Intesa Sanpaolo Banka d.d. Bosna i Hercegovina

Financial Statements as at 31 December 2017

Contents

The Management Board has pleasure in submitting its report for the year ended 31 December 2017.

Review of operations

The result for the year ended 31 December 2017 of the Bank is set out in the income statement on page 6.

Supervisory Board, Management Board and Audit Committee

During the course of 2017 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board

Vojko Čok	Chairman until 28.12.2017
Ivan Krolo	Vice-Chairman from 30.09.2017
Alessio Cioni	Member from 29.12.2017
Gabriele Pace	Member until 29.09.2017
Alan Galavić	Member
Miroslav Halužan	Member
Gianluca Tiani	Member, from 23.03.2017
Andrea Fazzorali	Member, from 09.06.2017
Marco Fabris	Member, until 08.06.2017

During the course of 2017 and up to the date of this report, the Audit Committee comprised:

Audit Committee

Dražen Karakašić	Chairman
Mirella Klarić	Member
Petar Sopek	Member
Zoltan Mogyorosi	Member
Andrea Tondo	Member

As of 31 December 2017 the Management Board comprised a director and three executive directors, who served during the year and up to the date of this report as follows:

Management Board

Almir Krkalić	Director and Chairman of the Management Board
Amir Termiz	Executive Director and Head of Retail Division
Marko Filipčič	Executive Director and Chief Financial Officer, from 01.10.2017
Edin Izmirlija	Executive Director and Head of Risk Management and Controlling Division, from 06.10.2017
Dario Grassani	Executive Director and Chief Financial Officer, until 30.04.2017

On behalf of the Management Board

Almir Krkalić	Marko Filipčič
Director	Executive Director

The Management Board is required to prepare financial statements, which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. Management has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then applying them consistently; making judgements and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements, following which the Supervisory Board is required to approve the financial statements.

The financial statements set out on pages 10 to 90 were authorised by the Management Board on 13th February 2018 for issue to the Supervisory Board, and are signed below to signify this, on behalf of the Bank, by:

For and on behalf of Management Board

Almir Krkalić	Marko Filipčič
Director	Executive Director

Independent Auditors' report to the shareholders of Intesa Sanpaolo Bank d.d. BiH

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Intesa Sanpaolo Banka d.d. BiH ("the Bank"), which comprise the statement of financial position of the Bank as at 31 December 2017, and the statements of comprehensive income, cash flows and changes in equity of the Bank for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the financial statements").

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2017 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in Bosnia and Herzegovina, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independent Auditors' report to the shareholders of Intesa Sanpaolo Bank d.d. BiH (*continued*)

Report on the Audit of the Financial Statements *(continued)*

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of 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.

Impairment of loans and receivables from customers

As at 31 December 2017, gross loans and receivables amount to BAM 1,342 million, impairment allowance amounts to BAM 64 million and impairment loss recognised in the income statement amounts to BAM 8 million (31 December 2016: gross loans and receivables: BAM 1,277 million, impairment allowance: BAM 85 million and impairment loss recognised in the income statement: BAM 7 million).

Key audit matter	How our audit addressed the matter
Impairment allowances on loans and receivables represent management's best estimate of the credit losses incurred within the loan portfolios and receivables at the reporting date. This area is determined to be a key audit matter as the determination of the appropriate amount of impairment losses requires the application of significant judgement and use of subjective assumptions by management. Specific impairment allowances for individually significant exposures (those in excess of BAM 150 thousand for retail loans and BAM 50 thousand for corporate loans) as well as for certain non-significant exposures, are determined on an individual basis by means of a discounted cash flows analysis based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral, with other key assumptions including those in respect of the haircuts to be applied on the value of collaterals, and a period for collateral disposal. Impairment allowance for non-performing individually non-significant exposures and impairment allowance for performing retail and corporate exposures (together "collective impairment allowance") are determined by modelling techniques. Historical experience and management judgment are incorporated into the model assumptions. The Bank is continuously recalibrating the model parameters which also requires our increased attention in the audit.	Our audit procedures in this area included, among others: • Testing of the design, implementation and operating effectiveness of the controls over the Bank's determination of loan impairment and the estimation of provisions against such assets. The controls tested included, among others, those over: - Calculation of days past due; - Timely identification of impaired loans and classification into appropriate risk classes; - Collateral valuation. • For impairment allowances calculated individually: – Selecting a sample of individual loans and receivables, with focus on those with the greatest potential impact on the financial statements due to their magnitude and risk characteristics, as well as lower value items which we independently assessed as high-risk, such as watchlist, restructured or rescheduled exposures, amounts due from clients operating in higher risk industries, non-performing exposures with low provision coverage and unsecured exposures. – For the sample selected, critically assessing, by reference to the underlying documentation (loan files) and through discussion with the loan officers and credit risk management personnel the existence of any impairment triggers as at 31 December 2017.

Independent Auditors' report to the shareholders of Intesa Sanpaolo Bank d.d. BiH (*continued*)

Report on the Audit of the Financial Statements *(continued)*

Key Audit Matters (continued)

Key parameters include Probability of default ("PD"), Recovery Indicator ("RI") and Loss Given Default ("LGD").	– For those loans and receivables where impairment triggers were identified, challenging key assumptions applied in the Bank's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral values, where relevant, with the assistance of our property valuation specialists, and taking into consideration the effects of forbearance, if any. • For collective impairment allowance: – Testing the underlying impairment models, including model approval, back-testing and validation processes and, using our own IT specialists, testing the completeness and accuracy of underlying data for the calculation and validation of the key parameters such as the PD and LGD. – Critically assessing the rationale for the changes made to the model parameters in 2017, by reference to our understanding of the business, current economic trends and market practices.

Other Information

Management is responsible for the other information. The other information comprises the information included in the Management`s Board report, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Independent Auditors' report to the shareholders of Intesa Sanpaolo Bank d.d. BiH (*continued*)

Report on the Audit of the Financial Statements *(continued)*

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of the 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.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

KPMG

Independent Auditors' report to the shareholders of Intesa Sanpaolo Bank d.d. BiH (*continued*)

Report on the Audit of the Financial Statements *(continued)*

Auditors' Responsibilities 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 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 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 controls.
- 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 controls.
- 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 auditors' 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 auditors' 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.

KPMG

Independent Auditors' report to the shareholders of Intesa Sanpaolo Bank d.d. BiH (*continued*)

Report on the Audit of the Financial Statements *(continued)*

Auditors' Responsibilities for the Audit of the Financial Statements (continued)

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or 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 the 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 Vedran Vukotić.

KPMG B-H d.o.o. za reviziju

13 February 2018

Registered Auditors
Zmaja od Bosne 7-7A

71000 Sarajevo

Bosnia and Herzegovina
KPMG B-H d.o.o. za reviziju

D.O.O. ZA REVIZIJU KPMG B-H 1 SARAJEVO

On behalf of KPMG B-H d.o.o. za reviziju:

Manal Bećirbegović
Executive director

Vedran Vukotić
FBiH registered auditor
Licence number: 3090017124

(all amounts are expressed in thousands of KM, unless otherwise stated)

	Notes	**2017**	**2016**
Interest income	*8*	75,535	78,140
Interest expense	*9*	(14,736)	(16,682)
Net interest income		**60,799**	**61,458**
Fee and commission income	*10*	27,452	23,906
Fee and commission expense	*11*	(4,949)	(4,117)
Net fee and commission income		**22,503**	**19,789**
Net trading income	*12*	2,097	2,468
Other operating income/(expense)	*13*	(5,893)	(5,407)
Other operating income/expense		**(3,796)**	**(2,939)**
Total operating income		**79,506**	**78,308**
Personnel expenses	*14*	(21,052)	(20,320)
Administrative expenses	*15*	(18,017)	(17,179)
Depreciation and amortisation		(3,941)	(3,508)
Operating expenses		**(43,010)**	**(41,007)**
Profit before impairment losses and other provisions and income tax		**36,496**	**37,301**
Net impairment losses and other provisions	*16*	(8,358)	(7,097)
Profit before tax		**28,138**	**30,204**
Income tax expense	*17*	(3,228)	(3,106)
Net profit for the year		**24,910**	**27,098**
Basic and diluted earnings per share (KM)	*18*	**55.63**	**60.52**

The accompanying notes form an integral part of these financial statements.

(all amounts are expressed in thousands of KM, unless otherwise stated)

	2017	2016
Profit for the year	**24,910**	**27,098**
Other comprehensive income for the year		
<u>Items that may be reclassified subsequently to profit or loss</u>		
Fair value reserves (available-for-sale financial assets)		
Change in fair value, net of deferred tax	(71)	(9)
<u>Items that will not be reclassified to profit or loss</u>		
Revaluation of property, plant and equipment (property classified as IAS 16)		
Change in fair value, net of deferred tax	418	-
Other comprehensive income	**347**	**(9)**
Total comprehensive income for the year	**25,257**	**27,089**

The accompanying notes form an integral part of these financial statements.

(all amounts are expressed in thousands of KM, unless otherwise stated)

	Notes	**31 December 2017**	**31 December 2016**
Assets			
Cash and cash equivalents	*19*	323,643	165,443
Reserves with Central Bank	*20*	147,453	251,305
Placements with other banks	*21*	14,636	47,135
Financial assets available for sale	*22 a)*	65,952	89,094
Financial assets at fair value through profit or loss	*22 b)*	607	1,746
Loans and receivables from customers	*23*	1,278,696	1,192,613
Income tax prepayment		2,747	2,207
Deferred tax assets	*32*	178	229
Other assets	*24*	11,989	9,756
Property and equipment	*25*	14,577	16,383
Intangible assets	*26*	6,574	6,595
Total assets		**1,867,052**	**1,782,506**
Liabilities			
Due to banks and other financial institutions	*27*	323,036	231,099
Due to customers	*28*	1,241,700	1,266,381
Financial liabilities at fair value through profit or loss	*22 c)*	148	1,546
Subordinated debt	*29*	121	281
Other liabilities	*30*	27,988	18,161
Provisions for liabilities and charges	*31*	4,701	4,979
Deferred tax liabilities	*32*	42	-
Total liabilities		**1,597,736**	**1,522,447**
Equity			
Share capital	*33*	44,782	44,782
Share premium		57,415	57,415
Regulatory reserves for credit losses		18,286	18,286
Other reserves and fair value reserves		1,574	1,227
Retained earnings		147,259	138,349
Total equity		**269,316**	**260,059**
Total liabilities and equity		**1,867,052**	**1,782,506**

The accompanying notes form an integral part of these financial statements.

(all amounts are expressed in thousands of KM, unless otherwise stated)

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2017	**44,782**	**57,415**	**18,286**	**980**	**247**	**138,349**	**260,059**
Profit for the year	-	-	-	-	-	24,910	24,910
Transactions with owners of the Bank							
Dividends	-	-	-	-	-	(16,000)	(16,000)
Other comprehensive income							
Net loss from change in fair value of financial assets available for sale	-	-	-	-	(79)	-	(79)
Deferred tax assets	-	-	-	-	8	-	8
Revaluation of property and equipment	-	-	-	-	460	-	460
Deferred tax liabilities	-	-	-	-	(42)	-	(42)
Total other comprehensive income	-	-	-	-	*347*	-	*347*
Total comprehensive income	**-**	**-**	**-**	**-**	**347**	**8,910**	**9,257**
Balance as at 31 December 2017	**44,782**	**57,415**	**18,286**	**980**	**594**	**147,259**	**269,316**

The accompanying notes form an integral part of these financial statements.

(all amounts are expressed in thousands of KM, unless otherwise stated)

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2016	**44,782**	**57,415**	**18,286**	**980**	**256**	**111,251**	**232,970**
Profit for the year	-	-	-	-	-	27,098	27.098
Other comprehensive income							
Net loss from change in fair value of financial assets available for sale	-	-	-	-	(10)	-	(10)
Deferred tax assets	-	-	-	-	1	-	1
Total other comprehensive income	-	-	-	-	*(9)*	-	*(9)*
Total comprehensive income	**-**	**-**	**-**	**-**	**(9)**	**27,098**	**27,089**
Balance as at 31 December 2016	**44,782**	**57,415**	**18,286**	**980**	**247**	**138,349**	**260,059**

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The accompanying notes form an integral part of these financial statements.

(all amounts are expressed in thousands of KM, unless otherwise stated)

	Notes	**31 December 2017**	**31 December 2016**
Cash flows from operating activities			
Profit for the year		24,910	27,098
Adjustments for:			
- depreciation and amortisation	*25, 26*	3,941	3,508
- net impairment losses and provisions	*16*	8,358	7,097
- net change in provisions for liabilities and charges		(203)	549
- net interest income		(60,799)	(61,458)
- net change in fair value of financial assets and liabilities at fair value through profit or loss	*12*	(64)	(96)
- net gain / loss from disposal of property and equipment	*13*	55	(96)
- impairment of property and equipment	*13*	555	-
- impairment of assets held for sale	*13*	289	-
- income tax expense	*17*	3,228	3,106
		(19,730)	(20,292)
Changes in:			
- placements with other banks		32,571	(17,354)
- loans and receivables from customers		(93,734)	(67,846)
- other assets		(1,625)	(1,680)
- obligatory reserve with the Central Bank		103,852	(100,084)
- financial assets and liabilities at fair value through profit or loss		(259)	10
- due to banks		91,881	1,611
- due to customers		(24,149)	206,494
- other liabilities		1,810	529
- provisions for liabilities and charges		(336)	(290)
		90,281	1,098
Income tax paid		(3,717)	(3,935)
Interest received		75,155	77,177
Interest paid		(15,212)	(17,091)
Net cash from operating activities		146,507	57,249
Cash flows from investing activities			
Acquisition of property and equipment		(1,582)	(3,612)
Proceeds from the sale of property and equipment		147	82
Acquisition of intangible assets		(1,902)	(2,902)
Proceeds/(acquisition) from financial assets available for sale		23,131	(47,589)
Net cash from investing activities		19,794	(54,021)
Cash flows from financing activities			
Dividends paid		(7,941)	-
Repayment of subordinated debt		(160)	(161)
Net cash flow used in financing activities		(8,101)	(161)
Net increase in cash and cash equivalents		158,200	3,067
Cash and cash equivalents at the beginning of the year	*19*	165,443	162,376
Cash and cash equivalents at the end of the year	*19*	323,643	165,443

The accompanying notes form an integral part of these financial statements.

1. GENERAL

Incorporation and registered activities

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina (the "Bank") was registered in the Cantonal Court in Sarajevo on 20 October 2000. Its registered address in Sarajevo is Obala Kulina Bana 9a

The Bank's main operations are as follows:
1. Accepting deposits from the public,
2. Granting short-term and long-term loans and guarantees to corporate customers, private individuals, local municipalities and other credit institutions,
3. Money market activities,
4. Performing local and international payments,
5. Foreign currency exchange and other banking-related activities,
6. Providing banking services through an extensive branch network in Bosnia and Herzegovina.

2. BASIS OF PREPARATION

Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

These financial statements were authorised by the Management Board on 13th February 2018 for submission to the Supervisory Board.

Basis of measurement

The financial statements have been prepared on the historical or amortised cost basis except for financial assets available for sale, financial assets and liabilities at fair value through profit or loss and property for 2017 as part of property and equipment due to a change in accounting policy.

Functional and presentation currency

These financial statements are presented in thousands of convertible mark ('000 KM) which is the functional currency of the Bank.

Use of estimates and judgments

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Results actually recorded upon settlement of transactions which were initially subject to estimates may eventually differ from those estimates.

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

Information on areas with significant uncertainty in the estimates and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in these financial statements are disclosed in Note 4.

Change in accounting policy

In accordance with Intesa Sanpaolo Group, the Bank has changed the accounting policy for the measurement and disclosure of buildings, from the cost model to the revaluation model.

IAS 8 introduces an exception to the usual treatment for this category: more specifically, paragraph 17 of the Standard states that a change in an accounting policy shall be dealt with as a revaluation in accordance with IAS 16 for a revaluation, without requiring retrospective applications.

3. SUMMARY OF ACCOUNTING POLICIES

The accounting policies set our below have been consistently applied for all periods presented in these financial statements.

(a) Foreign currency transactions

Transactions in currencies other than Convertible Marks ("KM") are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities are translated at the rates prevailing on the reporting date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Profits and losses arising on translation are included in the income statement for the period.

The Bank values its assets and liabilities at the middle rate of the Central Bank of Bosnia and Herzegovina valid at the reporting date. The principal rates of exchange set forth by the Central Bank and used in the preparation of the Bank's statement of financial position at the reporting dates were as follows:

31 December 2016	EUR 1= KM 1.95583	USD 1 = KM 1.855450
31 December 2017	EUR 1= KM 1.95583	USD 1 = KM 1.63081

(b) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue using the effective interest rate method. The effective interest rate is the rate that discounts estimated future cash flows of financial assets or liabilities over the life of the financial instrument (or, if appropriate, a shorter period) to its net carrying value. In the calculation of effective interest rates the Bank estimates future cash flows considering all contractual terms, but not future credit losses.

Calculation of the effective interest rate includes all paid or received transaction costs, fees and points, which are an integral part of the effective interest rate. Transaction costs include all incremental costs incurred directly in connection with the issuance or acquisition of financial assets or financial liabilities.

Interest income and expense recognised in the income statement include interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest rate method.

(c) Fee and commission income and expenses

Fee and commission income and expenses that are integral part of the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Fee and commission income and expenses, reported as such, comprise mainly fees related to credit card transactions, the issuance of guarantees and letters of credit, domestic and foreign payment transactions and other services and are recognised in the income statement upon performance of the relevant service.

(d) Net trading income

Net trading income comprises net gains and losses from foreign exchange trading, net gains and losses on financial instruments at fair value through profit or loss, and net gains and losses from the translation of monetary assets and liabilities denominated in foreign currency at the reporting date.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(e) Dividend income

Dividend income is recognised in the income statement when the right to receive income is established.

(f) Lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

(g) Income tax expenses

The income tax charge is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the reporting date and any adjustments to tax payable in respect of previous years.

The amount of deferred tax is calculated using the balance sheet liability method whilst taking into account the temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and amounts used for income tax purposes. Deferred tax assets and liabilities are recognised using the tax rates that are expected to apply on taxable income in the period in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the reporting date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects at the reporting date to recover or settle the carrying amount of its assets and liabilities. Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the statement of financial position. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable future profits will be available against which the deferred tax assets can be utilized. At each reporting date the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets for indications of potential impairment.

(h) Financial instruments

Recognition

Loans and receivables and other financial liabilities are recognised when advanced to borrowers or received from lenders (settlement date).

The Bank recognizes financial assets available for sale and financial assets and liabilities at fair value through profit or loss on the trade date which is the date when the Bank commits to purchase or sell the instruments.

Classification

The Bank classifies its financial instruments in the following categories: loans and receivables, financial assets available for sale, financial assets and financial liabilities at fair value through profit or loss and other financial liabilities. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of financial assets and liabilities upon initial recognition and re-evaluates this classification at each reporting date.

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determined payments that are not quoted in an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with these receivable and include placements with and loans to other banks, loans and receivables from customers and balances with the Central Bank.

ii) Financial assets available for sale

Financial assets available for sale are non-derivatives that are either designated in this category or not classified into any of the other categories. Financial assets classified as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates or equity prices. Financial assets available for sale include equity and debt securities.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(h) Financial instruments (*continued*)

iii) Financial assets and financial liabilities at fair value through profit or loss

Financial assets and financial liabilities at fair value through profit or loss have two sub-categories: financial instruments held for trading (including derivatives) and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category only 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 designated as such by management at initial recognition.

The Bank designates financial assets and financial liabilities at fair value through profit or loss when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminated or significantly reduced an accounting mismatch which would otherwise have arisen; or
- the asset or liability contains an embedded derivative that significantly modified the cash flows that would otherwise be required under the contract.

Financial assets and financial liabilities at fair value through profit or loss include derivative financial instruments classified as financial instruments held for trading and equity instruments designated by management at fair value through profit or loss. Management has designated equity instruments at fair value through profit or loss because the designation eliminates or significantly reduces an accounting mismatch related to share-based payments, which would otherwise arise.

iv) Other financial liabilities

Other financial liabilities comprise all financial liabilities which are not 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

Loans and receivables are initially recognised at fair value. After initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment.

Financial assets available for sale are measured initially at their fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset. Subsequent to initial recognition financial assets available for sale are measured at fair value, except for equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, which are stated at cost less impairment.

Gains and losses from changes in the fair value of available-for-sale financial assets are recognised directly in other comprehensive income until derecognition or impairment, when the cumulative amount previously recognised in other comprehensive income is transferred to the income statement. Interest income calculated using the effective interest rate method is recognised in the income statement.

Foreign exchange gains and losses on available-for-sale equity instruments are part of the fair value of these instruments and are recognised in other comprehensive income. Dividend income on available-for-sale equity securities is recognised in profit or loss when the right to receive payment has been established.

Financial assets and liabilities at fair value through profit or loss are initially recognised at fair value. All transaction costs are immediately expensed. Subsequent measurement is also at fair value. Gains and losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the income statement.

Other financial liabilities are initially measured at fair value including transaction costs. Subsequent to initial recognition the Bank measures other financial liabilities at amortized cost using the effective interest rate.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(h) Financial instruments (*continued*)

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, surrendered 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 and conditions.

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 Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (Level 1 of the fair value hierarchy).

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs (Level 2 and Level 3 of the fair value hierarchy). The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or liability measured at fair value has a bid price and an ask price, the Bank measures assets and long positions at the bid price and liabilities and short positions at the ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustments of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand.

Spot exchange transactions are always considered contributed instruments. Forward currency contracts are not contributed and are treated as financial derivatives pursuant to IAS 39.

The Bank recognizes transfers between levels of the fair value hierarchy as of the reporting period during which the change occurred.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(h) Financial instruments (*continued*)

Identification and measurement of impairment of financial assets

i) Financial assets carried at amortized cost

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has (or have) an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

For financial assets carried at amortised cost, the Bank first assesses whether objective evidence of impairment exists individually, for financial assets that are individually significant, or collectively, for financial assets that are not individually significant. Those individually significant assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred) discounted at the original effective interest rate of financial assets valid at the time the asset become impaired. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

For individually significant loans, the need for, and amount of impairment allowance is determined based on an assessment which includes the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of working capital and other financial support, the realisable value of collateral, and the timing of the expected cash flows.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(h) Financial instruments (*continued*)

Identification and measurement of impairment of financial assets (*continued*)

i) Financial assets carried at amortized cost (continued)

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrences that cause impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses with be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss rate and the expected rate of recovery at each reporting date, to ensure accurate reporting.

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

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as a reversal of impairment losses in the income statement.

The Bank also calculates provisions in accordance with the relevant regulations of the Banking Agency of the Federation of Bosnia and Herzegovina ("the Agency" or "FBA"). In accordance with these regulations, the relevant placements are classified into appropriate risk groups, depending on the past due days, the financial position of the borrower and collateral; and are provided for at prescribed rates. A general provision is also calculated in accordance with these regulations at a rate of 2% on exposure not specifically impaired.

The provisions calculated on the basis of the preceding paragraph ("the FBA provisions") are not recognised in these financial statements of the Bank. However, if the FBA provisions are greater than the impairment allowance calculated in accordance with IFRS, the difference is presented as an appropriation within regulatory reserves for credit losses.

ii) Financial assets available for sale

The Bank assesses at each reporting date 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 investment below its acquisition cost is considered in determining whether the assets are impaired.

If any such evidence exists for financial assets available for sale, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

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 recognised in profit or loss, the impairment loss is reversed through the income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognised in other comprehensive income.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(h) Financial instruments (*continued*)

Identification and measurement of impairment of financial assets (*continued*)

iii) Financial assets carried at cost

Financial assets carried at cost include equity securities classified as available for sale for which there is no reliable measure of fair value. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

An impairment loss is calculated as the difference between the carrying amount of the financial asset and the present value of expected future cash flows discounted by the current market interest rate for similar financial assets. Impairment losses on such instruments, recognised in the income statement, are not subsequently reversed through the income statement.

Specific financial instruments

i) Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to foreign exchange risks arising from operating, financing and investing activities. The Bank does not hold or issue derivative financial instruments for speculative trading purposes. All derivatives are classified as financial instruments at fair value through profit or loss. Hedge accounting is not applied.

Derivative financial instruments include foreign exchange forward contracts and are initially recognised and subsequently measured at their fair value in the statement of financial position. Fair values are obtained from discounted cash flow models.

All derivatives are classified as financial assets at fair value through profit or loss when their fair value is positive and as financial liabilities at fair value through profit or loss when it is negative

ii) Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank and current accounts with other banks.

Cash and cash equivalents exclude the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank’s day-to-day operations. The compulsory minimum reserve with the Central Bank is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

iii) Placements with banks and the obligatory reserve with the Central Bank

Placements with banks and the obligatory reserve with the Central Bank are classified as loans and receivables and are carried at amortized cost less impairment losses.

iv) Loans and receivables from customers

Loans to customers are presented at amortized cost net of impairment allowances to reflect the estimated recoverable amounts.

v) Equity securities

Equity securities are classified as available for sale and carried at fair value, unless there is no reliable measure of the fair value, in which case equity securities are stated at cost, less impairment.

(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(h) Financial instruments (*continued*)

Specific financial instruments (*continued*)

vi) Debt securities

Debt securities are classified as available-for-sale financial assets and carried at fair value.

vii) Borrowings and subordinated debt

Interest-bearing borrowings and subordinated debt are classified as other financial liabilities and are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortized cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings using the effective interest rate method.

viii) Current accounts and deposits from banks and customers

Current accounts and deposits are classified as other liabilities and initially measured at fair value plus transaction costs and subsequently stated at their amortized cost using the effective interest method.

(i) Property and equipment

Recognition and measurement

Equipment is stated at historical cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent cost is included in net book value or is accounted for as separate assets only if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day-to-day repairs and maintenance are recognised in the income statement as incurred.

As a result of the change in the accounting policy (please refer to Note 2), buildings for the year 2017, governed by IAS 16 “Property, Plant and Equipment”, are stated at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Increases in carrying amounts arising from revaluation, including currency translation differences, are recognised in the asset revaluation reserve, unless they offset previous decreases in the carrying amounts of the same asset, in which case, they are recognised in profit or loss. Decreases in carrying amounts that offset previous increases of the same asset are recognised against the asset revaluation reserve. All other decreases in carrying amounts are recognised as a loss in the statement of comprehensive income.

Gains and losses on disposal are determined by comparing proceeds with the carrying amount, and are included in the income statement as other income or operating expense.

Depreciation

Considering that the change in the valuation criterion occurred at the end of the year, amortisation for 2017 has been calculated using the preceding cost criterion; therefore, all property, has been amortised up to 31 December 2017. As of 2018, property valued using the criterion of revaluation according to IAS 16, will continue to be amortised for the useful life.

Depreciation is provided on all property and equipment except for land and assets in the course of construction on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The depreciation rates used by the Bank are as follows:

	2016	**2017**
Computers	20%	20%
Furniture and equipment	10%-15%	10%-15%
Business premises	3%	3%
Leasehold improvements	20%	20%

Depreciation method and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(j) Intangible assets

Intangible assets are stated at cost less accumulated amortization and impairment losses. The cost includes all expenditure that is directly attributable to the acquisition of the items.

Amortization is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The amortization rates used by the Bank are as follows:

Intangible assets - licenses	10% - 33.33 %
Intangible assets – software	20%

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(k) Assets repossessed from disbursement of loans

The Bank may recover assets that were originally received as collateral for the loan after exercising contractual rights or undertaking specific legal actions. When both of the following conditions are satisfied, the relevant assets shall be included in the Bank's balance sheet:

- The recovery activity has been completed
- The Bank has become owner of the asset

Classification and measurement of these assets depend on the scope for holding the property. More specifically, the asset may be classified according to IAS 16 (if the assets becomes instrumental), IAS 40 (if the property is held to earn rentals or for capital appreciation), IAS 2 (when the property has been acquired, in the ordinary course of business, exclusively with the intent to dispose of the asset in the reasonably short period of time). Classification under IFRS 5 is also possible when the conditions are met.

Following their initial recognition in the balance sheet at their fair value, the repossessed assets classified according to IAS 16, excluding property assets, shall be measured at cost (amortized and periodically tested for impairment). Repossessed property assets, such as functional property and valuable art collections (governed by IAS 16) and Investment property (governed by IAS 40) will be subsequently measured according to the revaluation model and fair value model respectively. Assets classified under IAS 2 shall be measured at the lower between cost and the net realizable value and shall not be amortized but only subject to the impairment test.

(l) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount of other assets is the greater of their value in use and fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognised.

(m) Employee benefits

Short-term benefits

On behalf of its employees, the Bank pays pension and health insurance which is calculated on the gross salary paid as well as tax on salaries which are calculated on the net salary paid. The Bank pays the above contributions into the state pension and health funds according to statutory rates during the course of the year. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with local legislation. These expenses are recorded in the income statement in the period in which the salary expense is incurred.

Obligations for contributions to defined contribution pension plans are recognised as an expense in income statement as incurred.

Long-term employee benefits: retirement severance payments and early retirement bonuses

The Bank pays to its employees' retirement severance benefits upon retirement in an amount representing three times the average salary of the respective employee in the period of the last three months.

The obligation and costs of these benefits are determined by using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the estimated interest rate on government bonds.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(m) Employee benefits (continued)

Share-based payments

Employees of the Bank receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments issued by the ultimate parent company. The Bank accounts for share-based payments as a cash-settled transaction.

The fair value of the amount payable to employees in respect of the ultimate parent company shares to be given to the employees is recognised as an expense with a corresponding increase in liabilities over the period in which the employees unconditionally become entitled to payments. The liability is remeasured at each reporting date and at the settlement date. Any changes in the fair value of the liability are recognised as a personnel expense in the income statement.

(n) Provisions for liabilities and charges

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

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

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

(o) Equity

Issued share capital

Issued share capital comprises ordinary and preference shares and is stated in KM at nominal value.

Regulatory reserve for credit losses

The regulatory reserve for credit losses represents the surplus of impairment allowances calculated in accordance with regulations as prescribed by the Agency over impairment allowances recognised in accordance with IFRS. The reserve is presented directly within equity (as a non-distributable reserve) and until 2012 any increase of the surplus was covered by transfers from retained earnings, after approval by shareholders.

Prior to 2012, the need for transfers from retained earnings to an earmarked reserve within equity (regulatory reserve for credit losses) was calculated for the whole credit-risk portfolio on a net basis, thereby taking into account both instances where application of Agency regulations would have resulted in a higher provision and instances where the application of Agency regulations would have resulted in a lower provision. However, from 2012, banks are required to calculate the requirement for regulatory reserves for credit losses taking into account only instances where higher provisions would have resulted from the application of the Agency rules. Retroactive application of this change in Agency rules is not required.

Based on the Decision of Minimum Standards for Capital Management and Asset Classification issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. Accordingly, the balance of the regulatory reserve presented in the financial statements as of 31 December 2012 has been carried forward unchanged to 31 December 2017.

Retained earnings

Retained earnings represent the accumulation of net profits after appropriations to owners and other transfers, such as transfers to regulatory reserves as described above.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(o) Equity (*continued*)

Fair value reserve

The fair value reserve comprises changes in fair value of financial assets available for sale, net of deferred tax.

Other reserves

Other reserves mainly relate to accumulated appropriations from retained earnings in accordance with the shareholder's decisions.

Dividends

Dividends on ordinary shares and preference shares are recognised as a liability until payment to beneficiaries in the period in which they are approved by the Bank's shareholders.

(p) Off-balance sheet commitments and contingent liabilities

In the ordinary course of business, the Bank enters into credit-related commitments which are recorded off balance sheet and primarily comprise guarantees, letters of credit, undrawn loan commitments and credit-card limits. Such financial commitments are recorded in the Bank's statement of financial position if and when they become payable.

(q) Managed funds for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail clients. These amounts do not represent the Bank's assets and are excluded from the statement of financial position. For the services rendered the Bank charges a fee.

(r) Segment reporting

A business segment is a distinguishable component of the Bank that is engaged in providing products or services, which is subject to risks and rewards that are different from those of other segments. A geographical segment is engaged in providing products or services within a particular economic environment distinguished from other segments engaged in providing products or services within other economic environments.

The Bank has identified 3 primary business segments: Retail, Corporate and Treasury. The primary segmental information is based on the Bank's internal reporting structure by business segment. Geographical concentration is not presented as the Bank's operations are concentrated in Bosnia and Herzegovina.

(s) New standards and interpretations

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2017 and earlier application is permitted; however the Bank has not early adopted the following new or amended standards in preparing these financial statements.

- IFRS 15 (*Revenue from Contracts with Customers*) establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programs. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 15.

- IFRS 9 (Financial instruments) published in July 2014, replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance of recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(s) New standards and interpretations *(continued)*

The following standards are expected to have a material impact on the Bank's financial statements in the period of initial application.

IFRS 9 Financial Instruments

In accordance with the guidance provided by the European Securities and Markets Authority (ESMA), regarding the requirements of IAS 8, paragraphs 30 and 31, information on the implementation of IFRS 9 - Financial Instruments in Intesa Sanpaolo Banka d.d. BiH, within the framework of and in alignment with a broader project activated by the ultimate parent group, Intesa Sanpaolo, and the direct parent company PBZ Bank, is provided below.

Regulatory provisions

As already known and analysed in the Financial Statements for 2016, the new accounting standard IFRS 9, published in July 2014 by the IASB and approved by the European Commission by Regulation no. 2067/2016, shall as of 1 January 2018 replace the existing IAS 39 which regulated recognition and measurement of financial instruments.

IFRS 9 is divided into three main phases: classification and measurement of financial instruments, impairment and hedge accounting.

With regard to the first area, IFRS 9 provides that the classification of financial assets is determined, on the one hand, by characteristics of the associated contractual cash flows and, on the other hand, by financial instrument management intent (business model). Instead of the previous four accounting categories, financial assets, according to IFRS 9, can be classified into three categories: Financial assets measured at amortised cost, Financial assets measured at fair value through other comprehensive income (for debt instruments, reserves are transferred to income statement in case of discontinuation of the instrument) and Financial assets measured at fair value through profit or loss. Financial assets can be classified in the first two categories and valued at amortised cost or fair value through other comprehensive income only if it is proved that it leads to cash flows that are solely principal and interest payments (so-called "solely payment of principal and interest" – "SPPI test"). Equity securities are always classified in the third category and are valued at fair value through profit or loss, unless the entity chooses (irrevocably, at the time of the initial entry) that shares which are not held for trading are classified at fair value through other comprehensive income. In that case, reserves recognised within other comprehensive income will never be transferred to the profit and loss account, even in the event of termination of a financial instrument (financial assets valued at fair value through other comprehensive income without "recycling").

Regarding the classification and valuation of financial liabilities, significant changes are not introduced in relation to the present standard.

In respect of impairment, for instruments valued at amortised cost and at fair value through other comprehensive income (other than equity instruments), a model based on the concept of expected losses is introduced instead of the present "loss incurred", with a view to faster loss recognition. IFRS 9 requires companies to enter the expected losses at the level of losses expected in the next 12 months (stage 1) from the initial entry of the financial instrument. The time horizon for calculating the expected loss becomes the entire remaining life of the asset that is the subject of the valuation where the credit quality of the financial instrument has experienced a "significant" deterioration in relation to the initial measurement (stage 2) or in case the asset is partially or fully non-performing (Stage 3). More specifically, the introduction of new impairment provisions includes:

- Allocation of performing financial assets at different levels of credit risk ("staging"), corresponding to value adjustments based on expected losses over the next 12 months (the so-called "Stage 1") or lifetime for the entire remaining duration of the instrument (the so-called "Stage 2"), in the presence of a significant increase in credit risk;
- Allocation of partially or fully non-performing financial assets in the so-called "Stage 3", always with value adjustments based on expected losses over the entire duration of the instrument;
- Inclusion of Expected Credit Losses ("ECL") in the calculation, as well as the expected future changes of the macroeconomic scenario.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(s) **New standards and interpretations *(continued)***

IFRS 9 Financial Instruments (*continued*)

The implementation project

Given the prevailing impact of the changes introduced by IFRS 9, both on the business and on the organization and reporting method, from the beginning of 2016, the Bank has launched a special project aimed at exploring different areas of the impact of this standard, defining its qualitative and quantitative impact, as well as identifying and implementing program and organizational changes required for harmonized, organizational and effective implementation.

Within the CFO and CRO areas, thematic working groups were established, based on provisions of the standard.
The said project, which is approaching its final stages, is at this point focused on supporting and monitoring of activities related to effects of the first implementation - First Time Adoption (FTA) of the new Standard and the implementation of the latest program and organizational measures aimed at ensuring consistent application of new rules.

A brief analysis of the activities carried out within the project and the finalization phase in regards to the main areas of impact, as defined above, is presented below.

Classification and Measurement

In order to comply with IFRS 9 rules - introducing a model that classifies financial assets defined, on the one hand, by contractual features of cash flows of instruments and, on the other hand, by management intent for which they are held - defines the methods of implementing the test of contractual characteristics of cash flows (the so-called SPPI Test) and finalizes business models adopted by various Structures through which the Bank operates.

Concerning the SPPI Test on financial assets, the methodology to be used was defined - and at the same time - an analysis of the composition of the existing portfolio of securities and loans was carried out in order to identify the correct classification at the time of the first application of the new standard.

With regard to debt securities, a detailed examination of cash flow characteristics of instruments classified by amortized cost and in the category of financial assets available for sale in accordance with IAS 39 was carried out in order to identify activities that, without passing the SPPI test, have to be valued at fair value through profit or loss in accordance with IFRS 9. From the analyses conducted, it was concluded that the Bank does not have debt securities falling on the SPPI test.

For the credit sector, the project conducted modular analysis taking into account the significance of the portfolio, its homogeneity and Business Department. In this respect, differentiated approaches to credit portfolios were used for physical and legal persons, and only marginal cases emerged in that context, which, in terms of specific contractual provisions or the nature of financing, determine not passing the SPPI test. Therefore, there are no significant impacts during the first application in the credit sector.

Regarding the second trigger for the financial asset classification (business model), the process of defining business models, at the level of each department, to be adopted in accordance with IFRS 9 has been completed. For “Hold to Collect” portfolios, thresholds have been defined to examine permitted frequent, but not significant, sales (both individually and collectively), or non-frequent sales, even if they are significant; At the same time, sales identification parameters that are consistent with this business model were set up since they can be attributed to increased credit risk. Based on the analyses carried out, the portfolio of securities, now classified at amortized cost, generally shows a decline in turnover, in accordance with the "Hold to Collect" business model strategy. Regarding debt securities currently classified as available-for-sale assets, the adoption of “Hold to Collect and Sell” business model was defined for the whole portfolio.

In addition, the current way of credit management, regarding physical and legal persons, can be attributed to the “Hold to Collect” business model, in principle.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(s) **New standards and interpretations *(continued)***

IFRS 9 Financial Instruments (*continued*)

Classification and Measurement (continued)

In more general terms, finally, in relation to management intentions for which the financial asset is held, it is reported that a separate document has been approved by the appropriate management levels in order to define core business model elements, citing the role regarding the classification model prescribed by the IFRS 9 standard.

As regards equity securities, instruments (classified in the category of financial assets available for sale in accordance with IAS 39) have been identified for which the FTA applies the option of classification by fair value through other comprehensive income (without "recycling" in profit and loss account); In addition, general criteria that must regularly lead the choice have been defined and the associated organisational process was formalised.

Impairment

Regarding the area of impairment:

- Methods for measuring change of credit quality of positions in the portfolio of financial assets are measured at amortized cost or at fair value through other comprehensive income;
- Criteria for determining significant increase in credit risk are defined for the purpose of proper allocation of performing exposures in "Stage 1" or "Stage 2". On the other hand, in view of partially or fully non-performing exposure, the alignment of the established accounting and regulatory definitions – present today – allows the current rules of exposure classification as partially or fully non-performing to be considered as equivalent to the rules of exposure classification within "Stage 3";
- Models were created - including forward looking data - that will be used for calculation of "expected credit loss" (ECL) during the next 12 months (for exposure in stage 1) and for the remaining duration of the instrument or lifetime (for exposure in Stage 2 and Stage 3). In order to take into account the forward looking data and the macroeconomic scenarios that the Group could encounter, it was decided to adopt, as further detailed in the text below, the so-called „Most likely scenario + add on" approach.

Regarding the monitoring of credit quality, and in line with the standard and guidelines of the supervisory body on the way of applying accounting standards for larger institutions, efforts have been made in conducting the timely credit quality analysis of each individual credit relationship (both in the form of card exposure and in the form of credit exposure) for the purpose of identifying any "significant deterioration" from the date of first entry and the consequent need for classification in Stage 2, as well as the conditions for returning to Stage 1 from Stage 2. In other words, the elected choice, for each case separately and for each reporting date, implies a comparison of the credit quality of the financial instrument at the time of valuation and at the time of issuance or purchase with the purpose of determining whether the criteria for classification to Stage 2 have been met.

Concerning the foregoing, the elements that will be the main determinants which need to be considered for the purpose of assessing the "steps" between the various "stages" are the following:

- Default probability change in relation to the moment of initial entry of the financial instrument in the financial statements. It is therefore an assessment implemented by adopting the "relative" criterion, which is configured as the main criteria;
- Eventual presence of due amount which remains overdue over 30 days. In the event of such case the credit risk of such exposure is considered "significantly increased" and is classified to Stage 2;
- Existence of "forbearance" measures;
- Finally, certain indicators of the internal credit risk tracking system will be taken into account – for the purpose of transition between "Stages" and where appropriate.

As described above, the inclusion of "forward looking" factors, particularly macroeconomic scenarios, is absolutely important element for estimating expected losses. From a methodological point of view, several possible alternative approaches were analysed to take these elements into account. In relation to different options considered, the Bank has decided to adopt the approach representing the so-called "Most likely scenario + Add-on" which, for the purpose of calculating expected credit loss (ECL) and "stage assignment", implies taking into account the loss by credits set for

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(s)* New standards and interpretations *(continued)

IFRS 9 Financial Instruments (*continued*)

Impariment (continued)

The baseline scenario, with the attributed add-on aimed at reflecting the effects resulting from the possibility of the realisation of alternative of macroeconomic scenarios.

Finally, special considerations also apply to the exposures classified in the so-called “Stage 3”. Although the essential definition of non-performing loans in IFRS 9 is equal to existing accounting standards, ECL calculations for the entire lifetime led to methodological considerations and for the needs of estimates to be implemented in this section, mainly in relation to:

- Inclusion of “forward looking” data;
- Consideration of alternative scenarios for collection, such as sale of non-performing portfolio, which must be attributed to the probability of realization in the context of the overall assessment;
- Collection estimates and deadlines, as well as probability of migration to lower categories.

The competent management bodies have approved the methodology for carrying out the impairment of assets.

Impact on information systems

Rational and efficient process of implementing new features introduced by IFRS 9 in the area of Classification and Measurement, primarily the impairment, has led to the need to carry out operations that have a significant impact on the IT area. Specific analyses have been carried out to this purpose, which led to identification of the main areas of impact; Consequently, targeting program architectures that need to be implemented have been set out and programs and procedures that need to be adjusted were identified, as well as the modifications that need to be made.

System interventions - set to meet the new requirements defined by the standard in terms of portfolio classification, credit risk measurement, accounting and disclosure - were, therefore, related to the implementation of already existing functionalities necessary for that purpose, as well as for the purpose of the integration of new software applications necessary for more effective and efficient management of subject matters.

More specifically, as far as the area of Classification and Measurement is concerned, once the specific ways in which the SPPI Test will be carried out was defined, the programs and procedures for its implementation, where and when needed, have been identified and purchased, both for securities and for credit exposures in the narrow sense.

Concerning the area of “Impairment”, after the main parameters to be considered for the purpose of assessing significant deterioration were executed, as well as ECL calculation methods (taking into account the “forward looking” elements), risk management programs at which one-position credit risk tracking and the calculation of the relevant ECL will be performed have been identified and implemented, as well as the necessary adjustments and upgrades. Similar analyses and interventions have been defined and are in the advanced stage of the implementation as regards the adjustment of accounting programs and for the purpose of guaranteeing appropriate publications in the financial statements.

Organizational impacts and additional development

Similar organizational measures were implemented simultaneously with IT implementations. Main organizational impacts concerned the revision and adaptation of existing operational processes, design and implementation of new processes and associated control measures, as well as revision of size and expansion of skills available within different structures - operational, management and control.

Activities related to the area of Classification and Measurement primarily concerned the business structures, with the aim of identifying and determining the business model, as well as defining the procedures for managing and monitoring the process of conducting the SPPI Tests.

Regarding the “Impairment”, the Bank’s target consisted of more effective and integrated implementation of on-going credit risk monitoring method, in accordance with IFRS 9, in order to ensure preventive measures to monitor potential reclassification of positions in Stage 2 and the disclosure of consistent and timely value adjustments in relation to actual credit risk.

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(s)* New standards and interpretations *(continued)

IFRS 9 Financial Instruments (*continued*)

Organizational impacts and additional development (continued)

Finally, the introduction of IFRS 9 also included an analysis in the sense of commercial offer (and, consequently, in terms of possible revision of product catalogue).Consequently, the said analysis took into account the following main impacts on the Bank's banking business arising from the combination of different thematic areas of the new standard:

- Possible need/opportunity – at least for certain portfolios – to review the adopted credit strategies again;
- Modification of certain products in the catalogue (potentially including the relevant price and duration, depending on the accompanying collateral, as well as collection mechanisms);
- Possible redefinition of the mission of certain business units, with associated portfolio management implications, control methods, risk assessment/measures and the associated limits and maximum amounts.

Hedge Accounting

As for Hedge Accounting, no impact is revealed with respect to the current portfolio and business operations of the Bank, since hedge accounting is not currently applied.

Estimated impact of the adoption of IFRS 9 – First Time Adoption ("FTA")

Based on the above, the following is an estimate of the impact expected for first-time adoption of IFRS 9 on net assets of the Bank as at 1 January 2018. These impacts, which concern both the amount and the composition of net assets, arise mainly:

- From the obligation to redefine the value adjustments of financial assets in the portfolio (both performing and non-performing) using the expected loss model - with the inclusion of multiple forward-looking components - in return for the existing loss model. Specifically, in relation to performing exposures, the increase in value adjustments is attributable to (i) allocation of the portion of the performing portfolio to "Stage 2" based on defined allocation criteria, with the consequent need to calculate the expected loss for the entire remaining life of financial assets, and (ii) inclusion of "forward looking" parameters arising from future macroeconomic scenarios in the calculation of expected losses. Regarding partially or fully non-performing loans, the impact is essentially caused by inclusion of forward looking parameters arising from the consideration of future macroeconomic scenarios in calculation for all NPL categories and the inclusion of sales scenario foreseen by the Bank's objective to reduce non-performing assets, for the part of the portfolio of non-performing receivables with features of transferability;

- From the need to reclassify the individual financial assets in the portfolio based on the combined result of two classification triggers provided by the standard: the business model on which these instruments are managed and the contractual characteristics of the related cash flows (SPPI Test).

The actual impacts of adopting the standards at 1 January 2018 may change because:

- The Bank has not finalised the testing and assessment of controls over its new IT systems; and
- The new accounting policies are subject to change until the Bank presents its first financial statements that include the date of initial application.

Estimated impact of adoption of IFRS is shown in the table below.

In thousands of KM	**As reported at 31 December 2017**	**Estimated adjustments due to adoption of IFRS 9**	**Estimated adjusted opening balance at 1 January 2018**
Impairment allowance	68,479	27,203	95,682
Retained earnings	147,259	(27,203)	120,056

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(s)* New standards and interpretations *(continued)

IFRS 9 Financial Instruments (*continued*)

Estimated impact of the adoption of IFRS 9 – First Time Adoption ("FTA") (continued)

In thousands of KM	**Impact on net Equity as at 1 January 2018 (FTA)**
	In gross amount before taxation
Performing loans impairment	(26,452)
Performing debt securities impairment	-
Non-performing loans impairment	(751)
Reclassification of financial instruments	-
Total	(27,203)

The following new or amended standards are not expected to have a material impact on the Bank's financial statements:

- *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*
- *IFRS 16 Leases*
- *Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)*
- *Annual Improvements to IFRSs 2014–2016 Cycle – various standards (Amendments to IFRS 1 and IAS 28)*
- *IFRS 15 Revenue from Contracts with Customers*
- *IFRIC 23 Uncertainty over Income Tax Treatments*

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated 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.

(a) Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. The need for impairment of the Bank's on and off-balance sheet exposure to credit risk is assessed on a monthly basis.

Impairment losses are made mainly against the carrying value of loans to corporate and retail customers (as disclosed in Note 23) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 35) and other assets (Note 24).

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 (corporate exposures above KM 50 thousand and retail exposures above KM 150 thousand) 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 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 enforceability of security, where these changes can be correlated with defaults.

(all amounts are expressed in thousands of KM, unless otherwise stated)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (*continued*)

(a) Impairment losses on loans and receivables (continued)

	31 December 2017	31 December 2016
Summary of impairment allowances:		
Impairment allowance for Loans and receivables from customers, including IBNR (Note 23)	63,529	84,519
Provisions for off-balance-sheet items, including IBNR (Note 31)	2,445	2,222
	65,974	**86,741**

As at 31 December 2017 and 31 December 2016, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognised were as follows:

	31 December 2017			31 December 2016		
	Corporate	**Retail**	**Total**	**Corporate**	**Retail**	**Total**
Gross exposure	41,609	35,128	**76,737**	72,705	33,620	**106,325**
Impairment allowance	(32,152)	(24,847)	**(56,999)**	(54,121)	(22,756)	**(76,877)**
Impairment rate	77%	71%	**74%**	74%	68%	**72%**

An increase in the impairment rate of 1 percentage point of the gross non-performing exposure presented above as at 31 December 2017, would lead to the recognition of an additional impairment loss of KM 767 thousand (2016: KM 1,063 thousand).

In addition to identified losses on impaired loans, as described above, the Bank also recognizes impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified ("IBNR"). Amounts, for which specific impairment losses have been identified, are excluded from this calculation.

The amount of IBNR as at 31 December 2017 amounted to KM 6,530 thousand for balance sheet exposure and KM 2,025 thousand for off-balance-sheet exposure (2016: KM 7,642 thousand for balance sheet exposure and KM 1,878 thousand for off-balance-sheet exposure). The total IBNR provision amounted to 0.54% (2016: 0.65%) of the relevant on and off-balance-sheet exposure.

(b) Taxation

The Bank provides for tax liabilities in accordance with the tax laws of the Federation of Bosnia and Herzegovina. Tax returns are subject to the approval of the tax authorities which are entitled to carry out subsequent inspections of taxpayers' records.

(c) Regulatory requirements

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

In addition to impairment allowances calculated and recognised in accordance with IFRS, the Bank also calculates impairment losses in accordance with the Agency regulations for capital adequacy calculation purposes.

(all amounts are expressed in thousands of KM, unless otherwise stated)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (*continued*)

(c) Regulatory requirements (continued)

The following table summarizes impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2017 are calculated in accordance with the new methodology, as explained in Note 3(o):

Summary of impairment allowances	**31 December 2017**	**31 December 2016**
Provisions for total balance-sheet items (Agency)	96,986	122,736
Provisions for total off-balance–sheet items (Agency)	7,627	7,206
	104,613	**129,942**
Impairment allowances under IFRS (including Other assets impairment)	66,624	87,669
Excess at the year end	**37,989**	**42,273**

Prior to 2012, any increase in allowance in accordance with the Agency regulations over amounts recognised under IFRS were required to be transferred to regulatory reserves from profit or retained earnings, upon the decision of the General Assembly. However, as explained in Note 3(o), based on the Decision on Minimum Standards of Capital Management and Asset Classification issued by the Agency in February 2013 any further shortfall in regulatory provisions after 31 December 2012 will be adjusted as a deduction of regulatory capital in the capital adequacy calculation without any transfer of this shortfall from retained earnings to regulatory reserves for credit losses within equity.

As presented in the above table, total Agency provisions exceeded provisions recognised under IFRS by KM 37,989 thousand as at 31 December 2017 (31 December 2016: KM 42,273 thousand). Out of this amount, KM 18,286 thousand has been recognised as a regulatory reserve for credit losses within equity as at 31 December 2017 (31 December 2016: KM 18,286 thousand). The remaining amount of KM 19,703 thousand (31 December 2016: 23,987), which represents the current year end shortfall, in line with the Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be recorded as a reduction of regulatory capital, for capital adequacy calculation.

(d) Litigation and claims

The Bank performs an individual assessment of all court cases and creates provisions in accordance with the assessment. The assessment of risks and proposal for provisions for legal cases is performed by the Legal Affairs Department and Finance Division, and a decision on the creation of provisions is made by the Bank’s management.

As stated in Note 31, the Bank provided KM 1,485 thousand (2016: KM 1,975 thousand), which management estimates as sufficient. Since the estimate is made considering the specifics of each individual case, it is not practicable for management to evaluate the financial impact of changes to the assumptions based on which provisions are quantified as at the reporting date.

5. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks: credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate and other price risk.

The Bank has established an integrated system of risk management by introducing a set of policies and procedures for analysis, evaluation, acceptance and risk management. Taking risk is core to the financial services business and the operational risks are an inevitable consequence of being in business.

The Management Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.

Risk management is carried out by the Risk Management Division whose main purpose is to support financial operations, coordinate access to domestic and international financial markets, and oversee and manage financial risk through internal risk reports including analysis by size and level of the risk.

5.1 Credit risk

5.1.1 Risk limit control and mitigation policies

The Bank takes on exposure to credit risk which is the risk that the counterparty will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Such risks are monitored on a revolving basis and are subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest payment and capital repayment obligations and by changing the lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

The limits of credit risk are determined in relation to the Bank's regulatory capital.

According to the Bank's policy, decision-making on exposure to credit risk is centralized and concentrated on the Credit Committee. Decisions of the Credit Committees are made upon consideration of proposals provided by the Risk Management Department. The terms for approval of each corporate loan are determined individually depending on client type, the loan's purpose, estimated creditworthiness and current market situation. Conditions for collateral are also determined according to client creditworthiness analysis, type of credit risk exposure, term of the placement as well as the placement amount.

Off-balance-sheet credit instruments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letter of credits carry the same risk as loans and are secured with similar collateral as are loans.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.2 Maximum exposure to credit risk before collateral held or other credit enhancement

	Maximum exposure	
	31 December 2017	**31 December 2016**
Included in the statement of financial position		
Current accounts with Central Bank and other banks	294,185	134,859
Reserves with the Central Bank	147,453	251,305
Placements with other banks	14,636	47,135
Debt securities available for sale	65,836	88,974
Loans and receivables from customers	1,278,696	1,192,613
Income tax prepayment	2,747	2,207
Other assets excluding fixed assets	9,551	9,589
Off-balance-sheet exposure		
Undrawn lending commitments	203,963	195,492
Financial guarantees and letters of credit	114,185	108,625
Total	**2,131,252**	**2,030,799**

For items included in the statement of financial position, the exposures set out above are based on net carrying amounts as reported in the statement of financial position. Off-balance-sheet exposure is also stated net of provisions.

The above table represents the maximum credit risk exposure of the Bank as at 31 December 2017 and 31 December 2016, without taking into account any collateral held or other credit enhancements attached.

The Bank holds collateral against loans and receivables to customers in the form of mortgages and other securities over assets and guarantees. Collateral value estimates are based on assessments by chartered court surveyors at the time of loan approval, reduced by a haircut at certain fixed percentages. In order to verify the adequacy of the impairment allowance on a continuous basis, collateral reassessments are regularly performed and back-tested in accordance with the principles and rules of the collateral management system, taking into proper consideration the volatility of collateral value and the time needed for its realisation, influenced by the local and global economic trend. Collateral is not held for loans and placements to banks.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.2 Maximum exposure to credit risk before collateral held or other credit enhancement (*continued*)

During the year the Bank obtains financial and non-financial assets by taking possession of collaterals it holds as security or calling on other credit enhancements, in case of failure by the debtors to repay their due amounts. Such process of foreclosure involves mainly real estate, equipment and vehicles. Repossessed items are presented as such in the statement of financial position once they meet the criteria for recognition according to IFRS and local law. The policy of the Bank is to sell repossessed assets; during the period of possession and pending their final sale to third parties, the assets can be temporarily used if they are functional to the Bank's standard operations, or leased operationally to third parties.

The gross amount of repossessed assets is presented in the following table:

	31 December 2017	**31 December 2016**
Other assets (*Note 24*)	3,345	2,239
	3,345	**2,239**

5.1.3 Credit risk management and policies for impairment and provisions

The Bank accounts for counterparty risks arising from the loan portfolio by making allowances for impaired loans. At each reporting date, the Bank checks the existence of objective evidence of impairment of financial assets, as previously explained in Note 3.

Loans and receivables with renegotiated terms

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

The Bank renegotiates loans to customers in financial difficulties to maximise collection opportunities and minimise the risk of default (rescheduling). Rescheduling is mainly performed in response to initial deterioration of the clients' financial position or for the prevention of further deterioration of the clients' financial position. The revised terms usually include extending the maturity, changing the timing of interest payments and when possible obtaining additional instruments of collateral. Following the restructuring the loans remain graded as restructured until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash-flows and there are no other indicators of impairment. Gross carrying amount of loans with renegotiated terms amount to KM 19,005 thousand for corporate loans and KM 4,745 thousand for retail loans as at 31 December 2017 (2016: KM 28,689 thousand for corporate and KM 4,732 for retail loans.)

For the purpose of credit monitoring and the management of credit risk, the Bank divides its credit portfolio into the following groups:

- Performing loans – loans that are neither past due nor impaired
- Past due but unimpaired loans
- Non-performing loans for which impairment has been recognised.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.3 Credit risk management and policies for impairment and provisions (*continued*)

The analysis of the loan portfolio according to the above-stated categories is presented below:

	31 December 2017	**31 December 2016**
Corporate		
Loans to customers that are neither past due nor impaired	675,589	612,280
Past due but not impaired loans	1,080	5,914
Non-performing loans (impaired loans)	41,609	72,705
Gross exposure	**718,278**	**690,899**
Less: impairment allowance	(35,341)	(57,604)
Net exposure	**682,937**	**633,295**
Retail		
Loans to customers that are neither past due nor impaired	565,230	525,572
Past due but not impaired loans	23,589	27,041
Non-performing loans (impaired loans)	35,128	33,620
Gross exposure	**623,947**	**586,233**
Less: impairment allowance	(28,188)	(26,915)
Net exposure	**595,759**	**559,318**
Total gross exposure	**1,342,225**	**1,277,132**
Portfolio impairment allowance (IBNR)	(6,530)	(7,642)
Specific impairment allowances	(56,999)	(76,877)
Net exposure	**1,278,696**	**1,192,613**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.3 Credit risk management and policies for impairment and provisions (*continued*)

a) Loans to customers that are neither past due nor impaired

The quality of the portfolio of loans to customers that are neither past due nor impaired can be assessed through the internal standard monitoring system. Loans to customers are regularly monitored and systematically reviewed in order to identify any irregularities or warning signals. These loans are subject to constant monitoring with the aim of taking timely action based on improvement/deterioration of the client's risk profile.

An overview of gross exposure of loans to customers that are neither past due nor impaired according to the business segment and the type of loan is as follows:

		Retail loans				**Corporate loans**	
	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
31 December 2017							
Standard monitoring	365,579	148,341	51,310	**565,230**	406,152	269,437	**675,589**
31 December 2016							
Standard monitoring	331,653	143,142	50,777	**525,572**	369,263	243,017	**612,280**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.3 Credit risk management and policies for impairment and provisions (*continued*)

b) Past due but not impaired loans

Loans to and receivables from customers less than 90 days overdue are not considered as impaired, unless other information is available to indicate the contrary. The gross amount of loans to and receivables from customers that were past due but not impaired was as follows:

				Past due days	
	Gross amount	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2017					
Corporate loans					
- Large	1,020	-	-	1,020	-
- Other	60	-	60	-	-
	1,080	**-**	**60**	**1,020**	**-**
Retail loans					
- Consumer	12,527	10,083	2,042	269	133
- Housing	8,668	7,269	1,233	110	56
- Credit Cards and overdrafts	2,394	202	1,759	409	24
	23,589	**17,554**	**5,034**	**788**	**213**
Total	**24,669**	**17,554**	**5,094**	**1,808**	**213**

				Past due days	
	Gross amount	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2016					
Corporate loans					
- Large	4,897	3,254	1,643	-	-
- Other	1,017	1,017	-	-	-
	5,914	**4,271**	**1,643**	**-**	**-**
Retail loans					
- Consumer	13,733	11,951	1,515	255	12
- Housing	10,594	8,927	1,333	334	-
- Credit Cards and overdrafts	2,714	119	2,016	374	205
	27,041	**20,997**	**4,864**	**963**	**217**
Total	**32,955**	**25,268**	**6,507**	**963**	**217**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.3 Credit risk management and policies for impairment and provisions (*continued*)

c) Non-performing loans

The breakdown of the gross and net amount of the loans to customers that are impaired along with the estimated value of related collateral held by the Bank as security (presented up to the maximum amount of the related exposure), are as follows:

	Retail loans				**Corporate loans**		
31 December 2017	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
Gross exposure	24,209	7,559	3,360	**35,128**	10,320	31,289	**41,609**
Impairment	(19,681)	(2,345)	(2,821)	**(24,847)**	(7,724)	(24,428)	**(32,152)**
Net	4,528	5,214	539	**10,281**	2,596	6,861	**9,457**
Rate of impairment	*81%*	*31%*	*84%*	*71%*	*75%*	*78%*	*77%*
Estimated value of collateral							
Cash deposit	-	-	-	**-**	-	-	**-**
Mortgage	354	5,151	-	**5,505**	2,175	7,099	**9,274**
Total	354	5,151	-	**5,505**	2,175	7,099	**9,274**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.3 Credit risk management and policies for impairment and provisions (*continued*)

c) Non-performing loans (continued)

	Retail loans				Corporate loans		
31 December 2016	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
Gross exposure	22,459	8,070	3,091	**33,620**	17,867	54,838	**72,705**
Impairment	(17,686)	(2,547)	(2,523)	**(22,756)**	(13,094)	(41,027)	**(54,121)**
Net	4,773	5,523	568	**10,864**	4,773	13,811	**18,584**
Rate of impairment	*79%*	*32%*	*82%*	*68%*	*73%*	*75%*	*74%*
Estimated value of collateral							
Cash deposit	-	48	-	**48**	-	-	**-**
Mortgage	237	5,488	-	**5,725**	4,080	13,597	**17,677**
Total	237	5,536	-	**5,773**	4,080	13,597	**17,677**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.4 Concentration of credit risk per geographic location

Geographic risk is highly concentrated on the state of Bosnia and Herzegovina. Geographic risk concentrations on net amounts of balance sheet exposure are as follows:

	Bosnia and Herzegovina	EU countries	Non-EU countries	Total
As at 31 December 2017				
Current accounts with the Central Bank and other banks	193,366	95,205	5,614	**294,185**
Reserves with the Central Bank	147,453	-	-	**147,453**
Placements with other banks	-	14,636	-	**14,636**
Debt securities available for sale	65,836	-	-	**65,836**
Loans and receivables from customers	1,278,696	-	-	**1,278,696**
Income tax prepayment	2,747	-	-	**2,747**
Other assets (without repossessed assets)	6,480	3,070	-	**9,551**
	1,694,578	**112,911**	**5,614**	**1,813,103**
As at 31 December 2016				
Current accounts with the Central Bank and other banks	97,770	35,956	1,133	**134,859**
Obligatory reserves with the Central Bank	251,305	-	-	**251,305**
Placements with other banks	-	47,135	-	**47,135**
Debt securities available for sale	88,974	-	-	**88,974**
Loans and receivables from customers	1,192,613	-	-	**1,192,613**
Income tax prepayment	2,207	-	-	**2,207**
Other assets (without repossessed assets)	7,268	2,321	-	**9,589**
	1,640,137	**85,412**	**1,133**	**1,726,682**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.2 Liquidity risk management

Liquidity risk is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank maintains its liquidity profiles in accordance with regulations laid down by the Banking Agency.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash-settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The following tables show the remaining contractual maturities of the Bank's assets and liabilities as at 31 December 2017 and 31 December 2016, except for financial assets available for sale which have been classified in accordance with their secondary liquidity characteristic as maturing within one month and obligatory reserves which have been classified in the maturity period within one month. Other items of assets and liabilities that have no contractual maturities are classified as having a remaining maturity of over 5 years.

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2017						
Assets						
Cash and cash equivalents	323,643	-	-	-	-	**323,643**
Reserves with the Central Bank	147,453	-	-	-	-	**147,453**
Placements with other banks	14,636	-	-	-	-	**14,636**
Financial assets available for sale	65,836	-	-	-	116	**65,952**
Financial assets at fair value through profit or loss	-	181	-	-	426	**607**
Loans and receivables from customers	94,563	95,170	324,356	538,868	225,739	**1,278,696**
Income tax prepayment and other assets	14,914	-	-	-	-	**14,914**
Property and equipment and intangible assets	-	-	-	-	21,151	**21,151**
Total assets	**661,045**	**95,351**	**324,356**	**538,868**	**247,432**	**1,867,052**
Liabilities and equity						
Due to banks and other financial institutions	23,976	105,730	49,718	132,191	11,421	**323,036**
Due to customers	685,962	33,096	224,269	276,477	21,896	**1,241,700**
Financial liabilities at fair value through profit or loss	-	148	-	-	-	**148**
Subordinated debt	-	41	80	-	-	**121**
Other liabilities and deferred tax	27,916	-	-	-	114	**28,030**
Provision for liabilities and charges	-	-	-	-	4,701	**4,701**
Share capital and reserves	-	-	-	-	269,316	**269,316**
Total liabilities and equity	**737,854**	**139,015**	**274,067**	**408,668**	**307,448**	**1,867,052**
Maturity gap	**(76,809)**	**(43,664)**	**50,289**	**130,200**	**(60,016)**	**-**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.2 Liquidity risk management (*continued*)

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2016						
Assets						
Cash and cash equivalents	165,443	-	-	-	-	**165,443**
Obligatory reserve with the Central Bank	251,305	-	-	-	-	**251,305**
Placements with other banks	47,135	-	-	-	-	**47,135**
Financial assets available for sale	88,974	-	-	-	120	**89,094**
Financial assets at fair value through profit or loss	17	1,431	-	-	298	**1,746**
Loans and receivables from customers	80,182	91,072	327,595	490,075	203,689	**1,192,613**
Income tax prepayment and other assets	12,192	-	-	-	-	**12,192**
Property and equipment and intangible assets	-	-	-	-	22,978	**22,978**
Total assets	**645,248**	**92,503**	**327,595**	**490,075**	**227,085**	**1,782,506**
Liabilities and equity						
Due to banks and other financial institutions	37,924	16,387	39,454	127,795	9,539	**231,099**
Due to customers	668,710	30,733	161,126	383,319	22,493	**1,266,381**
Financial liabilities at fair value through P&L	8	1,538	-	-	-	**1,546**
Subordinated debt	-	41	120	120	-	**281**
Other liabilities	18,047	-	-	-	114	**18,161**
Provisions for liabilities and charges	-	-	-	-	4,979	**4,979**
Share capital and reserve	-	-	-	-	260,059	**260,059**
Total liabilities and equity	**724,689**	**48,699**	**200,700**	**511,234**	**297,184**	**1,782,506**
Maturity gap	**(79,441)**	**43,804**	**126,895**	**(21,159)**	**(70,099)**	**-**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.2 Liquidity risk management (*continued*)

Future cash flows for interest bearing liabilities

The estimated future cash flows for the Bank's interest bearing liabilities, including expected interest as at 31 December 2017 and as at 31 December 2016 are shown in the following table:

	Total expected outflow						
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Carrying value
31 December 2017							
Liabilities							
Due to banks and other financial institutions	21,272	107,598	51,970	134,330	11,515	**326,685**	**323,036**
Due to customers	688,540	32,788	227,616	286,291	22,568	**1,257,803**	**1,241,700**
Subordinated debt	-	41	81	-	-	**122**	**121**
Total expected outflow	**709,812**	**140,427**	**279,667**	**420,621**	**34,083**	**1,584,610**	**1,564,857**

	Total expected outflow						
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Carrying value
31 December 2016							
Liabilities							
Due to banks and other financial institutions	42,624	11,920	40,199	129,414	9,600	**233,757**	**231,099**
Due to customers	669,360	31,307	166,458	399,771	23,427	**1,290,323**	**1,266,381**
Subordinated debt	-	42	124	122	-	**288**	**281**
Total expected outflow	**711,984**	**43,269**	**206,781**	**529,307**	**33,027**	**1,524,368**	**1,497,761**

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk

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, credit spreads, foreign exchange rates and equity prices.

The Management Board sets limits and guidelines for monitoring and mitigating market risks which is regularly monitored by the Risk Management Department of the Bank.

5.3.1 Foreign exchange risk

Exposure to currency risk arises from credit, deposit-taking and trading activities and is controlled on a daily basis in accordance with legal and internal limits for each currency as well as in total amounts for assets and liabilities denominated in or linked to foreign currencies.

In order to manage foreign exchange rate risk more efficiently, the Bank monitors economic and other business changes in the environment in order to predict possible changes in foreign currency activities, exchange rates, and foreign currency risk.

Overall exposure to foreign exchange risks is monitored within Risk Management Department using techniques such as Value-at-Risk (“VaR”) and stress testing.

FX Value-at-Risk is an individual, concise, statistical measurement of possible losses in the portfolio. VaR is a measurement of loss under normal movements of risk factors on the market. The likelihood of losses higher than VaR occurring is expected to be low.

The main model assumptions are:

- Being based on the historical methodology
- 99 percent as a confidence interval for Value-at-Risk computation
- One-day held period

The model covers foreign currency risk – valid for foreign currency transactions and positions denominated on foreign currencies; resulting from foreign currency rate volatility.

The model can compute VaR at different aggregation levels – from a single position to any sub-portfolio level. Therefore, the model allows a detailed analysis of risk profiles for the multi-level portfolio hierarchy and diversity effects occurring. Furthermore, VaR measurement can be expounded based on risk source (risk factors). These features of a more detailed risk monitoring system allow the determination of an efficient limit structure which can be compared through different organisational units.

The quality of the implemented risk measurement model is constantly assessed. The Bank performs back-testing of the computed VaR measures with the actual gain and losses for the same period.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk (*continued*)

5.3.1 Foreign exchange risk (*continued*)

During 2017, the Bank improved the model for calculation of VaR in accordance with best practices and as a result, the Bank recorded 2 back-testing exceptions (results for 2016: 2 exceptions) when actual losses exceeded the daily VAR amount.

The Bank is exposed to foreign currency risk when there is no matching between assets and liabilities and off-balance sheet positions due to cash flows denominated in foreign currencies. Portfolio exposure to foreign currency risk arises from portfolio sensitivity to fluctuations in exchange rate values. The degree of foreign currency risk depends on the amount of open positions and the degree of potential change in foreign currency rates.

The Bank considers that it is not currently exposed to foreign currency risk related to EUR due to the fact that Convertible Mark is pegged to EURO (1 EUR = KM 1.955830). Exposure is more prominent for USD and CHF. The Bank performs stress testing based on the assumption of a 10% increase or decrease in foreign currency rates against the relevant local currency. The sensitivity rate of 10% is used when reporting internally to key management personnel and represents management’s assessment of the reasonably possible change in foreign exchange rates. Stress testing is performed on an annual basis. The results of the most recent test performed are presented here below:

31 December 2017

Currency	Open position (in KM)	Stress Test	
		10% Move Up	10% Move Down
CHF	5,488	(548)	548
GBP	761	(76)	76
USD	(83,880)	8,388	(8,388)
HRK	8,766	(876)	876
CAD	3,934	(39)	39
SEK	5,941	(594)	594
other	10,415	(1,041)	1,041
EUR	(30,401,288)	-	-

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk (*continued*)

5.3.1 Foreign exchange risk (*continued*)

31 December 2016

Currency	Open position (in KM)	Stress Test	
		10% Move Up	10% Move Down
CHF	16,643	(1,664)	1,664
GBP	542	(54)	54
USD	(12,812)	1,281	(1,281)
HRK	17,875	(1,787)	1,787
CAD	21,114	(2,111)	2,111
AUD	12,259	(1,226)	1,226
other	24,813	(2,481)	2,481
EUR	1,700,176	-	-

The analysis outlined above is based on the open foreign currency position of the Bank, which includes all asset and liability and off-balance-sheet positions.

If the currency position of a foreign currency is “long” (assets exceeding liabilities) and the exchange rate for this currency increases/(decreases) in relation to the KM, the Bank will experience a foreign exchange gain/(loss).

If the currency position of a foreign currency is “short” (liabilities exceeding assets) and the exchange rate for this currency (increases)/decreases in relation to KM, the Bank will experience a foreign exchange (loss)/gain.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank monitors its foreign exchange (FX) position for compliance with the regulatory requirements of the Banking Agency of the Federation of Bosnia and Herzegovina established in respect of limits on open positions. The Bank seeks to match assets and liabilities denominated in foreign currencies to avoid foreign currency exposures.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk (*continued*)

5.3.1 Foreign exchange risk (*continued*)

Foreign exchange position

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2017 and 31 December 2016. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by currency. The Bank has a number of agreements governed by a foreign currency clause. The KM value of principal in such agreements is determined by the movement in foreign exchange rates. The principal balance of the related exposure is included in the table below in the column "EURO linked".

The Bank had the following significant currency positions:

31 December 2017	EURO	EURO linked	EURO total	USD	Other FX	KM	Total
Assets							
Cash and cash equivalents	88,948	-	88,948	5,487	13,453	215,755	**323,643**
Reserves with the Central Bank	-	-	-	-	-	147,453	**147,453**
Placement with other banks	9	-	9	14,627	-	-	**14,636**
Financial assets available for sale	64	-	64	-	-	65,888	**65,952**
Financial assets at fair value through profit or loss	426	-	426	-	-	181	**607**
Loans and receivables from customers	221	740,324	740,545	-	-	538,151	**1,278,696**
Income tax prepayment	-	-	-	-	-	2,747	**2,747**
Deferred Tax Assets	-	-	-	-	-	178	**178**
Other asset	2,432	-	2,432	35	-	9,522	**11,989**
Property and equipment and intangible assets	-	-	-	-	-	21,151	**21,151**
Total assets	**92,100**	**740,324**	**832,424**	**20,149**	**13,453**	**1,001,026**	**1,867,052**
Liabilities and equity							
Due to banks and other financial Institutions	308,483	-	308,483	-	745	13,808	**323,036**
Due to customers	498,279	99,997	598,276	20,156	12,549	610,719	**1,241,700**
Financial liabilities fair value through profit or loss	-	-	-	-	-	148	**148**
Subordinated debt	-	-	-	-	-	121	**121**
Other liabilities	2,008	-	2,008	32	101	25,847	**27,988**
Provision for liabilities and charges	-	-	-	-	-	4,701	**4,701**
Deferred tax	-	-	-	-	-	42	**42**
Share capital and reserves	-	-	-	-	-	269,316	**269,316**
Total liabilities and equity	**808,770**	**99,997**	**908,767**	**20,188**	**13,395**	**924,702**	**1,867,052**
Net foreign exchange position	**(716,670)**	**640,327**	**(76,343)**	**(39)**	**58**	**76,324**	**-**

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk (*continued*)

5.3.1 Foreign exchange risk (*continued*)

31 December 2016	**EURO**	**EURO linked**	**EURO total**	**USD**	**Other FX**	**KM**	**Total**
Assets							
Cash and cash equivalents	31,563	-	31,563	1,335	11,830	120,715	**165,443**
Obligatory reserves with the Central Bank	-	-	-	-	-	251,305	**251,305**
Placements with other banks	-	-	-	44,971	2,164	-	**47,135**
Financial assets available for sale	58	-	58	-	-	89,036	**89,094**
Financial assets at fair value through profit or loss	1,729	-	1,729	17	-	-	**1,746**
Loans and receivables from customers	385	739,044	739,429	-	-	453,184	**1,192,613**
Income tax prepayment	-	-	-	-	-	2,207	**2,207**
Deferred tax	-	-	-	-	-	229	**229**
Other asset	1,733	-	1,733	31	-	7,992	**9,756**
Property and equipment and intangible assets	-	-	-	-	-	22,978	**22,978**
Total assets	**35,468**	**739,044**	**774,512**	**46,354**	**13,994**	**947,646**	**1,782,506**
Liabilities and equity							
Due to banks and other financial institutions	195,291	-	195,291	25,556	4,592	5,660	**231,099**
Due to customers	471,167	135,329	606,496	20,975	11,283	627,627	**1,266,381**
Subordinated debt	-	-	-	8	1,538	-	**1,546**
Other liabilities	-	-	-	-	-	281	**281**
Provision for liabilities and charges	2,497	-	2,497	71	28	15,565	**18,161**
Deferred tax liability	-	-	-	-	-	4,979	**4,979**
Share capital and reserves	-	-	-	-	-	260,059	**260,059**
Total liabilities and equity	**668,955**	**135,329**	**804,284**	**46,610**	**17,441**	**914,171**	**1,782,506**
Net foreign exchange position	**(633,487)**	**603,715**	**(29,772)**	**(256)**	**(3,447)**	**33,475**	**-**

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk (*continued*)

5.3.2 Interest rate risk

Interest rate risk is defined as the exposure of a Bank's financial condition to adverse movements in interest rates, referring to the banking book, meaning the set of on- and off-balance-sheet financial assets and liabilities which are part of the core lending and deposit collecting activities performed by the Bank.

The Bank is exposed to interest rate risk as the Bank borrows and lends funds at both fixed and floating interest rates. The risk is managed by the Bank by maintaining an appropriate mix between fixed and floating rate borrowings and lending.

Interest rate risk reflects the possibility of loss of profit and/or erosion of capital due to a change in interest rates. It relates to all products and balances that are sensitive to changes in interest rates. This risk comprises two components: income component and investment component.

The income component arises from a lack of harmonisation between the active and passive interest rates of the Bank (interest on placements is fixed, interest for liabilities is floating and vice versa).

The investment component is a consequence of the inverted relationship between price and interest rate fluctuations of securities.

The Bank strives to protect itself from interest rate risk by harmonizing the type of interest rate (fixed and floating), currency, related interest rate and the date of interest rate change for all products for which it concludes contracts (which are sensitive to interest rate changes). Any mismatch among the abovementioned elements results in exposure of the Bank to interest rate risk.

The adopted system operates at an analytical level commensurate to the complexity and risk of the banking book, and ensures that the risk profile can be examined from two separate, but complementary, perspectives:

- The economic value perspective, which considers the impact of changes in interest rates and related volatilities on the present value of all future cash flows;
- The earnings perspective, focused on analysing the impact that changes in interest rates and related volatilities generate on the net interest income and, therefore, on the related effects on interest margin.

The Bank uses the following methods to measure interest rate risks:

- Shift sensitivity of fair value;
- Shift sensitivity of the interest margin.

The shift sensitivity of fair value measures the changes in economic value of a financial portfolio resulting from a parallel shift in the discount curves. The total value of shift sensitivity is broken down by time bucket (bucket analysis), in order to identify the distribution of risk over the time axis. The operating limit currently in force for shift sensitivity of fair value (by +100 bp parallel shift of yield curves) amounts to KM 5,867 thousand (EUR 3,000 thousand). The limit is set up by the Bank with the aim of keeping exposure within low levels which are compatible with self-imposed risk parameters.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.3 Market risk (*continued*)

5.3.2 Interest rate risk (*continued*)

If changes in interest rates had been 100 basis points higher and all other variables were held constant at 31 December 2017, the effect, in terms of economic value of interest risk-sensitive balance-sheet portfolios, would have been KM -2,556 thousand (31 December 2016: KM 1,816 thousand).

In 2017 the Bank established the limit by time-buckets on the following way:

Shift Sensitivity Limit (+100 bp)

TOTAL	**0-18 months**	**18 months - 5 years**	**above 5 years**
+/- KM 5,867 thousand (3 mio EUR)	+/- KM 5,867 thousand (3 mio EUR)	+/- KM 5,867 thousand (3 mio EUR)	+/- KM 5,867 thousand (3 mio EUR)

The results of the analysis of the shift sensitivity of fair value are below the current operating limit and are presented in the table below:

Shift Sensitivity (+100 bp)	**31 December 2017**				**31 December 2016**
	TOTAL	**0-18 months**	**18 months - 5 years**	**above 5 years**	**TOTAL**
EUR	**1,678**	169	1,424	85	3,591
USD	**76**	27	49	-	118
CHF	**13**	6	7	-	12
KM	**(4,323)**	(1,677)	(1,728)	(918)	(1,912)
Other currencies	**3**	2	1	-	7
Total	**(2,553)**	**(1,473)**	**(247)**	**(833)**	**1,816**

The sensitivity of the interest margin quantifies instead the short-term (twelve months) impact on the interest margin of a parallel, instantaneous and permanent shock in the interest rate curve. This measure highlights the effect of changes in interest rates on the portfolio being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a predictor of the future levels of the interest margin. The operating limit currently in force for shift sensitivity of interest margin (by -50 bp parallel shift of yield curves) amounts to KM -3,912 thousand (EUR -2,000 thousand).

The result of shift sensitivity of the interest margin, if changes in interest rates market moving had been 100 basis points higher and all other variables were held constant at 31 December 2017 is an increase of KM 3,670 thousand (31 December 2016: KM 2,416 thousand), while if changes in interest rates market moving had been 100 basis points lower the result is decrease of KM 5,489 thousand as of 31 December 2017 (31 December 2016: decrease of KM 35 thousand). In addition, the Bank also prepares shift sensitivity of the interest margin based on the sensitivity range of +50/-50 bps. Increase by 50 bps of interest rates would increase the result for the year by KM 1,863 thousand, while a decrease by 50 bps in interest rates would decrease result for the year by KM 2,597 thousand as of 31 December 2017 (31 December 2016: KM 1,538 thousand for +50 bps and decrease of KM 1 thousand for -50 bps).

In order to measure the Bank's vulnerability under stressful market conditions the interest rate risk measurement system adopted by the Bank allows a meaningful evaluation of the effect of stressful market conditions on the Bank ("scenario analysis"), or rather abrupt changes in the general level of interest rates, changes in the relationships among key market rates (i.e. basis risk), changes in the slope and the shape of the yield curve (i.e. yield curve risk), changes in the liquidity of key financial markets or changes in the volatility of market rates.

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.4 Capital management

The Bank's objectives for capital management, which is a broader concept, in the opinion of the Management Board, than the 'equity' shown in the statement of financial position, are as follows:

- to comply with the capital requirements set by the regulators of the banking markets in the local environment;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital position to support the development of its business activities.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, employing techniques based on the guidelines developed by Banking Agency of Federation of Bosnia and Herzegovina for supervisory purposes. The required information is filed with the Agency on a quarterly basis.

The Bank's regulatory capital for monitoring adequacy according to the Agency's methodology consists of:

- Tier 1 Capital or Core Capital: share capital (net of the carrying value of treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; amount of negative revaluation reserves arising from the effects of changes in the fair value of assets and audited profit for the current period, upon approval and retention by the General Shareholders Assembly;
- Tier 2 Capital or Supplementary Capital: qualifying principal amounts of subordinated loan capital, collective impairment allowances and amount of positive revaluation reserves arising from the effects of changes in the fair value of assets.
  From 31.12.2015, according to the Decision on the minimum standards for capital of banks and capital protection (Official Gazette of Federation of BiH 46/14, Article 9), the amount of subordinated loan is recognised in accordance with the amortization plan, in line with the methodology prescribed by the FBA Instruction dating from November 2015. According to the same Decision, collective impairment allowances cannot be higher than 1.25% of the Total weighted Risk (2016: 1.25%).
- Deductible items.

Risk-weighted assets are measured by means of a hierarchy of four weightings classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance-sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

(all amounts are expressed in thousands of KM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.4 Capital management (*continued*)

The table below summarises the computation of regulatory capital and the capital adequacy ratio of the Bank as of 31 December 2017 and 31 December 2016, taken from the calculations submitted to the Agency in respect of those period-ends.

	31 December 2017	31 December 2016
Tier 1 capital		
Share capital	**44,782**	**44,782**
Share premium	**57,415**	**57,415**
Statutory and other reserves	**614**	**614**
Retained earnings brought forward	**122,349**	**111,251**
Deferred tax assets	**(178)**	**(228)**
Intangible assets	**(6,574)**	**(6,595)**
Total qualifying Tier 1 Capital	**218,408**	**207,239**
Tier 2 capital		
General provisions – FBA regulations	**19,238**	**17,868**
Fair value reserves, positive	**175**	**246**
Subordinated debt	**-**	**34**
Audited profit for the period	**-**	-
Total qualifying Tier 2 Capital	**19,413**	**18,148**
Adjustment for shortfall in regulatory reserve	**(19,703)**	**(23,987)**
Total regulatory capital	**218,118**	**201,400**
Risk weighted assets (*)		
On balance sheet	**1,271,258**	**1,167,334**
Off balance sheet	**173,278**	**172,936**
Total	**1,444,536**	**1,340,270**
Operational risk	**94,521**	**89,148**
Total weighted risk	**1,539,057**	**1,429,418**
Capital adequacy ratio	**14.17%**	**14.09%**

(*) Risk weighted assets amounts stated above are calculated in accordance with FBA regulatory requirements.

In accordance with the Agency regulations, Tier 1 capital does not include the balance on the regulatory reserve for credit losses (KM 18,286 thousand at 31 December 2017) which is part of net equity in the statement of financial position. However, general provisions calculated in accordance with Agency rules (KM 19,238 thousand at 31 December 2017) are included as Tier 2 capital.

In addition, an adjustment is made for the shortfall in regulatory reserves in respect of any additional requirements calculated at the reporting date (date of submission of the capital adequacy calculation to the Agency, which, in accordance with local regulations, is performed on a quarterly basis). For 2017 this amounted to KM 19,703 thousand (2016: 23,987 thousand).

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.4 Capital management (*continued*)

In accordance with the Agency regulations, the Decision on minimum standards for capital management of banks and capital protection dated 30 May 2014 (Official Gazette of the Federation of BiH 46/14), audited profit for the year is included in the calculation of regulatory capital from the date when the audited financial statements for the period have been issued and approved by the General Shareholders Assembly.

Given the structure of Core and Supplementary capital, Core Capital ratio is almost equivalent to total CAR and reached 14,19% at the end of 2017 (minimum level: 9,0%). Leverage ratio reached 10.1% as of 31 December 2017 (regulatory limit: 6,0%).

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

6.1 Valuation models

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurement.

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued 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 valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premium used in estimating discount rates, bond and equity prices, foreign exchange rates, equity prices and expected price volatilities and correlations.

The objective of valuation techniques is to arrive at fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Bank determines the fair value of debt securities (treasury bills and bonds) using an internal valuation model which considers their remaining maturity and the latest available auction prices of equivalent instruments.

The fair value of foreign currency forward derivatives is estimated using available market data for FX spot and cash curves of relevant currencies. Based on such inputs, forward points and forward rates are computed, which are then used for daily mark-to-market of outstanding deals.

The fair value of equity securities classified as available for sale and at fair value through profit or loss traded on an active market is based on closing bid prices at the reporting date for these securities.

(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (*continued*)

6.2 Financial instruments at fair value – fair value hierarchy

The following table analyses financial instruments measured at fair value at the reporting date distributed according to the fair value hierarchy. The amounts are based on the values recognised in the statement of financial position.

31 December 2017	Note	Level 1	Level 2	Level 3	Total
Financial assets available for sale	*22 a)*				
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina		-	65,836	-	**65,836**
Equity securities issued by non-resident legal entities		-	64	-	**64**
Financial assets available at fair value through profit and loss	*22 b)*				
Equity shares		426	-	-	**426**
Derivatives held for trading – OTC product		-	181		**181**
Total		**426**	**66,081**	**-**	**66,507**
Financial liabilities available at fair value through profit and loss	*22 c)*				
Derivatives held for trading – OTC product		-	148	-	**148**
Total		**-**	**148**	**-**	**148**

31 December 2016	Note	Level 1	Level 2	Level 3	Total
Financial assets available for sale	*22 a)*				
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina		-	88,974	-	**88,974**
Equity securities issued by non-resident legal entities		-	58	-	**58**
Financial assets available at fair value through profit and loss	*22 b)*				
Equity shares		298	-	-	**298**
Derivatives held for trading – OTC product		-	1,448		**1,448**
Total		**298**	**90,480**	**-**	**90,778**
Financial liabilities available at fair value through profit and loss	*22 c)*				
Derivatives held for trading – OTC product		-	1,546	-	**1,546**
Total		**-**	**1,546**	**-**	**1,546**

(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (*continued*)

6.3 Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised.

31 December 2017	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	29,458	294,185	**323,643**	**323,643**
Reserves with the Central Bank	-	-	147,453	**147,453**	**147,453**
Placements with other banks	-	14,636	-	**14,636**	**14,636**
Loans and receivables from customers	-	246,840	1,019,453	**1,266,293**	**1,278,696**
Total	**-**	**290,934**	**1,461,091**	**1,752,025**	**1,764,428**
Liabilities					
Due to banks and other financial institutions	-	134,055	187,628	**321,683**	**323,036**
Due to customers	-	712,827	530,565	**1,243,392**	**1,241,700**
Subordinated debt	-	-	122	**122**	**121**
Total	**-**	**846,882**	**718,315**	**1,565,197**	**1,564,857**

31 December 2016	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	30,585	134,858	**165,443**	**165,443**
Reserves with the Central Bank	-	-	251,305	**251,305**	**251,305**
Placements with other banks	-	47,135	-	**47,135**	**47,135**
Loans and receivables from customers	-	244,651	930,275	**1,174,926**	**1,192,613**
Total	**-**	**322,371**	**1,316,438**	**1,638,809**	**1,656,496**
Liabilities					
Due to banks and other financial institutions	-	42,621	183,883	**226,504**	**231,099**
Due to customers	-	692,378	572,854	**1,265,232**	**1,266,381**
Subordinated debt	-	-	284	**284**	**281**
Total	**-**	**734,999**	**757,021**	**1,492,020**	**1,497,761**

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (*continued*)

6.3 Financial instruments not measured at fair value (*continued*)

In estimating the fair value of the Bank's financial instruments and in assigning the instruments to the relevant level of fair value hierarchy, the methods, assumptions and limitations described below apply in accordance with the approach revised at Intesa Sanpaolo Group.

Cash and cash equivalents

The carrying values of cash and balances with banks are generally deemed to approximate their fair value. Obligatory reserve with the Central Bank is classified as Level 3, as well as, on demand balances versus financial institutions in consideration of the fact that the setting of their exit price could include subjective valuations of the counterparty's credit risk difficult to quantify.

Placements with other banks

Placements with banks mostly represent overnight and short term deposits; hence there is no significant difference between the fair value of these deposits and their carrying value. Their classification to Level 2 of the fair value hierarchy depends on the absence, or low relevance, of non-observable parameters in setting their exit price.

Loans and receivables from customers, amounts due to customers, banks and other financial institutions

Fair value is estimated through discounted cash flow method in case of positions with residual medium-long term maturities, while it is approximated with the book value, net of collective impairment/individual adjustment in case of short-term loans, loans payable on demand or with an indefinite maturity for impaired loans.

For the purpose of division by fair value level, non performing/impaired assets are classified in Level 3, since the exit price is significantly influenced by the forecasts for losses determined by the credit officer based on future cash flow expectations and the related collection schedules. This entity specific assessment component outweighs other components (as, for example market interest rates), leading to attribution of Level 3 in the hierarchy.

Performing loans with original maturity equal or lower than 12 months, as well as short-term liabilities to customers and banks are classified into Level 2 of the fair value hierarchy, due to the absence or low relevance of non-observable parameters in setting their exit prices.

Medium-long term loans and liabilities with customers, banks and other financial institutions are classified into Level 3 of the fair value hierarchy, considering the relevance of entity specific assessment components in estimating the exit price.

7. OPERATING SEGMENTS

On a regular basis, the Bank's management analyses the overall results of the Bank with reference to the contributions by individually significant operating segments. Corporate, Retail and Treasury business lines have been identified as relevant operating segments, insofar as financial products managed by each of them and the respective counterparties with whom each segment enters into negotiation are specific for each segment and are not managed by / related to any of the others.

Even though lending and fund collection are actually performed by all operating segments, the financial characteristics of the loans, deposits and credit lines managed are specifically designed for each of them and are applicable only to counterparties related to each specific segment.

The financial results of each operating segment are recorded through a combined methodology of "direct" and "indirect" allocation of income and cost. Income is mainly directly allocated to the respective segment where it was generated, while costs are directly allocated whenever they are identified as immediately generated within the operating segment and are indirectly charged to the operating segments whenever they are sustained by central organisational units.

An internal transfer rate methodology is also applied for allocation of the cost of funding to the operating segments.

Income statement items in the tables presented below on segment information are in the format used for management reporting purposes.

(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (*continued*)

Segmental information for the year ending 31 December 2017

	Retail	Corporate	Treasury	Total
Interest income	48,911	25,671	953	75,535
Interest expense	(9,987)	(4,263)	(486)	(14,736)
Net interest income	**38,924**	**21,408**	**467**	**60,799**
Fee and commission income	19,428	7,738	285	27,451
Fee and commission expense	(4,159)	(756)	(34)	(4,949)
Net fee and commission income	**15,269**	**6,982**	**251**	**22,502**
Net profit of trading activities and foreign exchange	-	-	2,097	2,097
Other operating income/expense	(3,903)	(1,543)	(447)	(5,893)
Operating income/expense	**(3,903)**	**(1,543)**	**1,650**	**(3,796)**
Personnel expense	(15,726)	(4,723)	(603)	(21,052)
Other administrative expense	(14,228)	(3,153)	(635)	(18,017)
Depreciation expense	(3,419)	(455)	(68)	(3,941)
Operating expense	**(33,373)**	**(8,331)**	**(1,306)**	**(43,010)**
Profit before impairment losses, and other provisions and income tax	**16,917**	**18,516**	**1,062**	**36,496**
Reversal of Impairment / (Impariment losses) and provisions	(4,724)	(3,737)	104	(8,359)
PROFIT BEFORE INCOME TAX	**12,193**	**14,779**	**1,166**	**28,138**
Income tax				(3,228)
NET PROFIT FOR THE YEAR				**24,910**

(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (*continued*)

Segmental information as at 31 December 2017

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	29,458	-	294,185	323,643
Obligatory reserves with the Central Bank	-	-	147,453	147,453
Placements with other banks	-	-	14,636	14,636
Financial assets available for sale	-	-	65,952	65,952
Financial assets at fair value through profit or loss	-	-	607	607
Loans and receivables from customers	595,759	682,937	-	1,278,696
Other unallocated amounts	-	-	-	36,035
TOTAL ASSETS	**625,217**	**682,937**	**522,833**	**1,867,052**
Due to banks and other financial institutions	-	31,170	291,866	323,036
Due to customers	601,642	636,766	3,292	1,241,700
Financial liabilities at fair value through profit or loss	-	-	148	148
Subordinated debt	-	-	121	121
Other unallocated amounts	-	-	-	32,730
TOTAL LIABILITIES	**601,642**	**667,936**	**295,457**	**1,597,735**

(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (*continued*)

Segmental information for the year ending 31 December 2016

	Retail	Corporate	Treasury	Total
Interest income	48,728	28,640	772	78,140
Interest expense	(10,980)	(5,332)	(370)	(16,682)
Net interest income	**37,748**	**23,308**	**402**	**61,458**
Fee and commission income	16,559	7,141	206	23,906
Fee and commission expense	(3,535)	(508)	(74)	(4,117)
Net fee and commission income	**13,024**	**6,633**	**132**	**19,789**
Net profit of trading activities and foreign exchange	-	-	2,468	2,468
Other operating income/expense	(4,114)	(1,023)	(270)	(5,407)
Operating income/expense	**(4,114)**	**(1,023)**	**2,198**	**(2,939)**
Personnel expense	(15,319)	(4,411)	(590)	(20,320)
Other administrative expense	(13,509)	(2,996)	(674)	(17,179)
Depreciation expense	(3,045)	(409)	(54)	(3,508)
Operating expense	**(31,873)**	**(7,816)**	**(1,318)**	**(41,007)**
Profit before impairment losses, and other provisions and income tax	**14,785**	**21,102**	**1,414**	**37,301**
Impairment losses and provisions	(6,556)	(395)	(146)	(7,097)
PROFIT BEFORE INCOME TAX	**8,229**	**20,707**	**1,268**	**30,204**
Income tax				(3,106)
NET PROFIT FOR THE YEAR				**27,098**

(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (*continued*)

Segmental information as at 31 December 2016

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	30,585	-	134,858	165,443
Obligatory reserves with the Central Bank	-	-	251,305	251,305
Placements with other banks	-	-	47,135	47,135
Financial assets available for sale	-	-	89,094	89,094
Financial assets at fair value through profit or loss	-	-	1,746	1,746
Loans and receivables from customers	559,731	632,882	-	1,192,613
Other unallocated amounts	-	-	-	35,170
TOTAL ASSETS	**590,316**	**632,882**	**524,138**	**1,782,506**
Due to banks and other financial institutions	-	18,094	213,005	231,099
Due to customers	573,805	692,576	-	1,266,381
Subordinated debt	-	-	281	281
Other unallocated amounts	-	-	-	24,686
TOTAL LIABILITIES	**573,805**	**710,670**	**213,286**	**1,522,447**

(all amounts are expressed in thousands of KM, unless otherwise stated)

8. INTEREST INCOME

	2017	2016
Retail clients	46,696	46,158
Corporate clients	27,839	31,164
Banks and other financial institutions	289	201
Interest on available-for-sale financial assets	711	617
	75,535	**78,140**

9. INTEREST EXPENSE

	2017	2016
Retail clients	9,131	10,126
Corporate clients	3,674	4,591
Banks and other financial institutions	1,912	1,929
Other	19	36
	14,736	**16,682**

10. FEE AND COMMISSION INCOME

	2017	2016
Credit card activities	8,007	6,601
Domestic payment transactions	5,017	4,915
Account service fee	4,114	2,833
Foreign payment transactions	3,207	2,975
Guarantees	1,945	1,905
FX transactions	1,597	1,609
Loans to clients	1,887	1,425
Agency services	85	120
Other	1,593	1,523
	27,452	**23,906**

(all amounts are expressed in thousands of KM, unless otherwise stated)

11. FEE AND COMMISSION EXPENSE

	2017	2016
Credit card operations	3,659	3,031
Banks services	681	460
Domestic payment transactions	263	278
Other	346	348
	4,949	**4,117**

12. NET TRADING INCOME

	2017	2016
Net gains from foreign exchange spot trading	2,016	2,556
Net gains on equity securities	17	8
Net gains/losses on financial instruments at fair value through profit or loss	64	(96)
	2,097	**2,468**

13. OTHER OPERATING INCOME / (EXPENSE)

	2017	2016
Savings deposit insurance	(2,681)	(2,377)
Card intermediation expenses	(2,128)	(1,923)
Consultancy and the Federal Banking Agency expenses	(1,205)	(1,282)
Impairment of property and equipment (Note 25)	(555)	-
Provisions for assets held for sale (Note 24)	(289)	-
(Loss) / Gain on sale and write off of property and equipment	(55)	96
Other income / (expense)	(38)	32
Income from claims settled by insurance companies and recharges from customers	1,005	348
Impairment of repossessed assets (Note 24)	53	(301)
	(5,893)	**(5,407)**

(all amounts are expressed in thousands of KM, unless otherwise stated)

14. PERSONNEL EXPENSES

	2017	2016
Net salaries	13,501	13,403
Tax and contributions	7,117	6,474
Provisions for liabilities and charges (Note 31)	22	106
Other expenses	412	337
	21,052	**20,320**

Personnel expenses include KM 3,559 thousand (31 December 2016: KM 3,616 thousand) of defined pension contributions paid into the State pension plan. Contributions are calculated as percentage of the gross salary paid. The Bank had 567 employees as at 31 December 2017 (537 as at 31 December 2016).

15. ADMINISTRATIVE EXPENSES

	2017	2016
Maintenance expenses	4,321	3,479
Rent and other rent-related expense	3,728	3,562
Telecommunication and post expense	2,992	3,030
Security and transport costs	2,220	2,216
Consultancy expenses	1,030	772
Material expenses	861	916
Representation and marketing expense	828	579
Energy	763	758
Other insurance charges	532	523
Other costs	967	901
Net of provisions for liabilities and charges (Note 31)	(225)	443
	18,017	**17,179**

(all amounts are expressed in thousands of KM, unless otherwise stated)

16. NET IMPAIRMENT LOSSES AND OTHER PROVISIONS

The charge to income statement in respect of impairment losses and provisions is analysed as follows:

Net impairment losses and provisions	**2017**	**2016**
-for loans to customers (Note 23)	8,031	6,521
-for other assets (Note 24)	66	320
-for off-balance sheet items (Note 31)	261	256
	8,358	**7,097**

17. INCOME TAXES

	2017	**2016**
Current tax	3,136	3,334
Deferred tax (Note 32)	92	(228)
Total Income tax	**3,228**	**3,106**

Income tax recognised in the income statement comprises current tax. Official corporate income tax rate is 10% (2016: 10%).

	2017	**2016**
Profit before income tax	28,137	30,204
Tax calculated at rate of 10%	2,814	3,020
Non-deductible expenses	415	87
Non-taxable income	(1)	(1)
Income tax expense	**3,228**	**3,106**
Average effective income tax rate	**11.5%**	**10.3%**

18. BASIC AND DILUTED EARNINGS PER SHARE

	2017	**2016**
Net profit (KM'000)	24,910	27,098
Weighted average number of ordinary shares outstanding	447,760	447,760
Basic and diluted earnings per share (KM)	**55.63**	**60.52**

(all amounts are expressed in thousands of KM, unless otherwise stated)

19. CASH AND CASH EQUIVALENTS

	31 December 2017	31 December 2016
Current account with the Central Bank	193,366	97,548
Current accounts with other banks	100,819	37,310
Cash in hand in domestic currency	22,194	22,945
Cash in hand in foreign currency	7,264	7,640
	323,643	**165,443**

20. RESERVES WITH THE CENTRAL BANK

	31 December 2017	31 December 2016
Obligatory reserve	147,453	149,629
Special reserve	-	101,676
	147,453	**251,305**

The minimum obligatory reserve as of 31 December 2017 and 31 December 2016 is calculated for 10% of all deposits, and is calculated on a daily basis, and updated every ten calendar days, in arrears.
In October 2015 the Federal Banking Agency issued an Instruction Letter, based on Law of banks, based on which banks are obliged to calculate and keep additional special reserves with the Central Bank. The amount of this additional special reserve is calculated as 50% of daily balance of a vista and term deposits belonging to entities financed and managing the State Budget funds. Based on new Law of banks, from April 2017, above mentioned Decision was put out of force.

21. PLACEMENTS WITH OTHER BANKS

	31 December 2017	31 December 2016
Placements with banks	**14,636**	**47,135**

As at 31 December 2017, the Bank had placement with one bank in USD as follows:

- USD 9,000,000; maturity 4 January 2018; interest rate 1.5% p.a.

(all amounts are expressed in thousands of KM, unless otherwise stated)

22. FINANCIAL ASSETS AND LIABILITIES

a) Financial assets available for sale

	31 December 2017	31 December 2016
Debt instruments		
Bonds and Treasury bills issued by the Federation of Bosnia and Herzegovina	65,836	88,974
	65,836	88,974
Equity instruments		
Equity securities at cost	52	62
Equity securities at fair value	64	58
	116	120
	65,952	**89,094**

b) Financial assets at fair value through profit or loss

	31 December 2017	31 December 2016
Financial assets		
Equity shares designated at fair value through profit or loss	426	298
Derivatives held for trading	181	1,448
	607	**1,746**

Derivatives held for trading are represented by foreign currency swaps, details of which are presented in the table below:

Financial assets	**31 December 2017 Notional amount**	**31 December 2017 Fair value**	**31 December 2016 Notional amount**	**31 December 2016 Fair value**
Derivatives classified as held for trading – OTC products				
Forward foreign exchange contracts	**8,238**	**181**	**19,811**	**1,448**

(all amounts are expressed in thousands of KM, unless otherwise stated)

22. FINANCIAL ASSETS AND LIABLITIES (*continued*)

c) Financial liabilities at fair value through profit or loss

	31 December 2017	31 December 2016
Financial liabilities		
Derivatives held for trading	148	1,546
	148	**1,546**

Derivatives held for trading are represented by foreign currency swaps, details of which are presented in the table below:

Financial liabilities	31 December 2017 Notional amount	31 December 2017 Fair value	31 December 2016 Notional amount	31 December 2016 Fair value
Derivatives classified as held for trading – OTC products				
Forward foreign exchange contracts	**8,042**	**148**	**20,282**	**1,546**

(all amounts are expressed in thousands of KM, unless otherwise stated)

23. LOANS AND RECEIVABLES FROM CUSTOMERS

	31 December 2017	31 December 2016
Short-term loans		
Corporate		
- in KM and KM linked to foreign currency	277,501	282,532
- in foreign currency	1,328	1,090
Retail		
- in KM and KM linked to foreign currency	65,399	64,368
- in foreign currency	5	68
	344,233	**348,058**
Long-term loans		
Corporate		
-in KM and KM linked to foreign currency	438,714	406,164
-in foreign currency	735	1,113
Retail		
-in KM and KM linked to foreign currency	558,505	521,742
-in foreign currency	38	55
	997,992	**929,074**
Total loans	1,342,225	1,277,132
Less: impairment allowance	(63,529)	(84,519)
	1,278,696	**1,192,613**

Loans and receivables from customers are presented including accrued interest in the amount of KM 6,555 thousand (2016: KM 7,773 thousand), and net of up-front fees in the amount of KM 8,741 thousand (2016: KM 7,796 thousand).

As of 31 December 2017, the net amount of short-term and long-term loans in domestic currency includes loans disbursed and repayable in domestic currency index-linked to the KM:EUR exchange rate in the amount of KM 82,712 thousand and KM 698,562 thousand, respectively (31 December 2016: KM 28,838 thousand and KM 710,206 thousand, respectively).

Movements in the provision for impairment of loans and receivables are summarised as follows:

	2017	2016
Balance as at 1 January	**84,519**	**89,862**
Net charge to income statement (Note 16)	8,031	6,521
Unwinding of discount	(1,597)	(1,827)
Transfers – other	29	48
Write-offs	(27,453)	(10,085)
Balance as at 31 December	**63,529**	**84,519**

(all amounts are expressed in thousands of KM, unless otherwise stated)

23. LOANS AND RECEIVABLES FROM CUSTOMERS (*continued*)

Concentration of credit risk by industry:

Economic sector risk concentration in the gross amount of loans and receivables is as follows:

	31 December 2017	31 December 2016
Trade	288.076	274,032
Manufacturing, agriculture, forestry, mining and energy	200,278	214,950
Services, finance, sport, tourism	42,256	32,381
Construction industry	57,370	55,145
Administrative and other public institutions	57,126	61,066
Transport and telecommunications	54,181	47,649
Other	18,991	5,676
Citizens	623,947	586,233
	1,342,225	**1,277,132**

24. OTHER ASSETS

	31 December 2017	31 December 2016
Receivables from card operations	3,959	2,971
Assets acquired upon foreclosure of loans	3,345	2,239
Prepaid expenses	1,919	3,186
Fees receivable	1,076	1,079
Assets held for sale (Note 25)	1,031	-
Other assets	3,164	3,101
Total other assets	14,494	12,576
Less: impairment allowance	(2,505)	(2,820)
	11,989	**9,756**

The movement in the impairment allowance for other assets are summarised as follows:

Balance as at 1 January	**2,820**	**2,786**
Net charge to income statement (Note 16)	66	320
Net charge to income statement - Assets acquired upon foreclosure of loans (Note 13)	(53)	-
Net charge to income statement - Assets held for sale (Note 13)	289	-
Transfers – other	(367)	(135)
Write-offs and sale of property	(250)	(151)
Balance as at 31 December	**2,505**	**2,820**

(all amounts are expressed in thousands of KM, unless otherwise stated)

25. PROPERTY AND EQUIPMENT

Cost	Land and buildings	Computers and other equipment	Assets in the course of construction	Leasehold improvements	Total
At 1 January 2016	**12,869**	**18,718**	**132**	**8,992**	**40,711**
Additions	-	-	3,612	-	3,612
Disposals	(140)	(292)	-	(44)	(476)
Transfers	367	2,256	(3,358)	735	-
At 31 December 2016	**13,096**	**20,682**	**386**	**9,683**	**43,847**
Additions	-	-	1,582	-	1,582
Disposals	(20)	(561)	-	-	(581)
Reclassification to Other asses	(1,363)	-	-	-	(1,363)
Other comprehensive income	418	-	-	-	418
Impairment of building	(555)	-	-	-	(555)
Transfers	-	1,273	(1,444)	171	-
At 31 December 2017	**11,576**	**21,394**	**524**	**9,854**	**43,348**
Accumulated depreciation					
At 1 January 2016	**2,137**	**14,979**	**-**	**8,598**	**25,714**
Charge for the year	530	1,372	-	179	2,081
Disposals	(19)	(282)	-	(30)	(331)
At 31 December 2016	**2,648**	**16,069**	**-**	**8,747**	**27,464**
Charge for the year	535	1,276	-	259	2,070
Reclassification to Other asses	(332)	-	-	-	(332)
Disposals	(12)	(419)	-	-	(431)
At 31 December 2017	**2,839**	**16,926**	**-**	**9,006**	**28,771**
Net Book Value					
At 31 December 2016	**10,448**	**4,613**	**386**	**936**	**16,383**
At 31 December 2017	**8,737**	**4,468**	**524**	**848**	**14,577**

25. PROPERTY AND EQUIPMENT (*continued*)

Compared to previous financial statements, as at 31 December 2017, the Bank has changed the accounting criteria for the disclosure and measurement of the following classes of tangible assets:

- functional property (governed by IAS 16 “Property, Plant and Equipment);
- property held for investment (governed by IAS 40 “Investment property”).

As mentioned, the above amendment, applied from the current financial statements, has led in particular to:

- passage from the cost model to revaluation after initial disclosure of functional property;
- passage from measurement at cost to measurement at fair value for investment property.

As at the date 31.12.2017 the Bank, in co-operation with the Group, Intesa SPA, has appointed an independent valuer to conduct the valuation of the above mentioned class of assets, under the new accounting policy that it implemented. The appraisal was done by the professional company CBRE: United States Commercial Real Estate Services. The valuation was made using the income method, or the method of discounted cash flows ("DCF"). The DCF method is the most appropriate method for assessing the value of real estate that is used and which is being rented. Key assumptions used in the valuation were that business objects will be rented to third parties.

Consequently, the Bank has recognised a gain in the revaluation reserves of KM 418 thousand. In addition to those gains, a loss of KM 555 thousand is shown, directly recognised in profit and loss.

In case that the accounting policy did not change, and that buildings were kept at cost, the following carrying values would have been presented in the Bank`s financial statements:

In thousands of KM	**Amount at cost**	**Accumulated depreciation**	**Carrying value**
Buildings	13,004	(3,151)	9,853

The Bank reclassified in 2017 specific buildings that are not in operational use from Property and Equipment to Other Assets, Assets Held for Sale (IFRS 5 classification) in the amount of KM 1,031 thousand.

(all amounts are expressed in thousands of KM, unless otherwise stated)

26. INTANGIBLE ASSETS

	Software	Assets in the course of construction	Total
Cost			
At 1 January 2016	**11,579**	**646**	**12,225**
Additions	-	2,902	2,902
Transfers	1,372	(1,372)	-
At 31 December 2016	**12,951**	**2,176**	**15,127**
Additions	-	1,902	1,902
Disposals	(1,277)	-	(1,272)
Transfers	3,854	(3,854)	-
At 31 December 2017	**15,528**	**224**	**15,752**
Amortisation			
At 1 January 2016	**7,105**	**-**	**7,105**
Charge for the year	1,427	-	1,427
At 31 December 2016	**8,532**	**-**	**8,532**
Charge for the year	1,871	-	1,871
Disposals	(1,225)	-	(1,225)
At 31 December 2017	**9,178**	**-**	**8,532**
Net Book Value			
At 31 December 2016	**4,419**	**2,176**	**6,595**
At 31 December 2017	**6,350**	**224**	**6,574**

(all amounts are expressed in thousands of KM, unless otherwise stated)

27. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	31 December 2017	31 December 2016
Due to banks		
Current accounts and term deposits		
Demand deposits		
-in KM	6,008	760
-in foreign currencies	11,765	15,865
Term deposits		
-in KM	7,800	4,500
-in foreign currencies	108,482	25,495
	134,055	**46,620**
Borrowings		
Long-term borrowings		
-foreign banks	157,812	166,384
	157,812	**166,384**
Total Due to Banks	**291,867**	**213,004**
Due to other financial institutions		
Long-term borrowings		
-in KM	-	2,401
-in foreign currencies	31,169	15,694
Total borrowings from other financial institutions	**31,169**	**18,095**
Total Due to Banks and other Financial Institutions	**323,036**	**231,099**

Current accounts, deposits and borrowings from banks presented above include accrued interest in the amount of KM 145 thousand (2016: KM 193 thousand).
Borrowings from other financial institutions are presented including accrued interest in the amount of KM 202 thousand (2016: KM 129 thousand).

(all amounts are expressed in thousands of KM, unless otherwise stated)

28. DUE TO CUSTOMERS

	31 December 2017	31 December 2016
Demand deposits:		
Retail clients:		
-in KM	146,221	125,501
-in foreign currencies	65,364	59,724
Corporate clients:		
-in KM	319,806	369,602
-in foreign currencies	136,581	100,727
Total demand deposits	**667,972**	**655,554**
Term deposits:		
Retail clients:		
-in KM	115,988	112,447
-in foreign currencies	274,068	276,134
Corporate clients:		
-in KM	128,702	155,406
-in foreign currencies	54,970	66,840
Total term deposits	**573,728**	**610,827**
Total Due to customers	**1,241,700**	**1,266,381**

Amounts due to customers are presented including accrued interest in the amount of KM 7,944 thousand (2016: KM 8,444 thousand).

29. SUBORDINATED DEBT

	31 December 2017	31 December 2016
Ministry of Finance of Bosnia and Herzegovina	**121**	**281**

With the approval of the Banking Agency of Federation of Bosnia and Herzegovina and in accordance with the provisions of the FBA Decision on Minimum Standards for Capital Management of banks and capital protection, the subordinated debt is included in Tier 2 capital in the calculation of capital adequacy.

(all amounts are expressed in thousands of KM, unless otherwise stated)

30. OTHER LIABILITIES

	31 December 2017	31 December 2016
Liabilities to shareholders	8,194	135
Loan repayments before due dates	5,465	5,352
Credit card liabilities	3,463	2,788
Liabilities for employees' bonuses	2,136	1,710
Liabilities to vendors	1,667	1,546
Liabilities in respect of managed funds (Note 37)	86	8
Other liabilities	6,977	6,622
	27,988	**18,161**

31. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2017	31 December 2016
Provisions for off-balance-sheet credit risk	2,445	2,222
Provisions for legal proceedings	1,485	1,975
Provisions for retirement employee benefits	771	782
	4,701	**4,979**

(all amounts are expressed in thousands of KM, unless otherwise stated)

31. PROVISIONS FOR LIABILITIES AND CHARGES (*continued*)

Movement in provisions for liabilities and charges for the year ended 31 December 2017 are summarized as follows:

	Provisions for legal proceedings (Note 15)	Provisions for retirement employee benefits (Note 14)	Provisions for off-balance-sheet credit risk (Note 16)	Total
Balance at 1 January 2016	**1,742**	**693**	**2,029**	**4,464**
Net charge/(benefit) to income statement	443	106	256	805
Reductions arising from payments	(210)	(17)	(63)	(290)
Balance at 31 December 2016	**1,975**	**782**	**2,222**	**4,979**
Balance at 1 January 2017	**1,975**	**782**	**2,222**	**4,979**
Net charge to income statement	(225)	22	261	58
Reductions arising from payments	(265)	(33)	(38)	(336)
Balance at 31 December 2017	**1,485**	**771**	**2,445**	**4,701**

The calculation of provisions for retirement benefits of KM 485 thousand as of 31 December 2017 (2016: KM 491 thousand) is performed by an independent actuary, applying a discount rate of 5% over the working life and average salary of each employee.

Provisions for unused days of vacation of KM 286 thousand as of 31 December 2017 (2015: KM 291 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

(all amounts are expressed in thousands of KM, unless otherwise stated)

32. DEFERRED TAX BALANCES

The deferred tax liability relates to taxable temporary differences arising on fair value adjustments of financial assets available for sale. The effect of the fair value adjustment, net of relating tax is recognised in equity. Deferred tax assets relate to temporary differences arising on provisions that will be recognised for tax purposes in the moment of realization.

The movement of deferred tax balances is presented in the table below:

	Deferred tax liabilities	Deferred tax assets
As at 1 January 2016	**41**	**-**
Recognised in other comprehensive income		
Increase in deferred tax assets	-	1
Recognised in profit or loss		
Decrease in deferred tax liabilities	(41)	-
Increase in deferred tax assets for provisions for IAS 19 – retirements	-	7
Increase in deferred tax assets for provisions for litigations	-	75
Increase in deferred tax assets for other provisions	-	146
As at 31 December 2016	**-**	**229**
As at 1 January 2017	**-**	**229**
Recognised in other comprehensive income		
Increase in deferred tax liabilities	42	-
Increase in deferred tax assets	-	8
Recognised in profit or loss		
Decrease in deferred tax assets for provisions for IAS 19 – retirements	-	(7)
Decrease in deferred tax assets for provisions for litigations	-	(56)
Increase in deferred tax assets for other provisions	-	4
As at 31 December 2017	**42**	**178**

(all amounts are expressed in thousands of KM, unless otherwise stated)

33. SHARE CAPITAL

	31 December 2017 and 31 December 2016		
	Class ES Ordinary shares	**Class EP Preference shares**	**Total**
Number of shares	447,760	60	447,820
Pair value (KM)	100	100	100
Total	**44,776**	**6**	**44,782**

Each registered ordinary share carries the right of one vote per share, while preference shares are non-voting.

Preference shareholders are entitled to receive dividends when declared, non-cumulatively, with priority rights over the ordinary shareholders in receipt of dividends.

The shareholding structure of the Bank as at 31 December 2017 is as follows:

- Privredna banka Zagreb dd 99.99%
- Other 0.01%

The shareholding structure of the Bank as at 31 December 2016 was as follows:

- Privredna banka Zagreb dd 94.94%
- Other 5.06%

In the year 2017 Privredna Banka Zagreb dd tookover the shares of minority shareholders of the Bank, ending the membership of certain minority shareholders. This way, PBZ stayed the majority shareholder with 99.99%, but increased its percentage equity in the Bank's share capital for 5.05%

34. SHARE-BASED PAYMENTS

In 2012 the Bank purchased 78,028 equity shares representing an interest in the capital of Intesa Sanpaolo SpA (the ultimate majority shareholder of the Bank). The purchase is related to the application of the remuneration policy for the Bank's employees and was accounted for according to the provisions of IFRS 2 *Share Base Payments* as a cash-settled shared-based payment transaction, insofar the transaction occurred between entities belonging to the same group.

During 2017, part of the shares have been transferred to the beneficiaries (19,292) and new shares purchased (35,529). As of 31 December 2017 the Bank has 78,735 equity shares of Intesa Sanpaolo SpA left in its portfolio of financial assets at Fair Value through Profit and Loss (with fair value measured based on equity shares quotation on the Milan Stock Exchange). The residual shares will be assigned to beneficiaries when vesting conditions are met.

(all amounts are expressed in thousands of KM, unless otherwise stated)

35. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Bank enters into credit related commitments which are recorded off-balance-sheet and primarily include guarantees, letters of credit and undrawn loan commitments.

	31 December 2017	31 December 2016
Contingent liabilities		
Payment guarantees	36,492	43,759
Performance guarantees	74,878	60,202
Letters of credit	2,815	5,252
Total contingent liabilities	**114,185**	**109,213**
Commitments		
Undrawn lending commitments	203,964	197,127
Total commitments	**203,964**	**197,127**
Total contingent liabilities and commitments	**318,149**	**306,340**

(all amounts are expressed in thousands of KM, unless otherwise stated)

36. RELATED-PARTY TRANSACTIONS

The Bank is a member of the Intesa Sanpaolo S.p.A Group ("Intesa Sanpaolo Group"). The key shareholder of the Bank is Privredna banka Zagreb d.d. 99.99% (2016: Privredna banka Zagreb d.d. 94.94%) of the Bank's shares and the ultimate parent company is Intesa Sanpaolo S.p.A. The Bank considers that it has an immediate related-party relationship with its key shareholders and their subsidiaries; its associates; Supervisory Board members and Management Board members and other executive management ("key management personnel"); and close family members of key management personnel.

Related party transactions are part of the Bank's regular operations.

The overview of related party transactions as at 31 December 2017 and 31 December 2016 is presented below:

	31 December 2017	**31 December 2016**
Assets		
Receivables from key management personnel and their close family members	880	686
Bank accounts and loans – Intesa Sanpaolo Group	45,006	46,703
Financial assets at fair value through profit or loss – Intesa Sanpaolo Group	1	10
Other receivables – Intesa Sanpaolo Group	178	236
	46,065	**47,635**
Liabilities		
Deposits – key management personnel and their close family members	969	2,172
Borrowings and term deposits – Intesa Sanpaolo Group	107,967	11,446
Financial liabilities at fair value through profit or loss – Intesa Sanpaolo Group	145	1,536
Other liabilities – Intesa Sanpaolo Group	211	491
	109,292	**15,645**
Financial commitments and contingencies		
Financial Guarantees	7,670	3,400
Undrawn lending commitments – key management personnel and close family members	144	154
	7,814	**3,554**

(all amounts are expressed in thousands of KM, unless otherwise stated)

36. RELATED-PARTY TRANSACTIONS (*continued*)

	2017	2016
Income		
Interest income – key management personnel and close family members	52	59
Interest income – Intesa Sanpaolo Group	105	79
Other Income – Intesa Sanpaolo Group	171	199
	328	**337**
Expenses		
Interest expense – key management personnel and close family members	56	69
Interest expense – Intesa Sanpaolo Group	6	49
Other expenses – Intesa Sanpaolo Group	1,846	3,060
	1,908	**3,178**

The remuneration of key management personnel were as follows:

	2017	2016
Net salaries for key management personnel	1,078	1,144
Taxes and contributions on net salaries	659	685
Bonuses to management	570	456
Compensation for Supervisory Board members	40	72
Other management benefits	147	253
	2,494	**2,610**

(all amounts are expressed in thousands of KM, unless otherwise stated)

37. MANAGED FUNDS

The Bank manages assets on behalf of third parties. These assets are recorded separately from the Bank's assets.

	31 December 2017	31 December 2016
Liabilities		
Banks and insurance companies	40,498	33,237
Government organisations	8,416	8,737
Associations and Agencies	1,337	1,331
Other	523	427
Total	**50,774**	**43,732**
Assets		
Loans to companies	50,331	43,375
Loans to citizens	357	349
Total	**50,688**	**43,724**
Amounts due to original creditors – managed funds (Note 30)	**86**	**8**