ProCredit Bank

Bosnia and Herzegovina

Annual Report 2017

PROCREDIT BANK D.D. SARAJEVO

Financial statements
for the year ended 31 December 2017

Content

Independent Auditor's Report

To the Shareholders of ProCredit Bank d.d. Sarajevo

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of ProCredit Bank d.d. Sarajevo (the "Bank") as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2017;
- the statement of profit and loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code") and the ethical requirements of the Law on accounting and auditing of the Federation of Bosnia and Herzegovina that are relevant to our audit of the financial statements in the Federation of Bosnia and Herzegovina. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Responsibilities of management and those charged with governance for the financial statements

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

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

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

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our Independent auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our Independent auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those 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 control that we identify during our audit.

Refer to the original signed Bosnian version

PricewaterhouseCoopers d.o.o. Sarajevo
Sarajevo, Bosnia and Herzegovina

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Adis Pecikoza, licensed auditor

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Mirza Bihorac, director and licensed auditor

11 May 2018

PROCREDIT BANK D.D. SARAJEVO
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
For the year ended 31 December 2017

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

	Note	2017	2016
Interest and similar income		15,988	19,339
Interest expense and similar charges		(5,304)	(6,648)
Net interest income	8	**10,684**	**12,691**
Provision for impairment	9	(946)	(1,443)
Net interest income after provision for impairment of loans		**9,738**	**11,248**
Fee and commission income	10	5,177	6,348
Fee and commission expense	11	(1,657)	(1,407)
Foreign exchange differences, net	12	590	497
Other operating income	13	229	434
Personnel expenses	14	(5,920)	(6,715)
Depreciation and amortisation	20	(1,628)	(1,904)
Other operating expenses	15	(10,555)	(9,350)
Loss before tax		**(4,026)**	**(849)**
Income tax	16	(84)	(27)
Net loss for the year		**(4,110)**	**(876)**
Other comprehensive income		**-**	**-**
Total comprehensive loss for the year		**(4,110)**	**(876)**

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 66.

PROCREDIT BANK D.D. SARAJEVO
STATEMENT OF FINANCIAL POSITION
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

	Note	31 December 2017	31 December 2016
ASSETS			
Cash and balances at depository institutions	17	63,791	37,503
Obligatory reserves with Central Bank	18	35,005	29,496
Loans and advances to customers	19	327,665	283,305
Financial assets available-for-sale		43	43
Property, equipment and intangible assets	20	16,259	17,262
Deferred tax assets	16	149	233
Other financial assets	21	467	653
Other assets	22	2,042	2,640
TOTAL ASSETS		**445,421**	**371,135**
LIABILITIES			
Due to customers	23	246,453	241,756
Borrowings	24	140,480	70,792
Subordinated debt	25	8,806	8,805
Provisions	26	635	492
Other liabilities	27	964	1,009
TOTAL LIABILITIES		**397,338**	**322,854**
EQUITY			
Share capital	28	67,215	63,303
Share premium		293	293
Statutory reserves		228	228
Regulatory reserve for credit losses		863	863
Accumulates losses		(20,516)	(16,406)
TOTAL EQUITY		**48,083**	**48,281**
TOTAL LIABILITIES AND EQUITY		**445,421**	**371,135**

The statement of financial position is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 66.

These financial statements have been approved by the Management Board on 14 April 2018 and signed on their behalf by:

Edin Hrnjica

Edin Hrnjica
Director

Amir Salkanović

Amir Salkanović
Executive director

ProCredit Bank d.d. Sarajevo

For the year ended 31 December 2017

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

	Share capital	Share premium	Statutory reserves	Regulatory reserve for credit losses	Accumulated losses	Tota
Balance at 1 January 2016	*63,303*	*293*	*228*	*863*	*(15,530)*	*49,15*
Loss for the year	-	-	-	-	(876)	(876
Other comprehensive income	-	-	-	-	-	
Total comprehensive loss	-	-	-	-	*(876)*	*(876*
Issue of share capital	-	-	-	-	-	
Balance at 31 December 2016	**63,303**	**293**	**228**	**863**	**(16,406)**	**48,28**
Balance at 1 January 2017	*63,303*	*293*	*228*	*863*	*(16,406)*	*48,28*
Loss for the year	-	-	-	-	(4,110)	(4,110
Other comprehensive income	-	-	-	-	-	
Total comprehensive loss	-	-	-	-	*(4,110)*	*(4,110*
Issue of share capital	3,912	-	-	-	-	3,91
Balance at 31 December 2017	**67,215**	**293**	**228**	**863**	**(20,516)**	**48,08**

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 66.

PROCREDIT BANK D.D. SARAJEVO
STATEMENT OF CASH FLOWS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

	Note	2017	2016
Cash flow from operating activities			
Loss before income tax		(4,026)	(849)
Adjusted for:			
Increase in impairment allowance, net		946	1,443
Increase/(decrease) in provisions		143	(344)
Depreciation and amortization		1,628	1,904
Loss from impairment/sale of property, equipment and intangible assets		416	-
Cash flow before changes in assets and liabilities:		*(893)*	*2,154*
(Increase) in obligatory reserve with CBBH, net		(5,509)	(7,773)
(Increase)/decrease in loans and advances to customers, before provisions (net)		(45,772)	12,171
Decrease/(increase) in other assets, before provisions (net)		1.152	(1,296)
Increase/(decrease) in amounts due to customers (net)		4,697	(22,639)
(Decrease)/increase in other liabilities (net)		(45)	94
Cash flow from operating activities before income tax		*(46,370)*	*(17,289)*
Income tax paid		-	-
NET CASH USED IN OPERATING ACTIVITIES		**(46,370)**	**(17,289)**
Cash flow from investing activities			
Purchases of property, equipment and intangible assets		(943)	(1,642)
Purchase of financial assets available for sales		-	(3)
Income from sale of property, equipment and intangible assets		-	121
NET CASH USED IN INVESTING ACTIVITIES		**(943)**	**(1,524)**
Cash flow from financing activities			
Proceeds from/(repayment of) borrowings		69,688	(12,605)
Proceeds from /(repayment of) subordinated debt		1	(193)
Capital paid in		3,912	-
NET CASH FROM/(USED IN) FINANCING ACTIVITIES		**73,601**	**(12,798)**
Net increase/(decrease) in cash and cash equivalents		**26,288**	**(31,611)**
Cash and cash equivalents at the beginning of the year		**37,503**	**69,114**
Cash and cash equivalents at the end of the year	**17**	**63,791**	**37,503**

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 66.

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

1. General information

ProCredit Bank d.d. Sarajevo (the "Bank") is incorporated as a joint stock company domiciled in Bosnia and Herzegovina.

The Bank is part of a global network of financial institutions, managed and fully owned by ProCredit Holding AG & Co. KGaA.

The Bank is incorporated to perform all banking activities in accordance with the Law on banks in the Federation of Bosnia and Herzegovina and the main activities include commercial lending, receiving of deposits, foreign exchange deals, and payment operation services in the country and abroad and retail banking services. The Bank is a development-oriented commercial bank which offers customer services to small and medium enterprises and to private individuals.

The address of its registered office is as follows:

Head office: The Bank's registered address is in Sarajevo, Franca Lehara bb, Bosnia and Herzegovina.

The Bank operated with branches, Contact Centre and 24/7 (self-service) Zones, in order to provide customers with comprehensive and more accessible services.

Branch offices	***Service points:***
Sarajevo, Franca Lehara bb	Sarajevo, Stari Grad, Zelenih beretki 8
Tuzla, Aleje Alije Izetbegovića 2	Sarajevo, Ilidža, Ibrahima Ljubovića 20
Mostar, Biskupa Čule bb	Bijeljina, Atinska 1
Banja Luka, Prvog krajiškog korpusa 54	Zenica, Londža 77

As of 31 December 2017, the Bank employed 167 employees (2016.: 210 employees).

Management Board	
Director	Edin Hrnjica
Executive director	Amir Salkanović
Executive director	Maja Mehmedović, up to 15 August 2017
Executive director	Amel Agić, from 15 August 2017

Supervisory Board	
President	Borislav Kostadinov
Member	Igor Anić
Member	Emilija Spirovska
Member	Sandrine Massiani
Member	Svetlana Tolmačeva Dingarac, up to 13 January 2017
Member	Natia Tkhilaishvili, from 14 January 2017

Audit Board	
President	Violeta Ivanković
Member	Vesna Paunovska Petroska
Member	Martin Godemann
Member	Gazmend Rustemi
Member	Rumyana Velichkova Todorova

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies

a) *Basis of preparation*

Statement of compliance. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the revaluation of available for sale financial assets. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Going concern. As presented in the financial statements, the Bank incurred net loss for the year ended 31 December 2017 in the amount of BAM 4,110 thousand (2016: BAM 876 thousand). Management has prepared the 5-year business plan, adopted by the Supervisory Board on 22 December 2017, anticipating the reasonable growth of loan portfolio, interest income and deposit basis over the period 2018-2022. Management expects the operations to become profitable in the year ending 31 December 2018 and continue to be compliant with the regulatory requirements. During 2017, the shareholders paid in the additional equity of BAM 3.9 million and increased the funding (in the form of borrowings) by BAM 38.3 million. Additionally, there are ongoing activites with regard to additional equity of BAM 3.9 million planned to be paid by the Bank's shareholder till the end of second quarter of 2018, which will additionally improve and strengthen the Bank's capital adequacy. Based on the above the these financial statements have been prepared on a going concern basis.

Use of judgements and estimates. The preparation of financial statement in conformity with the relevant legal regulations and decisions of the Banking Agency in the Federation of Bosnia and Herzegovina (the "FBA") requires the use of estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial stamement preparation and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may 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 and in any future period affected. Management board estimations that refer to application of appropriate standards that have significant effect on financial statements and estimations with significant risk of possible significant adjustment are described in Note 4.

Functional and presentation currency. The Bank's financial statements are presented in Convertible Marks ("BAM"), which is the Bank's functional and presentation currency, rounded to the nearest thousand.

The principal accounting policies adopted in the preparation of financial stamement are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

b) *Interest income and expense*

Interest income and expense are recognised in profit or loss for all interest bearing instruments on an accrual basis using the effective interest rate, i.e. at the rate that discounts estimated future cash flows to net present value over the life of the underlying contract. Such income and expense are presented as interest and similar income or interest expense and similar charges in profit or loss. Interest income and expense also include fee and commission income and expense in respect of loans to and receivables from customers or borrowings from other banks, recognised on an effective interest basis.

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies (continued)

b) Interest income and expense (continued)

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When loans and other interest bearing instruments become doubtful of collection, they are written down to the present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.

c) Fees and commissions income and expenses

Fees and commissions income and expenses mainly comprise fees received from enterprises arising from domestic and foreign payments, the issue of guarantees and letters of credit and credit card business. Fees and commissions, except for those which form part of the effective interest rate of the instrument, are generally recognised on an accrual basis when the service has been provided.

d) Leases

To date, premises rental contracts entered into by the Bank are operating leases. The total payments made under operating leases are charged to Statement of comprehensive income on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

e) Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currency of the operation at the exchange rate at the date of transaction.

Monetary assets and monetary liabilities denominated in foreign currency at the reporting date are retranslated into the functional currency using the exchange rates prevailing at the reporting date. Income and expenses denominated in foreign currency are translated into functional currency at the exchange rates valid at the dates of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss. Non-monetary assets and items that are measured in terms of historical cost in foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the reporting date.

Exchange rates:

	31 December 2017 BAM	**31 December 2016** BAM
USD	1.630810	1.855450
EUR	1.955830	1.955830

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies (continued)

f) Income tax expense

Income tax charge is based on taxable profit for the year and comprises current and deferred tax. The income tax charge comprises current tax and deferred income tax and is recognised in profit or loss for the year.

Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The statutory corporate profit tax rate for 2017, applicable to taxable profits, is 10% (2016: 10%).

Deferred tax

Deferred income tax is provided, using the balance sheet liability method, for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. The movement 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, based on tax rates enacted or substantially enacted at the reporting date. Currently enacted tax rates are used in the determination of deferred income tax.

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that future taxable profit will be available against which the deferred tax assets can be utilised.

g) Financial assets and financial liabilities

i. Classification

The Bank classifies its financial assets and liabilities in the following categories: loans and receivables, investment in non-consolidated related parties and other financial liabilities. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its investments upon initial recognition

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading with the receivable and include loans to and receivables from banks, loans to and receivables from customers and obligatory reserves with the Central Bank of Bosnia and Herzegovina (“Central Bank“ or ”CBBH“).

Financial assets available for sale

Available-for-sale financial assets are non-derivative investments that are designated as available for sale or are not classified as another category of financial assets.

Financial assets designated as available for sale are intended to be held for an indefinite period of time but may be sold as a response to liquidity needs or changes in interest rates. Available-for-sale financial assets include equity securities.

Other financial liabilities

Other financial liabilities comprise all financial liabilities which are not designated at fair value through profit or loss. Other financial liabilities include borrowings, deposits, subordinated liabilities and other liabilities.

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies (continued)

g) Financial assets and financial liabilities (continued)

ii. Recognition and derecognition

Purchases and sales of financial assets available for sale are recognised on the trade date which is the date when the Bank commits to purchase or sell the instrument.

Loans and receivables and other financial liabilities are recognised when cash is advanced to borrowers or received from lenders.

The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

The Bank derecognises a financial liability 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 significantly change, the Bank will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions.

iii. Initial and subsequent measurement

Loans and receivables are initially recognised at fair value plus transaction costs. Subsequently, they are measured at amortised cost using the effective interest method.

Available-for-sale financial assets are initially recognised at fair value plus transaction costs that are directly attributable to its acquisition or issue.

Available-for-sale financial assets are subsequently measured at their fair value. Gains and losses from a change in the fair value of available-for-sale financial assets are recognised directly in a fair value reserve within equity. Equity instruments classified as available for sale that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost.

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies (continued)

g) Financial assets and financial liabilities (continued)

iv. Impairment of financial assets

Loans and receivables

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired.
If there is objective evidence that impairment of a loan or a portfolio of loans has occurred which influences the future cash flow of the financial asset.

The amount of impairment is calculated by using a defined percentage of specific risk group of receivables classified in line with the FBA's decisions, taking IAS 39 and IAS 37 into consideration, and applying it to the remaining receivables balance.

Depending on the size of the loan, such losses are either calculated on an individual loan basis or are collectively assessed for a portfolio of loans. The carrying amount of loans and receivables is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Losses from expected future events are not recognised. Interest on impaired assets continues to be recognised through unwinding of the discount in interest income.

Individually assessed loans and advances: Credit risk assessment on an individual basis is a separate estimate of future cash flows and determining the existence, or non-existence of loss for each individual placement and off-balance liability that the Bank shall apply in assessment of impairment of a placement and off-balance liability that are an integral part of individually significant exposure. For individually significant loans is estimated whether there i san objective evidence of an impairment, i.e. any factors which might influence the customer's ability to fulfil his/her contractual payment obligations towards the Bank.

Status of default - is assigned to all exposures that are determined to have an objective evidence of an impairment. The main indicator of default is considered a delay of receivables from clients, or a group of related parties more than 90 days in a materially significant amount. Due days count is starting on a day when the total amount of all outstanding liabilities, on all contractual amounts, became material.
Other indicators of default status are:

- Partial or complete write-off;
- Restructuring of receivables due to the deteriorating financial condition of a debtor, with the reduction of principal, interest or fees or by extending the repayment terms;
- Partial or total repayment by the guarantor;
- Liquidation or bankruptcy of a debtor;
- Court proceeding initiation by the Bank;
- The Bank can also decide that certain exposures impaired by external influences or extraordinary events.

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies (continued)

g) Financial assets and financial liabilities (continued)

In determining the amount of impairment of an individual loan the Bank takes into consideration the overall exposure to the client as well as the expected market value of a collateral. If there is objective evidence of impairment, loss is measured as a difference between carrying amount of an asset and net present value of future cash flows discounted at the original effective interest rate of financial assets (individual impairment). If the loan is contracted with a variable interest rate, the discount rate for the measurement of impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

Collectively assessed loans and advances: The following are cases in which loans are collectively assessed for impairment:

- Individually insignificant loans that show objective evidence of impairment;
- The group of loans which do not show signs of impairment, in order to cover all losses which have already been incurred but not detected on an individual loan basis.

In case the categorization of the credit exposure based on the impairment criteria and/or the status of restructuring changes and there is no more need for an assessment for specific individual impairment to establish the provisions, then the exposure will be collectively provisioned. Such provisions are called portfolio-based provisions.

Noted provisions are related to the individually insignificant and individually significant credit exposures that do not show signs of impairment are provisioned according to the results of the migration analysis and according to their similar risk characteristics i.e. according to the number of days they are in arrears.

Arrears of 90 or more days in material amount are considered to be a sign of impairment.

Individually insignificant and individually significant credit exposures that display signs of impairment and for which the impairment test showed no impairment are also included in the portfolio based provisions.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Provisions for individually assessed credit exposures – credit exposures that show signs of impairment, for which an impairment test is performed and where an impairment loss has been confirmed are provisioned according to the impairment loss that is determined by an assessment for specific individual impairment. However, in general, at least the minimum portfolio-based percentages, as applied for collectively assessed groups of credit exposures, shall be applicable.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether individually significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment (impairment for collectively assessed loans).

PROCREDIT BANK D.D. SARAJEVO
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017
(All amounts are in thousands of BAM, unless otherwise stated)

2. Significant accounting policies (continued)

g) Financial assets and financial liabilities (continued)

i. Reversal of impairment

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, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in profit or loss.

ii. Loans and receivables with renegotiated terms

Loans and advances with renegotiated terms which are considered to be individually significant are provisioned on an individual basis. The amount of the loss is measured as a difference between the restructured loan's carrying amount and the present value of its estimated future cash flows discounted at the loan's original effective interest rate (specific impairment). Loans and advances with renegotiated terms which are individually insignificant are collectively assessed for impairment.

iii. Offsetting financial instruments

Financial assets and liabilities are offset, and are presented in balance sheet as net amount, when there is a legally enforceable right to offset the recognized amounts and when there is an intention of settlement on a net basis, or the acquisition of assets and liabilities settlement takes place at the same time.

Income and expenses are presented on a net basis only when permitted by accounting standards or for gains and losses that are resulting from the group or similar transactions.

h) Cash and cash equivalents

Cash and cash equivalents includes notes and coins, balances on the Central bank's accounts, accounts with other domestic and foreign banks and highly liquid financial assets with original maturities of less than three months, which are subject to an insignificant risk of changes in value that the Bank uses for settlement of short-term obligations. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

i) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. Loans and advances to banks and loans and advances to customers are classified as loans and receivables. Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

j) Financial assets available for sale

This classification includes investment securities which the Bank intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.
Investment securities available for sale are initially measured at fair value plus incremental direct transaction costs and subsequently carried at fair value. Interest income on available for sale debt securities is calculated using the effective interest method, and recognised in profit or loss for the year.

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2. Significant accounting policies (continued)

j) Financial assets available for sale (continued)

Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired, at which time the cumulative gain or loss is reclassified from other comprehensive income to profit or loss for the year.

k) Property and equipment

Property and equipment are tangible assets that are held for use in the supply of services, rent or administrative purposes.

Property and equipment are stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent cost is included in the asset's carrying amount, or is recognised as a separate asset, only when it is probable that future economic benefits associated with the item will flow to the Bank and the rest of the item can be measured reliably. All other repairs and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

Property and equipment are periodically reviewed for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Assets under construction are reported at their cost of construction including costs charged by third parties. Upon completion, all accumulated costs of the asset are transferred to the relevant tangible property and equipment category and subsequently subject to the applicable depreciation rates.

Gains and losses on disposal of property and equipment are recognised in profit or loss.

Depreciation is charged on all assets except assets in the course of construction on a straight line basis so as to write off the cost of the assets over their estimated useful lives at the following annual rates:

	Useful life 2017	**Useful life 2016**
Buildings	40 years	40 years
Computers and telephone equipment	3 – 7 years	3 - 7 years
Furniture and equipment	5 -10 years	5 -10 years
Leasehold improvements	Over the lease period	Over the lease period

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

l) Intangible assets

Intangible assets that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses.

Subsequent expenditure is capitalised only if all of the features required by IAS 38 are satisfied. All other expenditure is expensed as incurred.

Amortisation is charged in comprehensive income report on a straight-line basis over the useful life of intangible assets:

	Useful life 2017	**Useful life 2016**
Software	5-10 years	5-10 years
Licenses and other intangible assets	5-10 years	5-10 years

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2. Significant accounting policies (continued)

m) Deposits, subordinated liabilities, liabilities on borrowings

Deposits, borrowings and subordinated liabilities are the Bank's sources of funding.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument.

Deposits, borrowings and subordinated liabilities are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

n) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, 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. The Management determines sufficiency of provisions on the basis of insight in 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 obligations is no longer probable, the provision is reversed.

o) Employee benefits

i. Liabilities for a contribution plan

The Bank, in the normal course of business, makes payments on behalf of its employees for pensions, health care, employment and personnel tax that are calculated on the basis of gross salaries and wages, food allowances, holyday cash and travel expenses according to the legislation. The Bank makes these contributions to the Government's health and retirement funds, at the statutory rates in force during the year, based on gross salary payments.

The Bank pays contributions to public pension insurance funds on a mandatory basis. Once the contributions have been paid, the Bank has no further payment obligations. The regular contributions constitute costs for the year in which they are due and as such are included in staff costs. The cost of these payments is charged to profit or loss in the same period as the related salary cost.

ii. Short-term employee benefits

Short-term employee benefit obligations are measured on undiscounted basis and are expensed as the related service is provided.

A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

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2. Significant accounting policies (continued)

o) Employee benefits (continued)

iii. Long-term employee benefits

According to local legal requirements, employees of the Bank are entitled to receive one-time benefit on retirement, dependent on factors such as age, years of service and the salary they had with the Bank.

Such payments are treated as post-employment benefits and the liability recognised in the statement of financial position is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets (if any), together with adjustments for unrecognised actuarial gains or losses and past service costs.

This obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by applying a discount rate which is similar to the rate of return on corporate bonds in the Federation of Bosnia and Herzegovina and the average interest rate of time deposit accounts held with commercial banks in the Federation of Bosnia and Herzegovina.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately in profit and loss as well as all past service costs.

p) Share capital

i. Share issue cost

Share capital represents the nominal value of paid-in ordinary shares classified as equity and denominated in BAM. Dividends are recognised as liability in the period in which they are declared.

ii. Share premium

Share premium represents the excess of contribution received over the nominal value of shares issued.

r) Statutory reserve

Statutory reserve is created in accordance with the Company Law of the Federation of Bosnia and Herzegovina, which requires 10% of the profit for the year to be appropriated to this reserve until reaching 25% of issued share capital. If the statutory reserve does not reach 25% of issued share capital within 5 business years, a joint stock company is required to increase its appropriations to this reserve to 20% of its profit for the year at the end of the fifth and any following business years until reaching 25% of the issued share capital. This reserve can be used for covering current and prior year losses.

s) Regulatory reserves for credit losses

Regulatory reserves for credit losses are recognized in accordance with regulations of the FBA. Regulatory reserves for credit losses are non-distributable.

t) Retained earnings / accumulated loss

Any profit (after appropriations) or loss for the year is transferred to retained earnings/accumulated losses.

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2. Significant accounting policies (continued)

u) Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

v) Off- balance-sheet commitments and contingencies

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

3. New accounting pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2017 or later, and which the Bank has not early adopted.

IFRS 9 "Financial Instruments: Classification and Measurement" (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

IFRS 9 "Financial Instruments" will have an impact on the recognition and measurement, the impairment as well as on the disclosure requirements of financial instruments. Based on the preliminary assessment, the application of IFRS 9 impairment requirements is expected to result in an increase in loss allowance at the moment of transition and moderate increases for expenses for allowance for losses on loans and advances. The new hedge accounting requirements will not affect the financial statements as the bank does not apply hedge accounting. IFRS 9 is applicable for annual periods beginning on or after 1 January 2018.

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3. New accounting pronouncements (continued)

The Bank assessed the impact of transition to IFRS 9 and the approximate values are presented below.

The Management of the Bank has carried out the implementation of IFRS 9, with the support of the ProCredit Holding in the part of testing Business Model and SPPI test. The implementation was carries out in accordance with principles established at the level of ProCredit Group.
Based on the calculations and analyses carried out by the date of the preparation of these financial statements, the transition to IFRS 9 is expected to result in a decrease of total financial assets by approximately BAM 1,334 thousand, largerly due to increase in opening balance of provision for expected credit losses in 2018 comparing to closing balance of provision for credit losses in 2017 calculated in accordance with IAS 39.

The above-mentioned impact assessment is preliminary, as all the activities to ensure the full implementation of IFRS 9 at the Bank have not been finalized:

- IFRS 9 will require the Bank to change accounting processes and internal controls,
- despite the parallel calculation being made in the second half of 2017, new systems and relevant controls were not operational for a longer period of time,
- new accounting policies and procedures, assumptions, judgments and valuation techniques will be subject to change as long as the Bank does not finalize its first financial statements including the date of first application.

No significant changes are expected for financial liabilities, other than changes in the fair value of financial liabilities designated at FVTPL, that are attributable to changes in the instrumen's credit risk, which will be presented in the other comprehensive income.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Bank's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The new standard is not expected to have a material impact on the Bank's financial statements.

Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the Standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new Standard. The new amendment is not expected to have a material impact on the Bank's financial statements.

3. New accounting pronouncements (continued)

IFRS 16, Leases (issued on 13 January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Bank is currently assessing the impact of the new standard on its financial statements.

Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities. The Bank will present this disclosure in its 2017 financial statements.

IFRS 17 "Insurance Contracts" (issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2021). IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The new standard is not expected to have a material impact on the Bank's financial statements.

IFRIC 22 "Foreign currency transactions and advance consideration" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018). This interpretation considers how to determine the date of the transaction when applying the standard on foreign currency transactions, IAS 21. The interpretation applies where an entity either pays or received consideration in advance for foreign currency-denominated contracts. The interpretation specifies that the date of transaction is the date on which the entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration. The new standard is not expected to have a material impact on the Bank's financial statements.

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3. New accounting pronouncements (continued)

IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019). IAS 12 specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. An entity should determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. An entity should assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the effect of uncertainty will be reflected in determining the related taxable profit or loss, tax bases, unused tax losses, unused tax credits or tax rates, by using either the most likely amount or the expected value, depending on which method the entity expects to better predict the resolution of the uncertainty.

An entity will reflect the effect of a change in facts and circumstances or of new information that affects the judgments or estimates required by the interpretation as a change in accounting estimate. Examples of changes in facts and circumstances or new information that can result in the reassessment of a judgment or estimate include, but are not limited to, examinations or actions by a taxation authority, changes in rules established by a taxation authority or the expiry of a taxation authority's right to examine or re-examine a tax treatment. The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgments and estimates required by the Interpretation. The new standard is not expected to have a material impact on the Bank's financial statements.

The following other new pronouncements are not expected to have any material impact on the Bank when adopted:

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after a date to be determined by the IASB).
- Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12 (issued on 19 January 2016 and effective for annual periods beginning on or after 1 January 2017).
- Amendments to IFRS 2 "Share-based Payments" (issued on 20 June 2016 and effective for annual periods beginning on or after 1 January 2018).
- Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" - Amendments to IFRS 4 (issued on 12 September 2016 and effective, depending on the approach, for annual periods beginning on or after 1 January 2018 for entities that choose to apply temporary exemption option, or when the entity first applies IFRS 9 for entities that choose to apply the overlay approach).
- Annual Improvements to IFRSs 2014-2016 cycle (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2017 for amendments to IFRS 12, and on or after 1 January 2018 for amendments to IFRS 1 and IAS 28).
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018) will have a minor impact on the financial statements. The interpretation is effective for annual periods beginning on or after 1 January 2018.
- Transfers of Investment Property - Amendments to IAS 40 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

There are no requirements or regulation imposed from the FBA or other regulators related with the presentation of applicable financial reporting framework.

4. Critical accounting estimates and judgments

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a) *Impairment losses on loans and advances*

The Bank reviews its loan portfolios to assess impairment on monthly basis. In determining whether an impairment loss should be recorded in profit or loss, the Bank makes judgments as to whether there are any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a Bank, or national or local economic conditions that correlate with defaults on assets in the Bank.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

A 10% increase or decrease in actual loss experience compared to the loss estimates used would result in an increase or decrease in impairment on collective basis by BAM 565 thousand (2016: BAM 1,920 thousand), respectively. Impairment losses for individually significant loans are based on estimates of discounted future cash flows of the individual loans, taking into account repayments and realisation of any assets held as collateral against the loans. However, the Bank does not perform sensitivity analysis for impairment of individually significant loans.

Assets accounted for at amortised cost are evaluated for impairment on the basis described in Note 5.1.

b) *Taxation*

The Bank is subject to income taxes in Bosnia and Herzegovina (FBiH and RS). Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspections of taxpayers' records. The interpretation of tax legislation by the tax authorities as applied to the transactions and activity of the Bank may not coincide with that of the management. As a result, transactions may be challenged by the tax authorities and the Bank may be assessed as liable for additional taxes, penalties and interest, which can be significant. In accordance with the Law on Tax authority of the respective entities of Bosnia and Herzegovina, tax liabilities are normally open to inspection by the tax authorities for a period of five years from the origination of the liability.

c) *Regulatory requirements*

The FBA is entitled to carry out regulatory inspections of the Bank. The assessment of the FBA may not coincide with that of the Management and may result in subsequent changes.

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5. Financial risk management

The Bank's activities expose it to a variety of financial risks; credit risk, liquidity risk and market risk. Market risk includes risk of foreign currencies, interest rates and other price risks. 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 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 Credit Risk Department and Service for risk management that work under policies approved by the Supervisory Board and Management Board. Internal policies and systems are reviewed regularly to reflect changes in market conditions, and products and services offered. On a continuous basis, the Bank is aligning and adjusting policies with legal acts and by-laws.

Processes on risk monitoring and risk controlling are adjusted in a timely manner to reflect changes in the operating environment.

5.1 Credit risk

The Bank is subject to credit risk through its lending activities and in cases where it acts as an intermediary on behalf of customers or third parties. Credit risk arises from customer credit exposures, credit exposure from interbank placements and issuer risk. It is divided into credit default risk and credit portfolio risk in order to facilitate focused risk management. Credit exposures to regulated financial and public institutions and issuers of securities are treated separately as a counterparty risk. The goal is to prevent the Bank from incurring losses caused by a counterparty's or issuer's lack of willingness or capacity to fulfil its obligations. The Bank seeks to minimise its exposure to counterparty risk through approval and selection processes for new counterparties and issuers, by limiting exposure to any single counterparty or group of counterparties as well as limiting the exposure to any single issuer or issuer class and through review of approved counterparties and established limits.

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality

The tables below set out information about the credit quality of financial assets and the allowance for impairment/loss held by the Bank against those assets.

The table represents a worst case scenario of credit risk exposure of the Bank at 31 December 2017 and 2016, without taking into account any collateral held or other credit enhancements attached. For financial assets, the exposures set out below represent the net carrying amounts as reported in the statement of financial position.

Maximum exposure to credit risk

	31 December 2017		31 December 2016	
	Carrying amount	Amount committed/ guaranteed	Carrying amount	Amount committed/ guaranteed
Placements at the Central Bank and other banks	91,885	-	57,099	-
Loans and advances to customers	327,665	-	283,305	-
Other financial assets	467	-	653	-
Financial assets available for sale	43	-	43	-
Loan commitments	-	29,325	-	32,747
Financial guarantees and letters of credit	-	41,970	-	40,788
Total	**420,060**	**71,295**	**341,100**	**73,535**

Placements at the Central Bank and other banks

Cash and current account with banks are neither past due nor impaired and are not collateralised. The credit quality of cash and balances with central banks is provided below. The Central Bank is not provided with a rating by recognised rating agencies. However, Bosnia and Herzegovina has stable economic growth, and income from indirect taxes are growing which enables the country to service public debt. The public debt has decreasing trend.

31 December 2017	**Fitch Rating**	**Total**
Neither past due nor impaired		
Central Bank of Bosnia and Herzegovina	Not rated	
- Current accounts		35,249
- Mandatory reserve		35,005
- Gyro Clearing accounts		5,161
ProCredit Bank AG, Frankfurt am Main, Deutschland	BBB	8,562
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main, Deutschland	AA-	7,248
Raiffeisen Bank International AG, Vienna, Austria	AA-	365
ProCredit Bank (Bulgaria) EAD	BBB	90
Zagrebačka Banka d.d. Zagreb, Croatia	BBB-	87
UniCredit Bank d.d. Mostar, Bosnia and Herzegovina	BBB-	50
ProCredit Bank Sh.a, Kosovo	BBB	41
ProCredit Bank a.d. Beograd, Serbia	BBB	27
Total cash and cash equivalents, excluding cash on hand		**91,885**

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality

Placements at the Central Bank and other banks (continued)

31 December 2016	Fitch Rating	Total
Neither past due nor impaired		
Central Bank of Bosnia and Herzegovina	Not rated	
- Current accounts		13,483
- Mandatory reserve		29,496
- Gyro Clearing accounts		890
ProCredit Bank AG, Frankfurt am Main, Deutschland	BBB	9,268
Raiffeisen Bank International AG, Vienna, Austria	BBB	3,303
ProCredit Bank a.d. Beograd, Serbia	BBB	190
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main, Deutschland	AA-	141
Zagrebačka Banka d.d. Zagreb, Croatia	BBB-	103
ProCredit Bank Sh.a, Kosovo	BBB	103
ProCredit Bank (Bulgaria) EAD	BBB	90
UniCredit Bank d.d. Mostar, Bosnia and Herzegovina	BBB-	32
Total cash and cash equivalents, excluding cash on hand		**57,099**

Interbank exposures are closely monitored on a daily basis by risk monitoring function and treasury unit. The Bank limits its deposits and other banking transactions to financially sound international banks. Before a business relationship is initiated and with a given bank, management of the Bank and risk management function carry out an analysis of the institution's financial standing. The financial performance of the counterparties is continuously monitored. Moreover, all correspondent banks in which the Bank has investment exposures are continuously monitored for their ratings by international rating agencies like: Standard & Poor's (S&P), Fitch and Moody's. A function independent from the treasury unit, risk management function, monitors that the exposure toward all banks does not exceed limits which are set. Daily monitoring is carried out in order to prevent the violation of exposure limits in certain institutions.

The table below presents the Bank's current accounts with corresponding banks by credit rating:

	31 December 2017	31 December 2016
Neither past due nor impaired		
- AA+ to AA- Raiting	7,613	141
- BBB+ to B- Raiting	8,857	13,079
Total cash at banks	**16,470**	**14,230**

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers

31 December 2017	Retail	Corporate	Total
Total gross amount	33,423	312,962	346,385
Allowance for impairment (individual and collective)	(2,389)	(16,331)	(18,720)
Net carrying amount	31,034	296,631	327,665
At amortised cost			
Neither past due nor impaired	24,742	260,220	284,962
Past due but not impaired	3,687	26,262	29,949
Impaired	3,036	28,438	31,474
Total gross amount	**31,465**	**314,920**	**346,385**
Allowance for impairment (individual and collective)	(2,389)	(16,331)	(18,720)
Net carrying amount	**29,076**	**298,589**	**327,665**
Past due but not impaired			
Past due 0 – 30 days	3,012	20,725	23,737
Past due 31 – 90 days	675	5,537	6,212
Past due 91 – 180 days	-	-	-
	3,687	**26,262**	**29,949**
Impaired			
Past due 0 – 30 days	-	-	-
Past due 31 – 90 days	-	-	-
Past due 91 – 180 days	510	5,829	6,339
Past due over 180 days	2,526	22,609	25,135
	3,036	**28,438**	**31,474**
Allowance for impairment			
Individual	(2,065)	(11,006)	(13,071)
Collective	(324)	(5,325)	(5,649)
Total allowance for impairment	**(2,389)**	**(16,331)**	**(18,720)**

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers (continued)

31 December 2016	Retail	Corporate	Total
Total gross amount	45,318	265,552	310,870
Allowance for impairment (individual and collective)	(3,107)	(24,458)	(27,565)
Net carrying amount	42,211	241,094	283,305
At amortised cost			
Neither past due nor impaired	28,241	228,844	257,085
Past due but not impaired	6,305	12,305	18,610
Impaired	3,115	32,060	35,175
Total gross amount	**37,661**	**273,209**	**310,870**
Allowance for impairment (individual and collective)	(3,107)	(24,458)	(27,565)
Net carrying amount	**34,554**	**248,751**	**283,305**
Past due but not impaired			
Past due 0 – 30 days	5,070	11,648	16,718
Past due 31 – 90 days	1,235	657	1,892
Past due 91 – 180 days	-	-	-
	6,305	**12,305**	**18,610**
Impaired			
Past due 0 – 30 days	-	-	-
Past due 31 – 90 days	-	-	-
Past due 91 – 180 days	365	964	1,329
Past due over 180 days	2,750	31,096	33,846
	3,115	**32,060**	**35,175**
Allowance for impairment			
Individual	(551)	(7,810)	(8,361)
Collective	(2,556)	(16,648)	(19,204)
Total allowance for impairment	**(3,107)**	**(24,458)**	**(27,565)**

Loans and advances with re-negotiated terms

Renegotiated loans that would otherwise be past due or impaired as at 31December 2017 totaled BAM 12,788 thousand (2016.: BAM 22,961 thousand) and that are, for the purpose of reporting, transferred to defaulted loans.

Renegotiated receivables for loans and advances given to customers as at 31 December 2017 and 2016 can be presented as following:

	Number	Net carrying amount
31 December 2017		
Corporate	186	12,051
Retail	103	737
	289	**12,788**
31 December 2016		
Corporate	312	21,468
Retail	171	1,493
	483	**22,961**

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers (continued)

Impairment and provisioning

Impairment provisions are recognised for financial reporting purposes only for losses that have been incurred at the reporting date based on objective evidence of impairment, see accounting policy 2 (g) (iv).

The Bank's policy requires the review of individual financial assets that are above materiality thresholds at least annually or more regularly when individual circumstances demand it. Impairment allowances on individually assessed exposures are determined by an evaluation of the incurred loss at the reporting date on a case-by-case basis, and are applied to all individually significant exposures. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account. The collective assessment of the impairment of a group of financial assets is based on a quantitative analysis of historical default rates for loan portfolios with similar credit risk characteristics. The quantitative default rates calculated in this manner were subjected to a qualitative analysis (migration analysis).

According to the internal methodology the Bank shall determine loan loss provisions according to the allocation of credit exposures into three different categories:

- ***Specific individual impairment*** in this category, the Bank would provision all individually significant credit exposures with objective evidence of impairment.
- ***Portfolio-based impairment*** in this category, the Bank would provision all significant credit exposures for which the Bank determines that are not impaired and insignificant exposures according to their similar credit risk characteristics.
- ***Lump-sum specific provisions*** in this category, the Bank would provision all individually insignificant credit exposures based on the number of days in arrears (more than 30 days in arrears).

The Bank accounts for counterparty risks arising from the loan portfolio by making allowances for impaired loans. Individually impaired loans are loans for which the Bank determines that there is objective evidence of impairment and it does not expect to collect all principal and interest due according to the contractual terms of the loan. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired.

Credit exposures in arrears are defined as credit exposures for which contractual exposure is overdue.

The quality of the loan portfolio is monitored on an on-going basis. The measure for loan portfolio quality is the portfolio at risk (PAR), which the Bank defines as all credit exposures outstanding with one or more payment in arrears by more than 30 days, in accordance to Procredit bank guidelines.

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers (continued)

Typically, the regular assessment for objective evidence of impairment is applicable for all on-balance sheet credit exposures, regardless of their size. Accordingly, the following indicators are signs of impairment:

- arrears of more than 90 days in a material amount
- the Bank has initiated court procedures
- bankruptcy proceedings have been initiated
- breach of covenants or conditions, unless the Bank has decided to waive or modify the covenant or condition
- all or part of the off-balance sheet exposure of a client shows signs of impairment
- any specific information on the client's business or changes in the client's market environment that as or is expected to have a negative impact on the future cash flow

If the loan is impaired, the total credit exposure towards the client is taken into consideration and the contamination principle applies. This means that once one loan is impaired, every individual loan to the client and to related parties will be reviewed in order to determine the extent to which other loans to the client or the group are also impaired.

The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. They have been developed internally and combine statistical analysis with credit analyst judgment and are validated, where appropriate, by comparison with externally available data. Clients of the Bank are segmented into four rating classes. The Bank's rating scale, which is shown below, reflects the range of default probabilities defined for each rating class. This means that, in principle, exposures migrate between classes as the assessment of their probability of default changes. The rating tools are kept under review and upgraded as necessary.

The Bank regularly validates the performance of the rating tools and their predictive power with regard to default events.

Bank's internal ratings scale:

Bank's scale	Description of the scale
< = 30 days	Investment grade
31 - 90 days	Standard monitoring
91 - 180 days	Special monitoring
> 180 days	Sub-standard

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers (continued)

The criteria for classification of financial assets or contingent liabilities into these groups are as follows:

Financial assets or contingent liabilities are assigned to the **Investment grade** group if they consist of exposures:
- to debtors who are not likely to default and who meet their payment obligations in a timely manner, with a maximum delay in payment of 30 days, and
- which are secured by pledged collateral graded as first class collateral.

Financial assets or contingent liabilities are assigned to the **Standard monitoring** group if they consist of exposures to debtors:
- whose cash flows are assessed as adequate to duly fulfil their due obligations, regardless of whether or not their present financial position is assessed as weak, without signs of further deterioration in the future and
- who settle their liabilities with a delay of between 31 and 90 days.

Financial assets or contingent liabilities are assigned to the **Special monitoring** group if they are consist of exposures to debtors:
- whose cash flows are assessed to be not sufficient for regular repayment of matured liabilities, or
- who settle their liabilities with a delay of between 91 to 180 days, or
- who are clearly under-capitalised, or
- who do not have sufficient long-term capital resources to finance long-term investments, or
- from whom the Bank does not currently receive satisfactory information or adequate documentation concerning repayment of liabilities.

Financial assets or contingent liabilities are assigned to the **Sub-standard** group if they consist of exposures to debtors:
- where there is a strong likelihood of loss of part or all of the financial asset, or of payment in respect of contingent liabilities, or
- who settle their liabilities with a delay of more than 180 days, or
- who are insolvent, or
- for whom a motion for commencement of process of liquidation or declaration of bankruptcy has been initiated and filed at the provisional court, or
- who are in the process of reform or in the process of liquidation, or
- who have declared bankruptcy, or
- from whom no repayment is expected, or
- for whose collateral the Bank may have questionable legal grounds for seizure.

Loans and advances with renegotiated terms include extended payment arrangements, approved external management plans, modification and deferral of payments. Once the loan is restructured, it remains in this category independent of the satisfactory performance after restructuring. Restructuring policies and practices are based on indicators or criteria which, in the judgment of local management, indicate that payment will most likely continue. These policies are kept under continuous review.
Loans and advances with renegotiated terms include extended payment arrangements, approved external management plans, modification and deferral of payments.

Restructuring of a credit exposure is generally caused by economic problems encountered by the client that adversely affect payment capacity, mostly caused by the significantly changed macro-economic environment in which the Bank's clients currently operate. Restructurings follow a thorough, careful and individual analysis of the client's changed payment capacity.

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers (continued)

Restructured credit exposures are not generally considered to be in arrears but are treated according to their current status. The Bank draws a distinction between standard restructured, watch restructured and impaired restructured credit exposures. Restructurings of credit exposures are generally necessitated by economic or payment problems encountered by the client. The decision to restructure a credit exposure is always taken by a Credit committee or Arrears committee and aims at full recovery of the credit exposure. If a credit exposure is restructured, amendments are made to the parameters of the loan. Otherwise, these credit exposures for which the terms have been nenegotiated would be past due or impaired

The internal rating systems described in Note 5.1 focus more on credit-quality mapping from the inception of the lending and investment activities. In contrast, impairment provisions are recognised for financial reporting purposes only for losses that have been incurred at the reporting date based on objective evidence of impairment. The impairment provision shown in the statement of financial position at year-end is derived out of four internal rating grades. However, the majority of the impairment provision comes from the bottom two grades. The table below shows the percentage of the Bank's on balance sheet items relating to loans and advances and the associated impairment provision percentage for each of the Bank's internal rating categories:

Loans and advances to customers (%)	**2017**	**2016**
Investment grade	93.1	91.3
Standard monitoring	0.6	0.6
Special monitoring	0.3	0.4
Sub-standard	6.0	7.7
	100	**100**

The internal rating tool assists management to determine whether objective evidence of impairment exists under IAS 39, based on the criteria set out in Note 5.1.

The Bank's policy requires the review of individual financial assets that are above materiality thresholds at least annually or more regularly when required by individual circumstances. Impairment allowances on individually assessed accounts are determined by an evaluation of the incurred loss at reporting date on a case-by-case basis, and are applied to all individually significant accounts.

The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

a) Past due but not impaired loans

Past due but not impaired loans are those loans, where contractual interest or principal payments are past due, but the Bank concludes based on the individual assessment made that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Bank.

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Loans and advances to customers (continued)

b) Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured as any modification of the terms and conditions of a credit exposure by agreement between the Bank and the customer to modify the payment plan of a credit exposure agreement in response to an increase in the current or future credit default risk associated with the client. A decision to restructure is subject to the following preconditions:

- the restructuring increases the probability that the borrower will be able to repay the credit exposure;
- the restructuring increases the probability that the Bank will recover the outstanding debt faster to a larger extent and/or at lower costs that could be achieved through a legal recovery process;
- the new payment plan is in line with the actual and expected future payment capacity of the borrower; and/or
- the borrower offers additional collateral, if possible and appropriate.

Depending on the type of exposure subject to restructuring (standard or impaired), the credit exposure may be categorized or not in a better category based on the performance of the exposure. Impaired restructured loans remain in the same category, independent of the performance after the restructuring.

c) Write-off policy

The Bank writes off a loan/security balance (and any related allowances for impairment losses) when it is determined that the loans/securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The smaller the outstanding amount, the higher the number of days in arrears and the greater the uncertainties surrounding recoveries (such as an unpredictable legal environment) are, the smaller will be the chances of recovery by the Bank.

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(i) Analysis of credit quality (continued)

Financial assets available for sale

Investments in share capital of non-banking financial institution which is not rated by Fitch, S&P or Moody's.
The maximum exposure to credit risk is represented by the carrying amount in the statement of financial position.

Loan commitments, financial guarantees and letter of credit

The maximum exposure from financial guarantees represents the maximum amount that the Bank would pay if the guarantee is called on, which may be significantly greater than the amount recognized as a liability. The maximum credit exposure for lending commitments is the full amount of the commitment (see Note 29).

(ii) Risk limit control and mitigation policies

The Bank takes on exposure to credit risk. Credit risk is one of the highest potential risks in the Bank's business; Management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in lending activities that lead to loans and advances and there is also credit risk in off-balance sheet financial instruments, such as loan commitments and guarantees.

Credit default risk from customer credit exposures is defined as the risk of losses due to a potential non-fulfilment of the contractual payment obligations associated with a customer credit exposure.

For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk and sector risk).

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 groups of borrowers, and to geographical and industry segments. Credit risk management committee is responsible to identify potential risks, propose measures for their minimization (or limits for control), and monitor the implementation of the measures approved by the Committee and report on developments in the subsequent meeting.

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

The maximum exposure to credit risk before taking collateral or other credit enhancement is the carrying value of each class of financial assets on the balance sheet, net of the amount of reserves (balance sheet exposure) and position in the off-balance (off-balance exposure).

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(ii) Risk limit control and mitigation policies (continued)

a) Collateral

The Bank measures the exposure to credit risk associated with certain kinds of collateral. The collateral serves as a guarantee that the bank, as the creditor, can recover the credit exposure and as a means of motivating the borrower to repay the credit exposure. Accordingly, the Bank monitors its reliance on different types of collateral.

The Bank has adopted a range of policies and practices to mitigate credit risk. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Cash,
- Mortgages on real estate,
- Pledges on business assets such as equipment, vehicles, inventory and receivables,
- Guarantee funds,
- Bank and corporate guarantees.

Loans to corporate entities and individuals which are approved are secured by a certain type of collateral which is determined at credit commitee.
For the purpose of providing adequate collaterale coverage, the Bank has used a range of first class guarantees from financial institutions, such as: European Investment Fund, USAID, etc. Loans that meet the guarantors conditions are largerly secured by this type of collateral.

In addition, in order to minimise the credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

The financial effect of collateral is presented by disclosing collateral values separately for:

- those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset ("over-collateralised assets"); and
- those assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets").

	Over-collateralised		Under-collateralised	
At 31 December 2017	**Carrying value of the assets**	**Fair value of collateral**	**Carrying value of the assets**	**Fair value of collateral**
Business	132,030	234,332	170,476	106,433
Private	16,221	50,016	8,939	3,562
	148,251	**284,348**	**179,415**	**109,995**

	Over-collateralised		Under-collateralised	
At 31 December 2016	**Carrying value of the assets**	**Fair value of collateral**	**Carrying value of the assets**	**Fair value of collateral**
Business	128,786	132,781	120,133	40,701
Private	22,169	30,926	12,217	2,608
	150,955	**163,707**	**132,350**	**43,308**

The fair value of the collateral is evaluated by the Bank on an individual basis. The assessed values are generally determined with reference to the market. Expected income from collateral liquidation is also taken into account in calculation of individual impairment provisioning.

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(ii) Risk limit control and mitigation policies (continued)

b) Credit-related contingencies

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

(iii) Concentration of credit risk

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

a) Geographical sectors

Geographic concentration of assets, liabilities and off-balance positions

As at 31 December 2017	**Total assets**	**Total liabilities**	**Contingent liabilities and commitments**
Bosnia and Herzegovina	428,951	256,858	71,295
EU countries	16,402	137,288	-
Non EU countries	68	3,192	-
	445,421	**397,338**	**71,295**

As at 31 December 2016	**Total assets**	**Total liabilities**	**Contingent liabilities and commitments**
Bosnia and Herzegovina	357,937	252,881	73,256
EU countries	12,905	66,782	-
Non EU countries	293	3,191	-
	371,135	**322,854**	**73,256**

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5. Financial risk management (continued)

5.1 Credit risk (continued)

(iii) Concentration of credit risk (continued)

b) Industry

Concentration of credit risk of loans, receivables from leasing activities and due receivables by industry sectors, on a gross basis, is as follows:

	2017		2016	
Concentration of risk by industry sectors	**BAM**	**%**	**BAM**	**%**
Wholesale and retail	110,621	32%	99,143	32%
Agriculture, forestry and fishing	180	0%	202	0%
Production	115,594	33%	85,422	27%
Individuals	241	0%	281	0%
Construction	21,835	6%	17,594	6%
Real estate	-	0%	-	0%
Tourism and hospitality	5,835	2%	4,965	2%
Financial institutions	-	0%	-	0%
Other	59,225	17%	57,944	19%
Total non-retail	**313,531**	**90%**	**265,551**	**85%**
Housing	4,254	1%	4,589	1%
Other	25,845	7%	28,351	9%
Independent craft shops	3,324	1%	12,378	4%
Total retail	**33,423**	**10%**	**45,318**	**15%**
Total	**346,954**	**100%**	**310,869**	**100%**

5.2 Market risk

The Bank takes on exposure to market risk. Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange prices and credit spreads, and the resulting changes in an obligor's or issuer's credit standing, will have an effect on the Bank's income. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk. Market risks arise from open positions in interest rate, foreign currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices.

The Management board sets limits and guidelines for managing, analysing and controlling market risk exposures within acceptable parameters while optimising the return on risk. The Assets and Liabilities Committee (ALCO) manages the short- and long-term liquidity position and exposures to market risk, which are regularly monitored by Risk management committees of the Bank. The Risk Unit is responsible for the development and implementation of risk management policies.

The Bank has a low level of exposure to market risk, because it does not engage in speculative transactions or in proprietary trading. Management of risk in this area is limited to protecting the institution from adverse movements in exchange and interest rates.

(i) Foreign currency risk

The Bank is exposed to currency risk through transactions in foreign currencies. Foreign currency exposure arises from credit, deposit-taking and trading activities. The Management board sets limits on the level of exposure by currency and in total for overnight positions, which are monitored on a daily basis by the Business department (Treasury). Based on the reports, the Bank's ALCO takes strategic currency decisions. Bosnia and Herzegovina is under a currency board regime according to which the local currency (BAM) is pegged to the EUR. The Bank's balance sheet positions are mainly in local currency and EUR so the Bank's exposure toward currency risk is low. The table below summarises the Bank's exposure to currency risk at 31 December 2017. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by currency.

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5. Financial risk management (continued)

5.2 Market risk (continued)

(i) *Foreign currency risk (continued)*

The currency table reflects the currency clause in the contracts, i.e. the amounts are classified based on the currency clause, not based on the actual currency of the cash flows.

As at 31 December 2017	EUR	EUR linked	USD	BAM	Other	Total
Assets						
Cash and cash equivalents	19,903	-	2,031	41,413	444	**63,791**
Obligatory reserve with Central Bank	-	-	-	35,005	-	**35,005**
Loans and advances to customers	172	251,905	-	75,588	-	**327,665**
Other financial assets	69	-	-	398	-	**467**
Total assets	**20,144**	**251,905**	**2,031**	**152,404**	**444**	**426,928**
Liabilities						
Deposits from customers	93,399	21,023	1,991	129,529	511	**246,453**
Borrowings	5,463	131,826	-	3,191	-	**140,480**
Subordinated debt	8,806	-	-	-	-	**8,806**
Other financial liabilities	189	-	-	326	-	**515**
Total liabilities	**107,857**	**152,849**	**1,991**	**133,046**	**511**	**396,254**
Net foreign exchange position	**(87,713)**	**99,056**	**40**	**19,358**	**(67)**	**30,674**
Contingencies and commitments	13,798	-	454	57,043	-	71,295

As at 31 December 2016	EUR	EUR linked	USD	BAM	Other	Total
Assets						
Cash and cash equivalents	12,183	-	1,927	22,646	747	**37,503**
Obligatory reserve with Central Bank	-	-	-	29,496	-	**29,496**
Loans and advances to customers	192	213,969	-	69,144	-	283,305
Other financial assets	96	-	-	557	-	653
Total assets	**12,471**	**213,969**	**1,927**	**121,843**	**747**	**350,957**
Liabilities						
Deposits from customers	104,607	24,206	2,087	110,224	632	**241,756**
Borrowings	57,245	10,356	-	3,191	-	**70,792**
Subordinated debt	8,805	-	-	-	-	**8,805**
Other financial liabilities	178	-	-	376	-	**554**
Total liabilities	**170,835**	**34,562**	**2,087**	**113,791**	**632**	**321,907**
Net foreign exchange position	**(158,364)**	**179,407**	**(160)**	**8,052**	**115**	**29,050**
Contingencies and commitments	13,986	-	659	67,741	-	82,386

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5. Financial risk management (continued)

5.2 Market risk (continued)

(i) Foreign currency risk (continued)

The following table shows sensitivity of the bank to 10% increase or decrease in BAM in relation to USD and other currencies. Positive amount indicates increase in gain or other capital when BAM is stronger for 10% related to other currencies. For 10% weakening of BAM related to relevant currency, effect would be the same, but with different sign.

	2017	2016
Profit / (loss)	10	9

(ii) Interest rate risk

Interest rate risk specifies the risk that movements in market interest rates will adversely affect the Bank's capital and interest earnings. Two subcategories are identified: the economic value risk and interest earnings risk. The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in future cash flows or fair values of financial instruments because of a change in market interest rates. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature at different times and different amounts. It is the responsibility of the bank's ALCO to keep the interest rate risk exposure within the set limits at all times. Before ALCO decides on a strategy that changes the asset/liability structure in such a way that a limit might be exceeded, the Bank's risk management unit calculates the interest structure that would result from the strategy. The Bank's ALCO is responsible for managing the compliance with set limits. Both the Bank's ALCO and the Bank's Risk management committee have the authority to decide on all final proposals to the Management board, related to the interest rate exposure modifications within the set limits. Principally, the interest rate risk is managed through monitoring interest rate gaps and by setting pre-approved limits for reprising bands.

Interest rate risk arises from differences between the maturities of assets and those of liabilities. Currently, the average maturity of loans is shorter than the average maturity of customer deposits, as a result of the implementation of loans with variable interest rates. There is a danger that the refinancing of loans will become more expensive if deposit interest rates increase. However, interest rates in Bosnia and Herzegovina were on lower level in 2017 compared to the previous years.

Among the various tools used to measure and analyse interest rate risk is maturity gap analysis. All interest rate-sensitive on- and off-balance sheet assets and liabilities are classified in predefined time buckets according to their remaining contractual maturity or next scheduled interest rate adjustment, and the gap (assets minus liabilities) is calculated for each time bucket. Stress testing is also used to analyse the impact of interest rate shifts on interest income.

Throughout 2017 the Bank continued its policy of minimising interest rate risk in its banking book. The Bank's goal is to match repricing profiles between assets and liabilities, and only uses derivatives to hedge its interest rate risk position in exceptional cases. The Bank had low exposure regarding the interest rate risk exposure and due to this the Bank never used derivatives.

Scenario analyses of yield curve shifts are carried out separately for each material operating currency, such as total economic value impact in present value and cumulative interest earnings impact (profit or loss) for a 3-month and 1-year period in present value. The analyses are completed separately for both, the most probable scenario and the worst case scenario, which assumes risk of concentration in financial market-based interest rates.

The scenario analysis provides an estimation of how the changes in the interest rate structure may affect the earnings and the economic value of the Bank.

The Bank seeks to ensure that the balance sheet structure is as balanced as possible across all maturities.

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5. Financial risk management (continued)

5.2 Market risk (continued)

(ii) Interest rate risk (continued)

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by the earlier of contractual repricing or maturity dates:

As at 31 December 2017	Effective interest rates	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Cash and cash equivalents	0.2%	56,879	-	-	-	-	6,912	**63,791**
Obligatory reserve with Central Bank	0.00%	35,005	-	-	-	-	-	**35,005**
Loans and advances to customers	4.88%	21,771	16,504	60,939	131,389	92,886	4,176	**327,665**
Other financial assets	0.00%	-	-	-	-	-	467	**467**
Total assets	**4.89%**	**113,655**	**16,504**	**60,939**	**131,389**	**92,886**	**11,555**	**426,928**
Deposits from customers	1.08%	60,640	11,872	43,860	46,092	1,383	82,606	**246,453**
Liabilities towards banks and other financial institutions	2.26%	741	13,663	33,294	74,417	18,365	-	**140,480**
Subordinated debt	6.84%	-	-	-	-	8,801	5	**8,806**
Other financial liabilities	0.00%	-	-	-	-	-	515	**515**
Total liabilities	**1.26%**	**61,381**	**25,535**	**77,154**	**120,509**	**28,549**	**83,126**	**396,254**
Interest sensitivity gap for 2017	**3.63%**	**52.274**	**(9.031)**	**(16.215)**	**10.880**	**64.337**	**(71.571)**	**30.674**

As at 31 December 2016	Effective interest rates	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Cash and cash equivalents	0.10%	27,603	-	-	-	-	9,900	**37,503**
Obligatory reserve with Central Bank	0.00%	29,496	-	-	-	-	-	**29,496**
Loans and advances to customers	8.02%	32,848	70,445	64,675	102,271	12,407	659	**283,305**
Other financial assets	0.00%	-	-	-	-	-	653	**653**
Total assets	**6.15%**	**89,947**	**70,445**	**64,675**	**102,271**	**12,407**	**11,212**	**350,957**
Deposits from customers	2.11%	59,908	15,419	47,603	52,177	1,053	65,596	**241,756**
Liabilities towards banks and other financial institutions	2.37%	652	12,505	12,454	38,897	5,847	437	**70,792**
Subordinated debt	7.39%	-	-	-	-	8,801	4	**8,805**
Other financial liabilities	0.00%	-	-	-	-	-	554	**554**
Total liabilities	**2.03%**	**60,560**	**27,924**	**60,057**	**91,074**	**15,701**	**66,591**	**321,907**
Interest sensitivity gap for 2016	**4.12%**	**29,387**	**42,521**	**4,618**	**11,197**	**(3,294)**	**(55,379)**	**29,050**

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5. Financial risk management (continued)

5.2 Market risk (continued)

(ii) Interest rate risk (continued)

Based on the above interest rate sensitivity, at 31 December 2017, if interest rates had been 1% lower with all other variables remaining constant, the result for the year would have been for BAM 564 thousand lower (2016. godine: BAM 549 thousand). Conversely, same effect with opposite result would be gained if interest rates would increase by 1%.

The interest rate sensitivity analysis includes all variable interest rate assets and liabilities and assumes that all short-term fixed rate assets and liabilities are reinvested upon maturity.

5.3 Liquidity risk

Liquidity risk in the narrowest sense (risk of insolvency) is the danger that the Bank will no longer be able to meet its current and future payment obligations in full, or in a timely manner. Liquidity risk in a broader sense (funding risk) is the danger that additional funding can no longer be obtained, or can only be obtained at increased market interest rates. The Bank's ALCO is responsible for deciding on all final proposals undertaken to manage liquidity and is also responsible for making strategic proposals to the Management board.

The Supervisory board has approved the Bank's Liquidity risk management program. The Bank manages liquidity risk by seeking to apply the optimum combination of maturity and foreign currency structure of the assets and liabilities. To determine the robustness of the Bank's liquidity in the face of potential shocks, the Risk Unit performs regular stress tests based on scenarios defined in the Liquidity risk management policy. If negative gaps are found, contingency plans are discussed by the ALCO and approved by the Management board.

Throughout 2017, all of the Bank's liquidity indicators remained in compliance with the defined limits. Several factors inherent to the Bank's business model serve to offset liquidity risk. Firstly, the Bank has a diversified portfolio of loans that are mostly repaid in monthly instalments. Secondly, customer deposits are diversified, i.e. they are spread across a large number of depositors each holding relatively small amounts.

Sources of liquidity are regularly reviewed by the Business department (Treasury) and the Risk Unit, on the basis of which measures are decided upon by the ALCO and the Risk management committee of the Bank with the aim of maintaining broad diversification by currency, geography, provider, product and term.

The primary responsibility for identifying, assessing, addressing, monitoring and communicating the Bank's liquidity and funding risk lies with the Management board. The Business department (Treasury) manages the liquidity situation on a daily basis. Liquidity risk is monitored in the regular ALCO meetings, in which members of the Management board participate. The Risk management unit is responsible for controlling and monitoring liquidity risk, ensuring that it is in line with the Liquidity risk management program and the limits which it sets, and is also responsible for monitoring to ensure that the measures defined by the ALCO are being put into practice.

The key tools for measuring liquidity risks are liquidity gap analyses, which estimate future funding needs or the levels of excess liquidity, applying different assumptions. Based on the maturity gap analyses, certain key liquidity indicators are calculated on at least a monthly basis and are closely monitored. One important indicator of short-term liquidity is the sufficient liquidity indicator (SLI), which compares the amounts of assets and liabilities available within the next 30 days, and must not fall below 1 for each material currency. This implies that the Bank always has sufficient funds to be able to repay the liabilities expected to be due within the next 30 days. As at 31 December 2017, this ratio was 2.79 while as at 31 December 2016 it was 1.67.

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5. Financial risk management (continued)

5.3 Liquidity risk (continued)

Another short-term key indicator is the highly liquid assets indicator, which relates highly liquid assets to customer deposits. The indicator must always exceed 20%, which implies that the Bank always holds funds which can quickly be converted into cash in order to repay 20% of all customer deposits. As at 31 Decembar 2017 this ratio was 40.70% while at 31 December 2016 it was 28.08%.

The Bank also analyses its liquidity situation from a more structural perspective, taking into account the liquidity gaps of the different time buckets and additional sources of potential liquidity. This analysis also takes into account credit lines which can be drawn by the Bank with some lead time, potential outflows due to unused approved exposures, and other assets which take some time to liquidate.

The table below divides the assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. Other assets and liabilities which do not have contractual maturity are classified into relevant maturity groupings in accordance with the Bank's plan.

Assets and liabilities maturity

As at 31 December 2017	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	63,791	-	-	-	-	63,791
Obligatory reserve with Central Bank	35,005	-	-	-	-	35,005
Loans and advances to customers	19,948	30,596	114,121	153,522	36,385	354,572
Other financial assets	467	-	-	-	-	467
Total assets:	**119,211**	**30,596**	**114,121**	**153,522**	**36,385**	**453,835**
Deposits	148,725	5,731	45,963	47,203	1,461	249,083
Borrowings	1,011	15,855	33,893	76,142	18,740	145,641
Subordinated debt and subordinated bonds	-	-	523	2,093	11,422	14,038
Other financial liabilities	964	-	-	-	-	964
Other liabilities	**150,700**	**21,586**	**80,379**	**125,438**	**31,623**	**409,726**
Net liquidity gap for 2017	(31,489)	9,010	33,742	28,084	4,762	44,109

As at 31 December 2016	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	37,503	-	-	-	-	37,503
Obligatory reserve with Central Bank	29,496	-	-	-	-	29,496
Loans and advances to customers	35,962	72,329	78,967	109,454	14,285	310,997
Other financial assets	653	-	-	-	-	653
Total assets:	**103,614**	**72,329**	**78,967**	**109,454**	**14,285**	**378,649**
Deposits	125,787	15,800	49,625	55,434	1,067	247,713
Borrowings	936	12,721	14,01	40,494	5,993	74,154
Subordinated debt and subordinated bonds	-	-	606	2,411	9,404	12,421
Other financial liabilities	554	-	-	-	-	554
Other liabilities	**127,277**	**28,521**	**64,241**	**98,339**	**16,464**	**334,842**
Net liquidity gap for 2016	(23,663)	43,808	14,726	11,115	(2,179)	43,807

5. Financial risk management (continued)

5.3 Liquidity risk (continued)

For liquidity purposes the Bank classifies demand and saving deposits as maturing within one month. The possibility that larhe amount of customer deposits will leave the Bank is very unlikely, considering that the porfolio of deposits are diversified by large number of depositors each holding relatively small amounts. Therefore the Bank does not consider having the liquidity gap in short term.

Off-balance sheet items maturity

(a) Loan commitments

The dates of the contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers and other facilities are summarised in the table above.

(b) Financial guarantees and letters of credit

Financial guarantees and letters of credit are also included in the table previously shown based on the earliest contractual maturity date.

5.4 Capital management risk

The Bank's objectives when managing capital, which is a broader concept than the item Equity in the statement of financial position, are:

- To comply with the capital requirements set by the regulators of the banking market in 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 base to support the development of its business.

Capital adequacy and the balance of capital are monitored regularly by the ALCO and Group risk management committee, based on the relevant internal acts and regulations prescribed by the supervisory authority (the FBA).

The required information and reports are submitted to the FBA on a monthly and a quarterly basis. Aside from ratios prescribed by local regulator and Basel II capital ratios, the leverage ratio and risk bearing capacity are monitored on a monthly basis by the Bank's Risk management committee and the ProCredit Group risk management committee.

The table below summarises the composition of regulatory capital and the capital adequacy ratio of the Bank for the years ended 31 December 2017 and 2016, prepared in accordance with FBA's regulations.

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5. Financial risk management (continued)

5.4 Capital management risk (continued)

	2017	2016
Capital		
Share capital	67,215	63,303
Share premium	293	293
Statutory reserves	228	228
Accumulated gain/(loss)	(20,516)	(16,406)
Intangible assets	(2,440)	(3,304)
Core capital	**44,780**	**44,114**
Amount of general reserves for credit losses for Bank's assets classified in A category	4,850	4,336
Amount of subordinated debts	8,801	8,801
Additional capital	**13,651**	**13,137**
Additional loan loss reserves in accordance with regulatory requirements	(8,717)	(9,108)
Deducted items from Bank's capital	**(8,717)**	**(9,108)**
Bank's net capital	**49,714**	**48,143**

	2017	2016
Bank's net capital	**49,714**	**48,143**
Total risk weighted assets	363,315	320,659
Total risk weighted operating risk	24,665	26,198
Total weighted risk	**387,980**	**346,857**
Capital adequacy ratio	**12.8%**	**13.9%**

The minimum capital requirement according to the FBA's regulations amounts to 12%.

The Management of the Bank believes that in the course of 2017 and 2016, the Bank was fully aligned with the requirements for capital management in accordance with the requirements of internal regulations and regulations prescribed by the FBA.

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5. Financial risk management (continued)

5.5 Operational risk

Operational risk is recognised as an important risk factor for the Bank, given that it relies on decentralised processing and decision-making. In line with Basel II, the Bank defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems and/or external events. This category includes all "risk events" in the areas of personnel, processes, and information technology. Operational risk is managed in accordance with Bank's Operational risk management policy .The principles outlined in this document have been designed to effectively manage the Bank's operational risk exposure. They are in compliance with the Basel II requirements for the "standard approach".

The overall framework for managing operational risks is best described as a complementary and balanced system comprising the following key components: corporate culture, governance framework, policies and procedures, risk assessments, new risk approvals (NRAs), key risk indicators and the risk event database. While the corporate culture, the governance framework, and policies and procedures define the basic organizational requirements, risk assessments, new risk approvals (NRAs), Key risk indicators and the risk event database form the key instruments with which the risk management process is executed.

The overall objectives of the Bank's approach to the management of operational risks are:

- to understand the drivers of the Bank's operational risks;
- to be able to identify critical issues as early as possible;
- to avoid losses caused by operational risks; and
- to ensure efficient use of the Bank's capital.

To deliver on these goals the following tools and processes have been implemented within the framework outlined above. They are presented in the sequence in which they are used within the operational risk management process. This process is subdivided into the following phases: identification, evaluation, treatment, monitoring, documentation and communication, and follow up.

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5. Financial risk management (continued)

5.5 Operational risk (continued)

- **Identification**
  - Annual operational risk assessments
  - Annual fraud risk assessments
  - Detailed process reviews as appropriate
  - New risk approval (NRA) process
  - Risk identification and documentation in the Risk event database (RED)
  - Ad hoc identification of potential risks
- **Evaluation/quantification**
  - Agreed standards to quantify risks
- **Mitigation and treatment**
  - Implementation of measures to avoid, reduce or mitigate the risks depending on priorities, efficiency considerations and regulations
  - Transfer of risk to an insurer or other party
- **Monitoring and control**
  - Process owners' responsibility to monitor risks
  - Key risk indicators (KRIs) and operational risk reports, risk bearing capacity calculation and monitoring
- **Communication, escalation, documentation**
  - Escalation levels to management bodies, regular reporting, risk committees
  - RED, management summary documents for risk events
- **Issue tracking / follow-up tables for material action plans**
  - Follow-up tools used in the Bank

As part of their initial training, all new staff members are taught how to recognise and avoid operational risk and how to maintain information security.

As of 31 December 2017, no significant legal proceedings were pending.

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6. Fair value of financial assets and liabilities

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. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

The table below summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Bank's statement of financial position at their fair value. Borrowings include a loan from ProCredit Holding in amount of BAM 9,779 thousands, final maturity date 29. July 2019.

	Carrying value		Fair value	
	2017	2016	2017	2016
Assets				
Loans and advances to customers	327,665	283,305	328,466	282,270
Liabilities				
Deposits from customers	246,453	241,756	244,858	244,198
Borrowings	140,480	70,792	139,821	66,842
Subordinated debt	8,806	8,805	9,959	10,126

Financial assets available for sale are carried at cost as they do not have a quoted market price in an active market, and their fair value cannot be reliably measured.

(i) Loans and advances to customers

The fair value of loans and advances is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans. The carrying value of loans with variable interest rate approximates their fair value.

(ii) Deposits from customers, borrowings and subordinated debt

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.
The estimated fair value of fixed interest-bearing deposits and other borrowings not quoted in an active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Fair value of term deposits with variable interest rate is approximately same as their carrying value at the reporting date.

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6. Fair value of financial assets and liabilities (continued)

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1), where quoted prices from actual trades are frequently available (ie. over 90% of trading days in a year).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following table presents the Bank's financial assets and liabilities that are measured at fair value at 31 December 2017.

	Level 1	Level 2	Level 3	Carrying value
Assets				
Financial assets:				
Cash and cash equivalents	-	63,791	-	63,791
Obligatory reserve with Central Bank	-	-	35,005	35,005
Loans and advances to customers	-	-	327,665	327,665
Financial assets available-for-sale	-	-	43	43
Other financial assets	-	-	467	467
Total assets	**-**	**63,791**	**363,180**	**426,971**
Liabilities				
Financial liabilities				
Deposits from customers	-	141,945	104,508	246,453
Borrowings	-	-	140,480	140,480
Subordinated debt	-	-	8,806	8,806
Other financial liabilities	-	-	515	515
Total liabilities	**-**	**141,945**	**254,309**	**396,254**

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6. Fair value of financial assets and liabilities (continued)

The following table presents the Bank's financial assets and liabilities that are measured at fair value at 31 December 2016.

	Level 1	Level 2	Level 3	Carrying value
Assets				
Financial assets:				
Cash and cash equivalents	-	37,503	-	37,503
Obligatory reserve with Central Bank	-	-	29,496	29,496
Loans and advances to customers	-		283,305	283,305
Financial assets available-for-sale	-	-	43	43
Other financial assets	-	-	653	653
Total assets	**-**	**37,503**	**313,497**	**351,000**
Liabilities				
Financial liabilities				
Deposits from customers	-	118,195	123,561	241,756
Borrowings	-	-	70,792	70,792
Subordinated debt	-	-	8,805	8,805
Other financial liabilities	-	-	554	554
Total liabilities	**-**	**118,195**	**203,712**	**321,907**

Fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. Market is considered active if quoted prices are easily and regularly available from trade, dealers, brokers, industry group, cost of services from regulatory agencies, and that those prices represent actual and regular transactions on the market based on the arm's length principles. Quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in Level 1. There is no instruments in Level 1, since it is considered that the local stock market is not active.

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7. Operating segments

The Bank generates the most significant part of its revenues in operations with legal entities and the focus of operations is the provision of financial services to small and medium-sized enterprises. Smaller volume of activities are in the retail and treasury business segment.

Segments	Operations
Corporate	Loans, deposits and other fnancial services for corporate entities
Retail	Loans, deposits and other financial services for retail
Treasury	Management of liquid assets

2017	**Corporate**	**Retail**	**Treasury**	**Total**
Net interest income	8,225	2,459	-	**10,684**
Net fee and commission income	2,106	1,414	-	**3,520**
Foreign exchange, net	-	-	590	**590**
Other operating income	189	40	-	**229**
Total income by segments	10,520	3,913	590	**15,023**
Assets by segments	327,548	19,078	98,795	**445,421**
Liabilities by segments	294,414	102,169	755	**397,338**

2016	**Corporate**	**Retail**	**Treasury**	**Total**
Net interest income	10,140	2,551	-	**12,691**
Net fee and commission income	3,158	1,782	-	**4,940**
Foreign exchange, net	-	-	497	**497**
Other operating income	283	151	-	**434**
Total income by segments	13,581	4,484	497	**18,562**
Assets by segments	359,603	11,532	-	**371,135**
Liabilities by segments	189,470	133,384	-	**322,854**

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8. Net interest income

	2017	2016
Interest and similar income		
Loans and advances to customers	15,988	19,339
	15,988	**19,339**
Interest expense and similar charges		
Interest expense and similar charges		
Deposits from customers	(2,585)	(4,177)
Deposited funds abroad	(80)	(85)
Borrowings and subordinated debt	(2,639)	(2,386)
	(5,304)	**(6,648)**
Net interest income	**10,684**	**12,691**

9. Provision for impairment of loans to customers

	2017	2016
Loans and receivables from customers (Note 19)	1,412	1,019
Other financial assets (Note 21)	(261)	620
Other assets	(205)	(196)
	946	**1,443**

10. Fee and commission income

	2017	2016
Customer bank services fees	2,020	1,989
Accounts maintenance fees	1,381	2,083
Guarantees and letters of credit	778	848
Payment card transactions	359	406
Fee income from payment	158	379
Foreign payment transactions	103	104
Fee income from commission services	66	40
Foreign exchange transactions	43	130
E banking	42	44
Fee income from pledge registry	36	17
Other	191	308
	5,177	**6,348**

11. Fee and commission expense

	2017	2016
Payment card transactions	480	472
Banks	405	301
Other bank services, foreign bank expenses	405	306
Other	367	328
	1,657	**1,407**

12. Foreign exchange differences, net

	2017	2016
Foreign exchange gains	56,593	42,691
Foreign exchange losses	(56,003)	(42,194)
	590	**497**

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13. Other operating income

	2017	2016
Income from previous period	112	19
Income from release provisions for long term employee benefits and court cases	-	250
Income from release of provisions for contingencies and commitments	16	-
Petty cash surpluses	10	8
Net gain from disposal of assets	-	121
Other	91	36
	229	**434**

14. Personnel expenses

	2017	2016
Salaries and wages	2,862	3,356
Taxes and contributions	2,022	2,377
Food allowances and transportation	756	904
Post-employment contributions	185	1
Other	95	77
	5,920	**6,715**

The number of persons employed by the Bank at year-end was 167 (2016.: 210).

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15. Other operating expenses

	2017	2016
Maintenance of fixed assets and equipment	2,364	2,130
Insurance	1,143	1,276
Rent	917	1,029
ProCredit Group consulting services	773	566
Provision and court disputes	677	266
Education	645	667
Subsequently determined expenses	508	117
Net loss from disposal of assets	416	-
Utilities and electricity	281	325
Audit and representation costs	266	185
Communication services	228	280
Consulting services	226	310
Services	218	177
Transportation services	206	207
Temporary contracts	200	214
Promotion and marketing	200	278
Provision for long term employee benefits and court cases	159	-
Administrative, court and other legal fees	168	275
Transportation	123	113
Other consumables	92	74
Stationery	89	81
Membership fees	76	82
Lawyer services	65	-
Water contributions and other taxes	64	69
Other taxes and contributions	34	34
Shortages and other penalties	19	25
Provision for contingencies and commitments	-	19
Other	398	551
	10,555	**9,350**

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16. Income tax

	2017	2016
Current income tax	-	-
Deferred income tax	84	27
Income tax expense, net	**84**	**27**

The tax rate on corporate income is 10% (2016: 10%).

Reconciliation of the accounting profit and current income tax expense

The calculation of income tax liability is made according to the valid legal regulations in Bosnia and Herzegovina and is presented as follows:

	2017	2016
Loss before tax	**(4,026)**	**(849)**
Tax credit calculated at a tax rate of 10% (2016: 10%)	(403)	(85)
Adjustments for:		
- Non-deductible expenses	30	30
- Non-taxable income	(83)	(96)
- Transfer pricing	11	7
	445	*144*
Current income tax	**-**	**-**

In accordance with the Law on Corporate income tax, tax losses can be carried forward for relief against profit of future accounting periods, but not for longer than 5 years. Tax losses, as per tax returns, which can be carried forward are as follows:

	31 December 2017	31 December 2016
Up to 1 year	-	-
Up to 2 years	-	-
Up to 3 years	43	-
Up to 4 years	1,440	43
Up to 5 years	4,452	1,440
	5,935	**1,483**

Deferred income tax

Deferred income taxes are calculated on all temporary differences under the balance sheet method using an effective tax rate of 10% (2016: 10%).

The Bank has recognised deferred tax assets relating to unused tax losses carried forward, as the Management board estimates that there will be future taxable profit against which the Bank can utilise these benefits.

Movement in deferred tax assets were as follows:

	Total
Balance at 1 January 2016	*260*
Release of deferred tax assets	(27)
Balance at 31 December 2016	**233**
Release of deferred tax assets	(84)
Balance at 31 December 2017	**149**

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17. Cash and balances at depository institutions

	31 December 2017	31 December 2016
Balances with the Central Bank other than obligatory reserve	35,249	13,483
Current accounts with other banks	21,631	14,120
Cash in hand	6,911	9,900
	63,791	**37,503**

18. Obligatory reserves with the Central Bank

	31 December 2017	31 December 2016
Obligatory reserve with the Central Bank	35,005	29,496
	35,005	**29,496**

The Central Bank determines the requirement for banks to hold obligatory reserves in the form of amounts required to be deposited with the Central Bank. As at 31 December 2017 obligatory reserve of the Bank, presented as part of the position accounts with the Central bank, amounted to BAM 35.005 thousand (2016: BAM 29.496 thousand).

The obligatory reserve requirement at 31 December 2017 amounted to 10% for liabilities regardless of maturity. The obligatory reserve is maintained through the average balance in the ordinary reserve account with the Central Bank.

19. Loans and advances to customers

	31 December 2017	31 December 2016
Retail		
Short term	2,172	3,212
Long term	31,251	42,106
	33,423	**45,318**
Corporate		
Short term	82,604	74,674
Long term	230,358	190,877
	312,962	**265,551**
Gross loans and advances to customers	**346,385**	**310,869**
Allowance for impairment	**(18,720)**	**(27,564)**
Net loans and advances to customers	**327,665**	**283,305**

The movement in impairment allowance for loans, leasing receivables and due receivables is as follows:

	2017	2016
Balance at 1 January	*27,564*	*31,273*
Additional impairment allowances (Note 9)	1,412	1,019
Write-offs	(10,256)	(4,728)
As at 31 December	**18,720**	**27,564**

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19. Loans and advances to customers (continued)

	31 December 2017			31 December 2016		
	Gross amount	Impairment allowance	Net amount	Gross amount	Impairment allowance	Net amount
Overdrafts	919	(41)	878	682	(34)	648
Housing	13,290	(336)	12,954	9,437	(470)	8,967
Consumer	3,727	(274)	3,453	5,858	(1,949)	3,909
Very small business	9,223	(2,779)	6,444	41,071	(5,114)	35,957
Small	76,670	(4,463)	72,207	92,882	(8,431)	84,451
Medium	240,959	(10,386)	230,573	157,762	(10,355)	147,407
Agricultural	1,597	(441)	1,156	3,177	(1,211)	1,966
	346,385	**(18,720)**	**327,665**	**310,869**	**(27,564)**	**283,305**

The credit quality of neither past due nor impaired loans and advances to customers is presented in Note 5.1 (i).

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20. Property, equipment and intangible assets

	Buildings	Leasehold improvements	Furniture and equipment	Assets in progress	Total	Intangible assets	Total
2017							
Cost							
Balance at 1 January 2016	*12,889*	*4,066*	*12,789*	*493*	*30,237*	*6,265*	*36,502*
Additions	9	20	14	1,590	*1,633*	9	1,642
Transfers	76	163	746	(1,549)	*(564)*	564	-
Disposals and write offs	-	(223)	(2,381)	-	*(2,604)*	-	(2,604)
Balance at 31 December 2016	**12,974**	**4,026**	**11,168**	**534**	***28,702***	**6,838**	**35,540**
Balance at 1 January 2017	*12,974*	*4,026*	*11,168*	*534*	*28,702*	*6,838*	*35,540*
Additions	-	-	-	*918*	*918*	25	943
Transfers from repossesed assets	501	-	-	-	*501*	-	501
Transfers within PPE	10	167	*529*	*(1,315)*	*(609)*	609	-
Disposals and write offs	(101)	(2,742)	*(1,733)*	-	*(4,576)*	(540)	(5,116)
Balance at 31 December 2017	**13,384**	**1,451**	**9,964**	**137**	***24,936***	**6,932**	**31,868**
Accumulated depreciation							
Balance at 1 January 2016	*1,002*	*3,055*	*10,555*	-	*14,612*	*4,191*	*18,803*
Charge for the year	264	349	769	-	*1,382*	522	1,904
Transfers	-	11	(11)	-	-	-	-
Disposals and write offs	-	(223)	(2,206)	-	*(2,429)*	-	(2,429)
Balance at 31 December 2016	**1,266**	**3,192**	**9,107**	**-**	***13,565***	**4,713**	**18,278**
Balance at 1 January 2017	*1,266*	*3,192*	*9,107*	-	*13,565*	*4,713*	*18,278*
Charge for the year	275	244	633	-	*1,152*	476	1,628
Disposals and write offs	(101)	(2,469)	(1,708)	-	*(4,278)*	(19)	(4,297)
Balance at 31 December 2017	**1,440**	**967**	**8,032**	**-**	***10,439***	**5,170**	**15,609**
Newt book value							
At 31 December 2017	**11,944**	**484**	**1,932**	**137**	***14,497***	**1,762**	**16,259**
At 31 December 2016	**11,708**	**834**	**2,061**	**534**	***15,137***	**2,125**	**17,262**

Transfers at position of building in amount of BAM 501 thousand refers to transfer of acquired assets into use for operating business.

Assets in progress mainly relates to equipment not put in use.

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21. Other financial assets

	31 December 2017	31 December 2016
Receivables from customers for banking services	598	928
Receivables from Governments	111	141
Receivables from legal entities	111	147
Receivables from non-banking financial institutions	76	138
Receivables from banks	45	47
Receivables from individuals	18	5
Impairment allowance for other financial assets	(492)	(753)
	467	**653**

Movement of impairment allowance for other financial assets is as follow:

	2017	2016
As at 1 January	*753*	*663*
(Release of)/additional impairment allowances (Note 9)	(261)	620
Write-offs	-	(530)
As at 31 December	**492**	**753**

22. Other assets

	31 December 2017	31 December 2016
Repossessed colateral	1,368	1,702
Prepaid expenses	387	582
Other assets	287	356
	2,042	**2,640**

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23. Deposits

	31 December 2017	31 December 2016
Corporate		
- Current accounts and demand deposits	88,588	59,927
- Term deposits	50,801	49,603
Retail		
- Current accounts and demand deposits	54,492	61,770
- Term deposits	52,572	70,456
	246,453	**241,756**

24. Borrowings

	31 December 2017	31 December 2016
ProCredit Holding AG	53,219	14,928
European Investment Bank (EIB)	45,438	32,023
ProCredit Bank AG Frankfurt	33,169	9,586
International Fund for Agricultural Development (IFAD)	3,191	3,191
Fondation for sustainable development - OdRaz	2,899	4,942
The Republic of Srpska Investment-Development Bank	2,564	5,414
The European Fund for Southeast Europe (EFSE)	-	708
	140,480	**70,792**

The Bank has not had any defaults of principal, or interest with respect to loans and other borrowings.

Interest rates on borrowings range from 0.60% to 3.75%.

Description of borrowers and borrowings:

ProCredit Holding AG

Principal (in EUR thousands)	**Maturity date**
2,000	2 June 2019
10,000	29 July 2019
5,000	31 March 2020
5,500	28 April 2020
2,500	1 July 2020
7,000	28 December 2020

European Investment Bank (EIB)

Principal (in EUR thousands)	**Maturity date**
5,206	20 December 2019
5,758	20 August 2020
4,998	20 July 2021
4,036	30 November 2023
5,002	20 October 2025
3,000	20 September 2027
3,663	10 December 2027
3,263	10 February 2028

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24. Borrowings (continued)

ProCredit Bank AG Frankfurt

Principal (in EUR thousands)	Maturity date
3,000	3 May 2018
1,900	3 May 2018
3,000	3 May 2018
4,000	30 March 2018
3,000	1 November 2018
2,000	5 March 2018

International Fund for Agricultural Development (IFAD)

Principal (in EUR thousands)	Maturity date
1,067	8 February 2018
554	25 December 2020

Fondation for sustainable development – OdRaz

Principal (in EUR thousands)	Maturity date
13,000	1 December 2022

The Republic of Srpska Investment-Development Bank

Principal (in EUR thousands)	Maturity date
10,400	1 June 2022

The European Fund for Southeast Europe (EFSE)

Principal (in EUR thousands)	Maturity date
2,500	22 March 2017

25. Subordinated debt

	2017	2016
Subordinated debt	8,806	8,805
	8,806	**8,805**

A subordinated loan agreement was signed between the Bank and ProCredit Holding AG on 31 August 2005. The amendments to the subordinated loan agreement were signed between the Bank and ProCredit Holding AG on 7 February 2013. The loan bears interest at 6m EURIBOR + 6.9% p.a. The amendments to the subordinated loan agreement were signed between the Bank and ProCredit Holding AG 30 December 2015. The loan bears interest at 6m EURIBOR + 6.75% p.a. The loan shall expire on 30 December 2022 and is repayable upon maturity. The amendments to the subordinated loan agreement were signed between the Bank and ProCredit Holding AG 16 December 2017. The loan bears interest at 6m EURIBOR + 5.88% p.a. The loan shall expire on 30 December 2027 and is repayable upon maturity.

The Bank has not had any defaults of principal or interest, or other breaches with respect to its subordinated debt.

26. Provisions

	31 December 2017	31 December 2016

Provisions for contingencies and commitments	262	278
Provisions for long term employee benefits	192	214
Provisions for court cases	181	-
	635	**492**

Movement in provisions for contingencies and commitments is as follows:

	2017	**2016**
Balance at 1 January	*278*	*259*
Net charge to profit or loss (Note 15)	-	19
Net release to profit or loss (Note 13)	(16)	-
Balance at 31 December	**262**	**278**

Movement in provisions for long term employee benefits and court cases is as follows:

	2017	**2016**
Balance at 1 January	*214*	*454*
Net charge to profit or loss (Note 15)	181	10
Net release to profit or loss (Note 13)	(22)	(250)
Balance at 31 December	**373**	**214**

27. Other liabilities

	31 December 2017	**31 December 2016**
Accruals	311	323
Credit card payables	296	274
Other liabilities to governments	92	46
Liabilities to suppliers	56	178
Liabilities to private entities	23	6
Other	186	182
	964	**1,009**

28. Share capital

	Ordinary shares	
	2017	**2016**
On issue at 1 January	*63,303*	*63,303*
New shares issued	3,912	-
At 31 December	**67,215**	**63,303**

The Bank's share capital consists of 6.721.483 ordinary shares (2016: 6.330.317). All shares have a par value of BAM 10 and are fully paid.

During 2017 the bank issued additional 3.912 shares with payment amounting to BAM 3,912 thousand.

Share premium represents the excess of paid-in amount over the nominal value of the issued shares.

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29. Commitments and contingencies

The following table indicates the contractual amounts of the Bank's contingencies and commitments by category:

	31 December 2017	31 December 2016
Guarantees		
- in domestic currency	27,644	26,071
- in foreign currency	14,061	13,820
Letters of credit	265	896
Unused credit lines	29,325	32,747
	71,295	**73,534**
Provision for contingencies and commitments:	(262)	(278)
	71.033	**73.256**

Movement in commitments and contingent liabilities is as follows:

	2017	2016
Balance at 1 January	*278*	*259*
Net (release)/charge	(16)	19
Balance at 31 December	**262**	**278**

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30. Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and borrowings.

These transactions were carried out on commercial terms and at market rates. The volumes of related party transactions and outstanding balances at year-end are as follows:

Related party transactions for 2017:

	ProCredit Holding	ProCredit Bank AG Frankfurt	Bank's management	Bank's Management close family members	Total
Deposits					
Balance at beginning of year	-	-	82	35	117
Deposits received during the year	-	-	472	58	530
Deposits repaid during the year	-	-	(528)	(63)	(591)
Balance at 31 December	**-**	**-**	**26**	**30**	**56**
Borrowings					
Loans outstanding at 1 January	**23,735**	**9,586**	**-**	**9**	**33,330**
Loans issued during the year	44,590	26,545	-	-	**71,135**
Loans repayments during the year	(6,226)	(2,962)	-	(4)	**(9,192)**
Balance at 31 December	**62,099**	**33,169**	**-**	**5**	**95,273**
Interest expense on borrowings	1,159	140	-	-	**1,299**
Increase and decrease of share capital					
Balance as at 1 January	63,303	-	-	-	**63,303**
Capital increase during the year	3,912	-	-	-	**3,912**
Balance at 31 December	**68,374**	**140**	-	-	**68,514**
Consulting fee [1]	736		-	-	**736**

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30. Related party transactions (continued)

Related party transactions for 2016:

	ProCredit Holding	ProCredit Bank AG Frankfurt	Bank's management	Bank's Management close family members	Total
Deposits					
Balance at beginning of year	-	-	74	58	132
Deposits received during the year	-	-	808	54	862
Deposits repaid during the year	-	-	(800)	(77)	(877)
Balance at 31 December	**-**	**-**	**82**	**35**	**117**
Borrowings					
Loans outstanding at 1 January	**28,836**	**-**	**-**	**-**	**28,836**
Loans issued during the year	1,388	9,584	-	-	10,972
Loans repayments during the year	(6,489)	-	-	-	(6,489)
Balance at 31 December	**23,735**	**9,584**	**-**	**-**	**33,319**
Interest expense on borrowings	1,388	-	-	-	**1,388**
Increase and decrease of share capital					
Balance as at 1 January	63,303	-	-	-	**63,303**
Capital increase during the year	-	-	-	-	**-**
Balance at 31 December	**64,691**		-	-	**64,691**
Consulting fee [1]	811		-	-	**811**

[1] Consulting fee relates to management fees for providing management services and support without VAT.

Key management compensation

During the reporting period, the total gross fee paid to the Management of the Bank is as follows:

	2017	2016
Salaries and other short-term benefits	333	348
Other long-term employee benefits	-	-
	333	**348**

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31. Net debt reconciliation

The table below presents an analysis of our debt and the movement of liabilities for borrowings and subordinated debt during 2016 and 2017. Debt items are those presented in the financial activities of the cash flow statement.

	Liabilities from financial activities		
	Borrowings	**Subordinated debt**	**Total**
Net debt as at 31 December 2015	83,397	8,998	92,395
Net repayments	(12,605)	(193)	(12,798)
Net debt as at 31 December 2016	70,792	8,805	79,597
Net proceeds	69,688	1	69,689
Net debt as at 31 December 2017	**140,480**	**8,806**	**149,286**

32. Events after the reporting period date

After the reporting period date and until date of signing these financial statements, there were no significant events that would require adjustment or disclosure in the financial statements.