Addiko Bank

Annual Report 2018

Addiko Bank d.d. Sarajevo
Bosnia and Herzegovina

Key data

based on the consolidated financial statements drawn up in accordance with IFRS

in BAM THS

	Bank 2018	Bank 2017	Change (%, pts)	Bank 2016	Change (%, pts)
Profit and Loss statement					
Net interest income	24,366	22,646	8%	17,986	35%
Net fee and commission income	9,798	9,252	6%	7,985	23%
Other operating income	5,604	9,318	-64%	6,768	-16%
Operating expenses	(36,046)	(37,096)	-3%	(60,755)	-41%
Operating result	**3,722**	**4,120**	**-8%**	**(28,016)**	>100%
Impairment losses	5,038	1,129	77%	(9,613)	>100%
Income tax	0	0	0%	0	0
Net profit for the year	**8,760**	**5,249**	**40%**	**(37,629)**	>100%
Selected items of the Statement of financial position					
Loans and receivables from customers	487,668	453,273	8%	371,663	31%
Current accounts and deposits from customers	654,725	643,733	2%	600,319	9%
Equity	204,223	212,047	4%	205,316	-1%
Total assets	890,327	892,357	0%	846,536	5%
Risk-weighted assets	637,947	597,782	7%	478,537	33%
Key ratios					
Net interest income/ total average assets	2.7%	2.6%	0.1	2.1%	0.1
Cost/income ratio	84.0%	90.0%	-6.0	185.6%	-101.6
Loan to Deposit Ratio	74.4%	70.5%	3.9	61.9%	12.5
Non-Performing Loan Ratio	11.0%	16.0%	-5.0	21.9%	-10.9
Cost of Risk Ratio	-1.5%	-0.4%	1.1	-0.7%	-0.8
NPL coverage Ratio	87.6%	84.4%	3.2	78.7%	8.9
Bank-specific figures					
Core Tier 1 ratio	27.3%	11.4%	>100%	14.5%	88%
Total capital ratio	27.3%	13.2%	>100%	16.0%	71%

The tables in this report may contain rounding differences. Any data is presented on the Addiko Bank dd Sarajevo level (referred to as Addiko Bank throughout the document) unless stated otherwise.

Letter from the CEO

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

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

Our 2018 operations resulted in net profit increase by 40% compared to earlier year and this was a consequence of effort in all business areas. We grew in lending, particularly in our focus segments, we showed above market average growth. We increased income and resulting profit of our operation by providing a stronger value proposition to our customers. Our brand shows a significant increase of strength on the market and leads to customer numbers growth and trust via deposit stability.

One of our legacy topics is level of non-performing loans (NPLs) driven dominantly by CHF loans. In 2018, our commitment to adress this topic, resulted in 31% decline in non-performing loans. With above average market provisioning coverage of 87.6%, we find this legacy portfolio to have a minimal risk for the Bank, while being proud that our new loan book shows excellent credit quality and performance.

At the same time, we worked on cost reductions. We are also proud that we achieved a reduction of the operating expense by 6.3% on a year-on-year rate, despite challenges of legacy costs and additional investments performed to grow the business and enhance the Bank’s digital capabilities. We ended 2018 with a significant increase of capital, allowing us to further increase our support to BiH bussiness enivroment and have a strong base for expansion of our own operations in the coming years.

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

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

EXECUTIVE BOARD

From left to right: Selma Omić, Member of the Management Board; Sanela Pašić, President of the Management Board; Belma Sekavić-Bandić, Member of the Management Board.

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Management Board Report

1. Overview of Addiko Bank

Addiko Bank dd Sarajevo is a part of an international banking group headquartered in Vienna, Austria, which operates through six banks with its core business in Croatia, Slovenia, Bosnia & Herzegovina, Serbia and Montenegro.

The Bank's strategy is focused on delivering core products and services relevant to Retail as well as Small and Medium Enterprises (SME) and corporate customers.

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

2. General economic environment

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

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

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

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

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

3. Significant events in YE18

3.1. Organisational structure and Operating Model implementation

The implementation of the Operating Model continued during the 2018.

The operating model ensures a higher level of service quality across the six countries, increase operational stability and enabling full leveraging of investments. The target operating model enables a better level of service, with better cost management and significantly lower operational risk. In addition, this model allows the Bank to follow best practices in the industry, and international standards, improve internal knowledge management, mentoring and transfer skills to employees. Furthermore, it offers interesting perspectives for highly skilled staff and experts.

3.2. Digital transformation & building digital capabilities

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

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

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

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

3.3. Continuous cost management and efficiency gains

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

While carrying legacy cost infrastructure from period before ownership change and attempting to reduce it, Addiko is challenged to invest into digital development and branch channel network in the same time. We are proud that we achieved a reduction of the operating expense by 6.3% on a year-on-year rate, despite challenges of legacy costs and additional investments performed to grow the business and enhance the Bank's digital capabilities. This is a result of the comittment for ongoing cost improvement, which will continue decline of the Cost-to-Income ratio (CIR) across the organization in the coming years.

3.4. Focus on improving customer experience

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

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

3.5. Review of the business strategy

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

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

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

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

3.6. Branches

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

At year end 2018 Addiko Bank Sarajevo operates a total of 38 branches (2017: 38).

3.7. Financial performance in brief

After having delivered on the turnaround in 2017, Addiko continues its path towards achieving an appropriate return on equity and shows good progress by posting a YE18 profit after tax of BAM 8.8 million (YE17: BAM 5.2 million), which for a better comparison requires the exclusion of one-off items (as detailed in section 4.1) leading to a normalized operating result in YE18 of BAM 10.0 million (YE17 BAM 7.5 million).

This is the result of Addiko Bank's ongoing focus on changing the business composition predominantly from lower margin Mortgage lending and Public finance towards higher value-added Consumer and SME lending. Rundown of these legacy segments (dominantly forgiveness and repayment of CHF loans) has reduced loan book by more than BAM 40 million but was overcompensated by above average market growth in focus segments, leading to overal growth of loan book by 8% compared to 2017. The performance of market growth in the last 12 months with regard to new disbursements clearly highlights that Addiko is delivering on its business strategy and that it will continue to develop the focus business segments as key revenue generators in the coming year.

Net interest income on a reported basis increased by 7.6% to BAM 24.4 million (YE17: BAM 22.6 million) with NIM at 3.3% (+2.7% to YE17).

Positive development in NII is driven by the increase in interest income from Consumer lending and SME business almost at the same level as well as the positive impact on interest expenses from repricing of deposits (-17 bps) overcompensating the run-down of the healthy legacy portfolio.

Despite the further reduction in average deposit pricing during 2018, customer deposits stayed stable at BAM 655 million (1.8% higher compared to BAM 644 million at YE17). The continuous improvements in the structure of customer deposits allows a slight reduction of excess liquidity while still improving the already very strong self-funding ratios (LTD Ratio: 2018 74% (YE17: 71%).

Net fee and commission income improved by 5.9% to BAM 9.8 million (YE17: BAM 9.3 million) as a consequence of higher growth in Consumer lending as new fee model and new product packages.

Other operating income is significantly driven by sale of repossessed real estate assets, income from card business, and recoveries of previously written-off amounts recorded directly to the statement of profit or loss

Operating expenses were reduced to BAM 36.0 million: YE17 BAM 37.01 million as result of higher productivity and tight cost management.

The performance in reduction of NPLs remains strong, driven by a focus on workout and collection, leading to a 31% decline in non-performing loans to BAM 119.3 million (BAM 173.5 million at YE17). While having fairly high NPL ratio of 11%, it is important to stress that NPLs come dominantly from legacy portfolio, while new lending demonstrates excellent performance and quality in repayment. The legacy NPL portfolio strongly declined in 2018 (YE17: 16%). The coverage is already above average market levels of 87.6% (YE17 84.4%), thus having minimal risk for the Bank and loan book.

3.8. Adoption of IFRS 9

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

The new rules on valuation are by contrast of lesser significance. The adoption results in an adjustment to retained earnings of EUR -6.5 million.

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

Addiko Bank Sarajevo maintained high regulatory reserves for credit losses from time of IAS 39 implementation. In 2018, with shift to IFRS 9, these regulatory reserves were no longer needed. As a result, Addiko Bank Sarajevo moved reserves to retained earnings in the amount of BAM 108 million and partly in favor of legal reserves in the amount of BAM 25 million. This activity resulted in major strengthening of the capital in total amount of BAM 133 million and increased capital adequacy ratio to 27.3% (YE17: 13.2%)

3.10. General Data Protection Regulation (GDPR)

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

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

4. Financial development of the Bank

4.1. Analysis of the profit and loss statement

in BAM THS

	Bank 2018	Bank 2017	Change (%)
Net interest income	24,366	22,646	7%
Net fee and commission income	9,798	9,252	6%
Net trading income	-	-	-
Net investment income	-	-	-
Net foreign exchange differences	2,010	1,759	14%
Other operating income	3,594	7,559	-51%
Operating income	39,768	41,216	-3%
Personnel expenses	(15,910)	(16,006)	1%
Depreciation	(1,485)	(1,652)	-10%
Amortization	(592)	(166)	257%
Other operating expenses	(18,059)	(19,272)	6%
Operating expenses	(36,046)	(37,096)	-3%
Net impairment loss on financial assets	5,038	1,129	339%
Other impairment losses and provisions	-	-	-
Profit before tax	8,760	5,249	67%
Income tax	-	-	-
Net profit for the year	8,760	5,249	67%

The year 2018 is marked by an improvement in the underlying development of the net interest income.

The net interest income increased to BAM 24.3 million, compared to BAM 22.6 million in December 2017.

This positive development is supported by the strong growth in high margin consumer loans as well as lower interest rates for customer deposits as a consequence of our strategic repositioning within all markets. The adjusted net interest margin amounts to 316bp at YE18, compared to 310bp YE17. This progress is a result of a continuous shift from non-focus assets i.e. Mortgage, Large Corporates and Public Finance towards Consumer and SME lending as well as moving towards less costly funding.

Net fee and commission income amounted to BAM 9.8 million (BAM 9.2 million in comparing period), with the development mainly due to higher income from the card business, payment transactions and new product packages.

Personnel expenses and other administrative expenses declined from BAM 35.2 million in 2017 to BAM 33.9 million at the current reporting date. The reduction of BAM 1.3 million is mainly due to lower other administrative expenses. The decrease in administrative expenses is based on a strict cost management and monitoring throughout the whole Addiko Bank. The cost-income ratio decreased by 90 points to 84.0% compared to 2017.

Depreciation and amortization of fixed assets increased to BAM 2.1 million from BAM, compared to 1.8 million in the previous year. These increased costs are mainly a result of IT investments in new software solutions.

In total, operating income amounts to BAM 39.8 million (2017: BAM 41.2 million) while operating expenses sum up to BAM 36 million (2017: BAM 37 million). This resulted in an operating result in the amount of BAM 3.8 million compared to BAM 4.1 million in 2017.

The development of risk provisions from BAM 1.1 million to BAM 5.0 million. This positive impact is caused by the release of risk provisions due to strong collection and recovery activities.

The result after tax for the year 2018 with BAM 8.8 million is significantly higher than the comparing period result of BAM 5.2 million.

4.2. Analysis of the statement of financial position

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

In BAM THS

	Bank 2018	Bank 2017	Change (%)
Assets			
Cash and balances with Central Bank	101,720	164,862	-38%
Trading assets	-	-	-
Derivative financial assets	-	-	-
Placements with other banks	51,254	70,037	-27%
Loans and receivables from customers	487,668	453,273	8%
Investment securities	207,581	164,611	26%
Investment property	-	855	-100%
Property and equipment	18,680	18,467	1%
Intangible assets	4,671	2,270	106%
Non-current assets and disposal groups classified as held for sale	4,368	4,771	-8%
Deferred tax assets	164	-	-
Current tax assets	1,783	1,783	0%
Other assets	12,438	11,428	9%
Total assets	890,327	892,357	0%

Total assets of the Addiko Bank Sarajevo decreased by BAM 2.0 million from BAM 892.3 million to EUR 890.3 million as a result of intentional excess liquidity optimisation.

Cash, cash balances at central banks decreased by BAM 63 million to BAM 102 million (2017: BAM 165 million), while other demand deposits decreased by BAM 19 million to BAM 51 million (2017: BAM 70 million).

Overall net receivables (gross receivables less credit risk provisions) increased from BAM 453.3 million (2017) to BAM 487.7 million due to increase in consumer and SME loans, demonstrating a growth by 8%, even after significant rundown of legacy portfolio.

Tangible assets increased by BAM 0.2 million from BAM 18.5 million in 2017 to BAM 18.7 million.

Intangible assets increased to BAM 4.7 million compared to year end 2017 (BAM 2.3 million) due to the introduction of new e-banking applications.

Tax assets remained on the same level as in 2017 and amount to BAM 1.7 million.

Other assets increased to BAM 12.4 million compared to BAM 11.4 million at the end of 2017.

In BAM THS

	Bank 2018	Bank 2017	Change (%)
Equity and liabilities			
Derivative financial liabilities	-	-	-
Current accounts and deposits from banks	611	5,211	-88%
Current accounts and deposits from customers	654,725	643,733	2%
Borrowings	-	-	-
Subordinated debt	-	-	-
Provisions	15,783	18,517	-15%
Other liabilities	14,985	12,849	17%
Total liabilities	686,104	680,310	1%
Share capital	100,403	100,403	0%
Profit for the year	8,760	5,249	67%
Retained earnings/(accumulated losses)	70,994	(29,830)	>100%
Reserves	24,066	136,225	-83%
Total equity	204,223	212,047	-4%
Total equity and liabilities	890,327	892,357	0%

On the liabilities' side, deposits increased by BAM 11.0 million to BAM 654.7 million in 2018 (2017: BAM 643.7 million). This development is mainly driven by an increase in deposits from customers mostly private individuals and SME. Liabilities from banks decreased by BAM 4.6 million to BAM 0.6 million in 2018 (2017: BAM 5.2 million).

Provisions decreased from BAM 18.5 million at year end 2017 to BAM 15.8 million in 2018. Included are provisions for legacy passive legal cases, which should further decrease as settlements and court achivements are developing very well.

The change in total equity in the amount of BAM 7.8 million is a result of implementation of IFRS 9 in the amount of BAM 13 million. Retained losses decreased as a result of covering loss from reserves and profit from current year. According to local regulation capital adequacy is 27.3 % and is above minimum prescribed 14.5% (12% + capital buffer 2.5%).

5. Analysis of non-financial key performance indicators

5.1. Human Resources management

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

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

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

Several small-scale efficiency and rightsizing programs continued in 2018. At year end 2018, the Addiko Bank Sarajevo had 393 employees (373 FTE). In the upcoming period, the focus will be on elevating the cultural and business transformation of Addiko Bank ensuring that "Values and Behaviors" are integrated into daily performance. This will require effective HR metrics in place to ensure that the right employees hold key positions and that the Bank is developing critical skills needed to be an innovation leader and a digital disruptor in the countries where it operates.

6. Internal Control System for accounting procedures

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

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

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

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

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

7. Nonfinancial reporting

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

8. Other disclosure

In relation to the required information in accordance with law on events after the reporting date please refer to Note 37. With respect to the explanations on substantial financial and non-financial risk as well as the goals and methods of risk management please refer to the risk report. In addition, information on the use of financial instruments are presented in the note 3.h.

9. Research & Development

Addiko Bank does not conduct any R&D activities.

10. Outlook

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

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

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

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

ADDIKO BANK D.D. SARAJEVO

Financial statements for the year ended 31 December 2018 and Independent auditor’s report

This version of the 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 financial reports and the accompanying audit report takes precedence over this translation.

Management Board's Report

The Management Board has pleasure in submitting its consolidated and unconsolidated financial statements for the year ended 31 December 2018.

Review of operations

The result for the year ended 31 December 2018 of the Bank is set out in the income statement on page 8.

Supervisory Board, Management Board and Audit Committee

During the course of 2018 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board until 31 December 2018

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

During the course of 2018 and up to the date of this report, the Audit Committee comprised:

Audit Committee until 31 December 2018

Đorđe Lazović	Chairman
Siniša Radonjić	Member
Jelena Mažuranić	Member since 28 September 2018
Ivan Trifunović	Member until 27 September 2018
Marlene Schellander-Pinter	Member until 27 September 2018
Claudia Mayrhofer	Member until 27 September 2018

As of 31 December 2018, the Management Board comprised a director and 2 executive directors, who served during the year and up to the date of this report as follows:

Management Board

Sanela Pašić	President of the Management Board
Belma Sekavić-Bandić	Member of the Management Board
Selma Omić	Member of the Management Board

On behalf of the Management Board:

Sanela Pašić
President of the Management Board

Belma Sekavić-Bandić
Member of the Management Board

Responsibility for the financial statements

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 their operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. Management has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

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

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

The financial statements set out on pages 8 to 108 were authorised by the Management Board on 22 March 2019 for issue to the Supervisory Board, and are signed below to signify this:

For and on behalf of Management Board

Sanela Pašić	**Belma Sekavić-Bandić**
President of the Management Board	Member of the Management Board

Addiko Bank d.d. Sarajevo
Trg Solidarnosti 12
71000 Sarajevo
Bosnia and Herzegovina

22 March 2019

Independent Auditor's Report

to the Owners of Addiko Bank d.d. Sarajevo

Opinion

We have audited the accompanying financial statements of Addiko Bank d.d. Sarajevo (the "Bank"), which comprise of the statement of financial position as at 31 December 2018, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for year then ended, and notes to the financial statements including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with the 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 Auditor's Responsibilities for 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) 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.

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.

Key audit matters (continued)

1. Impairment of carrying value of loans and receivables

Key audit matter	How the key audit matter was addressed in the audit
The International Accounting Standards Board (IASB) issued IFRS 9 – "Financial Instruments" which replaces "IAS 39 – Financial Instruments" as of the date of its effectiveness on 1 January 2018. The key changes arising from adoption of IFRS 9 are that the Bank's credit losses are now based on expected losses rather than an incurred loss model, and the change in the classification and measurement of the Bank's financial assets and liabilities, which are detailed in Note 2 (i) to the financial statements. As at 31 December 2018, the Bank's gross loans and receivables amount to KM 605,245 thousand and the related impairment allowances amount to KM 117,577. The policy for impairment of loans and receivables is presented in the accounting policies in Note 3 (h) to the financial statements. The Bank exercises significant judgement using subjective assumptions over both when and how much to record as loan impairment, and estimation of the amount of the impairment allowances for loans and receivables. Because loans and receivables form a major portion of the Bank's assets, and due to the significance of the judgments used in classifying loans and receivables into various stages stipulated in IFRS 9 and determining related impairment requirements, this audit area is considered a key audit risk. Key areas of judgment included: • The interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Bank's expected credit loss model. • The identification of exposures with a significant deterioration in credit quality. • Assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward looking macroeconomic factors (e.g. unemployment rates, interest rates, gross domestic product growth, property prices). • The need to apply additional overlays to reflect current or future external factors that are not appropriately captured by the expected credit loss model.	With respect to classification and measurement of financial assets and financial liabilities, our audit procedures comprised the following: • We read the Bank's IFRS 9 based classification and measurement of financial assets and financial liabilities policy and compared it with the requirements of IFRS 9; • We obtained an understanding and checked the Bank's business model assessment and the test on the contractual cash flows, which give rise to cash flows that are "solely payments of principal and interest" [SPPI test]; and • We checked the appropriateness of the opening balance adjustments. With respect to impairment methodology, our audit procedures comprised the following: • We read the Bank's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9; • We gained understanding of the Bank's key credit processes comprising granting and monitoring, and tested operating effectiveness of key controls over these processes; • We assessed the design and tested the operating effectiveness of relevant controls over the: a. Data used to determine the impairment reserve, including transactional data captured at loan origination, ongoing internal credit quality assessments, storage of date and interfaces to the expected credit loss model. b. Expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy. • For exposures determined to be individually impaired, we tested a sample of loans and receivables and examined management's estimate of future cash flows, assessed their reasonableness and checked the resultant impairment calculations; and • For provision against exposures classified as Stage 1 and Stage 2, we obtained an understanding of the Bank's impairment methodology, assessed the reasonableness of the underlying assumptions and the sufficiency of the data used by the management.

Key audit matters (continued)

1. Impairment of carrying value of loans and receivables

Key audit matter	How the key audit matter was addressed in the audit
	• We checked the appropriateness of the determination of significant increase in credit risk and the resultant basis for classification of exposures into various stages; • For a sample of exposures, we checked the appropriateness of the Bank's staging; • We checked and understood the key data sources and assumptions for data used in the Expected Credit Loss (ECL) models used by the Bank to determine impairment allowances; • For forward looking assumptions used by the Bank's management in its ECL calculations, we held discussions with management and corroborated the assumptions using publicly available information; • For a sample of exposures, we checked the appropriateness of determining Exposure at Default, including the consideration of prepayments and repayments in the cash flows and the resultant arithmetical calculations; • For Probability of Default (PD) used in the ECL calculations, we checked the Through the Cycle (TTC) PDs calculation and checked the appropriateness of development of PDs at a point in time (PIT); • We checked the calculation of the Loss Given Default (LGD) used by the Bank in the ECL calculations, including the appropriateness of the use of collateral and the resultant arithmetical calculations; • We checked the completeness of loans and receivables, off-balance sheet items, and other financial assets included in the ECL calculations as of 31 December 2018; We understood the theoretical soundness and tested the mathematical integrity of the models; • For data from external sources, we understood the process of choosing such data, its relevance for the Bank, and the controls and governance over such data; • Where relevant, we used information system specialists to gain comfort on data integrity; • We checked consistency of various inputs and assumptions used by the Bank's management to determine impairment provisions; and • We checked the appropriateness of the opening balance adjustments. We assessed the financial statement disclosures arising on adoption of IFRS 9 to determine if they were in accordance with the requirements of the Standard. Refer to the accounting policies, critical accounting estimates and judgements, disclosures of loans and receivables and credit risk management in Notes 2, 3, 4, 6 and 19 to the financial statements.

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

The Management Board is responsible for the preparation and fair presentation of the accompanying financial statements in accordance with the International Financial Reporting Standards, and for such internal control as the Management Board 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, the Management Board is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.

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

Auditor's Responsibilities for the Audit of the Financial Statements (continued)

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to 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 auditor's 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 independent auditor's 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 Sabina Softić.

Deloitte d.o.o.

Sead Bahtanović, director and licensed auditor

Deloitte
d.o.o.
Zmaja od Bosne 12c
71000 Sarajevo
ID: 4209047330000

Sabina Softić, partner and licensed auditor

Zmaja od Bosne 12c

Sarajevo, Bosnia and Herzegovina

22 March 2019

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

	Notes	2018	2017
Interest and similar income	7	29,480	28,267
Interest and similar expenses	8	(5,114)	(5,621)
Net interest income		**24,366**	**22,646**
Fee and commission income	9	13,497	12,850
Fee and commission expenses		(3,699)	(3,598)
Net fee and commission income		**9,798**	**9,252**
Dividend income		-	812
Net income on financial operations	10	2,010	1,759
Collected written-off receivables		977	3,501
Other operating income	11	2,617	3,246
Operating income		**39,768**	**41,216**
Personnel expenses	12	(15,910)	(16,006)
General and administrative expense	13	(18,059)	(19,272)
Depreciation and amortization	23, 24	(2,077)	(1,818)
Operating expenses		**(36,046)**	**(37,096)**
Profit before impairment losses, provisions and income tax		**3,722**	**4,120**
Impairment losses and provisions, net	14	5,038	1,129
PROFIT BEFORE INCOME TAX		**8,760**	**5,249**
Income tax	15	-	-
NET PROFIT FOR THE CURRENT YEAR		**8,760**	**5,249**
Basic earnings per share (KM)	35	**16.45**	**9.86**

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

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

	Notes	2018	2017
Profit for the year		**8,760**	**5,249**
Other comprehensive income			
Net change in fair value of financial assets measured at fair value through other comprehensive income		(5,958)	1,646
Deferred tax on financial assets measured at fair value through other comprehensive income	15	478	(164)
Total comprehensive income for the year		**3,280**	**6,731**

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

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

	Notes	31 December 2018	31 December 2017 (reclassified)
ASSETS			
Cash funds	16	27,339	27,324
Funds at the account with the Central Bank of Bosnia and Herzegovina	17	74,381	137,538
Funds at other banks	18	51,254	70,037
Financial assets at amortized cost	19	487,668	453,273
Assets available for sale	20	4,368	4,771
Financial assets through OCI	21	207,581	164,611
Investments in subsidiaries	22	-	855
Property and equipment	23	18,680	18,467
Intangible assets	24	4,671	2,270
Prepaid income tax		1,783	1,783
Other financial assets	25	7,626	6,274
Other assets	26	4,976	5,154
Total assets		**890,327**	**892,357**
LIABILITIES			
Due to other banks	27	611	5,211
Due to customers	28	654,725	643,733
Provisions	29	14,476	16,647
Provisions for financial commitments and contingencies	30	1,307	1,870
Other liabilities	31	14,985	12,849
Total liabilities		**686,104**	**680,310**
SHAREHOLDERS' EQUITY			
Share capital	32	100,403	100,403
Statutory reserves	32	25,101	-
Regulatory reserves	32	-	133,391
Fair value reserves		(1,035)	2,834
Accumulated earnings / (losses)		79,754	(24,581)
Total equity		**204,223**	**212,047**
TOTAL LIABILITIES AND EQUITY		**890,327**	**892,357**

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

Signed on behalf of Addiko Bank d.d. Sarajevo on 22 March 2019:

Sanela Pašić	**Belma Sekavić-Bandić**
President of the Management Board	Member of the Management Board

	Share capital	Statutory reserves	Regulatory reserves	Fair value reserves	Accumulated gains/(losses)	Total
31 December 2016	**100,403**	**7,799**	**133,391**	**1,352**	**(37,629)**	**205,316**
Net profit for 2017	-	-	-	-	5,249	5,249
Other comprehensive income						
Net change in fair value of financial assets available for sale, net of realized amounts	-	-	-	1,646	-	1,646
Net change in deferred taxes	-	-	-	(164)	-	(164)
Total other comprehensive income	**-**	**-**	**-**	***1,482***	**-**	***1,482***
Total comprehensive income	**-**	**-**	**-**	**1,482**	**5,249**	**6,731**
Transactions with the owner						
Coverage of losses	-	(7,799)	-	-	7,799	-
Other	-	-	-	-	-	-
Total transactions with the owner	**-**	**(7,799)**	**-**	**-**	**7,799**	**-**
31 December 2017	**100,403**	**-**	**133,391**	**2,834**	**(24,581)**	**212,047**
Impact of IFRS 9 first application - 1 January 2018	-	-	-	1,611	(12,715)	(11,104)
New balance as at 1 January 2018	**100,403**	**-**	**133,391**	**4,445**	**(37,296)**	**200,943**
Allocation of regulatory reserves	-	25,101	(133,391)	-	108,290	-
Net profit for 2018	-	-	-	-	8,760	8,760
Other comprehensive income						
Net change in fair value of financial assets through OCI, net of realized amounts	-	-	-	(5,958)	-	(5,958)
Net change in deferred taxes	-	-	-	478	-	478
Total other comprehensive income	**-**	**-**	**-**	***(5,480)***	**-**	***(5,480)***
Total comprehensive income	**-**	**-**	**-**	**(5,480)**	**8,760**	**3,280**
Transactions with the owner						
Coverage of losses	-	-	-	-	-	-
Other	-	-	-	-	-	-
Total transactions with the owner	**-**	**-**	**-**	**-**	**-**	**-**
31 December 2018	**100,403**	**25,101**	**-**	**(1,035)**	**79,754**	**204,223**

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

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

	Note	2018	2017
Operating activities			
Profit before income tax		8,760	5,249
Adjustments to reconcile net profit to net cash from operating activities:			
Depreciation and amortization	23, 24	2,077	1,818
Decrease in impairment losses and provisions, net	14	(5,038)	(1,129)
Provisions for employee benefits	29	350	336
Restructuring provisions	29	-	61
Accrued expenses	31	2,916	3,291
Loss / (gain) on sale of tangible and intangible assets	11, 13	32	(430)
Net gain on derecognition of assets through other comprehensive income	10	(257)	(438)
Dividend income recognized in the income statement	-	-	(812)
Foreign exchange adjustment	18, 19, 21, 30	496	602
Interest income on financial assets through OCI recognized in the income statement	7	(1,863)	(1,775)
Cash flow before changes in operating assets and liabilities:		*7,473*	*6,773*
Net increase in obligatory reserve with the Central Bank of Bosnia and Herzegovina	17	(973)	(3,793)
Net decrease in placements with other banks, before impairment losses	18	7,548	12,962
Net increase in financial assets at amortized cost, before impairment losses	19	(39,963)	(78,901)
Net decrease in provisions	29	(3,311)	(5,363)
Net increase in other assets, before impairment losses	25, 26	(2,188)	(5,334)
Net decrease in due to other banks	27	(4,600)	(313)
Net increase in due to customers	28	10,992	43,414
Net decrease in other liabilities	31	(781)	(3,526)
Cash used in operating activities		*(25,803)*	*(34,081)*
Income tax paid	-	-	-
Interest paid	-	-	-
Net cash used in operating activities		**(25,803)**	**(34,081)**
Investing activities			
Net increase in tangible and intangible assets	23, 24	(4,785)	(3,249)
(Increase) / decrease in financial assets through OCI	21	(46,878)	9,700
Proceeds from sale of investment in subsidiary	22	855	1,062
Proceeds from sale of tangible and intangible assets	23, 24	465	3,893
Dividends received	-	-	812
Interest income from financial assets through OCI	7	1,726	1,989
Net cash (used in) / from investing activities		**(48,617)**	**14,207**
Financing activities			
Increase in capital reserves	-	-	-
Net cash from financing activities		**-**	**-**
Net decrease in cash and balances with other banks		**(74,420)**	**(19,874)**
Cash and balances with other banks at the beginning of the year		**143,495**	**163,369**
Cash and balances with other banks at the end of the year		**69,075**	**143,495**

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

1. GENERAL INFORMATION

History and incorporation

Addiko bank d.d. Sarajevo (the ''Bank'') has received the approval from the Banking Agency of Federation of Bosnia and Herzegovina ("FBA") on 17 January 2000 and the Bank was registered at the Cantonal Court in Mostar on 21 January 2000.

The Bank conducts its operations in Federation of Bosnia and Herzegovina through the headquarters in Sarajevo and 38 branch offices in Federation of Bosnia and Herzegovina.

The Bank is registered in Federation of Bosnia and Herzegovina to perform payment operations, credit and deposit activities in the country and abroad, in accordance with the legislation of FBiH.

The immediate parent of the Bank is Addiko Bank AG Austria, while the ultimate owners are Advent International Corporation, United States of America, and the European Bank for Reconstruction and Development (EBRD).

By 30 March 2018, the Bank was the 100% owner of Addiko Invest d.o.o. Mostar, which, combined with the Bank, comprised the Group. The Company was responsible for the establishment and management of investment funds: Investment fund CROBiH Fond d.d. Mostar ("IF CROBiH"), Open investment fund Addiko BH Equity, Investment fund Fortuna fond d.d. Cazin, and OIF Kapital. On 30 March 2018, the sale and transfer of share were completed based on Contract on transfer of share between the Bank and the buyer, and by the Decision of the Municipal Court in Mostar on change of name, members and transfer of share no. Tt-O-270/18 of 18 April 2018, the registration of these changes was completed.

2. BASIS OF PREPARATION

a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board.

These financial statements were authorised by the Management Board of the Bank on 22 March 2019 for submission to the Supervisory Board for approval.

b) Basis of measurement

The financial statements have been prepared on the historical cost basis, except for financial assets and liabilities at fair value through profit or loss and certain financial instruments that are measured at fair value.

c) Functional and presentation currency

Financial statements are presented in convertible mark (KM), taking into account that this is the currency in which most of Bank's business transactions are presented. Convertible mark is pegged to the Euro (EUR 1 = KM 1.95583).

d) Use of estimates and judgements

The preparation of financial statements in accordance with IFRS 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. Actual results may eventually differ from those estimates.

2. BASIS OF PREPARATION (CONTINUED)

d) Use of estimates and judgements (continued)

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

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

e) Going concern

The financial statements of the Bank are prepared on a going concern basis, which assumes it will continue its business operations in the foreseeable future.

At 31 December 2018, the Bank reported capital adequacy ratio at the level of 27.29% (as at 31 December 2017: 13.2%), which is above the stipulated limit of 12%. With regard to liquidity and capital position of the Bank as at 31 December 2018, management has concluded that these financial statements can be prepared on the going concern basis, which assumes that the Bank will continue to operate in the foreseeable future.

f) New standards and interpretations

The following new standards, amendments to the existing standards and interpretation issued by the International Accounting Standards Board (IASB) are effective for the current reporting period:

- IFRS 9 “Financial Instruments” (effective for annual periods beginning on or after 1 January 2018),

- IFRS 15 “Revenue from Contracts with Customers” and further amendments (effective for annual periods beginning on or after 1 January 2018),

  IFRS 15 “Revenue from Contracts with Customers” – the standard is effect for annual periods beginning on or after 1 January 2018. IFRS 15 establishes a five-step model that applies to revenue from contracts with customers with limited exceptions. Based on the conducted analysis no significant impact was detected by adopting IFRS 15 in current economic and financial volumes on the financial statements of the Bank.

- Amendments to IFRS 2 “Share-based Payment” – Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),

- Amendments to IFRS 4 “Insurance Contracts” – Applying IFRS 9 “Financial Instruments” with IFRS 4 “Insurance Contracts” (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 “Financial Instruments” is applied first time),

- Amendments to IAS 40 “Investment Property” – Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),

- Amendments to IFRS 1 and IAS 28 due to “Improvements to IFRSs (cycle 2014-2016)” resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),

- IFRIC 22 “Foreign Currency Transactions and Advance Consideration” (effective for annual periods beginning on or after 1 January 2018).

The adoption of these new standards, amendments to the existing standards and interpretation has not led to any material changes in the Bank’s financial statements.

2. BASIS OF PREPARATION (CONTINUED)

g) Standards and interpretations in issue not yet adopted

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

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

The Bank has elected not to adopt these new standards, amendments and interpretations in advance of their effective dates. With the exception of IFRS 16: "Leases", the Bank anticipates that the adoption of these standards, amendments and interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

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

2. BASIS OF PREPARATION (CONTINUED)

h) Reclassification

For the purpose of better presentation and compliance with new IFRS and IAS, the Bank applied a new report format, and reclassified certain positions of the Statement of financial position for 2017 accordingly.

Positions 2017 reclassified	2017 reclassified	Reclassification	2017 reported	Positions 2017 reported
ASSETS				**ASSETS**
Cash funds	27,324	(116,171)	143,495	Cash and balances with other banks
Funds at the account with the Central Bank of Bosnia and Herzegovina	137,538	73,962	63,576	Obligatory reserve with the Central Bank of Bosnia and Herzegovina
Funds at other banks	70,037	56,084	13,953	Placements with other banks
Financial assets at amortized cost	453,273	-	453,273	Loans and advances to customers
Assets available for sale	4,771	-	4,771	Assets available for sale
Financial assets through OCI	164,611	1,047	163,564	Financial assets through OCI
Investments in subsidiaries	855	-	855	Investments in subsidiaries
Property and equipment	18,467	-	18,467	Property and equipment
Intangible assets	2,270	-	2,270	Intangible assets
Prepaid income tax	1,783	-	1,783	Prepaid income tax
Other financial assets	6,274	6,274	-	-
Other assets	5,154	(21,196)	26,350	Other assets
Total assets	**892,357**	**-**	**892,357**	**Total assets**
LIABILITIES				**LIABILITIES**
Due to other banks	5,211	-	5,211	Due to other banks
Due to customers	643,733	-	643,733	Due to customers
Provisions	16,647	-	16,647	Provisions
Provisions for financial commitments and contingencies	1,870	-	1,870	Provisions for financial commitments and contingencies
Other liabilities	12,849	-	12,849	Other liabilities
Total liabilities	**680,310**	**-**	**680,310**	**Total liabilities**
SHAREHOLDERS' EQUITY				**SHAREHOLDERS' EQUITY**
Share capital	100,403	-	100,403	Share capital
Reserves	-	-	-	Reserves
Regulatory reserves	133,391	-	133,391	Regulatory reserves
Fair value reserves	2,834	-	2,834	Fair value reserves
Retained losses	(24,581)	-	(24,581)	Retained losses
Total equity	**212,047**	**-**	**212,047**	**Total equity**
TOTAL LIABILITIES AND EQUITY	**892,357**	**-**	**892,357**	**TOTAL LIABILITIES AND EQUITY**

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

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments"

First time adoption of IFRS 9

In July 2014, the IASB published the final version of International Financial Reporting Standard 9 "Financial Instruments" ("IFRS 9"), which is mandatory for reporting periods beginning on or after 1 January 2018. The requirements of IFRS 9 represent a significant change from IAS 39 "Financial Instruments: Recognition and Measurement". The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The table below presents adjustment of the carrying amount of financial assets as a result of first application of IFRS as at 1 January 2018.

	IAS 39			IFRS 9	
	Measurement category	31 December 2017	Effect of IFRS 9	Measurement category	1 January 2018
ASSETS					
Cash funds	At amortized cost	27,324	-	At amortized cost	27,324
Funds at the account with the Central Bank of Bosnia and Herzegovina	At amortized cost	137,538	(1,319)	At amortized cost	136,219
Funds at other banks	At amortized cost	70,037	(916)	At amortized cost	69,121
Financial assets at amortized cost	At amortized cost	453,273	(8,678)	At amortized cost	444,595
Assets available for sale	-	4,771	-		4,771
Financial assets through OCI	FVOCI (available for sale)	164,611	-	FVOCI	164,611
Investments in subsidiaries	At cost less impairment losses	855	-	At cost less impairment losses	855
Property and equipment	-	18,467	-	-	18,467
Intangible assets	-	2,270	-	-	2,270
Prepaid income tax	At amortized cost	1,783	-	At amortized cost	1,783
Other financial assets	At amortized cost	6,274	(956)	At amortized cost	5,318
Other assets	At amortized cost	5,154	-	At amortized cost	5,154
Total assets		**892,357**	**(11,869)**		**880,488**
LIABILITIES					
Due to other banks	At amortized cost	5,211	-	At amortized cost	5,211
Due to customers	At amortized cost	643,733	-	At amortized cost	643,733
Provisions	At amortized cost	16,647	-	At amortized cost	16,647
Provisions for financial commitments and contingencies	At amortized cost	1,870	(765)	At amortized cost	1,105
Other liabilities	At amortized cost	12,849	-	At amortized cost	12,849
Total liabilities		**680,310**	**(765)**		**679,545**
SHAREHOLDERS' EQUITY					
Share capital	-	100,403	-	-	100,403
Reserves	-	-	-	-	-
Regulatory reserves	-	133,391	-	-	133,391
Fair value reserves	-	2,834	1,611	-	4,445
Retained losses	-	(24,581)	(12,715)	-	(37,296)
Total equity		**212,047**	**(11,104)**		**200,943**
TOTAL LIABILITIES AND EQUITY		**892,357**	**(11,869)**		**880,488**

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Effects of first application of IFRS 9

Adjustment of carrying amount was done within the following steps of IFRS 9 implementation:

- Booking out IAS 39 provisions in the total amount of KM 158,794 thousand into equity at the retained earnings (losses) position.
- Returning suspended interest from off-balance sheet into the balance sheet record in the amount of KM 89,048 thousand, with corresponding 100% impairment.
- Internal write-off of balance sheet receivables that meet conditions in line with the internal document "IFRS 9 Financial Instruments – Business Model Definition" in the amount of KM 85,116 thousand charged to impairment.
- Closing balance of IFRS 9 provisions as at 1 January 2018 amounts to KM 175,441 thousand recognized in the retained earnings position.

Total effect on the Retained earnings / (losses) position is an additional loss in the amount of KM 12,715 thousand, of which KM 1,611 thousand refers to calculation of expected credit losses on securities, whose effect is recognized within the other comprehensive income item, so the total IFRS 9 effect on equity amounts to KM 11,104 thousand of additional loss.

Classification and measurement of Financial Assets and Financial Liabilities

IFRS 9 establishes three principal classification categories for financial assets: measurement at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The previous categories according to IAS 39 – held-to-maturity, loans and receivables and available-for-sale - are no longer existing.

On initial recognition, a financial asset is classified into one of the categories, the basis of this classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset.

Business model assessment

In 2017, the Bank made an assessment of business models for all segments and set up documentation including the policies and objectives for each relevant portfolio as this best reflects the way the business is managed and information is provided to management. The information that was taken into account includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice, including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of assets
- How the performance of the portfolio is evaluated and reported to the management
- The risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed
- What is the aim of the business model – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. Information about sales activity is considered as part of an overall assessment on how the Bank´s stated objective for managing the financial assets is achieved and how cash flows are realized.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: “Financial Instruments” (continued)

Contractual cash flow characteristics

For the assessment whether contractual cash flows are solely payments of principal and interest, “principal” is defined as the fair value of the financial asset on initial recognition. “Interest” is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest (“SPPI”), Bank considered the contractual terms of the instrument and analysed the existing portfolio based on a checklist for SPPI criteria. This include assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition, considering the following: contingent events that would change the amount and timing of cash flows, leverage features, prepayment and extension terms, terms that limit the Bank´s claim to cash flows from specified assets and features that modify consideration for the time value of money.

Based on the entity’s business model and the contractual cash flow characteristics IFRS 9 defines the following principal classification categories:

- A financial asset is measured at amortized cost only if the object of the entity’s business model is to hold the financial asset and the contractual cash flows are solely payments of principal and interest on the principal outstanding (“SPPI criterion”).

- A financial asset is measured at fair value through other comprehensive income (FVOCI) if the asset is held in a business model in which assets are managed both in order to collect contractual cash flows and for sale and the contractual cash flows are solely payments of principal and interest on the principal outstanding (simple loan feature).

- Financial assets that do not meet these criteria are measured at fair value through profit or loss (FVTPL). Furthermore, embedded derivatives will no longer be separated from the financial host asset. The financial instrument is assessed in its entirety and measured at fair value through profit or loss.

For equity investments that are not held for trading, entities can make an irrevocable election at initial recognition to classify the instruments at FVOCI, with all subsequent changes in fair value being recognized in other comprehensive income (OCI). This election is available for each separate investment.

According to IFRS 9, embedded derivatives will no longer be separated from the financial host asset. The financial instrument is assessed in its entirety and measured at fair value through profit or loss.

The classification and measurement requirements for financial liabilities are only slightly changed compared to IAS 39. Changes to the fair value of liabilities resulting from changes in own credit risk of the liability are recognized in other comprehensive income, the remaining amount of the change in the fair value will be presented in profit or loss.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Impairment

IFRS 9 replaces the "incurred loss" model in IAS 39 with a forward-looking "expected credit loss" (ECL) model. The ECL is basically defined as the difference between the cash flows that are due to the bank in accordance with the contractual terms of a financial instrument and the cash flows that the bank expects to receive (considering probabilities of default and expected recoveries).

This will require considerable judgment over how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

The new impairment model applies to the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- lease receivables; and
- loan commitments and financial guarantee contracts issued (previously, impairment was measured under IAS 37 Provisions, Contingent Liabilities and Contingent Assets).

Under IFRS 9, no impairment loss is recognized on equity investments.

IFRS 9 requires a loss allowance to be recognized at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date. Lifetime ECL measurement applies if the credit risk of a financial asset at the reporting date has increased significantly since initial recognition. An entity may determine that a financial asset's credit risk has not increased significantly if the asset has low credit risk at the reporting date.

The impairment requirements of IFRS 9 are complex and require management judgements, estimates and assumptions, particularly in the following areas, which are discussed in detail below:

- assessing whether the credit risk of an instrument has increased significantly since initial recognition; and
- incorporating forward-looking information into the measurement of ECLs.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses and will be measured as follows:

- financial assets that are not credit-impaired at the reporting date: the present value of all cash shortfalls – i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive;
- financial assets that are credit-impaired at the reporting date: the difference between the gross carrying amount and the present value of estimated future cash flows.

Definition of default

Under IFRS 9, the Bank will consider a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realizing security (if any is held); or
- the borrower is more than 90 days past due on any material credit obligation to the Bank. Overdrafts are considered past due once the customer has breached an advised limit or been advised of a limit that is smaller than the current amount outstanding.

This definition is largely consistent with the definition that will be used for regulatory purposes (see Note 3 s). In assessing whether a borrower is in default, the Bank will consider indicators that are:

- qualitative: e.g. breaches of covenant;
- quantitative: e.g. overdue status and non-payment of another obligation of the same issuer to the bank; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Significant increase in credit risk

Under IFRS 9, when determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Bank's historical experience where available, expert credit assessment and forward-looking information.

The Bank will primarily identify whether a significant increase in credit risk has occurred for an exposure by comparing the one-year probability of default (PD) as at the reporting date; with the one-year PD that was estimated on initial recognition of the exposure.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Significant increase in credit risk (continued)

Assessing whether credit risk has increased significantly since initial recognition of a financial instrument requires identifying the date of initial recognition of the instrument. Modifying the contractual terms of a financial instrument may also affect this assessment.

Credit risk grades - The Bank will allocate each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default (PD) and applying experienced credit judgement. The Bank will use these grades in identifying significant increases in credit risk under IFRS 9. Credit risk grades are defined using qualitative and quantitative factors that are indicative of the risk of default. These factors may vary depending on the nature of the exposure and the type of borrower. Credit risk grades are targeted such that the risk of default occurring increases as the credit risk deteriorates – e.g. the difference in the risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3. Each exposure will be allocated to a credit risk grade on initial recognition based on available information about the borrower.

Exposures will be subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade.

Generating the term structure of PD - Credit risk grades will be a primary input into the determination of the term structure of PD for exposures. The Bank will collect performance and default information about its credit risk exposures analysed by jurisdiction, by type of product and borrower and by credit risk grading, whenever meaningful. For some portfolios, information purchased from external credit reference agencies may also be used as well. The Bank will employ statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time. This analysis will include the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors, as well as in-depth analysis of the impact of certain other factors (e.g. forbearance experience) on the risk of default.

For most exposures, key macroeconomic indicators are likely to include GDP growth, unemployment rate and others. The Bank's approach to incorporating forward-looking information into this assessment is discussed below.

The Bank has established a framework that incorporates both quantitative and qualitative information to determine whether the credit risk on a particular financial instrument has increased significantly since initial recognition. The framework aligns with the Bank's internal credit risk management process. The criteria for determining whether credit risk has increased significantly will vary by portfolio and will include a backstop based on delinquency.

The Bank will deem the credit risk of a particular exposure to have increased significantly since initial recognition if, based on the Bank's 's quantitative modelling, the one year PD is determined to have increased in absolute range between 4% to 5%, depending on the portfolio, since initial recognition.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Significant increase in credit risk (continued)

In certain instances, using its expert credit judgement and, where possible, relevant historical experience, the Bank may determine that an exposure has undergone a significant increase in credit risk if particular qualitative factors indicate so and those indicators may not be fully captured by its quantitative analysis on a timely basis. As a backstop, and as required by IFRS 9, the Bank will presumptively consider that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. The Bank will determine days past due by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received.

The Bank aims to monitor the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the criteria do not align with the point in time when an asset becomes 30 days past due;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month ECL and lifetime ECL measurements.

Inputs into measurement of ECLs

The key inputs into the measurement of ECLs are likely to be the term structures of the following variables:

- PD;
- loss given default (LGD); and
- exposure at default (EAD).

These parameters will be derived from internally developed statistical models, regulatory values as well as expert judgment. They will be adjusted to reflect forward-looking information as described below.

PD estimates are estimates at a certain date, which will be calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models will be based on internally compiled data comprising both quantitative and qualitative factors, wherever meaningful. Where it is available, market/external data may also be used as well.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Inputs into measurement of ECLs (continued)

If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD. While PDs are based on statistical models, the risk parameters (LGD, CCF) are leveraging on regulatory values and/or expert assessment.

Forward-looking information

Under IFRS 9, the Bank will incorporate forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since initial recognition and its measurement of ECLs. The Bank will formulate a 'base case' view of the future direction of relevant economic variables and a representative range of other possible forecast scenarios. This process will involve developing two or more additional economic scenarios and considering the relative probabilities of each outcome.

The base case will represent a most-likely outcome and be aligned with information used by the Bank for other purposes, such as strategic planning and budgeting. The other scenarios will represent more optimistic and more pessimistic outcomes. The Bank will also periodically carry out stress-testing of more extreme shocks to calibrate its determination of these other representative scenarios.

The Bank has identified and documented key drivers of credit risk for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk. These key drivers include within other factors also unemployment rates and GDP forecasts. Predicted relationships between the key indicators and default rates on various portfolios of financial assets have been developed based on analysing historical data.

Write-offs

Internal write-offs are fully defined in IFRS 9 and IFRS 9 Business Concept – Impairment. In accordance with the said standard, the Bank has defined the criteria for discontinuing the recognition of a financial asset.

Internal write-off criteria:

- Unsecured financial assets arising out of a loan contract or an executed case, if the debtor already runs a bankruptcy proceeding,
- Unsecured financial assets arising out of a loan contract or an executed case (guarantees, unlisted letters of credit, bills of exchange or other off-balance sheet obligations), if no repayment has been recorded for a period of one year,
- Financial assets arising from a loan contract or an executed case are secured,
- Real estate, if no repayment has been recorded for a period of 5 years,
- Movable property, if no repayment has been recorded for a period of 2 years,
- Other collateral (guarantees, shares, receivables, insurance), if no repayment has been recorded for a period of one year,

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: "Financial Instruments" (continued)

Write-offs (continued)

- Unsecured financial assets arising out of a loan contract or an executed case (guarantees, unlisted letters of credit, bills of exchange or other off-balance sheet obligations) that were subject to restructuring 3 or more times, and the bank has estimated that debtors are not able to repay their liabilities from regular operations or selling unnecessary funds.

- Financial assets for which the bank has the right to claim repayment from the debtor in court and other proceedings interrupted by a compulsory settlement in the amount in which the billing right has been interrupted.

- Any other financial asset or part of a financial asset that is recognized as uncollectible on grounds other than those set out above.

Derecognition and contract modification

IFRS 9 incorporates the requirements of IAS 39 for derecognition of financial assets and financial liabilities without substantive amendments. There is a certain immaterial impact on the bank based on adoption of new provisions.

Financial assets are derecognized when:

- The contractual rights to receive cash flows expire; or

- The Bank transfers the right to receive cash flows or undertakes the liability to pay the received cash flows to a third party through a "transfer of rights" contract;

- or (i) all significant risks and rewards associated with ownership of the asset have been transferred or (ii) are not transferred or retained all significant risks and rewards of ownership of the property but property control is transferred.

Contractual changes arising as a result of negotiations with the debtor can lead to two types of modification of the initially contracted cash flows.

Significant modifications leading to the derecognition of financial assets

If cash flows of financial assets have been modified or significantly altered due to re-negotiation, financial assets are derecognized (based on expiration of contractual rights to cash flows) in accordance with IFRS 9. New financial assets with modified terms are recognized and the difference between the amortized cost of financial assets that are derecognized and the fair value of new financial assets is recognized in profit or loss. If the borrower is in default or significant modification leads to default, then the new asset will be treated as POCI (purchased or originated credit-impaired asset). For POCI financial Assets, provisions for credit losses are not recognized, but the lifetime expected credit losses of the financial asset are stated in the credit adjusted interest rate at initial recognition. If the borrower is not in default or a significant modification does not lead to default then the new asset will be classified under Stage 1.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: “Financial Instruments” (continued)

Derecognition and contract modification (continued)

Significant modifications leading to the derecognition of financial assets (continued)

If the derecognition criteria are applied to debtors classified in Stage 3, then the change in expected cash flows instead of contractual cash flows is estimated. Revised contractual terms represent the borrower’s ability to repay the original cash flows involved in the estimate of the debtor’s impairment. This does not represent a significant change because it is essentially not a cash flow expiration.

Significant modifications that do not lead to the derecognition of financial assets

If the cash flows of a financial asset have been modified or re-negotiated in such a way that they do not result in derecognition of a financial asset in accordance with IFRS 9 – Financial Instruments, the Bank will make a new calculation of gross carrying amount based on re-contracted or modified cash flows using the initial effective interest rate for discounting. Gain or loss arising from the modification will be recognized in profit or loss.

The following criteria lead to significant modifications:

- Quantitative – significant change in contractual cash flows when the discounted present value of cash flows under new conditions discounted using the initially agreed effective interest rate differs from the discounted present value of the original financial instrument for at least 10%.
- Qualitative:
  - Change of debtor
  - Change of currency
  - Change of financing purpose
  - Change of key SPPI provisions in the loan contract.

Financial liabilities are derecognized when they are released, cancelled or expired.

Impacts on capital planning

IFRS 9.7.2.15 offers the selection of an accounting policy either to change the prior periods or to recognize effects of initial application of IFRS 9 in initial equity as at 1 January 2018. The Bank does not present the changed comparative data, and it presents the one-off effect as decrease of retained earnings (increase of accumulated losses) in the amount of KM 12,715 thousand. This effect is related to impairment.

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: “Financial Instruments” (continued)

Impacts from initial application

The new standard will affect the classification and measurement of financial instruments held as at 1 January 2019 as follows:

- based on assessments undertaken to date, the major part of the loan portfolio classified as loans and advances according to IAS 39 will still be measured at amortized costs according to IFRS 9;
- financial assets held for trading will furthermore be measured at FVTPL;
- Bank classified debt securities as available-for-sale according to IAS 39. Within the new classification of IFRS 9 these debt securities will be measured at FVTOCI as those assets are held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.
- for the equity instruments that are classified as available for sale under IAS 39, Bank will exercise the option to irrevocable designate them at initial recognition at FVTOCI;

No further significant changes regarding classification arose based on the business model criterion.

Regarding classification and measurement of financial liabilities no major impacts on the financial statements of the Bank occurred based on new regulations of IFRS 9.

Application

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, except as described below.

- The Bank will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will generally be recognized as reduction of earlier formed Regulatory reserves for credit losses at 1 January 2018.

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

2. BASIS OF PREPARATION (CONTINUED)

i) IFRS 9: “Financial Instruments” (continued)

Impacts from initial application

Changes between the measurement categories and carrying amounts of financial assets of the Bank according to IAS 39 and IFRS 9 as at 1 January 2018 are presented as follows:

Financial instruments - Classes of IAS 39	Financial instruments - Business models of IFRS 9
Financial assets available for sae	Held to Collect and Sale
Loans and receivables	Held to Collect

When it comes to classification of the Bank’s financial liabilities, it remained unchanged with respect to IAS 39. Financial liabilities of the Bank are financial liabilities measured at amortized cost.

Based on the analysis of the generation of cash flows in the past as well as expected future sales for the Bank, the following business models are defined:

- Held to Collect: including loans to customers;
- Held to Collect and Sale): including portfolio of debt securities available for sale;
- Other business model: including portfolio for trading, that the Bank currently does not have.

j) IFRS 16: “Leases”

IFRS 16: “Leases” was published by the IASB in January 2016. IFRS 16 comes into effecto on 1 January 2019 and IAS 17 “Leases” ceases to be in effect.

The standard establishes principles for recognition, measurement, presentation and disclosure of leases for both parties, the lessee and the lessor. The main purpose of this standard is that the lessee recognizes all lease contracts and the associated rights and obligations in the statement of financial position, i.e. to avoid the presentation of the lease in off-balance sheet records. According to IFRS 16, lease is not classified as financial or operating. Instead, the right to use assets and lease commitments for lease contracts is recognized. The right to use is initially measured at cost, which represents the initial lease liability adjusted for all lease payments made before the commencement date, plus initial direct costs and estimate of the cost of disassembling, removing or repairing the asset, less any received lease payments. The right to use is subsequently amortized using linear depreciation. Lease liability is initially measured as the present value of lease payments during lease contract, discounted using the interest rate specified in the contract; if the rate cannot be determined, the incremental interest rate is used. All lease liabilites are thus recognized as “right to use” in the statement of financial position. The exception are lease contracts concluded for a period of 12 months or less, as well as lease contracts with low value, which are contracts by the IASB up to USD 5,000 or less. For such cases it is possible to continue to recognize the off-balance sheet laiblity. For the lessee, the provisions of IAS 17 are largely adopted in the new IFRS 16. Lessee accounting remains dependent on which party retains the material benefits and the risks associated with the leased asset. Conceptually, the accounting of the lessor and the lessee are separated, which can lead to new challenges in the implementation of the new provisions.

2. BASIS OF PREPARATION (CONTINUED)

j) IFRS 16: "Leases"

Recognition of the "right to use" assets on the assets side of the balance sheet and the related lease liability on the assets side and equity, leads to an increase in total assets / equity and liabilities. Given that there is only an increase in liabilities on the equity and liabilities side, and all other items remain unchanged, the capital ratio is decreasing. Profit and loss will also have the effects of a new standard. The total amount of costs during the lease period remains unchanged, but the schedule for certain parts of profit or loss is changed. According to IAS 17, the costs related to leasing contracts were recognized on a straight-line basis to the amount of payment affecting the operating result. According to IFRS 16, the costs are allocated between interest expense and depreciation expense as described in IAS 17. Considering that the cost of interest is calculated using the effective interest rate and that the costs are reduced during the lease contract and that the amortization cost is recognized on a straight-line basis, this results in declining costs, where costs are greatest in the initial contract periods. Interest expense is recognized as part of the financial result. On the other hand, the annual depreciation of the right to use under IFRS 16 is less than the lease rate, which results in an increase in operating results. For the EBITDA indicator, increase is even more significant. Cash flow statement involves the transfer of outflows from operating activities to the cash flow statement on financial activities. Within the cash flow from operating activities, interest payments will be shown, and in the cash flow from financial activities, the principal will be paid.

<u>Leases in which the Bank is a lessor</u>

As the Bank's strategic decision focuses on core banking activity, the lease portfolio has been reduced and accordingly IFRS 16 will not have a significant impact on accounting where the Bank appears as the lessor. The same provisions as in IAS 17 are applied to determine whether a leas is operating or financial. If the lease is operating, the funds remain in the statement of financial position of the Bank and the income derived from that basis is shown in the income statement. If lease is financial, lease receivables are recognized in the statement of financial position.

<u>Leases in which the Bank is a lessee</u>

Addiko Bank has completed its initial assessment of the effects on financial statements, including an assessment of whether the lease contract will be renewed as well as the level the Bank will use the application exemptions. Land and buildings are mainly subject to leasing at the Bank. The Bank mainly uses the incremental rate of borrowing as a discount rate.

As at 31 December 2018, the minimum lease payments for irrevocable operating lease agreements amounted to KM 3,712 million on an undiscounted basis under IAS 17, which the Bank analysed for the potential recognition of additional lease liabilities under IFRS 16.

Based on the information available from the initial implementation of IFRS 16, the Bank does not expect the effects of the implementation of the new standard on initial balance of retained earnings. The effects of applying IFRS 16 lead to an increase in total assets of KM 3,639 million and an increase in lease liabilities of KM 3,639 million.

2. BASIS OF PREPARATION (CONTINUED)

j) IFRS 16: "Leases"

Application

The Bank will apply IFRS 16 on 1 January 2019 using a modified retrospective approach. The cumulative effects of applying IFRS 16 will be recognized as an increase in total assets and total liabilities as at 1 January 2019 without correction of comparative data. For contracts where the Bank is a lessee, the right to use assets in the amount of the lease liability will be stated in the statement of financial position (later the right to use will be adjusted for calculations and prepayments). The Bank will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as a lease in accordance with IAS 17. The Bank will not apply IFRS 16 to the lease of intangible assets. The Bank will use the exemption for short-term lease contracts and small value contracts where the right to use will not be recognized. For leases classified as operating leases, the applicable discount rate will be the incremental borrowing rate established on the date of initial application and will be used as a discount rate for leases classified as operating lease under IAS 17.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Policies set out below have been consistently applied to all periods, presented in these financial statements.

a) Basis of consolidation

a) Business combinations

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

b) Subsidiaries

Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal. All intercompany transactions, balances and unrealised surpluses and deficits on transactions between group companies have been eliminated in preparing the consolidated financial statements. Where necessary, the accounting policies used by subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

c) Transactions eliminated on consolidation

Intra-group balances and transactions, and income and expenses (except for foreign currency transaction gains or losses) arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

b) Investments

A subsidiary is a subject under Bank's control. Control is obtained by the Bank's cooperation in decisions on financial and business policies of the subject, in a way to obtain benefits from the related entity's business operations.

Investments in subsidiaries presented in these financial statements are valued by costs decreased by losses from value impairment of individual investment.

c) Interest income and expense

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

Interest income is not recognized for past-due, non-performing loans. The collected suspended interest is recognized as income upon receipt of cash. Interest on deposits is capitalized if stipulated in the contract.

d) Fee and commission income and expense

Fees and commissions consist mainly of fees earned on domestic and foreign payment transactions, and fees for loans and other credit instruments issued by the Bank.

Fees for payment transactions are recognised in the period when services are rendered.

Loan origination fees, after approval and drawdown of loans, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan over its life.

e) Net trading income

Net trading income comprises net gains and losses from foreign exchange trading, and net gains and losses from the translation of monetary assets and liabilities denominated in foreign currency at the reporting date.

f) Dividend income

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g) Taxation

Income tax expense based on income tax represents the sum of the current tax payable and deferred taxes.

The tax expense is based on taxable income for the year. Taxable profit differs from net profit as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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 balance sheet 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. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax assets and liabilities are not discounted and are classified as long term assets and/or liabilities in the statement of financial position.

Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also presented with in the equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Bank has the ability and intention to settle on a net basis.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial instruments

Recognition

Financial assets and financial liabilities are recognized when the Bank becomes a party to the contractual provisions of the instrument.

Classification

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

i) Financial assets at amortized costs

Financial assets are classified and subsequently measured at amortized cost if financial assets are in the held to collect model and cash flows meet the SPPI requirement. Financial assets are measured at fair value at initial recognition net of principal repayments, increased or decreased by cumulative depreciation using the effective interest rate on the difference between the amount at the beginning and the amount at maturity adjusted for any impairment.

Most of the financial assets of the Bank are measured at amortized cost.

ii) Financial assets at fair value through other comprehensive income

Financial assets are measured at fair value through other comprehensive income (FVTOCI) if the asset is held in a business model in which the asset is managed in order to collect the contracted cash flows and sell financial assets and the contractual cash flows represent payment of principal and interest (SPPI requirement).

Financial assets are measured at fair value where changes are recognized in other comprehensive income and are subject to impairment under the expected loss credit model (ECL).

Financial instruments at fair value through profit or loss include derivatives.

iv) Other financial liabilities

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial instruments (continued)

Initial and subsequent measurement

Financial assets carried at amortized cost are initially measured at fair value, and subsequently at amortized cost, using the effective interest rate method, less impairment losses. Costs toward third parties, such as loans insurance tariffs, are treated as a part of transaction cost.

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

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

Recognition of gains and losses on subsequent measurement of financial instruments

Gains and losses arising from changes in fair value of financial assets available for sale are recognized directly in equity as revaluation reserves with the exception of impairment losses, interest calculated using the effective interest method, and gains and losses arising from exchange rate differences on monetary assets, which are recognized in the income statement. In the case of the investment being disposed of, or impaired, the cumulative gain or loss previously recognized in the revaluation reserve is included in profit or loss for the period.

Dividends on these equity instruments are recognized in the income statement when the Bank establishes the right to receive payments.

Derecognition

The Bank derecognises financial assets (in full or partially) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership, and maintains control of the asset, the Bank continues to recognize the financial asset.

The Bank derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial instruments (continued)

Reclassification

The standard stipulates that the classification is to be determined in accordance with the business model applicable at the time of initial recognition of an asset. Regardless of the greater number of sales of the entity's assets, no reclassification is required unless there is a substantial change in the business model of the entity. The standard provides for a reclassification of an asset if entity's business model has changed due to sudden and significant changes in circumstances. However, the standard does not prescribe or permit reclassification in the event of gradual or progressive change.

Offsetting financial instruments

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

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

Fair value measurement

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial instruments (continued)

Identification and measurement of impairment of financial assets

i) Financial assets carried at amortised cost

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has (or have) an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the Bank.

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

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

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

Impairment is determined on a group level, for credit losses that are not individually significant. For the assessment of group impairment, the Bank uses statistical models and historical data on the probability of occurrence of events that cause impairment, the time required for recovery, and the amount of loss incurred, adjusted for management's assessment of whether current economic and credit conditions are such that it is likely that the actual losses will be higher or lower than those calculated on the basis of historical data.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial instruments (continued)

Identification and measurement of impairment of financial assets (continued)

i) Financial assets carried at amortised cost (continued)

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

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

The provisions calculated on the basis of the preceding paragraph (“the FBA provisions”) are not recognized in those financial statements of the Bank. However, if the FBA provisions are greater than the impairment allowance calculated in accordance with IFRS, the difference is presented as an appropriation within equity in the position “Regulatory reserves”.

ii) Financial assets at fair value through other comprehensive income

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as within other business model in accordance with IFRS 9 with irrevocable option for measurement at fair value through other comprehensive income, a significant or prolonged decline in the fair value of the investment below its acquisition cost is considered in determining whether the assets are impaired.

Specific financial instruments

i) Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to foreign exchange risks arising from operating, financing and investing activities. The Bank does not hold or issue derivative financial instruments for speculative trading purposes Hedge accounting is not applied.

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial instruments (continued)

Specific financial instruments (continued)

ii) Cash and cash equivalents

For the purpose of reporting cash flows, cash and balances with other banks are defined as cash, balances with the Central Bank and current accounts with other banks. Cash and balances with other banks exclude the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank's day-to-day operations. The compulsory minimum reserve with the Central Bank is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

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

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

i) Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. Cost includes the purchase price and directly associated cost of bringing the asset to a working condition for its intended use. Maintenance and repairs, replacements and improvements of minor importance are expensed as incurred. 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. Gains or losses on the disposal of property and equipment and intangible assets are included in the statement of income in the period in which they occur.

Properties in the course of construction are carried at cost, less impairment loss, if any. Depreciation commences when the assets are ready for their intended use. Depreciation is calculated on a straight-line basis over the estimated useful life of the applicable assets as follows:

	2018	2017
Buildings	2%	2%
Office equipment	10-33.3%	10-33.3%
Vehicles	20%	20%
Leasehold improvements	20%	20%

Leasehold improvements are capitalized and amortized on straight-line basis or during their useful life or over the lease term, depending on what is shorter. Gains and losses on disposal of assets are determined as difference of cash inflow and carrying amount amounts and are recognized within the income statement as gains or losses from sale or disposal of property and equipment.

The Bank reviews the estimated useful life of property and equipment at the end of each annual reporting period. There were no changes in estimated useful lives of long-term assets during 2018.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j) Intangible assets

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

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

Software		14,29% - 20%

k) Investment property

Investment property is property held by the Bank to earn rentals or for capital appreciation or for both, but not for sale in the ordinary course of business or for administrative purposes.

Investment property is measured initially at its cost, including transaction costs. Subsequently, investment property is stated at cost less accumulated depreciation and any impairment loss.

Investment property is depreciated on a straight-line basis over a period of 50 years.

Investment property is derecognised when either it has been disposed of or permanently withdrawn from use or no future economic benefits are expected from its disposal. Any gains or losses on the retirement or disposal of investment property are recognised in the income statement in the year of retirement or disposal.

l) Acquired tangible assets

The Bank occasionally acquires real estate and movable property in exchange for the settlement of certain loans and advances.

In accordance with the International Accounting Standard (“IAS”) 2: “Inventories”, such properties are initially recognised at cost. After the initial recognition, these assets are stated at the lower of the following two values – cost or net realizable value. An impairment loss is recognized whenever the carrying amount of an asset exceeds its net realizable value. Impairment losses are recognized in the income statement for the year.

Gains and losses from sales are recognized in the income statement for the year.

m) Impairment of non-financial assets

At each reporting period date, the Bank reviews the possibility of any indications of impairment arising, as well as the carrying amounts of its other assets to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss The Bank regularly reviews the remaining lifetime of the assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

n) Impairment of non-financial assets (continued)

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 recognized as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

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 recognized for the asset in prior years.

A reversal of an impairment loss is recognized 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.

o) Employee benefits

Short-term benefits

The Bank performs payment of liabilities in terms of taxes, contributions, and benefits from employment in accordance with the collective agreements in FBiH, as meal allowances, transport, one-time fee. These costs are recognized in the income statement in the same period as the cost of staff salaries.

Long-term employee benefits: retirement severance payments

In accordance with applicable laws and regulations, as well as the requirements of the Bank`s Employment Handbook, severance payments are made depending on the type of employment contract termination and for cases in which a payment is determined. In the event of termination of employment due to retirement, the Bank pays severance payments in the amount of 6 net individual salaries of employees, and in the case of termination of employment for economic, technical and organizational reasons, the employee is paid 50% of individual net salary, that the employee was realising with the employer for each year of service with the employer, rounded to the first following half. In addition to the above amount, the extra amount of severance pay may be approved by the Management Board and the Supervisory Board, appreciating the circumstances of each case.

Retirement benefits provisions are based on actuarial reports and are used only for the purposes they are intended for. At the end of each year, an assessment of accuracy of the amounts of provisions for retirement benefits and unused holiday accrual is performed.

In accordance with the Amendments to International Accounting Standard (“IAS”) 19: Employee Benefits”, additional provisions or reversal of such provisions are recognized in the Income statement, under “Personnel expenses”, assuming they are not related to actuarial gains and losses, otherwise they shall be immediately recognized in other comprehensive income. Benefits falling due more than 12 months after the statement of financial position date are discounted to their present value.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

p) Foreign currency translation

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

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

31 December 2018	1 EUR = 1.95583 KM	1 USD = 1.70755 KM
31 December 2018	1 EUR = 1.95583 KM	1 USD = 1.63081 KM

r) Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that the Bank will be required to settle the liability, and a reliable estimate of the amount of the liability can be made.

The amount recognized as a provision is the best estimate of the consideration required to settle the present liability at the reporting date, taking into account the risks and uncertainties surrounding the liability. Where a provision is measured using the cash flows estimated to settle the present liability, its carrying amount is the present value of those cash flows.

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.

s) Share capital and reserves

Issued share capital

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

Regulatory reserve for credit losses

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

s) Share capital and reserves (continued)

Prior to 2012, the need for transfers from retained earnings to an earmarked reserve within equity (regulatory reserve for credit losses) was calculated for the whole credit-risk portfolio on a net basis, thereby taking into account both instances where application of Agency regulations would have resulted in a higher provision and instances where the application of Agency regulations would have resulted in a lower provision, comparing to IFRS reserves. However, since 2012, banks are required to calculate the requirement for regulatory reserves for credit losses taking into account only instances where higher provisions would have resulted from the application of the Agency rules. Retroactive application of this change in Agency rules is not required. Based on the Decision of Minimum Standards for Capital Management and Asset Classification issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. By the Agency's decision of November 2018, banks are allowed to include reserves for credit losses in ordinary core capital. By the Decision of the Assembly of the Bank, reserves for credit losses in the amount of KM 133 million are partially transferred to retained earnings in the amount of KM 108 million, and the outstanding amount of KM 25 million into statutory reserves. By including these reserves in ordinary core capital, regulatory capital ratio increased to 27.29%.

Dividends

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

t) Off-balance sheet commitments and contingent liabilities

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

u) Managed funds for and on behalf of third parties

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

v) Segment reporting

Debt securities or shares of the Bank are not traded on public markets, and these financial statements are not subject to regulation by the Securities Commission, for the purpose of issuing any type of instruments in a public market. Accordingly, the Bank operates under a single business and geographical segment, that is, the provision of banking services in Bosnia and Herzegovina.

4. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATIONS

When applying the accounting policies described in Note 3, the Management makes the decisions, estimates and assumptions that affect the amounts of assets and liabilities that cannot be derived from other sources. The estimates and assumptions are based on historical experience and other relevant factors. Actual amounts may differ from those estimates. Significant estimates made by the Management as at 31 December 2018 and 2017 in these financial statements are presented below.

Estimates and assumptions are continually reviewed. Changes in accounting estimates are recognized in the period of change, if the changes are being reflected in the same, or in the period of the change and other future periods if it affects current and future periods.

Impairment losses on loans and receivables

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

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

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

The Bank first assesses whether objective evidence of impairment exists individually for assets that are individually significant. However, assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics and then assessed collectively for impairment.

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

The Bank has, upon initial implementation, and within the regular annual reassessment and validation process for parameters and models, updated parameters and certain ratings and PD models in December.

The first and main criterion for determining the type of impairment is determining whether the impairment trigger occurred, as defined in the policy for determining irregular payment of liabilities and reconstruction.

4. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATIONS (CONTINUED)

Impairment losses on loans and receivables (continued)

The client that are not in default will be provisioned based on portfolio principle, while the default clients will be provisioned individually or collectively depending on the significance of exposure at default (EAD) of their group of related parties. Individual risk provisions represent the impairment of assets for the amount that is not expected to be collected in the contractual maturity. The amount of impairment loss for the outstanding exposures is the result of gross exposure (balance and/or off-balance) impaired for the expected future cash flows discounted to their present value. The impairment losses on financial assets held at amortized cost will be calculated as the difference of the carrying amount of assets and present value of estimated future cash flows, discounted at the original effective interest rate.

Portfolio of risk provisions (PRP) represents impairment of assets for incurred but not reported (unidentified) losses. Default does not need to happen in order to estimate PRP, but it is a general measure of expected credit risk within the portfolio, adjusted for loss identification period (LIP).

Litigation and claims

As at 31 December 2018, there were 802 open court proceedings against the Bank, with total nominal value of KM 231.7 million, excluding contingent penalty interest. This amounts includes 11 claims with nominal value of KM 3.7 million according to which the claims have been already paid in previous periods, hence they do not represent an additional risk of losses, but are in the state of open court proceedings based on legal remedy. In addition, this amount includes 33 claims with nominal value of KM 42 million, which are, in accordance with contracts on ceding receivables (Brush), within the responsibility of underwriters of receivables with whom they are related, and they represent no risk for the Bank. These proceedings representing no risk for the Bank (already paid or risk transferred to underwriters) are not recorded in accounting records.

The largest number of proceedings is related to claims connected to CHF currency clause and increase of interest margin – total of 648 claims with nominal value of KM 14 million, and 4 claims with nominal value of KM 36 million, which combined the claims for damages in addition to CHF currency clause and increase of margin.

The Bank assesses the amount of provisions for expenses for litigations. The assessment is based on the estimated probability of future cash flows, arising from the past legal or constructive obligations. The Bank provisioned KM 13.6 million for litigations and claims as at 31 December 2018, which the Management believes to be sufficient amount.

During 2018, the Bank continued with intensified activities for resolving claims and litigations, and management of associated legal risk. The strategies for court proceedings are regularly, the adequate legal representation and coordination of Bank's defence is established, as well as the process of out-of-court settlement of disputes, recording and reporting on litigations and claims. This resulted in the aforementioned and other court decisions in favour of the Bank, and completion of certain proceedings.

4. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATIONS (CONTINUED)

Litigation and claims (continued)

Of the most significant court decisions made in favour of the Bank in 2018, we have listed: the Competition Council decision rejecting the request of the "Švicarac" Association for the determination of prohibited agreements and abuse of dominant position, 6 decisions on claims proceedings (ZADA PHARMACEUTICALS d.o.o. Tuzla KM 27.1 million – Decision on withdrawal of the lawsuit, CENTROTRANS-TRANSPORT ROBE d.o.o. Sarajevo KM 18.3 million – Second instance verdict on the rejection of the claim, HERMES d.o.o. Ljubuški KM 16 million – Second instance verdict on the rejection of the claim, CARESOS d.o.o. Ljubuški KM 1.5 million – First instance verdict on relection of the claim), 1 decision in the case of CHF and claims for damages (SARA KOMPANI d.o.o. ILIDŽA, Avdija Ćenanovic KM 2.2 million – Second instance verdict on the reinstatement of the case at first instance) and 3 final judgments of the Cantonal Court in Mostar by the lawsuits of individuals that confirmed the legality of the currency clause in CHF (Kemal Duraković, Rusmir Avdić, Sanja Ivić).

In the M-ROZIĆ d.o.o. Mostar case, the Cantonal Court in Mostar issued a final decision rejecting the appeal of the Bank and authorizing the counter-enforcement in the M-ROZIĆ d.o.o. Mostar case, on the basis of which in October 2018 the Municipal Court in Mostar issued a decision on counter-enforcement on bank accounts and assets of M-ROZIĆ d.o.o. Mostar (real estate) for the payment of the amount paid by the Bank on the basis of a revised verdict. The relevant decision on the counter-enforcement M-ROZIĆ d.o.o. Mostar filed an objection on which the Court has not yet decided. Also, regarding the M-ROZIĆ d.o.o. Mostar case, the court issued a final decision on the determination of the insurance measure on the assets that M-ROZIĆ d.o.o. Mostar has in Orca building, which has prevented their disposal (a large number of floor units).

The bank also received a first-instance verdict in the case filed against Kemal Duraković and the "Švicarac" Association for defamation. The procedure is based on appeals in the second instance.

Outstanding court decisions not made in favor of the Bank in 2018 include 2 decisions in CHF cases of legal entities (Bihać pivovara d.d. Bihać KM 1.5 million and Petrić d.o.o. za ugostiteljstvo Posušje KM 0.3 million – Second instance verdicts where legality currency the clause in CHF was confirmed, but the Bank was obliged to pay foreign currency differences, payment was made and an audit was made on the judgments), 1 decision in the CHF case of an individual (Aldin Kovač – Second instance verdict confirming the legality of the currency clause in CHF, contract annulled as indefinite and indefinable, the Bank is not obliged to pay), and 1 decision in the declarative case (PETROL d.d. shareholders KM 2.9 million – final verdict for revocation of Energopetrol's role in Petrol d.d., the Bank has no obligation to pay or surrender any rights).

As at 31 December 2018, the Bank executes executive, litigation and bankruptcy proceedings for the collection of claims and other rights and interests. On the same there is a certain number of litigations day against the Bank, initiated by legal and natural persons.

In order to collect receivables on loans, guarantees, letters of credit or other bases, the Bank has a total of 7,058 active legal disputes with a total value of KM 115,160 thousand KM led by Credit Risk Management Department / Retail Collection Team as at December 31, 2018, and a total of 10 active litigation cases led by the Credit Risk Management Departmetn / Credit Operations Team, namely: bank cases for a total of 2 cases with total debts of KM 3,215 thousand and cases for synthetic portfolio cases totaling 8 with a total value of 21,432 thousand KM .

4. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATIONS (CONTINUED)

Loans with CHF foreign currency clause

For the purpose of resolving loan portfolio with the CHF foreign currency clause, the Bank initiated the CHF project on 8 March 2016.

In March 2016, the Bank offered incentives to retail customers with foreign currency clause loans in Swiss franc, which are reflected in the reduction of credit commitments by 30% accompanying the conversion into local currency at current exchange rate and a fixed interest rate of new loans of 5.99%. The project officially ended in December 2016, but the Bank has continued to consider and realize received offers during 2018. The Bank incurred losses on this basis for 2018 in the amount of KM 1.5 million.

The Bank identified 2,544 retail loan parties as the scope of the project, which the Bank had as at 29 February 2016. The project officially ended on 5 December 2016, given that the Bank continued with realization of incoming requests, and all subsequent client requests are considered individually as a part of regular activities. As at 31 December 2018, 1,755 requests were realized (69% of total parties), while a certain number of parties was closed by regular repayment during the project, i.e. with no use of reliefs (260 parties). The outstanding number of retail parties with CHF foreign currency clause in Bank's portfolio as is 529 as at 31 December 2018.

Total amount of approved reliefs (write-offs) for balance sheet receivables is KM 39,518 thousand (KM 15,175 thousand for performing clients and KM 24,343 thousand for non-performing clients. The write-off was done indirectly for non-performing clients (charged to created impairment allowance in the amount of KM 23,963 thousand), and the total effect of conversion and liquidation to the income statement amounts to KM 15,555 thousand.

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. The interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Bank may not coincide with that of the management. As a result, transactions may be challenged by tax authorities and the Bank may be assessed additional taxes, penalties and interest, which can be significant. In accordance with the Law on Tax Authority of FBiH, expiration period of the tax liability is five years. This practically means that tax authorities could determine payment of outstanding liabilities in the period of five years from the origination of the liability.

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 regulation.

Acquired tangible assets

The Bank occasionally acquires properties in settlement of certain loans and advance payments. Properties are stated at net realizable value of the dependent claims on loans and receivables or at the current fair value of such assets less selling costs, depending on which is lower. Gains and losses from the sale are recognized in the statement of profit or loss.

4. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATIONS (CONTINUED)

Retirement severance payments

Costs for long-term provisions relating to the future outflows for retirement pay for employees who are to be retired, are formed on the basis of an actuarial calculation in accordance with International Accounting Standard ("IAS") 19: Employee Benefits". For this calculation, Bank hired a certified actuary who calculates on the basis of data from the Human Resources records, of the Bank according to the estimated time of retirement of employees. The present value of future liabilities is calculated using a discount rate. These liabilities are used exclusively to cover the costs for which are formed. At the end of each financial year, the Bank assesses these provisions. If it is estimated that the provision is higher / lower than estimated amount, the difference will affect the income or expense, except when it is a result of changes in actuarial assumptions, this change is recorded in equity as part of actuarial losses or gains.

Appointed actuary made a new calculation of provisions in December 2018 in accordance with the International Accounting Standard ("IAS") 19: "Employee Benefits" as at 31 December 2018. According to the calculation, the Bank has recorded a decrease/release of previously recognized provision. Assessment of short-term provisions for unused vacation days is done according to the number of days of unused vacation leave on the day of statement of financial position and average monthly gross salary per employee.

Impairment of assets available for sale

The Bank determines that the capital investment available for sale is impaired when there has been a significant or extended decline in the fair value below their cost. Determination of meaning of significant and extended decline requires judgement. In making this judgment, the Bank, among other factors, also estimates normal action price volatility.

In addition, impairment may be appropriate when there is evidence of declining financial health of the investor, industry and sector performance, changes in technology, and operational and finance cash flows.

The fair value of properties and investment properties

The fair value of real estate and investment properties is estimated based on the market value of similar properties in similar locations, by certified evaluators on a regular basis. Fair value is determined by the method of capitalization valuation method taking into account the actual or possible achievable annual income of assessed property, which is then put in relation with the value of the investment. The actual annual income is reduced by maintenance costs, depreciation, tax and risk of the absence of rent or non-issuance of property lease. Specific factors that were used in the assessment are those for the market of Bosnia and Herzegovina.

5. SEGMENT REPORTING

The Bank monitors business by business segment (public companies, corporate, retail) and by geographical segment (offices) for purposes of group reporting of Parent Bank and because of internal financial analysis, in order to manage the Bank's results and achieve greater profitability.

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

- Business with retail segments-Retail (RET), in which are identifies three sub-segment as follows:
  - sub-segment of physical persons (PI),
  - affluent sub-segment (AFF),
  - and sub-segment of small and medium enterprises (SME)
- Business with corporate segment – Corporate (COR)
- Operations with the segment of public enterprises – Public (PUB)
- Treasury (TRE)
- Other (OTH)

The tables below shows the overall analysis of the income statement for the Bank, since it represents a major segment of the consolidated income statement.

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

5. SEGMENT REPORTING (CONTINUED)

	RET	COR	PUB	TRE	OTH	Total
For the year ended 31 December 2018						
Interest income	23,441	3,501	997	266	1,275	29,480
Interest expenses	(4,585)	(144)	(113)	(272)	-	(5,114)
Net interest income	**18,856**	**3,357**	**884**	**(6)**	**1,275**	**24,366**
Fee and commission income	9,833	1,040	151	2,469	4	13,497
Fee and commission expenses	(363)	-	-	(3,336)	-	(3,699)
Net fee and commission income	**9,470**	**1,040**	**151**	**(867)**	**4**	**9,798**
Other income	**2,677**	**113**	**326**	**2,488**	**-**	**5,604**
Operating income	**31,003**	**4,510**	**1,361**	**1,615**	**1,279**	**39,768**
Operating expenses	**(22,154)**	**(3,946)**	**(2,152)**	**(1,138)**	**(6,656)**	**(36,046)**
Profit before impairment, provisions and income tax	**8,849**	**564**	**(791)**	**477**	**(5,377)**	**3,722**
Impairment losses and provisions	402	2,563	794	623	656	5,038
PROFIT BEFORE INCOME TAX	**9,251**	**3,127**	**3**	**1,100**	**(4,721)**	**8,760**
Income tax	-	-	-	-	-	-
NET PROFIT FOR THE CURRENT YEAR	**9,251**	**3,127**	**3**	**1,100**	**(4,721)**	**8,760**

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

5. SEGMENT REPORTING (CONTINUED)

	RET	COR	PUB	TRE	OTH	Total
For the year ended 31 December 2017						
Interest income	22,609	3,438	932	285	1,003	28,267
Interest expenses	(5,064)	(153)	(167)	(237)	-	(5,621)
Net interest income	**17,545**	**3,285**	**765**	**48**	**1,003**	**22,646**
Fee and commission income	8,819	1,162	148	2,718	3	12,850
Fee and commission expenses	(41)	-	-	(3,368)	(189)	(3,598)
Net fee and commission income	**8,778**	**1,162**	**148**	**(650)**	**(186)**	**9,252**
Other income	**5,474**	**632**	**298**	**7,184**	**173**	**13,761**
Operating income	**31,797**	**5,079**	**1,211**	**6,582**	**990**	**45,659**
Operating expenses	**(20,805)**	**(2,293)**	**(1,208)**	**(692)**	**(12,098)**	**(37,096)**
(Loss) / profit before impairment, provisions and income tax	**10,992**	**2,786**	**3**	**5,890**	**(11,108)**	**8,563**
Impairment and provisions	4,437	(2,211)	(68)	(5,472)	-	(3,314)
LOSS BEFORE INCOME TAX	**15,429**	**575**	**(65)**	**418**	**(11,108)**	**5,249**
Income tax	-	-	-	-	-	-
NET LOSS FOR THE CURRENT YEAR	**15,429**	**575**	**(65)**	**418**	**(11,108)**	**5,249**

The table below shows the total assets and liabilities by segment for the Bank, since it represents a major segment of the consolidated statement of financial position.

BANK	RET	COR	PUB	TRE	OTH	Total
31 December 2018						
Total assets	392,232	124,644	91,012	225,907	56,532	**890,327**
Total liabilities	549,912	77,951	32,276	436	25,529	**686,104**
31 December 2017						
Total assets	391,273	99,220	66,796	269,367	65,701	**892,357**
Total liabilities	468,437	131,641	4,700	50,366	25,166	**680,310**

6. FINANCIAL RISK MANAGEMENT

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

The Bank's activities expose it to a variety of financial risks: credit risk, market risk, liquidity risk and operating risks.

a) Credit risk management

The Bank takes on exposure to credit risk which is the risk that the counterparty will be unable to pay amounts in full when due. Based on the allocation of placements and borrowers into risk categories, the Bank identifies and assesses the possible level of credit losses, that is the general credit risk and potential credit loss.

Assessments of credit losses are being performed by the Bank individually for each debtor or group of related individuals and / or on a portfolio level, segmented according to relevant criteria. The Bank regularly monitors the mentioned risks and reviews them in accordance with internal programs and policies and decisions of the Banking Agency of Federation of BiH.

The Bank manages credit risk through a regular analysis of the creditworthiness of existing and potential borrowers to pay off its liabilities for equity and interests, and changes in indebtedness limits where necessary. This is done in accordance with set procedures for credit approval, additional lending, investment activities, and assumptions for potential off-balance sheet commitments. In addition, with the Bank's exposure to credit risk, it manages and further reduces to a minimum any form of risk related to quality, concentration, providing billing (all loans are insured by collateral, guarantees, mortgages and other types of insurance), maturity and currency.

The Bank has formed a separate organisational unit in charge of managing and controlling credit risk and the collection of problematic receivables, pursuant to the organisational chart used within Addiko Bank Group. The Bank introduced clearer and stricter criteria for granting new financing. The Bank also raised the alert level for continuous monitoring and early recognition of risks and steps taken to address before mentioned. The assessment of credit risk and responsibility is partly transferred from the credit committee on to personal responsibility, in order to better assess risk (not only at the level of a credit committee).

The Bank approves the loans in accordance with a defined process of loan approval, based on the borrower's creditworthiness and exclusively based on its sustainable cash flow, as the primary source of the repayment of loans. Credit decisions are made, or holder of jurisdiction is determined by the total liabilities / limits group of related persons.

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

For all loans in the Bank, there are several levels of authority for approving them, of which the highest is the Supervisory Board of the Bank. The relevant department responsible for credit risk management provides a non-binding opinion for every approval, and is authorized to approve loans up to EUR 250,000 of exposure of the debtor and/or a group of related persons (four eyes system), and has the right to vote in the local credit committee with decision-making competence up to EUR 5,000,000.

In order to ensure business activities, and based on the estimated risk of potential losses, the Bank calculates provisions, based on the risk exposure arising from the loan and off-balance sheet claims.

The Bank calculates provisions for relevant loans using one of three approaches (methods):

- Portfolio provisions for latent losses (PRPLL) are applied to loans for which the loss event (IBNR) is still not recognized by the Bank on a particular date

- Portfolio risk provisions – collective impairment (SRPci) are applied for loans of the Bank, which based on their amount, are below the level of materiality relevant for the individual assessment of impairment and for which an objective evidence of impairment, has already been detected. Such individually insignificant loans, are being grouped by the Bank in portfolios with similar characteristics and impairment is being assessed on a collective basis.

- Individual provisions for risks – individual impairment (SRPii) represents the impairment allowance for each individual loan for an amount that is expected to not be collected in the agreed period. The amount of loss for which the remaining exposure is corrected, is the result of gross exposure reduction of expected future cash flows discounted to present value, where the expected future cash flows are assessed and recognized for each individual loan (party).

Managing problematic placements

Problematic placements (NPL status) are those which include investments that are overdue more than 90 days (significant material delay means that the liabilities exceed 2.5% of total exposure and higher than EUR 250, and the delay from entering the significant material delay of more than 90 days) or who have reported problems in business. According to the categorization of investments in C, D and E, or assets with a special provision in accordance with IAS (NPL) with an internal rating of 5A or worse. Placements in category B, and/or internal rating ranging from 4A to 4E, are additionally monitored with the active participation of the Restructuring function, but are not considered NPL placements.

Since March 2017, managing problematic placements is organized by the Loan Operations Management Department (restructuring function and workout function), which is responsible for business with the corporate segment (COR) and the segment of public enterprises (PUB), including retail (in whole or partially) in the event that they constitute a group of related parties with one or more legal entities, and the Credit Risk Management and Collection Department in retail segment, which is in charge of small and medium enterprises SME (Micro) and retail.

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Managing problematic placements (continued)

Restructuring function within the Loan Operations Management Department is responsible for all COR and PUB clients (with all their related parties) with the delay status of over 90 days, a 5A rating and worse, and local classifications categories C, D and E, and the transfer of clients from Markets is immediate upon meeting these requirements. Before the transfer to Loan Operations Management Department, Market works out a Protocol of the client transfer and the approval of the transfer is in the responsibility domain of the credit committees. In addition, the Restructuring function has the right of withdrawal of other clients with a better rating of 5A in all cases in which the Restructuring function estimates that there could be a deterioration of the credit risk.

Upon identification of a client as an NPL client, the Restructuring function assumes competence and responsibility for the whole group of clients with the Bank as well as for defining collection strategy at the client group level. Transfer of clients to the Restructuring function is performed at the clients related party group level, whereby all group members are allocated the credit rating of the worst group member. Exceptionally, the Restructuring function can assume on one group member or allocate different credit ratings to the group members; however, this must be explained, documented and approved by competent bodies.

After assuming clients, the Restructuring function assumes functions of both the Market and Credit Risk Management departments, as it is now competent for client processing and monitoring, for proposing manners of resolution and manners of possible collection of the Bank's receivables, for determination of the credit risk at the loan account/client level by applying the local regulations and IFRS, for obtaining valid collateral appraisal, for client rating adjustments, for assessment and proposal of the amount of SRP and for collection of receivables using all legal means available.

The Restructuring function clients are monitored every six months via a credit report which is submitted for approval to the respective Credit Committees' competences.

In terms of a type of an organizational unit, the Loan Operations Management Department consists of:

- Underwriting Function,
- Financial Analysis Function,
- Corporate Monitoring Function,
- Restructuring Function,
- Workout Function,

Collection Department in charge of collection from retail sector and MICRO enterprises borrowing clients is organized and operates through the following functions:

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Managing problematic placements (continued)

- Early Collection is in charge of servicing irregular clients/debtors, co-debtors and guarantors that are 1 to 90 days past-due;
- Delayed Collection, Legal Affairs and Assets Repossession Function is in charge of servicing irregular clients / debtors, co-debtors and guarantors whose contracts are cancelled, and for initiating and leading court proceedings for receivables collection;
- Restructuring Function is in charge of conducting financial restructuring measures for the portfolio within Sector's authority;
- Administration Function provides administrative support to the Sector in the collection process and is responsible for sending collection letters and debt notices to clients by SMS and letters. The Function is responsible for activating collateral instruments, debt calculations, contract cancellations, cooperation with external collection agencies, objections, etc.

Maximum exposure to credit risk

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

	2018.	2017.
Included in the statement of financial position		
Cash funds	27,339	27,324
Funds at the account with the Central Bank of Bosnia and Herzegovina	74,381	137,538
of which: Obligatory reserve	*64,549*	*63,576*
Funds with other banks	51,254	70,037
of which: Current accounts	*31,117*	*42,229*
of which: Funds with maturity over 30 days	*6,584*	*13,953*
of which: Special current accounts	*13,553*	*13,875*
Financial assets at amortized cost	487,668	453,273
Financial assets through other comprehensive income	207,332	164,264
of which: debt securities	*207,332*	*164,264*
Other financial assets	7,626	6,274
Total financial assets	**855,600**	**858,710**
Off-balance-sheet exposure		
Commitments and contingencies	145,848	127,324
Total credit risk exposure	**1,001,448**	**986,034**

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

The maximum exposure is presented without deducting the value of any underlying collateral. Loans and advances to customers are presented without deducting the accrued income fee.

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Financial assets at amortized cost - rating system

Rating system of the Bank (as well as in the entire Addiko Group) must be presented in accordance with the Main scale (five rating classes and five levels within each class). The probability of default of a certain client, whose rating was assigned from an internal Addiko Group rating scale, was expressed through the internal rating.

Client's rating is audited and updated in accordance with Bank's internal acts, more precisely Addiko Group.

All rating results are presented in accordance with the main Addiko Group scale, which is comprised of 25 ratings (5 for disordered cases/non-payment and 20 for regular).

Addiko Group groups ratings into 5 rating classes:

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

As at the reporting date, exposures with "No rating" can be identified, which are related to newly originated placements which receive the first behavioural rating 6 months after approval or clients that left the "default" status, and which will be assigned a rating in the following monthly rating calculation cycle.

The Bank's credit risk exposure arising from loans and advances to clients is given below:

	Corporate		Retail		Total	
	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions
31 December 2018						
No rating	4,228	(232)	3,196	(253)	7,424	(485)
1A-1E	37,074	(32)	87,034	(932)	124,108	(964)
2A-2E	81,206	(366)	107,213	(1,914)	188,419	(2,280)
3A-3E	92,204	(1,087)	24,137	(1,660)	116,341	(2,747)
4A-4E	9,430	(1,687)	41,557	(6,247)	50,987	(7,934)
5A-5E	15,298	(10,070)	102,668	(93,097)	117,966	(103,167)
Total	**239,440**	**(13,474)**	**365,805**	**(104,103)**	**605,245**	**(117,577)**
Total (net)		**225,966**		**261,702**		**487,668**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Financial assets at amortized cost - rating system (continued)

	Corporate		Retail		Total	
	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions
31 December 2017						
No rating	499	(27)	1,604	(108)	2,103	(135)
1A-1E	11,007	(13)	65,186	(1,123)	76,193	(1,136)
2A-2E	50,802	(834)	112,253	(2,163)	163,055	(2,997)
3A-3E	102,142	(2,284)	29,927	(617)	132,069	(2,901)
4A-4E	17,837	(2,011)	46,425	(1,441)	64,262	(3,452)
5A-5E	38,243	(23,247)	133,278	(122,062)	171,521	(145,309)
Total	**220,530**	**(28,416)**	**388,673**	**(127,514)**	**609,203**	**(155,930)**
Total (net)		**192,114**		**261,159**		**453,273**

Bank's credit risk exposure based on financial assets at amortized costs by level of credit risk is presented below:

	STAGE 1		STAGE 2		STAGE 3		TOTAL	
	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions
31 December 2018								
No rating	6,873	(307)	550	(178)	1	-	7,424	(485)
1A-1E	123,228	(836)	880	(128)	-	-	124,108	(964)
2A-2E	184,780	(1,783)	3,633	(492)	6	(5)	188,419	(2,280)
3A-3E	108,950	(1,502)	7,379	(1,235)	12	(10)	116,341	(2,747)
4A-4E	18,283	(559)	32,366	(7,141)	338	(234)	50,987	(7,934)
5A-5E	-	-	-	-	117,966	(103,167)	117,966	(103,167)
Total	**442,114**	**(4,987)**	**44,808**	**(9,174)**	**118,323**	**(103,416)**	**605,245**	**(117,577)**
Total (net)		**437,127**		**35,634**		**14,907**		**487,668**

Bank's credit risk exposure based on funds with other banks is presented below:

	STAGE 1		STAGE 2		STAGE 3		UKUPNO	
	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions
31 December 2018								
No rating	-	-	-	-	-	-	-	-
1A-1E	16,597	(39)	-	-	-	-	16,597	(39)
2A-2E	1,556	(9)	-	-	-	-	1,556	(9)
3A-3E	33,587	(438)	-	-	-	-	33,587	(438)
4A-4E	-	-	-	-	-	-	-	-
5A-5E	-	-	-	-	-	-	-	-
Total	**51,740**	**(486)**	**-**	**-**	**-**	**-**	**51,740**	**(486)**
Total (net)		**51,254**		**-**		**-**		**51,254**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Financial assets at fair value through other comprehensive income - rating system

Bank's credit risk exposure based on financial assets at fair value through other comprehensive income by level of credit risk is presented below:

	STAGE 1		STAGE 2		STAGE 3		TOTAL	
	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions
31 December 2018								
No rating	43	-	-	-	-	-	43	-
1A-1E	189,027	(332)	-	-	-	-	189,027	(332)
2A-2E	12,944	(1)	-	-	-	-	12,944	(1)
3A-3E	5,567	(104)	-	-	-	-	5,567	(104)
4A-4E	-	-	-	-	-	-	-	-
5A-5E	-	-	-	-	-	-	-	-
Total	**207,581**	**(437)**	**-**	**-**	**-**	**-**	**207,581**	**(437)**

Risk provisions in the amount of KM 437 thousand are stated within other comprehensive income.

Financial assets at based on commitments and contingencies - rating system

Bank's credit risk exposure based on commitments and contingencies by level of credit risk is presented below:

	STAGE 1		STAGE 2		STAGE 3		TOTAL	
	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions	Gross	Risk provisions
31 December 2018								
No rating	1,488	(82)	4	(1)	-	-	1,492	(83)
1A-1E	33,405	(42)	40	(3)	-	-	33,445	(45)
2A-2E	57,506	(152)	97	(8)	2	(1)	57,605	(161)
3A-3E	51,785	(503)	147	(15)	1	(1)	51,933	(519)
4A-4E	750	(14)	1,538	(212)	5	(3)	2,293	(229)
5A-5E	-	-	-	-	387	(270)	387	(270)
Total	**144,934**	**(793)**	**1,826**	**(239)**	**395**	**(275)**	**147,155**	**(1,307)**
Total (net)		**144,141**		**1,587**		**120**		**145,848**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Financial assets at amortized cost: analysis by performance

	2018	2017
Neither past due nor impaired	486,041	435,555
Past due but not impaired	881	1,162
Impaired (non-performing loans)	118,323	172,486
Gross	**605,245**	**609,203**
Collective and individual impairment STAGE 3 / (SRPii/ SRPci)	(103,416)	(146,048)
Provision Portfolio for Latent Losses STAGE 1 / Stage 2 (PRPLL)	(14,161)	(9,882)
Net	**487,668**	**453,273**

Neither past due nor impaired loans

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

	2018	2017
Corporate	223,647	181,283
Retail	262,394	254,272
	486,041	**435,555**

Past due but not impaired loans

Past due but not impaired loans and receivables, by the sectoral structure and days of delay, can be summarized as follows:

31 December 2018	up to 30 days	30 to 60 days	60 to 90 days	90 to 180 days	over 180 days	Total
Corporate	493	-	-	-	-	493
Retail	328	36	24	-	-	388
	821	**36**	**24**	**-**	**-**	**881**

31 December 2017	up to 30 days	30 to 60 days	60 to 90 days	90 to 180 days	over 180 days	Total
Corporate	966	-	1	-	-	967
Retail	131	49	15	-	-	195
	1,097	**49**	**16**	**-**	**-**	**1,162**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Financial assets at amortized cost: analysis by performance (continued)

Impaired loans

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

	Corporate	Retail	Total
31 December 2018			
Gross	15,298	103,025	**118,323**
Collective and individual impairment STAGE 3	(10,070)	(93,346)	(103,416)
Net	**5,228**	**9,679**	**14,907**
Collateral fair value	8,267	26,821	35,088
31 December 2017			
Gross	38,280	134,206	**172,486**
Collective and individual impairment (SRPii/ SRPci)	(23,270)	(122,778)	(146,048)
Net	**15,010**	**11,428**	**26,438**
Collateral fair value	15,839	23,272	39,111

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Financial assets at amortized cost: Analysis per past due/delay days

Loans of the Bank (gross and net) per past due/delay days are presented in the table below:

	Corporate	Retail	Total
31 December 2018			
Not past-due	233,464	247,881	481,345
1 to 90 days past-due	45	20,488	20,533
Over 90 days past-due	5,931	97,436	103,367
Total gross loans and receivables	**239,440**	**365,805**	**605,245**
Provision Portfolio for Latent Losses (STAGE 1/STAGE 2)	3,404	10,757	14,161
Collective and individual impairment (STAGE 3)	10,070	93,346	103,416
Total provisions for potential losses	**13,474**	**104,103**	**117,577**
Net loans and receivables	**225,966**	**261,702**	**487,668**
31 December 2017			
Not past-due	203,492	248,831	452,323
1 to 90 days past-due	572	17,677	18,249
Over 90 days past-due	16,466	122,165	138,631
Total gross loans and receivables	**220,530**	**388,673**	**609,203**
Provision Portfolio for Latent Losses (PRPLL)	5,144	4,738	9,882
Collective and individual impairment (SRPii/ SRPci)	20,250	125,798	146,048
Total provisions for potential losses	**25,394**	**130,536**	**155,930**
Net loans and receivables	**195,136**	**258,137**	**453,273**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Rescheduled and restructured receivables

A restructured loan is a loan that is refinanced, reprogrammed or otherwise converted, or a loan in which, due to the borrower's changed conditions and repayment capabilities, or its inability to make repayment in line with initially agreed repayment schedule; or because of the revised (lower) current market rate, previously agreed deadlines (period or repayment schedule) and/or other conditions subsequently changed so that the Bank can allow the borrower easier (and for the Bank itself more secure) debt servicing.

Overview the restructured and refinanced loans, at 31 December 2018 and 2017 is given below:

	Number of restructured loan	Amount
31 December 2018		
Corporate clients	1	2,048
Retail clients and entrepreneurs	180	2,373
Total	**181**	**4,421**
31 December 2017		
Corporate clients	2	9,047
Retail clients and entrepreneurs	268	10,946
Total	**270**	**19,993**

Sector concentration

Analysis of the financial assets exposed to credit risk of the Bank by industrial sectors on a gross and net basis (net of provisions) is shown in the following table:

	2018	%	2017	%
Retail customers	359,107	59.33	388,600	63.79
Trade	99,810	16.49	88,859	14.59
Administration and other public services	21,952	3.63	34,573	5.68
Services, tourism and catering business	19,460	3.22	9,006	1.48
Construction industry	16,031	2.65	10,893	1.79
Financial institutions	10,600	1.75	10,647	1.75
Mining and industry	8,997	1.49	-	-
Power industry	7,353	1.21	2,597	0.43
Transport and communications	6,170	1.02	7,307	1.20
Real estate	5,918	0.98	4,988	0.82
Agriculture, forestry and fishing	1,936	0.32	2,710	0.44
Other	47,911	7.91	49,023	8.03
Less: Allowance for impairment	*(117,577)*	-	*(155,930)*	-
	487,668	**100**	**453,273**	**100**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

a) Credit risk management (continued)

Off-balance sheet items

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

	Up to 1 year	1 to 5 years	Over 5 years	Total
As at 31 December 2017				
Borrowings	50,424	28,198	9,647	88,269
Payable, performance guarantees and letters of credit	49,846	9,040	-	58,886
	100,270	**37,238**	**9,647**	**147,155**
As at 31 December 2016				
Borrowings	55,331	22,959	9,475	87,765
Payable, performance guarantees and letters of credit	3,778	37,481	171	41,430
	59,109	**60,440**	**9,646**	**129,195**

b) Market risk

Given that the Bank represents the main segment of the consolidated Statement of financial position, the following chapter analyses the market risk from the perspective of the Bank.

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

General Requirements

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

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

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Market risk (continued)

Risk Measurement

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

The Bank uses VaR to measure the following market risks:

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

Bank's VaR by types of risk in 2018 and 2017 amounts to:

	Minimum	Maximum	Average	31 December
2018				
Interest rate risk	75	276	135	175
Foreign currency risk	1	3	2	1
Price risk	1	5	2	3
Credit spread risk	76	288	170	192
	153	**572**	**309**	**371**
2017				
Interest rate risk	89	212	134	141
Foreign currency risk	1	2	1	1
Price risk	1	2	2	2
Credit spread risk	23	73	45	33
	114	**290**	**181**	**177**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

c) Foreign currency risk

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

Foreign currency risk exposure is controlled daily in accordance with legislation and the internally set limits for each currency and for the financial assets and liabilities denominated in foreign currencies. During the year opened currency positions (gaps) were held within the limits prescribed by the Decisions of Banking Agency of FBiH and the internal limits set according to the HGAA methodology. Foreign currency adjustment of financial assets and liabilities are reflected through purchase and sales of all foreign currencies and by including foreign currency clause into agreements on deposits and monitoring approval of loans with contracted currency clause. Foreign currency risk activities and responsibilities are defined in the Foreign Currency Risk Program.

Loans and deposits denominated in KM with contracted currency clause are presented within appropriate foreign currency position.

Sensitivity analysis

The following table indicates the currencies to which the Bank had significant exposure at 31 December 2018 and 31 December 2017, considering that the Bank represents the main segment of the consolidated financial statement. The Euro was not analyzed since the exchange rate of KM is linked to the Euro exchange rate.

Currency	FX Open position 31 December 2018	10% increase	10% decrease	FX Open position 31 December 2017	10% increase	10% decrease
USD	302	52	(52)	(37)	(6)	6
CHF	(621)	(108)	108	(152)	(25)	25

FX open position represents net exposure in foreign currency. The analysis calculates the effect of a reasonably possible movement of the currencies against the KM and their influence on gain or loss, with all other variables held constant. Negative values in the table reflect a potential net reduction in income, while a positive amount reflects a net potential increase.

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

c) Foreign currency risk (continued)

The Bank had the following currency position:

	EUR	USD	CHF	Other currencies	KM	Total
31 December 2018						
ASSETS						
Cash funds	4,907	751	833	1,240	19,608	27,339
Funds at the account with the Central Bank of BiH	-	-	-	-	74,381	74,381
Funds with other banks	17,733	1,808	1,041	2,402	28,270	51,254
Financial assets at amortized cost	280,611	-	7,141	-	199,916	487,668
Assets available for sale	-	-	-	-	4,368	4,368
Financial assets through other comprehensive income	178,179	23,636	-	-	5,766	207,581
Investments in subsidiaries	-	-	-	-	-	-
Property and equipment	-	-	-	-	18,680	18,680
Intangible assets	-	-	-	-	4,671	4,671
Prepaid income tax	-	-	-	-	1,783	1,783
Other financial assets	2,224	3,793	4	14	1,591	7,626
Other assets	166	62	-	2	4,746	4,976
Total assets	**483,820**	**30,050**	**9,019**	**3,658**	**363,780**	**890,327**
LIABILITIES						
Due to other banks	491	70	18	14	18	611
Due to customers	292,879	29,393	3,984	3,653	324816	654,725
Provisions	-	-	-	-	14476	14,476
Provisions for financial commitments and contingencies	219	6	-	-	1082	1,307
Other liabilities	3,805	6	25	10	11,139	14,985
Total liabilities	**297,394**	**29,475**	**4,027**	**3,677**	**351,531**	**686,104**
Assets - off-balance sheet	10,659	-	-	-	281,016	291,675
Liabilities - off-balance sheet	195,583	273	5,638	-	1,956	203,450
Net foreign exchange position	**1,502**	**302**	**(646)**	**(19)**	**291,309**	**292,448**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

c) Foreign currency risk (continued)

	EUR	USD	CHF	Other currencies	KM	Total
31 December 2017						
ASSETS						
Cash funds	4,103	558	742	972	20,949	27,324
Funds at the account with the Central Bank of BiH	-	-	-	-	137,538	137,538
Funds with other banks	32,752	2,404	555	4,838	29,488	70,037
Financial assets at amortized cost	293,806	-	13,116	-	146,351	453,273
Assets available for sale	-	-	-	-	4,771	4,771
Financial assets through other comprehensive income	134,573	19,754	-	-	10,284	164,611
Investments in subsidiaries	-	-	-	-	855	855
Property and equipment	-	-	-	-	18,467	18,467
Intangible assets	-	-	-	-	2,270	2,270
Prepaid income tax	-	-	-	-	1,783	1,783
Other financial assets	782	3,491	-	14	1,985	6,274
Other assets	178	59	-	6	4,911	5,154
Total assets	**466,194**	**26,266**	**14,415**	**5,830**	**379,652**	**892,357**
LIABILITIES						
Due to other banks	556	50	4,502	15	88	5,211
Due to customers	293,091	25,992	3,462	5,723	315,465	643,733
Provisions	-	-	-	-	16,647	16,647
Provisions for financial commitments and contingencies	252	15	-	24	1,579	1,870
Other liabilities	2,205	6	22	10	10,606	12,849
Total liabilities	**296,104**	**26,063**	**7,986**	**5,772**	**344,385**	**680,310**
Assets - off-balance sheet	7,921	-	1,221	-	185,804	194,946
Liabilities - off-balance sheet	187,026	293	7,621	-	-	194,940
Net foreign exchange position	**(9,015)**	**(90)**	**29**	**58**	**221,069**	**212,051**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

d) Interest rate risk management

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

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

The following table shows the sensitivity of gain and loss to a reasonable change in interest rates (parallel movement), with all other variables left constant.

	Sensitivity interest rate changes	Sensitivity interest rate changes	Sensitivity interest rate changes	Sensitivity interest rate changes
31 December 2018	**+200bp**	**-200bp**	**+100bp**	**-100bp**
BAM	2,188	-3,062	1,189	-1,406
EUR	-13,169	15,920	-6,885	7,569
CHF	-1,158	1,247	-590	612
USD	-1,009	1,109	-516	541
OTHER	2	-2	1	-1
Total	**-13,146**	**15,213**	**-6,801**	**7,314**
31 December 2017	**+200bp**	**-200bp**	**+100bp**	**-100bp**
BAM	3,789	(4,336)	1,958	(2,095)
EUR	(14,427)	18,164	(7,616)	8,545
CHF	(27)	19	(13)	11
USD	(123)	133	(63)	65
OTHER	103	(107)	52	(53)
Total	**(10,685)**	**13,873**	**(5,682)**	**6,473**

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Liquidity risk management

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

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

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

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

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Liquidity risk management (continued)

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

	Less than 1 month	1 - 3 months	3-12 months	Over 1 year	Total
As at 31 December 2018					
ASSETS					
Cash funds	27,339	-	-	-	27,339
Funds at the account with the Central Bank of BiH	74,381	-	-	-	74,381
Funds with other banks	51,254	-	-	-	51,254
Financial assets at amortized cost	108,427	21,651	87,206	270,384	487,668
Assets available for sale	-	-	4,368	-	4,368
Financial assets through other comprehensive income	207,581	-	-	-	206,508
Investments in subsidiaries	-	-	-	-	-
Property and equipment	-	-	-	18,680	18,680
Intangible assets	-	-	-	4,671	4,671
Investment property	-	-	-	-	-
Prepaid income tax	-	-	-	1,783	1,783
Other financial assets	7,626	-	-	-	7,626
Other assets	4,976	-	-	-	4,976
Total assets	**481,584**	**21,651**	**91,574**	**295,518**	**890,327**
LIABILITIES					
Due to other banks	611	-	-	-	611
Due to customers	467,108	35,794	56,992	94,831	654,725
Provisions	-	-	-	14,476	14,476
Provisions for financial commitments and contingencies	-	-	-	1,307	1,307
Other liabilities	14,985	-	-	-	14,985
Total liabilities	**482,704**	**35,794**	**56,992**	**110,614**	**686,104**
Maturity mismatch	**(1,120)**	**(14,143)**	**34,582**	**184,904**	**204,223**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Liquidity risk management (continued)

	Less than 1 month	1 - 3 months	3-12 months	Over 1 year	Total
As at 31 December 2017					
ASSETS					
Cash funds	27,324	-	-	-	27,324
Funds at the account with the Central Bank of BiH	137,538	-	-	-	137,538
Funds with other banks	58,357	-	11,680	-	70,037
Financial assets at amortized cost	115,669	14,187	75,492	247,925	453,273
Assets available for sale	-	-	4,771	-	4,771
Financial assets through other comprehensive income	164,611	-	-	-	164,611
Investments in subsidiaries	-	-	-	855	855
Property and equipment	-	-	-	18,467	18,467
Intangible assets	-	-	-	2,270	2,270
Investment property	-	-	-	-	-
Prepaid income tax	-	-	-	1,783	1,783
Other financial assets	6,274	-	-	-	6,274
Other assets	5,154	-	-	-	5,154
Total assets	**514,927**	**14,187**	**91,943**	**271,300**	**892,357**
LIABILITIES					
Due to other banks	718	-	4,493	-	5,211
Due to customers	437,291	12,587	72,352	121,503	643,733
Provisions	-	-	-	16,647	16,647
Provisions for financial commitments and contingencies	-	-	-	1,870	1,870
Other liabilities	12,849	-	-	-	12,849
Total liabilities	**450,858**	**12,587**	**76,845**	**140,020**	**680,310**
Maturity mismatch	**64,069**	**1,600**	**10,327**	**136,051**	**212,047**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Liquidity risk management (continued)

Analysis of financial liabilities by the remaining undiscounted contractual maturity

The table below shows the remaining undiscounted maturities of the financial liabilities of Bank:

	Less than 1 month	1 - 3 months	3-12 months	Over 1 year	Total	Carrying amount
As at 31 December 2018						
Due to other banks	611	-	-	-	611	611
Due to customers	467,109	35,964	57,377	99,664	660,114	654,725
	467,720	**35,964**	**57,377**	**99,664**	**660,725**	**655,336**
As at 31 December 2017						
Due to other banks	718	-	4,583	-	5,301	5,211
Due to customers	437,291	12,629	73,219	127,777	650,916	643,733
	438,009	**12,629**	**77,802**	**127,777**	**656,217**	**648,944**

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

f) Fair value of financial assets and liabilities

IFRS 13 defines fair value as a price which would be obtained by sale of some asset position or paid for the transfer of a liability in a transaction between market participants on valuation date.

For a higher consistency and comparability in fair value measures and the related information, this IFRS defines a fair value hierarchy that classifies inputs to the valuation technique in three levels:

- Level 1 inputs: quoted market prices (unadjusted) in an active market for identical assets or liabilities and to which entity has access on the day of balancing.
- Level 2 inputs: inputs other than quoted prices included in Level 1 that are based on observable inputs, either directly or indirectly for the relevant asset or liability.
- Level 3 inputs: unobservable inputs for assets or liabilities.

IFRS 13 provides for three valuation techniques that operators may use in determining fair value.

- The market approach - price and other relevant information is used from market transactions with identical or comparable (i.e. similar) assets and liabilities or a group of assets and liabilities.
- Income approach - future amounts are deducted to a single, present (i.e. discounted) amount.
- Cost approach - valuation technique whereby a sum that would be required at the present time to replace the service capacity of an asset (often referred to as current replacement cost) is acquired.

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

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

f) Fair value of financial assets and liabilities (continued)

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

As at 31 December 2018	Carrying amount	Fair value total	Level 1	Level 2	Level 3
Financial assets carried at fair value					
Financial assets through other comprehensive income	207,581	207,581	201,919	5,567	95
Financial assets not carried at fair value					
Cash funds	27,339	27,339	-	-	27,339
Funds at the account with the Central Bank of BiH	74,381	74,381	-	-	74,381
Funds with other banks	51,254	51,257	-	-	51,257
Financial assets at amortized cost	487,668	498,963	-	-	498,963
Investments in subsidiaries	-	-	-	-	-
Other financial assets	7,626	7,626	-	-	7,626
Other assets	4,976	4,976	-	-	4,976
Other assets for which the fair value is disclosed					
Property and equipment	18,680	18,680	-	-	18,680
Intangible assets	4,671	4,671	-	-	4,671
Assets available for sale	4,368	4,368	-	-	4,368
	888,544	**899,842**	**201,919**	**5,567**	**692,356**
Financial liabilities not carried at fair value					
Due to other banks	611	611	-	-	611
Due to customers	654,725	660,431	-	-	660,431
Other liabilities	14,985	14,985	-	-	14,985
	670,321	**676,027**	**-**	**-**	**676,027**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

f) Fair value of financial assets and liabilities (continued)

As at 31 December 2017	Carrying amount	Fair value total	Level 1	Level 2	Level 3
Financial assets carried at fair value					
Financial assets through other comprehensive income	164,611	164,611	144,263	20,001	347
Financial assets not carried at fair value					
Cash funds	27,324	27,324	-	-	27,324
Funds at the account with the Central Bank of BiH	137,538	137,538	-	-	137,538
Funds with other banks	70,037	70,037	-	-	70,037
Financial assets at amortized cost	453,273	469,221	-	-	469,221
Investments in subsidiaries	855	855	-	-	855
Other financial assets	6,274	6,274	-	-	6,274
Other assets	5,154	5,154	-	-	5,154
Other assets for which the fair value is disclosed					
Property and equipment	18,467	18,467	-	-	18,467
Intangible assets	2,270	2,270	-	-	2,270
Assets available for sale	4,771	4,771	-	-	4,771
	890,574	**906,522**	**144,263**	**20,001**	**742,258**
Financial liabilities not carried at fair value					
Due to other banks	5,211	5,317	-	-	5,317
Due to customers	643,733	651,927	-	-	651,927
Other liabilities	12,536	12,536	-	-	12,536
	661,480	**669,780**	**-**	**-**	**669,780**

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

f) Fair value of financial assets and liabilities (continued)

By definition, fair value is the value that a third party will pay for a contract in a fair transaction. To be able to calculate fair market value, one must reduce future cash flows to their present value, which have clear cash flows defined by a contract. An investor is willing to take the contract if it fairly compensates the price on all risks surrounding the contract. This means that the investor will discount all future cash flows with this return rate, which leads us to present value that the investor is willing to pay for the contract. The present value, based on the manner in which it was received, guarantees the investor a required annual return rate and represents the fair value.

The table below presents the movements of financial assets that fall into Level 3 of the hierarchy and that are subject to recurring fair value measurement:

BANK	S.W.I.F.T SCRL	Registry of securities of FBiH	Sarajevo stock exchange	Total
As at 1 January 2018	52	43	32	127
Increase for the year	-	-	-	-
As at 31 December 2018	**52**	**43**	**32**	**127**
As at 1 January 2017	52	43	32	127
Increase for the year	-	-	-	-
As at 31 December 2017	**52**	**43**	**32**	**127**

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

g) Operating risks

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

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

- definition and identification of operating risk,
- development and application of methods and systems for measurement, analysis, limitations and control of operating risks in accordance with regulatory and Addiko Group requirements,
- measurement, analysis and supervision of operating risk in line with minimum standards for operating risk management,
- maintenance of database on losses from operating risks – regular data collection and reporting on loss events,
- regular updates of new and existing policies, manuals and procedures in accordance with regulations and Addiko Group standards,
- performing qualitative estimates (scenario analyses and risk assessment) in order to identify and assess risk in business processes,
- reputation risk management aiming at risk identification, assessment, monitoring and control and reporting,
- education of all employees in order to improve their knowledge and experience, awareness and skills in dealing with operating risk or specific processes (e.g. collection of data on losses, risk assessment),
- development of an internal control system, through the mapping of all internal bank processes, by defining the owners of those processes, recognition of risks which incur in the process, adequate way of decrement of those risks, and testing the effectiveness of established controls,
- assessment and establishing adequate operating risk management in new product development,
- assessment of outsourcing risk and management of outsourced activities within the Bank in cooperation with business units responsible for outsourced activities.

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

g) Operating risks (continued)

In order to improve processes for managing operational risk in the Bank, the following activities are planned:

- continuous education of all employees in order to improve their knowledge and awareness skills in dealing with operating risk - strengthening OpRisk culture,
- defining key indicators of operating risk,
- development of a risk matrix in defined bank business processes based on the results of internal control system,
- testing risk controls established for SIK relevant bank processes,
- development of methodology for monitoring new risk categories, model risk and “conduct” risk.

h) Capital risk management

In accordance with the Law on Banks (Official Gazette of Federation of BiH no. 39/98, 32/00, 48/01, 27/02, 41/02, 58/02, 13/03, 19/03, 28/03 and 27/17), the minimum amount of a bank’s paid-in capital and the lowest level of the capital a bank has to maintain, cannot be lower than KM 15,000 thousand. The Bank’s subscribed capital amounted to KM 100,403 thousand in line with these provisions. The Bank covered the accumulated loss for 2016 in the amount of KM 29,830 thousand from profit generated in 2017 in the amount of KM 5,249 thousand, while the outstanding amount of KM 24,581 thousand was stated as an uncovered losses from previous years.

Regulatory capital represents the sum of core and supplementary capital, after regulatory adjustments.

The Bank’s core capital is comprised of the sum of regulatory capital after regulatory adjustments and supplementary capital after regulatory adjustments.

Items of ordinary core capital of the Bank consist of equity instruments, premiums on shares, retained earnings, accumulated other comprehensive income, other reserves and reserves for general banking risks. The Bank deducts loss of current financial years from of ordinary capital items, uncovered loss from previous years, intangible assets, deferred tax assets etc. The additional core capital of the Bank consists of items of additional capital after regulatory adjustments. The items of additional capital are equity instruments and instrument-related premium accounts.

The Bank’s supplementary capital consists of the Bank’s supplementary capital items after deductions for regulatory adjustments. Supplementary capital cannot be more than one third of the core capital. Supplementary capital items consist of equity instruments and subordinated debts, premiums written on equity instruments and general write-downs for credit losses up to 1.25% of risk-weighted exposure amounts.

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

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

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

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

h) Capital risk management (continued)

The Bank is under obligation to maintain capital adequacy at the minimum of 12%, i.e. to harmonize the scope and the structure of its operations with the performance indicators that are defined by the regulations of the Banking Agency especially with the Decision on Minimum Standards for Bank Capital Management and other decisions of the Banking Agency in the field of supervision and control of bank operations, and the Law on Banks of Federation of BiH.

The Bank's Management monitors adequacy ratios and other business indicators on a regular basis. Reports on indicators are submitted to the Banking Agency quarterly in the prescribed form.

	2018	2017
Core capital - Tier I		
Share capital	100,403	100,403
Statutory reserves	25,101	-
Retained earnings (Uncovered and current loss)	70,994	(29,830)
Intangible assets	(4,671)	(2,270)
Accumulated other comprehensive income	(1,035)	-
Deductions from ordinary core capital	(17,957)	
Total core capital	**172,835**	**68,303**
Supplementary capital - Tier II		
General credit risk allowances	7,039	7,472
Positive revaluation reserves	-	2,834
Deductions from supplementary capital	(7,039)	-
Total supplementary capital	**-**	**10,306**
Net capital	**172,835**	**78,609**
Amount of exposure weighted for credit risk / Total risk-weighted assets	563,089	543,474
Total amount of exposure for position, currency and merchandise risk	3,163	-
Weighted operating risk	67,178	54,312
Total risk-weighted assets	**633,430**	**597,786**
Capital adequacy as at 31 December	27.29%	13.2%
Rate of core capital relative to total risk-weighted assets	**27.29%**	**11.4%**

**The amounts of capital and other balance sheet items in the above table are calculated in accordance with FBiH regulations.*

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

7. INTEREST INCOME

	2018	2017
Interest income on financial assets at amortized cost		
Of which: retail	20,097	19,251
Of which: corporate	7,254	7,103
Of which: banks	266	138
Interest on financial instruments through other comprehensive income	1,863	1,775
	29,480	**28,267**

8. INTEREST AND SIMILAR EXPENSES

	2018	2017
Interest on deposits - retail	4,552	5,026
Interest on deposits - corporate	290	357
Interest on funds of other banks	272	237
Other interest	-	1
	5,114	**5,621**

9. FEE AND COMMISSION INCOME

	2018	2017
Fees on other services - retail	7,240	6,868
Fees on other services - corporate	3,017	2,772
Fees on services to banks	2,484	2,478
Fees on issued guarantees	756	732
	13,497	**12,850**

10. NET INCOME ON FINANCIAL OPERATIONS

	2018	2017
Conversion of assets and liabilities denominated in foreign currencies, net	1,753	1,321
Net gain from derecognition of assets through other comprehensive income	257	438
	2,010	**1,759**

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

11. OTHER OPERATING INCOME

	2018	2017
Income from credit card operations	1,054	1,103
Net income from sale of repossessed collateral	856	707
Release of provisions for employee benefits (Note 29)	159	117
Net rent income	78	122
Income from expenses re-invoiced to related parties	24	57
Income from sale of own property and equipment	17	432
Income from insurance companies	9	26
Income from broker services	-	-
Other income	420	682
	2,617	**3,246**

12. PERSONNEL EXPENSES

	2018	2017
Gross salaries	12,220	12,625
Other employee benefits	3,690	3,381
	15,910	**16,006**

The average number of employees in the Bank for the years ended 31 December 2018 and 2017 was 388 and 420, respectively.

13. GENERAL AND ADMINISTRATIVE EXPENSES

	2018	2017
Maintenance and repairs	5,084	6,029
Memberships and other dues	2,543	2,388
Rent	2,467	2,000
Advertising, marketing and sponsorships	1,418	1,320
Consulting services	1,252	1,959
Other services	1,056	900
Insurance	974	1,064
Utilities	895	994
Telecommunication expenses	692	914
Security	377	429
Other taxes and contributions	343	365
Court proceedings	226	251
Small inventory write-off	195	264
Loss on disposal of tangible and intangible assets	49	2
Other expenses	488	393
	18,059	**19,272**

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

14. IMPAIRMENT LOSSES AND PROVISIONS, NET

	2018	2017
Financial assets at amortized cost (Note 19)	(5,135)	(5,997)
Reliefs to clients with CHF foreign currency loans	1,230	1,533
Provisions for court proceedings (Note 29)	790	744
Directly written-off assets at amortized cost	299	1,122
Financial commitments and contingencies – release of provisions (Note 30)	203	313
Impairment of acquired assets	-	501
Other financial assets (Note 25)	58	(206)
Impairment of assets out of use	-	18
Funds at the account with the Central Bank of BiH (Note 17)	(798)	-
Change in value of expected credit losses on financial assets at fair value through other comprehensive income (Note 21)	(1,178)	-
Funds with other banks (Note 18)	(507)	18
Impairment of tangible and intangible assets, and investment property (Notes 23, 24 and 25)	-	31
Impairment of investments in subsidiaries (Note 22)	-	794
	(5,038)	**(1,129)**

Release of provisions for credit risks in 2018 is mainly a result of increased receivables collection activities and updated parameters in credit risk calculations.

15. INCOME TAX

a) Components of income tax

	2018	2017
Current tax	-	-
Deferred tax	-	-
Total tax through income statement	**-**	**-**
Deferred tax through comprehensive income	478	(164)

Bank’s tax liability is calculated based on the accounting profit, taking into account non-deductible expenses and non-taxable income. The tax rate for the years ended 31 December 2018 and 31 December 2017 was 10%.

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

15. INCOME TAX (CONTINUED)

a) Components of income tax (continued)

Reconciliation of income tax presented in the tax balance and the accounting income tax can be presented as follows:

	2018	2017
Profit before income tax	**8,760**	**5,249**
Income tax benefit at 10%	**876**	**525**
Effects of non-deductible expenses	13,822	956
Effects of non-deductible income	(824)	(392)
Used tax losses from previous years	(13,874)	(1,089)
Effect of unused tax losses from previous years	(8,692)	(22,538)
Current income tax	**-**	**-**
Unrecognized deferred tax assets	**(8,692)**	**(22,538)**

In accordance with the Corporate Income Tax Act, the taxable losses may be carried forward for the next five years. Deferred tax assets related to losses incurred in the current year were not recorded in the accompanying financial statements since it is uncertain that the Bank will have sufficient taxable profit against which it can utilize the benefits from unutilized tax losses carry forward and related deferred tax asset.

The Bank has no deferred tax assets as a result of tax losses carry forward which it plans on using.

The Bank has unrecognized tax losses amounting to KM 554 thousand which expire in 2021, and KM 8,138 thousand which expire in 2020.

Deferred tax assets / (liabilities)

	2018	2017
Deferred tax assets (liabilities)		
Financial assets through other comprehensive income (Note 21)	164	(314)
	164	**(314)**

Movement in deferred taxes can be presented as follows:

BANK	31 December 2017	Recognized in the current result	Recognized in other comprehensive income	31 December 2018	Deferred tax assets	Deferred tax liabilities
Financial assets through other comprehensive income	(314)	-	478	164	164	-
	(314)	**-**	**478**	**164**	**164**	**-**

16. CASH FUNDS

	2018	2017
Cash funds	27,339	27,324
Of which: Cash at hand and in Bank's treasury - domestic currency	*19,608*	*20,950*
Of which: Cash at hand and in Bank's treasury - foreign currency	*7,731*	*6,374*
	27,339	**27,324**

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

17. FUNDS AT THE ACCOUNT WITH THE CENTRAL BANK OF BOSNIA AND HERZEGOVINA

	2018	2017
Obligatory reserve with the Central Bank of Bosnia and Herzegovina	64.549	63.576
Funds exceeding the Obligatory reserve	10.353	73.962
Total funds at the account with the Central Bank of BiH	***74.902***	***137.538***
Less: Impairment for potential losses	*(521)*	-
	74.381	**137.538**

The Management Council of the Central Bank of Bosnia and Herzegovina ("CBBiH") adopted the Decision on determining and maintaining obligatory reserves and determining CBBiH fee on reserve amount. By this decision, the basis for calculation of the obligatory reserve comprises deposits and loaned assets, regardless of the currency. The decision determines the unified obligatory reserve rate of 10%, which the CBBiH applies to the basis for obligatory reserve calculation. The decision became effective upon publishing in the "Official Gazette of BiH", and it has been applied since 1 July 2017. The Decision also stipulates that the CBBiH does not calculate fees on the amount of funds in the obligatory reserve. For the funds exceeding the obligatory reserve, the CBBiH calculates the fee at the rate equal to 50% of the rate applied by the European Central Bank (ECB) on deposits of commercial banks.

The previous decision stipulated the following: the rates of obligatory reserve were 10% of total short-term deposits and loans, and 7% of total long-term deposits and loans.

Movement in gross exposures for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Gross exposure 1 January 2018	**137,538**	**-**	**-**	**137,538**
IFRS 9 effect	-	-	-	-
Gross exposure 1 January 2018	**137,538**	-	-	**137,538**
Change of gross exposure	(62,636)	-	-	(62,636)
of which: increase	80,163	-	-	80,163
of which: decrease	(142,799)	-	-	(142,799)
Gross exposure 31 December 2018	**74,902**	-	-	**74,902**

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

17. FUNDS AT THE ACCOUNT WITH THE CENTRAL BANK OF BOSNIA AND HERZEGOVINA (CONTINUED)

Movement in impairment for 2018 can be presented as follows

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Impairment 1 January 2018	**-**	**-**	**-**	**-**
IFRS 9 effect	(1,319)	-	-	(1,319)
Impairment 1 January 2018	**(1,319)**	-	-	**(1,319)**
Change in impairment (Note 14)	798	-	-	798
of which: increase	(4,437)	-	-	(4,437)
of which: decrease	5,235	-	-	5,235
Impairment 31 December 2018	**(521)**	**-**	**-**	**(521)**

18. FUNDS WITH OTHER BANKS

	2018	2017
Current accounts	31,383	42,209
Special current accounts	13,760	13,875
Short-term deposits in banks in the following countries:	6,597	14,018
Of which: OECD countries		
Cash funds with maturity over 30 days	*6,597*	*14,018*
Total gross funds with other banks	51,740	70,102
Less: Impairment for potential losses	(486)	(65)
	51,254	**70,037**

As at 31 December 2018, the Bank had several placements on the inter-banking market, in EUR and USD currency. The amounts of placements were:

- USD 1,000,000, maturity on 3 January 2019, interest rate 2.40% p.a.,
- EUR 2,500,000, maturity on 4 January 2019, interest rate 0.59% p.a..

Movement in gross exposures for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Gross exposure 1 January 2018	**70,102**	-	-	**70,102**
IFRS 9 effect	-	-	-	-
Gross exposure 1 January 2018	**70,102**	**-**	**-**	**70,102**
Change of gross exposure	(18,058)	-	-	(18,058)
of which: increase	39,824	-	-	39,824
of which: decrease	(57,944)	-	-	(57,944)
Derecognized assets	(419)	-	-	(419)
Forex differences	115	-	-	115
Gross exposure 31 December 2018	**51,740**		**-**	**51,740**

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

18. FUNDS WITH OTHER BANKS (CONTINUED)

Movement in impairment for 2018 can be presented as follows

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Impairment 1 January 2018	**(65)**	-	-	**(65)**
IFRS 9 effect	(916)	-	-	(916)
Impairment 1 January 2018	**(981)**	**-**	**-**	**(981)**
Change in impairment (Note 14)	502	-	-	502
of which: increase	(1.174)	-	-	(1.174)
of which: decrease	1.676	-	-	1.676
Derecognized assets (Note 14)	5	-	-	5
Forex differences	(12)	-	-	(12)
Impairment 31 December 2018	**(486)**	**-**	**-**	**(486)**

The movements in the allowance for impairment losses for 2017 (comparative period) are summarized as follows:

	2017
Balance as at 1 January	**47**
Changes in allowance for potential losses, net (Note 14)	18
Balance as at 31 December	**65**

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

19. FINANCIAL ASSETS AT AMORTIZED COST

	Corporate		Retail		Total	
	2018	2017	2018	2017	2018	2017
Total financial assets at amortized cost	239,440	220,530	365,805	388,673	605,245	609,203
Less: impairment losses	(13,474)	(28,416)	(104,103)	(127,514)	(117,577)	(155,930)
Total	**225,966**	**192,114**	**261,702**	**261,159**	**487,668**	**453,273**

Loans are mainly approved to clients in Federation of Bosnia and Herzegovina.

Movement in gross exposures for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Gross exposure 1 January 2018	**383,674**	**52,078**	**173,451**	**609,203**
IFRS 9 effect	-	-	3,932	3,932
Gross exposure 1 January 2018	**383,674**	**52,078**	**177,383**	**613,135**
Change of gross exposure	(83,533)	3,436	6,902	(73,195)
of which: increase	*277,785*	*5,469*	*22,293*	*305,547*
of which: decrease	*(350,672)*	*(13,404)*	*(14,666)*	*(378,742)*
of which: transfer between levels	*(10,646)*	*11,371*	*(725)*	-
Write-offs	(1,036)	(527)	(54,053)	(55,616)
Purchased or originated assets	269,469	6,677	686	276,832
Derecognized assets	(126,644)	(16,923)	(16,629)	(160,196)
Forex differences	184	67	4,034	4,285
Gross exposure 31 December 2018	**442,114**	**44,808**	**118,323**	**605,245**

Movement in impairment for 2018 can be presented as follows

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Impairment 1 January 2018	**(7,163)**	**(2,719)**	**(146,048)**	**(155,930)**
IFRS 9 effect	2,468	(11,146)	(3,932)	(12,610)
Impairment 1 January 2018	**(4,695)**	**(13,865)**	**(149,980)**	**(168,540)**
Change in impairment (Note 14)	(1,395)	2,173	(9,352)	(8,574)
of which: increase	*(5,998)*	*(18,798)*	*(31,234)*	*(56,030)*
of which: decrease	*3,934*	*25,869*	*17,653*	*47,456*
of which: transfer between levels	*669*	*(4,898)*	*4,229*	-
Effect on interest income	-	-	(1,243)	(1,243)
Write-offs	122	138	46,215	46,475
Purchased or originated assets (Note 14)	(3,901)	(1,407)	(586)	(5,894)
Derecognized assets (Note 14)	877	3,776	11,623	16,276
Change in models/parameters (Note 14)	4,088	(761)	-	3,327
Forex differences	(83)	772	(93)	(596)
Impairment 31 December 2018	**(4,987)**	**(9,174)**	**(103,416)**	**(117,577)**

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

19. FINANCIAL ASSETS AT AMORTIZED COST (CONTINUED)

The movements in the allowance for impairment losses for 2017 (comparative period) are summarized as follows:

	2017
Balance as at 1 January	**185,470**
Increase in allowance for loans to corporate clients (Note 14)	4,140
Decrease in allowance for loans to retail clients (Note 14)	(10,137)
Decrease – unwinding (interest income on impaired receivables)	(1,840)
CHF reliefs	(7,852)
Write-off	(13,218)
Effects of FX changes	(633)
Balance as at 31 December	**155,930**

Weighted average interest rates on loans can be summarized as follows:

	2018	2017
Corporate	3.35%	3.73%
Retail	7.26%	7.44%

20. ASSETS AVAILABLE FOR SALE

In 2018, the Bank retained its own properties reclassified in 2017 in assets available for sale and is actively working on their sale over the Agency for sale and via Bank's sale channels. During 2018, the Bank sold one floor of the building in Tuzla and apartment in Mostar with value of KM 405 thousand, and made an investment in the property in Tuzla in the amount of KM 2 thousand, so as at 31 December 2018 total value of assets available for sale amounts to KM 4,368 thousand.

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

21. FINANCIAL ASSETS THROUGH OTHER COMPREHENSIVE INCOME

	2018	2017
Debt securities		
Bonds		
Republic of Bulgaria	14,867	15,064
Government of Spain	14,759	9,574
Governemtn of Italy	14,634	9,749
Republic of Romania	14,498	15,140
BNP Paribas	14,313	-
Barclays PLC	14,108	14,536
Lloyds Bank	13,549	14,607
Credit Agricole	13,289	-
Government of Republika Srpska	12,945	12,716
Commerzbank AG	11,273	11,629
Societe Generale	10,923	11,622
Republic of Hungary	10,691	7,037
Banco Santader SA	9,988	-
Daimler International BV	9,612	-
JP Morgan Chase and CO	8,447	8,500
JP Autoceste FBiH	5,502	-
KA Finanz AG	4,943	4,966
Toyota	3,647	3,706
LVMH MOET HENNESSY LOUIS VUITTON SE	3,638	3,696
Total Capital S.A.	1,641	1,721
Government of Federation of BiH	65	46
Treasury notes		
Government of Republika Srpska	-	19,955
	207,332	*164,264*
Equity securities		
CROBIH Fund	122	174
S.W.I.F.T SCRL	52	52
Registry of securities of FBiH	43	43
Sarajevska berza d.d. Sarajevo	32	32
Mutual fund Addiko BH EQUITY	-	46
	249	*347*
	207,581	**164,611**

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

21. FINANCIAL THROUGH OTHER COMPREHENSICE INCOME (CONTINUED)

The structure of bonds and treasury notes at nominal value as at 31 December 2018 can be presented as follows:

Assets	Number	Discount price	Nominal price	Maturity	Coupon
Bonds					
JP Morgan Chase and CO	4,300	8,444	8,410	27.1.2020	0.55 + 3M EURIBOR
Republic of Bulgaria	7,000	14,666	13,691	21.3.2023	1.88%
Government of Spain	6,300	14,668	12,322	31.10.2023	4.40%
LVMH MOET HENNESSY LOUIS VUITTON SE	1,800	3,630	3,520	13.11.2020	1.75%
Barclays Bank	7,000	13,909	13,691	23.3.2021	1.88%
Total Capital S.A.	800	1,570	1,565	28.1.2019	4.88%
Toyota Motor Credit Corp.	1,800	3,619	3,520	23.7.2020	1.80%
KA Finanz AG	2,500	4,936	4,890	11.8.2020	0.38%
Republic of Hungary	2,300	4,133	3,927	29.3.2021	6.38%
Republic of Serbia	7,400	12,731	12,636	25.2.2020	4.88%
Republic of Hungary	3,500	6,448	5,976	22.11.2023	5.75%
Lloyds Bank	7,300	13,547	14,278	21.6.2024	0.78 + 3M EURIBOR
Republic of Italy	7,600	14,625	14,864	1.11.2021	0.35%
Commerzbank AG	6,000	11,256	11,735	13.9.2023	0.50%
Republic of Romania	2,300	4,810	4,498	18.9.2020	4.63%
Republic of Romania	4,500	9,584	8,801	28.10.2024	2.88%
Societe Generale	5,800	10,918	11,344	22.5.2024	0.8 + 3M EURIBOR
BNP Paribas	5,000	9,428	9,779	7.6.2024	0.75 + 3M EURIBOR
BNP Paribas	2,500	4,870	4,890	10.10.2023	1.13%
Government of Federation of BiH	64	65	64	30.6.2019	2.50%
Credit Agricole	7,000	13,287	13,691	6.3.2023	0.60% + 3M Euribor
Daimler Internetaional BV	5,000	9,611	9,779	11.5.2022	0.30% + 3M Euribor
Banco Santander SA	5,000	9,868	9,779	9.2.2022	1.38%
JP Autoceste FBiH	5,500	5,502	5,500	28.12.2020	2.60%
Receivables for undue interest		1,072	-		
Receivables for accrued interest		125	-		
		207,322	**203,150**		

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

21. FINANCIAL THROUGH OTHER COMPREHENSICE INCOME (CONTINUED)

The structure of bonds and treasury notes at nominal value as at 31 December 2017 can be presented as follows:

JP Morgan Chase and CO	4,300	8,497	8,410	27.1.2020	0.55 + 3M EURIOBOR
Republic of Bulgaria	7,000	14,863	13,691	21.3.2023	1.88%
Government of Spain	4,000	9,516	7,823	31.10.2023	4.40%
LVMH MOET HENNESSY LOUIS VUITTON SE	1,800	3,688	3,520	13.11.2020	1.75%
Barclays Bank	7,000	14,337	13,691	23.3.2021	1.88%
Total Capital S.A.	800	1,650	1,565	28.1.2019	4.88%
Toyota Motor Credit Corp.	1,800	3,678	3,520	23.7.2020	1.80%
KA Finanz AG	2,500	4,959	4,890	11.8.2020	0.38%
Republic of Hungary	2,300	4,163	3,751	29.3.2021	6.38%
Republic of Serbia	7,400	12,512	12,068	25.2.2020	4.86%
Republic of Hungary	1,500	2,799	2,446	22.11.2023	5.75%
Lloyds Bank	7,300	14,605	14,278	21.6.2024	0.78 + 3M EURIBOR
Republic of Italy	5,000	9,743	9,779	1.11.2021	0.35%
Commerzbank AG	6,000	11,612	11,735	13.9.2023	0.50%
Republic of Romania	6,800	14,965	13,300	18.9.2020	4.63%
Societe Generale	5,800	11,617	11,344	22.5.2024	0.8 + 3M EURIBOR
Government of Federation of BiH	46	46	46	30.9.2018	2.61%
Receivables for undue interest		1,048	-		
Receivables for accrued interest		12	-		
		144,310	**135,857**		
Treasury notes					
Government of Republika Srpska	1,000	9,963	10,000		
Government of Republika Srpska	1,000	9,992	10,000		
		19,955	**20,000**		
		164,265	**155,857**		

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

21. FINANCIAL THROUGH OTHER COMPREHENSICE INCOME (CONTINUED)

Movement in gross exposures for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Gross exposure 1 January 2018	**164,264**	**-**	**-**	**164,264**
IFRS 9 effect	-	-	-	-
Gross exposure 1 January 2018	**164,264**	**-**	**-**	**164,264**
Change of gross exposure	10,363	-	-	10,363
of which: increase	*14,016*	-	-	*14,016*
of which: decrease	*(3,653)*	-	-	*(3,653)*
Newly originated assets	52,706	-	-	52,706
Derecognized assets	(20,001)	-	-	(20,001)
Gross exposure 31 December 2018	**207,332**	**-**	**-**	**207,332**

Movement in impairment for 2018 can be presented as follows

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Impairment 1 January 2018	**-**	**-**	**-**	**-**
IFRS 9 effect	(1,611)	-	-	(1,611)
Impairment 1 January 2018	**(1,611)**	**-**	**-**	**(1,611)**
Change in impairment (Note 14)	774	-	-	774
of which: increase	(931)	-	-	(931)
of which: decrease	1,705	-	-	1,705
Newly originated assets (Note 14)	(221)	-	-	(221)
Derecognized assets (Note 14)	625	-	-	625
Forex differences	(4)	-	-	(4)
Impairment 31 December 2018	**(437)**	**-**	**-**	**(437)**

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

22. INVESTMENTS IN SUBSIDIARIES

Investments in subsidiaries as at 31 December 2018 and 2017 are stated at cost:

	2018	2017
Addiko Invest d.o.o. Mostar	-	855
	-	**855**

Name	Principal activity	Headquarters	% ownership
Addiko Invest d.o.o. Mostar	Financial services	Bosnia and Herzegovina	100

By 30 March 2018, the Bank was the 100% owner of Addiko Invest d.o.o. Mostar, which, combined with the Bank, comprised the Group. The Company was responsible for the establishment and management of investment funds: Investment fund CROBiH Fond d.d. Mostar (“IF CROBiH”), Open investment fund Addiko BH Equity, Investment fund Fortuna fond d.d. Cazin, and OIF Kapital. On 30 March 2018, the sale and transfer of share were completed based on Contract on transfer of share between the Bank and the buyer, and by the Decision of the Municipal Court in Mostar on change of name, members and transfer of share no. Tt-O-270/18 of 18 April 2018, the registration of these changes was completed.

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

23. PROPERTY AND EQUIPMENT

	Buildings and land	Office equipment and vehicles	Investments in progress	Leasehold improvements	Total
COST					
31 December 2016	**48,623**	**23,864**	**220**	**2,471**	**75,178**
Additions	73	73	1,279	4	1,429
Transfer from/to	25	519	(984)	440	-
Transfer to assets available for sale (Note 20)	(16,032)	-	-	-	(16,032)
Disposals	(1,009)	(1,883)	-	(150)	(3,042)
31 December 2017	**31,680**	**22,573**	**515**	**2,765**	**57,533**
Additions	17	88	1,108	271	1,484
Transfer from/to	290	149	(463)	24	-
Disposals	-	(4,706)	(27)	(5)	(4,738)
31 December 2018	**31,987**	**18,104**	**1,133**	**3,055**	**54,279**
ACCUMULATED DEPRECIATION					
31 December 2016	**25,668**	**21,111**	**-**	**2,123**	**48,902**
Depreciation for the year	482	740	-	213	1,435
Transfer to assets available for sale (Note 20)	(9,317)	-	-	-	(9,317)
Disposals	(409)	(1,424)	-	(150)	(1,983)
Impairment losses	29	-	-	-	29
31 December 2017	**16,453**	**20,427**	**-**	**2,186**	**39,066**
Depreciation for the year	402	533	-	258	1,193
Disposals		(4,657)		(3)	(4,660)
31 December 2018	**16,855**	**16,303**	**-**	**2,441**	**35,599**
PRESENT VALUE					
31 December 2018	**15,132**	**1,801**	**1,133**	**614**	**18,680**
31 December 2017	**15,227**	**2,146**	**515**	**579**	**18,467**

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

24. INTANGIBLE ASSETS

COST	
31 December 2016	**25,043**
Additions	1,820
31 December 2017	**26,863**
Additions	3,301
Disposals – write-off	(16)
31 December 2018	**30,148**
ACCUMULATED DEPRECIATION	
31 December 2016	**24,216**
Additions	377
31 December 2017	**24,593**
Additions	884
Disposals – write-off	-
31 December 2018	**25,477**
NET CARRYING AMOUNT	
31 December 2017	**2,270**
31 December 2018	**4,671**

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

25. OTHER FINANCIAL ASSETS

	2018	2017
Receivables for funds with non-banking financial organization (VISA; MasterCard)	3,773	3,493
Credit card operations	3,260	1,409
Purchased receivables	924	924
Fees and commission receivables	95	79
Other receivables	1,504	1,298
Total other financial assets	*9,556*	*7,203*
Less: Impairment	(1,930)	(929)
	7,626	**6,274**

Movement in gross exposures for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Gross exposure 1 January 2018	**5,361**	**-**	**1,842**	**7,203**
IFRS 9 effect	-	-	-	-
Gross exposure 1 January 2018	**5,361**	**-**	**1,842**	**7,203**
Change of gross exposure	2,308	-	58	2,366
of which: increase	7,026	-	96	7,122
of which: decrease	(4,718)	-	(38)	(4,756)
Write-off	-	-	(13)	(13)
Gross exposure 31 December 2018	**7,669**	**-**	**1,887**	**9,556**

Movement in impairment for 2018 can be presented as follows

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Impairment 1 January 2018	**-**	**-**	**(929)**	**(929)**
IFRS 9 effect	(43)	-	(913)	(956)
Impairment 1 January 2018	**(43)**	**-**	**(1,842)**	**(1,885)**
Change in impairment	-	-	(58)	(58)
of which: increase	-	-	(96)	(96)
of which: decrease	-	-	38	38
Write-off	-	-	13	13
Impairment 31 December 2018	**(43)**	**-**	**(1,887)**	**(1,930)**

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

25. OTHER FINANCIAL ASSETS (CONTINUED)

The movements in the allowance for impairment losses for 2017 (comparative period) are summarized as follows:

	2017
Balance as at 1 January	**1,135**
Impairment allowances (Note 14)	(206)
Balance as at 31 December	**929**

26. OTHER ASSETS

	2018	2017
Repossessed collateral available for sale	9,387	10,789
Advances to suppliers	429	778
Empty buildings	246	246
Deferred tax assets	164	-
Office equipment	26	125
Other assets	888	682
	10,497	***11,107***
Less: Allowance for impairment	*(6,164)*	*(7,466)*
	4,976	**5,154**

Changes in allowance for impairment for potential losses can be summarized as follows:

	2018	2017
Balance as at 1 January	**7,466**	**7,447**
Changes in impairment (Note 14)	-	501
Sale of assets	(1,302)	(482)
Balance as at 31 December	**6,164**	**7,466**

27. DUE TO OTHER BANKS

	2018	2017
Short-term deposits:		
KM	18	84
Foreign currencies	593	634
	611	*718*
Long-term deposits:		
Foreign currencies	-	4,493
Total deposits from banks:	*611*	*5,211*
	611	**5,211**

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

27. DUE TO OTHER BANKS (CONTINUED)

Long-term deposits as at 31 December 2018 and 2017 can be presented as follows:

	2018	2017
Addiko Bank AG, Austria (fixed-term deposits for period no longer than 3 years)	-	4,493
	-	**4,493**

28. DUE TO CUSTOMERS

	2018	2017
Demand deposits:		
Retail:		
KM	148,192	135,269
Foreign currency	149,561	127,637
	297,753	*262,906*
Corporate:		
KM	135,896	137,070
Foreign currency	14,670	16,576
	150,566	*153,646*
Total demand deposits	**448,319**	**416,552**
Fixed-term deposits:		
Retail:		
KM	25,330	29,100
Foreign currency	155,934	174,164
	181,264	*203,264*
Corporate:		
KM	15,397	14,026
Foreign currency	9,745	9,891
	25,142	*23,917*
Total fixed-term deposits	**206,406**	**227,181**
	654,725	**643,733**

As at 31 December 2018, the Bank has no fixed term deposits. Deposit in CHF from Addiko Bank AG, Austria, with the floating interest rate of 6M Libor + 2.015% p.a. matured in December 2018.

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

29. PROVISIONS

	2018	2017
Provisions for court proceedings	13,612	15,360
Provisions for employee benefits	599	492
Provisions for restructuring	164	661
Provisions for severance payments and vacations	101	134
Total	**14,476**	**16,647**

Movement in provisions can be presented as follows:

	Provisions for restructuring	Employee payables (Note 11)	Provisions for court proceedings (Notes 11 and 14)	Total
Balance as at 31 December 2016	**1,977**	**664**	**18,228**	**20,869**
Increase	61	453	5,187	5,701
Decrease	-	(117)	(4,443)	(4,560)
Decrease due to payment	(1,377)	(374)	(3,612)	(5,363)
Balance as at 31 December 2017	**661**	**626**	**15,360**	**16,647**
Increase	-	509	790	1,299
Decrease	-	(159)	-	(159)
Decrease due to payment	(497)	(276)	(2,538)	(3,311)
Balance as at 31 December 2018	**164**	**700**	**13,612**	**14,476**

Average interest rate on interest expense is 0.74% as at 31 December 2018 (31 December 2017: 0.91%).

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

29. PROVISIONS (CONTINUED)

Provisions for restructuring (continued)

The following table presents the expected maturity period of provisions for restructuring:

	2018	2017
less than 1 year	164	661
1 to 5 years	-	-
Total	**164**	**661**

Provisions for severance payments

Significant actuarial assumptions for calculating present value of employees' severance payments are: discount rate, expected salary growth, and mortality rate.
The sensitivity analysis (0.5bp) in case of change in discount rate can be presented as follows:

			in KM
Discount rate	4.00%	3.50%	4.50%
Present value of liabilities (KM)	101	104	98
% deviation with respect to the used rate		2.86%	(2.75%)

If interest rate used for discounting would be 0.5% lower, the value of liabilities would have increased for 3.03%. If interest rate used for discounting would be 0.5% higher, the value of liabilities would have decreased for 2.91%.
The sensitivity analysis of severance payments in case of earnings change can be presented as follows:

			in KM
	current	0.5% lower	0.5% higher
Average severance payment	3,255.41	3,239.13	3,271.69
Present value of liabilities (KM)	100,918	100,413	101,422
% deviation with respect to the used rate		0.50%	(0.50%)

A change in earnings directly proportionately affects the change in severance payments.
The sensitivity analysis of severance payments in case of mortality rate change can be presented as follows:

			in KM
	current	1 year less	1 year more
Average age	57,88	56,88	58,88
Present value of liabilities (KM)	100,918	197,175	104,631
% deviation with respect to the used rate		(3.71%)	3.68%

29. PROVISIONS (CONTINUED)

Provisions for restructuring

By the end of 2016, the Bank adopted a decision on moving organizational units of Addiko Bank d.d. Sarajevo from Mostar to Sarajevo, initiating move project and adoption of the Program on caring for surplus employees and conducting restructuring measures.

In the beginning of January 2017, the Management Board of the Bank approved additional funds for provisions for restructuring, reorganization, cost optimization, and decrease of number of employees in 2017, caused by economic, technical and organizational reasons, in accordance with provisions of the International Accounting Standard ("IAS") 37: "Provisions, Contingent Liabilities and Contingent Assets".

In the first half of the year severance payments were paid by the Program to employees that did not accept new employment contract with relocation of workplace.

As at 31 December 2018, total provisions amount to KM 164 thousand.

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

29. REZERVISANJA (NASTAVAK)

Provisions for severance payments (continued)

The expected maturity period for severance payments can be presented as follows:

	2018	2017
In the following 12 months	-	-
1 to 5 years	16	20
5 to 10 years	85	114
Over 10 years	-	-
	101	**134**

30. PROVISIONS FOR FINANCIAL COMMITMENTS AND CONTINGENCIES

	2018	2017
Unused loans	88,269	87,765
Performance guarantees	34,223	19,432
Payable guarantees	22,813	20,502
Letters of credit	1,850	1,496
Total	**147,155**	**129,195**
Provisions for financial commitments and contingencies	**1,307**	**1,870**

Movement in gross exposures for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Gross exposure 1 January 2018	**128,282**	**415**	**498**	**129,195**
IFRS 9 effect	-	-	-	-
Gross exposure 1 January 2018	**128,282**	**415**	**498**	**129,195**
Change of gross exposure	18,374	1,307	-	19,681
of which: increase	*18,374*	*1,307*	-	*19,681-*
of which: decrease	-	-	-	-
of which: transfer between levels	-	-	-	-
Newly originated assets	35,161	104	4	35,269
Derecognized assets	(36,883)	-	(105)	(36,988)
Forex differences	-	-	(2)	(2)
Gross exposure 31 December 2018	**144,934**	**1,826**	**395**	**147,155**

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

30. PROVISIONS FOR FINANCIAL COMMITMENTS AND CONTINGENCIES (CONTINUED)

Movement in impairment for 2018 can be presented as follows:

	STAGE 1	STAGE 2	STAGE 3	TOTAL
Impairment 1 January 2018	**(1,529)**	**(7)**	**(334)**	**(1,870)**
IFRS 9 effect	806	(41)	-	765
Impairment 1 January 2018	**(723)**	**(48)**	**(334)**	**(1,105)**
Change in impairment (Note 14)	1,245	(166)	63	1,142
of which: increase	*(1,396)*	*(681)*	*(211)*	*(2,288)*
of which: decrease	*2,641*	*515*	*274*	*3,430*
of which: transfer between levels	-	-	-	-
Newly originated assets	(1,349)	(26)	(4)	(1,379)
Derecognized assets	34	-	-	34
Forex differences	-	-	1	1
Impairment 31 December 2018	**(793)**	**(240)**	**(274)**	**(1,307)**

Changes in impairment losses for 2017 (comparative period) are presented as follows:

	2017
Balance as at 1 January	**1,588**
Release of provisions (Note 14)	313
FX effects	(31)
Balance as at 31 December	**1,870**

During its operations, the Bank assumes credit commitments, which are the accounts in off balance sheet, and are related to guarantees, letters of credit and undrawn loan commitments. The Bank has formed provisions according to these exposures as indicated in the table above.

31. OTHER LIABILITIES

	2018	2017
Liabilities for unallocated proceeds	7,601	5,384
Accrued bonuses	2,038	1,802
Trade payables	1,920	1,169
Liabilities toward employees	1,057	1,049
Accrued expenses	878	1,489
Limited assets	467	546
Liabilities for credit card operations	262	244
Other tax liabilities	176	246
Protested guarantees	150	150
Managed funds (Note 34)	98	99
Deferrals	78	62
Deferred tax liability (Note 15)	-	314
Other liabilities	260	295
	14,985	**12,849**

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

32. EQUITY

Shareholders' equity

Direct owner of the Bank is Addiko Bank AG Austria, while the ultimate owner is Advent International Corporation, United States of America.

Ownership structure of the Bank is as follows:

	31 December 2018		31 December 2017	
	Share capital	Ownership %	Share capital	Ownership %
Addiko Bank AG Beč, Austria	100,401	99.998	100,401	99.998
Other shareholders	2	0.002	2	0.002
	100,403	**100.00**	**100,403**	**100.00**

During 2018, the Bank allocated profit for 2017 in the amount of KM 5,249 thousand for coverage of losses from 2016, after which the uncovered loss amounted to KM 24,581 thousand. By the FBA Decision on including reserves for credit losses in core capital and decision of the Assembly for reserves to be transferred to retained earnings, loss from 2016 is completely covered.

Regulatory reserves

FBA adopted the decision allowing banks to include reserves for credit losses in ordinary core capital. Based on the decision, the Bank Assembly adopted the decision on transfer of reserves for credit losses in the amount of KM 133,391 thousand to retained earnings. By the same decision, the Assembly stipulated that 25% of core capital in the amount of KM 25,101 thousand will be transferred from retained earnings to statutory reserves to meet the condition stipulated by Companies Act.

As at 31 December 2018, the required amount of regulatory reserves was KM 24,996 thousand (31 December 2017: KM 21,986 thousand).

33. RELATED PARTY TRANSACTIONS

In accordance with the International Accounting Standard ("IAS") 24: "Related Party Disclosures", related parties are parties or entities that represent:

a) enterprises that directly, or indirectly through one or more intermediaries, control the reporting company or are under its control, i.e. which the reporting entity controls together with other entities (including holding companies, subsidiaries and fellow subsidiaries);

b) associated persons - companies in which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;

c) individuals who directly or indirectly have the voting rights in the Bank that gives them significant influence over the Bank, as well as any other entity which is expected to influence, or be influenced by the relating individual in their dealings with the Bank;

d) executives in key positions, i.e. individuals having authority and responsibility for planning, directing and controlling the activities of the Bank, including directors and officers of the Bank and members of their immediate families; and

e) companies in which any person described in (c) or (d) has a substantial interest in the voting rights or which is directly or indirectly owned by the mentioned individuals, or where the same may have a significant impact. This includes enterprises owned by directors or major shareholders of the Bank and enterprises that have a member of key management in both their company and in a same or similar positions at the Bank.

In considering each possible related party transaction, attention is directed to the essence of the relationship, not merely the legal form.

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

33. RELATED PARTY TRANSACTIONS (CONTINUED)

	2018	2017
Receivables		
Placements - Addiko Bank d.d. Zagreb	469	916
Other - Addiko Bank a.d. Banja Luka	313	20
Other - Addiko Bank AG Austrija	136	-
Other - Addiko Bank d.d. Zagreb	101	-
Placements - Addiko Bank d.d. Ljubljana	59	180
Placements - Addiko Bank AG Austria	48	338
Placements - Addiko Bank a.d. Beograd	42	14
Other - Addiko Bank a.d. Podgorica	20	-
Placements - Addiko Bank a.d. Banja Luka	-	11,735
	1,188	**13,203**
Liabilities		
Deposits - Addiko Bank a.d. Banja Luka	544	547
Other - Addiko Bank AG Austria	476	-
Other - Addiko Bank a.d. Beograd	262	-
Other - Addiko Bank d.d. Zagreb	55	94
Deposits - Addiko Bank a.d. Podgorica	31	8
Deposits - Addiko Bank a.d. Beograd	18	8
Deposits - Addiko Bank AG Austria	9	4,494
Other - Addiko Bank a.d. Banja Luka	4	2
Deposits - Addiko Bank d.d. Zagreb	2	139
	1,401	**5,292**

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

33. RELATED PARTY TRANSACTIONS (CONTINUED)

	2018	2017
Income		
Fee and commission income - Addiko Bank a.d. Banja Luka	320	485
Other income - Addiko Bank AG Austria	136	45
Interest income - Addiko Bank a.d. Banja Luka	59	-
Other income - Addiko Bank a.d. Banja Luka	7	55
Interest income - Addiko Bank d.d. Zagreb	5	12
Fee and commission income - Addiko Bank d.d. Zagreb	2	-
Interest income - Addiko Bank a.d. Beograd	-	5
	529	**602**
Expenses		
Administrative expenses - Addiko Bank d.d. Zagreb	501	630
Other expenses - Addiko Bank AG Austria	471	458
Administrative expenses - Addiko Bank a.d. Beograd	179	-
Interest expense - Addiko Bank AG Austria	63	99
Fee and commission expense - Addiko Bank d.d. Zagreb	46	42
Administrative expenses - Addiko Bank a.d. Banja Luka	21	64
Fee and commission expense - Addiko Bank a.d. Banja Luka	19	18
Other expenses - Addiko Bank a.d. Beograd	-	214
Fee and commission expense - Addiko Bank a.d. Beograd	-	1
	1,300	**1,526**

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

33. RELATED PARTY TRANSACTIONS (CONTINUED)

The remunerations to the Management Board and Supervisory Board members are presented as follows:

	2018	2017
Management and Supervisory Board remunerations	852	850
Taxes and contributions on remunerations	659	667
	1,511	**1,517**

34. MANAGED FUNDS

The Bank manages funds as an agent and on behalf of third parties, so these are stated separately from bank's assets. For these services, the Bank charges commission in the amount of 1% of total placed cash.

	2018	2017
Assets		
State institutions	683	656
Total	**683**	**656**
Liabilities		
Corporate loans	600	578
Retail loans	181	177
Total	**781**	**755**
Difference (Note 31)	**(98)**	**(99)**

35. PROFIT PER SHARE

	2018	2017
Net profit for the current year	8,760	5,249
Weighted number of shares	532,500	532,500
Basic profit per share in KM	**16.45**	**9.86**

Diluted loss per share was not determined because the Bank has no potential share dilution such as convertible debt and options.

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

36. LEASE

Operating lease is mainly related to rent of branch offices, rent of leased space for ATM machines and rent for archiving space and apartments.

Future total minimum lease payments by the long-term operating lease agreement are:

	2018	2017
Less than 1 year	848	984
1 to 5 years	2,585	3,153
Over 5 years	279	559
	3,712	**4,696**

Rent expense in business year 2018 for the Bank amount to KM 2,467 thousand, while in 2017 it amounted to KM 2,000 thousand.

Future total minimum expected operating lease collections are:

	2018	2017
Less than 1 year	7	12
1 to 5 years	45	47
Over 5 years	-	-
	52	**59**

Lease income in business year 2018 for the Bank amounts to KM 78 thousand, while in 2017 it amounted to KM 117 thousand.

37. SUBSEQUENT EVENTS

Between the reporting date and the date of approval of these financial statements there were no material events that would require disclosure.

38. APPROVAL OF THE FINANCIAL STATEMENTS

Signed on behalf of Addiko Bank d.d. Sarajevo, Sarajevo, on 22 March 2019:

Sanela Pašić
President of the Management Board

Belma Sekavić-Bandić
Member of the Management Board

Business units of Addiko Bank d.d.

Addiko Bank d.d. Sarajevo
Centrala, Trg Solidarnosti 12, 71 000 Sarajevo
+387 33 755 755
+387 33 755 855
info.fbih@addiko.com

Bihać
Bosanska b.b.,
77 000 Bihać, Bosanska b.b.
Tel. + 387 37 229 761,
Fax +387 37 229 773

Bugojno
Sultan Ahmedova b.b.,
70 230 Bugojno,
Tel. +387 30 259 565,
Fax +387 30 259 564

Busovača
16. Kolovoza b.b.,
72 260, Busovača,
Tel. + 387 30 735 090,
Fax. + 387 30 735 091

Čapljina
Ante Starčevića b.b.,
88 300 Čapljina,
Tel. +387 36 808 292,
Fax +387 36 808 810

Čitluk
Kralja Tomislava 93,
88 260 Čitluk,
Tel. +387 36 640 420,
Fax +387 36 640 427

Gračanica
22. divizije b.b.,
75 320 Gračanica,
Tel. + 387 35 701 361,
Fax +387 35 701 368;

Gradačac
H. K. Gradaščevića b.b.,
76 250, Gradačac,
Tel + 387 35 821 490,
Fax + 387 35 821 495

Grude
Dr. Franje Tuđmana 4,
88 340 Grude,
Tel. +387 39 660 390,
Fax +387 39 661 745

Ilidža
Rustempašina b.b.,
71 210 Ilidža,
Tel. +387 33 770 293,
Fax +387 33 770 298;

Jajce
Kulina Bana 1,
70 101 Jajce,
Tel. +387 30 654 555,
Fax. +387 30 654 558

Kiseljak
Josipa Bana Jelačića b.b.,
71 250 Kiseljak,
Tel. + 387 30 877 288,
Fax. + 387 30 877 297

Konjic
Trg državnosti b.b.,
88 400 Konjic,
Tel. +387 36 735 300,
Fax +387 36 735 303

Kreševo
Fra Grge Martića 122,
71 260 Kreševo,
Tel. +387 30 800 603,
Fax +387 30 800 608

Livno
PC Forum Splitska b.b.,
80 101 Livno,
Tel. +387 34 208 613,
Fax +387 34 201 385

Lukavac
Lukavačkih brigada b.b, TZC “Omega”,
75 300, Lukavac,
Tel. +387 35 551 101,
Fax +387 35 551 106

Ljubuški
Stube IV, lamela A,
88 320 Ljubuški,
Tel. +387 39 835 794,
Fax +387 39 835 795

Mostar
Stjepana Radića, lamela E,
88 000 Mostar,
Tel. +387 36 448 120/121,
Fax +387 36 335 877

Mostar
Trg Hrvatskih velikana b.b.-Rondo,
88 000 Mostar,
Tel. +387 36 449 850,
Fax +387 36 335 832

Novi Travnik
Ive Andrića 35,
72 270 Novi Travnik,
Tel.+ 387 30 795 212/211,
Fax, + 387 30 795 214

Orašje
V ulica 29,
76 270 Orašje,
Tel. +387 31 719-800/805,
Fax +387 31 719 808

Posušje
Fra Grge Martića b.b.,
88 240 Posušje,
Tel. +387 39 685 191,
Fax +387 36 335 876

Sarajevo
Dobrinja, Mustafe Kamerića 6-7,
71 000 Sarajevo,
Tel.+387 33 775 373,
Fax +387 33 775 378

Sarajevo
Otoka, Bulevar Meše Selimovića bb,
71 000 Sarajevo,
Tel.+387 33 715 026,
Fax +387 33 715 816

Sarajevo
Maršala Tita 18a,
71 000 Sarajevo,
Tel. +387 33 563 191,
Fax +387 33 217 285

Sarajevo
Pofalići, Zmaja od Bosne b.b.,
71 000 Sarajevo,
Tel. +387 33 723 604,
Fax +387 33 723 600;

Sarajevo
Ferhadija 1,
71 000 Sarajevo,
Tel.+387 33 252 485,
Fax +387 33 252 488

Sarajevo
Trg solidarnosti 12,
71 000 Sarajevo,
Tel. +387 33 755 724,
Fax +387 33 755 725

Široki Brijeg
Fra Didaka Buntića b.b.,
88 220 Široki Brijeg,
Tel. +387 39 702 500,
Fax +387 39 702 508

Tešanj
1. Mart br. 3,
74 260 Tešanj,
Tel. + 387 32 665 260
Fax. +387 32 665 268

Tomislavgrad
Mijata Tomića b.b.,
80 240 Tomislavgrad,
Tel. +387 34 352 311,
Fax +387 34 352 329

Travnik
Trg republike 11a,
72 270 Travnik,
Tel. +387 30 540 852/861,
Fax +387 30 540 660

Tuzla
Maršala Tita 2b,
75 101 Tuzla,
Tel +387 35 302 241,
Fax + 387 35 302 242

Tuzla
Mije Kreoševića Guje 2,
75 101 Tuzla,
Tel.+387 35 302 320,
Fax +387 36 335 865

Uskoplje
Kralja Tomislava b.b.,
70 280 Uskoplje,
Tel. +387 30 496 420,
Fax +387 30 495 733

Visoko
Dr. Džananovića 8,
71 300, Visoko,
Tel. +387 32 731 001,
Fax +387 32 731 002

Vitez
PC 96,
72 250 Vitez,
Tel. +387 30 718 608,
Fax +387 30 718 603

Zenica
PSC Kamberovića polje,
72 000 Zenica,
Tel. + 387 32 449 733,
Fax. + 387 32 449 738

Živinice
Alije Izetbegovića 36,
75 270 Živinice,
Tel. + 387 35 743 190/191,
Fax +387 35 743 195

Responsible for content:

Addiko Bank d.d. Sarajevo
71 000 Sarajevo
Trg Solidarnosti 12
Tel. +387 33 866 666, +387 33 755 755,
Fax +387 33 755 855
addiko-fbih.ba
e-mail: info.fbih@addiko.com

Important notice:

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