance with the policy for initial recognition of financial instruments and subsequently remeasured at their fair value. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and options pricing models.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.7. Derivative Financial Instruments (Continued)

All derivatives are carried as assets when their fair value is positive and as liabilities when negative. Changes in the fair value of derivatives are included in the profit or loss statement under “net profit on financial instruments”. All derivatives are classified as held for trading.

Some hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is termed an embedded derivative. When the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealized and realized gains and losses recognized in the profit or loss unless there is no reliable measure of their fair value.

Derivative financial instruments include foreign exchange forward contracts and foreign exchange swaps.

3.8.8. Accounting Policies Applicable up to December 31, 2017

Classification

Up to December 31, 2017 the Bank classified its financial instruments into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; available-for-sale financial assets and other financial liabilities. Management determines the classification of financial instruments upon initial recognition.

As at December 31, 2017, the Bank held loans and receivables, available-for-sale financial assets and financial assets at fair value through profit or loss.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Financial Assets Available for Sale

Financial assets available for sale are those assets which the Bank intends to hold for an indefinite period and which can be sold for liquidity purposes or due to changes in interest rates, exchange rates or changes in equity prices.

Financial assets and Financial Liabilities at Fair Value through Profit or Loss

Financial assets at fair value through profit or loss are assets other than those measured at amortized cost or at fair value through other comprehensive income.

In this category of instruments there are two sub-categories: financial assets held for trading (including derivatives) and those designated by management as carried at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term, for the purpose of short-term profit-taking, or if designated as such by management.

The Bank classifies financial assets and liabilities as financial instruments at fair value through profit or loss when:

- the assets and liabilities are managed, evaluated and reported internally at fair value;
- such designation eliminates or significantly reduces an accounting mismatch that would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.8. Accounting Policies Applicable up to December 31, 2017 (Continued)

Classification (Continued)

Other Financial Liabilities at Amortized Cost

Other financial liabilities comprise all financial liabilities that are not measured at fair value through profit or loss and include amounts due to customers, due to banks and other financial institutions, and subordinated debt.

Initial and Subsequent Measurement

Investments are initially recognized at fair value increased by transaction costs for all financial assets and liabilities not carried at fair value through profit or loss. Financial assets are derecognized at a time when the Bank has transferred substantially all the risks and rights arising from ownership of the assets or when the Bank's right to receive cash flows arising from financial assets has expired.

Financial assets measured at fair value through other comprehensive income (FVtOCI) is subsequently stated at fair value. Gains and losses on the fair value adjustments of the financial assets at FVtOCI are recorded within equity until derecognition or recording an impairment loss, when cumulative gain or loss, previously recognized within equity may be reclassified to the retained earnings within equity. However, the interest calculated using the effective interest method is recognized within the statement of profit or loss. Dividend income is recognized within profit or loss went the Bank's entitlement to receive dividend has been established.

Available-for-sale financial assets and financial assets carried at fair value through profit and loss are subsequently stated at fair value. Loans and receivables as well as assets held to maturity are measured at amortized cost using the effective interest method. Gains or losses arising from fair value adjustments of financial assets carried at fair value through profit and loss are recognized in the statement of profit or loss or comprehensive income in the period when earned/incurred. Gains and losses arising from fair value adjustments of financial assets available for sale are directly stated in equity, until their derecognition or impairment charges, when the cumulative income or expense previously recognized in equity is recognized in the statement of profit or loss. However, interest calculated using the effective interest method is recognized in the statement of profit or loss. Dividends are recognized in the statement of comprehensive income when the entity's right to receive payment is established.

Impairment of Financial Assets

Financial Assets Carried at Amortized Cost

At each reporting date, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets has suffered impairment.

A financial asset or a group of financial assets is considered to be impaired and impairment losses are incurred only if there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event'), the estimated future cash flows of the financial asset or group of financial assets have been affected by the event or events, and that the amount of the loss incurred can be reliably estimated. The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include the following:

- Significant financial difficulty of the counterparty;
- Delay in liability settlement of over 90 days for materially significant amounts;
- Allocation of higher risk category to the borrower according to the classification of the Banking Agency of the Republic of Srpska;
- Allocation of low credit rating to the borrower according to the internal credit rating scale;
- Loan restructuring (significant changes in loan terms, interest rate decrease, partial grace periods granted) necessary due to the credit (financial) situation (not caused by market conditions or technical changes); this includes extensions;

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.8. Accounting Policies Applicable up to December 31, 2017 (Continued)

Impairment of Financial Assets

Financial Assets Carried at Amortized Cost (Continued)

- Reduced loan coverage, e.g. caused by decrease in value of collaterals (particularly with regard to project financing) if other cash flow sources are insufficient;
- Debtor's non-cooperation in instances of evident and documented repayment difficulties; and
- Liquidation or bankruptcy of the debtor.

In instances of reduced loan coverage, e.g. caused by decrease in value of collaterals (particularly with regard to project financing) the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is an objective evidence of the impairment of financial assets carried at amortized cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

When a loan is irrecoverable it is written off by derecognition of both the relevant loan and the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the profit or loss as the income from reversal of impairment allowance.

When possible, the Bank seeks to restructure loans rather than foreclose collaterals securing loan repayment. If the terms of the financial assets are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, an assessment is made of whether the financial asset should be derecognized. If the cash flows of the renegotiated assets are substantially different, then the contractual rights to cash flows from the original financial assets are deemed to have expired. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. Rescheduled loans will be subject to individual or group-level assessment for impairment and provisioning using the original effective interest rate.

Assets Classified as Available for Sale

At each reporting date, the Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value is recognized in the statement of profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial Instruments (Continued)

3.8.8. Accounting Policies Applicable up to December 31, 2017 (Continued)

Impairment of Financial Assets (Continued)

Assets Classified as Available for Sale (Continued)

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the profit and loss to the extent of the previously recognized losses, whereas the remaining amount is recognized within equity under revaluation reserve until such security is sold.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognized in other comprehensive income.

Reclassification

A financial asset classified as available for sale that would have met the definition of loans and receivables (had it not been designated as available for sale) may be reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity. For a financial asset reclassified out of the available-for-sale category, any previous gain or loss on that asset that has been recognized in other comprehensive income shall be amortized to profit or loss over the remaining life of the asset using the effective interest method.

3.9. Equity Investments

Equity investments in subsidiaries are measured at cost less impairment, if any. At each reporting date, the Bank assesses whether there is impairment of equity investments in the subsidiaries. These are consolidated under the full consolidation method and included in the consolidated financial statements of the Group.

3.10. Property and Equipment

Land, Buildings and Equipment

Property and equipment are carried at their fair value, as periodically determined by certified appraisers, subsequently decreased by the accumulated depreciation and impairment, if any.

Subsequent expenditures are included in the asset’s carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repair and maintenance costs are charged to the statement of comprehensive income during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of buildings and equipment are credited to equity as revaluation reserve. The increase is recognized in the profit or loss statement only to the extent that it reverses a revaluation decrease of the same asset previously recognized as an expense in the profit or loss. If an asset’s carrying amount is decreased as a result of a revaluation, the decrease is recognized as an expense in the profit or loss statement. The decrease is debited directly to revaluation reserve within equity to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Revaluation reserves included in equity in respect of property and equipment are transferred directly to retained earnings successively (annually) or when the asset is derecognized. This may involve transferring the entire revaluation reserves when the asset is retired or disposed of.

(Thousands of BAM)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.10. Property and Equipment (Continued)

Land, Buildings and Equipment (Continued)

Land is not depreciated. Depreciation of other assets is calculated based on their cost or previously revalued amounts using the straight-line method to allocate their cost or revalued amounts to the residual value of the assets over their estimated useful lives:

	Depreciation Rate	Useful Life (years)
Buildings	1.18% - 3.33%	30 - 85
Computer equipment	20.00%-33.33%	3 - 5
Furniture and other equipment	6.67% - 33.3%	3 - 15

Management believes that depreciation rates applied fairly reflect the economic useful lives of property and equipment.

Gains and losses on disposal of assets are determined as the difference between the proceeds from the disposal and the carrying amounts of assets and are recognized in the profit or loss statements within gains or losses on the sale of disposal of property and equipment.

Investment Property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in supply of goods or services or for administrative purposes. Investment property is initially measured at cost increased by transaction costs. Subsequent to initial recognition, investment property is stated at fair value. Gains or losses arising from changes in the fair value are included in the profit or loss statement in the period in which they arise. When the use of a property changes from owner-occupied to investment property, the property is remeasured to fair value and reclassified as investment property.

Investment properties are derecognized when either they have been disposed of or when the investment property is permanently retired from use and no future economic benefit is expected from its disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognized in the income statement in the period of derecognition.

3.11. Intangible Assets

Intangible assets are stated at fair value as periodically determined by valuation, net of accumulated amortization. Intangible assets include computer software and licenses.

The Bank recognizes an intangible asset only if it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. Such investments are capitalized at cost.

Revaluations of intangible assets are conducted regularly so that the carrying amounts do not differ significantly from the amounts that would be recognized by determining the fair values of assets at the statement of financial position date. If the carrying amount of an intangible asset is increased as a result of revaluation, the increase is directly recorded as an increase in the revaluation reserves within equity.

If the carrying amount of an intangible asset is reduced as a result of revaluation, the decrease should be recognized as an expense unless the revaluation reserve has not been previously formed or directly charged to the revaluation reserve.

Intangible assets are derecognized when they are sold or when there are no future economic benefits expected from their use. Gains or losses arising from the retirement or disposal of an intangible asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and recognized as income or expenses in the profit or loss statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11. Intangible Assets (Continued)

The estimated useful lives of intangible assets are as follows:

	Amortization Rate	Useful Life (years)
Intangible assets	9.83% - 33.33%	3 - 10

3.12. Leases

Leases in which the Bank, as the lessee, assumes all the risks and rewards of ownership, are classified as finance leases. All other leases are operating leases.

a) Finance Leases

Finance lease is a lease that, substantially, transfers all the risks and rewards incidental to ownership of the leased item. After the expiry of the lease period, the right of ownership can but need not be transferred.

Upon initial recognition, the Bank as the lessor recognizes the funds given to finance lease in the statement of financial position as long-term financial investments equal to the amount of the purchase value of the leased asset plus future interest.

Gross investment in the lease represents the total amount of all minimum lease payments and any non-guaranteed residual value attributable to the lessor. Net investment in the lease equals gross investment in the lease as decreased by the unearned finance income calculated at an interest rate defined by the relevant lease contract. Investments in the lease stated in the statement of financial position as long-term financial investments are subsequently measured at amortized cost less the assessed allowance for impairment.

Finance income, i.e. interest income based on the finance lease operations is recognized based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.

b) Operating Leases

The Bank as the Lessor

Leases are classified as operating leases if the terms of the lease do not transfer substantially all risks and rewards of ownership to the lessee.

Assets used for operating lease are recognized within the statement of financial position of the lessor at cost and are depreciated in accordance with the depreciation policy applied to the lessors own assets. Lease income from operating leases (rentals) is recognized as income in the period it refers to.

Initial direct costs incurred by lessors in negotiating and arranging an operating lease may be recognized as expenses of the period when incurred or be added to the carrying amount of the leased asset, deferred and recognized as an expense over the lease term on the same basis as the rental income.

The Bank as the 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 lease are recognized as expenses of the period when incurred.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.13. Tangible Assets Acquired in Lieu of Debt Collection

The Bank occasionally acquires real estate and movable property in lieu of collection of certain loans and receivables.

In accordance with the relevant IAS and IFRS such assets are initially recognized at cost. After the initial recognition, these assets are stated at the lower of the following two values - cost and net realizable value. An impairment loss is recognized whenever the carrying amount of an asset exceeds its net realizable value. Impairment losses are recognized in the profit or loss statement for the year.

Gains and losses on the sales of such assets are recognized in the profit or loss statement for the year.

3.14. Impairment of Non-Financial Assets

All assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets that have an indefinite useful life are not subject to amortization and are tested for impairment whenever there are indications that these may be impaired or at least annually.

An impairment loss is recognized in the amount by which the carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use.

Non-financial assets that are impaired are assessed at each reporting date for possible reversal of the impairment. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reduced up to the amount of the carrying value of the assets which does not exceed the carrying amount that would have been determined, net of accumulated depreciation/amortization, had the impairment loss not been accounted for.

3.15. Financial Liabilities Measured at Amortized Cost

Deposits

Transaction accounts and deposits are initially recognized at fair value, net of transaction costs. Subsequently, they are stated at their amortized cost, using the effective interest rate, and any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the profit or loss statement over the period of their utilization using the effective interest method.

Borrowings

Borrowings are initially recognized at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the profit or loss statement over the period of utilization using the effective interest method.

3.16. Provisions

Provisions for liabilities and charges are maintained at the level that the Bank’s management considers sufficient for absorption of losses. The management determines the sufficiency of provisions based on considerations of into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

Provisions are released only for the expenditures for which they were initially recognized. If an outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

Provisions for restructuring and damage claims/losses per legal suits filed are recognized when:

- the Group has a present legal or constructive obligation as a result of past events;
- it is more likely than not that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.17. Issued (Share) Capital

Share capital consists of ordinary (common stock) shares. Share capital is stated at nominal value.

3.18. Dividends

Dividends are recognized as liabilities in the period wherein a decision on dividend disbursement is made by the Bank's shareholders.

3.19. Revaluation and Fair Value Reserves

For Property, Equipment and Intangible Assets

Revaluation surpluses are credited to revaluation reserves. When the carrying amount of an asset increases due to revaluation, such increase is to be included in equity as revaluation surplus (reserve). However, the increase is recognized in profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.

When an asset's carrying value decreases due to revaluation, such decrease is to be recognized as an expense. However, the decrease is to be charged within equity up to the amount of the existing (previously recorded) revaluation surplus relating to the asset.

For Financial Assets at Fair Value through Other Comprehensive Income (FVtOCI)

Reserves for financial assets at FVtOCI include fair value adjustments of such financial assets net of deferred taxes.

Accounting Policies Applicable up to December 31, 2017

For Financial Assets Available for Sale

Revaluation reserves for financial assets available for sale include changes in the fair value of financial assets available for sale, net of deferred taxes.

3.20. Earnings per Share

The Bank presents basic earnings per share. Basic earnings per share is calculated by dividing the profit or loss for the current period intended for ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

Since the Bank has no potentially dilutive ordinary shares such as convertible debt and options on shares, the Bank does not calculate diluted earnings per share.

3.21. Off-Balance Sheet Commitments and Contingent Liabilities

In the ordinary course of business, the Bank enters into off-balance sheet contingent liabilities recorded on the off-balance sheet accounts, which primarily include guarantees, letters of credit, undrawn loans and loans per credit cards. Such financial commitments are recorded in the statement of financial position, if and when they become payable.

Financial guarantees are contracts that require the Bank to undertake specific payments per guarantees to reimburse to the guarantee beneficiaries for the losses incurred due to inability of certain debtors to make the due payments in accordance with the terms of debt instruments.

Liabilities per guarantees issued are initially recognized at fair value, which is amortized over the validity period of the guarantee. Liabilities per guarantees are subsequently measured at amortized amount or the present value of expected payments (when a payment under the guarantee is likely), whichever is higher.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.22. Managed Funds - Custody Operations

Assets and income arising from operating activities, where the Bank performs custody operations, which include holding or keeping the funds for the benefit of individuals, creditors and other institutions are included in Bank's financial statements.

3.25. Segment Reporting

An operating segment represents a group of assets and business activities engaged in providing products or services that are subject to risks and returns that are different from those of other operating segments.

A geographical segment provides products or services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments.

The Bank monitors its performance per operating segments and per geographical segments (branches) for the purposes of consolidated reporting. The geographical segment was not published due to the fact that the Bank's operations are concentrated in Bosnia and Herzegovina. Detailed information on the segments, as well as the structure and the result on each of the segments, is provided in Note 5.

4. KEY ACCOUNTING ESTIMATES AND ASSUMPTIONS

In the normal course of business, the Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly reviewed and are based on historical experience and other factors such as the expected flow of future events that can be reasonably assumed in existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

4.1 Impairment Losses on Loans and Receivables

The Bank monitors the credit rating of its customers on an ongoing basis. The need for impairment of the Bank's on-balance and off-balance sheet exposures to credit risk is assessed on a monthly basis, using available data. Impairment losses are made mainly against the carrying value of loans to corporate and retail customers and as provisions for contingent liabilities and commitments arising from off-balance exposure to customers, mainly in the form of undrawn framework loans, guarantees, letters of credit and other assets.

Impairment losses are also considered for credit risk exposures to banks and for other assets not carried at fair value, where the primary risk of impairment is not credit risk.

The Bank first assesses whether objective evidence of impairment exists individually for assets that are individually significant and collectively for assets that are not individually significant. However, assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics and then assessed collectively for impairment.

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

Expected credit losses are calculated using the following formula:

$$ECL = \sum_{t=1}^{T} (PD_t \cdot EAD_t \cdot LGD_t)$$

(ECL = expected credit loss, PD = probability of default, LGD = loss given default).

4. KEY ACCOUNTING ESTIMATES AND ASSUMPTIONS (Continued)

4.1 Impairment Losses on Loans and Receivables (Continued)

Expected credit losses are calculated separately for each scenario used, where forward-looking information is taken into account and represent probability-weighted numbers. Thereafter, aggregation is performed.

- Loss Given Default (LGD)

The Bank estimates LGD value based on the difference between the contractual cash flows and the cash flows it expects to receive through recovery, including recovery from the collateral foreclosure cash flows. LGD is usually expressed as a percentage.

LGD is best modelled using individual elements (recovery rate percentage, collateral value, and the like).

- Probability of Default (PD)

Probability of default is a probability that a loan/receivable will default within a specific time period.

Several approaches are used in modelling PDs for ECL calculation.

- Exposure at Default (EaD)

This is an estimate of the outstanding exposure at the time of default on a future date, where expected changes in the exposure after the reporting date are taken into account, including payments of principal and interest, as well as expected drawdowns of funds.

The first and foremost criterion for defining the type of impairment is determining whether an impairment trigger has occurred, as defined in the Bank's default and workout policy.

Loans of the borrowers that are not in the default status will be subject to portfolio (collective) impairment while the default-status loans will be subject to either individual or collective impairment and provisioning depending on the significance of the exposure at default (EaD) to their group of related entities. Special risk provisions represent impairment allowances of assets for the amounts expect not be collected upon contractually agreed maturity. The loss amount for which the remaining exposure is adjusted is a result of the gross exposure (on-balance and/or off-balance sheet) decreased by expected future cash flows discounted to their present value. Impairment losses on financial assets carried at amortized cost is calculated as the difference between the carrying value of assets and the present value of the expected future cash flows from such assets discounted at the original effective interest rate.

Stage3CI/STAGE3II represent a risk measure of identified losses (default on the obligation to make the payment) and can always be allocated to the individual loan facility.

In accordance with the recommendations resulting from the Asset Quality Review (AQR) performed as of March 31, 2017, the Bank made the following adjustments to the calculated imapirment allowances (provisions) for loans and receivables due from customers:

- For non-retail segments (corporate) 060_PJRE, 070_CO, 081_SCPI, 087_SCCO, 089_SCOT, 090,_EX, LIP factor was increased from 0.5 to 1

- The Bank applied the suggested LGD rates: segment: 011_PISe = 70%, 012_PIOt =80%. Based on the recommendations resulting from AQR, the Bank applied the suggested unsecured portfolio LGD rate of 70% to the entire corporate loan portfolio (segment: 060_PJRE, 070_CO, 081_SCPI, 087_SCCO, 089_SCOT, 090_EX, 100_OTH).

The aggregate effect of the implemented aforesaid adjustments and changes to the accounting estimates according to AQR findings was realized as of December 31, 2017, which led to the increase in impairment allowances (provisions) of the loans and receivables due form customers by the amount of BAM 5,240 thousand.

The aggregate effect of the implemented methodology under IFRS 9 was realized as of December 31, 2017, and January 1, 2018, which led to the increase in impairment allowances (provisions) of the loans and receivables due form customers by the amount of BAM 475 thousand.

4. KEY ACCOUNTING ESTIMATES AND ASSUMPTIONS (Continued)

4.2. Taxation

The Bank records tax liabilities in accordance with the tax laws of the Republic of Srpska. Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspections of taxpayers' records. 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 the Tax Administration of the Republic of Srpska, expiration period of the tax liability is five years. This virtually means that tax authorities could determine payment of outstanding liabilities in the period of five years from the origination of the liability.

4.3. Regulatory Requirements

The Banking Agency of the Republic of Srpska is authorized to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets, liabilities and equity, in accordance with the underlying regulations.

4.4. Litigation

The Bank makes individual assessment of all court cases and makes the related provisions based on professional legal advice received.

As disclosed in Note 29, the Bank made provisions of BAM 1,863 thousand for litigations in 2018 (2017: BAM 3,106 thousand), which the management estimated as sufficient. In 2018, the number of lawsuits involving the Bank was further reduced, as was the aggregate amount claimed in litigation (by BAM 13 million), as a result of the Bank's intensified activities of the legal risk management (adequate defense at court, and amicable settlement of disputes where possible, etc.).

4.5. Tangible Assets Acquired in Lieu of Debt Collection

The Bank occasionally acquires real estate in lieu of debt collection per certain loans and receivables. Real estate is stated at the lower of the net recoverable value of the related loan receivable and the current fair value of such assets less costs to sell. Gains or losses arising on disposal of such assets are recognized in the statement of profit or loss.

4.6. Employee Retirement Benefits

Long-term provisions related to the future outflows for retirement benefits are formed based on the actuarial calculation performed in accordance with IAS 19. For the purposes of the assessment, the Bank engages a certified actuary to perform the calculation based on the data from the Bank's HR Department records according to the estimated time of employees' retirement. The present value of the future liabilities is calculated by applying a discount rate. These provisions are only used to settle the expenses that the provisions have originally been made for. At each year-end, the Bank re-assesses these provisions. If the amount recorded is higher/lower than estimated amount, the difference is reflected through profit and loss, except in the event that such a difference is a result of actuarial assumptions, when it is presented within equity as actuarial gain or loss.

In December 2018, a certified actuary performed a new actuarial calculation as of December 31, 2018 in accordance with IAS 19. Following the new calculation, the Bank recorded a decrease in the previously recognized provisions by crediting actuarial gains within equity. An assessment of short-term provisions for unused annual leaves (vacations) is performed based on the number of days of unused vacation as of the statement of financial position date and the average monthly gross salary per employee.

4.7. Impairment of Financial Assets at FVtOCI

The Bank determines that the equity investments available-for-sale are impaired when there has been a significant and prolonged decrease in their fair value below their cost. Determining a significant and prolonged decrease demands estimates. Among other factors, the Bank estimates normal fluctuations in the prices of shares.

4. KEY ACCOUNTING ESTIMATES AND ASSUMPTIONS (Continued)

4.7. Impairment of Financial Assets at FVtOCI (Continued)

In addition, impairment may be appropriate when there is evidence of the deterioration of the sound financial standing of the investor, deterioration of the success of the industry or the sector as well as changes in technology and operating and financing cash flows.

4.8. Fair Value of Property, Equipment and Investment Property

Fair value of property, equipment and investment property is regularly assessed based on the market value of similar property situated at similar locations by certified appraisers. Fair value is determined by means of capitalization valuation method (income approach) that takes into account actual or realizable annual income from the property under valuation relative to the value of the underlying investment. The actual annual income is then decreased by the costs of maintenance, depreciation, taxes and risk of rent payment default or failure to lease property. Factors applied in the assessment are specific for the market of Bosnia and Herzegovina.

(Thousands of BAM)

5. SEGMENT REPORTING

Segments recognized for reporting purposes in accordance with IFRS 8 include the following:

- Operations with the Retail segment, within which the following two sub-segments are recognized:
  - sub-segment of private individuals (PI) and
  - sub-segment of micro entities;
- Operations with the Corporate segment, within which three sub-segments are recognized: small, medium, and large entities;
- Operations with the Public segment – segment of public enterprises; and
- Treasury.

Since the Bank operates mainly in Bosnia and Herzegovina, secondary (geographical) segments are not presented.

The tables below show the overall breakdown of the Bank's statement of profit and loss.

	RET	COR	PUB	TRE	OTH	Total
Year Ended December 31, 2018						
Interest income calculated using the effective interest method	22,968	6,960	2,163	287	(93)	32,285
Other interest income	-	10	-	-	-	10
Interest expenses	(4,676)	(609)	(953)	(813)	-	(7,051)
Net interest income	**18,292**	**6,361**	**1,210**	**(526)**	**(93)**	**25,244**
Fee and commission income	12,634	2,201	148	-	-	14,983
Fee and commission expenses	(2,190)	(378)	(25)	-	-	(2,593)
Net fee and commission income	**10,444**	**1,823**	**123**	**-**	**-**	**12,390**
Net profit from financial instruments	-	-	-	91	-	91
Other operating income	-	-	-	-	2,819	2,819
Other operating expenses	-	-	-	-	(3,699)	(3,699)
Total operating income	28,736	8,184	1,333	(435)	(973)	36,845
Staff costs	(9,213)	(1,692)	(215)	(214)	(1,466)	(12,800)
Depreciation/amortization charge	(1,815)	(333)	(42)	(42)	(290)	(2,522)
Other administrative costs	(9,492)	(1,743)	(222)	(221)	(1,508)	(13,186)
Total operating expenses	(20,520)	(3,768)	(479)	(477)	(3,264)	(28,508)
OPERATING PROFIT/(LOSS) BEFORE CREDIT RISK PROVISIONS	**8,216**	**4,416**	**854**	**(912)**	**(4,237)**	**8,337**
Provisions for potential losses, commitments and write-offs	(8,105)	1,710	1,299	-	37	(5,059)
PROFIT/(LOSS) BEFORE TAXES	111	6,126	2,153	(912)	(4,200)	3,278
Income tax expense	-	-	-	-	7	7
Net profit for the year	**111**	**6,126**	**2,153**	**(912)**	**(4,193)**	**3,285**

(Thousands of BAM)

5. SEGMENT REPORTING (Continued)

	RET	COR	PUB	TRE	OTH	Total
Year Ended December 31, 2017						
Interest income calculated using the effective interest method	21,141	5,216	3,331	147	-	29,835
Other interest income	-	48	-	-	-	48
Interest expenses	(4,360)	(527)	(1,153)	(1,999)	-	(8,039)
Net interest income	**16,781**	**4,737**	**2,178**	**(1,852)**		**21,844**
Fee and commission income	11,188	2,489	192	67	-	13,936
Fee and commission expenses	(1,108)	(440)	(50)	(315)	-	(1,913)
Net fee and commission income	**10,080**	**2,049**	**142**	**(248)**	**-**	**12,023**
Net profit from financial instruments	-	-	-	86	-	86
Other operating income	1,273	1,607	310	-	372	3,562
Other operating expenses	(1,930)	(2,802)	(1,727)	-	(1,429)	(7,888)
Total operating income	**26,204**	**5,591**	**903**	**(2,014)**	**(1,057)**	**29,627**
Staff costs	(9,919)	(2,075)	(216)	(186)	(1,526)	(13,922)
Depreciation/amortization charge	(1,551)	(324)	(34)	(29)	(239)	(2,177)
Other administrative costs	(9,820)	(2,055)	(214)	(184)	(1,511)	(13,784)
Total operating expenses	(21,290)	(4,454)	(464)	(399)	(3,276)	(29,883)
OPERATING PROFIT/(LOSS) BEFORE CREDIT RISK PROVISIONS	**4,914**	**1,137**	**439**	**(2,413)**	**(4,333)**	**(256)**
Provisions for potential losses, commitments and write-offs	4,957	(332)	109	-	(10)	4,724
PROFIT/(LOSS) BEFORE TAXES	9,871	805	548	(2,413)	(4,343)	4,468
Income tax expense	-	-	-	-	7	7
Net profit for the year	**9,871**	**805**	**548**	**(2,413)**	**(4,336)**	**4,475**

The table below shows the total assets and liabilities of the Bank:

	RET	COR	PUB	TRE	OTH	Total
December 31, 2018						
Total assets	293,238	183,757	50,119	268,549	-	795,663
Total liabilities	426,503	125,776	72,544	16,379	-	641,202
December 31, 2017						
Total assets	296,315	166,991	65,148	180,854	-	709,308
Total liabilities	357,103	101,748	66,567	32,344	-	557,762

6. FINANCIAL RISK MANAGEMENT

The risk management strategy of the Bank is to maintain stable performance in the future. The Bank possesses an internal risk management model. The most significant tools and methods used in the model for internal risk management are: internal credit rating system (for corporate and retail segments and banks), collaterals, internal indicators in respect of provisions/bad debts, etc. The use of risk management tools has a great impact on asset quality, liquidity structure, efficiency ratios and early warnings, and reduce the Bank's exposure to all types of risk.

The Bank is exposed to the following major risks: credit risk, market risk, liquidity risk, and operational risks.

6.1. Credit Risk Management

The Bank is exposed to credit risk which is the risk of their inability to collect due loans and other receivables with interest accrued thereon within contractually defined terms.

The Bank manages credit risk through an ongoing analysis of the creditworthiness of existing and potential borrowers to pay their liabilities for principal and interest, and changes in indebtedness limits where necessary. This is performed in in accordance with the loan approval, additional lending and investment activity procedures in place and assumptions regarding contingent off-balance sheet liabilities. In addition, the Bank also manages its exposure to credit risk by minimizing any form of risk related to quality, concentration, collection securitization, maturity and currency.

The Bank has formed separate organizational units in charge of managing and controlling credit risk and the collection of bad debts aligned with the organizational chart used within Addiko Group. The Bank approves loans in accordance with the defined loan approval process bases on the borrower creditworthiness, i.e., solely based on the estimates of the borrower's sustainable cash flows as the primary source of loan repayment.

For every loan, there are several levels of authority for their approval, the highest of which is the Supervisory Board of the Bank. Loan approval decision are made (and the competent authority level determined) based on total liabilities/ limits defined at the level of a group of related parties.

6.1.1 Management of Non-Performing Loans

NPL management is organized through the work of the Risk Management Department, i.e., through its two teams: Loan Restructuring and Workout, which is in charge of corporate (COR) and public sector (PUB) segments, and the Retail Collection Team in charge of the retail segment customers (including private individuals and entrepreneurs).

Non-performing (NPL status) loans are loans that over 90 days past due in repayment (materially significant past-due means that the liabilities exceed 2.5% of the total exposure and that the delay from entering the materially significant past-due status is longer than 90 days) or loans where borrowers have exhibited problems in business operations indicating borrowers' inability to discharge their liabilities from operations and evident risk of default. According to the local categorization these are exposures classified in C, D and E categories, or assets with special provisions in accordance with IFRS 9 (NPLs) with an internal rating of 5A or worse. Loans with internal ratings ranging from 4A to 4E (WL status) are additionally monitored with the active involvement of the Risk Management Department in order to minimize potential losses through active creation of the strategy for prevention of the customer transition to the default status.

The Loan Restructuring and Workout Team, is in charge of corporate and public segment clients (with all their related parties) with the status of over 90 days past due, with 5A or a worse rating and categories C, D and E within the local classification; transfer of customers from the Market Department is performed immediately upon fulfillment of these criteria. Prior to transfer to the Risk Management Department/Loan Restructuring and Workout Team, the Market Department prepares a Client Transfer Protocol and the credit committees are in charge of transfer approval. In addition, the Risk Management Department is entitled to assume other borrowing customers with ratings better than 5A in all instances where the Department estimates that the credit risk could deteriorate. The portfolio of credit rating 4 borrowers is monitored by the Monitoring Committee that considers the watch list status borrowers on a monthly basis and proposes measures for risk elimination and mitigation in order to prevent migrations to the NPL status.

6. FINANCIAL RISK MANAGEMENT (Continued)

6.1. Credit Risk Management (Continued)

6.1.1 Management of Non-Performing Loans (Continued)

Upon identification of a client as a NPL client, the Risk Management Department/Loan Restructuring and Workout Team assumes competence and responsibility for the whole group of clients with the Bank as well as for defining collection strategy at the client group level.

Transfer of borrowing clients to the Risk Management Department is performed at the client group level, whereby all group members are allocated the credit rating of the worst group member. Exceptionally, the Department can assume on one group member or allocate different credit ratings to the group members; however, this must be explained, documented and approves by competent bodies.

After assuming clients, the Risk Management Department assumes functions of both the Market and Underwriting Departments, as it is responsible for borrowing client processing and monitoring, for proposing manners of resolution and manners of possible collection of the Bank's receivables to the competent Credit Committee, calculation of the credit risk at the client/loan facility levels under both local regulations and IFRS/IAS, for obtaining valid collateral appraisal, for borrower rating adjustments, for assessment and proposal of the amount of individually assessed loan loss provisions (the so-called SRP Stage 3), and for collection of receivables using all legal means available.

All the borrowers under the remit of the Risk Management Department/Loan Restructuring and Workout Functions are subject to the mandatory monitoring on a semi-annual basis in the form of a credit report, which is approved by the Credit Committees in line with their respective competences.

The Loan Restructuring and Workout Functions are parts of the Risk Management Department dealing with the early risk assessment, loan restructuring and all legal activities relating to enforced collection.

The Collection Department in charge of the retail clients – SMEs and individuals – whose liability settlement is one or more days past due and with debts matured amounting to EUR 10 (in BAM equivalent) in instances of private individuals (PI) and EUR 25 (in BAM equivalent) in instances of micro-sized entities.

The Collection Department "covers" all collection activities starting from the client's day 1 past due stats and includes late collection phases (90+, 180+ days past due), all legal procedures (including execution procedure) and repossession and re-sale of assets,

The process of collection from the Retail segment clients involves collection per all loan facilities with days past due, through the functions of:

- Client Recovery – while the client is in the category of up to 90 days past due it is considered recoverable, and all activities undertaken are focused on the recovery of the client and the return of the client back to the performing status; and

- Debt Collection – once the number of days past due per a single loan facility or a single borrower exceeds 90 days, client recovery is no longer deemed possible; accordingly, the focus shifts to minimizing the losses.

Early collection is the first and most important collection phase. The early collection strategy is based on the early and consistent contact with the borrowers. The early collection procedure entails a combination of activities aimed at encouraging the borrower to settle liabilities immediately after their maturity: telephone calls and texting, delivery of written reminders, collateral activation, negotiations and attempts to find the best solution in the common interests of the Bank and the borrower. The goal of the restructuring activities here is to prevent new NPLs and contribute to the maintenance of the portfolio quality.

Late collection approach is intended to encourage and enable timely addressing of NPLs and set up a system for prevention of accumulation of NPLs. It is based on the following basic principles: more debt settlement, voluntary sales of assets preferred to the foreclosure of assets, avoidance of lawsuit instigation to claim smaller value debts, full outsourcing of unsecuritized receivables and minimum or (ideally) no instigation of lawsuits for debt collection, optimized use of resources with focus on the receivables with the highest possible recoveries, provision of a balance between the collection costs and the net present value of the collected amounts, clearing of the previous NPL portfolio, sales of assets acquired in lieu of debt collection through authorized real estate agencies, etc.

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.1. Credit Risk Management (Continued)

6.1.2 Maximum Credit Risk Exposure

The table below shows the Bank's maximum exposure to credit risk, by the statement of the financial position items.

	Performing			Non-Performing			Total		
Financial instruments at December 31, 2018	Exposure	S1 and S2 provisions	Net	Exposure	S3 provisions	Net	Exposure	Provisions	Net
Cash and balances held with the Central Bank[1)]	104,891	(734)	104,157	-	-	-	104,891	(734)	104,157
Balances held with other banks	58,568	(121)	58,447	-	-	-	58,568	(121)	58,447
Loans and receivables	510,127	(14,269)	495,858	89,926	(76,106)	13,820	600,053	(90,375)	509,678
Loans and receivables due from customers	507,320	(14,214)	493,106	88,682	(74,892)	13,790	596,002	(89,106)	506,896
Other financial assets	2,807	(55)	2,752	1,244	(1,214)	30	4,051	(1,269)	2,782
Investments in securities[2)]	55,017	(118)	54,899	-	-	-	55,017	(118)	54,899
Total financial assets	**728,603**	**(15,242)**	**713,361**	**89,926**	**(76,106)**	**13,820**	**818,529**	**(91,348)**	**727,181**
Off-balance sheet items	114,208	(1,025)	113,183	221	(149)	72	114,429	(1,174)	113,255
Total credit risk exposure	**842,811**	**(16,267)**	**826,544**	**90,147**	**(76,255)**	**13,892**	**932,958**	**(92,522)**	**840,436**

[1)] The line item does not include cash in the amount of BAM 25,789 thousand.
[2)] The line item does not include equity investments in the amount of BAM 229 thousand.

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.1. Credit Risk Management (Continued)

6.1.2 Maximum Credit Risk Exposure

	Total gross carrying value	Collective and individual impairment (SRPii/ SRPci)	Portfolio provisions for losses (PRPLL)	Total net carrying value
December 31, 2017				
Cash and balances with the Central Bank[1)]	100,839	-	-	100,839
Balances held with other banks	19,425	(11)	(4)	19,410
Loans and receivables				
Loans and receivables due from banks	635,187	(102,227)	(8728)	524,232
Loans and receivables due form customers	630,587	(99,849)	(8,719)	522,019
Other financial assets	4,600	(2,378)	(9)	2,213
Financial assets available for sale[2)]	2,029	-	-	2,029
Total financial assets	**757,480**	**(102,238)**	**(8,732)**	**646,510**
Contingent liabilities and commitments	126,097	(232)	(2,314)	123,551
Total credit risk exposure	**883,577**	**(102,470)**	**(11,046)**	**770,061**

1) The line item does not include cash in the amount of BAM 21,204 thousand.
2) The line item does not include equity investments in the amount of BAM 229 thousand.

The maximum exposure is presented without deducting the value of any underlying collateral.

6.1.3. Loans and Receivables Due from Customers - the Rating System

The Bank's rating system is presented in accordance with the internal rating scale of Addiko Group (five rating classes and five levels within each class). The probability of default (PD) of a certain client, whose rating has been assigned within the internal Addiko Group's rating scale, is expressed through the internal ratings, as follows:

- Rating Class 1 (ratings of 1A - 1E), which includes customers from the best to the very good credit worthiness;
- Rating Class 2 (ratings of 2A - 2E), which includes clients from good to moderate credit worthiness;
- Rating Class 3 (ratings of 3A - 3E), which include clients from acceptable to insufficient creditworthiness;
- Rating Class 4 (ratings of 4A - 4E) comprising of customers under surveillance measures, as a result of short-term or long-term indicators of business difficulties, in a particular client or within a certain industry;
- Rating Class 5 (ratings of 5A - 5E), which includes clients where there is a significant delay in the payment obligations or a significant doubt about client's creditworthiness.

The Bank's credit risk exposure arising from loans and receivables due from customers and banks and balances with other banks, by category, is provided below:

	December 31, 2018				December 31, 2017			
	Exposure	S1 and S2 provisions	S3 provisions	Net	Gross	Portfolio provisions (PRPLL)	Collective and Individual Impairment (SRP/SRPci)	Net
No rating	2,708	(72)	(151)	2,485	1,414	(41)	(2)	1,371
1A-1E	156,291	(818)	-	155,473	108,228	(743)	(4)	107,481
2A-2E	219,315	(2,719)	(11)	216,585	211,721	(2,018)	(116)	209,587
3A-3E	147,855	(4,325)	(40)	143,490	172,391	(4,680)	(156)	167,555
4A-4E	40,592	(6,384)	(532)	33,676	39,343	(1,235)	(2,857)	35,251
5A-5E	87,809	(17)	(74,158)	13,634	116,915	(6)	(96,725)	20,184
Total	**654,570**	**(14,335)**	**(74,892)**	**565,343**	**650,012**	**(8,723)**	**(99,860)**	**541,429**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.1. Credit Risk Management (Continued)

6.1.4. Loans and Receivables Due from Customers - Performance Breakdown

	2018	2017
Neither past due nor impaired	504,722	504,497
Past due but not impaired	2,598	5,497
Impaired (non-performing)	88,682	120,593
Gross	**596,002**	**630,587**
S3 provisions	(74,892)	-
S1 and S2 provisions	(14,214)	-
SRPii / SRPci provisions	-	(99,849)
PRPLL provisions	-	(8,719)
Net	**506,896**	**522,019**

Neither past-due nor impaired loans

Neither past-due nor impaired loans and receivables based on the segment structure can be summarized as follows:

	2018	2017
Public sector	26,137	40,105
Non-banking financial institutions	15,880	9,738
Corporate customers	162,703	156,948
Entrepreneurs	11,057	10,478
Retail - individuals	288,786	287,003
Other	159	225
	504,722	**504,497**

Past-due but not impaired loans

Past due but not impaired loans and receivables, by the segment structure and days past due, can be summarized as follows:

	Up to 30 days	30 - 60 days	60 - 90 days	90 - 180 days	Over 180 days	Total
December 31, 2019						
Public sector	-	-	-	-	-	-
Non-banking financial institutions	-	-	-	-	-	-
Corporate customers	73	-	-	-	-	73
Entrepreneurs	-	-	-	-	-	-
Retail - individuals	1,983	298	244	-	-	2,525
Other	-	-	-	-	-	-
	2,056	**298**	**244**	**-**	**-**	**2,598**

	Up to 30 days	30 - 60 days	60 - 90 days	90 - 180 days	Over 180 days	Total
December 31, 2017						
Public sector	7	-	-	-	-	7
Non-banking financial institutions	-	-	-	-	-	-
Corporate customers	3,937	109	-	-	-	4,046
Entrepreneurs	1	-	-	-	-	1
Retail - individuals	839	414	190	-	-	1,443
Other	-	-	-	-	-	-
	4,784	**523**	**190**	**-**	**-**	**5,497**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.1. Credit Risk Management (Continued)

6.1.4. Loans and Receivables Due from Customers - Performance Breakdown (Continued)

Impaired loans

Impaired loans with the fair value of related collateral, held by the Bank as security instruments, may be summarized as follows:

	Public sector	Non-banking financial institutions	Corporate	Entrepreneurs	Retail	Other	Total
December 31, 2018							
Exposure	4,886	-	12,154	525	71,112	5	88,682
Stage 3 provisions	(1,674)	-	(9,589)	(474)	(63,152)	(3)	(74,892)
Net	**3,212**	**-**	**2,565**	**51**	**7,960**	**2**	**13,790**
Collateral fair value	2,057	-	5,203	184	27,579	-	35,023

	Public sector	Non-banking financial institutions	Corporate	Entrepreneurs	Retail	Other	Total
December 31, 2017							
Gross	5,355	-	36,902	1,135	77,077	124	120,593
Collective and individual impairment (SRPii/ SRPci)	(1,871)	-	(28,086)	(972)	(68,811)	(109)	(99,849)
Net	**3,484**	**-**	**8,816**	**163**	**8,266**	**15**	**20,744**
Collateral fair value	1,836	-	14,861	203	28,081	-	44,981

6.1.5. Rescheduled and Restructured Receivables

A restructured loan is a loan that is refinances, rescheduled or otherwise converted, i.e., a loan in which, due to the borrower's changed conditions and repayment capabilities, or its inability to make repayment in line with initially agreed repayment schedule or because of the revised (lower) current market rate, the previously agreed deadlines (period or repayment schedule) and/or other terms and conditions have subsequently been altered so that the Bank can allow the borrower easier (and for the Bank itself more secure) debt servicing. The breakdown of the restructured and refinanced loans, at December 31, 2018 and 2017 is provided below:

	Number of renegotiated loans	Amount
December 31, 2018		
Corporate clients	-	-
Retail clients - individuals and entrepreneurs	62	1,330
Total	**62**	**1,330**
December 31, 2017		
Corporate clients	4	6,724
Retail clients - individuals and entrepreneurs	207	3,729
Total	**211**	**10,453**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.1. Credit Risk Management (Continued)

6.1.6. Loans and Receivables Due from Customers - Concentration per Industry

The breakdown of the Group's and the Bank's financial assets exposed to credit risk per industry on the gross and net bases (net of provisions) is shown in the following table:

	2018 Amount	2018 %	2017 Amount	2017 %
Retail customers	376,318	45.9%	379,426	50.0%
Trade	58,067	7.1%	68,020	8.9%
Mining and industry	70,105	8.5%	80,179	10.5%
Services, tourism and catering business	3,819	0.5%	9,919	1.3%
Transport and communications	4,179	0.5%	1,918	0.3%
Real estate	2,283	0.3%	598	0.1%
Agriculture, forestry and fishing	3,840	0.5%	1,444	0.2%
Construction industry	6,613	0.8%	10,307	1.4%
Financial institutions	220,590	26.9%	131,733	17.4%
Power industry	22,048	2.7%	20,275	2.6%
Administration and other public services	46,958	5.7%	47,600	6.3%
Other	5,155	0.6%	7,820	1.0%
Allowance for impairment	(91,230)		(110,970)	
Collected fees not recognized within income	(1,564)		(1,759)	
	727,181		**646,510**	

The amounts presented in the table above do not include cash in the amount of BAM 25,789 thousand and equity securities of BAM 229 thousand (2017: BAM 21,204 thousand and BAM 229 thousand, respectively).

6.1.7. Off-Balance Sheet Items

The contractual amounts of the Bank's off-balance sheet financial liabilities that it has committed to extend to customers are summarized in the table below:

	Up to 1 year	1 - 5 years	Over 5 years	Total
December 31, 2018				
Irrevocable loan commitments	25,710	28,899	16,975	**71,584**
Payment and performance guarantees and letters of credit	10,517	31,332	996	**42,845**
	36,227	**60,231**	**17,971**	**114,429**
December 31, 2017				
Irrevocable loan commitments	32,026	31,946	25,519	**89,491**
Payment and performance guarantees and letters of credit	12,205	23,405	996	**36,606**
	44,231	**55,351**	**26,515**	**126,097**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.2. Market Risk Management

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

General Requirements

The Bank develops its market risk strategy on the basis of strategic discussions between the competent units of Treasury and Risk Controlling. Decisions on combined business and risk strategies are only made by the Asset and Liability Management Committee (ALCO).

As part of the daily reporting procedure, the management receives value-at-risk (VaR) and performance figures for trading transactions on a daily basis and figures on the banking book investments and market risk steering on a weekly basis. There is also a daily report to the Management in which the key risk and performance figures of the branches are communicated. In these, the value-at-risk at the branch level is compared to the defined limits. Limit breaches initiate defined escalation processes up to the Executive Board level.

Risk Measurement

The principal tool used to measure and control market risk exposure within the Bank's trading portfolio is value-at-risk (VaR). VaR of a trading portfolio is the estimated loss that will arise on the portfolio over a specified period of time (holding period) given an adverse movement with a specified probability (confidence level). The model is based upon a 99% confidence level, assumes a 1 day holding period and takes into account 250 historical scenarios. The use of a 99% confidence level means that losses exceeding the VaR figure should occur, on average, not more than once every 100 days.

The Bank uses VaR to measure the following market risks:

- general interest rate risk in the trading book;
- foreign exchange risk on the statement of financial position level (both trading and banking books);
- equity and debt securities risk in the trading book;
- credit spread risk.

The Bank's VaR per risk type for years 2018 and 2017:

	Minimum	Maximum	Monthly average	December 31
2018				
Interest rate risk	40	106	89	40
Foreign currency risk	3	16	7	16
Price risk	-	-	-	-
Credit spread risk	-	68	6	68
Total	**43**	**190**	**102**	**124**
2017				
Interest rate risk	29	96	53	29
Foreign currency risk	2	6	4	3
Price risk	-	-	-	-
Credit spread risk	1	35	14	1
Total	**32**	**137**	**71**	**33**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.3. Foreign Currency Risk

Foreign currency risk is the Bank's exposure to possible impact of change in foreign currency exchange rate and danger that unfavorable changes may result in loss denominated in BAM (local currency). The level of risk is a function of height and length of the Bank's exposure to possible changes in foreign exchange rates, and depends on the amount of the Bank's borrowing in foreign currencies and the degree of alignment of assets and liabilities of the Bank's balance sheet and off-balance sheet, i.e., the degree of matching of the foreign currency flows.

Foreign currency risk exposure arises from credit, deposit, investment and trading activities. It is controlled daily in accordance with legislation and the internally set limits for each currency and for the assets and liabilities denominated in foreign currencies. During the year open currency positions were maintained within the limits prescribed by the Decisions of the Banking Agency of the Republic of Srpska and the internal limits set according to the Addiko Group's methodology. Currency matching of the financial assets and financial liabilities is maintained by selling and purchasing all currencies, by contracting deposits and approving loans with currency clause index and by monitoring such loans. Foreign currency risk management activities and responsibilities are defined by the program, policies and procedures for foreign currency risk management.

Sensitivity Analysis

The following table indicates the currencies to which the Bank had significant exposures at December 31, 2018 and 2017. The position in euros was not analyzed since BAM is pegged to EUR.

Currency	FX Open position, December 31, 2018	10% increase	10% decrease	FX Open position, December 31, 2017	10% increase	10% decrease
USD	1,720	294	(294)	210	34	(34)
CHF	9	2	(2)	175	29	(29)

FX open position represents net exposure in a foreign currency. The analysis calculates the effect of a reasonably predictable movements of the currencies against BAM and their influence on the profit or loss, with all other variables held constant. Negative values in the table reflect a potential net reduction of the profit, while positive amounts reflect a net potential increase.

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.3. Foreign Currency Risk (Continued)

Loans and receivables extended in BAM with contracted currency clause are presented within the appropriate foreign currency buckets.

The Bank had the following significant currency positions:

	EUR	USD	CHF	Other currencies	FX Subtotal	BAM Subtotal	Total
December 31, 2018							
ASSETS							
Cash and balances held with the Central Bank	9,067	554	585	1,092	11,298	118,648	129,946
Balances held with other banks	42,636	11,034	2,460	2,317	58,447	-	58,447
Loans and receivables	372,695	-	4,058	1	376,754	132,924	509,678
Loans and receivables due from customers	371,914	-	4,058	1	375,973	130,923	506,896
Other financial assets	781	-	-	-	781	2,001	2,782
Investments in securities	52,896	-	-	-	52,896	2,232	55,128
Property and equipment	-	-	-	-	-	29,080	29,080
Land, buildings and equipment	-	-	-	-	-	26,679	26,679
Investment property	-	-	-	-	-	2,401	2,401
Intangible assets	-	-	-	-	-	5,874	5,874
Tax assets	-	-	-	-	-	1,395	1,395
Receivables for prepaid income taxes	-	-	-	-	-	1,395	1,395
Deferred tax assets	-	-	-	-	-	-	-
Assets held for sale	-	-	-	-	-	545	545
Other assets	263	-	-	-	263	5,307	5,570
Total assets	**477,557**	**11,588**	**7,103**	**3,410**	**499,658**	**296,005**	**795,663**
LIABILITIES							
Financial liabilities measured at amortized cost	343,698	9,868	7,093	2,196	362,855	269,932	632,787
Deposits due to banks	21,618	1	-	-	21,619	9,731	31,350
Deposits due to customers	263,265	9,867	7,086	2,191	282,409	257,836	540,245
Borrowings	52,512	-	-	-	52,512	-	52,512
Other financial liabilities	6,303	-	7	5	6,315	2,365	8,680
Other provisions	438	1	-	-	439	3,410	3,849
Tax liabilities	-	-	-	-	-	582	582
Current tax liabilities	-	-	-	-	-	-	-
Deferred tax liabilities	-	-	-	-	-	582	582
Other liabilities	333	-	-	-	333	3,651	3,984
Total liabilities	**344,469**	**9,869**	**7,093**	**2,196**	**363,627**	**277,575**	**641,202**
Net foreign currency position	**133,088**	**1,719**	**10**	**1,214**	**136,031**	**18,430**	**154,461**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.3. Foreign Currency Risk (Continued)

	EUR	USD	CHF	Other currencies	FX Subtotal	BAM Subtotal	Total
December 31, 2017							
ASSETS							
Cash and balances held with the central bank	4,365	779	895	1,217	7,256	114,607	121,863
Balances held with other banks	9,720	7,345	370	1,975	19,410	-	19,410
Loans and receivables	431,500	1	5,653	1	437,155	87,077	524,232
Loans and receivables due from customers	430,833	1	5,653	1	436,488	85,531	522,019
Other financial assets	667	-	-	-	667	1,546	2,213
Securities available for sale	24	-	-	-	24	2,234	2,258
Property and equipment	-	-	-	-	-	29,997	29,997
Land, buildings and equipment	-	-	-	-	-	27,609	27,609
Investment property	-	-	-	-	-	2,388	2,388
Intangible assets	-	-	-	-	-	4,438	4,438
Tax assets	-	-	-	-	-	1,212	1,212
Receivables for prepaid income taxes	-	-	-	-	-	1,212	1,212
Deferred tax assets	-	-	-	-	-	-	-
Assets held for sale	-	-	-	-	-	545	545
Other assets	1	-	-	-	1	5,352	5,353
Total assets	**445,610**	**8,125**	**6,918**	**3,193**	**463,846**	**245,462**	**709,308**
LIABILITIES							
Financial liabilities measured at amortized cost	323,805	7,894	6,743	2,093	340,535	206,005	546,540
Deposits due to banks	44,056	-	-	-	44,056	5,991	50,047
Deposits due to customers	245,365	7,894	6,734	2,093	262,086	197,295	459,381
Borrowings	28,300	-	-	-	28,300	-	28,300
Other financial liabilities	6,084	-	9	-	6,093	2,719	8,812
Other provisions	822	20	-	-	842	5,895	6,737
Tax liabilities	-	-	-	-	-	589	589
Current tax liabilities	-	-	-	-	-	-	-
Deferred tax liabilities	-	-	-	-	-	589	589
Other liabilities	567	-	-	-	567	3,329	3,896
Total liabilities	**325,194**	**7,914**	**6,743**	**2,093**	**341,944**	**215,818**	**557,762**
Net foreign currency position	**120,416**	**211**	**175**	**1,100**	**121,902**	**29,644**	**151,546**

6. FINANCIAL RISK MANAGEMENT (Continued)

6.4. Interest Rate Risk Management

Interest rate risk represents the possibility of a decrease in planned or expected yield on interest-bearing or interest rate sensitive positions due to a change in interest rates and/or yield on the capital market.

Interest rate risks arise when assets or liabilities transactions are in a mismatch with the funds and/or capital investments when it comes to concordance rates and maturity dates. In case there is an excess of fixed interest rate on assets, an increasing interest rate would, for example, have a negative effect on the present value of the bank and/or on net interest revenue. The same consequences would happen if there was a decrease in the fixed interest rate on the liabilities side.

The following table shows the sensitivity of the current portfolio value to a reasonable change in interest rates (parallel movement), with all other variables constant. The amounts are stated in thousands of BAM.

	Interest rates changes	Sensitivity	Interest rates changes	Sensitivity
December 31, 2018				
BAM	+/-100 bp	2,180/(2,380)	+/-200 bp	4,181/(4,982)
EUR	+/-100 bp	(2,255)/2,534	+/-200 bp	(4,267)/5,391
CHF	+/-100 bp	(29)/30	+/-200 bp	(57)/62
USD	+/-100 bp	-/-	+/-200 bp	-/-
Other	+/-100 bp	-/-	+/-200 bp	-/-
Total		**(104)/184**		**(143)/471**
December 31, 2017				
BAM	+/-100 bp	4,003/(4,256)	+/-200 bp	7,771/(8,783)
EUR	+/-100 bp	(4,576)/5,216	+/-200 bp	(8,605)/11,181
CHF	+/-100 bp	114/(123)	+/-200 bp	220/(257)
USD	+/-100 bp	206/(218)	+/-200 bp	400/(449)
Other	+/-100 bp	19/(19)	+/-200 bp	37/(39)
Total		**(234)/600**		**(177)/1,653**

6.5. Liquidity Risk Management

The Bank defines liquidity risk as the risk of not being able to meet due payment obligations on time or in full amount; or – in the event of a liquidity crisis – only being able to procure refinancing at increased market rates; or only being able to sell assets at a discount to market prices.

The main objective of liquidity risk management and control is to ensure that the Bank maintains the capacity to make payments and undertake refinancing activities at any time.

Monitoring of liquidity risk is carried out, on one hand, on the basis of the liquidity ratio and “time-to-wall” key indicators (maximum liquidity time horizon), under normal and stress conditions, and on the other hand, through the integration of the structural liquidity risk into overall Bank control (risk-bearing capacity).

Limits for short-term liquidity as well as for the limitation of long-term structural liquidity have been set, both at the Bank level and for the individual branches, and are monitored constantly. To ensure that existing liquidity gaps can be closed at any time through the mobilization of the liquidity potential, threshold values are being defined for all scenarios and if these are exceeded, measures must be introduced to reduce the identified liquidity risks.

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.5. Liquidity Risk Management (Continued)

Maturity Analysis

The following tables show the analysis of the Group's assets and liabilities by maturity based on the remaining period from the statement of financial position date to the agreed due date:

	Up to 1 month	1 - 3 months	3 - 12 months	Over 1 year	Total
December 31, 2018					
ASSETS					
Cash and balances held with the Central Bank	129,946	-	-	-	129,946
Balances held with other banks	58,447	-	-	-	58,447
Loans and receivables	-	-	-	-	-
Loans and receivables due from customers	40,714	31,731	88,674	348,559	509,678
Other financial assets	38,003	31,731	88,674	348,488	506,896
Investments in securities	2,711	-	-	71	2,782
Property and equipment	53,121	-	2,002	5	55,128
Land, buildings and equipment	-	-	-	29,080	29,080
Investment property	-	-	-	26,679	26,679
Intangible assets	-	-	-	2,401	2,401
Tax assets	-	-	-	5,874	5,874
Receivables for prepaid income taxes	-	-	-	1,395	1,395
Deferred tax assets	-	-	-	1,395	1,395
Assets held for sale	-	-	-	-	-
Other assets	-	-	545	-	545
ASSETS	3,314	-	-	2,256	5,570
Total assets	**285,542**	**31,731**	**91,221**	**387,169**	**795,663**
LIABILITIES					
Financial liabilities measured at amortized cost	333,620	16,373	82,923	199,871	632,787
Deposits due to banks	10,549	1,500	4,900	14,401	31,350
Deposits due to customers	314,073	14,205	72,200	139,767	540,245
Borrowings	318	668	5,823	45,703	52,512
Other financial liabilities	8,680	-	-	-	8,680
Other provisions	912	578	474	1,885	3,849
Tax liabilities	-	-	-	582	582
Current tax liabilities	-	-	-	-	-
Deferred tax liabilities	-	-	-	582	582
Other liabilities	3,898	-	-	86	3,984
Total liabilities	**338,430**	**16,951**	**83,397**	**202,424**	**641,202**
Maturity mismatch	**(52,888)**	**14,780**	**7,824**	**184,745**	**154,461**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.5. Liquidity Risk Management (Continued)

Maturity Analysis (Continued)

	Up to 1 month	1 - 3 months	3 - 12 months	Over 1 year	Total
December 31, 2017					
ASSETS					
Cash and balances held with the central bank	121,863	-	-	-	121,863
Balances held with other banks	19,410	-	-	-	19,410
Loans and receivables	111,503	19,953	77,875	314,901	524,232
Loans and receivables due from customers	109,290	19,953	77,875	314,901	522,019
Other financial assets	2,213	-	-	-	2,213
Securities available for sale	251	-	1	2,006	2,258
Property and equipment	-	-	-	29,997	29,997
Land, buildings and equipment	-	-	-	27,609	27,609
Investment property	-	-	-	2,388	2,388
Intangible assets	-	-	-	4,438	4,438
Tax assets	-	-	-	1,212	1,212
Receivables for prepaid income taxes	-	-	-	1,212	1,212
Deferred tax assets	-	-	-	-	-
Assets held for sale	-	-	545	-	545
Other assets	5,353	-	-	-	5,353
Total assets	**258,380**	**19,953**	**78,421**	**352,554**	**709,308**
LIABILITIES					
Financial liabilities measured at amortized cost	264,984	25,982	115,177	140,397	546,540
Deposits due to banks	6,059	13,694	14,915	15,379	50,047
Deposits due to customers	249,715	11,600	97,294	100,772	459,381
Borrowings	398	688	2,968	24,246	28,300
Other financial liabilities	8,812	-	-	-	8,812
Other provisions	738	946	1,020	4,033	6,737
Tax liabilities	-	-	-	589	589
Current tax liabilities	-	-	-	-	-
Deferred tax liabilities	-	-	-	589	589
Other liabilities	3,801	-	-	95	3,896
Total liabilities	**269,523**	**26,928**	**116,197**	**145,114**	**557,762**
Maturity mismatch	**(11,143)**	**(6,975)**	**(37,776)**	**207,440**	**151,546**

Analysis of Financial Liabilities per Remaining Contractual Maturity, Undiscounted

The table below shows the remaining undiscounted maturities of the Bank's financial liabilities as at December 31, 2018 and 2017:

	Up to 1 month	1-3 months	3-12 months	Over 1 year	Total	Net carrying value
December 31, 2018						
Deposits due to banks	10,591	1,500	4,900	14,401	31,392	31,350
Deposits due to customers	315,890	12,720	77,072	143,156	548,838	540,245
Borrowings	459	767	10,085	44,713	56,024	52,512
Other financial liabilities	8,680	-	-	-	8,680	8,680
Total	**335,620**	**14,987**	**92,057**	**202,270**	**644,934**	**632,787**

	Up to 1 month	1-3 months	3-12 months	Over 1 year	Total	Net carrying value
December 31, 2017						
Deposits due to banks	6,059	-	28,609	15,379	50,047	50,047
Deposits due to customers	248,577	12,226	100,654	105,001	466,458	459,381
Borrowings	398	795	3,420	26,887	31,500	28,300
Other financial liabilities	8,166	-	-	-	8,166	8,166
Total	**263,200**	**13,021**	**132,683**	**147,267**	**556,171**	**545,894**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.6. Fair Value of Financial Assets and Liabilities

The fair value of financial assets and financial liabilities that are traded in the active markets can be measured based on quoted market prices or dealer quotes. For all other financial instruments, the Bank determines fair value using other valuation techniques.

The Bank measures the fair value using the following fair value hierarchy that reflects the significance of input parameters, used in the measurement:

- Level 1 inputs: quoted market prices (unadjusted) in an active market for identical assets.
- Level 2 inputs: inputs other than quoted prices included in Level 1 that are based on observable inputs, either directly or indirectly for the relevant asset or liability. This category includes instruments measured using: quoted market prices in active markets for similar instruments, quoted prices for identical or similar instruments that are considered less than active or other measurement techniques, in which all of the significant inputs, directly or indirectly, are observable from market data.
- Level 3 inputs: unobservable inputs. This category includes all instruments for which measurement techniques are not observable and these parameters have a significant impact on the assessment of the value of the instruments. This category includes instruments that are measured based on quoted prices for similar products that require significant adjustments or assumptions to reflect differences between the instruments.

The fair values of the Bank's assets and liabilities, at levels in accordance with IFRS 13, can be summarized as follows:

December 31, 2018	Carrying value	Fair value total	Difference	Level 1	Level 2	Level 3
Financial assets carried at fair value						
Investments in securities	55,128	55,128	-	52,872	2,027	229
Financial assets other than carried at fair value						
Cash and balances held with the Central Bank	129,946	129,946	-	-	-	129,946
Balances held with other banks	58,447	58,447	-	-	-	58,447
Loans and receivables	509,678	523,662	13,984	-	-	523,662
Loans and receivables due from customers	506,896	520,880	13,984	-	-	520,880
Other financial assets	2,782	2,782	-	-	-	2,782
Property and equipment	29,080	29,080	-	-	-	29,080
Intangible assets	5,874	5,874	-	-	-	5,874
Assets held for sale	545	545	-	-	-	545
Total	**788,698**	**802,682**	**13,984**	**52,872**	**2,027**	**747,783**
LIABILITIES						
Financial liabilities carried at fair value						
Financial liabilities held for trading	-	-	-	-	-	-
Financial liabilities other than carried at fair value						
Financial liabilities at amortized cost	632,787	644,304	11,517	-	-	644,304
Deposits due to banks	31,350	31,350	-	-	-	31,350
Deposits due to customers	540,245	551,762	11,517	-	-	551,762
Borrowings	52,512	52,512	-	-	-	52,512
Other financial liabilities	8,680	8,680	-	-	-	8,680
Total	**632,787**	**644,304**	**11,517**	**-**	**-**	**644,304**

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.6. Fair Value of Financial Assets and Liabilities (Continued)

December 31, 2017	Carrying value	Fair value total	Difference	Level 1	Level 2	Level 3
Financial assets carried at fair value						
Investments in securities	2,258	2,258	-	-	2,029	229
Financial assets other than carried at fair value						
Cash and balances held with the Central Bank	121,863	121,863	-	-	-	121,863
Balances held with other banks	19,410	19,410	-	-	-	19,410
Loans and receivables	524,232	528,929	4,697	-	-	528,929
Loans and receivables due from customers	522,019	526,716	4,697	-	-	526,716
Other financial assets	2,213	2,213	-	-	-	2,213
Property and equipment	29,997	29,997	-	-	-	29,997
Intangible assets	4,438	4,438	-	-	-	4,438
Assets held for sale	545	545	-	-	-	545
Total	**702,743**	**707,440**	**4,697**	**-**	**2,029**	**705,411**
LIABILITIES						
Financial liabilities carried at fair value						
Financial liabilities held for trading	-	-	-	-	-	-
Financial liabilities other than carried at fair value						
Financial liabilities at amortized cost	546,540	557,819	11,279	-	-	557,819
Deposits due to banks	50,047	51,307	1,260	-	-	51,307
Deposits due to customers	459,381	468,463	9,082	-	-	468,463
Borrowings	28,300	29,237	937	-	-	29,237
Other financial liabilities	8,812	8,812	-	-	-	8,812
Total	**546,540**	**557,819**	**11,279**	**-**	**-**	**557,819**

By definition fair value is the value a third party is willing to pay for a contract in an arm's length transaction. In order to calculate the fair market value, the future cash flows must be discounted to their present value where there are cash flows clearly defined by the terms of the contract. The Investor is willing to assume the contract if the contract compensates fairly the price per all risks included in the contract. This means that the investor demands an adequate rate of return that covers all the risks. Accordingly, the investor will discount all future cash flows using this return rate to arrive at the present value that the investor is willing to pay for the contract. The present value arrived at in this manner guarantees the investor the required annual rate of return and represents the fair value:

$$FV_l = \sum_{i=1}^{T} \frac{CF_i}{(1+RRR_i^l)^i}$$

FV fair value of loan l

T maturity of the loan

CF_n cash flows (principal and interest) as per loan agreement

RRR_n^l rate of return per investor for the maturity n and loan l

The required rate of return:

$$RRR_n = r_n + s_n^l + (1 - cr_l) fc_n + cc_l \cdot ec^l$$

r_n risk-free interest for the currency of the loan l and maturity of the cash flows

s_n^l n- annual premium for idiosyncratic credit risk aligned with the risk of the country of debtor's origin

fc_n funding spread

ec^l pre-tax excess equity cost

cr_l percentage share of the contract coverage by capital, which represents an economic capital requirement for each contract.

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.6. Fair Value of Financial Assets and Liabilities (Continued)

The following table presents movements in the financial assets carried at fair value within Level 3 of the fair value hierarchy:

	Banja Luka Stock Exchange	Central Securities Register	Euro Axis Bank	S.W.I.F.T.	Vučijak a.d.	Total
Balance at January 1, 2018	175	30	-	24	-	229
Increase in the year	-	-	-	-	-	-
Decrease in the year	-	-	-	-	-	-
Change in revaluation reserves	-	-	-	-	-	-
Sales	-	-	-	-	-	-
Balance at December 31, 2018	175	30	-	24	-	229
Balance at January 1, 2017	175	30	418	24	-	647
Increase in the year	-	-	-	-	-	-
Decrease in the year	-	-	-	-	-	-
Change in revaluation reserves	-	-	(9)	-	-	(9)
Sales	-	-	(409)	-	-	(409)
Balance at December 31, 2017	175	30	-	24	-	229

During 2018, there were no reclassifications between the Levels.

6.7. Operational Risks

Operational risk management is an important part of the Bank's operations, which allows their long-term successful business and the preservation of reputation.

As part of operational risk framework, the Bank implements the following activities:

- definition and identification of operational risk;
- development and application of methods and systems for measurement, analysis, limitations and control of operational risks in accordance with regulatory and requirements of Addiko Group;
- measurement, analysis and supervision of operational risk in line with minimum standards for operational risk management;
- maintenance of database on losses from operational risks – regular data collection and reporting on loss events;
- regular updates of the existing and development of new policies, manuals and procedures in accordance with regulatory and requirements of Addiko Group;
- performing qualitative estimates (scenario analyses and risk assessment) in order to identify and assess risk in business processes;
- reputation risk management aiming at risk identification, assessment, monitoring and control and reporting reputational risk;
- education of all employees in order to improve their knowledge and experience, awareness and skills in dealing with operational risk or specific processes (e.g. collection of data on losses, risk assessment);
- development of the internal control system through the process of mapping all the relevant SIK processes within the Bank, by definition of their owners, recognition of risks arising within a process, adequate alleviation of those risks and testing operating effectiveness of the controls in place;
- assessment and establishment of adequate operational risk management upon development of new products;
- assessment of the risk of outsourcing and management of outsourced activities within the Bank in collaboration with organizational units that are owners of the outsourced activities.

6. FINANCIAL RISK MANAGEMENT (Continued)

6.8. Capital Risk Management

In accordance with the effective Law on Banks, the minimum amount of a bank's paid-in capital to be maintained at all times must not be below BAM 15,000 thousand. The Bank's subscribed capital amounted to BAM 153,049 thousand in line with these provisions.

Pursuant to the new Decision on Bank Capital Calculation enacted by the Banking Agency of the Republic of Srpska ("BARS") in 2017, the Bank's capital is comprised of regulatory capital as the sum of the Bank's core capital and supplementary capital after the regulatory adjustments:

- The Bank's core capital is the sum of the regular core capital and additional core capital after regulatory adjustments;
- The Bank's supplementary capital is comprised of the equity instruments and subordinated debts, share premium accounts, general provisions for credit losses and other items after regulatory adjustments.

Regular core capital items include: equity instruments if the recognition criteria are met for them, share premium accounts relating to the equity instruments, retained earnings, other comprehensive income, other reserves and reserves for general banking risks.

The Bank deducts from the regular core capital items the following: loss for the current financial year, unabsorbed prior years' losses, intangible assets, deferred tax assets depending on the future profitability, all tax expenses relating to the regular core capital items predictable at the time of the item calculation, investments into the Bank's own equity instruments (e.g., redeemed Treasury shares), the amount of the Bank's qualified interest in a non-FSI entity, and free delivery (settlement) risk and other legally prescribed items if they arise during the banking operations.

The Bank's additional core capital is comprised of additional core capital items less the regulatory adjustments and application of the temporary exemption of the regulatory capital deductibles.

The Bank deducts from the additional core capital items the following: the Bank's direct and indirect investments into own additional core capital instruments, including those instruments that would be subject to the Bank's purchase obligation under the existing contractual commitments, the Bank's direct and indirect investments in additional core capital instruments of a FSI entity if the entity has a reciprocal investment into the Bank, which the Agency believes to have been made with a view to artificial increase in the regulatory capital, the amount of direct or indirect Bank's investment into the additional core capital instruments of a FSI entity if the Bank holds a significant interest therein, the amount of direct or indirect Bank's investment into the additional core capital instruments of a FSI entity if the Bank holds no significant interest therein, excluding items that, as the issue underwriter, it has held for no more than five working days, the amount of items to be deducted from the supplementary capital that exceed the Bank's supplementary capital, tax liabilities relating to the additional core capital items predictable at the time of the item calculation, unless the Bank adequately adjusts the amount of the additional core capital items to the extent that such tax liabilities may reduce their amount

The Bank's supplementary capital is comprised of the supplementary capital items less the regulatory adjustments and application of the temporary exemption of the regulatory capital deductibles. The supplementary capital may not exceed a half of the core capital, and as from July 26, 2018 it may not exceed one third of the core capital

The supplementary capital items include: paid equity instruments and subordinated debts recognized as supplementary capital items, share issue premium accounts, and general provisions for credit losses maximum up to 1.25% of the amount of the risk-weighted exposures

Equity instruments and subordinated debts meeting the inclusion criteria may be included in the supplementary capital only after the Bank has obtained a prior approval from the Agency.

(Thousands of BAM)

6. FINANCIAL RISK MANAGEMENT (Continued)

6.8. Capital Risk Management (Continued)

The Bank deducts from the supplementary capital items the following: the Bank's direct or indirect investments in its own supplementary capital instruments, including its own supplementary capital instruments subject to a potential purchase obligation under the existing contractual commitments, the Bank's investments in the supplementary capital instruments of a FSI entity if the entity has a reciprocal investment into the Bank, which the Agency believes to have been made with a view to artificial increase in the regulatory capital, the Bank's direct or indirect investments in the supplementary capital instruments of a FSI entity if the Bank holds a significant interest therein, the amount of direct or indirect Bank's investment into the supplementary capital instruments of a FSI entity if the Bank holds no significant interest therein, excluding items that, as the issue underwriter, it has held for no more than five working days.

The table below provides the Bank's capital structure for the purpose of calculation of the Bank's capital adequacy ratio in accordance with the new Decision on Bank Capital Calculation enacted by the Banking Agency of the Republic of Srpska ("BARS") (Official Gazette of RS no. 74/2017 and 114/2017):

	2018	2017
Core capital		
Equity instruments recognized at the regular core capital	153,094	153,094
Retained earnings	(65,564)	(70,039)
Other comprehensive income	63	20
(-) Other intangible assets	(5,874)	(4,437)
Other reserves	56,819	-
Regular core capital	**138,538**	**78,638**
Additional core capital	**-**	**-**
Total core capital	**138,538**	**78,638**
Supplementary capital		
Total supplementary capital	6,404	6,177
Total regulatory capital	**144,942**	**84,815**
Risk exposures		
Risk-weighted exposures for credit risk, financial derivatives exposure to credit risk and free delivery (settlement) risk	512,299	494,158
Total exposures to the position risk, currency and commodity risks	4,507	21,803
Total operational risk exposure	74,730	69,932
Total risk exposures	**591,536**	**585,893**
Ratio of the regular core capital	23.42%	13.42%
Regular core capital surplus	98,609	39,090
Core capital ratio	23.42%	13.42%
Core capital surplus	85,300	25,908
Regulatory capital ratio	24.50%	14.48%
Regulatory capital surplus	73,958	14,508

As of December 31, 2018 and 2017 all the Bank's capital ratios were in compliance with the regulatory requirements. From the foregoing it is evident that the Bank has a solid capital position.

With regard to capital risk management, the Bank aims to:

- provide compliance with the Banking Agency of the Republic of Srpska requirements;
- provide compliance with Addiko Group standards;
- provide solid capital basis as a support for further development of Bank's operations;
- provide possibilities of long-term business operation while ensuring profit for shareholders.

The Bank's management monitors adequacy ratios and other performance indicators on a regular basis. Reports on indicators are submitted to the Banking Agency of the Republic of Srpska quarterly in the prescribed form.

6. FINANCIAL RISK MANAGEMENT (Continued)

6.8. Capital Risk Management (Continued)

The Bank manages capital and performs reconciliations in accordance with its goals, market changes and risks typical for Bank's operations.

Up to 2010, the Bank calculated and recorded provisions for credit risks in accordance with the regulatory rules prescribed by BARS.

In 2010, with the mandatory implementation of the newly adopted IAS 39, the regulatory rules were amended. The new rules required lower amounts of provisions compared to the previous (regulatory) methodology. As a result of the new standard implementation, the Bank credited reversal of the said provisions to the account of other reserves as "shortfall provisions from profit for estimated losses" in the amount of BAM 61,826 thousand.

On January 1, 2018, upon first-time adoption of IFRS 9 (wit mandatory implementation as from January 1, 2019), the aforesaid amount was reduced by BAM 475 thousand, which led to a decrease in the balance of the reserves for credit losses as per regulatory requirements by BAM 61,351 thousand.

On December 19, 2018, BARS issued the Decision on the Conditions for Inclusion of the Formed Reserves for Credit Losses into the Regular Core Capital of Banks (Official Gazette of RS no. 117/2018), whereby conditions are prescribed that banks need to fulfill in order to recognize the reserves for credit losses as the regular core capital item in accordance with the Decision on Bank Capital Calculation.

The aforesaid BARS Decision dated December 19, 2018 prescribes two conditions the Bank must fulfill:

- Submit to BARS a decision of the Bank's Shareholder Assembly on inclusion of the formed reserves for credit losses into the Bank's regular core capital, i.e., a decision on the allocation of the formed reserves to an appropriate item of its regular core capital in accordance with Article 6, para. 1 of the Decision on Bank Capital Calculation;

- Previously reduce the amount of the formed reserves for credit losses by any predictable costs in accordance with the effective tax legislation.

The Bank believes that the remaining balance of BAM 61,351 thousand on the account of the reserves for credit losses per regulatory requirement is tax exempt given the fact that, in years prior to the implementation of the Decision on the Minimum Standards for Credit Risk Management and Classification of Assets in Banks under IAS 39, these reserves for credit losses increased the Bank's taxable income so that there would be double taxation.

Considering all the aforesaid, on December 27, 2018, the Bank's Shareholder Assembly enacted Decision no. 01-1-22786/2018 on inclusion of the formed reserves for credit losses into the other reserves.

Due to the inclusion of the formed reserves for credit losses into the other reserves the Bank's regulatory capital increased by BAM 56,819 thousand as BAM 4,532 thousand remained as the balance of the reserves for credit losses as per regulatory requirements.

Capital management entails ongoing monitoring and the measures that the Bank may take to maintain the legally prescribed ratios and limits include the following:

- adjustments of dividend payments to shareholders, i.e., increase of the share capital from profit allocation;
- increase of the capital reserves from profit allocation;
- new issues of shares, which can be private and public;
- increase of the supplementary capital items.

Given the Bank's rather high capital adequacy ratio, the Bank does not anticipate the need to increase the capital, but in the event that the Bank needs to take measures in order to comply with the effective regulations, the Bank's owner demonstrated the willingness to support the Bank.

(Thousands of BAM)

7. INTEREST INCOME AND EXPENSES

	Year Ended December 31, 2018	2017
Interest income calculated using the effective interest method	32,285	29,835
Financial assets available for sale	-	210
Loans and receivables	-	29,625
Financial assets at FVtOCI	148	-
Financial assets at amortized cost (AC)	32,137	-
Other interest income	10	48
Dividend income	10	48
Total interest income	32,295	29,883
Financial liabilities at amortized cost (AC)	(6,836)	(7,807)
Other liabilities	-	(66)
Negative interest on financial assets	(215)	(166)
Total interest expenses	(7,051)	(8,039)
Net interest income	**25,244**	**21,844**

7.1. Interest Income

a) *Interest Income - Breakdown per Source*

	Year Ended December 31, 2018	2017
Bonds	148	210
Public sector (Government)	121	120
Banks	27	90
Loans and receivables	32,011	29,568
Public sector (Government)	1,764	2,549
Public companies	944	659
Non-banking financial institutions	357	198
Corporate customers - private companies	5,962	4,625
Entrepreneurs	396	354
Retail customers - individuals	22,548	21,141
Non-residents	-	-
Other entities	40	42
Cash and balances held with the Central Bank	-	-
Balances held with other banks	126	57
Dividend income	10	48
	32,295	**29,883**

b) *Interest Income - Breakdown per Product*

	Year Ended December 31, 2018	2017
Loans and receivables due from customers	31,390	28,849
Payment cards	621	719
Treasury bills	-	-
Bonds	148	210
Balances held with other banks	126	57
Cash and balances held with the Central Bank	-	-
Dividend income	10	48
	32,295	**29,883**

(Thousands of BAM)

7. INTEREST INCOME AND EXPENSES (Continued)

7.1. Interest Expenses

a) Interest Expenses - Breakdown per Source

	Year Ended December 31, *2018*	*2017*
Deposits	5,912	7,010
Public sector (Government)	356	379
Public companies	120	45
Banks	164	1,719
Non-banking financial institutions	438	309
Corporate customers - private companies	176	212
Entrepreneurs	1	2
Retail customers - individuals	4,636	4,327
Non-residents	-	-
Other entities	21	17
Negative interest on financial assets	215	166
Other liabilities	-	66
Borrowings	924	797
Banks	260	-
Non-banking financial institutions	664	797
	7,051	**8,039**

b) Interest Expenses - Breakdown per Product

	Year Ended December 31, *2018*	*2017*
Current accounts and deposits of customers	5,748	5,291
Current accounts and deposits of banks	164	1,719
Negative interest on financial assets	215	166
Borrowings	924	797
Other liabilities	-	66
	7,051	**8,039**

8. FEE AND COMMISSION INCOME AND EXPENSES

8.1. Fee and Commission Income

	Year Ended December 31, *2018*	*2017*
Fee income arising from domestic payment transfers	6,411	5,621
Fees earned on VISA card operations	3,341	3,087
Fee income arising from international payment transfers	1,686	2,065
Fee income from currency conversion operations	743	824
Charges for early loan repayment, reminders and other loan fees	739	891
Commission from issued guarantees, letters of credit and other sureties	597	431
Brokerage commissions	1	31
Insurance fees and commissions	491	53
Other fee and commission income	974	933
	14,983	**13,936**

(Thousands of BAM)

8. FEE AND COMMISSION INCOME AND EXPENSES

8.1. Fee and Commission Income (Continued)

In accordance with the requirements of IFRS 15, fee and commission income may be presented as follows:

	Year Ended December 31,	
	2018	*2017*
Account maintenance	5,299	4,557
Transactions	2,974	3,251
Card operations	2,313	2,365
Lending operations	706	863
Issue of guarantees, letters of credit and other sureties	595	427
Securities	-	31
Insurance	739	192
Currency conversion operations	2,076	2,128
Other	281	122
	14,983	**13,936**

8.2. Fee and Commission Expenses

	Year Ended December 31,	
	2018	*2017*
Fee expenses incurred on payment card operations	1,722	1,225
Fees for loans, issued guarantees and other fees	296	116
Fee expenses incurred on domestic payment transfers	312	296
Fee expenses incurred on international payment transfers	145	137
Fee expenses incurred on stock exchange operations and Central Register fees	74	139
Fee expenses per funds available for liquidity maintenance	44	-
	2,593	**1,913**

In accordance with the requirements of IFRS 15, fee and commission expenses may be presented as follows:

	Year Ended December 31,	
	2018	*2017*
Account maintenance	-	8
Transactions	586	624
Card operations	1,713	1,217
Securities – customer bonuses	108	-
Other	186	64
	2,593	**1,913**

9. NET PROFIT FROM FINANCIAL INSTRUMENTS

	Year Ended December 31,	
	2018	*2017*
Profit on the financial assets held for trading (FVtPL)	(23)	(136)
Profit on the financial assets available for sale	-	318
Foreign exchange gains/(losses)	114	(96)
	91	**86**

(Thousands of BAM)

10. OTHER OPERATING INCOME

	Year Ended December 31,	
	2018	*2017*
Reversal of provisions for litigations	812	1,765
Gains on the sales and value adjustments of tangible assets acquired in lieu of debt collection	826	570
Rental income	405	378
Income from closing dormant accounts	-	104
Sales of consultancy services	5	25
Capital gains on the sales of acquired tangible assets, property and equipment	-	227
Other income	771	493
	2,819	**3,562**

11. OTHER OPERATING EXPENSES

	Year Ended December 31,	
	2018	*2017*
Fees payable to the Deposit Insurance Agency of RS costs	1,138	976
Provisions for litigations	767	2,398
Fees payable to the Banking Agency of RS	604	623
Litigation costs and court fees	405	1,573
Fees payable to the other regulatory institutions	385	406
Losses on the sales and fair value adjustments of the tangible assets acquired in lieu of debt collection	-	177
Appraisal costs	-	1,226
Disposals and write-offs of property and equipment	19	125
Other expenses	381	384
	3,699	**7,888**

12. STAFF COSTS

	Year Ended December 31,	
	2018	*2017*
Net salaries	7,064	7,603
Payroll taxes and contributions	4,351	4,769
Other employee benefits	810	875
Reversal of provisions for retirement benefits/unused annual leaves	(11)	(47)
Provisions for employee bonuses	586	723
	12,800	**13,923**

Other employee benefits include the cost of employee commuting allowances, paid recreation hours, insurance and other forms of employee benefits.

(Thousands of BAM)

13. OTHER ADMINISTRATIVE EXPENSES

	Year Ended December 31, 2018	2017
Software lease costs	3,842	4,221
Property insurance and security	1,036	1,104
Telecommunications	1,266	1,410
Cost of materials, fuel, energy and services	951	1,230
Indirect taxes and contributions	887	873
Advertising, marketing and entertainment	1,084	1,217
Rental costs	1,392	1,208
Maintenance	1,236	799
Non-material costs	165	111
Intellectual services rendered by related banks	246	403
Consulting services	58	157
Membership fees and commissions	116	169
Per diems and other travel costs	239	250
Sponsorship and humanitarian aid projects	141	153
Other expenses	527	479
	13,186	**13,784**

14. PROVISIONS FOR POTENTIAL LOSSES, COMMITMENTS AND WRITE-OFFS

	Year Ended December 31, 2018	2017
Cash and balances held with the Central Bank (Note 16)	234	-
Balances held with other banks (Note 17)	(102)	(9)
Loans and receivables due from customers (Note 18.1)	(4,465)	4,509
Other financial assets (Note 18.2)	(322)	(221)
Investments in securities (Note 19)	(26)	-
Contingent liabilities and commitments (Note 30)	85	(1,747)
Recovery of the receivables previously written off	164	3,204
Write-offs	(627)	(1,012)
	(5,059)	**4,724**

15. INCOME TAXES

a) *Components of Income Taxes*

	2018	2017
Current income tax expenses	-	-
Deferred tax benefits	(7)	(7)
	(7)	**(7)**

b) *Reconciliation between tax expense and profit before taxes multiplied by the applicable tax rate*

	2018	2017
Profit before taxes	3,278	4,468
Income taxes at the statutory tax rate of 10%	328	447
Adjustments		
Tax effects of expenses not recognized for tax purposes	152	344
Tax effects of income not recognized for tax purposes	(198)	(24)
Tax effects of recognized provisions for potential losses	314	92
Non-deductible entertainment costs	1	2
Non-deductible default interest	3	11
Tax effects of non-deductible depreciation and charge	(80)	(104)
Tax effects of provisions for employee benefits	(21)	(47)
Utilization of tax losses carried forward	(499)	(721)
Reversal of deferred tax (liabilities)/assets	(7)	(7)
Income tax expense	**(7)**	**(7)**
Effective tax rate	**0.21%**	**0.16%**

(Thousands of BAM)

15. INCOME TAXES (Continued)

b) Reconciliation between tax expense and profit before taxes multiplied by the applicable tax rate (Continued)

The Bank's taxable income amounted to BAM 4,993 thousand for FY 2018. The Bank eliminated the taxable income amount using the same amount of the tax losses carried forward from prior periods. The remaining gross tax losses of BAM 7,140 thousand will be available for elimination or reduction of the Bank's taxable profits in the ensuing years. A tax loss is available for carryforward within five years from inception (the aforesaid amount can be used up to December 31, 2021).

c) Deferred Taxes

The following table shows items for which deferred tax assets and liabilities were formed:

	2018	*2017*
Deferred tax liabilities		
Revaluation reserves from property and equipment	(242)	(248)
Changes in fair value of securities available for sale	-	-
Property and equipment - different tax and accounting depreciation rates	(340)	(341)
	(582)	**(589)**
Deferred tax liabilities, net	**(582)**	**(589)**

Movements on the Bank's deferred taxes were as follows:

	January 1, 2018	Recognized in the profit or loss	Recognized in other comprehensive income	December 31, 2018	Deferred tax assets	Deferred tax liabilities
Revaluation reserves from property and equipment	(249)	8	h(1)	(242)	-	(242)
Property and equipment - different tax and accounting rates	(340)	-	-	(340)	-	(340)
	(589)	**8**	(1)	**(582)**	**-**	**(582)**

	January 1, 2017	Recognized in the profit or loss	Recognized in other comprehensive income	December 31, 2017	Deferred tax assets	Deferred tax liabilities
Revaluation reserves from property and equipment	(256)	6	1	(249)	-	(249)
Property and equipment - different tax and accounting rates	(340)	-	-	(340)	-	(340)
	(596)	**6**	**1**	**(589)**	**-**	**(589)**

16. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	2018	*2017*
Cash in hand:		
- in local currency	14,491	13,768
- in foreign currencies	11,298	7,256
Balances with the Central Bank (BAM)		
- obligatory reserve	45,137	47,106
- gyro account	59,754	53,733
Less: Impairment allowance of cash and balances with the Central Bank	(734)	-
	129,946	**121,863**

(Thousands of BAM)

16. CASH AND BALANCES HELD WITH THE CENTRAL BANK (Continued)

The obligatory reserve represents amounts required to be deposited with the Central Bank of Bosnia and Herzegovina. Pursuant to the Decision of the Central Bank of Bosnia and Herzegovina, starting from August 31, 2016, the required reserve represents 10% of average balance of liabilities per deposits and borrowings irrespective of their maturities.

The required reserve is maintained as the average balance on the current account with the Central Bank of Bosnia and Herzegovina. This reserve is available for liquidity purposes. The Central Bank pays banks a fee for the total obligatory reserve held on the account in the manner prescribed by the Law.

Movements on the Bank's gross exposure in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Gross exposure at January 1, 2018	121,863	-	-	-	121,863
Change in the gross exposure	8,817	-	-	-	8,817
of which, increase	82,776	-	-	-	82,776
of which, decrease	(73,959)	-	-	-	(73,959)
of which, transfers among Stages	-	-	-	-	-
Write-offs	-	-	-	-	-
Originated or purchased assets	-	-	-	-	-
Derecognized assets	-	-	-	-	-
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Gross exposure at December 31, 2018	**130,680**	**-**	**-**	**-**	**130,680**

Movements on the impairment allowance/provisions in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Provisions at January 1, 2018	(968)	-	-	-	(968)
Change in the provisions	234	-	-	-	234
of which, transfers among Stages	-	-	-	-	-
of which, increase	-	-	-	-	-
of which, decrease	234	-	-	-	234
of which, effects on the interest income	-	-	-	-	-
Write-offs	-	-	-	-	-
Modification effect not resulting in derecognition of assets	-	-	-	-	-
Originated or purchased assets	-	-	-	-	-
Derecognized assets	-	-	-	-	-
Model/parameter changes	-	-	-	-	-
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Provisions at December 31, 2018	**(734)**	**-**	**-**	**-**	**(734)**

(Thousands of BAM)

17. BALANCES HELD WITH OTHER BANKS

	2018	*2017*
Foreign currency accounts held with foreign and domestic banks	51,223	13,363
Short-term deposits placed for periods of up to 7 days	7,345	6,061
Foreign currency cheques in the course of collection	-	1
Total	**58,568**	**19,425**
Less: Impairment allowance of the balances held with other banks	(121)	(15)
	58,447	**19,410**

As of December 31, 2018, the amount of BAM 7,345 thousand relates to the foreign currency term deposits totaling USD 4.3 million, with a 7-day maturity, placed with Erste Group Bank AG Austria at an interest rate of 2.4%.

Foreign currency accounts held with foreign and domestic banks accrue interest depending on the terms of respective contracts executed with those banks for various currencies.

Movements on the Bank's gross exposure in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Gross exposure at January 1, 2018	19,401	-	24	-	19,425
Change in the gross exposure	37,488	-	-	-	37,488
of which, increase	38,298	-	-	-	38,298
of which, decrease	(810)	-	-	-	(810)
of which, transfers among Stages	-	-	-	-	-
Write-offs	-	-	(25)	-	(25)
Originated or purchased assets	8,463	-	-	-	8,463
Derecognized assets	(7,337)	-	-	-	(7,337)
Foreign exchange effects	553	-	1	-	554
Other movements	-	-	-	-	-
Gross exposure at December 31, 2018	**58,568**	**-**	**-**	**-**	**58,568**

Movements on the impairment allowance/provisions in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Provisions at January 1, 2018	(31)	-	(12)	-	(43)
Change in the provisions	(114)	-	12	-	(102)
of which, transfers among Stages	-	-	-	-	-
of which, increase	(118)	-	-	-	(118)
of which, decrease	4	-	12	-	16
of which, effects on the interest income	-	-	-	-	-
Write-offs	-	-	-	-	-
Modification effect not resulting in derecognition of assets	-	-	-	-	-
Originated or purchased assets	-	-	-	-	-
Derecognized assets	-	-	-	-	-
Model/parameter changes	-	-	-	-	-
Foreign exchange effects	24	-	-	-	24
Other movements	-	-	-	-	-
Provisions at December 31, 2018	**(121)**	**-**	**-**	**-**	**(121)**

(Thousands of BAM)

17. BALANCES HELD WITH OTHER BANKS (Continued)

Movements on the impairment allowance/provisions in 2017 were as follows:

	2017.
Balance at January 1	*7*
Charge for the year	13
Reversal/decrease	(4)
Charge for the year, net (Note 14)	*9*
Foreign exchange effects, net	*(1)*
Balance at December 31	**15**

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

Loans and receivables at amortized cost comprise the following:

	2018	*2017*
Loans and receivables due form customers	506,896	522,019
Other financial assets	2,782	2,213
	509,678	**524,232**

18.1. Loans and Receivables Due from Customers

	2018	*2017*
Retail customers	31,055	365,494
Private companies	20,975	178,868
Public sector (Government)	15,893	45,535
Public companies	154,166	21,257
Entrepreneurs	11,605	11,636
Non-residents	362,419	1,462
Non-banking financial institutions	1,309	9,743
Other organizations	144	351
Total, gross	**597,566**	**632,346**
Less: Impairment allowance of loans and receivables	(89,106)	(108,568)
Total loans, net	**508,460**	**523,778**
Accrued fee income charged	(1,564)	(1,759)
Total net loans and receivables due from customers	**506,896**	**522,019**

Loans and receivables due from customers per product type are presented below:

	2018	*2017*
Investment loans	146,727	180,804
Consumer loans	244,664	222,322
Housing loans	62,948	77,333
Loans for working capital	36,162	35,072
Mortgage loans	24,120	28,993
Account overdrafts	60,753	58,722
Car loans	165	291
Paid guarantees	159	164
Other	21,868	28,645
Total	**597,566**	**632,346**
Less: Impairment allowance of loans and receivables	(89,106)	(108,568)
Total loans, net	**508,460**	**523,778**
Accrued fee income charged	(1,564)	(1,759)
Total net loans and receivables due from customers	**506,896**	**522,019**

(Thousands of BAM)

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

18.1. Loans and Receivables Due from Customers (Continued)

During 2018 the Bank acquired real estate properties and movables used as collateral securitizing loans in the total amount of BAM 1,836 thousand (2017: BAM 1,097 thousand). During 2018 the Bank sold assets acquired in lieu of debt collection with the carrying value of BAM 421 thousand (2017: BAM 103 thousand).

Movements on the Bank's gross exposure in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Gross exposure at January 1, 2018	483,060	28,606	121,786	-	633,452
Change in the gross exposure	(70,132)	18,348	(11,411)	-	(63,195)
of which, increase	356,479	30,536	72,217	-	459,232
of which, decrease	(397,524)	(35,114)	(89,789)	-	(522,427)
of which, transfers among Stages	(29,087)	22,926	6,161	-	-
Write-offs	(10)	(54)	(27,651)		(27,715)
Originated or purchased assets	176,360	4,237	7,228	-	187,825
Derecognized assets	(121,846)	(9,763)	(1,975)	-	(133,584)
Foreign exchange effects	105	9	738	-	852
Other movements	(58)	-	(11)		(69)
Gross exposure at December 31, 2018	467,479	41,383	88,704	-	597,566

Movements on the impairment allowance/provisions in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Provisions at January 1, 2018	(5,153)	(4,199)	(100,978)	-	(110,330)
Change in the provisions	(1,565)	1,045	(1,920)	-	(2,440)
of which, transfers among Stages	1,771	118	(1,88)	-	-
of which, increase	(6,317)	(1,658)	(11,401)	-	(19,376)
of which, decrease	2,981	2,585	12,559	-	18,125
of which, effects on the interest income	-	-	(1,189)	-	(1,189)
Write-offs	-	2	27,468	-	27,470
Modification effect not resulting in derecognition of assets	-	-	-	-	-
Originated or purchased assets	(1,644)	(359)	(335)	-	(2,338)
Derecognized assets	503	503	1,462	-	2,468
Model/parameter changes	3,347	(6,691)	-	-	(3,344)
Foreign exchange effects	(1)	(2)	(589)	-	(592)
Other movements	-	-	-	-	-
Provisions at December 31, 2018	**(4,513)**	**(9,701)**	**(74,892)**	**-**	**(89,106)**

Movements on the impairment allowance/provisions in 2017 were as follows:

	2017.
Balance at January 1	124,950
Charge for the year	24,331
Reversal/release	(27,356)
Decrease - unwinding (interest income on impaired receivables)	(1,484)
Reversal/release for the year, net (Note 14)	**(4,509)**
Foreign exchange effects, net	(1,746)
Write-offs	(10,127)
Balance at December 31	**108,568**

(Thousands of BAM)

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

18.2. Other Financial Assets

	2018	2017
Other financial assets		
In BAM:		
- receivables due from customers per court rulings	455	1,605
- receivables from collateral foreclosures	46	45
- receivables per credit cards	1,209	889
- advances paid to suppliers	313	433
- rental income receivables	68	75
- receivables for consultancy services rendered	6	2
- third party receivables (managed funds)	424	199
- receivables for assets sold	-	1
- other receivables	536	473
In foreign currencies:		
- receivables per credit cards	728	607
- prepaid interest	1	1
- other receivables	266	270
Total	**4,052**	**4,600**
Less: Impairment allowance of other financial assets	(1,270)	(2,387)
	2,782	**2,213**

Movements on the Bank's gross exposure in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Gross exposure at January 1, 2018	2,225	-	2,375	-	4,600
Change in the gross exposure	353	12	52	-	417
of which, increase	657	-	63	-	720
of which, decrease	(292)	-	(11)	-	(303)
of which, transfers among Stages	(12)	12	-	-	-
Write-offs	-	-	(1,449)	-	(1,449)
Originated or purchased assets	215	1	276	-	492
Derecognized assets	-	-	(8)	-	(8)
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Gross exposure at December 31, 2018	**2,793**	**13**	**1,246**	**-**	**4,052**

Movements on the impairment allowance/provisions in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Provisions at January 1, 2018	(32)	-	(2,372)	-	(2,404)
Change in the provisions	(19)	(4)	(298)	-	(321)
of which, transfers among Stages	-	-	-	-	-
of which, increase	(28)	(4)	(314)	-	(346)
of which, decrease	9	-	16	-	25
of which, effects on the interest income	-	-	-	-	-
Write-offs	-	-	1,455	-	1,455
Modification effect not resulting in derecognition of assets	-	-	-	-	-
Originated or purchased assets	-	-	-	-	-
Derecognized assets	-	-	-	-	-
Model/parameter changes	-	-	-	-	-
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Provisions at December 31, 2018	**(51)**	**(4)**	**(1,215)**	**-**	**(1,270)**

(Thousands of BAM)

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

18.2. Other Financial Assets (Continued)

Movements on the impairment allowance/provisions in 2017 were as follows:

	2017.
Balance at January 1	2,280
Charge for the year	336
Reversal/release	(115)
Charge for the year, net (Note 14)	221
Release	(114)
Balance at December 31	**2,387**

19. INVESTMENTS IN SECURITIES

19.1. Debt and Equity Securities

	2018	*2017*
Financial assets at FVtOCI		
Balance at December 31		
Bonds of BNP Paribas BA	9,758	-
Bonds of Commerce Bank Frankfurt	7,515	-
Bonds of Intesa Sanpaolo SPA	5,927	-
Bonds of UBS AG	9,818	-
Bonds of UniCredit SPA	6,020	-
Bonds of the Polish Government	13,834	-
RS Ministry of Finance bonds	2,027	-
Equity securities		
Banja Luka Stock Exchange	175	-
Central Register of Securities, Banja Luka	30	-
S.W.I.F.T	24	-
Financial assets at FVtPL		
Debt securities		
RS Ministry of Finance bonds	-	2,029
Equity securities		
Banja Luka Stock Exchange	-	175
Central Register of Securities, Banja Luka	-	30
S.W.I.F.T	-	24
	55,128	**2,258**

The Bank's investments in debt securities totaling BAM 54,899 thousand as of December 31, 2018 refer to the long-term debt securities issued by the Ministry of Finance of Republic of Srpska at interest rates ranging from 1.5% to 6%, securities issued by EU banks at interest rates ranging from 0.5% to 2.75%, and securities issued by the Government of Poland at an interest rate of 4.5%.

(Thousands of BAM)

19. INVESTMENTS IN SECURITIES (Continued)

19.1. Debt and Equity Securities (Continued)

Movements on the Bank's gross exposure in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Gross exposure at January 1, 2018	2,029	-	-	-	2,029
Change in the gross exposure	52,870	-	-	-	52,870
of which, increase	53,316	-	-	-	53,316
of which, decrease	(446)	-	-	-	(446)
of which, transfers among Stages	-	-	-	-	-
Write-offs	-	-	-	-	-
Originated or purchased assets	-	-	-	-	-
Derecognized assets	-	-	-	-	-
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Gross exposure at December 31, 2018	**54,899**	**-**	**-**	**-**	**54,899**

Movements on the impairment allowance/provisions in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Provisions at January 1, 2018	(93)	-	-	-	(93)
Change in the provisions	(25)	-	-	-	(25)
of which, transfers among Stages	-	-	-	-	-
of which, increase	(96)	-	-	-	(96)
of which, decrease	71	-	-	-	71
of which, effects on the interest income	-	-	-	-	-
Write-offs	-	-	-	-	-
Modification effect not resulting in derecognition of assets	-	-	-	-	-
Originated or purchased assets	-	-	-	-	-
Derecognized assets	-	-	-	-	-
Model/parameter changes	-	-	-	-	-
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Provisions at December 31, 2018	**(118)**	**-**	**-**	**-**	**(118)**

19.2. Derivative Financial Assets and Liabilities

Derivatives held for trading

	2018	*2017*
Assets		
Fair value:		
Currency forwards and currency swaps	-	-
Notional amount:		
Currency forwards and currency swaps	115,394	134,952
Liabilities		
Fair value:		
Currency forwards and currency swaps	-	-
Notional amount:		
Currency forwards and currency swaps	115,394	134,952

(Thousands of BAM)

19. INVESTMENTS IN SECURITIES (Continued)

19.2. Derivative Financial Assets and Liabilities (Continued)

The Bank uses foreign currency forward contracts and currency swaps to manage foreign exchange risk. Derivatives are classified as financial instruments held for trading, as the Bank has not implemented hedge accounting.

The notional amounts of certain types of financial assets provide a basis for comparison with the assets in the statement of financial position, but do not necessarily indicate the amount of future cash flows or current fair value of the assets and therefore do not indicate the exposure to credit risk, or the risk of price changes.

20. EQUITY INVESTMENTS

Consolidated financial statements used to be prepared for the Bank/Group until December 31, 2017 and included consolidated financial statements of the Bank and entity Hypo-Alpe-Adria Leasing d.o.o., Banja Luka under the Bank's control (subsidiary) up to September 7, 2017, when the liquidation procedure was instigated, where by the Bank lost control over its subsidiary.

As of December 31, 2018 and 2017, the Bank had no equity investments in other entities.

21. PROPERTY AND EQUIPMENT

21.1. Land, Buildings and Equipment

	Land and buildings	Equipment, and other assets	Investments in progress	Total
Cost				
Balance, January 1, 2017	*37,965*	*11,720*	*59*	*49,744*
Additions	13	604	58	675
Transfers	-	58	(58)	-
Retirement and disposal	-	(191)	-	(191)
Impairment	(119)	-	-	(119)
Derecognition	-	-	(57)	(57)
Sales	-	(2,983)	-	(2,983)
Reclassifications	(547)	-	-	(547)
Balance, December 31, 2017	**37,312**	**9,208**	**2**	**46,522**
Balance, January 1, 2018	*37,312*	*9,208*	*2*	*46,522*
Additions	-	87	84	171
Transfers	-	1	(1)	-
Retirement and disposal	-	(30)	-	(30)
Sales	-	(2)	-	(2)
Balance, December 31, 2018	**37,312**	**9,264**	**85**	**46,661**
Accumulated depreciation				
Balance, January 1, 2017	*10,273*	*9,225*	-	*19,498*
Charge for the year	566	560	-	1,126
Retirement and disposal	-	(180)	-	(180)
Impairment	1,095	-	-	1,095
Sales	-	(2,471)	-	(2,471)
Reclassifications	(155)	-	-	(155)
Balance, December 31, 2017	**11,779**	**7,134**	**-**	**18,913**
Balance, January 1, 2018	*11,779*	*7,134*	-	*18,913*
Charge for the year	546	553	-	1,099
Retirement and disposal	-	(28)	-	(28)
Sales	-	(2)	-	(2)
Balance, December 31, 2018	**12,325**	**7,657**	**-**	**19,982**
Net book value:				
at December 31, 2018	**24,987**	**1,607**	**85**	**26,679**
at December 31, 2017	**25,533**	**2,074**	**2**	**27,609**

(Thousands of BAM)

21. PROPERTY AND EQUIPMENT (Continued)

21.1. Land, Buildings and Equipment (Continued)

The Bank's property as of December 31, 2018 included land and buildings with the carrying value of BAM 707 thousand for which the Bank did not possess appropriate title deeds (2017: BAM 723 thousand). As of December 31, 2018, the Bank had no mortgage or pledge liens assigned over its property and equipment.

As of December 31, 2017, the Bank recorded impairment in the amount of BAM 1,227 thousand, of which the amount of BAM 1 thousand was recorded as a decrease of previously recognized revaluation reserve while BAM 1,226 thousand was recognized in the profit and loss statement.

If the value of property and equipment were presented at historical cost, the Bank would have recognized the following amounts:

	2018	*2017*
Cost	49,757	49,617
Accumulated depreciation	(25,781)	(24,620)
Net book value	**23,976**	**24,997**

21.2. Investment Property

Cost	
Balance at January 1, 2017	*3,915*
Balance at December 31, 2017	**3,915**
Balance at January 1, 2018	*3,915*
Additions	13
Balance at December 31, 2018	**3,928**
Accumulated depreciation	
Balance at January 1, 2017	*1,361*
Appraisal effects	13
Reclassification	153
Balance at December 31, 2017	**1,527**
Balance at January 1, 2018	*1,527*
Balance at December 31, 2018	**1,527**
Net book value:	
at December 31, 2018	**2,401**
at December 31, 2017	**2,388**

22. INTANGIBLE ASSETS

	Licenses, software
Cost	
Balance at January 1, 2017	*18,247*
Additions	1,948
Reclassifications	57
Balance at December 31, 2017	**20,252**
Balance at January 1, 2018	*20,252*
Additions	2,875
Disposal and retirement	(16)
Balance at December 31, 2018	**23,111**
Accumulated amortization	
Balance at January 1, 2017	*14,764*
Charge for the year	1,050
Balance at December 31, 2017	**15,814**
Balance at January 1, 2018	*15,814*
Charge for the year	1,423
Balance at December 31, 2018	**17,237**
Net book value:	
at December 31, 2018	**5,874**
at December 31, 2017	**4,438**

(Thousands of BAM)

22. INTANGIBLE ASSETS (Continued)

If the value of intangible assets were presented at historical cost, the Bank would have recognized the following amounts:

	2018	*2017*
Cost	22,806	19,947
Accumulated depreciation	(16,932)	(15,509)
Net book value	**5,874**	**4,438**

23. ASSETS HELD FOR SALE

In accordance with IFRS 5, the Bank classified assets not used by the Bank and intended for sale as the assets held for sale. The net carrying value of the assets held for sale amounted to BAM 545 thousand.

24. OTHER ASSETS

Breakdown of the Bank's non-financial assets:

	2018	*2017*
Other non-financial assets		
In local currency:		
- Tangible assets received in lieu of debt collection	2,256	1,773
- Consumables, tools and fixtures	119	100
- Prepaid expenses	73	288
- Receivables for prepaid income taxes in Brčko District	-	-
- Receivables for deposited funds	407	509
- Receivables from investment funds	-	305
- Receivables for assets in acquisition	315	376
- Other receivables	2,137	2,001
In foreign currencies:		
- Prepaid expenses	263	1
- Other receivables	-	-
Total:	**5,570**	**5,353**
Less: Impairment allowance	-	-
	5,570	**5,353**

25. FINANCIAL LIABILITIES MEASURED AT AMORTIZED COST (AC)

25.1. Deposits Due to Banks and Other Financial Institutions

Deposits due to banks and financial institutions, grouped per agreed placement/maturity period, are presented below:

	2018	*2017*
Demand deposits	10,049	6,059
Short-term deposits	1,000	25,449
Long-term deposits	20,301	18,539
	31,350	**50,047**

Deposits due to banks and financial institutions classified per currency are presented below:

	2018	*2017*
Local currency	9,731	5,991
Foreign currency	21,619	44,056
	31,350	**50,047**

Deposits denominated in BAM with contracted currency clause are presented within appropriate foreign currency items.

(Thousands of BAM)

25. FINANCIAL LIABILITIES MEASURED AT AMORTIZED COST (AC) (Continued)

25.2. Deposits Due to Customers

Deposits due to customers, grouped per agreed placement/maturity period, are presented below:

	2018	2017
Demand deposits	307,908	243,628
Short-term deposits	8,168	5,293
Long-term deposits	224,169	210,460
	540,245	**459,381**

Deposits due to customers classified per customer type are presented below:

	2018	2017
Retail customers	380,925	334,187
Private companies	81,252	61,780
Public sector	32,086	20,549
Non-residents	19,705	18,312
Public companies	11,872	11,535
Entrepreneurs	7,469	6,941
Other organizations	6,936	6,077
	540,245	**459,381**

Deposits due to customers classified per currency are presented below:

	2018	2017
Local currency	257,836	197,295
Foreign currency	282,409	262,086
	540,245	**459,381**

Deposits denominated in BAM with contracted currency clause are presented within appropriate foreign currency items.

25.3. Borrowings

	2018	2017
Long-term foreign currency borrowings:		
EBRD (European Bank for Reconstruction and Development)	9,877	-
EFSE (European Fund for Southeast Europe)	15,659	-
	25,536	**-**
Long-term local currency borrowings:		
- RS Development and Employment Fund	4,151	2,510
- Fund for Development of Eastern Region of the Republic of Srpska	2,991	2,504
- RS Housing Fund	19,834	23,286
	26,976	**28,300**
	52,512	**28,300**

Long-term borrowings in local currency were contracted with a foreign currency clause.

EBRD (European Bank for Reconstruction and Development) approved a long-term loan to the Bank for general long-term financing of micro-sized, small and medium entities in EUR. The interest rate was defined as 6-month EURIBOR adjusted for percentage points as the determined minimum interest rate in accordance with the relevant Financing Agreement. The companies that are extended loans from these funds are required to comply with the prescribed environmental and social provisions of the legislation of Bosnia and Herzegovina and the Republic of Srpska.

(Thousands of BAM)

25. FINANCIAL LIABILITIES MEASURED AT AMORTIZED COST (AC) (Continued)

25.3. Borrowings (Continued)

EFSE (European Fund for Southeast Europe) approved a long-term loan to the Bank for general long-term financing of micro-sized, small and medium entities in EUR. The interest rate was defined as 6-month EURIBOR adjusted for percentage points as the determined minimum interest rate in accordance with the relevant Financing Agreement. The companies that are extended loans from these funds are required to comply with the prescribed environmental and social provisions of the legislation of Bosnia and Herzegovina and the Republic of Srpska.

RS Development and Employment Fund, Banja Luka approved a loan to the Bank for financing development projects. The repayment was agreed in accordance with the repayment schedules to the end users of the loans. Interest is charged at the rate of 6-month EURIBOR as adjusted for percentage points in accordance with the criteria for adjustment of interest rates pursuant to the Framework Agreement applied to the Investment Development Bank of the Republic of Srpska Banja Luka credit facilities.

RS Fund for Development of Eastern Region of the Republic of Srpska – which assist in development projects in the eastern region of the Republic of Srpska – approved a loan to the Bank. The repayment was agreed in accordance with the repayment schedules to the end users of the loans. Interest is charged at the rate of 6-month EURIBOR as adjusted for percentage points in accordance with the criteria for adjustment of interest rates pursuant to the Framework Agreement applied to the Investment Development Bank of the Republic of Srpska Banja Luka credit facilities.

Housing Fund of the Republic of Srpska, Banja Luka has provided a loan to the Bank for financing the purchase, reconstruction, and extension of homes. The repayment was agreed in accordance with the repayment schedules to the end users of the loans. Interest is charged at the rate of 6-month EURIBOR as adjusted for percentage points in accordance with the criteria for adjustment of interest rates pursuant to the Framework Agreement applied to the Investment Development Bank of the Republic of Srpska Banja Luka credit facilities.

25.4. Other Financial Liabilities

	2018	*2017*
Local currency liabilities:		
- Accounts payable	437	521
- Liabilities arising from credit card operations	545	478
- Liabilities per advances received	103	116
- Early loan repayments	593	422
- Blocked customer accounts	99	130
- Unrealized payments for foundation of entities	109	116
- PTA liabilities	-	55
- Dividend payment liabilities	70	70
- Other liabilities	130	245
Foreign currency liabilities:		
- Early loan repayments	5,145	4,752
- Accounts payable	1,117	905
- Liabilities arising from credit card operations	67	252
- PTA liabilities	-	12
- Other liabilities	265	738
	8,680	**8,812**

(Thousands of BAM)

26. OTHER LIABILITIES

Breakdown of the Bank's non-financial liabilities is provided in the table below:

	2018	2017
Local currency liabilities:		
- Liabilities to employees	1,722	1,680
- Liabilities for taxes and contributions	860	849
- Liabilities to employees for unused annual leaves	293	314
- Deferred interest income	100	100
- Other deferred fees	86	95
- Accrued expenses	790	678
- Other liabilities	64	180
Foreign currency liabilities		
- Other liabilities	69	-
	3,984	**3,896**

Movements on provisions for unused annual leaves are presented below:

	2018	2017
Balance at January 1	**314**	**366**
Charge for the year	-	-
Release of provisions	-	-
Reversal of provisions	(21)	(52)
(Reversal) for the year, net	***(21)***	***(52)***
Balance at December 31	**293**	**314**

27. EQUITY

Share Capital

The Bank's share capital includes initial shareholder investments and subsequent share issues. The Bank's shareholders are entitled to participation in the management of the Bank, as well as in the distribution of profit.

During 2018 the Bank did not increase/decrease its share capital. The Bank's share capital comprises 153,094,205 common stock (ordinary) shares with a par value of BAM 1 per share, which was registered with the District Commercial Court of Banja Luka on January 25, 2017 under Decision no. 057-0-Reg-17-001851.

As of December 31, 2018, the Bank's majority shareholder was Addiko Bank AG with a 99.86% equity interest (December 31, 2017: equity interest of the majority shareholder was 99.86%).

Reserves

The Bank's reserves as of December 31, 2018 and 2017 are provided in the following table:

	2018	2017
Legal reserves	-	-
Other reserves from profit	56,819	-
Special reserves for regulatory losses according to BARS regulations	4,532	61,826
Balance at December 31	**61,351**	**61,826**

On December 19, 2018, BARS issued the Decision on the Conditions for Inclusion of the Formed Reserves for Credit Losses into the Regular Core Capital of Banks (Official Gazette of RS no. 117/2018), whereby conditions are prescribed that banks need to fulfill in order to recognize the reserves for credit losses as the regular core capital item in accordance with the Decision on Bank Capital Calculation.

(Thousands of BAM)

27. EQUITY (Continued)

Reserves (Continued)

Considering all the aforesaid, on December 27, 2018, the Bank's Shareholder Assembly enacted Decision no. 01-1-22786/2018 on inclusion of the formed reserves for credit losses into the other reserves.

Due to the inclusion of the formed reserves for credit losses into the other reserves the Bank's regulatory capital increased by BAM 56,819 thousand as BAM 4,532 thousand remained as the balance of the reserves for credit losses as per regulatory requirements (Note 6.8).

As of December 31, 2018 and 2017, the Bank had no recorded shortfall reserves as per BARS regulations.

	2018	*2017*
Total reserves per regulatory requirements for balance sheet assets and off-balance sheet items	96,897	128,525
Total impairment allowance as per IAS/IFRS(for balance sheet assets and off-balance sheet items	92,405	113,516
Special reserves for regulatory losses per BARS regulations	4,532	61,826
The excess amount of credit loss reserves according to BARS regulations	(40)	(46,817)

28. EARNINGS PER SHARE

	2018	*2017*
Net profit for the year	3,285	4,475
Weighted average number of shares outstanding	153,094	153,094
Basic earnings per share (in BAM)	**0.021**	**0.029**

The Bank has no potentially dilutive ordinary shares such as convertible debt and share options. Therefore, the Bank does not calculate diluted earnings per share.

29. OTHER PROVISIONS

Other provisions as of December 31, 2018 and 2017 are presented below:

	2018	*2017*
Litigation	1,863	3,106
Restructuring	507	775
Other provisions	16	16
Retirement benefits	290	294
	2,676	4,191
Provisions for contingent liabilities	1,173	2,546
	3,849	**6,737**

Movements on the Bank's provisions may be summarized as follows:

	Restructuring	Retirement Benefits	Litigations	Other	Total
January 1, 2017	**1,282**	**312**	**9,846**	**1,049**	**12,489**
Charge for the year	-	-	2,398	-	2,398
Reversal or decrease	-	(15)	(1,765)	-	(1,780)
Release	(507)	(3)	(7,373)	(1,033)	(8,916)
December 31, 2017	**775**	**294**	**3,106**	**16**	**4,191**

	Restructuring	Retirement Benefits	Litigations	Other	Total
January 1, 2018	**775**	**294**	**3,106**	**16**	**4,191**
Charge for the year	-	-	766	-	766
Reversal or decrease	-	-	(812)	-	(812)
Release	(268)	(4)	(1,197)	-	(1,469)
December 31, 2018	**507**	**290**	**1,863**	**16**	**2,676**

(Thousands of BAM)

29. OTHER PROVISIONS (Continued)

Movements on the Bank's provisions for off-balance sheet exposures in 2018 are shown below:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Provisions at January 1, 2018	(980)	(48)	(232)	-	(1,260)
Change in the provisions	611	(294)	77	-	394
of which, transfers among Stages	50	(35)	(15)	-	-
of which, increase	(226)	(333)	(63)	-	(622)
of which, decrease	787	74	155	-	1,016
of which, effects on the interest income	-	-	-	-	-
Write-offs	-	-	-	-	-
Modification effect not resulting in derecognition of assets	-	-	-	-	-
Originated or purchased assets	(440)	(3)	(32)	-	(475)
Derecognized assets	121	7	38	-	166
Model/parameter changes	-	-	-	-	-
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Provisions at December 31, 2018	**(688)**	**(338)**	**(149)**	**-**	**(1,175)**

Movements on the Bank's provisions for off-balance sheet exposures in 2017 are shown below:

	2017.
January 1	799
Charge for the year	2,254
Reversal	(507)
Charge for the year , net (Note 14)	**1,747**
December 31	**2,546**

Provisions for Restructuring

The table below presents the expected maturities of restructuring provisions:

	2018	*2017*
Within a year	507	776
From 1 to 5 years	-	-
	507	**776**

Provisions for Retirement Benefits

From the total decrease in the amount of provisions for retirement benefits in the amount of BAM 4 thousand in 2018, BAM 2 thousand refers to the actuarial losses per demographic assumptions and BAM 2 thousand to the actuarial losses per financial assumptions. More details on actuarial assumption used in the calculation of the provisions for retirement benefits are provided in Note 31 – Retirement Benefits.

Provisions for Litigations and Other Provisions

In an attempt to collect receivables arising from loans, guarantees, letters of credit or other grounds, as at December 31, 2018 the Bank was involved in the total of 3,773 court cases with the aggregate value of BAM 82,623 thousand.

As of December 31, 2018, there were 179 pending lawsuits filed against the Bank, with the total nominal value of claims sought of BAM 31,061 thousand, excluding penalties and default interest.

(Thousands of BAM)

29. OTHER PROVISIONS (Continued)

Provisions for Litigations and Other Provisions (Continued)

The aforesaid amount includes 19 cases with the total nominal amount of BAM 299 thousand, where the claims had been paid in prior periods, so that they do not pose any additional risk of contingent losses, but were still listed as pending lawsuits as there were procedures in progress as per extraordinary remedy, i.e., case revisions were underway as of December 31, 2018. The aforesaid amount also includes 21 lawsuits totaling BAM 9,744 thousand, which, in accordance with the agreements on assignment of receivables (Brush), were transferred under the remit of the assuming party and do not pose any risk to the Bank. Such cases not posing any risk to the Bank (already paid for or with risks transferred to the assuming parties) are not accounted for.

There were 74 lawsuits altogether with claims relating to the loans contracted with CHF currency clause and the alleged increased interest margin. The aggregate nominal value of such suits amounted to BAM 3,204 thousand.

The Bank assesses the amount of provisions for litigation costs based on the estimated probability of cash outflows arising from the past or constructive obligations. As of December 31, 2018, the Bank made provisions for litigation losses/costs in the amount of BAM 1,862 thousand, which was estimated as sufficient by the management.

In 2018 the Bank intensified activities or resolving the ongoing lawsuits and managing legal risk inherent in the lawsuits. Strategies were reviewed per case as well as models of legal representation of the Bank and court defense coordination, out-of-court resolution or settlement processes were set up, as well as recording of and reporting on lawsuits involving the Bank. The foregoing resulted in a significant decrease in the total number of lawsuits involving the Bank and their aggregate value compared to those as at December 31, 2017.

30. COMMITMENTS AND CONTINGENT LIABILITIES

Loans, Payment and Performance Guarantees and Letters of Credit

	2018	*2017*
Loan commitments	71,584	89,491
Payment guarantees	28,817	20,327
Performance guarantees	12,609	11,169
Letters of credit and other sureties	1,419	5,110
	114,429	**126,097**

In the course of their business, the Bank assumes credit commitments which are maintained on the off-balance sheet accounts and primarily include guarantees, letters of credit and undrawn portions of loans approved. The Bank formed provisions for these exposures, as disclosed in Note 14.

Movements on the Bank's gross off-balance sheet exposure in 2018 were as follows:

	Stage 1 (12-month ECL)	Stage 2 (lifetime ECL-unimpaired assets)	Stage 3 (lifetime ECL-impaired assets)	POCI assets	TOTAL
Gross exposure at January 1, 2018	124,631	1,122	344	-	126,097
Change in the gross exposure	6,580	2,012	(82)	-	8,510
of which, increase	41,811	3,251	273	-	45,335
of which, decrease	(32,640)	(3,795)	(390)	-	(36,825)
of which, transfers among Stages	(2,591)	2,556	35	-	-
Write-offs	-	-	-	-	-
Originated or purchased assets	30,341	5	32	-	30,378
Derecognized assets	(50,374)	(109)	(73)	-	(50,556)
Foreign exchange effects	-	-	-	-	-
Other movements	-	-	-	-	-
Gross exposure at December 31, 2018	**111,178**	**3,030**	**221**	**-**	**114,429**

(Thousands of BAM)

31. RETIREMENT BENEFITS

The following significant actuarial assumptions were used in calculation of the present value of the employee retirement benefits: discount rate, expected salary growth rate and mortality rate.

Sensitivity analysis of retirement benefits to the change in the discount rate may be presented as follows:

			In BAM
Discount rate	5%	4.5%	5.5%
Present value of the liabilities (in BAM)	289,726	305,464	275,224
% of variance	-	5.43%	(5.01%)

If the interest rate used for discounting were 0.5% lower, the present value of the liabilities would increase by 5.43%. On the other hand, if the discount rate were by 0.5% higher, the present value of the liabilities would decrease by 5.01%.

Sensitivity analysis of retirement benefits to the change in the average salary may be presented as follows:

			In BAM
Average retirement benefit amount	current	0.5% lower	0.5% higher
Present value of the liabilities (in BAM)	289,726	288,277	291,174
% of variance	-	(0.5%)	0.5%

The impact of changes in salary amounts is directly proportional to the changes in retirement benefit amounts.

Sensitivity analysis of retirement benefits to the change in the mortality rate may be presented as follows:

			In BAM
Average age	current	1 year younger	1 year older
Present value of the liabilities (in BAM)	289,726	280,456	297,247
% of variance	-	(3.2%)	2.6%

If the employees were a year older on average, the present value of retirement benefits would increase by 2.6%, and if they were a year younger on average, the average retirement benefit would decrease by 3.2%.

The expected maturity periods of provisions for retirement benefits are provided below:

	2018	*2017*
Within the ensuing 12 months	28	40
From 1 to 5 years	64	56
From 5 to10 years	56	62
After 10 years	142	136
Total	**290**	**294**

32. RELATED PARTY TRANSACTIONS

In accordance with IAS 24, a related party is a person or an entity that is related to the entity that is preparing its financial statements

- A person or a close family member related to the entity if it:
  - o has control or joint control over the reporting entity;
  - o has significant influence over the reporting entity; or
  - o is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(Thousands of BAM)

32. RELATED PARTY TRANSACTIONS (Continued)

- An entity is related to a reporting entity if any of the following conditions applies:
  - The entity and the reporting entity are members of the same group;
  - One entity is an associate or joint venture of the other entity;
  - Both entities are joint ventures of the same third party;
  - One entity is a joint venture of a third entity and the other entity is an associate of the third entity;
  - The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity;
  - The entity is controlled or jointly controlled by a person identified in point one;
  - A person identified above has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
- In accordance with IAS 24, the Bank's related parties are:
  - the major shareholder and its related parties (entities included in the consolidation of Addiko Group);
  - Supervisory Board and Management members (i.e., key management personnel);
  - key management personnel family members; and
  - legal entities where the Bank holds significant equity interests (above 10%).

The following table presents the assets and liabilities arising from the Bank's transactions with related parties:

	2018	2017
ASSETS		
Foreign currency accounts:		
ADDIKO BANK d.d., Ljubljana, Republic of Slovenia	570	564
ADDIKO BANK d.d., Zagreb, Republic of Croatia	1,089	300
ADDIKO BANK d.d., Sarajevo	525	546
ADDIKO BANK a.d., Beograd, Serbia	71	127
ADDIKO BANK AG, Vienna, Austria	3,680	904
Other assets, net:		
ADDIKO BANK d.d., Zagreb, Republic of Croatia	-	10
ADDIKO BANK d.d., Sarajevo	3	60
ADDIKO BANK a.d., Podgorica, Montenegro	-	13
ADDIKO BANK a.d., Beograd, Serbia	-	10
ADDIKO BANK AG, Vienna, Austria	-	352
ADDIKO BANK d.d., Ljubljana, Republic of Slovenia	45	-
	5,983	**2,886**
LIABILITIES		
Demand deposits:		
ADDIKO BANK a.d., Beograd, Serbia	25	3
ADDIKO BANK a.d., Podgorica, Montenegro	122	53
ADDIKO BANK d.d., Zagreb, Republic of Croatia	-	-
Short-term deposits:		
ADDIKO BANK d.d. Sarajevo	-	11,755
ADDIKO BANK a.d. Beograd , Serbia	-	13,694
Other liabilities:		
ADDIKO BANK a.d., Beograd, Serbia	328	454
ADDIKO BANK d.d., Sarajevo	153	155
ADDIKO BANK d.d., Zagreb, Republic of Croatia	67	97
ADDIKO BANK a.d., Podgorica, Montenegro	3	9
ADDIKO BANK AG, Vienna, Austria	463	497
	1,161	**26,717**

OFF-BALANCE SHEET ITEMS		
Unused loan limit		
ADDIKO BANK d.d., Ljubljana, Republic of Slovenia	19,558	-

(Thousands of BAM)

32. RELATED PARTY TRANSACTIONS (Continued)

The following table presents the income and expenses arising from the Bank's transactions with related parties:

	2018	2017
Interest income:		
ADDIKO BANK AG, Vienna, Austria	-	2
Fee and commission income:		
ADDIKO BANK d.d., Sarajevo	17	17
Hypo Alpe-Adria-Leasing d.o.o., Banja Luka	-	1
Other operating income:		
ADDIKO BANK d.d., Sarajevo	20	35
Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	-	801
ADDIKO BANK AG, Vienna, Austria	242	92
ADDIKO BANK d.d. Zagreb, Republic of Croatia	-	1
	279	**949**
Interest expenses:		
ADDIKO BANK AG, Vienna, Austria	(3)	(1.604)
ADDIKO BANK d.d. Sarajevo	(59)	(74)
ADDIKO BANK a.d. Beograd , Serbia	(105)	(48)
ADDIKO BANK d.d. Zagreb, Republic of Croatia	(3)	(1)
Fee and commission expenses:		
ADDIKO BANK d.d., Sarajevo	(722)	(514)
ADDIKO BANK d.d., Zagreb, Republic of Croatia	(8)	(4)
ADDIKO BANK d.d. Ljubljana, Republic of Slovenia	(44)	(1)
ADDIKO BANK a.d. Beograd , Serbia	(4)	(4)
Other operating expenses:		
ADDIKO BANK AG, Vienna, Austria	(535)	(280)
ADDIKO BANK d.d., Zagreb, Republic of Croatia	(461)	(441)
ADDIKO BANK d.d., Sarajevo	(6)	(45)
ADDIKO BANK a.d. Beograd , Serbia	(201)	(219)
	(2,151)	**(3,235)**
	(1,872)	**(2,286)**

Salaries and payroll taxes and contributions paid to and on behalf of the Bank's Supervisory/Management Board members and key management personnel are provided below:

	2018	2017
Net salaries	441	424
Payroll taxes and contributions	288	278
Severance pays and retirement benefits	-	-
Taxes and contributions payable on severance pays and retirement benefits	-	-
	729	**702**

(Thousands of BAM)

32. RELATED PARTY TRANSACTIONS (Continued)

The following table provides details on loans and deposits of the Bank's key management personnel and their family members:

	2018	2017
ASSETS		
Management Board		
Loans	10	13
Impairment allowances	-	-
Key management personnel		
Loans	423	119
Impairment allowances	(25)	(1)
Family members of the Bank's key management personnel		
Loans	5	13
Impairment allowances	-	-
Total assets	**413**	**144**
LIABILITIES		
Management Board		
Deposits	17	44
Provisions for contingent liabilities	-	-
Key management personnel		
Deposits	515	64
Provisions for contingent liabilities	-	-
Family members of the Bank's key management personnel		
Deposits	104	4
Provisions for contingent liabilities	-	-
Members of the governing bodies and management of the Banking Group		
Deposits	26	-
Provisions for contingent liabilities	-	-
Total liabilities	**662**	**112**
Irrevocable crediting commitments		
Supervisory Board	14	14
Management Board	22	26
Key management personnel	65	23
Family members of the Bank's key management personnel	9	-
Total irrevocable crediting commitments	**110**	**63**

The following table provides details on interest and fee and commission income and expenses relating to the Bank's key management personnel and their family members:

	2018	2017
Supervisory Board	-	-
Management Board		
Interest income	1	1
Fee and commission income	2	1
Other expenses	(4)	-
Key management personnel		
Interest income	23	7
Interest expenses	(5)	(2)
Fee and commission income	7	1
Other expenses	(4)	-
Family members of the Bank's key management personnel		
Interest income	-	1
Interest expenses	(1)	-
Fee and commission income	1	-
Total	**20**	**9**

(Thousands of BAM)

33. OPERATING LEASE ARRANGEMENTS

Operating lease is mostly related to office space leases for branches and the lease of space for ATM installation.

Total future minimum lease payments to be settled pursuant to the long-term lease contracts were as follows:

	2018	2017
Up to 1 year	653	663
From 1 to 5 years	1,016	606
Over 5 years	-	-
	1,669	**1,269**

The Bank's operating lease expenses in the financial year 2018 amounted to BAM 1,392 thousand (2017: BAM 1,208 thousand).

Total future minimum lease payments to be collected pursuant to the long-term lease contracts were as follows:

	2018	2017
Up to 1 year	364	379
From 1 to 5 years	-	-
Over 5 years	-	-
	364	**379**

The Bank's operating lease income in the financial year 2018 amounted to BAM 405 thousand (2017: BAM 378 thousand).

34. EVENTS AFTER THE REPORTING PERIOD

Until the issue date of these financial statements, there have been no events after the reporting date that that would significantly affect the Bank's financial statements or require additional disclosures or adjustments in the notes thereto.

35. 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 insurance) taxes, among others. 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, thus creating uncertainties and areas of legal contention.

Tax returns, along 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 and the Group 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 Administration of the Republic of Srpska, expiration period of the tax liability is five years. This virtually means that tax authorities could determine payment of outstanding liabilities in the period of five years from the origination of the liability. The aforedescribed situation creates tax risks in the Republic of Srpska that are substantially more significant than those typically existing in countries with more developed tax systems.

(Thousands of BAM)

36. EXCHANGE RATES

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

		In BAM
	December 31, 2018	December 31, 2017
USD	1.707552	1.630810
CHF	1.742077	1.671364
EUR	1.955830	1.955830

Bodies of the Bank
On December 31, 2018

Supervisory board

Hans-Hermann Anton Lotter	Chairman
Biljana Rabitsch	Vice-Chairman
Meliha Povlakić	Member
Razvan Munteanu	Member
Damir Karamehmedović	Member

Audit Committee

Đorđe Lazović	Chairman
Siniša Radonjić	Member
Ivan Trifunović	Member
Marlene Schellander-Pinter	Member
Claudia Mayrhofer	Member

Management Board

Mario Ivanković	President of the Management Board
Boštjan Pečenko	Member of the Management Board
Žaklina Dimitrijević	Member of the Management Board

Internal Auditor: Srđan Lamešić

Bank headquarters

Addiko Bank a.d. Banja Luka

78000 Banja Luka
Aleja Svetog Save 13
Tel. +387 (0)51 951 000
Fax +387 (0)51 336 518
addiko-rs.ba
E-mail: info.rs.ba@addiko.com

Business units

Banja Luka
Ivana Frane Jukića 9
78 000 Banja Luka,
telefon: +387 51 241-800, 244-930,
241-897, 241-873, 244-916, 244-919
fax: +387 51 244-996

Banja Luka
Aleja Svetog Save 13,
78 000 Banja Luka,
telefon: +387 51 336-515, 336-517,
336-513, 336-514
fax:+ 387 51 336-516

Banja Luka
Trg Krajine 2, Robna kuća Boska
78 000 Banja Luka,
telefon: +387 51 228-730,
fax:+ 387 51 218-637

Banja Luka
Cara Lazara 21b, Obilićevo,
78 000 Banja Luka,
telefon: +387 51 432-930,
fax:+ 387 51 432-931

Banja Luka
Karađorđeva 147, Lauš,
78 000 Banja Luka, telefon: +387 51 288-740,
fax: +387 51 288-742

Banja Luka
Majke Jugovića,
78 000 Banja Luka, Starčevica
telefon: +387 51 435-930,
fax:+ 387 435-932

Bijeljina
Trg kralja Petra I Karađorđevića 1,
76 300 Bijeljina,
telefon: +387 55 225-436, 225-430,
fax:+387 55 225-437

Bijeljina
Neznanih junaka 34,
76 300 Bijeljina,
telefon: +387 55 292-365, 292-360,
fax:+387 55 292-361

Bileća
Kralja Aleksandra 15,
89 230 Bileća,
telefon: +387 59 381-050,
fax: +387 59 381-051

Bratunac
Gavrila Principa bb,
75420 Bratunac, telefon: +387 56 420-315,
fax: +387 56 420-317

Brčko
Bulevar mira 11,
76 000 Brčko,
telefon: +387 49 235-408, 235-401,
fax: +387 49 235-420, 235-421

Brod
Trg Patrijarha Pavla bb,
74 450 Brod,
telefon: +387 53 621-711, 621-710,
fax: +387 53 621-392

Čelinac
Cara Lazara 1,
78240 Čelinac,
telefon:+387 051 555-380,
fax: +387 51 555-382

Derventa
Jovana Dučića i Čika Jove Zmaja,
74 400 Derventa,
telefon: +387 53 333-303, 334-103,
fax: +387 53 312-420

Doboj
Kralja Dragutina 13,
74 000 Doboj,telefon: +387 53 201-307, 201-308,
fax: +387 53 201-326

Foča
Njegoševa 6,
73 300 Foča,
telefon: +387 58 220-590,
fax: +387 58 210-056

Gacko
Solunskih dobrovoljaca bb,
89 240 Gacko,
telefon: +387 59 472-979,
fax: +387 59 472-979

Gradiška
Vidovdanska bb,
78 400 Gradiška, telefon: +387 51 825-820,
fax: +387 51 825-821

I. Sarajevo
Hilandarska 1
71 124 I. Sarajevo,
telefon: +387 57 310-301, 310-650,
fax: +387 57 316-717

Kotor Varoš
Cara Dušana 44,
78220 Kotor Varoš,
telefon: +387 51 784-650,
fax:+387 51 784-652

Kozarska Dubica
Svetosavska 10
79 240 Kozarska Dubica,
telefon: +387 52 424-663,
fax: +387 52 421-671

Laktaši
Karađorđeva 41
78 250 Laktaši,
telefon: +387 51 535-252, 535-250,
fax: +387 51 535 251

Modriča
Cara Lazara 4
74 480 Modriča,
telefon: +387 53 821-901, 821-421,
fax: +387 53 820-382

Mrkonjić Grad
Svetog Save 2
70 260 Mrkonjić Grad,
telefon: +387 50 220-980,
fax: +387 50 220-981

Nevesinje
Skver Nevesinjska puška bb
88 280 Nevesinje,
telefon: +387 59 610-260, 610-262,
fax: +387 59 610-261

Novi Grad
Karađorđeva 45
79 220 Novi Grad,
telefon: +387 52 721-250,
fax: +387 52 751-329

Pale
Nikole Tesle 12
71 420 Pale,
telefon: +387 57 202-880, 202-888,
202-890, 202-893, fax: +387 57 202-883

Prijedor
Kralja Petra I Oslobodioca bb
79 101 Prijedor,
telefon: +387 52 241-790,
fax: +387 52 243-202

Prnjavor
Veljka Milankovića 1
78 430 Prnjavor,
telefon: +387 51 640-521,
fax: +387 51 655-496

Sokolac
Cara Lazara bb
71 350 Sokolac,
telefon: +387 57 401-200,
fax: +387 57 401-362

Teslić
74 270 Teslić,
Svetog Save bb
telefon: +387 53 410-012, 431-821,
fax: +387 53 410-010

Trebinje
Preobraženska 2
89 101 Trebinje,
telefon: +387 59 273-513, 273-514,
273-515, fax: +387 59 273-519

Višegrad
Trg palih boraca bb
73 240 Višegrad,
telefon: +387 58 631-130, 631-120,
fax: +387 58 631-132

Zvornik
Svetog Save bb
75 400 Zvornik,
telefon: +387 56 232-600, 232-601,
fax: +387 56 210-192

Responsible for content:

Addiko Bank a.d. Banja Luka
78000 Banja Luka
Aleja Svetog Save 13
Tel. +387 (0)51 951 000
Fax +387 (0)51 336 518
addiko-rs.ba
E-mail: info.rs.ba@addiko.com

Important notice:

This Annual report has been prepared with great care and the information it contains has been checked. The possible occurrence of rounding errors, typesetting and printing errors and errors in expression can however not be precluded. The English language report is a translation.