ProCredit Bank

Annual Report 2019

Contents:

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

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

The Management Board is responsible for the submission to the Supervisory Board of its annual financial statements, following which the Supervisory Board and the General Assembly is required to approve the financial statements.

The financial statements set out on pages 10 to 94 were authorised by the Management Board on 30 May 2020 for issue to the Supervisory Board, and are signed bellow to signify this, on behalf of the Bank, by:

For and on the behalf of Management Board

President of the Management Board

Amir Salkanović

Member of Management Board

Amina Durmo Trlin

ProCredit Bank d.d. Sarajevo

3

Sarajevo

ProCredit Bank d.d. Sarajevo

Franca Lehara bb

71000 Sarajevo

Bosna i Hercegovina

30 May 2020.

Independent Auditors' report

To the shareholders of ProCredit Bank d.d. Sarajevo

Opinion

We have audited the financial statements of ProCredit Bank d.d. Sarajevo ("the Bank"), which comprise the statement of financial position as at 31 December 2019, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2019 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

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 *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (*IESBA Code*) together with the ethical requirements that are relevant to our audit of the financial statements in Federation of Bosnia and Herzegovina, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements of the Bank for the year ended 31 December 2018, were audited by another auditor who expressed an unmodified opinion on those financial statements on 31 May 2019.

Independent Auditors' report
To the shareholders of ProCredit Bank d.d. Sarajevo *(continued)*

Key Audit Matters

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

Impairment of loans and receivables from customers

As at 31 December 2019, gross loans and receivables amounted to BAM 411 million, impairment allowance amounted to BAM 13 million and impairment loss recognised in the income statement amounted to BAM 0.6 million (31 December 2018: gross loans and receivables: BAM 379 million, impairment allowance: BAM 14 million and release of impairment recognised in the income statement: BAM 0.7 million).

Refer to Note 3 Significant accounting policies, Note 4 Critical accounting judgements and key sources of estimation uncertainty, Note 19 Loans and receivables to customers, and Note 5.1 Credit risk.

Key audit matter	How our audit addressed the matter
Impairment allowances represent Management Board's best estimate of the expected credit losses ("ECL") within the loans and receivables from customers at the reporting date. We focused on this area as the determination of impairment allowances requires a significant amount of judgment from the Management over both the timing of recognition and the amounts of any such impairment. The ECL model of the Bank is based on the requirements of IFRS 9 *Financial Instruments*, that uses a dual-measurement approach, under which the impairment allowance is measured as either 12-month or life time expected credit losses, depending on whether there has been a significant increase in credit risk.	Our audit procedures in this area included, among others: • Inspecting the Bank's ECL impairment provisioning methodology and assessing its compliance with the relevant requirements of the financial instruments standard (IFRS 9). As part of the above, we challenged the Management Board on whether the level of the methodology's sophistication is appropriate based on an assessment of the entity-level and portfolio-level factors; • Making relevant inquiries of the Bank's risk management and information technology (IT) personnel in order to obtain an understanding of the provisioning process, IT applications used therein, key data sources and assumptions used in the ECL model. Also, assisted by our own IT specialists, assessing and testing of the Bank's IT control environment for data security and access; • Testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans, including, but not limited to, the controls relating to the identification of significant increase in credit risk, loss events and default, appropriateness of the classification of exposures into performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the impairment allowances;

This version of the Auditors' report is a translation from the original, which was prepared in Bosnian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over translation..

Independent Auditors' report
To the shareholders of ProCredit Bank d.d. Sarajevo *(continued)*

Key Audit Matters (continued)

Key audit matter	How our audit addressed the matter *(continued)*
The impairment allowances for majority of the exposures (Stage 1, Stage 2 and Stage 3 below EUR 50 thousand (together "collective impairment allowance") are determined by modelling techniques relying on key parameters as probability of default (PD) and loss given default (LGD), taking into account historical experience, identification of exposures with a significant deterioration in credit quality and forward-looking information . Expected credit losses for individually significant exposures (above EUR 50 thousand) non performing exposures are determined on an individual basis by means of a discounted cash flows analysis. The process involves subjectivity and reliance on a number of significant assumptions, including those in respect of the probable sale proceeds from the related collateral and the minimum period for collateral disposal. For the above reasons, impairment of loans and receivables from customers was considered by us to be a significant risk in our audit, which required our increased attention. Accordingly, we considered this area to be our key audit matter.	— For loss allowances calculated on a collective basis and with the assistance of our own financial risk management specialist: • Testing accuracy of input data used for establishing risk parameters (PD, LGD, full and partial prepayment factors, exposure at default (EAD)) and obtaining explanations for exceptions, where necessary. • Evaluating the overall modelling approach of calculation of ECLs, including the calculation of main risk parameters (PD, LGD, full and partial prepayment factors and EAD) and macroeconomic factors. • Challenging the approach and independent recalculation of PD, LGD and prepayments factors used by the Bank (including macroeconomic factors incorporated into the ECL model), and EAD parameters by reference to individual client contracts and repayment schedules for a sample of exposures. • On a sample basis independently recalculating the amount of ECL, using the above estimated LGDs, PDs and prepayment factors and reconciling it with actual ECL recognized. — For a risk-based sample of loans and receivables: • critically assessing the existence of any triggers for classification to Stage 2 or Stage 3 as at 31 December 2019, by reference to the underlying documentation (loan files) and through inquiries of the loan officers and credit risk management personnel; • for individually significant exposures classified in Stage 3, challenging key assumptions applied in the Management Board's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral values and realization period by reference to loan files and market rates or by performing respective independent recalculations, assisted by our own valuation specialists, where relevant. — Assessing the accuracy and completeness of the impairment-related disclosures with the requirements of relevant financial reporting standards.

Key Audit Matters (continued)

Going concern considerations related to COVID-19

Refer to note 2.5 Going concern and note 34. Events after the reporting date which specifically addressed the uncertainties related to the COVID 19 outbreak.

Key audit matter	How our audit addressed the matter *(continued)*
The Bank's financial statements are prepared on a going concern basis. In 2019, the Bank reported a net loss in the amount of BAM 1,559 thousand (2018: net profit of BAM 49 thousand), and as at 31 December 2019 had accumulated losses of BAM 22,542 thousand (31 December 2018: accumulated losses of BAM 20,983 thousand). Due to the losses reported in priod years, the Bank has received several capital injections from the majority shareholder in order to maintain its capital adequacy ratio at least at the minimum level required by the Federal Banking Agency ("FBA"). As disclosed in Note 5.5, the Bank's total capital adequacy ratio as at 31 December 2019 amounted to 15.0%. Although the ratio is above the FBA's minimum prescribed level, potential future losses without adequate capital support may erode the capital base. In addition, the World Health Organization declared on 11 March 2020 the coronavirus (COVID-19) outbreak a pandemic. The measures taken by the Government of BiH (at all levels) to counter the effects of the outbreak include border closures, quarantine, severe limitations imposed on cross-border and domestic transportation, ban on social, cultural, leisure or sport events, among other things. As a consequence, the Bank expects that the circumstances may result in higher level of defaults and decrease in interest income, with effects on the Bank's liquidity and capital adequacy. In the wake of the above facts and circumstances, the Management Board performed a reassessment of whether the Bank would have sufficient resources and adequate capital to continue as a going concern for a period of at least 12 months from the reporting date.	Our audit procedures in this area included, among others: • Inspecting the Management Board's assessment of the going concern basis of accounting, including their evaluation of the business/operating and liquidity risks arising from the COVID-19 outbreak, and plans for further actions in response to the risks identified. As part of the procedure we also made corroborating inquiries of the Bank's CEO and CRO; • Analyzing the Bank's capital adequacy position (in particular, the minimum capital requirement), inquiring of the Management Board regarding their alternative plans for future actions in relation to the going concern assessment; • Comparing the Bank's profit and loss and cash flows forecasts for the current and previous years to the current year's outcomes to assess the quality of the Management Board's forecasting process; • Evaluating the Bank's analysis of COVID-19-related sources of risk for the Bank's business and financial resources, including potential negative effect of the spread of COVID-19 on Bank's credit portfolio, as compared with our own understanding of the risks. We considered Management Board's plans to take action to mitigate the risks; • Considering the above procedures, challenging the Bank's financial performance and cash flow forecasts provided to us in support of the management's use of the going concern basis of accounting, by assessing the planned measures to be implemented by the Bank; specifically challenging the key assumptions and judgements with most significant impact on these forecasts, including, among others: — forecast of interest and similar income; — expected loan impairment losses; — capital adequacy position; — availability of additional funding

Key Audit Matters (continued)

Key audit matter	How our audit addressed the matter *(continued)*
The Bank's going concern assessment was based on analysis of profit and loss forecasts, as well as liquidity projections and capital adequacy. The preparation thereof incorporated a number of complex assumptions and required the Management Board to apply significant judgment. As part of the assessment, the Bank also considered a number of actions aimed at alleviating the potential disruption to its business and liquidity position, such as FBA and BiH Government measures. The Management Board concluded that the range of possible outcomes considered at arriving at this judgment does not give rise to material uncertainties related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. Note 34 to the financial statements further explains how the judgment was formed by the Management Board. The COVID-19 pandemic is an unprecedented challenge for humanity and for the economy globally, and at the date of the financial statements its effects are subject to significant levels of uncertainty. The Bank's use of the going concern basis of accounting is a key audit matter due to the associated extent of uncertainty, and consequently, high level of judgment required in evaluating the Management Board's plans for future actions and their financial impact.	• Performing an analysis of the going concern conclusion's sensitivity to changes in the aforementioned key assumptions adopted in the going concern assessment, and considering whether there were any indicators of management bias in the assessment; • Evaluating the appropriateness of Bank's disclosures in respect of the going concern assessment, subsequent events and any related uncertainties in the financial statements.

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

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

Independent Auditors' report
To the shareholders of ProCredit Bank d.d. Sarajevo *(continued)*

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

- Identify and 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 auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is Vedran Vukotić.

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

Registered Auditors

Zmaja od Bosne 7-7A
71000 Sarajevo

30 May 2020

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

This version of the Auditors' report is a translation from the original, which was prepared in Bosnian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over translation.

Statement of profit or loss for the year ended 31 December 2019
(all amounts are expressed in thousands of BAM, unless otherwise stated)

	Notes	**2019**	**2018**
Interest income calculated using the effective interest method	*7*	15,213	15,161
Other interest income	*7*	87	187
Interest expense	*8*	(5,621)	(5,308)
Net interest income		**9,679**	**10,040**
Fee and commission income	*9*	6,047	5,765
Fee and commission expense	*10*	(1,717)	(1,716)
Net fee and commission income		**4,330**	**4,049**
Net income from foreign currency trading	*11*	853	623
Other operating income	*12*	697	244
Net operating income		**15,559**	**14,956**
Administrative expenses	*13*	(8,056)	(8,221)
Personnel expenses	*14*	(5,146)	(5,157)
Depreciation and amortisation	*20,21,22*	(1,562)	(1,319)
Other operating expenses	*15*	(1,588)	(1,045)
Operating expenses		**(16,352)**	**(15,742)**
Profit/(Loss) before impairment losses and income tax		**(793)**	**(786)**
Impairment losses, net	*16*	(692)	920
		(692)	**920**
PROFIT /(LOSS) BEFORE TAX		**(1,485)**	**134**
Income tax expense	*17*	(74)	(85)
NET LOSS / PROFIT FOR THE PERIOD		**(1,559)**	**49**
(Loss)/Earnings per share (BAM)	*31*	**(0,22)**	**0,01**

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

Statement of other comprehensive income for the year ended 31 December 2019
(all amounts are expressed in thousands of BAM, unless otherwise stated)

	Notes	2019	2018
Net (loss) / profit for the period		**(1,559)**	**49**
Other comprehensive income		-	-
Total other comprehensive income		-	-
TOTAL COMPREHENSIVE (LOSS) / INCOME FOR THE YEAR		(1,559)	49

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

Statement of financial position as at 31 December 2019
(all amounts are expressed in thousands of BAM, unless otherwise stated)

	Notes	31 December 2019	31 December 2018
ASSETS			
Cash and cash equivalents	*18*	88,246	72,750
Obligatory reserves at the Central Bank of BiH	*18*	47,047	40,299
Loans and receivables to customers	*19*	398,254	364,866
Investment securities		43	43
Current tax assets		236	195
Investment property	*20*	1,681	-
Property and equipment	*21*	12,967	13,675
Intangible assets	*22*	985	1,348
Deferred tax assets	*17*	80	109
Other assets and receivables	*23*	3,444	6,374
TOTAL ASSETS		**552,983**	**499,659**
LIABILITIES			
Liabilities to banks	*24*	39,180	41,058
Liabilities to other financial institutions	*25*	169,842	141,805
Liabilities to customers	*26*	282,167	255,800
Subordinated debt	*27*	8,804	8,803
Provisions for liabilities and charges	*28*	818	619
Other liabilities	*29*	3,067	910
TOTAL LIABILITIES		**503,878**	**448,995**
EQUITY AND RESERVES			
Share capital	*30*	71,126	71,126
Share premium		293	293
Statutory reserves		228	228
Accumulated losses		(22,542)	(20,983)
TOTAL EQUITY AND RESERVES		**49,105**	**50,664**
TOTAL LIABILITIES, EQUITY AND RESERVES		**552,983**	**499,659**

The accompanying notes form an integral part of these financial statement

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

	Notes	31 December 2019	31 December 2018
CASH FLOW FROM OPERATING ACTIVITIES			
Net profit/(loss) before taxr		(1,485)	134
Adjustments for:			
Depreciation and amortisation		1,562	1,319
Impairment losses, net		692	(920)
Net gain from sale of property and equipments		(5)	(130)
Net loss from writte off of property and equipment		1	60
Net change in provisions for liabilities and charges		259	82
Net (gain)/loss from sale of repossessed assets		(380)	(30)
Impairement allowance for repossessed assets		578	118
Net interest income		(9,679)	(10,040)
		(8,457)	**(9,407)**
Changes in operating assets and liabilities:			
Net change in obligatory reserves with CBBH		(6,846)	(5,294)
Net change in loans and receivables, before impairment		(34,160)	(37,346)
Net change in other assests and receivables, before impairment		2,740	(4,606)
Net change in liabilities to customers		26,387	9,347
Net change in other liabilities		488	(56)
Paid income tax		(86)	-
Received interest		15,141	15,093
Paid interest		(5,006)	(5,052)
NET CASH FLOW USED / (REALISED) IN OPERATING ACTIVITIES		**(9,799)**	**(37,321)**
CASH FLOW FROM INVESTING ACTIVITIES			
Purchase of property and equipment		(161)	(148)
Proceeds from property and equipment sold		11	135
NET CASH FLOW USED IN FINANCING ACTIVITIES		**(150)**	**(13)**
FINANCING ACTIVITIES			
Proceeds from liabilities to banks and other financial institutions		42,997	61,678
Repayments of liabilities to banks and other financial institutions		(17,138)	(19,297)
Lease liabilities paid		(414)	-
Increase in share capital		-	3,912
NET CASH FLOW USED IN FINANCING ACTIVITIES		**25,446**	**46,293**
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS		**15,496**	**8,959**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	*18*	**72,750**	**63,791**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	*18*	**88,246**	**72,750**

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

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

	Share capital	Share premium	Statutory eserves	Regulatory reserves for loan losses	(Accumulated losses)	Total
Balance as at 31 December 2019	**71,126**	**293**	**228**	**-**	**(20,983)**	**50,664**
Net loss for the period	-	-	-	-	(1,559)	(1,559)
Other comprehensive income						
Other comprehensive income	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	-	-
Balance as at 31 December 2019	71,126	293	228	-	(22,542)	49,105

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

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

	Share capital	Share premium	Statutory reserves	Regulatory reserves for loan losses	(Accumulated losses)	Total
Balance as at 1 January 2018	**67,215**	**293**	**228**	**864**	**(21,850)**	**46,750**
Transfer of regulatory reserves for loan losses to accumulated losses*				(864)	818	(46)
Net profit for the period	-	-	-	-	49	49
Increase in share capital	3,911	-	-	-	-	3,911
Other comprehensive income						
Other comprehensive income	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	-	-
Balance as at 31 December 2018	**71,126**	**293**	**228**	-	**(20,983)**	**50,664**

* Transfer of regulatory reserve for loan losses to accumulated losses base on the Decison on terms for inclusion of formed regulatory reserves for loan lossess in Common Equity Tier 1 of the bank published by the Banking Agency of FBiH on 8 November 2018.

The accompanying notes form an integral part of these financial statements

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

1. REPORTING ENTITY

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 Bank's registered address is in Sarajevo, Franca Lehara bb, Bosnia and Herzegovina. As at 31 December 2019 the Bank had 139 employees (31 December 2018: 147 employees).

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
Sarajevo, Franca Lehara bb
Mostar, Biskupa Čule bb
Banja Luka, Prvog krajiškog korpusa 54

Service Points
Sarajevo, Ilidža, Ibrahima Ljubovića 20
Bijeljina, Majevička 102
Tuzla, Aleje Alije Izetbegovića 2

The Supervisory Board, Management Board and Audit Committee

During 2019 and on the date of this report, the members of the Supervisory Board were:

Supervisory Board

Gian Marco Felice	Chairman since 31 May 2019
Borislav Kostadinov	Chairman until 31 May 2019
Igor Anić	Deputy Chairman
Wolfgang Bertelsmeier	Member
Aida Soko	Member
Natia Tkhilaishvili	Member

During 2019 and on the date of this report, the members of the Audit Committee were:

Audit Committee

Violeta Ivanković	Chairman
Vesna Paunovska Petroska	Member
Rumyana Velichkova Todorova	Member

During 2019 and on the date of this report, the members of Management Boand were:

Management Board

Amir Salkanović	Chairman since 8 November 2019
Edin Hrnjica	Chairman until 8 November 2019
Amina Durmo - Trlin	Member since 8 November 2019
Amel Agić	Member until 8 November 2019
Vladimir Rajić	Member

2. BASIS OF PREPARATION

2.1. Statement of compliance

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

These financial statements were authorised by the Management Board on 30 May 2020 for submission to the Supervisory Board.

This is the first set of the Bank's financial statements in which of International Financial Reporting Standard 16 „*Leases*" has been applied. The related changes to significant accounting policies are described in Note 2.6.

2.2. Basis for measurement

These financial statements have been prepared on the historical or amortised cost basis.

2.3. Functional and presentation currency

These financial statements are presented are presented in Bosnian Marks ("BAM"), which is the Bank's functional and presentation currency, rounded to the nearest thousand . Bosnian Mark is pegged to Euro (1 EUR = 1.95583 BAM).

2.4. Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Although these judgements and estimates are based on management's best knowledge of current events and conditions, actual results may differ from those estimates.

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

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

2.5 Going concern

As presented in the financial statements, the Bank incurred net loss for the year ended 31 December 2019 in the amount of BAM 1.559 thousand (31 December 2018: net gain BAM 49 thousand). Management has prepared the 5-year business plan, adopted by the Supervisory Board on 6 December 2018, anticipating the reasonable growth of loan portfolio, interest income and deposit basis over the period 2019-2023. Initially, the Management expected the operations to become profitable in the year ending 31 December 2020 however this may change due to the effects of COVID 19. Neverthless the Bank will still continue to be compliant with the regulatory requirements. Increase in share capital, in the amount of BAM 3,900 million has alredy been initiated in December 2019 (currently registration is pending completion of legaly prescribed procedures) which will additionally improve and strengthen the Bank's capital adequacy. The Bank has also initiated a process of transferring subordinated debt to equity, in the amount of BAM 8,004 million, which is expected to be finalised in 2020 (together with registration of increase in share capital).

Based on the above, these financial statements have been prepared under a going concern assumption, which means that the Bank will be able to realize its receivables and settle liabilities in the ordinary course of business.

2. BASIS OF PREPARATION *(continued)*

2.6. Changes in significant accounting policies

International Financial Reporting Standard 16 "*Leases*" ("IFRS 16) has been published in January 2016 which replaces International Financial Accounting Standard 17 "*Leases*" (IAS 17). The standard eliminates an existing model of dual accounting for leases and instead it requires from business entities to report most of the leases in the statement of financial position using the single model, eliminating the differences between operating and financial leases.

The Bank applied IFRS 16 using a modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings at 1 January 2019. Accordingly, the comparative information presented for 2018 is not restated – i.e. it is presented, as previously reported, under IAS 17 and related interpretations. At initial recognition at 1 January 2019 the amount of right-of-use asset equals to the amount of the lease liability, so there was no one-off effect on the initial balance of retained earning. The details of the changes in accounting policies are disclosed below. Additionaly, the disclosure requirements in IFRS 16 have not generally been applied to comparative information.

I. Definition of lease

Previously, the Bank determined at contract inception whether an arrangement is or containes a lease under previous requirements of the standard. The Bank now assesses whether a contract is or contains a lease based on the definition of a lease, as explained in Note 3.5.

On transition to IFRS 16, the Bank elected to apply the allowed simplifications in the assessment of the leases and used a possibility of maintaining the lease definition when switching to a new standard. This means that it used the possibility of keeping the lease definition on transition to the new standard. This means that Bank has applied IFRS 16 on contracts which have already been previously identified as leases in accordance to IAS 17 and IFRIC 4 and has not performend reassessment on whether there is as leases under IFRS 16.

II. As a lessee

As a lessee, the Bank leases assets such as business premise and equipment. The Bank previously classified these leases as operating leases under IAS 17 based on its assessment of whether the lease transferred significantly all of the risks and rewards incidental to ownership of the underlying asset to the Bank. Under IFRS 16, the Bank recognises right-of-use assets and lease liabilities for most of these leases – i.e. these leases are on-balance sheet.

At commencement or on modification of a contract that contains a lease component, the Bank allocates the consideration in the contract to each lease component on the basis of its relative stand-alone prices.

On transition, for these leases, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Bank's incremental borrowing rate as at 1 January 2019.

Right-of-use assets are measured at an amount equal to the lease liability, adjusted by the amount of any prepaid lease payments.

The Bank has tested its right-of-use assets for impairment on the date of transition and has concluded that there is no indication that the right-of-use assets are impaired.

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

2. BASIS OF PREPARATION *(continued)*

2.6. Changes in significant accounting policies *(continued)*

The Bank used a number of practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17. In particular, tha Bank uses following exemptions:

- did not recognise right-of-use assets and liabilities for leases of low value assets;
- did not recognise right-of-use assets and liabilities for leases for which the lease term ends within 12 months of the date of initial application;
- excluded initial direct costs from the measurement of the right-of-use asset at the date of initial application; and
- used subsequent knowledge in determination the lease term.

III. As a lessor

At the transition date the Bank did not have any lease contact as a lessor.

IV. Impact on financial statements

On transition to IFRS 16, the Bank recognised additional right of use assets and additioanl lease liabilities. Right-of-use assets was recognised in the amount equal to the lease liabilities, and therefore the application of IFRS 16 had no effect on the opening balance of retained earnings as at 1 January 2019. Effects of the transition on the right – of – use assets have been shown Note 21 *Property and equipment* and for lease liabilites in Note 29 *Other liabilities and payables.*

The impact on transitin is summarised below:

in BAM'000	**As at 1 January 2019**
Right-of-use assets	2,307
Lease liabilities	2,307

When measuring lease liabilities for leases that were classified as operating lease. the Bank discounted lease payments using its incremental borrowing rate at 1 January 2019 of 3.95% for other equipment and 3.65% for business premises.

in BAM'000	
Operating lease commitment as of 31 December 2018 as disclosed in the Bank's financial statements	2,690
Recognition exemption for:	
short-term leases	(22)
leases of low-value assets	(74)
Undiscounted lease liability	2,594
Discounted at incremental borrowing rate as of 1 January 2019	2,307
Lease liabilities recognised as of 1 January 2019	**2,307**

3. SIGNIFICANT ACCOUNTING POLICIES

Except for the previously described changes in Note 2.5, the Bank has consistently applied the accounting policies further described below to all periods disclosed in these financial statements.

3.1 Foreign currency transactions

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

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

	31.12.2019	31.12.2018
USD	1.74799	1.70755
EUR	1.95583	1.95583

3.2. Interest income and expense

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest rate method. The "effective interest rate" is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- gross carrying amount of the financial asset; or
- the amortized costs of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instruments, but not expected credit loss ("ECL"). For purchased or originated credit impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

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

Amortised cost and gross carrying value

The amortised cost of a financial asset or a financial liability is the amount at which the financial assets or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

"Gross carrying amount of financial assets" is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

3. SIGNIFICANT ACCOUNTING POLICIES

3.2. Interest income and expense *(continued)*

Calculation of interest income and expense

Effective interest rate on a financial asset or financial liability is calculated on initial recognition of a financial asset or liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect the movements in market rates of interest.

However, for financial assets that have been credit-impaired subsequently to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of financial assets. If the asset is no longer credit-impaired, the calculation of interest income returns to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate on the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

3.3. Fee and commission income and expenses

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

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

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognizes revenue when it transfers controls over a service to a customer.

The table below shows the nature and timing of the satisfaction of performance obligation, including significant payment terms and related revenue recognition policies.

Type of service	Nature and timing of satisfaction of performance obligations, including significant payment terms	Revenue recognition under IFRS 15
Private and business clients banking service	The Bank provides banking services to private and business customers, including account management, provision of overdraft facilities, foreign currency transactions, credit card and servicing fees. Fees for ongoing account management are charged to the customer's account on a monthly basis. The Bank sets the rates separately for private and business banking customers on an annual basis. Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place. Servicing fees are charged on a monthly basis and are based on fixed rates reviewed annually by the Bank.	Revenue from account service and servicing fees is recognised over time as the services are provided. Revenue related to transactions is recognised at the point in time when the transaction takes place.

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.4. Net income from foreign currency trading

Gains less losses from foreign exchange trading include unrealized and realized gains and losses from foreign exchange spot transactions.

3.5. Leases

The Bank has applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17 and IFRIC 14. The details of accounting policies under IAS 17 and IFRIC 14 are disclosed separately.

Policy applicable from 1 January 2019

At inception of a contract, the Bank assesses whether a contact is, or contains, a lease. A contract is, or contains a lease, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Bank uses the definiton of a lease in accordance with IFRS 16.

This policy is applied to the contracts entered into on or after 1 January 2019.

i) As a lessee

The Bank recognizes right-of-use asset and a lease liabiliy from the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to business premises. The lessee incurs a liability for these costs at commencement date of the lease or as a result of the use of the relevant property over a specified period.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term, or over the period for which the lease is expected to be active. In addition, right-of-use asset is periodicaly reduced by impairment losses, if any and adjusted for any remeasruement of lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate. The Bank determines the incremental borrowing rate as an interest rate paid to borrow funds (determined as the interest rate that the Bank would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions).

After the lease commencement date, the lessee measures the lease liability at amortised cost using the effective interest method in order to: (i) increase the carrying amount of the lease to reflect interest on the lease liability; (ii) decrease the lease's carrying amount for the lease payments made; and (iii) remeasure the carrying amount of the lease to reflect the reassessment or modification of the lease, or to reflect modified lease payments that are substantially fixed.

The reassessment of the lease liability should reflect changes made to the lease payment. Lease payments are modified when there are: (i) changes in amounts expected to be payable under the residual value guarantee; (ii) change in future lease payments based on change in index or rate unless a variable interest rate is applied. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Bank presents right-of-use assets in '*Property and equipment*' and lease liabilities in '*Other liabilities*' in the statement of financial position.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.5. Leases *(continued)*

Short-term leases and leases of law value

The Bank has elected not to recognise right-of-use assets and lease liabilities to leases of low-value assets and short-term leases. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

ii) As a lessor

Generally, accounting policies of the Bank as a lessor do not differ significantly from the requirements of IFRS 16. The Bank only entered into lease contracts as a lessor in 2019.

The Bank recognises lease payments received under operating leases as income on a straightline basis over the lease term.

Policy applicable before 1 January 2019

i) As a lessee

In the comparative period, as a lessee, the Bank classified leases that transferred substantially all of the risks and rewards of ownership as finance leases. When this was the case, the leased assets were measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Minimum lease payments were the payments over the lease term that the lessee was required to make, excluding any contingent rent. Subsequent to initial recognition, the assets were accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases were classified as operating leases and were not recognised in the Bank's statement of financial position. Payments made under operating leases were recognised in profit or loss on a straight-line basis over the term of the lease.

3.6. Income tax

Tax expense, on income tax base, is the sum of current tax liabilities and deferred taxes.

Current income tax

Net income differs from taxable income of the period reported in income statement and statement of comprehensive income, as it includes items of income and expense that are taxable or non-taxable in other years, as well as items that are never taxable or are deductible. The Bank's current tax liabilities are calculated by applying tax rates that are in effect or in the process of being adopted at the reporting date.

Deferred income tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.7. Financial assets and liabilities

Recognition and initial measurement

The Bank initially recognises loans and advances, deposits, debt securities and subordinated liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus any transaction costs that are directly attributable to its acquisition or issue, except for financial assets and liabilities at fair value through profit and loss.

3.7.1 Financial assets

(i) Classification and subsequent measurement

The Bank classifies its financial assets based on their underlying business model (ie. the purpose of managing financial assets) and the contractual cash flows characteristic ("Solely Payments of Principle and Interest", further "SPPI test" or "SPPI") in the following measurement categories:

- Financial assets measured at amortised cost
- Financial assets measured at fair value through other comprehensive income (FVOCI)
- Financial assets at fair value through profit and loss (FVPL)

The classification requirements for debt and equity instruments are described below.

Business model assessment

Differentiation is made between the following business models:

- "hold to collect": The financial assets are held with the aim of collecting the contractual cash flows .
- "hold to collect and sell": The financial assets are held with the aim of both collecting the contractual cash flows and selling the financial assets, and
- "other": This business model is used for financial assets that are neither allocated to the 'hold to collect' business model nor to the 'hold to collect and sell' business model.

The Bank makes an assessment of the objective of a business model in which the asset is held at the portfolio level (ie. on the basis of a group of financial assets) because this best reflects the way the business is managed and information is provided to the management. The following criteria, among others are taken into account:

- The business and risk strategy of the Bank.
- The way in which the development of the business model is evaluated and reported to the Management and Supervisory Board of the Bank, and
- If there were sales in previous period, the frequency, volume, timing and reasons for those sales as well as expectations regarding future sales activities.

As a result, the balance sheet items allocated to the 'hold to collect' business model are: "Central bank balance", "Current accounts with other banks", "Loans and advances to customers" and "Other assets". "Investment securities" are allocated to the "hold to collect and sell" business model.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.7. Financial assets and liabilities *(continued)*

3.7.1 Financial assets *(continued)*

(i) Classification and subsequent measurement (continued)

Assessment of whether contractual cash flows are solely payments of principal and interest (SPPI)

Test of features of contractual cash flows from the point of view of solely payment of principal and interest is one of the criteria for the classification of financial assets in an individual category of measurement. SPPI test is implemented for the purpose of establishing whether the interest rate on unsettled principle reflects the fee for time value of money, credit risk and other basic risks of borrowing, lending costs and profit margin.

SPPI test is performed:

- for each financial asset, allocated to a business model whose purpose is to hold financial assets for the payment of contractual cash flows and a business model for the purpose of collecting contractual cash flows and selling financial asset on the date of its initial recognition,
- for each financial asset in cases where the original asset has been significantly modified and therefore re-recognised as new assets,
- when introducing new models and/or loan programs to determine in advance the eligibility of the considered loan term and conditions in relation to the need to subsequently monitor the value of any financial assets that would arise from them.

Equity instruments have contractual cash flows that do not meet the SPPI criterion. The Bank designates its equity instuments at fair value through other comprehensive income.

- **Financial assets at amortised cost**

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ("SPPI"), and that are not designated at fair value through profit and loss, are measured at amortized cost.

After initial recognition, the carrying amount of these assets is adjusted by any expected credit loss (ECL) allowance recognised and measured as described in Note 5.1.1.

Interest income is calculated using the effective interest rate and it is included in the line „Interest income calculated using the effective interest rate method".

Financial assets at amortised cost at the balance sheet date include: cash and cash equivalents, obligatory reserves at the Central Bank of BiH, loans and receivables to customers and other assets.

- **Financial assets through other comprehensive income**

Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at fair value through profit and loss, are measured at fair value through other comprehensive income.

Measurements in fair value of a financial asset measured through other comprehensive income are recognised through other comprehensive income except for recognition of gains or losses on impairment, interest income and foreign exchange differences that are recognised in profit or loss, except in case of equity investments where unrealised gains/losses are never reclassified to profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.7. Financial assets and liabilities *(continued)*

3.7.1. Financial assets *(continued)*

When the financial asset through other comprehensive income is derecognised, the cumulative gain or loss previously recognised through other comprehensive income is reclassified from equity to income statement, except for equity investments for which gains and losses are not recycled to profit or loss statement but directly transferred to retained earnings Interest income is calculated using the effective interest rate method.

At the balance sheet date, the Bank did not hold any debt instrumetns classified as financial assets at fair value through other comprehensive income. Investment securities include equity investments that are classied as financial assets through other comprehensive income at the balance sheet date.

- **Financial assets at fair value through profit and loss**

Financial assets are subsequently measured at fair value through profit or loss unless subsequently measured at amortised cost or at fair value through other comprehensive income. Gains and losses arising from changes in the fair value of a financial asset at fair value through profit or loss are recognised in the income statement.

In addition, the Bank has the option to designate, on initial recognition, financial assets that otherwise meet the requirements to be measured at amortised cost or at FVOCI at fair value through profit and loss, if doing so significantly reduces the accounting mismatch that would otherwise arise.

At the balance sheet date, the Bank did not hold any financial assets at fair value through profit and loss.

(ii) Derecognition of financial assets

The Bank derecognizes financial assets (in whole or in part) when the contractual rights to receive the cash flows from the financial instrument expire or when it loses control over contractual rights over that financial asset. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when rights have been realized, transferred or expired.

When the financial assets is derecognised, the difference between the carrying amount (or the carrying amount allocated to the portion of the assets that is derecognised) and the amount received (including any new assets less any new liabilities) and any cumulative gain or loss previously recognized through comprehensive income is recognised in the income statement.

Any cumulative gain or loss recognised through other comprehensive income in respect of equity investment securities designated as at fair value through other comprehensive income is not recognised in profit or loss on derecognition of such securities, but are directly recognised in retained earnings.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.7. Financial assets and liabilities *(continued)*

3.7.1. Financial assets *(continued)*

(iii) Modification of financial assets

Modification of financial assets is a process where the terms of the original contract are modified as a result of:

1) caused by current borrowers' needs (for example a reduction in the effective interest rate, prolongation of contract period, collateral substitution) and not caused by financial difficulties of the borrower,

2) caused by the current financial difficulties of the borrower or the difficulties that will arise soon, or by deteriorating the borrowers creditworthiness.

Modification of financial assets occurs when changes to some or all of the contract's provisions have been made.

In the case of a financial asset that represents a debt instrument (securities and loans and receivables), the Bank determines whether the modification is significant or whether the difference between the present value of the remaining modified cash flows discounted using the original effective interest rate and the current value of the modified cash flows discounted using the original effective interest rate is more than 10%.

If the modification is significant, the Bank ceases to recognize the original financial asset and begins to recognize new financial assets at fair value plus transaction costs and recalculates the new effective interest rate for the asset. The modification date is consequently considered to be the date of initial recognition for the purpose of calculating the impairment, including the purpose of determining whether a significant increase in credit risk has occurred.

However, the Bank also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the modification was driven by the debtor being unable to meet the originally agreed payments. The differences in the carrying amount are also recognized in profit or loss as a gain or loss on derecognition.

If the modification of the financial asset is not significant and the modification did not result in derecognition of the financial asset, then the Bank recalculates the gross carrying amount of the asset based on the revised cash flows of the financial asset and recognizes the modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting modified cash flows at the original effective interest rate (or using an effective interest rate adjusted for credit risk in the case of POCI assets).

If the modification occurs because of the financial difficulties of the debtor, the gain or loss is recorded together with the impairment loss. In other cases, it is recorded as interest income calculated using the effective interest rate method.

(iv) Impairment

IFRS 9 outlines a "three-stage" model for impairment of financial assets based on changes in credit quality since initial recognition of financial assets.

Impairment of financial assets is recognized on the basis of the expected credit loss model (ECL) for assets subsequently measured at amortized cost and assets subsequently measured at fair value through other comprehensive income (other than equity instruments).

Calculation and measurement of ECLs is an area of significant judgement, and implies methodology, models and data inputs. The following components of ECL calculation have the major impact on credit loss allowance for ECLs: default definition, significant increase in credit risk, PD, LGD and EAD. The Bank regularly reviews and validates models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience.

See Note 5.1.1. for more details

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.7. Financial assets and liabilities *(continued)*

3.7.2. Financial liabilities

(i) Classification

The Bank classifies financial liabilities at fair value through profit or loss and at amortised cost. The classification depends on the intention for which the financial instruments have been acquired. The Management determines the classification of financial instruments at initial recognition and reviews that classification at each reporting date.

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss have two sub-categories: financial instruments held for trading (including derivatives) and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category only if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term for the purpose of short-term profit taking or designated as such by management at initial recognition. The Bank has no financial liabilities classified at fair value through profit or loss.

Other financial liabilities

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

(ii) Initial and subsequent measurement

Financial liabilities at fair value through profit or loss are initially recognised at fair value, while transaction costs are immediately expensed. Subsequent measurement is also at fair value.

Gains and losses arising from a change in the fair value of financial liabilities at fair value through profit or loss are recognised in the income statement.

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

(iii) Derecognition of financial liabilities

The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

(iv) Modification of financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.7. Financial assets and liabilities *(continued)*

3.7.3 Offsetting of financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

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

3.7.4. Specific financial instruments

Cash and cash equivalents

Cash and cash equivalents include cash in hand, unrestricted balances held with the Central Bank, current accounts with other banks and higly liquid financial assets with original maturities of three months or less from the date of acquisition.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

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

Loans and receivables

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

"Loans and receivables" captions in the statement of financial position include:

— loans and receivables measured at amortised cost (see Note 3.7.1), thet are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;

Investment securities

The investment securities caption in the statement of financial position includes equity investement securities designated as at fair value through other comprehensive income.

Financial guarantees and loan commitments

'Financial guarantees' are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

Borrowings and subordinated debt

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

Current accounts and deposits from banks and customers

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

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

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.8 Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent cost is included in net book value or is accounted for as separate assets only if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day-to-day repairs and maintenance are recognised in the income statement as incurred. Land is not depreciated.

Depreciation is charged from the moment the fixed asset is ready for its intended use. It is calculated in the basis of the estimated useful life of the asset, using the straight-line method.

Useful lives of tangible assets are as follows:

	Useful life 2019	**Useful life 2018**
Buildings	40 years	40 years
Computers	3 – 7 years	3 – 7 years
Furniture and equipment	5 – 10 years	5 – 10 years
ATMs	5 – 8 years	5 – 8 years
Motor vehicles	3 – 5 years	3 – 5 years
Other assets	2 – 7 years	2 – 7 years

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the statement of profit or loss in the period they occur.

3.9. Intangible assets

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

Useful life of intangible assets is as follows:

	Useful life 2019	**Useful life 2018**
Intangible assets	5 years	5 years

3.10. Investment property

Investment property, which is property held to earn rental income and/or for capital appreciation, is measured initially at its cost, including transaction costs. Subsequent to initial recognition, investment property is stated at cost, less accumulated depreciation and any recognized accumulated impairment losses. Depreciation commences when the assets are ready for their intended use and is calculated in the basis of the estimated useful life of the asset, using the straight-line method as follows:

	Useful life 2019	**Useful life 2018**
Buildings	40 years	-

The Bank did not have investment property in 2018. Rental income from investment property are classified within 'Other operating income' in the Statement of profit and loss.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.11 Assets repossessed from disbursement of loans

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

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

The Bank classifies repossessed assets under IFRS 5 and subsequenty measures tham at lower of between book value and fair value less costs to sell.

3.12 Impairment of non-financial assets

At each reporting period date, the Bank reviews the carrying amounts of its property and equipment to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Recoverable amount is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

3.13 Provisions for liabilities and charges

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.14. 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 allowances 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.

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.

3.15. Equity and reserves

Share capital

i. Share issue cost

Shere capital represents the nominal value of paid-in ordinary shares classified as equity and is denominated in BAM. Dividens are recognized 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.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.15. Equity and reserves *(continued)*

Statutory reserves

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 five 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.

Regulatory reserves for credit losses

Regulatory reserves for credit losses are recongnised in accordance with regulations of the Federal Banking Agency. Regulatory reserves are non-distributable.

Retained earnings/accumulated loss

Profit or loss for the period after appropriations to owners is transferred to retained earnings/accumulated losses.

3.16. Earnings per share

The Bank publishes basic and diluted earnings per share (EPS) data.

Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. The Bank does not have preference shares.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.17 New standards and interpretations

Several new standards and accompanying additions are in place for the accounting period starting on 1 January 2019. The Bank believes that the new standards and amendments to the standards will not have a significant impact on the financial statements in the period of first application.

However, a new regulatory framework issued by the Federal Banking Agency and effective from 1 January 2020 is expected to have significant effect on the Bank's financial statements from the moment of adoption. Currently, the Bank prepares its statutory financial statements in accordance with IFRS. However, under the local regulations, as of 1 January 2020 the Bank is required, in addition, to aply new regulatory requirements for its statutory financial statements which will present new basis of preparation.

3.17.1. New regulatory requirements that take the effect in the accounting periods starting on or after 1 January 2020

The Banking Agency of Federation of BiH has published a new Decision on managing credit risk and establishing expected credit losses on 20 June 2019 (Official Gazette of FBiH No 44/19 from 26.06.2019), whose implementation is mandatory for all banks from 1 January 2020.

Decision on managing credit risks and establishing expected credit losses states:

a) Guidance on managing the credit risks
b) Exposure allocation method into credit risk levels and establishment of expected credit losses
c) Acceptable collateral for the purposes of establishing expected credit losses
d) Acceptable collateral for the purposes of limitation of maximum allowable exposure compared to the issued equity,
e) Treatment of assets acquired in the collection of receivables process
f) Reporting method to the Banking Agency of FBiH

The new Decision's requirements in the area of impairment are based on the model of expected credit losses under IFRS 9 but there are certain specifics (for example specification of minimum rates of expected credit losses for credit risk levels). In accordance to the aforementioned statements, banks were held responsible to calculate the effects of the initial application of new Decision as at 31 December 2019 i.e. opening balances as at 1 January 2020, and record them on the equity accounts i.e. present them as a part of CET 1 capital as at that day.

The effects of the initial application represent the difference between the expected credit losses established in relation with the requirements of this Decision and those which the Bank has determined and recorded in accordance with its internal methodology that is complementary with the requirements of IFRS 9. Requirements of the new Decision are summurised bellow:

Exposure allocation method into credit risk levels and establishment of expected credit losses

The Bank is obliged to allocate each exposure at amortized cost and fair value through other comprehensive income into one of the following categories:

a) Stage 1 – performing
b) Stage 2 – underperforming
c) Stage 3 – non-performing

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

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.17 New standards and interpretations *(continued)*

3.17.1. New regulatory requirements that take the effect in the accounting periods starting on or after 1 January 2020 *(continued)*

In accordance with the exposure allocation into the credit risk levels, the Bank is responsible to apply following minimum rates of expected credit losses:

1. Stage 1:

a) For exposures with low credit risks – 0,1% of exposure
b) For other exposures – 0,5% of exposure.

If the Bank in accordance with its internal methodology determines higher amount of expected credit losses than the amount arising from the requirements of this Decision, the Bank is obliged to recognise the higher amount.

2. Stage 2:

For exposures included in stage 2 the Bank is responsible to determine and record the expected credit losses by the choosing higher of the two:

a) 5% of exposure
b) Amount determined as per internal methodology of the Bank.

3. Stage 3:

Minimum rates of the expected credit losses classified in Stage 3 depend on the fact whether the exposure is secured by acceptable collateral or not, in relation to that, minimum rates are as follows:

a) Exposures secured with acceptable collateral

Days overdue	Minimum expected credit loss
to 180 days	15%
from 181 to 270 days	25%
from 271 to 365 days	40%
from 366 to 730 days	60%
from 731 to 1460 days	80%
over 1460 days	100%

b) Exposures which are not secured with acceptable collaretal

Days overdue	Minimum expected credit loss
to 180 days	15%
from 181 to 270 days	45%
from 271 to 365 days	75%
from 366 to 456 days	85%
over 456 days	100%

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

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.17 New standards and interpretations *(continued)*

3.17.1. New regulatory requirements that take the effect in the accounting periods starting on or after 1 January 2020 *(continued)*

The FBA's Decision defines the types of acceptable collateral in the form of real estates and equipment and minimum corrective factors for such collaterals.

Minimum rates of expected credit losses for receivables from customers, receivables on the basis of factoring and finance leasing and other receivables are listed in the following table:

Days overdue	Minimum expected credit loss
no delays in the materially significant amounts	0,5%
to 30 days	2%
from 31 to 60 days	5%
from 61 to 90 days	10%
from 91 to 120 days	15%
from 121 to 180 days	50%
from 181 to 365 days	75%
over 365 days	100%

In addition, Decision defines the requirements for "accounting write-off" based on which the Bank must write-off balance sheet exposure two years after the Bank has recorded the expected credit losses in the amount of 100% of gross value of total exposure and declared it fully due.

The Decision also defines the treatment of assets acquired in the process of collection of receivables by which the Bank recognizes forseclosed assets at the lower of:

a) Net book value of the Bank's receivables. If the net book value of recorded expected credit losses equals the receivables amount, the Bank will record repossessed assets at technical value in the amount of BAM 1.
b) Estimated fair value by independent valuer reduced by expected costs to sell.

If the Bank does not sell the repossessed assets its valude must be reduced to BAM 1 within the period of next three years from the date of initial recognition, and for the assets recorded before 1 January 2019 the Bank is obliged to reduce their value to BAM 1 in the period of two years from the date of initial implementation of the Decision.

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

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3.17 New standards and interpretations *(continued)*

3.1.17 New regulatory requirements that take the effect in the accounting periods starting on or after 1 January 2020 *(continued)*

Effects of initial adoption

Effects of the initial adoption are presented in the table bellow:

'000 BAM	Balance as at 31 December 2019	Revaluation per FBA Decision	1 January 2020
ASSETS			
Loans and receivables to customers	398,254	(5,680)	**392,574**
Other assets and receivables	3,444	65	**3,509**
LIABILITIES			
Provisions for off balance sheet items	3,067	(214)	**2,853**
EQUITY			
Accumulated losses	(22,542)	(5,829)	**(28,371)**

Due to the fact that the effects have significant impact on the total equity, and for the compliance purposes with the capital regulatory requirements in the following period, the Bank has calculated the rate of CET 1 capital, which amounts to 12.21% as at 1 January 2020, Tier 1 capital rate that amounts to 12.21% as well as the total capital rate which amounts to 14.78% (including 1.25% risk weighted assets) and they are all above the prescribed minimum rates.

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

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

Impairment losses on loans and receivables

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

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the financial statements is included in the following notes:

- Note 3.7.1: classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding.
- Note 5.1.1: establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2019 is included in the following notes.

- Note 5.1.1.: impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information.
- Note 6: determination of the fair value of financial instruments with significant unobservable inputs
- Note 5.1.1.: impairment of financial instruments: key assumptions used in estimating recoverable cash flows.

Taxation

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

Regulatory requirements

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

Litigation and claims

The total amount of legal proceedings is BAM 1,152 thousand (2018: BAM 882 thousand). The Bank performs an individual assessment of all court cases and creates provisions in accordance with the assessment. The assessment of risks and proposal for provisions for legal cases is performed by the Legal Affairs Department and Finance Division, and a decision on the creation of provisions is made by the Bank's management.

As stated in Note 28, the Bank provided BAM 425 thousand (2018: BAM 258 thousand), which management estimates as sufficient.

5. FINANCIAL RISK MANAGEMENT

The Bank is exposed to risks in the course of its business activities. An informed approach to risk management is a central component of our business model. This is also reflected in our risk culture and our risk appetite. By following a consistent approach to managing risks, the aim is to ensure that the liquidity and capital adequacy of the Bank continues to be appropriate at all times, as well as to achieve steady results. The overall risk profile of the bank is appropriate and stable. This is based on an overall assessment of the individual risks, as presented in this risk report.

While the business strategy lists the objectives of the Bank for all material business activities and regions of operation and presents the measures to be taken to achieve them, the bank risk strategy addresses the material risks arising from the implementation of the business strategy and defines the objectives and measures of risk management. The risk strategy is broken down into strategies for all material risks in the Bank. The strategies are updated annually and are approved by the Management of the Bank following discussions with the Supervisory Board.

The principles of our business activity, as listed below, provide the foundation for our risk management. The consistent application of these principles reduces the risks to which the Bank is exposed.

Focus on core business

The Bank focus on the provision of financial services to small and medium businesses as well as to private clients. Accordingly, income is generated primarily in the form of interest income on customer loans and fee income from account operations and payments. All of the Banks' other operations are performed mainly in support of the core business. The Bank assume mainly credit risk, interest rate risk and liquidity risk in the course of their day-to-day operations. At the same time, the Bank avoids or very strictly limits all other risks involved in banking operations.

High degree of transparency, simplicity and diversification

The Bank's focus on small and medium-sized businesses entails a very high degree of diversification in both customer loans and customer deposits. In terms of client groups, this diversification spans economic sectors, client groups (SMEs and private clients) and income groups. The diversification of the loan portfolio is a central pillar of the credit risk management policy. A further characteristic of our approach is that we seek to provide our clients with simple, easily understandable services. This leads to a high degree of transparency not only for the respective client, but also from a risk management point of view. Both the high degree of diversification and our simple, transparent services and processes result in a significant reduction of the Bank's risk profile.

Key elements of risk management

Risk management comprises identifying, quantifying, managing, monitoring, controlling and reporting risks. In managing risks, the Bank takes account of the "Minimum Requirements for Risk Management" (MaRisk), of relevant publications by national and international regulatory authorities and of Bank's knowledge of the markets acquired over many years. The mechanisms designed to hedge and mitigate risks are monitored regularly to ensure their effectiveness, and the procedures and methods used to manage risks are subject to ongoing further development.

5. FINANCIAL RISK MANAGEMENT *(continued)*

The key elements of risk management in the Bank are presented below.

- The Bank applies a single common risk management framework, which defines minimum standards. The risk management policies and standards are approved by the Management of the Bank and are updated at least annually. These specify the responsibilities at Bank level, and establish minimum requirements for managing, monitoring and reporting.
- All risks assumed are managed by ensuring at all times an adequate level of regulatory and internal capital of the Bank,
- The annually conducted risk inventory ensures that all material and non-material risks are identified and, if necessary, considered in the strategies and risk management processes,
- Monitoring and control of risks and possible risk concentrations is carried out using comprehensive analysis tools for all material risks,
- Early warning indicators (reporting triggers) and limits are set and monitored for all material risks,
- Regular stress tests are performed for all material risks and for each individual risk category,
- Regular and ad-hoc reporting is carried out on the risk profile
- The effectiveness of the chosen measures, limits and methods is continuously monitored and controlled.
- Processes and procedures for an effective internal control system are in place. These ae based on principles of segregation of duties, dual control and, for all risk-relevant operations, the separation of front and back office up to the management level,
- New or significantly changed products undergo a thorough analysis before being used for the first time in order to ensure detailed new risk assessment.

Organisation of risk management position and risk reporting

The Management of the Bank bears responsibility for risk management within the Bank. The Bank has risk management department, a risk management committee and an ALCO, as well as specialised committees that address individual risks. These committees monitor and manage the risk profile of the Bank.

At the Bank level, risk positions are analysed regularly, discussed intensively and documented in standardised reports. The risk department of the Bank reports regularly to the different risk functions within the Bank and the Supervisory Board is informed on at least a quarterly basis about all risk-relevant developments.

The management of key risks in the Bank is described in greater detail in the following section. This includes: credit risk, foreign currency risk, interest rate risk and liquidity and funding risk..

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

Management of individual risks

5.1 Credit risk

The Bank defines credit risk as the risk that losses will be incurred if the party to a transaction cannot fulfil its contractual obligations at all, not in full or not on time. Within overall credit risk we distinguish between customer credit risk, counterparty risk (including issuer risk) and country risk. Credit risk is the most significant risk facing the Bank, and customer credit exposures account for the largest share of that risk.

Maximum exposure to credit risk:

	31 December 2019	31 December 2018
Central bank balances	108,677	74,484
Current accounts with other banks	19,905	30,810
Investment securities	43	43
Loans and receivables to customers	398,253	364,866
Other assets	436	428
Contingent liabilities and commitments	77,910	70,286
Total:	**605,224**	**540,917**

5.1.1. Customer credit risk

The key objectives of credit risk management are to achieve high loan portfolio quality, low risk concentrations within the loan portfolio and appropriate coverage of credit risks with loan loss provisions.

The Bank serves a broad spectrum of clients, ranging from relatively small business clients with increasingly formalised structures to larger SMEs. For our lending operations, we apply the following principles, among others:

- Analysis of the debt and payment capacity of borrowers, including an analysis of future capital flows,
- Documenting credit risk analyses and processes conducted during lending operations, ensuring that the analyses performed can be understood by knowledgeable third parties,
- Strictly avoiding over indebtedness among credit clients,
- Building a long-term relationship with the client, maintaining regular contact and documenting the development of the exposure within the regular monitoring reports,
- Strictly monitoring the repayment of credit exposures,
- Applying closely customer-oriented, intensified loan management in the event of arrears,
- Collecting collateral in the event of insolvency.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

The Bank's framework for managing customer credit risk is presented in the relevant policies and standards. The policies specify, among other things, the responsibilities for managing credit risk in the Bank, the principles for the organisation of the lending business, the principles involved in lending operations, and the framework for the valuation of collateral for credit exposures. The standards contain detailed explanations of the Bank's lending operations with business clients and private clients and of the range of credit offered. They also set forth the rules governing restructuring, risk provisioning and write-offs. Thus, the policies and standards define risk-mitigating measures for the pre-disbursement phase (credit risk assessment) and the post-disbursement phase (e.g. regular monitoring of the financial situation, review of early warning indicators, and both intensified and problem loan management).

The Bank divides its credit exposures into three categories: small and medium-sized business credit exposures and credit exposures to private clients. Depending on the client category to which the respective credit exposure is assigned, different credit risk assessment processes are applied. These processes differ from one another in terms of the following attributes: the degree of segregation of duties, type of information that provides the basis for the credit analysis, criteria for credit decisions, and collateral requirements. A strict separation of front and back office functions up to the management level is applied for risk-relevant operations.

The experience of the Bank has shown that a thorough creditworthiness assessment constitutes the most effective form of credit risk management. The credit decisions of the Bank are therefore based predominantly on an analysis of the client's financial situation and creditworthiness. Regular on-site visits are performed for all clients to ensure an adequate consideration of their specific features and needs.

All credit decisions in the Bank are taken by a credit committee. Its members have approval limits that reflect their expertise and experience. All decisions on medium credit exposures are taken by credit committees at the Bank. If the exposures are particularly significant for the Bank based on its size, the decision is taken by the Supervisory Board of the Bank.

The most important factor for credit committee decisions is a funding and collateral structure that is based on the client's needs and conditional on the respective risk profile. In this context, the following general principles apply: the lower the loan amount, the more detailed the documentation provided by the client, the shorter the loan period, the longer the client's history with the Bank, and the higher the client's account turnover with the Bank, then the lower the collateral requirements will be.

The Bank'a and the group credit risk management policies limit the possibility for unsecured credit operations. Depending on the risk profile and the term of the exposure, loans may also be issued without being fully collateralised. As a general rule, credit exposures with a higher risk profile are covered with solid collateral, mostly through mortgages.

The valuation of immovable collateral is based on assessments conducted by external, independent experts, included in the list of the Bank's certified assessors. In order to ensure that a reduction in the value of the collateral is detected at an early stage and appropriate measures can be taken, plausibility checks of collateral value are a fixed component of the monitoring process for exposures. The assessments are updated at regular intervals, with plausibility checks being carried out by specialised Bank's staff.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

Based on our collateralisation requirements, securing loans with mortgages is among the most important instruments for limiting credit risk.

Type of collateral	% of total	31 December 2019	% of total	31 December 2018
Property	70.4%	224,749	63.9%	196,698
Movable property	11.5%	36,828	16.8%	51,635
Financial guarantees	16.4%	52,297	17.9%	55,028
Cash deposits	1.7%	5,425	1.4%	4,237
Total		**319,299**		**307,598**

The value of collateral is based on the most recent appriaisals taking into account internally defined haircuts depending on the type of collateral. For each loan, the value of disclosed collateral in the table above is capped at the carring amount of the loan that it is held against. The early detection of increases in credit risk at the borrower level is incorporated into all lending-related processes, resulting in prompt identification and timely assessment of the financial difficulties faced by clients.

Moreover, the Bank has developed indicators for the early identification of risks based on quantitative and qualitative risk features. These include, but are not limited to, declining account turnover or volume, high usage of granted credit lines and overdrafts over a longer period of time, and arrears. Regular recording and analysis of these early warning indicators helps to manage the performing portfolio, identify potential default risks at an early stage and take the required measures to avoid a significant increase in credit risk. Reports on the affected portfolio are regularly given to the branch managers, the Bank's head office and in aggregated form to ProCredit Holding.

Exceptional events which could have an impact on a significant part of the loan portfolio (common risk factors) are also analysed and discussed. This can lead to the imposition of limits on risk exposures towards certain groups of clients, e.g. in specific sectors of the economy or geographical regions.

In addition, asset quality indicators were implemented, on the basis of which the loan portfolio is divided into the categories: performing, underperforming and defaulted. Exposures are assigned to these categories based on a risk classification and other risk characteristics of the borrower. Of particular importance here are the risk classification, overdue contractual payments (especially those over 90 days overdue), initiation of bankruptcy proceedings or similar court procedures, restructurings or collateral liquidations by other banks, as well as other factors indicating a significant deterioration of the economic situation of the client. The indicators allow for a clear overview of the quality of the Bank's portfolio and that of an individual bank, and represent one of the most important tools for the credit risk management process.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

- The *performing* loan portfolio shows no signs of a potential risk increase. Although some exposures show early warning signals, these may not necessarily result in a risk increase being determined.
- The *underperforming* loan portfolio comprises exposures showing increased credit risk. This can be caused by temporary payment difficulties (30-90 days), restructuring or other factors. Nevertheless, the Bank still assesses full repayment of the exposure to be possible, e.g. after restructuring.
- The *defaulted* loan portfolio comprises all exposures in default, most of which have shown lasting payment difficulties (over 90 days) or other negative factors, e.g. initiation of bankruptcy proceedings. Further details are provided below.

Once a higher risk of default is detected for a credit exposure, it is placed under intensified management. This centres on close communication with the client, identification of the source of higher credit default risk and close monitoring of their business activities. Decisions on measures to reduce the credit default risk are taken by the authorised decision-making bodies. In addition, specialised recovery officers may be called in to support the intensified management of the credit exposure. One of the first steps in managing such loans is to determine the economic and financial situation of the client, as this is the most important basis for decisions on whether or not the exposure can be restructured. The aim is to take such decisions at an early stage, while the chances of stabilisation are high and before the exposure enters an advanced phase of payment delay. When a credit exposure is classified as defaulted, it is passed on to officers responsible for customer service. These officers are supported by specialists in settlement and liquidation (legal department). Collateral is sold through liquidation to a third party at the highest possible price, typically via public auction. The majority of the collateral sold consists of tangible assets such as land or buildings.

Assets obtained by taking possession of collateral (repossessed property)

Details of non-financial assets obtained by the Bank during the year by taking possession of collateral held as security against loans and advances and held at the year-end are shown below.

	31 December 2019	31 December 2018
Real estate	2.258	5.201
Land	79	111
Total	**2.337**	**5.312**

The Bank's policy is to pursue timely realisation of the collateral in an orderly manner. The Bank does not generally use the non-cash collateral for its own operations.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

Loss allowances

Loss allowances are established in line with the defined Bank standards, which are based on IFRS 9 impairment model. The forward-looking expected credit loss (ECL) model is the central element of the approach to quantifying credit loss allowances for on- and off-balance sheet financial instruments. The model calculates loss allowances considering the credit losses expected over various default scenarios in the future. The calculated loss allowances represent the sum of probability-weighted outcomes; ECL estimates are unbiased and include supportable information about past events, current conditions, and forecasts of future economic conditions.

Three-stage approach

At each reporting date, all credit exposures to customers are allocated among the three stages listed below, based on the development of credit risk since initial recognition. A specific methodology is applied for each stage in order to determine impairment. During the lifetime of an exposure, movement is possible between the stages.

- *Stage 1* comprises exposures for which credit risk has not significantly increased since initial recognition as well as those showing low credit risk as of the reporting date and for which thus there is no indication of a trigger for allocation to Stage 2 or Stage 3. Generally, all exposures are allocated to Stage 1 upon initial recognition, with the exception of those categorised as purchased or originated credit impaired (POCI) assets. For Stage 1 exposures, the expected credit losses arising from possible default events within the period of up to 12 months following the reporting date are recognised in expenses. For exposures with a remaining maturity of less than 12 months, the shorter contractual maturity is applied.

- *Stage 2* comprises exposures for which credit risk has significantly increased since initial recognition, but for which there are no objective indications of impairment. Loss allowances are established in an amount equivalent to the expected credit losses over the entire remaining maturity.

- *Stage 3* includes all defaulted exposures, i.e. as of the reporting date, there is both a significant increase in credit risk and objective indications of impairment. The respective calculation of loss allowances is performed based on the expected credit losses over the entire remaining maturity considering 100% probability of default.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

Calculation of expected credit loss (ECL)

The following parameters are used in the calculation of expected credit loss:

- Exposure at default (EAD):

EAD is the expected exposure amount at the time of a loan default. It is derived from the currently outstanding receivable from the customer and possible future changes under the applicable contractual condition. Thus, the EAD consist of the gross carrying amount at the time of default. For exposures with regular repayment plans, the modelled EAD is adjusted for the expected possibility of early repayment base on historical observations and on scenarios for the development of the economic environment and associated forecasts. Based on historical data, estimates are made of the potential exposures that may arise in the future from the utilisation of existing credit commitments such as credit lines and overdraft facilities. For financial guarantees, the EAD corresponds to the guaranteed amount, based on professional discretion, the conversion factor has generally been set at 100%.

- Probability of default (PD):

The probability of a loan default within a certain period of time is derived from historical default events. These data include the time, type and amount of default, as well as information about the risk characteristics of clients as used in the internal risk classification system. The parameters take into account country specifics and also differentiate the risk levels of exposures according the the customer segments defined at the Bank level. The Bank uses statistical models to analyse collected data and make forecasts for the expected PD based on scenarios for the development of the economic environment. In addition, PDs over the remaining lifetime of an exposure are estimated.

- Loss given default (LGD):

The expected LGD is based on historical data about recoveries obtained from defaulted clients. LGDs are calculated on a discounted cash flows, taking into account the cost of recovery, and the size of the credit exposure. Estimated LGDs are modelled as forward-looking forecasts that account for the assumed scenarios about the development of the economic environment.

Input data for the assessment of credit risk parameters are based on multi-year data histories for all borrowers in the Bank. Regression analysis is used to estimate the impact of client risk characteristics as well as macroeconomic factors for the considered parameters. Selection of relevant macroeconomic factors (GDP growth, inflation rate, unemployment rate) is based on their statistical significance and economic plausibility. For PDs and LGDs, a probability-weighted average value is calculated based on the various scenarios for the macroeconomic factors in the forecast year. In accordance with IFRS 9, the Bank uses three macroeconomic scenarios: baseline, optimistic and pessimistic each with a weight of 25%, 50% and 25%. Macroeconomic forecasts are based on IMF macroeconomic predictions.

Changes in these assumptions can lead to changes in the calculated loss allowances over time. The Bank acknowledges that discretionary decisions of the Management and estimations uncertainties can have a significant impact on the establishment of loss allowances for collectively and individually assessed exposures. Such discretion is based on the applied definition of default, the approach to determining a significant increase in credit risk (SICR), and the selected macroeconomic factors.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

Expected credit loss for all performing exposures (Stage 1 and 2) and individually insignifficant non performing exposures classified as Stage 3 (below EUR 50.000) are determined using the collective assessment of credit risk. Expected credit loss for individually significant Stage 3 exposures are determined on an individual basis (described in details below under *Definition of default*).

Significant increase in credit risk (SICR)

Quantitative and qualitative information is used to determine whether there is a significant increase in credit risk.

The quantitative test (introduced as at 31 December 2019) for SICR consist of a comparison between the expected PD over the remaining lifetime as of the reporting date and the expected PD over the corresponding time period at initial recognition. A SICR is deemed to occur if the difference between PDs exceeds a set limit of 250%. In this case the respective financial instrument is transferred from Stage 1 to Stage 2. Conversely, a transfer from Stage 2 to Stage 1 is possible when the associated credit risk has decreased significantly.

Additionally, qualitative criteria are used for SICR decisions. A transfer from Stage 1 to Stage 2 occurs if one of the following criteria applies:

- Contractual payments are past due by more than 30 days but not more than 90 days.
- Classification of the customer as "restructured" pursuant to internal policies (adjustment of contractually agreed conditions).
- The customer is assigned to a risk class defined as insufficient in the risk classification system.

Impaired credit exposures

A credit exposure is considered as credit impaired and transferred to Stage 3 if one of the following criteria is applies at the reporting date:

- Contractual payments are more than 90 days past due,
- Indications of significant financial difficulty of the debtor,
- Loan repayment is not possible without the realisation of collateral,
- Initiation of bankruptcy proceedings for the customer,
- Legal proceedings against the client that endanger the existence of the business or repayment capacity and
- Allegations of fraud against the customer.

Definition of default

The Bank has adjusted the definition of impairement according to IFRS 9 to the regulatory definition of default. This is also the definition used for internal risk management and is applied to all exposures which are part of the Bank's customer loan portfolio. The Bank considers an exposure to be impaired, and transferred to Stage 3, if at least one of the above criteria is met and the expected cash flows have been negatively impacted to such an extent that full repayment of the receivable can no longer be assumed.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

When determining provisions in Stage 3, a distinction is drawn between individually significant and individually insignificant credit exposures; the threshold is EUR 50,000. For significant exposures with indications of impairment, an individual assessment is performed to determine provisioning, taking account for the expected inflows, including collateral liquidation. For individually insignificant exposures, loss allowances are determined using parameters for the collective assessment of credit risk. Returning an exposure from Stage 3 to lower stage is possible if the customer is able to settle outstanding debts in full without recourse to collateral realisation. No migration between stages is possible for POCI exposures.

Purchased or Originated Credit Impaired (POCI) exposures

The Bank has separate rules for POCI (Purchased or Originated Credit Impaired) exposures. Within our business model, the acquisition of impaired exposures is not permitted. POCI exposures can only arise in a course of a new negotiation through significant modification of the contractually agreed cash. For POCI exposures, no allowances for impairment are made at the time of initial recognition. In subsequent periods, any changes to the estimated lifetime ECL are recognised as an expense in the profit and loss and reported accordingly as loss allowances for these exposures.

Changes to contractual terms (modifications)

Changes to the originally agreed contractual conditions of an exposures are possible, in particular with the aim of improving the prospect of repayment and, if possible, avoiding default, foreclosure or the realization of collateral. The Bank uses quantitative and qualitative factors to determine the existence of a substantial modification of contractual conditions. As a quantitative factor, the net present value of cash flows is determined in order to assess the changed condition of an exposure (The Net Present Value Test). In the event of a substantial modification, the original loan is derecognised and a new loan is recognised at its fair value at the modification date. In the case of non-substantial change, the gain or loss from modification is recognized in profit or loss.

Write off

When a loan is uncollectable, it is written off against the corresponding loss allowance which has been set aside, provided there is no justified expectation of repayment.

For exposures of any size, the Bank carry out an individual assessment of justified feasibility of repayments. For exposures bellow EUR 10 thousands, this assessment is to be carried out at the latest once payment is 180 days overdue; for largest exposures, at the latest after 360 days, particularly if there is no realisable collateral. Based on the assessment the Bank may decide to write off the exposure or continue to actively manage the exposure in order to allow for further repayment of the loan.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

Credit quality analysis and credit risk concentration

The following table provides an overview of the respective gross and net customer loan portfolio, as well as respective loss allowances:

	Stage 1 Stage 12-month ECL	Stage 2 Life time ECL	Stage 3 Life time ECL	POCI	Total
31 December 2019					
Business loans					
Gross outstanding amount	340,516	37,637	14,671	270	**393,094**
Loss allowances	(987)	(337)	(10,395)	(263)	**(11,982)**
Carrying amount	**339,529**	**37,300**	**4,276**	**7**	**381,112**
Private loans					
Gross outstanding amount	15,642	1,689	858	-	**18,189**
Loss allowances	(286)	(82)	(679)	-	**(1,047)**
Carrying amount	**15,356**	**1,607**	**179**	-	**17,142**

	Stage 1 Stage 12-month ECL	Stage 2 Life time ECL	Stage 3 Life time ECL	POCI	Total
31 December 2018					
Business loans					
Gross outstanding amount	339,642	2,575	18,678	-	**360,895**
Loss allowances	(1,559)	(232)	(10,642)	-	**(12,433)**
Carrying amount	**338,083**	**2,343**	**8,036**	-	**348,462**
Private loans					
Gross outstanding amount	16,018	216	2,589	-	**18,823**
Loss allowances	(115)	(36)	(2,268)	-	**(2,419)**
Carrying amount	**15,903**	**180**	**321**	-	**16,404**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

The following table shows the information on credit quality of loans and receivables. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranted.

31 December 2019

	Stage 1	Stage 2	Stage 3	POCI	Total
Loans and advances to customers					
Grade 1-5	337,136	36,097	-	-	373,233
Grade 6-7	-	1,146	-	-	1,146
Grade 8	-	-	13,342	-	13,342
Not graded	19,022	2,083	2,187	270	23,562
Total	**356,158**	**39,326**	**15,529**	**270**	**411,283**
Less: imapirment	**1,273**	**419**	**11,074**	**263**	**13,029**
Total	**354,885**	**38,907**	**4,455**	**7**	**398,254**

31 December 2019

	Stage 1	Stage 2	Stage 3	POCI	Total
Guarantees					
Grade 1-5	40,547	1,557	-	-	42,104
Grade 6-7	39	39	-	-	78
Grade 8	-	-	-	-	-
Not graded	280	-	-	-	280
Total	**40,866**	**1,596**	-	-	**42,462**
Less: imapirment	**42**	**6**	-	-	**48**
Total	**40,824**	**1,590**	-	-	**42,414**

31 December 2019

	Stage 1	Stage 2	Stage 3	POCI	Total
Loan commitments					
Grade 1-5	31,817	1,651	-	-	33,468
Grade 6-7	-	-	-	-	-
Grade 8	-	-	-	-	-
Not graded	1,529	6	-	-	1,535
Total	**33,346**	**1,657**	-	-	**35,003**
Less: imapirment	**54**	**2**	-	-	**56**
Total	**33,292**	**1,655**	-	-	**34,947**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

31 December 2018

	Stage 1	Stage 2	Stage 3	Total
Loans and advances to customers				
Grade 1-5	329,708	-	-	329,708
Grade 6-7	-	1,960	-	1,960
Grade 8	-	-	15,607	15,607
Not graded	25,952	831	5,660	32,443
Total	**355,660**	**2,791**	**21,267**	**379,718**
Less: imapirment	**1,674**	**268**	**12,910**	**14,852**
Total	**353,986**	**2,523**	**8,357**	**364,866**

31 December 2018

	Stage 1	Stage 2	Stage 3	Total
Guarantees				
Grade 1-5	32,856	-	-	32,856
Grade 6-7	-	-	-	-
Grade 8	-	-	-	-
Not graded	1,715	-	-	1,715
Total	**34,571**	-	-	**34,571**
Less: imapirment	**93**	-	-	**93**
Total	**34,478**	-	-	**34,478**

31 December 2018

	Stage 1	Stage 2	Stage 3	Total
Loan commitments				
Grade 1-5	31,800	-	-	31,800
Grade 6-7	-	-	-	-
Grade 8	-	-	-	-
Not graded	3,564	2	-	3,566
Total	**35,364**	**2**	-	**35,366**
Less: imapirment	**71**	-	-	**71**
Total	**35,293**	**2**	-	**35,295**

The credit risk of loans and receivables and credit lines and guarantees is presented through the internal credit risk classification. Not graded category relates to all private clients and business clients with exposure below EUR 50,000.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

The following table sets out information about the overdue status of loans and advances to customers in Stages 1, 2 and 3, excluding POCI.

31 December 2019

	Stage 1	Stage 2	Stage 3	**Total**
Loans and advances to customers – gross carrying amount				
Current	347,958	36,288	207	**384,453**
Overdue < 30 days	8,200	2,991	845	**12,036**
Overdue > 30 days < 90 days	-	47	218	**265**
Overdue > 90 days	-	-	14,259	**14,259**
Total:	**356,158**	**39,326**	**15,529**	**411,013**

31 December 2018

	Stage 1	Stage 2	Stage 3	**Total**
Loans and advances to customers – gross carrying amount				
Current	353,908	2,157	2,170	**358,235**
Overdue < 30 days	1,752	102	240	**2,094**
Overdue > 30 days < 90 days	-	532	526	**1,058**
Overdue > 90 days	-	-	18,331	**18,331**
Total:	**355,660**	**2,791**	**21,267**	**379,718**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

The following table presents gross and net exposures, broken down according to economic sector and by stage.

31 December 2019	**Business loans**					**Private loans**			
in BAM '000	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transporation and storage	Other economic activities	Housing	Investment loans and OVDs	Others	**Total**
Stage 1									
Gross outstanding amount	110,962	3	130,170	32,909	66,471	10,969	4,364	310	**356,158**
Loss allowances for loans to customers	(334)	-	(348)	(90)	(214)	(198)	(82)	(7)	**(1,273)**
Net outstanding amount	110,628	3	129,822	32,819	66,257	10,771	4,282	303	**354,885**
Stage 2									
Gross outstanding amount	11,710	-	15,818	4,548	5,560	1,608	69	13	**39,326**
Loss allowances for loans to customers	(99)	-	(145)	(35)	(57)	(79)	(3)	(1)	**(419)**
Net outstanding amount	11,611	-	15,673	4,513	5,503	1,529	66	12	**38,907**
Stage 3									
Gross outstanding amount	8,217	458	3,151	387	2,458	446	342	70	**15,529**
Loss allowances for loans to customers	(5,476)	(458)	(2,255)	(309)	(1,897)	(352)	(262)	(65)	**(11,074)**
Net out standing amount	2,741	-	896	78	561	94	80	5	**4,455**
POCI									
Gross outstanding amount	-	-	270	-	-	-	-	-	**270**
Loss allowances for loans to customers	-	-	(263)	-	-	-	-	-	**(263)**
Net outstanding amount	-	-	7	-	-	-	-	-	**7**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

31 December 2018	Business loans					Private loans			
in BAM '000	Wholesale and retail trade	Agriculture, forestry and fishing	Production	Transporation and storage	Other economic activities	Housing	Investment loans and OVDs	Others	**Total**
Stage 1									
Gross outstanding amount	105,216	11	137,965	38,802	57,246	12,927	3,241	252	**355,660**
Loss allowances for loans to customers	(536)	-	(615)	(151)	(252)	(89)	(28)	(3)	**(1,674)**
Net outstanding amount	104,680	11	137,350	38,651	56,994	12,838	3,213	249	**353,986**
Stage 2									
Gross outstanding amount	655	-	963	72	773	205	116	7	**2,791**
Loss allowances for loans to customers	(59)	-	(91)	(10)	(72)	(22)	(14)	-	**(268)**
Net outstanding amount	596	-	872	62	701	183	102	7	**2,523**
Stage 3									
Gross outstanding amount	10,488	142	4,903	827	2,389	350	1,358	810	**21,267**
Loss allowances for loans to customers	(5,768)	(142)	(2,659)	(599)	(1,555)	(235)	(1,274)	(678)	**(12,910)**
Net out standing amount	4,720	-	2,244	228	834	115	84	132	**8,357**
POCI									
Gross outstanding amount	-	-	-	-	-	-	-	-	-
Loss allowances for loans to customers	-	-	-	-	-	-	-	-	-
Net outstanding amount	-	-	-	-	-	-	-	-	-

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

Credit risk at the portfolio level is assessed on a monthly basis and, if necessary, more frequently. This includes an analysis of portfolio structure and quality, restructured exposures, write offs, the coverage level and concentration risk.

Concentration risk in the customer loan portfolio is effectively limited by a high degree of diversification. This diversification is a consequence of lending to small and medium-sized businesses in various economic sectors and to private clients, and the distribution of the loan portfolio.

The following table presents gross loans broken down according to business area, economic sector and loan size.

31 December 2019	up to EUR 50,000	EUR 50,000 – 250,000)	over 250,000 EUR	Total
Business loans				
Production	7,270	55,100	87,039	149,409
Trade	11,150	52,675	67,064	130,889
Transport, telecommunications and communications	3,950	19,304	14,591	37,845
Agriculture, forestry	461	-	-	461
Other	5,696	29,346	39,448	74,490
Total business loans	**28,527**	**156,425**	**208,142**	**393,094**
Private loans				
Housing loans	5,554	6,896	573	13,023
Investment loans and OVDs	2,822	1,368	584	4,774
Other	392	-	-	392
Total private loans	**8,768**	**8,264**	**1,157**	**18,189**
Total customer loan portfolio (gross)	**37,295**	**164,689**	**209,299**	**411,283**

31 December 2018	up to EUR 50,000	EUR 50,000 – 250,000	over 250,000 EUR	Total
Business loans				
Production	7,406	51,318	85,658	144,382
Trade	10,622	52,474	52,500	115,596
Transport, telecommunications and communications	3,646	20,352	15,391	39,389
Agriculture, forestry	697	-	-	697
Other	4,939	26,921	28,971	60,831
Total business loans	**27,310**	**151,065**	**182,520**	**360,895**
Private loans				
Housing loans	6,764	5,792	607	13,163
Investment loans and OVDs	2,348	440	558	3,346
Other	2,314	-	-	2,314
Total private loans	**11,426**	**6,232**	**1,165**	**18,823**
Total customer loan portfolio (gross)	**38,736**	**157,297**	**183,685**	**379,718**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

In addition, the Bank limit the concentration risk of their portfolios by means of the following requirements: Large credit exposures (those exceeding 10% of the regulatory capital of the Bank) require the approval of the Group Risk Management Committee and of the Supervisory Board of the Bank. No large credit exposure may exceed 25% of regulatory capital of a Bank, and the sum of all large credit exposures of a Bank may not exceed 150% of its regulatory capital.

The quality of the loan portfolio in all client categories is monitored by credit control units at the Bank. They assess the quality of the credit analysis as well as compliance with internal procedures and identify signs of fraudulent activity. These teams comprise experienced staff who not only conduct on-site visits to customers in order to monitor the lending process but also systematically screen the portfolio for irregularities.

Continuous training of the staff ensures that credit risk is properly evaluated whenever a loan is issued, and that credit exposures are closely observed throughout their lifetime and, if necessary, that appropriate measures are taken in a timely manner.

5.1.2 Counterparty risk, including issuer risk

The Bank defines counterparty risk, including the risk of the issuer, as the risk that a counterparty/issuer cannot fulfil its contractual obligations at all, not in full or not on time. Counterparty risk in the bank mainly arises from keeping highly liquid assets for the purpose of managing liquidity. There are also structural exposures towards Central Bank of Bosnia and Herzegovina in the form of mandatory minimum reserves.

In order to minimize the counterparty's risk, the Bank conducts business with banks with high credit ratings, short-term placements and the Bank uses a very limited number of financial instruments.

The Bank is prohibited from engaging in speculative trading and, where necessary, the Bank purchases highly liquid securities with a maximum maturity of up to three months. During 2019 and 2018, the Bank did not invest or deposit funds with other institutions.

	31 December 2019	in %	31 December 2018	in %
Central bank balances	108,792	84.5%	74,484	70.8%
Loss allowances for central bank balances	*(115)*		-	
Of which obligatory reserve	47,047		40,299	
Of which other balances	61,745		34,185	
Current accounts with other banks (mainly ProCredit group)	19,905	15.5%	30,827	29.2%
Loss allowances for current accounts with other banks institutions	-		*(17)*	
Total	**128,697**	**100%**	**105,294**	**100%**

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.1 Credit risk *(continued)*

5.1.1. Customer credit risk *(continued)*

The exposures to counterparties and issuers are managed on the basis of the limit system, as is the case with clients' credit risk. The Bank concludes transactions only with other counterparties for which an analysis has been made and for which a limit has been approved. An approval is also required prior to investing in securities other than those centrally issued or central bank securities in local currency with a remaining maturity of up to three months. During 2019 and 2018, the Bank did not invest or deposit funds with other institutions.

5.1.2 Country risk

The Bank defines country risk as the risk that the Bank is not able to enforce rights over certain assets in a country or that a counterparty in that country is unable to perform an obligation due to convertibility or transfer restrictions or expropriation of its cross-border obligations. Country risk thus arises solely from cross-border transactions.

The Bank is only exposed to country risk to a very limited extent through nostro accounts maintained with other banks (mainly ProCredit Bank member banks).

5.2. Market risks

Market risks are defined as risks of possible losses due to changes in market prices, such as exchange rates or other parameters which influence prices. Relevant market risks for the Bank are foreign currency risk and interest rate risk in the banking book. The Bank manages market risks in such a way that their impact is as limited as possible from an overall risk perspective. In line with the ProCredit Group strategy, currency risk and interest rate risk cannot be used for speculative purposes. The Bank is non-trading book institution.

5.2.1. Foreign currency risk

Foreign currency risk is the risk that the Bank incurs losses due to exchange rate fluctuations or that the Bank's equity is reduced through currency translation effects. Foreign currency risk can have adverse effects on income and can lead to a decline in regulatory capital ratios.

Results are impacted negatively when the volume of its assets and liabilities denominated in foreign currencies do not match and the exchange rates move unfavourably. The key risk indicator that captures the balance sheet discrepancy for each currency is the open currency position (OCP). Limits for OCP are set at the Bank level and also take into account limits prescribed by the regulator.

The following table shows the open credit positions of the Bank in EUR and in USD. The position "other currencies" mainly includes CHF and other currencies with relatively small transaction volume. The banks keeps their significant amount of assets and liabilities in EUR and due to the fixed EUR/BAM rate the Bank assumes that this risk is very limited.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.2. Market risks (continued)

5.2.1. Foreign currency risk (continued)

31 December 2019	**BAM**	**EUR***	**USD**	**Other currencies**	**Total**
Financial assets					
Cash and cash equivalents	63,125	22,899	1,852	370	88,246
Obligatory reserves at the Central bank of BiH	47,047	-	-	-	47,047
Loans and advances to customers	80,891	317,363	-	-	398,254
*of which indexed to EUR**	-	317,363	-	-	317,363
Current tax assets	236	-	-	-	236
Investment in securities	-	43	-	-	43
Other assets	272	161	3	-	436
	191,571	**340,466**	**1,855**	**370**	**534,262**
Financial liabilities					
Liabilities to banks	-	39,180	-	-	39,180
Liabilities to financial institutions	1.799	168,043	-	-	169,842
Liabilities to customers	160,104	120,094	1,809	160	282,167
*of which indexed to EUR**		16,773			16,773
Subordinated debt	-	8,804	-	-	8,804
Provisions for guarantees and loan commitments	77	26	1	-	104
Other liabilities	1,830	246	-	-	2,076
	163,810	**336,393**	**1,810**	**160**	**502,173**
Net position	*27,761*	*4,073*	*45*	*210*	*32,089*

* The Bank has a number of agreements governed by a foreign currency clause. Due to the fixed relationship between EUR and BAM, the Bank is not exposed to significant currency risk from positions denominated in EUR.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.2. Market risks (continued)

5.2.1. Foreign currency risk (continued)

31 December 2018	BAM	EUR*	USD	Other currencies	Total
Financial assets					
Cash and cash equivalents	45,229	25,160	1,855	506	72,750
Obligatory reserves at the Central bank of BiH	40,299	-	-	-	40,299
Loans and advances to customers	80,186	284,680	-	-	364,866
*of which indexed to EUR**	-	*281,781*	-	-	*281,781*
Current tax assets	195	-	-	-	195
Investment in securities	-	43	-	-	43
Other assets	236	192	-	-	428
	167,075	**310,075**	**1,855**	**506**	**478,581**
Financial liabilities					
Liabilities to banks	-	41,058	-	-	41,058
Liabilities to other financial institutions	-	141,805	-	-	141,805
Liabilities to customers	157,853	95,212	2,233	502	255,800
*of which indexed to EUR**		22,823			
Subordinated debt	-	8,803	-	-	8,803
Provisions for guarantees and loan commitments	113	51	1	-	165
Other liabilities	182	204	-	-	386
	158,148	**287,133**	**2,234**	**502**	**448,017**
Net position	*8,927*	*22,942*	*(379)*	*4*	*31,494*

* The Bank has a number of agreements governed by a foreign currency clause. Due to the fixed relationship between EUR and BAM, the Bank is not exposed to significant currency risk from positions denominated in EUR.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.2. Market risks (continued)

5.2.2. Interest rate risk in the banking book

Interest rate risk is the risk of incurring losses due to changes in market interest rates and primarily arises from differences between the repricing maturities of assets and liabilities. The aim of interest rate risk management is to keep these differences as small as possible in all currencies. This is particularly relevant against the background of the limited opportunities to manage this risk using interest rate derivatives in local currency.

The measuring, monitoring and limiting of interest rate risk is based on economic value impact and P&L-oriented indicators. The risk is measured on a regular basis, at least quarterly. The assets and liabilities are distributed across time buckets according to the terms of the underlying contracts. Interest-bearing sight deposits and savings accounts are included in the gap analyses.

At the Bank level, we assume a parallel shift of the interest rate curve. For EUR and USD the interest rate shock is ± 200 basis points, whereas for domestic currencies the magnitude of the shock is derived on the basis of a historical analysis. Limits are set in relation to regulatory capital (non-netted in each case) for the economic value impact and for the P&L effect.

Total net weighted position of banking book is stated in absolute amount and represents economic value impact which is a result from application of standard interest rate shock.

	Economic Value Impact	
Currency	**31 December 2019**	**31 December 2018**
BAM	(587)	(289)
EUR	(1,504)	3,906
USD	-	(31)
Other currencies	(27)	(7)
Total (in BAM '000)	**(2,118)**	**3,579**

The Bank started with economic value impact calculations in line with the new regulation framework in 2018.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.3. Liquidity and funding risk

Liquidity and funding risk addresses the Bank's short- and long-term ability to meet its financial obligations in a complete and timely manner, even in stress situations.

The Bank assesses short-term liquidity risk in the Bank on the basis of a liquidity gap analysis, among other instruments, and the Bank monitors this risk using numerous indicators. These include a 30-day liquidity indicator (sufficient liquidity indicator - "*SLI*"), a survival period and the minimum liquidity ratio stipulated by Capital Requirements Regulations - CRR (Liquidity Coverage Ratio, *'LCR'*) as well as a local regulator. The SLI measures whether institutions have sufficient liquidity in relation to the expected inflows and outflows of funds in the next 30 days. The survival period is the timeframe during which the banks are able to fulfil all payment obligations, despite reduced liquidity inflows and elevated outflows. The calculation applies outflows derived from historical analyses of deposit movements in the Bank. LCR indicates whether the Bank have sufficient liquidity to cover the net outflows expected in the next 30 days, even in the event of a specified severe economic shock scenario.

In addition, early warning indicators are defined and monitored, and the key indicator in this respect is the highly liquid assets *(HLA)* indicator, which ensures that the Bank holds sufficient highly liquid assets at all times to be able to pay out a certain percentage of all customer deposits.

Market-wide, institution-specific, combined and longer-term stress tests are conducted monthly and ad hoc to make sure that the Bank keeps sufficient liquid funds to meet its obligations, even in difficult times. Moreover, the Bank has a contingency plan. If unexpected circumstances arise and the Bank proves not to have sufficient liquid funds, the ProCredit group has also developed a liquidity contingency plan and ProCredit Holding would step in as a "lender of last resort". ProCredit Holding keeps an adequate liquidity reserve available for this purpose. The amount of the liquidity reserve is determined on the basis of group stress tests and monitored on a regular basis.

The liquidity of the Bank is managed on a daily basis by the respective treasury departments, based on the Group ALCO-approved cash flow projections, and is monitored by risk management and ALCO. The Bank had enough liquidity available at all times in 2019 to meet all financial obligations in a timely manner.

The following tables show the undiscounted cash flows of the financial assets and financial liabilities of the Bank according to their remaining contractual maturities. The remaining contractual maturity is defined as the period between the balance sheet date and the contractually agreed due date of the asset or liability, or the due date of a partial payment under the contract for an asset or liability.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.4 Liquidity risk management *(continued)*

	Carrying amount	Gross nominal inflow/out flow	up to 1 month	1 - 3 months	4 - 12 months	1 – 5 years	over 5 years
31 December 2019							
Financial assets							
Cash and cash equivalents	88,246	88,246	88,246	-	-	-	-
Obligatory reserves with Central bank BiH	47,047	47,047	47,047	-	-	-	-
Loans and receivables to customers	398,254	436,199	23,509	45,006	101,185	197,805	68,694
Current tax assets	236	236	-	-	236	-	-
Investment in securities	43	43	-	-	-	-	43
Other assets	436	436	436	-	-	-	-
Total assets	**534,262**	**572,207**	**159,238**	**45,006**	**101,421**	**197,805**	**68,737**
Financial liabilities							
Liabilities to banks	39,180	39,269	-	23,635	15,634	-	-
Liabilities to other financial institutions	169,842	179,624	676	925	53,502	109,368	15,152
Liabilities to customers	282,167	283,806	171,455	16,044	72,477	20,726	3,104
Subordinated debt	8,804	12,986	-	-	527	2,100	10,359
Other liabilities	2,076	2,363	38	100	454	1,205	566
Total liabilities	**502,069**	**518,048**	**172,131**	**40,704**	**142,594**	**133,399**	**29,181**
Contingent liabilities							
Financial guarantees	48	42,462	42,462	-	-	-	-
Credit commitments (irrevocable loan commitments)	56	24,785	24,785	-	-	-	-
Contractual liquidity surplus	**32,089**	**(13,088)**	**(80,140)**	**4,302**	**(41,173)**	**64,406**	**39,556**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.4 Liquidity risk management *(continued)*

	Carrying amount	Gross nominal inflow/out flow	up to 1 month	1 - 3 months	4 - 12 months	1 – 5 years	over 5 years
31 December 2018							
Imovina							
Cash and cash equivalents	**72,750**	**72,750**	72,750	-	-	-	-
Obligators reserves with Central bank BiH	**40,299**	**40,299**	40,299	-	-	-	-
Loans and receivables to customers	**364,866**	**407,149**	32,993	45,600	93,654	181,531	53,371
Current tax assets	**195**	**195**	-	-	195	-	-
Investment in securities	**43**	**43**	-	-	-	-	43
Other assets	**427**	**427**	427	-	-	-	-
Total assets	**478,580**	**520,863**	**146,469**	**45,600**	**93,849**	**181,531**	**53,414**
Liabilities							
Liabilities to banks	**41,058**	**41,075**	-	11,847	29,391	-	-
Liabilities to customers	**255,800**	**257,205**	167,439	8,793	41,074	39,233	665
Liabilities to other financial institutions	**141,805**	**145,202**	659	5,039	9,804	108,853	20,847
Subordinated debt	**8,803**	**13,788**	-	-	263	2,624	10,901
Other liabilities	**472**	**472**	472	-	-	-	-
Total liabilities	**447,938**	**457,742**	**168,570**	**25,679**	**80,532**	**105,710**	**32,413**
Contingent liabilities							
Guarantees	**93**	**34,571**	34,571	-	-	-	-
Credit commitments (irrevocable loan commitments)	**71**	**24,981**	24,981	-	-	-	-
Contractual liquidity surplus	**30,477**	**3,569**	**(81,653)**	**19,921**	**13,317**	**75,821**	**21,001**

Short-term liquidity risk is measured primarily by means of LCR. As of 31 December 2019, the LCR was 187% (2018: 414%), and thus comfortably above the local regulatory requirement of minimum 100%.

Funding risk is the danger that additional funding cannot be obtained, or can only be obtained at higher costs. It therefore covers parts of the non-systemic effect of interest rate changes. This risk is mitigated by the fact that the Bank finances its lending operations primarily through customer deposits which are supplemented by long-term credit lines from international financial institutions (IFIs). As of 31 December 2019 the largest funding source was customer deposits, with BAM 282 million (2018: BAM 255 million). International Financial Institutions within the group and the Other International financial institutions (IFIs) are the second largest source of funding.

The Bank manages, measures and limits funding risk through business planning, maturity gap analysis and several indicators, including stress scenario on a vista funding withdrawals. The funding needs of the Bank, identified in the business planning process, are monitored and regularly reviewed at the Bank and at the group level. ProCredit Holding also offers bridge financing in the event of assessed need, and currently the Bank has stand by line approved by ProCredit Holding in the amount of EUR 5 million. A key indicator for limiting funding risk is the deposit concentration indicator. Two more indicators additionally restrict the level of funding from the interbank market.

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.5 Capital management

Capital management in the Bank is guided by the principle that the Bank may at any time incur greater risks than they are able to bear. This principle is monitored using different indicators for which early warning indicators and limits have been established.

The indicators for the Bank include, in addition to regulatory standards, a capital adequacy calculation in accordance with CRR requirements, a Tier 1 leverage ratio in accordance with CRR and an internal capital adequacy assessment.

The objective of capital management is to maintain sufficient and adequate capital level which can in any moment meet all of qualitative and quantitative requirements. Thus providing normal activity of the Bank.

The capital management framework of the Bank has the following objectives:

— Compliance with regulatory capital requirements (normative perspective)
— Ensuring adequate capitalisation in the economic perspective
— Compliance with the internally defined capital requirements and creation of a sufficient capital buffer

The capital management of the Bank is governed by internal policies and monitored on a monthly basis by the ACLO committee.

Internal capital adequacy

ProCredit Bank faces various risks resulting from its business activities. The Bank manages the risks appropriately and in accordance with their significance to the Bank. The risk catalogue is an instrument which should identify materiality of risks to which the Bank is exposed, to present the overall risk profile of the Bank. The risk catalogue is a basis for the Bank's risk management. The risk catalogue consists of the introductory document and a special risk catalogue table. The introductory document provides for an overview of the general risk catalogue framework, responsibilities and steps to be taken to assess individual risk categories. The risk catalogues provides for an overview of all potential risks and assessment of their significance to the Bank.

The risk catalogue is regularly updated, at least once a year, or more often if required, starting the risk identification process and assessing their materiality. In determination of materially significant risks to which the Bank is exposed, and which will be included into internal capital adequacy assessment process, the type, scope and complexity of business operations are taken into account as well as specifics of market where the bank operates. Also, previous experience in risk management of the Bank and ProCredit Group are taken into account, including historical data on negative effects on financial performance and capital of the Bank.

Identification and risk management is performed by Risk Management Department in cooperation with other relevant Departments/Units in accordance with the criteria for material significance for specific risk stated in risk catalogue. Similar risks are managed together with the main risk (e.g. credit risk). The risk catalogue is subject to discussion among all relevant Department/Units including the bank's Management and Supervisory board.

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.5 Capital management *(continued)*

Within the internal capital adequacy assessment process the Bank has defined all requirements in accordance with the principles proscribed by Federal Banking Agency on risk management. Methodology of internal process of the Bank's capital adequacy assessement and asessment of the adequacy of the liquidy position, including assumptions used in the internal methodology, are approved by the Bank's Supervisory board. This act define methodology of stress testing for ICAAP. The stress test has to be performed once per year as minimum. Information on stress testing are as follows:

Risk	Description	Assumptions
Credit risk	Internal model with ECL rates	Reliability level 99.8%
Counterparty risk	Internal model – reiting related to probabily of raiting migration and PDs	Ratings for the banks are decreased by 2 notches
Currency risk	VaR	Reliability level 99.8%
Operating risk	Analysis of the probability of the number of events and the probability of loss per event	Reliability level 99.8%
Interest rate risk	Simplified calculations with simulation of stronger interest rate shock	Interst rate shock of 400 bp
Liquidity risk	Internal and external factors	Prolonged market stress simulation

Regulatory capital adequacy

Methods for the calculation of capital adequacy are based on the local regulation which is in line with Basel II requirement. Compliance with regulatory requirements are monitored on a regularal basis. During the reporting period, all regulatory capital requirements were met at all times.

The capital adequacy ratio of the Bank is above the prescribed limit of 12%. Following table presents the structure of equity and capital requirements of the Bank on 31 December 2019 and 31 December 2018:

In BAM '000	31 December 2019	31 December 2018
Common equity Tier 1 capital	47,697	48,748
Additional Tier 1 capital	-	-
Tier 2 capital	1,888	2,966
Total capital	**49,585**	**51,714**
Risk weighted assets (unaudited)	**331,493**	**306,656**

	31 December 2019	31 December 2018
Common equity Tier 1 capital	14.4%	15.9%
Tier 1 capital ratio	14.4%	15.9%
Total capital ratio	**15.0%**	**17.2%**

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

5. FINANCIAL RISK MANAGEMENT *(continued)*

5.5 Capital management *(continued)*

The capital ratios decreased slightly in the 2019 financial year. During the course of 2019, the CET1 ratio and T1 ratio declined to 14.4% due to the growth of the balance sheet. The total capital ratio fell to 15.0% as a result of growth as well as the early repayment of supplementary capital instruments. The Bank already initiated capital increase at the end of 2019 which will be effective in first half of 2020.

Within the internal capital adequacy assessment process the Bank will calculate the regulatory capital requirement for credit risk in accordance with the FBA Decision on calculation of a bank's capital (standardised approach). In addition, based on the internal model it shall calculate internal capital requirement for credit risk and compare it to the regulatory capital requirement to avoid possible credit risk underestimations due to use of the standardised approach. The Bank will also perform the credit risk stress test to avoid possible credit risk underestimations due to use the standardised approach in the crisis circumstances.

In additon, the Bank is obliged to ensure and maintan an additional leverage ratio which is not risk-based (financal leverage ratio). This is defined as the ratio of the Tier 1 capital to total weighted on- and off-balance sheet risk exposures. The minimum requirement for the leverage ratio has set at 6%. As of year-end the Bank reported leverage ratio of 8.3%.

Leverage ratio

	31 December 2019	31 December 2018
Tier 1 capital	47,697	48,748
Assets	574,623	569,990
Leverage ratio	**8.3%**	**8.6%**

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

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

31 December 2019	Category	Level 1	Level 2	Level 3	Fair value	Carrying amount
Financial assets						
Cash and cash equivalents	AC	6,712	81,534	-	**88,246**	**88,246**
Obligatory reserves at Central bank of BiH	AC	-	47,047	-	**47,047**	**47,047**
Loans and receivables to customers	AC	-	-	400,650	**400,650**	**398,254**
Other assets	AC	-	-	436	**436**	**436**
Investment securities	FVOCI	-	63	-	**63**	**43**
Total		**6,712**	**128,644**	**401,086**	**536,442**	**534,026**
Financial liabilities						
Liabilities to banks	AC	-	-	38,602	**38,602**	**39,180**
Liabilities to other financial institutions	AC	-	-	170,224	**170,224**	**169,842**
Liabilities to customers	AC	-	168,489	114,057	**282,546**	**282,167**
Subordinated debt	AC	-	-	10,646	**10,646**	**8,804**
Other liabilities	AC	-	-	2,076	**2,076**	**2,076**
Total		**-**	**168,489**	**335,605**	**504,094**	**502,069**

31 December 2018	Category	Level 1	Level 2	Level 3	Fair value	Carrying amount
Financial assets						
Cash and cash equivalents	AC	7,755	64,995	-	**72,750**	**72,750**
Obligatory reserves at Central bank of BiH	AC	-	40,299	-	**40,299**	**40,299**
Loans and receivables to customers	AC	-	-	363,609	**363,609**	**364,866**
Other assets	AC	-	-	428	**428**	**428**
Investment securities	FVOCI	-	55	-	**55**	**43**
Total		**7,755**	**105,349**	**364,037**	**477,141**	**478,386**
Financial liabilities						
Liabilities to banks	AC	-	-	41,061	41,061	41,058
Liabilities to other financial institutions	AC	-	-	140,043	140,043	141,805
Liabilities to customers	AC	-	158,649	97,677	256,326	255,800
Subordinated debt	AC	-	-	11,003	11,003	8,803
Other liabilities	AC	-	-	386	386	386
Total		**-**	**158,649**	**290,170**	**448,819**	**447,852**

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

The Bank's fair value determination gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. For short-term financial instruments carried at amortised costs, the carrying value represents a reasonable estimate of fair value.

Upon acquisition, financial instruments are measured at fair value. In principle, this is the transaction price at the time they are acquired. Depending on their respective category, financial instruments are subsequently recognised either at fair value or at (amortised) cost.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market between market participants at the measurement date.

The Bank applies the IFRS hierarchy to measure fair value. The hierarchy categorises the inputs used in the valuation techniques to measure fair value into three levels:

(a) Level 1 Inputs

Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. A market is regarded as active if market transactions with the asset or liability occur there sufficiently frequently and in sufficient volumes to ensure the ongoing availability of pricing information.

(b Level 2 Inputs

Other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, the valuation techniques applied are approximations of the current fair value of similar instruments and discounted cash flow analysis using observable market parameters. The Bank applies individual observable interest and exchange rates, made available predominantly by the Central bank of Bosnia and Herzegovina.

(c) Level 3 Inputs

Unobservable inputs for the asset or liability. If observable market interest rates are not available, internal rates are used as an input for a discounted cash flow model. These internal rates reflect the cost of funds, taking into account foreign currency effects and maturities as well as a risk margin, e.g. Bank's Funding interest rates. Internal rates are regularly compared to those applied for third-party transactions and are consistent with the parameters of an orderly transaction between market participants under market conditions at the measurement date.

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.

Deposits from banks, other financial institutions, customers 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.

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.

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

7. INTEREST INCOME

	31 December 2019	31 December 2018
Interest revenue calculated using the effective interest rate method		
Loans and receivables		
business clients	14,009	13,600
private clients	1,188	1,556
Banks	16	5
Other interest income	87	187
	15,300	**15,348**

8. INTEREST EXPENSE

	31 December 2019	31 December 2018
Financial institutions	2,508	2,189
Private and business clients	1,634	1,944
Banks	619	396
Subordinated debt	525	524
Interest expense from lease liabilities	66	-
Other interest expense	269	255
	5,621	**5,308**

9. FEE AND COMMISION INCOME

	31 December 2019	31 December 2018
Major service lines		
Payment transactions	2,713	2,512
Account maintenance fee	1,796	1,780
Credit card business	391	423
Other	340	257
Fee and commission income from contract with customers	5,240	4,972
Letters of credit and guarantees	807	793
	6,047	**5,765**

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

10. FEE AND COMMISION EXPENSE

	31 December 2019	31 December 2018
Payment transactions	873	820
Credit card business	785	756
Account maintenance fee	13	34
Other	46	106
	1,717	**1,716**

11. NET INCOME FROM FOREIGN CURRENCY TRADING

	31. decembar 2019.	31. decembar 2018.
Income from foreign currency transactions	881	656
Net gains and losses from FX revaluation	(28)	(33)
	853	**623**

12. OTHER OPERATING INCOME

	31 December 2019	31 December 2018
Gain on sale of repossessed assets	380	30
Rent income from investment properties	85	-
Income from litigation settlements	75	8
Income from sale of property and equipment	5	130
Other income	152	76
	697	**244**

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

13. ADMINISTRATIVE EXPENSES

	31 December 2019	31 December 2018
IT expenses	3,385	2,903
Advisory services	1,081	1,100
Recruitment and education	544	581
Security services	342	330
Transportation expenses	267	293
Utility and electricity expenses	239	242
Marketing	232	225
Legal and court fees	211	176
Repairs and maintenance	189	257
Telecommunications	188	180
Lease expenses	142	635
Audit fees	108	125
Insurance	102	158
Other taxes and contributions	88	104
Membership fees	82	72
Office supplies	43	35
Other administrative expenses	813	805
	8,056	**8,221**

14. PERSONNEL EXPENSES

	31 December 2019	31 December 2018
Gross salaries	2,720	2,798
Social security expenses	1,652	1,630
Post-employment contributions	157	28
Post-employment benefits	7	5
Social security refund	(20)	(21)
Other employee expenses	630	717
	5,146	**5,157**

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

15. OTHER OPERATING EXPENSES

	31 Decembar 2019	31 Decembar 2018
Impairment of repossessed assets	578	118
Deposit insurance expenses	538	494
Provisions for court cases (Note 28)	167	78
Expenses from other litigation settlements	157	-
Expenses for taxes based on tax inspection	-	187
Loss from disposal of property, plant and equipment	1	60
Other expenses	147	108
	1,588	**1,045**

16. IMPAIRMENT LOSSES, NET

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

	31 December 2019	31 December 2018
Increase in impairment charge	3,828	2,894
Release of impairment charge	(3,032)	(3,794)
Recovery of written-off loans	(108)	(158)
Direct write-offs	4	138
	692	**(920)**

The net charge in respect of impairment losses to income statement per type of asset is analysed as follows:

	31 December 2019	31 December 2018
Impairment / (Release) of loans and receivables to customers, net *(Note 19)*	662	(797)
Impairment / (Release) of other assets and receivables, net *(Note 18)*	(8)	(90)
Impairment of funds held at the Central bank of BiH, net	115	-
(Release) / impairment from current accounts with other banks, net	(17)	15
Release of provisions from off-balance exposures, net	(60)	(48)
	692	**(920)**

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

17. INCOME TAX

Total income tax recognized in the income statement can be shown as follows:

	31 December 2019	31 December 2018
Current tax	45	-
Deferred tax	29	85
	74	85

Reconciliation of effective tax rate may be presented as follows:

	31 December 2019	31 December 2018
(Loss)/Profit before income tax	(1,559)	49
Income tax at a rate of 10%	(156)	5
Effects of unrecognized revenues	-	(106)
Effects of unrecognized expenditures – permanent difference	112	102
Transfer pricing	-	10
Derecognition of previously recognised deferred tax asset	29	85
Tax charge in Republic of Srpska*	45	-
Utilised/(Unutilised) tax losses carried forward	(44)	11
Income tax	74	85
Effective tax rate	-	173%

*Income tax charged in RS is calculated separately based on specific cost allocation for expenses and income incurred in RS.

The change in deferred tax assets may be presented as follows:

	31 December 2019	31 December 2018
Balance at the beginning of period	109	194
Release of deferred tax assets	(29)	(85)
Balance at the end of the period	80	109

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. The Bank does not establish deferred tax assets for losses carried forward.

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

17. INCOME TAX *(continued)*

Tax effect of BAM 5,578 thousand relating to tax loss of BAM 558 thousand as at 31 Decmeber 2019 can be carried forward in accordance with the filed tax report are as follows:

	31 December 2019	31 December 2018
Expire in 2020	11	-
Expire in 2021	671	763
Expire in 2022	4,452	4,452
Expire in 2024	444	
Total	**5,578**	**5,215**

18. CASH AND CASH EQUIVALENTS AND OBLIGATORY RESERVES AT THE CENTRAL BANK OF BOSNIA AND HERZEGOVINA

	31 December 2019	31 December 2018
Cash in hand	6,712	7,755
Balances at central bank	108,791	74,484
Loss allowances for cash and central bank balances	*(115)*	-
Cash and central bank balances	**115,388**	**82,239**
Current accounts with other banks	19,905	30,827
Loss allowances for current account with other banks	-	*(17)*
Obligatory reserve which does not qualify as cash and cash equivalenst	47,047	40,299
Cash and cash equivalents for the statement of cash flows	**88,246**	**72,750**

The minimum reserve requirement is calculated as a percentage of the average amount of total deposits and borrowed funds for each business day during 10 calendar days after the mandatory reserve maintenance period.

From 1 July 2016, a single rate of 10% of total short-term and long-term deposits and borrowed funds is applied. Cash held as a compulsory reserve in the CBBH account is not available for use without the special approval of CBBH and FBA.

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

18. CASH AND CASH EQUIVALENTS AND OBLIGATORY RESERVES AT THE CENTRAL BANK OF BOSNIA AND HERZEGOVINA *(continued)*

The changes in loss allowances for central bank balances are presented in the following table. All central bank balances are classified as Stage 1.

	2019	2018
Impairment allowances as of 1 January	-	-
Newly recognized financial assets (*Note 16*)	(115)	-
Derecognition	-	-
Impairment allowances as of 31 December	**(115)**	-

The changes in loss allowances for current accounts with other banks are presented in the following table. All balances with other banks are classified as Stage 1.

	2019	2018
Impairment allowances as of 1 January	(17)	(2)
Newly recognized financial assets (*Note 16*)	-	(15)
Derecognition (*Note 16*)	17	-
Impairement allowances as of 31 December	-	**(17)**

Credit reitings of banks where the Bank has current accounts are as follows:

	31 December 2019	Credit risk rating
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main, Germany	3,313	AA-
ProCredit Bank AG, Frankfurt am Main, Germany	9,449	BBB
ProCredit Bank a.d. Belgrade, Serbia	240	BBB-
ProCredit Bank (Bugarska) EAD	90	BBB-
ProCredit Bank Sh.a, Kosovo	38	BB
Raiffeisen Bank International AG, Vienna, Austria	1,634	BBB+
Zagrebačka Banka d.d. Zagreb, Croatia	60	BBB-
Raiffeisen Bank International d.d. Sarajevo, Bosnia and Herzegovina	5,004	B
UniCredit Bank d.d. Mostar, Bosnia and Herzegovina	77	B
Gross value	**19,905**	
Less: impairment	-	
Net value	**19,905**	

During 2019 there were no changes in credit ratings of listed banks.

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

19. LOANS AND RECEIVABLES TO CUSTOMERS

The analysis of loans and receivables according to the original maturity is as follows:

	31 December 2019	31 December 2018
Short-term loans:		
Short-term loans in domestic currency	70,294	69,578
Short-term loans in foreign currency (*including indexed to EUR*)	1,531	2,257
	71,825	*71,835*
Long term loans:		
Long-term loans in domestic currency	15,596	16,646
Long-term loans in foreign currency (*including indexed to EUR*)	323,862	291,237
	339,458	*307,883*
Total loans before impairment	***411,283***	***379,718***
Less: impairment	(13,029)	(14,852)
	398,254	364,866

Interest rates on loans and receivables to customers as at 31 December 2019 and 31 December 2018 are as follows:

	31 December 2019		31 December 2018	
	'000 BAM	Annual interest rate	'000 BAM	Annual interest rate
Domestic currency				
Business	84,780	2.00% – 12.50%	84,927	2.00% – 14.00%
Private	1,110	3.50% – 15.00%	1,297	3.50% – 16.00%
Foreign currency				
Business	308,314	3.00% – 12.00%	275,672	2.00% – 13.25%
Private	17,079	1.90% – 14.00%	17,822	2.80% – 18.00%
	411,283		*379,718*	

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

19. LOANS AND RECEIVABLES TO CUSTOMERS *(continued)*

All loans and receivables to customers are measured at amortized cost. The following tables show reconciliationsfrom the opening to the closing balance of the loans and advances to customers and respective loss allowances.

	Stage 1	Stage 2	Stage 3	POCI	**Total**
Gross outstanding amount as of 1 January 2019	**355,660**	**2,791**	**21,267**	**-**	**379,718**
New loans and receivables originated	223,544	54	44	296	223,938
Modification of contractual cash flows of financial assets	-	-	40	-	40
Derecognitions (including write-offs)	(97,530)	(550)	(5,866)	(26)	(103,972)
Changes in interest accrual, principal and disbursement fee	(85,909)	(1,108)	(1,424)	-	(88,441)
Transfer from Stage 1 to Stage 2	(42,734)	42,734	-	-	-
Transfer from Stage 1 to Stage 3	-	-	-	-	-
Transfer from Stage 2 to Stage 1	3,232	(3,232)	-	-	-
Transfer from Stage 2 to Stage 3	-	(1,411)	1,411	-	-
Transfer from Stage 3 to Stage 2	-	132	(132)	-	-
Transfer from Stage 3 to Stage 1	2		(2)	-	-
Other movements	(107)	(84)	191	-	-
Gross outstanding amount as of 31 December 2019	**356,158**	**39,326**	**15,529**	**270**	**411,283**

	Stage 1	Stage 2	Stage 3	POCI	**Total**
Impairement allowances as of 1 January 2019	(1,674)	(268)	(12,910)	-	**(14,852)**
New loans and receivables originated	(1,264)	(5)	(17)	(263)	**(1,549)**
Release due to derecognition	551	73	1,629	-	**2,253**
Transfers to Stage 1	(250)	250	-	-	**-**
Transfers to Stage 2	250	(265)	14	-	**-**
Transfers to Stage 3	-	6	(6)	-	**-**
Change in credit risk	1,114	(210)	(2,271)	-	**(1,367)**
Usage of allowance	-	-	2,069	-	**2,069**
Other movements	-	-	418	-	**417**
Impairement allowances as of 31 December 2019	**(1,273)**	**(419)**	**(11,074)**	**(263)**	**(13,029)**

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

19. LOANS AND RECEIVABLES TO CUSTOMERS *(continued)*

	Stage 1	Stage 2	Stage 3	POCI	**Total**
Gross outstanding amount as of 1 January 2018	305,787	10,624	31,088	-	347,499
New loans and receivables originated	48,350	-	-	-	48,350
Modification of contractual cash flows of financial assets	-	-	(12)	-	(12)
Derecognitions (including write-offs)	-	-	(9,228)	-	(9,228)
Changes in interest accrual, principal and disbursement fee	(325)	(4,731)	(1,835)	-	(6,891)
Transfer from Stage 1 to Stage 2	(1,072)	1,072	-	-	-
Transfer from Stage 1 to Stage 3	(766)	-	766	-	-
Transfer from Stage 2 to Stage 1	3,581	(3,581)	-	-	-
Transfer from Stage 2 to Stage 3	-	(840)	840	-	-
Transfer from Stage 3 to Stage 2	-	247	(247)	-	-
Transfer from Stage 3 to Stage 1	105	-	(105)	-	-
Other movements	-	-	-	-	-
Gross outstanding amount as of 31 January 2018	**355,660**	**2,791**	**21,267**	-	**379,718**

	Stage 1	Stage 2	Stage 3	POCI	**Total**
Impairement allowances as of 1 January 2018	(1,479)	(743)	(18,744)	-	**(20,966)**
New loans and receivables originated	(1,043)	-	-	-	**(1,043)**
Release due to derecognition	-	-	1,885	-	1,885
Transfers to Stage 1	(98)	97	1	-	-
Transfers to Stage 2	96	(209)	113	-	-
Transfers to Stage 3	4	182	(186)	-	-
Change in credit risk	846	405	(1,296)	-	**(45)**
Usage of allowance	-	-	4,753	-	**4,753**
Other movements	-	-	564	-	**563**
Impairement allowances as of 31 December 2018	**(1,674)**	**(268)**	**(12,910)**	-	**(14,852)**

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

20. INVESTMENT PROPERTY

Cost	
Balance at 1 January 2018	-
Additions	-
Balance at 31 December 2018	-
Transfers	1,987
Balance at 31 December 2019	**1,987**
Accumulated depreciation	
Balance at 1 January 2018	-
Charge for the year	-
Balance at 31 December 2018	-
Charge for the year	12
Transfers	294
Balance at 31 December 2019	**306**
NET BOOK VALUE	
Balance at 31 December 2018	-
Balance at 31 December 2019	**1,681**

During 2019 the Bank leased part of it headquorter building to third party which is then recognized as investment property. The fair value of investment properties at 31 December 2019 was performed by the external appraiser (from the listo of approved appraireser) and futher confirmed by internal appraires employed by the Bank who have appropriate qualifications and recent experience in estimating assets at fair value at relevant locations.

The fair value of investment property was determined using the market value method which reflects current value on the market, taking into consideration object's construction value and other factors (location, usability, quality and other factors). The fair value of investment property amounts to BAM 2.4 million.

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

21. PROPERTY AND EQUIPMENT

	Buildings and land	Office equipment	Right of use assets - properties	Right of use assets - equipment	Total
Cost					
At 1 January 2018	**14,829**	**10,098**	-	-	**24,927**
Additions	15	133	-	-	148
Transfers	56	(58)	-	-	(2)
Disposals and write off	(664)	(2,816)	-	-	(3,480)
At 31 Decembar 2018	**14,236**	**7,357**	-	-	**21,593**
Effects of the first application of IFRS 16 ***(Note 2.6)***	-	-	**1,981**	**326**	**2,307**
Additions	3	158	-	-	161
Transfers	(1,987)	-	-	-	(1,987)
Disposals and write off	(65)	(350)	(324)	-	(739)
Na dan 31. decembar 2019.	**12,187**	**7,165**	**1,657**	**326**	**21,335**
Accumulated depreciations					
At 1 January 2018	**2,400**	**8,031**	-	-	**10,431**
					-
Charge for the year	372	532	-	-	904
Disposals and write off	(614)	(2,803)	-	-	(3,417)
At 31 Decembar 2018	**2,158**	**5,760**	-	-	**7,918**
Charge for the year	340	461	269	117	1,187
Transfers	(294)	-	-	-	(294)
Disposals and write off	(67)	(341)	(35)	-	(443)
At 31 Decembar 2019	**2,137**	**5,880**	**234**	**117**	**8,368**
Net book value:					
Balance at 31 December 2018	**12,078**	**1,597**	-	-	**13,675**
Balance at 31 December 2019	**10,050**	**1,285**	**1,423**	**209**	**12,967**

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

22. INTANGIBLE ASSETS

	Software	Licences	Total
Cost			
Balance at 1 January 2018	1,856	5,076	6,932
Balance at 31 December 2018	1,856	5,076	6,932
Balance at 31 December 2019	1,856	5,076	6,932
Accumulated depreciation			
Balance at 1 January 2018	1,007	4,163	5,170
Charge for the year	147	267	414
Balance at 31 December 2018	1,154	4,430	5,584
Charge for the year	144	219	363
Balance at 31 December 2019	1,298	4,649	5,947
Carrying value:			
Balance at 31 December 2018	702	646	1,348
Balance at 31 December 2019	558	427	985

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

23. OTHER ASSETS AND RECEIVABLES

	31 December 2019	31 December 2018
Repossessed assets	2,337	5,312
Inventory	2	3
Short-term financial assets	599	599
Advances given	58	70
Other assets	611	561
	3,607	**6,545**
Less: impairment allowances	(163)	(171)
	3,444	**6,374**

Repossessed assets are non-financial assets acquired in the process of collection of credit claims with the aim to sell these assets as soon as the conditions are met. Assets are recognized at the lower of fair value less cost to sell or net carryng value of receivables. Depreciation is not charged on the repossessed assets. Any subsequent impairment or increases up to the initial value is recorded under other operating income/expense.

Changes in impairment of other assets and receivables can be shown as follows:

	31 December 2019	31 December 2018
Balance as at the beginning of year	**(171)**	**(492)**
New financial assets originated	(15)	(39)
Derecognition	26	552
Change in credit risk	(3)	(423)
Other movement	-	231
Balance as at the end of the period	**(163)**	**(171)**

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

23. OTHER ASSETS AND RECEIVABLES *(continued)*

The following tables show reconciliations from the opening to the closing balance of the loss allowance for financial assets:

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairement allowances as of 1 January 2019	(2)	(6)	(163)	-	**(171)**
New financial assets originated	-	(15)	-	-	**(15)**
Derecognition of assets	-	-	26	-	**26**
Change in credit risk	1	-	(4)	-	**(3)**
Impairement allowances as of 31 December 2019	**(1)**	**(21)**	**(141)**	-	**(163)**

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairement allowances as of 1 January 2018	(6)	(17)	(469)	-	**(492)**
New financial assets originated	(4)	(14)	(21)	-	**(39)**
Release due to derecognition	1	16	535	-	**552**
Change in credit risk			(423)		**(423)**
Other movement	7	9	215		**231**
Impairement allowances as of 31 December 2018	**(2)**	**(6)**	**(163)**	-	**(171)**

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

24. LIABILITIES TO BANKS

The analysis of liabilities to banks according to the original maturity is as follows:

	31 December 2019	31 December 2018
Long-term borrowings:		
Long-term borrowings from foreign banks and financial institutions	-	-
Less: Current portion of long-term borrowings	-	-
	-	-
Short-term borrowings:		
Add: Current portion of long-term borrowings	-	-
Short-term deposits:		
Short-term bank deposits with a maturity of up to three months	23,470	11,735
Short-term bank deposits with a maturity of up to one year	15,710	29,323
	39,180	**41,058**

25. LIABILITIES TO OTHER FINANCIAL INSTITUTIONS

	Remaining maturity					
31 December 2019	up to 3 months	3 - 12 months	1 - 5 years	more than 5 years	non cash relevant	**Total**
Liabilities with fixed interest rates	2,411	28,870	122,701	15,152	-	**169,134**
Liabilities with variable interest rates	107	243	358	-	-	**708**
Total	**2,518**	**29,113**	**123,059**	**15,152**	-	**169,842**

	Remaining maturity					
31 December 2018	up to 3 months	3 - 12 months	1 - 5 years	more than 5 years	non cash relevant	**Total**
Liabilities with fixed interest rates	5,314	13,347	95,962	20,290	-	**134,913**
Liabilities with variable interest rates	1,950	4,942	-	-	-	**6,892**
Total	**7,264**	**18,289**	**95,962**	**20,290**	-	**141,805**

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

26. LIABILITIES TO CUSTOMERS

	31 December 2019	31 December 2018
Current accounts:		
Private	107,163	95,116
Business	25,948	29,185
	133,111	*124,301*
Demand deposits:		
Private	24,461	25,690
Business	10,917	8,659
	35,378	*34,349*
Term deposits:		
Private	43,894	43,975
Business	69,784	53,175
	113,678	*97,150*
	282,167	**255,800**

27. SUBORDINATED DEBT

	31 December 2019	31 December 2018
ProCredit Holding AG	8,804	8,803
	8,804	**8,803**

There is one active borrowing from related party ProCredit Holding AG, approved on 31 August 2005, in total amount of BAM 8,803 thousand and includes only principal liability. The amendment to the subordinated debt agreement was signed on 16 December 2017. The principal will be charged interest at the rate of 6M EURIBOR + 5.88% per annum. Maturity date for this borrowing is as of 30 December 2027. The Bank was not in delay of principal or interest of this credit line nor dit it breach other provisions of subordinated debt contract. The funds of the subordinated loan are available to cover losses only in case of bankruptcy or liquidation of the Bank, and are not available for loss coverage of regular business operations of the Bank. In case of liquidation or bankruptcy of the Bank, the liabilities under the subordinated loan are subordinated to the other liabilities of the Bank.

Subject to the approval of FBA, subordinated debt may be used as additional capital for regulatory purpose. The Bank has initiated a process of transferring subordinated debt to equity which is expected to be finalised in 2020.

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

28. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2019	31 December 2018
Provisions for court cases	425	258
Provisions for employee benefits	204	197
Provisions for guarantees and loan commitments	104	164
Other	85	-
	818	**619**

Gurantees and loan commitments

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

	31 December 2019	31 December 2018
Loan commitments		
Loan commitments (revocable)	10,218	10,383
Loan commitments (irrevocable)	24,785	24,981
	35,003	*35,364*
Guarantees		
Performance guarantees	27,803	21,226
Payment guarantees	14,659	13,345
Letters of credit	445	351
	42,907	*34,922*
Total gurantees and loan commitments	77,910	70,286

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

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

Movements in provisions for liabilities and charges were as follows:

Provisions for:	**1 January 2018**	**Additions**	**Releases**	**Used**	**31 December 2018**
Post-employment benefits (*Note 14*)	**192**	5	-	-	**197**
Provisions for court cases	**180**	78	-	-	**258**
Provisions for off-balance items (*Note 16*)	**212**	116	(164)		**164**
Other provisions	-	-	-	-	-
Total	**584**	**199**	**(164)**	**-**	**619**

Provisions for:	**1 January 2019**	Additions	Releases	Used	**31 December 2019**
Post-employment benefits (*Note 14*)	**197**	7	-	-	**204**
Provisions for court cases (Note 15)	**258**	239	(72)	-	**425**
Provisions for off-balance items (*Note 16*)	**164**	8	(68)	-	**104**
Other provisions	-	85	-	-	**85**
Total	**619**	**339**	**(140)**	**-**	**818**

The total amount of legal proceedings is BAM 1,152 tousand (2018: BAM 882 thousand) which mainly relates to court procedures initiated by ex employees. The Bank creates provisions in support with its internal and external legal advisors and adjust the level of provisions based on the cirsumstances that exists at each reporting date.

If there are a number of similar obligations, the probability of outflows required to settle the obligation is determined by assuming that the same obligations are involved.

The following actuarial assumptions for 2019 were used to calculate the effects of provisions in accordance with IAS 19:

a. ***Demographic assumptions:***
- i. Average mortality rate – 0.79%
- ii. Average fluctuation rate – 2.95%

b. ***Financial assumptions:***
- iii. Discount rate– 3.0% and
- iv. Expected salary growth – 2.0%

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

29. OTHER LIABILITIES AND PAYABLES

	31 December 2019	31 December 2018
Lease liabilities	1,669	-
Accruals	817	395
Liabilities to legal entities	100	83
Liabilities for credit cards operations	202	221
Deferred income	160	123
Liabilities to suppliers	77	43
Liabilities to governments	26	5
Non-income tax liabilities	2	34
Other liabilities	14	6
	3,067	**910**

i. Lease liabilities

The Bank applied the new requirements IFRS 16 using the modified retrospective approach based on which the comparative information for 2018 is not restated – i.e. it is presented, as previously reported, under IAS 17.

	Currency	Nominal interest rate	Agreed/ expected maturity	Present value as at 31.12.2019
Lease liability – business premises	BAM	3.65%	2020-2027	1,456
Lease liability - equipment	BAM	3.95%	2020-2022	213
				1,669

Amounts recognised in profit and loss

	2019
Leases under new requirements of IFRS 16	
Interest on lease liabilities *(Note 8)*	66
Depreciation of righ-of-use assets *(Note 21)*	386
Expenses relating to low value assets and short-term leases *(Note 13)*	142

	2018
Operating lease under earlier requirements of IAS 17	
Operating lease (*Note 13*)	635

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

30. SHARE CAPITAL

Capital is made up of 7,112,649 ordinary shares at nominal value of BAM 10. Equity instruments of the Bank are not traded in a public market, but are listed at Sarajevo Stock Exchange.

The shareholding structure is as follows:

Shareholders	No. of Shares	'000 BAM	%
ProCredit Holding AG&CO. KGaA, Frankfurt, Germany	7,112,649	10	100.00
Total	**7,112,649**	**71,126,490**	**100.00**

During 2018 a capital increase of BAM 3,911 thousand was made.

	2019	2018
Balance as of January 1	71,126	67,215
Weighted average number of regular shares outstanding	-	3,911
Balance as of December 31	**71,126**	**71,126**

31. BASIC EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit/loss attributable to ordinary shareholders by weighted average number of ordinary shares in issue during the year.

	31 December 2019	31 December 2018
(Loss) / (Profit) attributable to ordinary shareholders (BAM '000)	(1,559)	49
Weighted average number of regular shares outstanding	7,112,649	6,917,066
	(0.22)	**0.01**

Diluted earnings per share are not presented as the Bank has not issued dilutive equity instruments.

32. SEGMENT REPORTING

The Bank is managed as one operating segment.

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

33. RELATED PARTY TRANSACTIONS

Balances with related parties can be summarized as follows:

	31 December 2019	31 December 2018
Assets		
ProCredit bank Germany	9,449	9,434
ProCredit bank Serbia	240	179
ProCredit bank Bulgaria	90	90
ProCredit bank Kosovo	57	62
ProCredit Holding Germany	-	10
	9,836	**9,775**
Management Board	2	1
Family members of key personnel	98	309
	100	**310**
Total	**9.936**	**10,085**

	31 December 2019	31 December 2018
Liabilities		
ProCredit Holding Germany	137,830	98,487
ProCredit bank Germany	39,180	41,058
ProCredit bank Kosovo	63	13
Quipe Germany	51	43
ProCredit bank Serbia	-	4
	177,124	**138,605**
Management Board	23	79
Family members of key personnel	92	144
	115	**223**
Total	**177,239**	**138,828**

	31 December 2019	31 December 2018
Income		
ProCredit bank Germany	16	25
	16	**25**
Management Board	1	-
Family members of key personnel	8	7
	9	**8**
Total	**25**	**33**

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

33. RELATED PARTY TRANSACTIONS *(continued)*

	31 December 2019	31 December 2018
Expenses		
ProCredit Holding Germany	(3,167)	(3,160)
Quipe Germany	(2,285)	(2,104)
ProCredit bank Germany	(921)	(733)
ProCredit Academy Germany	(340)	(375)
ProCredit bank Serbia	(96)	(92)
ProCredit bank Kosovo	(24)	(43)
Quipe Kosovo	(13)	(45)
ProCredit Academy Macedony	(6)	-
ProCredit bank Bugarska	-	(1)
	(6,852)	**(6,553)**
Management Board	(647)	(323)
Supervisory Board	(4)	(16)
Family members of key personnel	(840)	(828)
	(1,491)	**(1,167)**
Total	**(8,343)**	**(7,720)**

Fees to the Management and other members of the management:

The following fees were paid to the Management Board members during the period:

	31. December 2019.	31. December 2018.
Net salaries	357	176
Taxes and contributions on salaries	276	134
Other benefits	13	13
	646	**323**

34. EVENTS AFTER THE REPORTING DATE

On 11 March 2020 the World Health Organization declared the coronavirus outbreak a pandemic, and the Federation of Bosnia and Herzegovina government declared a state of emergency on 16 March 2020. Responding to the potentially serious threat the COVID – 19 presents to public health, the Government of Bosnia and Herzegovina (at all levels) authorities have taken measures to contain the outbreak, including introducing restrictions on the cross-borders movement of people, entry restrictions on foreign visitors and the 'lock-down' of certain industries, pending further developments. In particular, airlines and railways limited international transport of people, schools, universities, restaurants, cinemas, theatres and museums and sport facilities, retailers excluding food retailers, grocery stores and pharmacies were closed. Some businesses in Bosnia and Herzegovina have also instructed employees to remain at home and have curtailed or temporarily suspended business operations

The wider economic impacts of these events include:

- disruption to business operations and economic activity in Bosnia and Herzegovina, with a cascading impact on both upstream and downstream supply chains;
- significant disruption to businesses in certain sectors, both within Bosnia and Herzegovina and in markets with high dependence on a foreign supply chain as well as export-oriented businesses with high reliance on foreign markets. The affected sectors include trade and transportation, travel and tourism, entertainment, manufacturing, construction, retail, insurance, education and the financial sector;
- significant decrease in demand for non-essential goods and services;
- an increase in economic uncertainty, reflected in more volatile asset prices and currency exchange rates.

Following the declaration of state of emergency, the government of Federation of Bosnia and Herzegovina has announced a State aid program to counter the negative effects of the outbreak of COVID -19 on the economy.

Based on publicly available information, on the day these financial statements were authorized for issue, the Management considered the potential epidemic development, the expected impact on the Bank and the economic environment in which the Bank operates, including measures taken by the Government of Federation of Bosnia and Herzegovina. Furthermore, based on the Decision on temporary measures of banks to mitigate negative economic consequences caused by COVID-19 issued by the Federal Banking Agency, the Management of the Bank is considering temporary measures that could be offered to clients and the impact of these measures on portfolio quality.

In order to protect business continuity and liquidity position of the Bank, the Management has implemented a number of measures, with particular emphasis on:

- continuous communication with the Headquarter, monitoring of the situation and regular reporting on quality status of portfolio, liquidity and equity position,
- active approach to corporate clients that are negatively affected by the outbreak of the epidemic, and who may need or require refinancing of the exposure,
- retail clients affected by the outbreak are offered solutions to mitigate their payment obligations,
- establishment of work in shift rotations and remote working for significant number of administrative and background jobs,
- adherence to the very strict standards of precaution, including social distance in customer service jobs,
- active cooperation and communication with the Agency in order to implement the requirements of the Decision,
- regular monitoring of the current and planned liquidity positions and liquidity buffers and its compliance with strict regulatory requirement,
- regular monitoring and assessment of potential effects on the financial performance, risk-weighted assets and capital of the bank using different stress based scenarios.

34. EVENTS AFTER THE REPORTING DATE *(continued)*

In accordance with the Decision on temporary measures of banks to mitigate negative economic consequences caused by "COVID-19" issued by the FBA, the Bank has already prepared a Program containing special measures for clients affected by adverse consequences of the pandemic outbreak of COVID-19. In order to select the most favourable and appropriate measures for the client and the Bank, the Bank will be guided by a defined level of client risk, which is mainly reflected through the industry in which the client operates and, in the case of private individuals, job loss and income reduction.

Even thought, the Bank used general assessment for the whole economy to simulate a general shock for the loan portfolio, the Management is of the view that certain sectors have felt more severe downturn, such as transport, tourism and manufacturing, as also evidenced by the number of requests submitted for approval of temporary measures in the Bank. Currently, there is no significant concentration in any of these industries in the total portfolio.

The Bank grants reliefs to its clients with the aim of overcoming the difficulties they face and facilitating clients to settle their obligations to the Bank in the following period. According to the Agency's Decision, reliefs can be granted to clients who on 29 February 2020 were in arrears for less than 90 days or were categorised as stage 1 or 2. If the client was classified in stage 3, and has days past due more than 90 days, and submits a request to the Bank for a moratorium, the request will also be taken into consideration. As a rule, the exposure will not be treated as a restructuring, except in the case of clients who are stage 3 and are in areas less than 90 days.

The number of approved requests for temporary measures, according to the latest available data on 30 April 2020, amounts to 17.8% of the total volume of the portfolio of private individuals, and 33.4% of business entities, which in total gives 32.5% of the portfolio.

The outbreak of the COVID-19 pandemic has caused a number of negative economic consequences that threaten the decline in gross domestic product (GDP), employment, public revenues, investment and exports, which in turn affects the entire domestic economy and, in this context, the banking sector.

The Bank estimated that the spread of COVID 19 virus infection during 2020 would have a negative impact on operating income and increase impairment losses for the same year. On the revenue side, the Bank estimates higher reduction in interest income (in line with expected reduction in volume of loans) compering to fee income as most of the transactions are performed using digital channels. In coordination with the Group, the Bank continuously evaluate situation and is using scenario based testing (on a portfolio and sector level) in order to evaluate needs for additional provisions and readjust forecast.

Despite expected negative effects the Bank maintains adequate capital position. The Bank monitors its capital adequacy on a monthly basis and its compliance with regulatory requirements. As described in note 2.5 the Bank is in the process of registering capital increase in the amount of BAM 3.9 million which was initiated before year end, and capitalizing subordinated debt as explained earlier in the report.

The Bank has a stable liquidity position and no significant deposit outflows are recorded. The Bank regularly monitors liquidity indicators compliance with regulators' requirements and it does not expect significant negative impact on liquidity. In case of a liquidity disruptions, the Bank has available standby line from ProCredit Holding.

In summary, key assumptions applied by the Bank in the analysis of the COVID 19 impact assessment includes:

- The funding level can be sustained at the existing level and the Bank is performing various stress test situations on its liquidty positions. In addition the Bank takes into account funding available from the existing cash exces fund, parent and other creditors.
- The Bank is anticipating additional losses which are analysed under different scenarios and are taken into account to monitor capital position.
- The Bank is expecting share capital increase and capitalisation of the subordinated debt.

34. EVENTS AFTER THE REPORTING DATE *(continued)*

In management's view, the above factors support the assertion that the Bank will have sufficient resources to continue for a period of at least 12 months from the reporting date. Management concluded that the range of possible outcomes considered at arriving at this judgment does not give rise to material uncertainties related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. Management cannot however preclude the possibility that extended lock down periods, an escalation in the severity of such measures, or a consequential adverse impact of such measures on the economic environment the Bank operates in will not have an adverse effect on the Bank, and its financial position and operating results, in the medium and longer term.