# One Bank, One Team, One UniCredit.

Capital and balance sheet management
Transform
Enhanced service model
Ethics and Respect
Team 23
Compliance
Grow and strengthen client franchise
Process optimisation
Sustainable results
Sustainability
Paperless bank
Growth engines
Customer experience
Disciplined risk management
"Go-to" bank for SMEs
"Do the right thing!"

# 2019

## Annual Report and Accounts

Banking that matters. | UniCredit Bank Banja Luka

Banking that matters. UniCredit Bank Banja Luka

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# Message from the President of the Bank Management Board

"With a focus on ethics and respect and the principle that we always do the right thing, we have shown that the way we achieve results is important to us as the result itself and that respecting these values and principles is crucial in making decisions and behavior in our everyday business."

**Gordan Pehar**
President of the Bank Management Board

# Dear Clients, Shareholders and Partners, Dear Colleagues...

Behind us is another successful business year, in which we confirmed the position of the market leader, achieved planned targets, significantly improved our customers' satisfaction, and launched and realized several programs that strengthened our position in, and impact on the social community. We are grateful to our clients, shareholders and partners for the indicated trust and cooperation. We are grateful to our employees for the exceptional commitment and devoted work that contributed to the shared successful outcome.

In 2019, the Bank achieved the result significantly above the planned, and continued the growing trend from the previous years. With the profit in amount of 29.6 million BAM, assets that amounted to 1.7 billion BAM and capital in amount of 244.8 million BAM, we confirmed the position of the systemically strong and important financial institution on the local market.

Thus, as the part of the Central and Eastern European Division, we gave our contribution to the successful conclusion of the Transform 2019 Strategic Plan of our Group, as well as to strengthening of the cooperation and synergy within all the key targets, nurturing the "One Bank, One UniCredit" Strategic Approach.

We maintain the long-term stability and sustainability of the Bank through the strong capital position (capital adequacy rate 20.8%), the loan portfolio with the low share of bad loans (2.3%) and high NPL coverage ratio (88.9%), as well as the well-balanced Balance Sheet and the adequate liquidity level at every moment. The good result was also contributed by the continuous growth of lending activity towards private individuals and legal entities (9.5% y/y), as well as the growth of deposits from customers (2.9% y/y), which was also the confirmation of the continuously growing trust of the customers in the Bank.

The total number of active clients in the financial year of 2019 reached 147 thousand, while the number of active users of the mobile banking service grew by 32.8%.

Placing the strong focus on the values such as "Ethics and Respect" and one fundamental principle in daily work to "Do the Right Thing", we showed that the way in which we achieved our results we considered as important as the results themselves, and that the respect for these values and principles was crucial when making our decisions, and in the day-to-day conduct. For our clients, we would like to improve the service quality continuously.

As well as previously, we will make sure that all our next goals are directed towards the satisfaction of our customers, the service model strengthening, digital transformation, better productivity and efficiency. At the same time, we will keep increasing the awareness that we are personally responsible for our work, as well as to pass the culture of the respect for compliance, customers' rights protection, data security, and the prudent risk management that are crucial for long term sustainability and reputation of our Bank and the Group.

The positive cooperation with partners in the new projects, but the relationships with the social community also continued in 2019. We realized the third cycle of the paid practice for students of the final years, i.e. the "First Big Chance" and made it possible again for several successful young people to get their first employment, but, at the same time, we opened possibility of cooperation with the high school students in the project on the financial literacy improvement with the young people by signing the Agreement on Cooperation with the High School of Economics in Banja Luka, in the "Social Impact Banking" project. Through the cooperation with the long-standing partner Grad Banja Luka /City of Banja Luka/, we rewarded the most successful scholarship holders, the high school and university students. In the way, we wanted to send the message to young people that, on the local market, there are successful companies that recognize and support personal endeavor, efforts and learning.

Additionally, our wish is to stay among the most preferred ones to work for in our segment, develop further the internal resources and reward individual contributions and quality correctly. We would like to continue creating the positive work environment, in which everybody has the equal opportunity to prove themselves and improve. Therefore, in addition to the continuous opportunity to develop and learn constantly, we also dedicated the previous year to the physical improvement of the work conditions for our colleagues, so, in addition to the improvement of the work conditions in branch offices, we also commenced creating even more functional and modern premises for the team work and collaboration in the Head Office of the Bank.

Bearing in mind all the previously stated key leverages of our success, I would like, on behalf of the Bank Management Board, to express once more my heartfelt gratitude to all of you for the indicated trust, and to our colleagues for contribution to the achieved results of UniCredit Bank Banja Luka, the Division of Central and Eastern Europe (CEE Division), to which we belong, as well as to the 2019 result of UniCredit Group, finally.

Let's keep working together, with the same spirit and energy, making sure we always "Do the right thing!"

Yours sincerely,

Gordan Pehar

**Gordan Pehar**
President of the Bank Management Board

# About UniCredit Group

UniCredit is a simple successful pan-European Commercial Bank, with a fully plugged in CIB, delivering a unique Western, Central and Eastern European network to its extensive client franchise. UniCredit offers both local and international expertise to its clients, providing them with unparalleled access to leading banks in its 13 core markets through its European banking network: Italy, Germany, Austria, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Hungary, Romania, Russia, Serbia, Slovakia and Slovenia. Leveraging on an international network of representative offices and branches, UniCredit serves clients in another 18 countries worldwide.

**Strategic Plan Team 23**

As the Strategic Plan “Transform 2019“ has been successfully completed, we are turning towards the new four-year Strategic Plan “Team 23“. The new Strategic Plan “Team 23“ directs the activities to maximize the value creation for all our stakeholders, keep the focus on customer satisfaction owing to the simplified processes and the innovative products. As “One UniCredit” we approached the new plan in the same spirit and with the same energy in the way we accomplished the “Transform 2019”. Doing the right thing, we stay dedicated to the shared success and the aim to become the real pan-European winner.

The successful realization of the new strategy of UniCredit is based on 4 key pillars of the Strategic Plan “Team 23“:

- **Grow and Strengthen the Client Franchise** – we are focused on strengthening and growing of the customer base across all the segments. Our strategic initiatives are focused on the user experience, so that we would improve our customers’ satisfaction and the service quality.
- **Transform and Maximize** P**roductivity** – being customer-oriented, we stay focused on the process optimization and adopt the new work methods, in order to enhance productivity, improve processes and minimize operational risks.
- **Disciplined Risk Management and Controls** – we will keep our strict risk discipline and the high quality of the new facilities portfolio. Compliance with all the regulations and rules remains our key priority, as each of us is the first defense line.
- **Capital and Balance Sheet Management** – we continue the decisive activities along with the proactive approach to the capital and balance sheet management.

The way in which we achieve our results we consider as important as the results themselves, due to which we give the priority to the long-term sustainability compared to the one-time solutions. Based on our two values, Ethics and Respect, our principle and corporate culture make sure that we always: Do the Right Thing!

# Business Principle: Do the Right Thing!

At UniCredit, our corporate culture is based on two key values: Ethics and Respect. Our dedication to "Do the Right Thing" is our leading principle for all types of relationships with our stakeholders, investors, clients, colleagues and the community.

**For our customers:** we continuously improve their experience, while we are committed to the data protection and confidentiality.

**For our shareholders (investors)**: execution, discipline & transparency, favoring long-term sustainable outcomes.

**For our colleagues:** we launch the dedicated initiatives to create the attractive and positive working environment.

**For our community**: we support the financial access and inclusion through the "Social Impact Banking Initiatives"

**For our environment:** in partnership with our clients in the shift to a low carbon economy solutions, giving the contribution through our own direct impact.

Throughout Team 23, we all are committed to:

- Building a great and inclusive place to work;
- Expanding our work-life balance initiatives;
- Reinforcing our speak-up culture through the anti-retaliation policies;
- Improving the way we work through digitalization.

Together, let's make sure that UniCredit remains a true pan-European winner!

# One Bank,
# One UniCredit.

Our strategy is clear and long-term: UniCredit is a simple successful Pan European Commercial Bank, with a fully plugged in CIB, delivering a unique Western, Central and Eastern European network to its extensive and growing client franchise.

# Macroeconomic Overview in 2019

After the global economic growth expanded in mid-2018, a weakening of growth started in 2019 with the mild signs of stabilization looking towards the end of the year. The main reasons for the turnaround in 2019 were the worsening of the global manufacturing activity and investments, further fueled by the increased political uncertainty amid repeated escalations of trade tensions and developments related to Brexit. A weak recovery of the global economic activity is predicted, which will have an impact on the growth of advanced economies but also a slow recovery of the developing economies. Given the continued inflationary pressures and the weak dynamics of the euro area growth, the monetary policy remained highly flexible over the long term to support the underlying inflationary pressures and inflation trends over the medium term.

For all Central and Eastern European countries, the year of 2019 proved to be better than expected, with Russia avoiding the new sanctions and Turkey managing to get out of recession faster than expected. In the EU and Central and Eastern Europe, greater resilience arose from the solid domestic demand, and the private consumption and investment continued rising above the potential. Exports were lagging in all countries, but with significant investment projects and fiscal relief in certain countries, they managed to maintain an adequate level of growth. In EU-CEE, 2020 will further highlight the gap between strong domestic demand and weak exports. Poor exports will continue their negative impact on industrial production.

For Bosnia and Herzegovina, economic growth in 2019 was repeatedly adjusted under the influence of the reduced external demand until the last forecast of 2.6%. The 2019 slowdown mainly reflected the weaker foreign demand and the deterioration of the economic growth of the major trade partners, but also the effect of the slower investment activities in the country. In 2020, the growth is expected to be driven mainly by personal consumption, as exports are likely to remain reduced because of the weak economic activity in major trading partners, and investments are likely to increase only slightly because of the sustained political uncertainty.

The slowdown of the external environment is already spilling over into industrial production, which recorded a y/y decline of 5.5% in 2019. One of the main reasons for such a large decline in industrial production can also be found in the absence of production of the significant oil refinery in the country, due to its reconstruction and modernization which will also last in 2020, as well as the complete cessation of work in a significant strategic company for aluminum production in the majority state ownership, for which finding of the new potential investor is still awaited.

Exports particularly weakened during the third quarter -16.5% y/y, pulling the cumulative exports into deeply negative territory -3.4% y/y. Cumulative growth in imports decreased to only 1.2% compared to the previous year (vs. 4,5% in the first half). The current account deficit is likely to increase significantly due to weakening exports, but should be covered mainly by foreign direct investment and other foreign financing.

The registered unemployment rate was declining much faster than expected, partly due to increased emigration abroad, but still at a high level of 33.3%. Due to the increase in the real disposable household income in the context of relatively low inflation, personal consumption continued its strong growth. Recent data continue indicating the further growth in disposable household income, given the continued employment growth, real wages and remittances.

Consumer prices have been low in Bosnia and Herzegovina since the year's beginning, and are expected to reach only 0.3% at the year's end. The level of oil prices on the world market, food and the important domestic factors such as excise duties on certain products have a significant impact on the consumer prices of Bosnia and Herzegovina.

BIH recorded a steady growth in the direct foreign investments, and in the first nine months of 2019, the additional BAM 861 million were recorded. Despite the increased investments, Bosnia and Herzegovina deteriorates its position further in the World Bank's Doing Business 2020 Report, and is currently ranked 90th out of 190 economies, i.e. the worst positioned country in the region. Unlocking the potential of the private sector remains a major challenge for BIH. Private sector growth is weak and insufficient to improve the labor market outputs, constrained by a high tax burden and a poor business environment.

Total public debt in the nine months of 2019 was 31.9% of GDP. This percentage places Bosnia and Herzegovina in the category of moderately indebted countries. Despite the relatively good fiscal results in earlier years, public finances today are still characterized by structural rigidity on the spending side, reflected in high current spending and poor targeting at social assistance benefits.

Almost 15 months after the general elections (2018, October), a state-level Government was formed, but there is still no agreement on the Government of the Federation of Bosnia and Herzegovina, which remains uncertain due to disagreement over changes to the electoral law. In such a political environment, it is not surprising that the EU Commission in its Opinion on Bosnia and Herzegovina's application for EU membership dated 29 May 2019 (European Commission - PRESS PUBLICATIONS - Press Release - Key Findings of the Opinion of Bosnia and Herzegovina on EU Membership Application and the analytical report) did not recommend the European Parliament and the Council offering the candidate status to the country.

Political uncertainty threatens the growth of investment activity, as it is largely dependent on foreign financing, which in turn depends on the continued IMF funding under the Extended Fund Facility /EFF/ program. So far, under the extended arrangement between BIH and the IMF, two tranches of approximately 150 million BAM per tranche have been deposited into the entities' accounts, with the total value of the credit program terminated in 2018, June amounting to approximately BAM 1.1 billion. The delay in continuance of IMF financing has resulted in a prolongation of the investment activity as this relies heavily on foreign financing, which in turn depends on the continued IMF financing.

In 2019, March, Standard and Poor's upgraded the Bosnia and Herzegovina's outlook for a B rating, from a stable outlook to a positive outlook, which has been the first improvement since 2012. The Moody's Investors Service credit rating has remained unchanged since 2018 of the "stable B3 outlook ".

#### Expectations for 2019

The growth will be driven mainly by consumption, as exports will remain reduced because of the weak economic activity in major trading partners, and investments will increase slightly due to sustained political uncertainty.

Despite the suspension of IMF funding, Bosnia and Herzegovina's fiscal position is likely to remain stable. Even after a state-level Government was formed, political development and the deterioration of the external environment still pose a potential risk of the negative impact.

# Banking Sector in 2019

According to the preliminary reports, the banking sector in Bosnia and Herzegovina made profit before tax in the amount of BAM 337 million. This is an increase by BAM 15 million (+4.6%) compared to the same period of the previous year, largely conditioned by significantly reduced expenses of the loan loss provisions and increased fees and commissions. The return on average equity was thus at 11.1%, and improved compared to 9.6% in 2018.

However, the banking sector in BIH shares many challenges with the banking sectors of other countries. The low inflation rate in the euro area delays the growth of EURIBOR, which also delays the increase in interest rates on loans in the BIH banking sector. Low interest rates are designed to encourage borrowing, but limit the ability of a bank to borrow at profitable rates, putting additional pressure on margins. This is actually reflected in the further decline in the sector's interest income. Total revenues increased (+2.5%), and, in their structure, the share of net income from fees and commissions increased, while net interest income decreased.

The capital adequacy of the banking sector, which is continuously maintained above the regulatory limit, increased further to 18.1% in 2019, which is satisfactory capitalization at the sector level.

The structure of the sector did not change significantly. Two banks are prominent in terms of assets volume, and carry more than 30% of the total loan portfolio of the market, while 16 banks on the market have less than BAM 1 billion in the total assets. The number of banks on the market remained the same (23 banks), the number of employees in the banking sector decreased down to 9,379 and the number of branches to 825.

The year was marked by the growth in loans by 6.7% y/y, with the Households with the accomplished growth of 8.0% and Legal entities 5.5%. Households recorded continuous growth, where growth was mainly generated by consumer loans, while housing loans recorded weak growth. Legal entities recorded a better growth compared to the previous year's growth due to the increase in loans to the public companies, although loans to private companies also continued growing (+4.9%).

In the period from I-IX 2019, the share of non-performing loans decreased down to the level of 7.7% (end of 2018: 8.8%). The non-performing loans coverage remained almost unchanged at the level of 78%.

Household deposits increased by 9.0%, with the higher growth recorded in short-term deposits (+15.9%) while the time deposits slightly increased (+4.9%). The reduced inclination towards time depositing is due to a declining trend in interest rates. On the other hand, the strong growth in sight deposits was also influenced positively by higher household income. Corporate deposits recorded the growth of 10.3%, where private companies recorded the growth of 8.8%, and the public companies and government institutions by 13.6%.

In 2019, Central Bank of Bosnia and Herzegovina adjusted the remuneration rate for the funds exceeding the minimum reserves to the European Central Bank's (ECB) new deposit facility rate. This rate in 2019 amounted to: 0.2% for the period 01.01.- 30.04.2019; 0.4% for the period 01.05.-20.09.2019 and 0,5% for the period 21.09.- 31.12.2019. The remuneration rate on the minimum reserves has remained unchanged (0.0%). The average amount of the minimum reserve continued growing in 2019 compared to the end of the previous year. Banks invest part of their assets in securities, mostly issued by the FBIH and RS, which resulted in the increase in securities in banks' financial statements. In 2019, 20 million BAM treasury bills were issued by the FBIH Government, while the RS Government had a treasury bills issue in the amount of BAM 40 million. Entity Governments had significantly more bond issues in 2019, out of which the FBIH Government had BAM 200 million, while the RS Government issued BAM 244 million of bonds.

**Expectations for 2019**

A precondition for further development of the banking sector is a stable political environment in the country and ensuring that further investment activities are carried out. The banking sector positive trends are expected to continue in 2020 despite continued low market rates, through increased lending volumes and continued efforts by banks to compensate for the income growth through the non-interest income. The share of non-performing loans should continue its downward trajectory.

# Business Overview

UniCredit Bank a.d. Banja Luka (hereinafter: the "Bank") is the licensed commercial bank with the registered office in Banja Luka, Bosnia and Herzegovina.

As the legal successor of the first bank built in this area "Privilegovana Zemaljska Banka za BIH - Filijala Banja Luka" ("Privileged Land Bank for BIH – Branch Office of Banja Luka") founded in 1910, UniCredit Bank a.d. Banja Luka has had the longest tradition of banking operations in Bosnia and Herzegovina in its foundations. In its 110-year history, this Bank went through several different transformations and operated successfully in different legal and organizational forms.

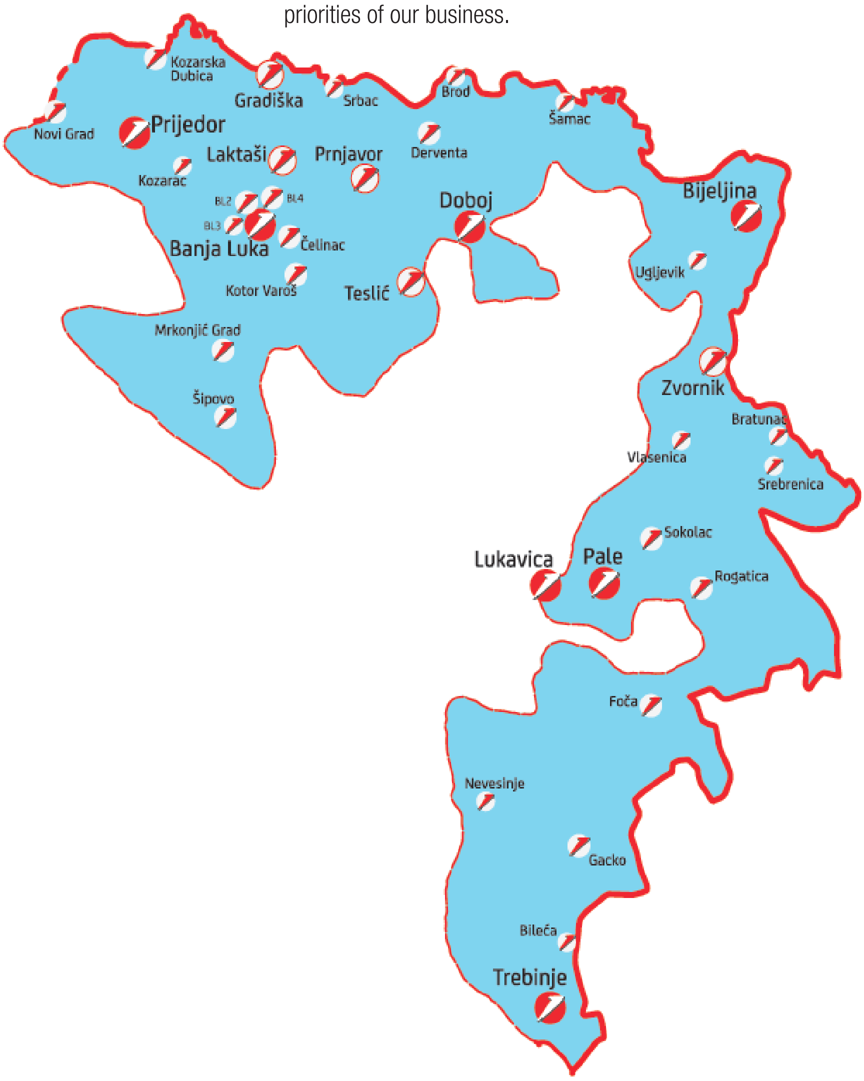
The Bank provides the full range of financial services to companies and private individuals in Republic of Srpska, one of the two entities of Bosnia and Herzegovina. The set of banking services provided by the Bank includes the operations with private individuals, small and medium sized companies, corporate and investment banking, business with financial institutions and public sector as well as international operations.

The Bank actively participates in the implementation of new development projects in the banking sector, and contributes through its engagement to the promotion of corporate responsibility related to the compliance and operational risks, as well as the implementation of the highest reporting standards and sharing the know-how gained from the rich experience and affiliation to the UniCredit Group.

Using precisely the best practices of the banks – Legal Entities of the UniCredit Group, while taking into account the specifics and true needs of our clients, we strive to provide our clients with an integrated approach to our products and services through simplified contracting procedures. In this way, besides increasing the work efficiency, we strive to provide the simplicity and ease in dealing with the Bank to the clients.

Constant improvement of our business model and offer of products for individuals and legal entities, long-term and partner relationship with our clients, and the support to the development of our economy, through projects of public and social importance, still remain the main priorities of our business.

**The Branch Network Map**



# Business Segments Overview

## Retail Segment

#### Organization

The Retail Segment provides a wide range of products and services to the customers, through two business areas Individual Sales and Small Business Sales. It manages the network of business units of Branch Offices and multi-channels such as ATMs, mobile and electronic banking.

In 2019, the Bank business network was divided into four geographically and economically connected regions (Banja Luka – Prijedor Region, Doboj – Gradiška Region, Sarajevo – Bijeljina Region, Trebinje – Foča Region), with the total of 36 organizational units at the end of 2019.

In its portfolio Retail Banking has more than 146 thousand active clients within the segment of private individuals and SB segment.

Retail objectives are constantly focused on improvement of relationships with the existing and acquisition of new clients, with the continuous improvement and development of products and services, but also a clear focus on digital products and further development of alternative channels, accelerating the process of digital transformation, and synergy in accessing the customers together with Corporate and Investment Banking Segment. Retail analyzes and improves key processes and adapts to new market conditions that increasingly indicated the need to accelerate the transition of clients from traditional to digital channels, their training about the previously stated, and to improve the service promptness and the customer satisfaction.

#### Commercial Activities in 2019

Clients recognize the Bank as a reliable partner and owing to that also in 2019, the Bank recorded a growth in the volume of loans and deposits in the Retail segment.

Thus, the volume of Retail loans grew in 2019 compared to previous year (4.9%) and it amounted to BAM 551.0 million at the end of 2019, noting that all key portfolio quality indicators improved. The main drivers of this growth were new non-purpose loans adapted to the customer needs and market requirements. The market share in loans to private individuals amounted to 20.85% in Republic of Srpska and 5.22% in BIH at the end of 2019, November.

Due to strengthening of customers' trust in the Bank, deposits of Retail customers also increased up to BAM 532.6 million at the end of 2019. Market share in deposits of private individuals amounted to 12.65% in RS and 3.49% in BIH conclusively with the end of 2019, November.

The development of the Bank's products continued in 2019 primarily in the area of improving the quality of services, as well as through simplification and acceleration of processes. The focus in 2019 was to increase the degree of automation and simplification of the products offer. "End to End" application for loan approval ("Consumer Finance Platform") was upgraded in 2019, and the activities commenced in introduction of new module for Private Individuals overdrafts, as well as the completely new module for Legal entities loans, which is based on the same platform (SME tool).

Digitization and strengthening of the direct channels have been recognized as the key development direction, where mobile banking also played a significant role. Modern technologies give us the opportunity to access our Bank account and carry out the desired transactions through the mobile phone, at any time and from any location, whereby the banking itself takes on the global characteristics.

In 2019, the Bank was active in promotion of the Bank's products through various campaigns, where we highlight:

- "My reward for practical habits" trough which we connected our m-card and m-bank services and encouraged our customer, via discount with the vendors, and numerous prizes, to use m-card and m-bank actively.
- In 2019, our Bank organized a right to discount of 10% selected partners of the Bank for each purchase in instalments by Visa UniCredit credit cards.

## Business Segments Overview

**Organization**

Corporate and Investment Banking segment operates with large and medium-sized domestic business entities, public and financial sector, as well as with the international customers to which, in addition to the financing products, it also offers products from the domain of global transaction banking and financial markets.

Through the business centers East and West structured according to the geographic and economic connection, the Bank covers the whole territory of Republic of Srpska, and manages the business relationships with more than a thousand clients, large and medium sized by the amount of income.

**Commercial Activities in 2019**

In 2019, the key focus of Corporate and Investment Banking was on the business relationship with the stable and perspective companies, as well as the business operations with government institutions and public sector.

Despite the challenging environment, the Bank increased lending to corporate clients with a total loan amount of BAM 510.1 million at the end of 2019, while the corporate clients' deposits amounted to BAM 503.1 million. Market share in loans to Legal Entities amounted to 18.46% in Republic of Srpska and 5.06% in BIH at the end of 2019, November, and in the part of deposits, the market share amounted to 24.56% in Republic of Srpska and 5.03% at the BIH level at the end of 2019, November. The structure and stability of the loan portfolio were strengthened, retaining the share of bad loans at significantly lower level compared to the market. Throughout the entire year, the Bank also participated in securities auctions and confirmed its high market share in this business segment, as well.

In 2019, the Bank continued to take part in all significant and major private sector transactions in the country, which are related to the corporate banking clients, while retaining a dominant position in the business relationship with the state and public institutions.

The Bank also provided the support to the local companies through projects in the field of Renewable Energy and Energy Efficiency Improvements and Support to Women in Business as well as small and medium-sized companies, in cooperation with international financial institutions (GGF and EBRD).

Through the International Centre, we became recognizable on the market of Republic of Srpska, at the same time using the best practices, the know-how, experience and network of UniCredit Group with the aim of comprehensive support to the customers of Corporate and Investment Banking.

In addition to many commercial activities, it is important to emphasize that in both business segments, in Retail and Corporate and Investment Banking, we continued working intensively on strengthening of the human resources quality, as one of the key preconditions for growth and long-term sustainability and stability of the Bank

# Financial Overview of the Bank

The Financial Statements of the Bank were prepared in compliance with the Law on Accounting and Auditing of Republic of Srpska, according to which all legal entities are required to prepare the Financial Statements in line with the International Accounting Standards and International Financial Reporting Standards (hereinafter: IAS and IFRS).

In the reporting period, the Bank operated in compliance with Law on Banks of Republic of Srpska and decisions stipulated by the Banking Agency of Republic of Srpska (hereinafter: BARS), as well as other valid legal regulations and by-laws, and prepared the reports defined by the BARS and the other local institutions, as well as reports for the majority owner (managerial and for the needs of preparation of the consolidated statements at the UniCredit Group level).

## Financial indicators

In 2019, the Bank confirmed the previous trend of continuous growth and the maintenance of high standards in sense of profitability and efficiency.

## Profit and loss

The generated net profit in 2019 amounted to BAM 29.6 million and was higher by 6.5% than the profit made in the year before as a result of lower net impairment losses/recoveries per credit risk.

Total operating income in 2019 amounted to BAM 66.8 million, which was lower by 3.1% compared to the total operating income generated in 2018, as the result of decrease in net interest income.

The total operating expenses in 2019 amounted to BAM 33.1 million and they recorded growth by 2.8% vs. previous year, mostly as the result of the increase in Depreciation and amortization and in personnel expenses.

The share of operating expenses in the total operating income increased from 46.7% to 49.6%, which presents the negative trend and it is the result of the increase in the total operating expenses.

Table: Financial Performance Indicators Overview

| UniCredit Bank a.d. Banja Luka<br>in thousand BAM | 2019 | 2018 | Change |
|---|---|---|---|
| **Profit and loss** | | | |
| Total operating income | 66 780 | 68 922 | -3,1% |
| Total operating expenses | (33 095) | (32 205) | 2,8% |
| Profit before tax | 32 372 | 30 365 | 6,6% |
| Net Profit for the year | 29 581 | 27 771 | 6,5% |
| **Balance sheet** | | | |
| Loans and receivables due from customers | 1 026 118 | 937 374 | 9,5% |
| Deposits and borrowings due from customers | 1 035 665 | 1 006 651 | 2,9% |
| Total equity and reserves | 244 795 | 218 675 | 11,9% |
| Total assets | 1 661 630 | 1 662 231 | 0,0% |
| **Capital adequacy** | | | |
| Total risk weighted assets (RWA) | 1 024 680 | 953 664 | 7,4% |
| Own funds (Regulatory capital ) | 213 116 | 188 299 | 13,2% |
| Capital adequacy ratio (CAR) | 20,8% | 19,7% | 1,1pp |
| **Business indicators** | | | |
| Cost income ratio | 49,6% | 46,7% | 2,9pp |
| Return on equity (ROAE) | 12,9% | 13,3% | -0,4pp |
| Return on assets (ROAA) | 1,9% | 1,8% | 0,1pp |
| Customers Loans to deposits ratio | 99,1% | 93,1% | 6,0pp |
| **Number of employees** | 448 | 441 | 7 |
| **Number of organizational units** | 36 | 36 | 0 |

Chart: **Operating income structure**

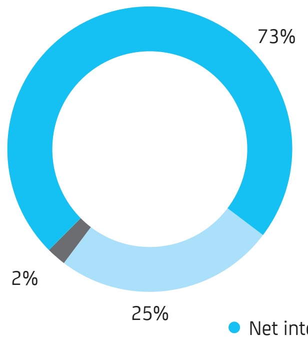
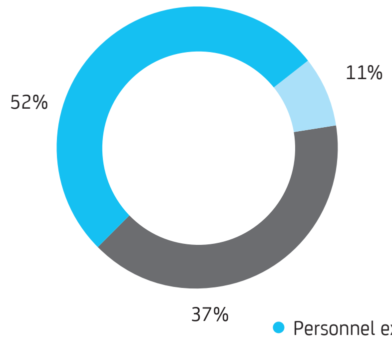



Chart: **Operating expenses structure**




The decrease of operating income resulted in lower profit before impairment and provisions by the amount of BAM 3.0 million compared to the previous year.

Net interest income was generated in amount of BAM 48.7 million, which is lower by 5.5% compared to the same period of the previous year, and it formed 73% of the total operating income of the Bank. The fall of the net interest income compared to the previous year was the result of lower interest income, which was not fully compensated through the decrease in the interest expense.

Net fee and commission income amounted to BAM 16.4 million, which was higher by 5.0% compared to the same period of the previous year, and formed 25% of the total operating income. The increase in fees was mainly the result of growth in fees for loans and customer packages.

The other items of income included the net foreign exchange gains upon recalculation of monetary assets and liabilities in the amount of BAM 1.6 million, dividend and profit sharing income in the amount of BAM 10 thousand and together they made 2% of the total operating income of the Bank.

Total operating expenses amounted to BAM 33.1 million, which was higher by 2.8% compared to the same period of the previous year. HR expenses amounted to BAM 17.2 million, recording a growth by 2.8% compared to the previous year, accounting for 52% of the total operating costs. Other administrative costs with BAM 12.3 million participated with 37% in the Total operating expenses, while the depreciation costs of tangible and intangible assets amounted to BAM 3.6 million and made 11% of Total operating expenses. The recorded growth of the Total operating expenses compared to the previous year was mainly the result of the increase in Depreciation and personnel expenses.

In 2019, the Bank allocated BAM 0.9 million for the costs of net impairment losses/recoveries per credit risk, which was lower by BAM 4.9 million or 85.2% compared to the previous year, maintaining the high quality of the portfolio.

## Balance Sheet

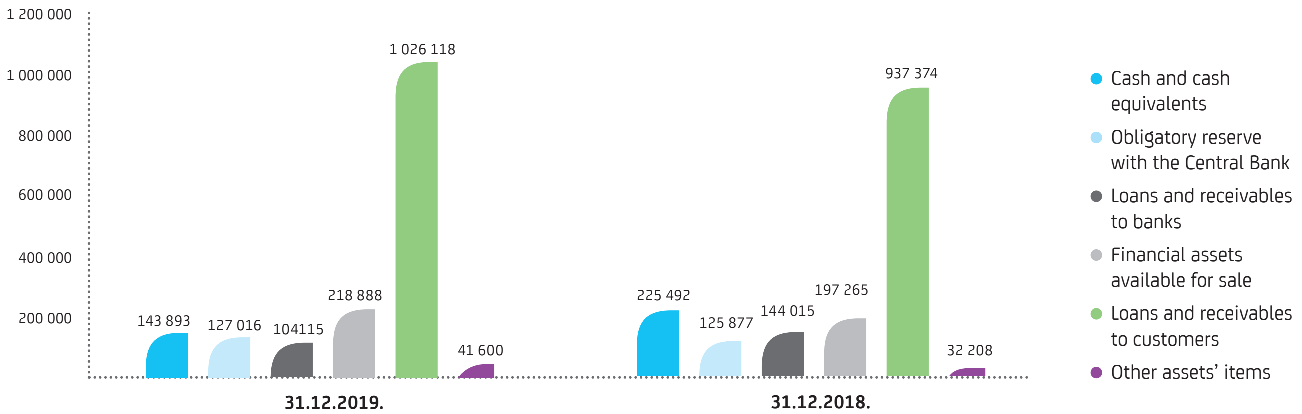
**Assets**

At the end of 2019, the total assets of the Bank reached the amount of BAM 1.7 billion and it was at approximately the same level as in the previous year.

In the structure of the Bank assets, the most significant share of 62% belongs to Loans and receivables due from customers amounting to BAM 1,026.1 million and recording the growth of 9.5% compared to the previous year's end. Loans and receivables due from banks amounted to BAM 104.1 million, and together with the minimum reserve held with the Central Bank, cash and cash equivalents and the other assets, they accounted for 38% of total assets of the Bank.

Financial assets at fair value through the other comprehensive income participated with 13% in the total Bank's assets. They amounted to BAM 218.9 million which was higher by 11.0% compared to the previous year's end and consisted of securities issued by the Government of Republic of Srpska.

Chart: **Bank Assets structure**




Other items of assets consist of tangible assets, intangible assets, financial assets held for trading, deferred tax asset and other assets.

In the structure of the most significant item of the assets - loans and receivables due from customers, loans to legal entities accounted for 53% and loans to private individuals accounted for 47%. Net loans to legal entities as at December 31, 2019 amounted to BAM 543.3 million, while net loans to private individuals amounted to BAM 482.8 million.

Gross loans provided to legal entities increased by 4.0%, while gross loans provided to private individuals increased by 6.1% compared to the end of the previous year.

**Liabilities**

In the structure of the Bank liabilities, Deposits and borrowings due to customers had the most significant share (62%). Total deposits and borrowings due to customers amounted to BAM 1,035.7 million and they increased by BAM 29.0 million or 2.9% compared to balance at the previous year's end.

Deposits and borrowing due to banks amounted to BAM 353.9 million which was lower by BAM 61.8 million or 14.9% vs. the end of the previous year.

Total Deposits and borrowings due to customers and banks as at December 31, 2019 amounted to BAM 1,389.5 million (31.12.2018:

Chart: **Bank Liabilities structure**

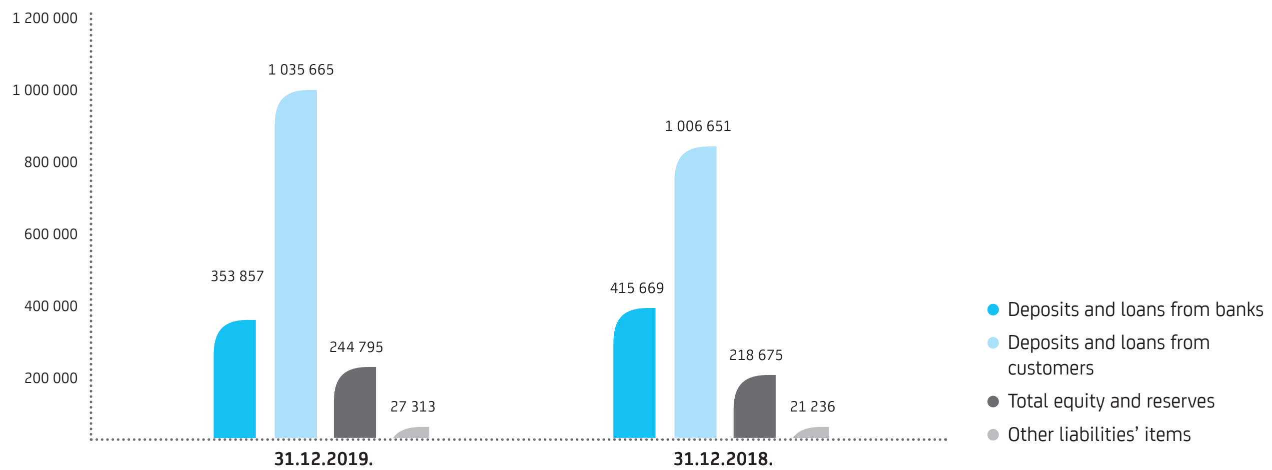


Chart: **Structure of deposits from legal entities**

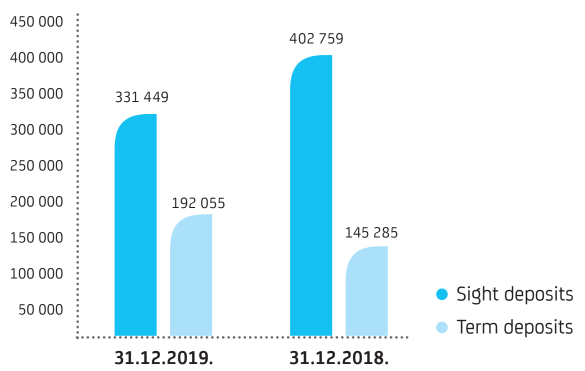
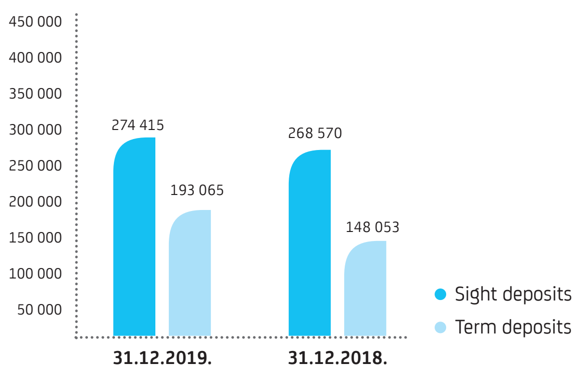



Chart: **Structure of deposits from individuals**




BAM 1,422.3 million), which was lower by BAM 32.8 million or 2.3% compared to the balance at the previous year's end.
n the structure of Deposits and borrowings due to customers, deposits and loans taken from legal entities formed 55%, while deposits of private individuals made 45%.

The legal entities deposits amounted to BAM 523.5 million at the end of 2019, which was lower by BAM 24.5 million or 4.5% vs. the end of the previous year. Sight deposits of the legal entities formed 63.3%, while the term deposits formed 36.7% of total legal entities' deposits.

The private individuals deposits amounted to BAM 467.5 million, which was higher by BAM 50.9 million or 12.2% compared to the previous year. The private individuals sight deposits formed 58.7%, while term deposits formed 41.3% of the private individuals total deposits.

ustomers Loan to deposit ratio increased from 93.1% to 99.1% as a result of the lower increase in deposits from customers compared to the increase in loans placed to customers in 2019 vs. 2018.

**Capital and reserves**

Capital and reserves of the Bank amounted to BAM 244.8 million at the end of 2019, which was higher by BAM 26.1 million compared to previous year's end as the result of the increase in the reserves from profit.

Based on the Shareholders' Meeting Decision, in 2019 the Bank paid out a dividend to shareholders in the total amount of BAM 5.6 million (20% of the 2018 net profit). The remaining amount of net profit from 2018 was allocated to retained earnings (undistributed profit), which presented the constituent of capital and reserves.

As at 31.12.2019, the capital adequacy ratio amounted to 20.8% (31.12.2018: 19.7%), which was significantly above the regulatory minimum of 12%.

# Team 23

Our new plan is called Team 23, in recognition of the outstanding work done together for Transform 2019. Team 23 is based on four strategic pillars:

- Grow and strengthen client franchise
- Transform and maximise productivity
- Disciplined risk management & controls
- Capital and balance sheet management

# Grow and strengthen client franchise.

Team 23 focuses on strengthening and growing our client franchise across all segments: SMEs, individuals and corporates.
Our strategic initiatives focus on the customer experience, to improve customer satisfaction and service quality. This is how we will increase our Net Promoter Score at Group-level.

# Management and Organizational structure

In accordance with the RS Law on Banks and the Articles of Association of the Bank, the governance bodies of the Bank are: Shareholders' Meeting, Supervisory Board and Management Board. The Bank also has the Audit Committee, and other committees in accordance with regulations.

**Shareholders' Meeting of the Bank**

The Shareholders' Meeting of the Bank consists of its shareholders. The Shareholders' Meeting is chaired and the decisions are signed by the Chairman of the Shareholders' Meeting, who is elected by the present shareholders at the beginning of each meeting.
As of 31 December 2019, the Bank had 61 shareholders in total, out of whom/which UniCredit S.p.A, Milan had the largest share with 99.43% of the participation in the total equity of the Bank.
As at 31 December 2019, the Bank's share capital amounted to BAM 97,055 thousand and it consisted of 138,650 ordinary "B" class shares with nominal value of BAM 700.00 per share.
According to the ownership structure of the shareholders, the private capital participates with 99.96%, and the cooperative with 0.04% in the total capital of the Bank, and by origin of the capital 99.49% is composed of the foreign capital, and 0.51% of the domestic capital.
The ordinary "B" class shares are entitled to one vote in the Shareholders' Meeting of the Bank. Owners of ordinary shares are entitled to manage the Bank, have the right to participate in profit and other rights defined by the Articles of Association, the legal and other regulations.

**Supervisory Board**

The Supervisory Board manages the Bank's operations and the work of Management Board, determines the proposal for the Bank's business policy and strategy, the business plan and submits them to the Shareholders' Meeting for the final approval and adopts the general acts, and has the other competencies specified in the Law on Banks of Republic of Srpska and the Articles of Association of the Bank. The Supervisory Board has the President and four members elected by the shareholders at the Shareholders' Meeting of the Bank for a period of four years.

As of 31 December 2019, the Supervisory Board of the Bank was composed of:

| | | |
|---|---|---|
| Pasquale Giamboi | President | UniCredit S.p.A. |
| Laura-Kristina Orlić | Deputy President | UniCredit S.p.A. |
| Daniel Svoboda | Member | UniCredit S.p.A. |
| Perica Rajčević | Member | Independent Member |
| Zoran Vasiljević | Member | Independent Member |

**Management Board**

The Management Board organizes the work, manages the operations and represents the Bank. Management Board is appointed by the Supervisory Board, with prior approval of the Banking Agency of Republic of Srpska.

Management Board Members of the Bank in 2019 were:

| | |
|---|---|
| Gordan Pehar | President of the Bank Management Board |
| Siniša Adžić | Member of the Bank Management Board |
| Slađan Stanić | Member of the Bank Management Board |
| Nevena Nikše | Member of the Bank Management Board |
| Tsvetelin Petyov Minchev | Member of the Bank Management Board |

**Audit Committee**

The Audit Committee is responsible for supervision over the implementation, and engagement of an external auditing company, which will conduct the audit of financial statements, and has the other responsibilities as defined by the Law on Banks of Republic of Srpska and the Articles of Association of the Bank.
The Audit Committee consists of three members who are appointed by the Supervisory Board for a period of four years.

As of 31 December 2019, Members of the Audit Committee of the Bank were:

| | | |
|---|---|---|
| Jelena Poljašević | President | Independent Member |
| Ante Križan | Member | Zagrebačka Banka d.d., Zagreb. |
| Antonija Matošin | Member | Zagrebačka Banka d.d., Zagreb. |

**Employees**

At the end of 2019, the Bank had 448 employees.

Being aware that our current and future development depends on the quality and commitment of our employees, we constantly work on improvement of knowledge and competencies, through targeted trainings and educations. Through development activities we strive to use the modern technologies and tools as diversely as possible, such as: electronic learning, participation in projects of acquiring and sharing knowledge within the Group, mentoring and others. In the development activities, the Bank pays special attention to the training of sales staff, managers and employees of high potential, identified as talents.
Throughout 2019, we were focused on the development of leadership skills at all levels of managers. Considering the fact that most of the Bank's managers are appointed internally from our resources, we initiated the First Time Manager program, through which the newly appointed managers acquired the basic leadership skills through several

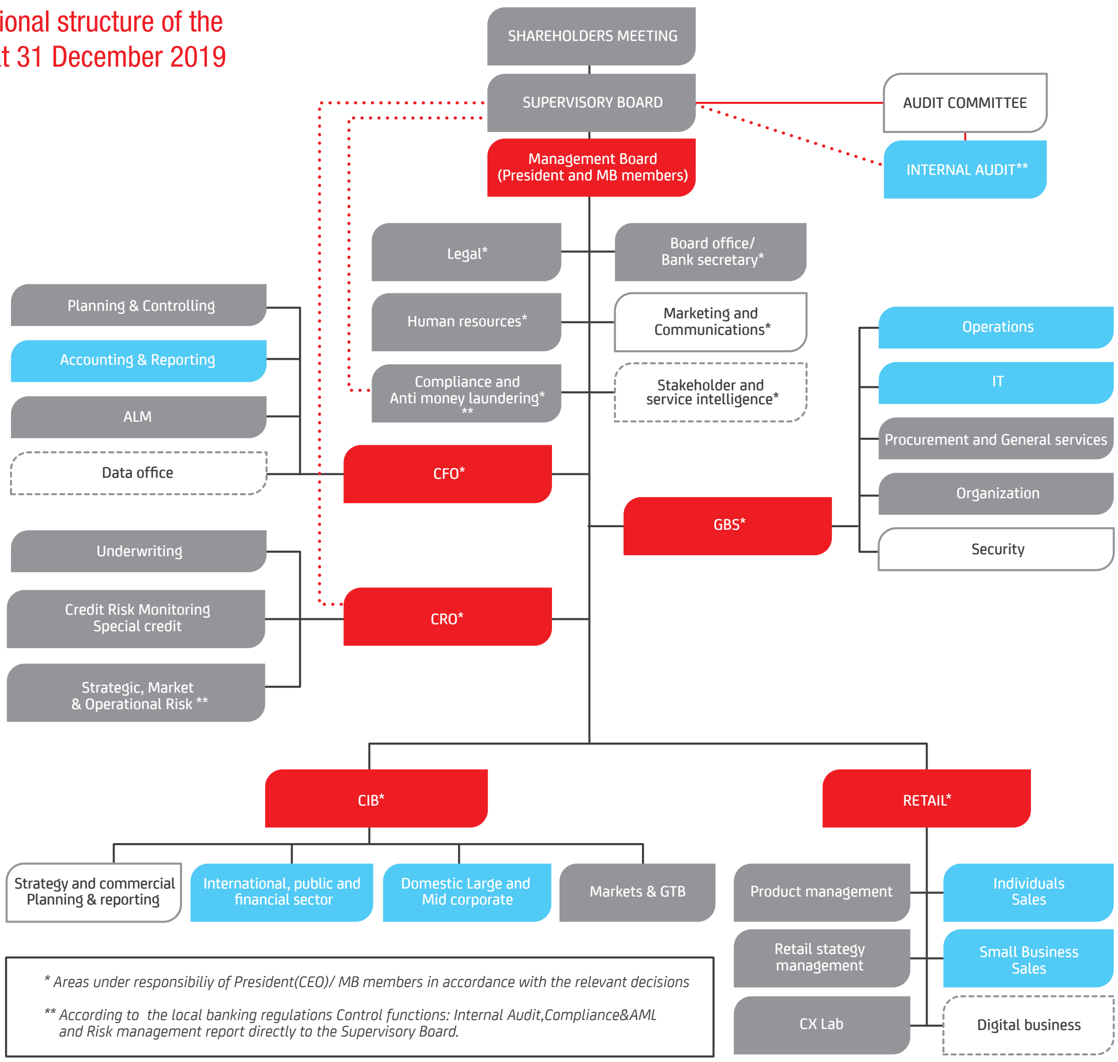
different trainings. In 2019, we continued paying attention to the training of new employees, and continued the implementation of the Induction Program, through which all new employees experienced the first work days in the Bank being trained in the Banja Luka Branch Office, and through various other activities, for three weeks as long as the training lasted, they were prepared to do the job on their own.

We pay constant attention to the renewal of our staff, and in 2019 we continued with the "First Big Chance" project, through which we invited students of the final years to participate in the program, through which they had the opportunity to gain their first working experience. Students passed a six-month practical training, through which they were informed about the business operations of the entire Bank, and today some of them are our new colleagues.

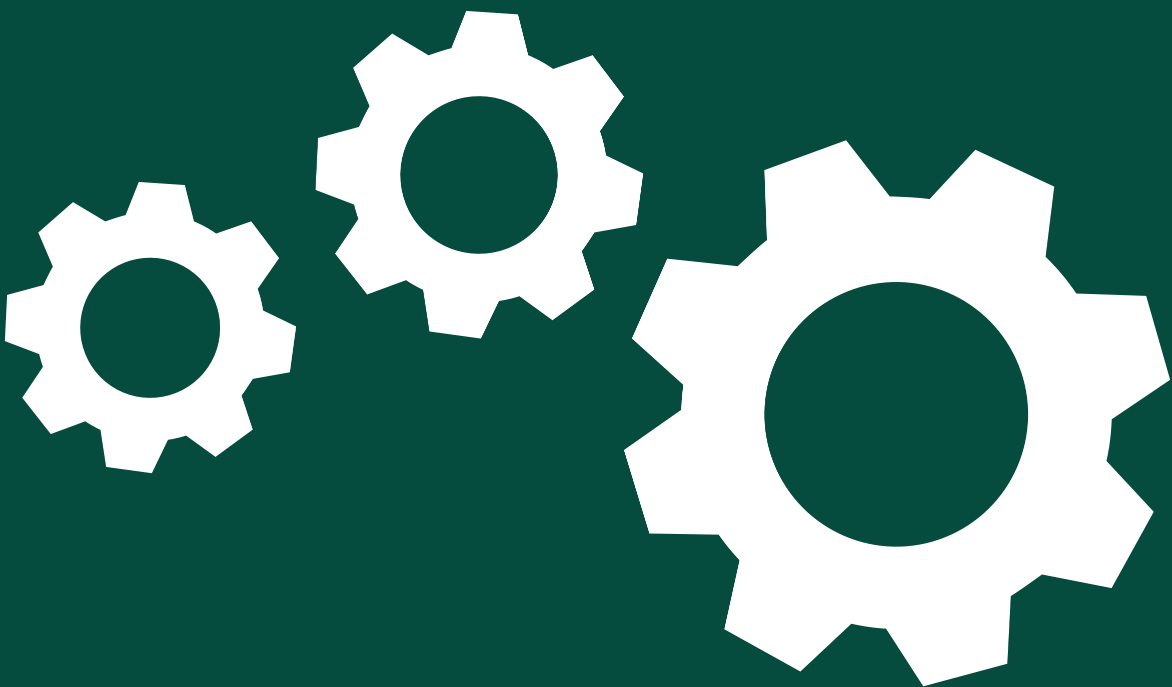
Employee satisfaction continues to be one of the important business drivers, and we interviewed employees through the internal communication channels for suggestions on activities that would help improve their work-life balance. Based on the proposal, we introduced the flexible working hours at the end of 2019, which should facilitate the harmonization of the business and private obligations on a daily basis. Examining of the various new approaches to work will continue to be our priority in the coming period. Another new feature in the year was the introduction of Specific Life Events (SLE), where we introduced different types of support and gifts in situations such as: getting married, giving birth, retiring, and similarly.

To facilitate the administration of all databases within Human Resources, a new application was implemented enabling the employees and managers to access the basic administrative information faster: vacation data, hours of work, training data, and similarly. One of the processes supported through the new allocation is the performance appraisal system, which was improved further through the process and provided more information on employee satisfaction, personal aspirations, training needs and similarly, which guaranteed even more transparency and openness when planning the next steps in the employee development.

## Organisational structure of the Bank as at 31 December 2019



# Transform and Maximise Productivity.



Our customer focus drives the right process optimisation, leading to new ways of working. We will continue to maximise productivity across the value chain, improving processes and products while minimising operational risk. A great example of our transformation is the paperless bank, currently being rolled out across our networks.

# Disciplined risk management & controls

We run the business with disciplined origination, enhanced business accountability and in-depth monitoring by control functions. Our reinforced governance and steering ensure targeted actions wherever necessary.
A Group culture driven by the principle: “Do the right thing!” means that each employee is part of the first line of defense.

# Independent Auditors’ Report

## To the Supervisory Board and Shareholders of UniCredit Bank a.d. Banja Luka

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**Opinion**

We have audited the accompanying financial statements (pages 5 to 77) of UniCredit Bank a.d. Banja Luka (hereinafter: the “Bank”), which comprise the statement of financial position as at December 31, 2019, and the related statement of profit and loss and other comprehensive income, statement of changes in equity and statement of cash flows for the 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 UniCredit Bank a.d. Banja Luka as at December 31, 2019, and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards.

**Basis for Opinion**

We conducted our audit in accordance with the International Standards on Auditing (ISA). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) (IESBA Code) and we have fulfilled our other ethical responsibilities in accordance with the requirements of 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 most significant in our audit of the financial statements for the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

**Key Audit Matters (CONTINUED)**

| Key Audit Matter | Responsive Audit Procedure |
|---|---|
| ***Expected credit losses for loans and provisions for guarantees*** | |
| As of December 31, 2019 the Bank's loans and receivables totaled BAM 1,061,117 thousand, whereas the total impairment allowance of loans amounted to BAM 34,999 thousand.<br><br>Measurement of impairment losses per loans and provisions for guarantees is considered a key audit matter because definition of ECL assumptions is subjective due to the extent of judgment made by the Management Board.<br><br>The most significant judgments pertain to:<br>• the assumptions used in the expected credit loss model developed (ECL) for the assessment of the credit risk of the exposures and future cash flows of borrowers;<br>• timely identification of exposures with significant credit risk increase and credit impairment;<br>• valuation of collaterals and assumptions in respect of the future cash flows of the loan exposures individually assessed for impairment.<br><br>Management has disclosed additional information on the impairment losses per loans and provisions for guarantees issued in Notes 2, 14, 15, 21 and 34.1 to the submitted financial statements. | Based on our risk assessment and knowledge of the industry, we examined the impairment losses per loans and provisions for guarantees, and assessed the methodology applied and assumptions used by the Bank in accordance with the description of the key audit matter.<br><br>We performed the following tests and procedures:<br>• we evaluated the key controls over the assumptions used in ECL models for credit risk assessment of the borrower exposures and expected future cash flows;<br>• we obtained and substantively tested evidence supporting the assumptions used in ECL models applied in allocation to impairment stages, assumptions used to arrive at 12-month and lifetime probability of default (PD) parameters, and methods used to calculate probability of losses (LGD) due to inability to collect receivables;<br>• we obtained and substantively tested evidence supporting the appropriateness of determining the assumptions for calculation of the impairment losses per loans and provisions for guarantees issued;<br>• we assessed the key movements in the high-risk loan portfolio since the previous period per segments in comparison to the historical data;<br>• we evaluated the methodologies applied using our experience and knowledge of the industry;<br>• we engaged our IT specialists and credit risk specialists in the areas that required specific expertise;<br>• we evaluated the accuracy and completeness of the disclosures made in the financial statements.<br><br>Based on the audit procedures performed, we identified no significant findings in respect of the accuracy of the impairment charges for loans and provisions for guarantees in 2019. |

**Responsibilities of Management Board and the Supervisory Board for the Financial Statements**

Management Board is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards, and for such internal control as 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, 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.

The Supervisory Board is responsible for overseeing the Bank's financial reporting process.

#### Auditors’ Responsibility for the Audit of the Financial Statements

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

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

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

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

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

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

Banja Luka, February 17, 2020

Mirko Ilić
Partner
Certified Auditor

DELOITTE D.O.O. BANJA LUKA 1

Deloitte d.o.o. Banja Luka
Braće Mažar i majke Marijve 58 i 60, Banja Luka

*Translation of the Auditors' Report issued in the Serbian language*

## Statement of Profit or Loss and Other Comprehensive Income

| | Note | Year Ended December 31, 2019 BAM '000 | 2018 BAM '000 |
|---|---|---|---|
| Interest income and similar income | 6 | 57,213 | 60,590 |
| Interest expenses and similar expenses | 7 | (8,490) | (9,047) |
| **Net interest income** | | **48,723** | **51,543** |
| | | | |
| Fee and commission income | 8 | 19,938 | 18,617 |
| Fee and commission expenses | 9 | (3,534) | (2,991) |
| **Net fee and commission income** | | **16,404** | **15,626** |
| | | | |
| Dividend and profit sharing income | 10 | 10 | 10 |
| Net foreign exchange gains upon translation of monetary assets and liabilities | 11 | 1,643 | 1,743 |
| Gains on investments | | | - |
| **Total operating income** | | **66,780** | **68,922** |
| | | | |
| Personnel expenses | 12 | (17,209) | (16,747) |
| Property and equipment depreciation charge | 22 | (2,279) | (1,595) |
| Intangible assets' amortization charge | 23 | (1,347) | (879) |
| Other administrative expenses | 13 | (12,260) | (12,984) |
| Total operating expenses | | (33,095) | (32,205) |
| | | | |
| **Profit before impairment and provisions** | | **33,685** | **36,717** |
| | | | |
| **Net impairment losses/recoveries per credit risks** | 14 | **(860)** | **(5,797)** |
| a) Financial assets at amortized cost | | (1,833) | (4,702) |
| b) Financial assets at fair value through other comprehensive income | | 973 | (1,095) |
| | | | |
| **Provisions for risks and expenses** | 15 | **(1,897)** | **(874)** |
| Provisions for credit risks and guarantees | | (1,927) | (514) |
| Provisions for employee retirement benefits | | 30 | 10 |
| Provisions for litigations | | - | (370) |
| | | | |
| Other operating income and expenses | | 1,314 | (194) |
| Gains/losses on sales of property and equipment | | 130 | 513 |
| | | | |
| **Profit before tax** | | **32,372** | **30,365** |
| | | | |
| Income tax | 16 | (2,791) | (2,594) |
| | | | |
| **Profit for the year** | | **29,581** | **27,771** |

| | Note | Year Ended December 31, 2019. BAM '000 | 2018. BAM '000 |
|---|---|---|---|
| **Profit for the year** | | **29,581** | **27,771** |
| **Other comprehensive income, net of income tax** | | | |
| Items that may subsequently be reclassified to profit and loss: | | | |
| - Positive effects of tangible assets revaluation | | 2,365 | |
| - (Losses)/gains on the financial assets at fair value through other comprehensive income | | (273) | 650 |
| | | | |
| **Total comprehensive income for the year** | | **31,673** | **28,421** |
| | | | |
| | | **BAM** | **BAM** |
| **Earnings per share (basic and diluted)** | *31* | **213.35** | **200.30** |

These financial statements were approved by the Bank's Management on January 29, 2020.

Signed on behalf of UniCredit Bank a.d. Banja Luka by:

Gordan Pehar
President of the Management Board

Nevena Nikše
Member of the Management Board

## Statement of Financial Position

As of

| | Note | December 31, 2019 BAM'000 | December 31, 2018 BAM'000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 17 | 143,893 | 225,492 |
| Financial assets held for trading | | 244 | 1 |
| Financial assets at fair value through other comprehensive income | 18 | 218,888 | 197,265 |
| **Financial assets at amortized cost** | | **1,257,249** | **1,207,266** |
| a) Obligatory reserve held with the Central Bank | 19 | 127,016 | 125,877 |
| b) Loans and receivables due from banks | 20 | 104,115 | 144,015 |
| c) Loans and receivables due from customers | 21 | 1,026,118 | 937,374 |
| Property and equipment | 22 | 23,715 | 17,761 |
| Intangible assets | 23 | 10,530 | 8,115 |
| Deferred tax assets | 27 | 6 | 77 |
| Other assets | 24 | 7,105 | 6,254 |
| **Total assets** | | **1,661,630** | **1,662,231** |
| | | | |
| **Liabilities** | | | |
| **Financial liabilities at amortized cost** | | **1,392,598** | **1,422,320** |
| a) Deposits and borrowings due to banks | 25 | 353,857 | 415,669 |
| b) Deposits and borrowings due to customers | 26 | 1,035,665 | 1,006,651 |
| c) Lease liabilities | 26 a | 3,076 | - |
| **Tax liabilities** | | **644** | **178** |
| a) Current tax liabilities | | 381 | 178 |
| b) Deferred tax liabilities | 27 | 263 | - |
| Other liabilities | 28 | 18,555 | 17,737 |
| **Provisions for risks and expenses** | 29 | **5,038** | **3,321** |
| a) Provisions for credit risk on commitments and financial guarantees issued | | 2,959 | 1,032 |
| b) Provisions for employee retirement benefits | | 222 | 252 |
| c) Provisions for litigations | | 1,857 | 2,037 |
| **Total liabilities** | | **1,416,835** | **1,443,556** |
| | | | |
| **Equity and reserves** | | | |
| Share capital | 30 | 97,055 | 97,055 |
| Share premium | | 373 | 373 |
| Legal reserves | | 9,706 | 9,706 |
| Capital reserves | | 42,846 | 39,242 |
| Regulatory reserves for credit losses | | - | 3,604 |
| **Fair value reserves** | | 4,488 | 2,447 |
| Retained earnings | | 60,746 | 38,477 |
| Net profit for the year | | 29,581 | 27,771 |
| **Total equity and reserves** | | **244,795** | **218,675** |
| **Total liabilities, equity and reserves** | | **1,661,630** | **1,662,231** |

# Statement of Changes in Equity

For the year

| | Share capital BAM '000 | Share premium BAM '000 | Legal reserves BAM '000 | Capital reserves BAM '000 | Regulatory reserves for credit losses BAM '000 | Fair value reserves BAM '000 | Retained earnings BAM '000 | Net profit for the year BAM '000 | Total BAM '000 |
|---|---|---|---|---|---|---|---|---|---|
| **Balance as at January 1, 2018** | **97,055** | **373** | **9,706** | **39,242** | **3,496** | **(114)** | **25,589** | **25,775** | **201,122** |
| Effects of IFRS 9 first-time adoption | - | - | - | - | 108 | 1,911 | - | - | 2,019 |
| Profit distribution | - | - | - | - | - | - | 25,775 | (25,775) | - |
| Dividend payment (Note 31) | - | - | - | - | - | - | (12,887) | - | (12,887) |
| Net profit for the year | | | | | | | | 27,771 | 27,771 |
| **Other comprehensive income** | | | | | | | | | |
| Net loss from changes in fair value of financial assets through other comprehensive income | - | - | - | - | - | (445) | - | - | (445) |
| Net gain from provisions for credit risks on financial assets at fair value through other comprehensive income | - | - | - | - | - | 1,095 | - | - | 1,095 |
| Total other comprehensive income | - | - | - | - | - | 650 | - | - | 650 |
| **Balance as at December 31, 2018** | **97,055** | **373** | **9,706** | **39,242** | **3,604** | **2,447** | **38,477** | **27,771** | **218,675** |
| Profit distribution | - | - | - | - | - | - | 27,771 | (27,771) | - |
| Dividend payment (Note 31) | - | - | - | - | - | - | (5,553) | - | (5,553) |
| Transfer to reserves | - | - | - | 3,604 | (3,604) | - | - | - | - |
| Net profit for the year | - | - | - | - | - | - | - | 29,581 | 29,581 |
| **Other comprehensive income** | | | | | | | | | |
| Net gain from changes in fair value of financial assets through other comprehensive income | - | - | - | - | - | 649 | - | - | 649 |
| Net loss from provisions for credit risks on financial assets at fair value through other comprehensive income | - | - | - | - | - | (973) | - | - | (973) |
| Net gains for period recognized in equity | - | - | - | - | - | - | 51 | - | 51 |
| Effects of tangible assets revaluation – property (Notes 22 and 27) | - | - | - | - | - | 2,365 | - | - | 2,365 |
| *Total other comprehensive income* | - | - | - | - | - | *2,041* | *51* | - | *2,092* |
| **Balance as at December 31, 2019** | **97,055** | **373** | **9,706** | **42,846** | **-** | **4,488** | **60,746** | **29,581** | **244,795** |

## Statement of Cash Flows

*For the year*

| | Year Ended December 31, 2019 BAM '000 | Year Ended December 31, 2018 BAM '000 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Interest income and similar income | 57,213 | 60,590 |
| Interest expenses and similar expenses | (8,490) | (9,047) |
| Fee and commission income | 19,938 | 18,617 |
| Fee and commission expenses | (3,534) | (2,991) |
| Dividend and profit sharing income | 10 | 10 |
| Net foreign exchange gains upon translation of monetary assets and liabilities | 1,643 | 1,743 |
| Administrative operating expenses | (29,469) | (29,731) |
| Other inflows | 1,443 | 319 |
| **1. Net cash generated by operating activities** | **38,754** | **39,510** |
| | | |
| **Changes in operating assets and liabilities** | | |
| **Changes in the financial assets at amortized cost** | | |
| Obligatory reserve held with the Central Bank | (1,139) | (9,875) |
| Loans and receivables due from banks | 39,900 | (43,571) |
| Loans and receivables due from customers | (90,021) | (45,205) |
| | | |
| **Changes in the financial liabilities at amortized cost** | | |
| Deposits and borrowings due to banks | (61,812) | 19,768 |
| Deposits and borrowings due to customers | 29,014 | 143,023 |
| Lease liabilities | (664) | - |
| | | |
| Other assets | (1,142) | (906) |
| Other liabilities | 818 | 812 |
| **2. Net changes in operating assets and liabilities** | **(85,046)** | **64,046** |
| | | |
| **3. Net cash generated by operating activities before tax (1+2)** | **(46,292)** | **103,556** |
| | | |
| 4. Income tax paid | (2,582) | (2,622) |
| | | |
| *5. Net cash generated by operating activities (3+4)* | *(48,874)* | *100,934* |
| | | |
| **Cash flows from investing activities** | | |
| Tangible assets | (1,792) | (2,305) |
| Intangible assets | (3,762) | (3,107) |

# Statement of Cash Flows (CONTINUED)

*For the year*

| | Year Ended December 31, | |
|---|---|---|
| | 2019 BAM '000 | 2018 BAM '000 |
| Financial assets at fair value through other comprehensive income | (21,623) | (27,723) |
| Dividend payment | (5,548) | (12,875) |
| **6. Net cash used in investing activities** | **(32,725)** | **(46,010)** |
| | | |
| **7. Net (decrease)/increase in cash (5+6)** | **(81,599)** | **54,924** |
| | | |
| **8. Cash and cash equivalents at the beginning of year** | **225,492** | **170,568** |
| **9. Cash and cash equivalents at the end of year (7+8)** | **143,893** | **225,492** |

## 1. THE REPORTING ENTITY

UniCredit Bank a.d. Banja Luka is a shareholding company registered in the Republic of Srpska for performance of payment transactions, credit and deposit and other banking operations in the country and abroad in accordance with the regulations of the Republic of Srpska.

History of the Bank is related to the beginning of the past century, i.e. to 1910 and establishment of the Monetary Institute which subsequently developed into the “Banka za trgovinu i obrt”. In the following 60 years, numerous transformations and changes of names under which the Bank operated were made: in 1956, the “Sreska Komunalna Banka”, in 1961, the “Komunalna Banka”, and in 1966, the “Kreditna Banka”. By the reform of the banking system in 1971, the “Kreditna Banka” was merged by the “Privredna Banka Sarajevo” as its branch, and in 1976 it obtained a high degree of autonomy and was registered as the “Osnovna Banka”. Under the Decision of the Founder Assembly in December 1989 the Bank was spun off from the “Privredna Banka Sarajevo” system into an independent bank, under the name of “Banjalučka Banka d.d. Banja Luka”. From June 1998, it continued its operations as a shareholding company under the name Banjalučka Banka a.d. Banja Luka.

In accordance with regulations on privatization of state-owned capital in the Republic of Srpska, in October 2000, the Bank’s shares held by state-owned enterprises were transferred to the management of the RS Ministry of Finance until the completion of the state-owned capital privatization process.

In early 2002, the Government of the Republic of Srpska sold the state-owned shares of the Bank to the company Verano Motors d.o.o. Belgrade. The first Shareholders’ Meeting of the private Bank adopted a decision on the change of the name from Banjalučka Banka into Nova Banjalučka Banka a.d. Banja Luka.

Since the end of 2002, the Bank’s shares have been quoted on the Stock Exchange. At the end of 2005, having purchased a package of shares (83.3% equity interest) at the Stock Exchange, Bank Austria Kreditanstalt AG Vienna became the majority owner of the Bank, which also at the end of the same year became a member of UniCredit Group and changed its name to UniCredit Bank Austria AG.

With the change in the ownership structure after the entry of Bank Austria as the majority shareholder, the Bank became a member of HVB Group, and after the change in the ownership structure of Bank Austria whose majority owner became UniCredit Bank S.p.A. Milan, the Bank became a member of UniCredit Group. In 2008, the name Nova Banjalučka Banka a.d. Banja Luka was changed, hence since June 1, 2008, the Bank has been operating under the name of UniCredit Bank a.d. Banja Luka.

During 2016, ownership of all banks in Central-Eastern Europe was transferred from UniCredit Bank Austria AG, as the Sub-holding, to UniCredit S.p.A. – Holding, Italy at the level of UniCredit Group.

UniCredit S.p.A. Italy is the Bank’s majority shareholder with 99.4252% equity shares at the end of 2019.

As at December 31, 2019, the Bank consisted of the Head Office in Banja Luka (with the registered address at no. 7, Marije Bursać Street), and 36 branch offices (December 31, 2018: 31 branch offices and 5 agencies).

As at December 31, 2019, the Bank had 448 employees (2018: 441 employees).

The tax identification number of the Bank is 4400958880009, and its VAT code is 400958880009.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION

## 2.1. Statement of Compliance

The accompanying financial statements represent annual financial statements of UniCredit Bank a.d. Banja Luka, prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

## 2.2. General Preparation Criteria

The annual financial statements include:

- Statement of Profit or Loss and Other Comprehensive Income (Income Statement),
- Statement of Financial Position (Balance Sheet),
- Statement of Changes in Equity,
- Statement of Cash Flows (compiled using the direct method), and
- Notes to the financial statements.

The accompanying financial statements have been prepared on the going concern basis, since the Bank's governing bodies did not identify any symptoms in the capital and financial structures or any economic effects that could indicate uncertainty regarding the ability of the Bank to continue to operate profitably in the foreseeable future.

The adopted measurement criteria are in line with this assumption and the principles of accrual accounting, the relevance and significance of the accounting information, and prevalence of the economic substance over the legal form. Compliance with these criteria has not changed since the previous years, except for the changes described below, which relate to the introduction of new standards and interpretations.

According to IFRS, management has to make judgments, estimates and assumptions that affect the application of accounting principles and the amounts of assets and liabilities, reported income and expenses, as well as the disclosure of contingent assets and liabilities. Estimates and related assumptions are based on the historical experience and other factors that are considered reasonable under the given circumstances and have been used to estimate the carrying amount of assets and liabilities that are not readily available from other sources.

## 2.3. Functional Currency and Presentation Currency

These financial statements are stated in convertible marks (hereinafter: "BAM"), BAM being the Bank's functional currency. The data in tables and explanations are presented in thousands of convertible marks (BAM '000), unless otherwise stated.

The Central Bank of Bosnia and Herzegovina (hereinafter: the "Central Bank") implements the policy on FX rate in line with the principle of the Currency Board, according to which BAM is pegged to EUR at the rate of BAM 1 = EUR 0.511290, which was used for 2019 and 2018.

## 2.4. Subsidiaries, Joint Ventures and Associates

As of the reporting date, the Bank did not have:

- Subsidiaries, i.e. entities, including structured entities, over which it has direct or indirect control,
- Joint arrangements with other entities, which in accordance with the IFRS 11 include joint control, joint operations and joint ventures, or
- Associates.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.5. Impact and Application of New and Revised IFRS

**Initial application of the new and amendments to the existing standards that came into effect**

In 2019 the following standards, amendments or interpretations of existing accounting standards came into force:

- Amendments to IAS28: Long-Term Interests in Associates and Joint Ventures;
- Amendments to IAS19: Plan Amendment, Curtailment or Settlement;
- Annual Improvements to IFRS Standards 2015-2017 Cycle;
- IFRS16 - Leases;
- IFRIC23 Uncertainty over Income Tax Treatments;
- Amendments to IFRS9: Prepayment Features with Negative Compensation.

**IFRS 16**, effective starting from January 1, 2019 modifies the current set of international accounting principles and interpretations on leases and, in particular, IAS 17.

IFRS 16 introduces a new definition for leases and confirms the current distinction between the two types of leases (operating and finance) with reference to the accounting treatment to be applied by the lessor.

With reference to the accounting treatment to be applied by the lessee, the new accounting standard sets, for all the leasing typologies, recognition as an asset, representing the right of use of the underlying asset and, at the same time, a liability reflecting the future payments of the lease contract.

At the initial recognition such an asset is measured based on the lease contract cash flows. After the initial recognition, the right-of-use will be measured on the basis of the provisions set for tangible assets measured using IAS 16, IAS 38 or IAS 40 cost model, reduced by accumulated depreciation and any accumulated impairment losses, the revaluation model or the fair value model, depending on what is applicable.

In this context, the Bank has initiated activities aimed at ensuring compliance with these accounting principles, in particular in the part regarding the calculation of the right-of-use and liabilities for leasing, which represent the main differences in relation to the current accounting model required by previous IAS 17. The activities were aimed at identifying lease contracts and development of rules, principles and IT applications that will be used for the proper assessment of new assets and liabilities and the subsequent calculation of related economic effects.

More details about the content of the standard and accounting choices that the Bank implemented are presented in the "Significant Accounting Policies, 3.6. Tangible Assets" section of this document.

With regards to the initial application of IFRS 16, the Bank has decided, as the standard allows, to calculate the lease liabilities as the present value of future payment of leases as at January 1, 2019, and to determine the right of use based on the value of lease liabilities.

As a result of above mentioned decision, the recalculation of comparative data for the previous period has not been performed.

As at January 1, 2019 the Bank has recognized the right of use of tangible assets in the amount of BAM 3,077, which relates to office space lease contracts and lease liabilities in the same amount.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.5. Impact and Application of New and Revised IFRS (CONTINUED)

**IFRS 15** "Revenue from Contracts with Customers", effective starting from January 1, 2019, which has been endorsed by the European Union with Regulation EU 2016/1905 dated September 22,2016 (published on October 29, 2016), modifies the current set of international accounting principles and interpretations on revenue recognition and, in particular, IAS 18.

IFRS 15 provides for:

- two approaches for revenue recognition ("at a point in time" or "over time");
- a new model for transaction analysis ("five-step model") focused on the transfer of control; and
- a requirement for a more detailed disclosure to be included in the explanatory notes to the financial statements.

Applying the new accounting standard could have effects on:

(i) reclassification between line items of the income statement used for presenting revenues,

(ii) change in the timing recognition of such revenue, when the contract with the customer contains several performance obligations that must be accounted for separately under the accounting standard,

(iii) different measurements of the revenues so as to reflect their variability.

Adoption of IFRS 15 did not have significant effects on the current economic and financial volumes.

**New Standards and Amendments to the Existing Standards in Issue, but not yet Effective**

As at December 31, 2019 the following standards, amendments, interpretations or revisions, were issued, but have not yet come into force:

| | |
|---|---|
| IFRS 17 | Insurance Contracts |
| IFRS 10 and IAS 28 (amendments) | Sale or Contribution of Assets between an Investor and its Associate or Joint Venture |
| Amendments to IFRS 3 | Definition of a business |
| Amendments to IAS 1 and IAS 8 | Definition of material |
| Conceptual Framework | Amendments to References to the Conceptual Framework in IFRS Standards |

The Bank's management has elected not to adopt these new Standards, amendments to existing Standards and new interpretations in advance of their effective dates. The management anticipates that the adoption of these new Standards, amendments to existing Standards and new interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

## 2.6. Classification and Measurement

In accordance with IFRS 9, classification of assets and liabilities is based on the business model and characteristics of the contractual cash flows. The analysis of the business models has been performed by mapping the Bank's business areas and by allocating a specific business model to each of them. In this regard, a "hold-to-collect" or "hold-to-collect and sell" business models have been allocated to the business areas comprising the Bank's portfolio in accordance with the intention of holding and expected sales of financial instruments. For the classification of financial assets into the new categories stipulated by IFRS 9, the analysis of the business models was complemented by the analysis of the contractual cash flows ("SPPI Test").

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.6. Classification and Measurement (CONTINUED)

In this regard, the Bank has established processes to analyze the portfolio of debt securities and loans by which it assesses whether the features of their contractual cash flows allow their measurement at amortized cost ("hold-to-collect" portfolio) or at fair value through other comprehensive income ("hold-to-collect and sell" portfolio").

The analysis is performed both by contract and by defining specific clusters based on the features of transactions and using a specific tool developed by the Group (SPPI Tool) in order to analyze the features of the contracts against IFRS 9 requirements, or by using external data providers.

In applying the above rules, the financial assets and liabilities of the Bank are classified as follows.

**a) Financial Assets Held for Trading**

Financial asset is classified as held for trading if:

- it is acquired or generated principally for the purpose of selling or repurchasing it in the near term;
- it is part of the portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term;
- it is held for profit making;
- it is a derivative contract not defined by hedge accounting, including derivatives with a positive fair value embedded in financial liabilities other than those that are measured at fair value through profit or loss.

Like other financial instruments, financial assets held for trading are initially measured at fair value at settlement date, which is usually equal to the amount paid, excluding transaction costs and income, which are recognized in profit and loss account, if they can be directly attributed to financial assets.

Trading book derivatives are recognized at the trading date. After initial recognition, this financial asset is measured at fair value through profit and loss account.

A gain or loss arising from the sale or repurchase or change in the fair value of a financial asset held for trading is recognized in the profit and loss account under the item of "net gains on trading and foreign exchange gains on the translation of monetary assets and liabilities", including gains or losses from financial derivatives relating to financial assets and/or financial liabilities designated at fair value or other financial assets that are mandatorily held at fair value. If the fair value of a financial instrument falls below zero, which can be the case with derivative contracts, it is recognized on "financial liabilities held for trading" item.

These assets are measured similarly to the "financial assets held for trading" but gains and losses, whether realized or unrealized, are recognized within the item of "gains/(losses) on financial assets/liabilities at fair value through profit and loss".

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.6. Classification and Measurement (CONTINUED)

**b) Financial Assets at Fair Value through Other Comprehensive Income**

Financial assets are classified at fair value through other comprehensive income if:

- They reflect the business model "hold-to-collect and sell";
- Their cash flows are solely payments of principal and interest.

This category also includes equity instruments not held for trading and for which the Bank applies the option allowed by the Standard for instrument measurement at fair value through other comprehensive income.

Upon initial recognition, on settlement date, financial assets are measured at fair value, which is usually equal to the consideration paid plus transaction costs and income that can be attributed directly to the instrument.

After initial recognition, interest accrued on interest-bearing instruments is recorded in the profit and loss account under the criterion of amortized cost within the item of "interest income and similar income".

Gains and losses arising from changes in fair value are recognized in the statement of comprehensive income and reported in equity within the "fair value reserve" item. In case of disposal, accumulated gains and losses are recorded in the profit and loss on the item "gains (losses) on disposal and repurchase of financial asset at fair value through other comprehensive income".

In respect of equity instruments, gains and losses arising from changes in fair value are recognized in the statement of comprehensive income and reported in equity under " fair value reserve " item. In case of disposal, accumulated gains and losses are recorded under the "reserves" item.

In accordance with the provisions of IFRS 9, impairment losses on equity instruments are not recognized in the profit or loss statement. Only dividends are recognized in the profit or loss statement under the item "income from dividends and similar income".

**c) Financial Assets at Amortized Cost**

Financial assets are classified at amortized cost if:

- their business model is holding for collection and
- their cash flows are solely for payment of principal and interest.

Upon initial recognition, on settlement date, financial assets at amortized cost are measured at fair value, which is usually equal to the consideration paid plus transaction costs and income that can be attributed directly to the instrument. After initial recognition at fair value, these assets are measured at amortized cost that requires interest recognition on an accrual basis using the effective interest method during the life of the loan. Such interest is recognized within the item of "interest income and similar income". The carrying value of a financial asset at amortized cost is adjusted to take into account the impairment allowances/write-offs arising from the measurement process.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.6. Classification and Measurement (CONTINUED)

**c) Financial Assets at Amortized Cost (Continued)**

Impairment losses are recorded in the profit and loss under the “net impairment losses/recoveries on loans relating to the financial assets at amortized cost”. In case of disposal, accumulated gains and losses are recorded in the profit and loss under the “gains (losses) on disposal and redemption of financial assets at amortized cost”.

Amounts arising from adjusting the carrying amount of financial assets, gross cumulative write-offs, made to reflect changes in contractual cash flows that do not lead to discontinuation of accounting recognition, are recognized in profit and loss as gains / losses on contractual changes, yet such a line item does not include the effect of contractual change in the amount of expected loss recognized under the item “ net impairment losses/recoveries on loans that relate to the item: “financial assets at amortized cost”.

**d) Financial Liabilities Measured at Amortized Cost**

Financial liabilities measured at amortized cost include financial instruments (other than those held for trading or those that are designated at fair value) that represent different forms of financing by third parties. These financial liabilities are recognized at the settlement date initially at fair value that is usually received, less any transaction costs that can be directly attributed to the financial liability. Thereafter, these instruments are measured at amortized cost using the effective interest method. Such interest is recognized within the item of “interest expenses and similar expenses”.

**e) Financial Liabilities Held for Trading**

Financial liabilities held for trading include derivatives not designated as hedging instruments. These liabilities are measured at fair value upon initial recognition and for the duration of the transaction.

A gain or loss arising from the sale or repurchase or change in the fair value of a financial liability held for trading is recognized in the profit and loss account under the item of “net gains (losses) on trading and foreign exchange gains/losses on the translation of monetary assets and liabilities”.

**f) Qualitative Information on Fair Value**

Fair value disclosures are made in accordance with the requirements of IFRS 13. 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 in the principal at the measurement date (i.e., the exit price).

For financial instruments that are quoted in active markets, fair value is determined on the basis of official prices in the principal market the Bank operates in and has access to (mark to market).

A financial instrument is considered to be quoted on an active market if quoted prices are easily and regularly available from pricing services, distributors, brokers, pricing agencies or regulatory agencies, and these prices represent real and regular market transactions at the “arm’s length” principle. If the published price quotation on an active market does not exist for a financial instrument as a whole, but for active markets for its components, fair value can be determined on the basis of relevant market prices for the component parts.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.6. Classification and Measurement (CONTINUED)

**g) Fair Value Measurement Principles**

Fair values of financial assets and financial liabilities traded in active markets are based on the quoted market prices. For all other financial instruments, the Bank determines fair values using fair value assessment (valuation) techniques.

Valuation techniques for fair value involve models of cash flow discounting to the net present value, comparison to the similar instruments with identifiable market prices and other valuation techniques. Assumptions and inputs used in valuation techniques include risk-free and reference interest rates, credit margins, prices of shares and bonds, FX rates, prices of indices and other variables and their correlations. The objective of the valuation techniques is to compute the fair value that best reflects the price of a financial instrument as at the reporting date, i.e., the price that would be determined by other market participants under the normal market conditions.

When calculating fair value, the Bank takes into account fair value hierarchy rules prescribed by IFRS 13, which reflect the significance of inputs used in the valuation process. Each instrument is assessed individually in detail. Levels of the fair value hierarchy are determined based on the lowest level of inputs relevant for determining the fair value of an instrument.

**h) Fair Value Assessment Models**

Financial instruments carried at fair value are grouped in three levels of the fair value hierarchy under IFRS 13, as follows:

- Level 1 – instruments that are measured by means of active market quoted prices. Those are instruments whose fair value can be determined directly based on prices quoted in active liquid markets.
- Level 2 – instruments that are measured by means of valuation techniques using available market inputs. Those are instruments whose fair value is determined by comparison to similar instruments traded in active markets or where all inputs used in the measurement techniques are available in the market.
- Level 3 – instruments that are measured by means of valuation techniques using market data that are not available on the active market. Those are instruments whose fair value cannot be determined directly using available market information, and where somewhat different valuation techniques are used for the calculation of value.

**i) Debt Securities**

Debt securities are measured through a two-phase process dependent on the liquidity of the relevant market. Liquid instruments in active markets are measured at market value (mark to market) and are therefore classified into Level 1 of the fair value hierarchy. Instruments not traded in active markets are measured using models that make the most use of the relevant and available parameters, and the least use of the inputs unobservable in the market. Given the aforesaid, depending on the significance of unobservable inputs, bonds are classified in an appropriate level.

**j) Offsetting of Financial Instruments**

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

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

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.7. Impairment

**a) General**

Loans and debt securities classified as financial assets at amortized cost, financial assets at fair value through other comprehensive income and relevant off-balance sheet exposures are tested for impairment in accordance with IFRS 9.

For such purposes, these instruments are classified into Stage 1, Stage 2, or Stage 3 according to their absolute or relative credit quality compared to the initial payment.

Specifically:

- Stage 1: includes (i) newly approved or acquired credit exposures, (ii) exposures for which credit risk has not significantly increased since initial recognition, (iii) exposures with low credit risk;
- Stage 2: includes credit exposures that have a significant credit risk increase since initial recognition;
- Stage 3: includes impaired credit exposures.

For exposures in Stage 1, the impairment is equal to the expected credit loss that is calculated over a time horizon of up to one year.

For exposures in Stage 2, the impairment is equal to the expected credit loss that is calculated over a time horizon corresponding to the entire lifetime of the exposure.

For exposures in Stage 3, the impairment is calculated on a collective basis or on an individual basis, depending on the client's characteristics.

In order to meet the requirements of the standards the Group has developed specific models for calculating the expected loss on the basis of PD, LGD and EAD parameters used for regulatory purposes and adjusted to ensure consistency with the accounting regulations.

In this context, forward-looking information is included through the elaboration of specific scenarios. The stage allocation model is the key aspect of the new accounting model required for expected credit loss calculation, whose aim is transfer of credit exposures from Stage 1 to Stage 2. Stage 3 includes exposures at default.

At the Bank, the Stage allocation assessment includes a combination of relative and absolute triggers. Considering a low number of observations in the portfolio, the Bank uses only qualitative criteria in recognition of significant credit risk increase, such as:

a) Forbearance status classification – results in an exposure automatically classified in Stage 2 at least within next 9 months (since the date of classification). After that period, if there are no other significant triggers of credit risk deterioration, the transaction may be returned into Stage 1.

b) 30 days past due – if a transaction reaches 30 dpd, it should be classified as Stage 2.

c) Restructuring status – all performing exposures transferred to the remit of the Special Credit Unit are automatically classified as Stage 2.

d) Watch list classification.

e) Manual adjustments – customers with recognized increasing credit risk but not classified using the main qualitative criteria.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.7. Impairment (CONTINUED)

### a) General (continued)

When it comes to financial assets consisted of securities, in accordance with the Standard, the Bank classified them to Stage 2, since securities are classified as non-investment grade securities.

The impairment calculated for impaired (default status) assets includes forward-looking adjustments and multiple scenarios applicable to this class of assets.

The definition of default is aligned with the principles embedded in the Definition of Default Guidelines issued by European Banking Authority (EBA), where the aggregate borrower exposure is classified as a default exposure if only one of the transactions is in the default status (the so called "debtor approach").

### b) Parameters and risk definitions used for impairment calculation

As mentioned above, specific models have been developed for calculating the expected loss based on PD, LGD and EAD parameters and the effective interest rate:

- PD (Probability of Default), represents the likelihood of the occurrence of a credit exposure default event over a given time horizon;
- LGD (Loss Given Default), represents the percentage of estimated loss, and thus the expected recovery rate, at the date of the occurrence of credit exposure default;
- EAD (Exposure at Default) represents the measurement of exposure at the time of credit exposure non-payment;
- Effective interest rate is a discount rate that expresses the time value of money.

Furthermore, specific adjustments have been developed on probability of default (PD), loss given default (LGD) and exposure at default (EAD) parameters used in the expected credit loss (ECL) calculation. The new model has been developed for allocation of unimpaired assets to the so-called Stages, at the transaction level, between Stage 1 and Stage 2.

The main difference between the two Stages refers to the time horizon for which the expected credit loss is expected to be calculated. In fact, for Stage 1 transactions a one-year expected credit loss is applied, while a "lifetime" expected credit loss applies to Stage 2 transactions.

The basic adjustments made to the credit parameters are the following:

- Inclusion of the "point-in-time" approach in the parameters' calculation, instead of the "through-the-cycle" adjustment (TTC),
- Inclusion of forward-looking information (FLI), and
- credit parameters calculation considering the period of assets' duration.

As for what concerns the lifetime PDs, the TTC PD curves, obtained by fitting the observed cumulative default rates, PDs have been further calibrated to reflect a point in time and forward-looking expectation about the portfolio default rates.

Recovery rate embedded in the TTC LGD has been adjusted to reflect the most recent recovery rate trend as well as expectation about a future trend and discounted at the effective interest rate or its best approximation.

The lifetime EAD has been obtained by extending the 1Y managerial model, including expectation about future drawing levels.

The expected credit loss derived from such adjusted parameters takes into consideration macroeconomic forecasts applying multiple scenarios so to offset the partial non linearity naturally embedded in the correlation between macroeconomic changes and the key components of expected loss. In this sense the Group has developed a so called "overlay factor" that should be directly applied on expected loss. The same scenario is used by the Group in other risk relevant processes (EBA stress test and ICAAP). In those processes the Bank provides the necessary information in the required scope and regulated format.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.7. Impairment (CONTINUED)

**c) Definition of default**

The default definition is key for determining expected credit losses. The definition of default is used to measure the amount of expected credit losses and to determine whether the loss is based on a 12-month or a lifetime expected credit loss.

All exposures classified as default exposures are regarded as having objective evidence of impairment. According to the Basel III Standard, exposures are in the default status when they are over 90 days past due in liability settlement and/or the customer is unable to settle at least one of its credit liabilities in full without the Bank resorting to the collection measures.

For legal entities and private individuals' exposures, the Bank determines the default status at the debtor level taking into account all the debtor's exposures. Counting of the number of days past due in liability settlement commences when liabilities matured at the individual borrower level exceed the materiality threshold defined. Materiality threshold for legal entities equals the liabilities matured in the amount of 1% of the total exposure of the customer and BAM 1,000. Materiality threshold for individuals equals the liabilities matured in the amount of 1% of the total exposure of the customer and BAM 200.

**d) Significant credit risk increase**

The Bank monitors all financial assets subject to impairment request to estimate whether there has been a significant increase in credit risk from initial recognition. If there is a significant increase in credit risk, the Bank measures the loss based on a lifetime rather than a 12-month expected credit loss.

hen assessing whether a credit risk on a financial instrument has significantly increased since its initial recognition, the Bank compares the risk of default arising on the financial instrument at the reporting date based on the remaining maturity of the instrument, with the risk of default foreseen for the remaining maturity as of the reporting date when the financial instrument was recognized for the first time. In making this assessment, the Bank also considers quantitative and qualitative information that is reasonable and evident, including historical experience and forward-looking information, available without undue expense or effort, based on the Bank's historical experience and expert credit assessments, including FLI.

**e) Purchased or originated credit impaired assets – (POCI)**

POCI financial asset is a financial asset that is credit impaired upon origination. The Standard defines the special rules for these items in terms of their valuation rules, recognition of loss provisions, recognition of interest income and the application of discount rates.

POCI assets include:

- Loans and debt securities purchased when they were already of impaired credit value larger than 5% of its net accounting value, unless the seller is selling financial assets that are not connected with credit risk,
- Purchased financial assets or refinanced exposure (partial or full) that was classified as credit risk Stage 3 in a different bank,
- Loans disbursed to customers with already impaired credit value. Additionally, new financing is significant in relation to the total customer exposure.
- Exposures that are classified as credit risk Stage 3, and for which a significant modification has been performed in accordance with Manual for classification and recognition of financial assets.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.7. Impairment (CONTINUED)

**e) Purchased or originated credit impaired assets – (POCI) (continued)**

Regarding the determination of new significant financing, the relative and absolute thresholds are applied. New financing is significant if the following criteria are met: it is at least 20% of total exposure in default of the borrower's liabilities or ≥ BAM 100.000.

While determining POCI status of assets, the Bank is obliged to consider exposure on a single exposure level, not on client level. The Bank determines expected credit loss for POCI assets on an individual basis.

**f) Write-offs**

The Bank performs write-offs of bad exposures when the exposure is entirely due and when expected credit loss has been classified as 100% of gross accounting value. The Bank defines two types of write-offs: accounting and permanent write-off.

***Accounting write-off*** is transfer of balance sheet exposure to off-balance, during which the Bank keeps the right to perform measures of payment collection from debtors. The Bank performs accounting write-offs of balance sheet exposures that is in non-performing status i.e. bad exposures classified as credit risk Stage 3, two years after the last of the two events; expected loss has been booked at 100% of gross accounting value and the exposure was classified as entirely due.

***Debt acquittal*** is write-off of balance sheet exposure that leads to termination of recognition of entire exposure or its part in general ledger of the Bank (balance and off balance). In case there is any kind of sign that a certain amount will be collected from the client, the Bank will not perform permanent write-off of exposure. Permanent write-off is performed only in case when the Bank has written the exposure off and has informed the client of it. In this case the Bank no longer has the right to oblige the debtor to repay his obligation.

**g) Derecognition of financial assets**

In the event of significant changes to the terms and conditions, the Bank ceases to recognize financial assets such as a credit to a client when the contractual terms have been changed to such extent that the contract becomes a new loan, where the difference is recognized in the gain or loss of derecognition but to the extent that impairment losses have not already been recorded. The newly recognized credit is classified as Stage 1 for ECL measurement purposes, unless new credit is POCI.

When assessing the derecognition of a loan to a client, the Bank shall, inter alia, consider the following factors: change in the currency of the loan, introduction of equity interest provisions, change of the other contracting party, or in the event that the amendment results in the instrument no longer meeting the SPPI test criteria. If the change in the terms does not lead to a change in cash flows, the derecognition will not take place. Based on the change in cash flows discounted by the original EIR, the Bank records the gain or loss on the change, to the extent that the impairment loss is not already recorded.

In the event that there are no significant changes to the terms Financial asset (or its part or part of a group of similar financial assets) is derecognized when the right to receive cash flows from the financial asset expires or when virtually all of the risks and rewards associated with the ownership or control over property were transferred.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.8. Presentation of Expected Credit Losses in the Statement of Financial Position

Expected credit losses are presented in the statement of financial position as follows:

- For financial assets measured at amortized cost: impairment allowance or impairment, as deduction from the gross carrying value of the asset;
- For debt instruments measured at fair value through other comprehensive income: not recognized as impairment, but as item of fair value reserves within equity,
- For liabilities under undrawn loans and contracts on financial sureties (guaranties, letters of credit and other guarantees): as provisions for risks and expenses within liabilities.

## 2.9. Regulatory Requirements Related to Impairment

In accordance with the local regulations, the Bank calculates provisions for credit risks according to the Banking Agency of the Republic of Srpska ("BARS") regulations. Loans, receivables and other exposure of the Bank are classified into categories prescribed by BARS depending on the expected recoverability determined based on the number of days past due, an assessment of the debtor's financial position and the quality of the collateral. The assessed amount of specific provisions for potential losses (regulatory reserve for credit losses) is calculated by applying percentages prescribed by BARS.

The percentages are prescribed depending on the category of financial assets as follows:

- Category A – Good assets 2%
- Category B – Special watch assets 5% -15%
- Category C – Substandard assets 16% - 40%
- Category D – Bad assets 41%- 60%
- Category E – Loss 100%

If general and special regulatory provisions for potential losses calculated in compliance with BARS regulations are higher than impairment allowances and provisions calculated in compliance with IFRS requirements and the opening balance of the regulatory reserves, such difference represents shortfall regulatory reserves for credit losses.

When calculating the regulatory capital, the amount of the shortfall reserves for credit losses under regulatory requirements and classification criteria represents a deductible item, i.e., it is subject to regulatory adjustments.

## 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

### 2.9. Regulatory Requirements Related to Impairment (CONTINUED)

The following table summarizes impairment and provisions in accordance with IFRS 9, IAS 39 and BARS regulations:

| | IFRS 9<br>December 31, 2019<br>BAM '000 | IAS 39<br>December 31, 2018<br>BAM '000 |
|---|---|---|
| *Impairment* | | |
| **1. Cash and cash equivalents** | - | - |
| **2. Financial assets at amortized cost** | **35,601** | **74,796** |
| a) Obligatory reserve held with the Central Bank | 468 | 1,304 |
| b) Loans and receivables due from banks | 134 | 165 |
| c) Loans and receivables due from customers | 34,999 | 73,327 |
| **3. Other assets** | **1,022** | **1,436** |
| **4. Provisions for credit risk on commitments and financial guarantees given** | **2,959** | **1,032** |
| **TOTAL (1+2+3+4)** | **39,582** | **77,264** |

In 2019 the Bank has performed accounting write-off of credit exposures by transferring the exposures from balance sheet to off balance, in total amount of BAM 32,064 thousand and permanent write-off because of inability to collect payment in amount of BAM 8,435 thousand, out of which BAM 7,267 thousand has been written off in the second quarter of 2019 during the NPE portfolio sale, and the remaining BAM 1,168 thousand during the rest of the year.

| | BARS<br>December 31, 2019<br>BAM '000 | BARS<br>December 31, 2018<br>BAM '000 |
|---|---|---|
| *Impairment* | | |
| Loans and receivables due from banks | 404 | 13 |
| Loans and receivables due from customers | 62,683 | 71,654 |
| Other assets | 4,147 | 5,593 |
| Provision for undrawn loans and guarantees | 4,329 | 4,575 |
| **TOTAL** | **71,563** | **81,835** |

Lesser amount of BARS provisions as at end of 2019 compared to end of 2018 is also a consequence of permanent write-offs in amount of BAM 8,435 thousand, while the accounting write-offs will be implemented on January 1, 2020 according to BARS regulations.

Shortfall regulatory reserves for credit losses:

| | December 31, 2019<br>BAM '000 | December 31, 2018<br>BAM '000 |
|---|---|---|
| Impairment and provisions according to BARS | 71,563 | 81,835 |
| Impairment and provisions according to IFRS 9 | (39,582) | (77,264) |
| Accounting write off according to IFRS 9 | (32,064) | - |
| Regulatory reserves | - | (3,604) |
| | | |
| **Shortfall regulatory reserves** | **(83)** | **967** |

In accordance with BARS regulation, and based on decision of the Bank's Management Board that was put into force in April 2019, regulatory reserves in the amount of BAM 3,604 thousand have been transferred to equity reserves that are included in the Bank's equity instruments.

# 2. BASIS OF THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

## 2.10. Comparative Financial Information

In order to achieve consistency of presentation in the current reporting period in accordance with IFRS 9, certain reclassifications of items were made as at December 31, 2018, which had no impact on the Bank's financial performance and capital:

Statement of financial position:

- within deposits, deposits of BAM 648 thousand, which were recorded on transit accounts as of December 31, 2018 were not shown separately for corporate and retail clients, which was adjusted in 2019 (Note 26).
- In the statement of cash flows for Interest-bearing and non-Interest-bearing liabilities (Note 34.3.2.a), the maturity structure as of December 31, 2018 was changed in line with the Bank's new monitoring methodology during 2019 .

# 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies described hereunder have been consistently applied to all the years included in these financial statements.

## 3.1. Interest Income and Expenses

Interest income represents the accrued interest whose base for calculation is the facility expressed in the balance sheet assets. Interest income can also be negative in the case that the Bank pays interest on facility given to the other party, and then it is recognized as interest expense. Interest expenses represent the accrued interest whose base for calculation of liabilities is expressed in balance sheet liabilities. Interest expense can also be positive in the case that the other party pays the Bank interest on the given deposit, and then it is recognized as interest income.

Interest income is recognized in the profit and loss depending on the fact whether the calculation of interest is performed on performing exposures – credit risk stage 1 and 2 (PE), or on non-performing exposures – credit risk stage 3 (NPE). Recognition of interest income in the profit and loss is performed using the effective interest rate. The effective interest rate is the rate, by which the net present value of the future expected net inflows/ outflows is equalized with the net carrying amount of financial assets/liabilities. Net book value of financial assets/liabilities is equal to the amount of inflows / outflows based on financial assets/liabilities, decreased by all fees and inflows / outflows on the basis of the asset/liabilities.

One-time collected/paid fees on the occasion of approval /taking of loans, i.e. issuance of securities are considered as interest income/expense and are recognized in Profit and Loss Account on the time basis in the period of loan collection/repayment.

Matured and not matured yet uncollected interest on performing exposures is also subject to provisioning (impairment allowance) with provisions accrued in the same way as for the principal, to which the interest receivables are related.

For non-performing exposures the Bank will:

- suspend matured yet uncollected interest

- further calculation after interest suspension continues and is booked within off-balance sheet items, and

- interest income is recognized in the profit or loss statement upon collection.

Interest income and expenses recognized and stated in the statement of profit or loss include:

- Interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest method, and
- Interest on financial assets at fair value through other comprehensive income calculated using the effective interest method.

## 3.2. Fee and Commission Income and Expenses

Fees and commissions, which are constituent part of the effective interest rate applicable to financial assets and financial liabilities, are included in interest income and expenses.

Other fee and commission income, which mainly comprise fees related to credit card transactions, guarantees, loans, domestic and foreign payment transactions and other services and are recognized in the statement of profit or loss upon performance of the relevant service. Other fee and commission expenses, primarily service and transaction fees are recognized as expenses upon receipt of the service.

# 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 3.3. Net Trading Gains and Losses and Foreign Exchange Gains and Losses on Translation of Monetary Assets and Liabilities

Net trading gains and losses and foreign exchange gains and losses arising on translation of monetary assets and liabilities include unrealized and realized trading and net foreign exchange (FX) gains and losses on derivative financial instruments, and gains and losses arising on translation of monetary assets and liabilities.

## 3.4. Foreign Currencies

Transactions in foreign currencies are translated into BAM at the exchange rate prevailing at the date of each transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into BAM at the foreign exchange rate effective at that date. Foreign exchange differences arising on translation are recognized in the statement of profit and loss, except in the case of FX gains and losses arising on non-monetary financial assets at fair value through other comprehensive income, which are recognized within equity. Non-monetary assets and liabilities denominated in foreign currencies measured at amortized cost are translated into BAM using the exchange rate effective at the date of the transaction and are not retranslated at the reporting date.

## 3.5. Specific Instruments

*Cash and Cash Equivalents*

Cash and cash equivalents include: cash, cheques in the process of collection and cash deposited on the account with the Central Bank in excess of the amount of the obligatory reserve.

*Financial Guarantees and Loan Commitments*

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are initially recognized at their fair value, which is amortized over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of its amortized amount and the present value of any expected payment (when a payment under the guarantee has become probable).

Loan commitments are firm commitments to approve loans under pre-specified terms and conditions.

## 3.6. Tangible Assets

Tangible assets recognized according to IAS 16 – „Property, Plant and Equipment“, include the following items:

- land;
- buildings;
- furniture and fixtures;
- plant and machinery;
- other machinery and equipment.

# 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 3.6. Tangible Assets (CONTINUED)

Tangible assets are classified in the following categories:

- tangible assets used for the Bank's own business activities;
- tangible assets held as investment – for earning rental income (investment property);
- inventories in the scope of IAS 2, which include tangible assets acquired in collateral foreclosure.

*Tangible assets used for own business purposes*

Tangible assets used for own business purposes are held for use in production or supply of goods or services or for administrative purposes and are expected to be used longer than one year. This category also includes tangible assets that are leased or are in the process of construction and is leased under finance lease arrangements.

The item of property, plant and equipment includes assets that the Bank uses as a lessee in a lease contract (right of use), or leases out under operating lease, as well as leasehold improvements connected with assets that can be individually identified. Leasehold improvements are usually performed in order to adjust the leased space to the expected use.

Improvements and additional expenses relating to the property, plant and equipment that can be identified, but are not separable, are recognized within the line item of other assets.

Assets held as investment property are covered by IAS 40, i.e., those are held to earn rental income and / or for capital appreciation.

Property, plant and equipment are initially recognized at cost including all costs directly attributable to bringing the asset into use (transaction costs, professional fees, direct transport costs incurred in bringing the asset to the desired location, installation costs and dismantling costs).

Subsequent expenditures are added to the carrying amount or recognized as a separate asset only when it is probable that there will be future economic benefits in excess of those initially foreseen and the cost can be reliably measured. Other expenses borne at a later time (e.g. normal maintenance costs) are recognized as incurred within the profit and loss items:

- other administrative expenses, if they refer to assets used for own business; or
- other operating income/expenses, if they refer to property held as investment.

After initial recognition, tangible assets are measured as follows:

- buildings and land used for the Bank's own business are measured using the revaluation model;
- tangible assets used in business, other than buildings and land, are measured using the cost model;
- buildings and land held as investment are measured at fair value.

The revaluation model requires that tangible assets are stated in the balance sheet at a value that is not significantly different from the fair value. Revaluation is performed by independent external appraisers via a "desktop" or an "on-site" assessment, based on asset relevance.

Positive changes in the fair value are recognized within the other comprehensive income, under the item of tangible assets, and are accumulated within the revaluation reserves unless the said changes offset previous negative changes recognized in the profit and loss under item of other operative income and expenses.

Negative changes in the fair value are recognized under other operating income and expenses, unless they offset the previous positive changes recognized in the other comprehensive income, under the item tangible assets and accumulated within the revaluation reserves.

# 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 3.6. Tangible Assets (CONTINUED)

The cost model requires that the gross carrying value be amortized through the asset's lifetime.

Tangible assets measured using both the revaluation model and the cost model are subject to straight-line depreciation during their useful lives for those if they have definite lifetimes.

Depreciation rates used for property and equipment are set out below:

| | 2019 | 2018 |
|---|---|---|
| Buildings | 2.0% - 5.0% | 2.0% - 5.0% |
| Electronic systems | 12.5% - 25.0% | 12.5% - 25.0% |
| Office furniture and equipment | 12.5% - 20.0% | 12.5% - 20.0% |
| Other | 12.5% - 25.0% | 12.5% - 25.0% |
| Leasehold improvements | 20.0% | 20.0% |

Depreciation is calculated monthly and is recognized under the line item of tangible assets' depreciation charge.

Items with indefinite useful lives are not depreciated.

Land and buildings are recognized separately, even if acquired together. Land is not depreciated since it usually has an indefinite useful life. Buildings have a finite useful life and are therefore subject to depreciation.

The estimate of the useful life of an asset is reviewed at least at each accounting period-end based, inter alia, the terms of the asset's use, maintenance conditions and expected obsolescence, and, if expectations differ from the previous estimates, the depreciation amount for the current and subsequent financial years is adjusted accordingly.

If there is clear evidence that an asset measured according to the cost model has been impaired, the carrying amount of the asset is compared to its recoverable value, which is equal to the greater of its fair value less costs to sell and its value in use, i.e., the present value of the future cash flows expected to be generated from the asset. Any value adjustment is recognized in the profit and loss item of the net value write-down of the property, plant and equipment.

If the value of a previously impaired asset is recovered, its increased carrying amount cannot exceed the net carrying amount it would have had if no impairment losses had been recognized in the previous period.

# 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 3.6. Tangible Assets (CONTINUED)

***Change of the model for measurement of tangible assets: property used for the Bank's own business and investment property***

Based on the foregoing, for the purposes of preparing the financial statements at December 31, 2019, the Group has decided to change the model of measurement of the following tangible assets:

- properties used for the Bank's own business purposes (in line with IAS 16 "Property, Plant and Equipment") providing for transition from the cost model to the revaluation model for the measurement subsequent to initial recognition;
- properties held as investment (ruled by IAS 40 "Investment property") providing for the transition from the cost model to the fair value model.

The change in the measurement model for properties ensures both a higher alignment of the financial information with the strategies of the property management and a more reliable, relevant and direct representation of the economic substance, and the related accounting impacts on the activities that will be taken.

The representation of voluntary changes in accounting principles (accounting policies) is regulated by IAS 8 which establishes, as a general rule, that these changes have to be represented retrospectively starting from the most remote date when this is feasible. This means that, based on the general principle, at the date of the change introduction, the opening balances of the comparative year and the data for that year shown in the financial statements and in the notes must be restated.

However, this general rule allows for exceptions. More precisely, under IAS 8.17, a change in measurement of the property, plant and equipment, i.e., the transition from the cost model to the revaluation model is considered an accounting policy change that should be treated as normal continued revaluation in line with IAS 16. As a result, the revaluation model has been applied prospectively and not retrospectively as required by the general principle stipulated by IAS 8, without making any adjustment of the opening balances of the comparative year and of the comparative data, or of the interim financial statements prior to the date of the change.

Consequently, for the properties used for the Bank's own business activities, which are in the scope of IAS 16, the transition from the cost model measurement to the measurements at the current revalued amounts at requires determination of the related fair value at December 31, 2019.

The differences between this value and the previous value determined by applying the "cost" model are recognized:

- if negative, in the income statement,
- if positive, in the other comprehensive income statement, and accumulated in equity under the item of revaluation reserves, unless impairment was accounted for on that asset; in this case, the positive differences between fair value and book value are recognized in the income statement.

As the change in the property measurement model took place at the end of the year, the calculation of the depreciation for FY 2019 was made using the previously applied cost model.

From 2020 onward, properties used for the Bank's own business, measured according to IAS 16 revaluation model, will continue to be depreciated over their useful life.

**Effects resulting from the change in the valuation model for tangible assets**

In the financial statements as at December 31, 2019, the change in the valuation model of the properties resulted in an overall positive balance sheet effect of BAM 2,628 thousand as detailed below:

- revaluation reserves in equity in the amount of BAM 2,635 thousand and
- deferred tax liabilities in the amount of 263 thousand.

# 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

## 3.6. Tangible Assets (CONTINUED)

**Change of the model for measurement of tangible assets: property used for the Bank's own business and investment property (Continued)**

In accordance with regulations of the regulators of the Republic of Srpska banking sector, revaluation reserves from changes in the value of tangible assets cannot be included into the calculation of the regulatory capital.

Beside the positive effect of change in the value, in the profit or loss statement for 2019, the Bank recognized negative effects in the amount of BAM 53 thousand, which cannot be included in the tax statement, so that the total negative effect presented in the profit or loss amounted to BAM 58 thousand.

**Tangible assets used as investment (Investment property)**

Buildings and land held as investments, including the right of use over land and buildings classified as investment property, are measured using the fair value model. Such assets are not subject to depreciation and impairment test.

The Bank had no investment property as at December 31, 2019.

**Inventories in the scope of IAS 2**

Inventories are assets held for sale in the ordinary course of business. They are accounted for at the lower of their carrying amounts and net realizable value. Any value adjustment arising from the application of the aforementioned criterion is recognized under item of the net value write-down of the property, plant and equipment.

**Derecognition**

Items of property, plant and equipment are derecognized in case of disposal or when no future economic benefits are expected from an asset's use or future sale, while any difference between the sale proceeds or the recoverable amount and its carrying value is recognized within gains/(losses) on tangible assets.

For tangible assets measured at revalued amounts, any gain on the sale, including the amounts accumulated in the revaluation reserves, is reclassified to the equity reserves, with no impact on the profit and loss.

## 3.7. Tangible Assets Acquired by Collateral Foreclosure

Tangible assets acquired by collateral foreclosure (property and equipment) in order to prevent losses from the crediting operations are recognized on the date of transfer of ownership of the property or the date of acquisition of control over the equipment, at the lower of the following two values:

- the net carrying value of receivables secured by collateral, or
- the amount of settlement of the claims specified in the court decision, under which the collateral is being taken over.

## 3.8. Intangible Assets

Intangible assets are measured at cost less accumulated amortization and impairment. Cost includes all costs directly attributable to the acquisition of the assets.

Intangible assets, with the exception of intangible assets in progress, are amortized on a straight-line basis over their estimated useful lives. Useful life is reviewed and adjusted, if necessary, at each reporting date.

Amortization rates used for intangible assets are set out below:

| | 2019 | 2018 |
|---|---|---|
| Intangible assets – software and licenses | 20.0%-25.0% | 20.0%-25.0% |

# 4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

## 4.1. Provisions for Risks and Expenses

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made for unidentified losses on off-balance-sheet credit risk exposures in accordance with regulations.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of future losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of different transactions, as well as other relevant facts. Provisions are released only for such expenditure in respect of which provisions were recognized at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

## 4.2. Equity

***Share capital*** comprises common stock (ordinary) shares and is stated in BAM at nominal value.

***Reserves from profit*** were formed through the distribution of the net profits from prior years. According to the Companies Act, upon distribution of profit as per the annual accounts, shareholding companies in the Republic of Srpska are required to allocate minimum 5% of their annual profit to reserves from profit until the amount of such reserves reaches the level of 10% of the company's shareholding capital.

***Share premium*** represents the accumulated positive difference between the nominal value of the issued shares and the paid-in amount.

***Fair value reserves*** generated based on the fair value calculation include changes in fair value and reserves for credit risks of financial assets at fair value through other comprehensive income, net of deferred tax.

***Dividends*** on ordinary shares are recognized as a liability in the period in which they are approved by the Bank's shareholders.

***Retained earnings*** or accumulated profit include retained and unallocated earnings that can be distributed in the ensuing period.

## 4.3. Commitments and Contingent Liabilities

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

## 4.4. Managed Funds for and on Behalf of Third Parties (Consignment)

The Bank manages funds for and on behalf of third parties. These funds do not constitute part of the Bank's assets, and, therefore, they are excluded from the statement of financial position. The Bank receives fee income for providing these services and does not bear any credit risk.

# 4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

## 4.5. Segment Reporting

An operating segment represents portion of assets, liabilities and business activities (products and services) subject to risks and benefits different from those in other operating segments. A geographic segment generates products or services within a specific economic environment that are subject to risks and benefits different from those operating in other economic environments.

The Bank has identified three main segments: Corporate and Investment Banking, Retail and Other.

Basic information per segment is based on the internal reporting structure of operating segments. Segment results are measured by applying an internal funding price (Note 5).

## 4.6. Employee Benefits

*Employee Salaries*

Gross salary costs are recorded in the statement of profit or loss in the period when incurred. Gross salaries include net employee salaries/wages, personal income tax and payroll, i.e., social insurance contributions calculated as the prescribed percentage rates applicable to the gross salary amount. The aforesaid contributions are paid by the Bank to the mandatory social insurance funds.

Employee commuting allowances, meal allowances, annual leave allowance and other benefits to employees are paid in accordance with the local legislation. These costs are recognized in the statement of profit or loss in the period when incurred.

*Jubilee Awards*

The Bank pays out jubilee awards to its employees in accordance with the regulations of the Republic of Srpska. Jubilee awards are paid out in the amount of one average salary paid by the Bank in the month preceding the payment for the completion of 20 years of service, or two average salaries paid by the Bank for the completion of 30 years of service with the Bank.

*Retirement Benefits*

In accordance with internal regulations on salaries, the Bank pays retirement benefits to employees upon retirement in the amount of three average monthly net salaries of the vesting employee. Calculation of long-term provisions for employee retirement benefits is performed annually by a certified actuary using the projected unit credit method. The projected unit credit method takes into consideration each year of service with the Bank, where the sum of all the particular units is the final liability which is measured individually for each unit. Liabilities are measured at present values of estimated future cash flows discounted at an econometrically modelled interest rate, which is more adequate in the existing market conditions than the interest rate on Government long-term debt securities.

## 4.7. Dividend Income

Dividend income is recognized in the statement of profit or loss when the Bank's right to receive dividends has been established.

## 4.8. Earnings per Share

Earnings per share are calculated by dividing the profit or loss and other comprehensive income for the current period by the weighted average number of ordinary shares outstanding during the period.

# 4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

## 4.9. Leases

Leases where the Bank as a lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. At the reporting date, the Bank had no finance leases. All other leases are classified as operating leases. Payments made under operating leases are recognized in the statement of profit or loss on a straight-line basis over the lease term.

As noted in the section "*Initial implementation of new and amendment to existing standards that came into effect*", effective from January 1. 2019, lease payments will only be recognized for short-term leases and leases of small value, while the leases with terms of over one year and with underlying assets of higher value will be recognized as tangible assets.

## 4.10. Income Tax

Income tax is based on the taxable profit for the year and comprises current and deferred taxes.

*Current Income Tax*

Current income tax is the amount calculated by applying the prescribed tax rate of 10% to the taxable income determined in the income tax return, which represents the amount of the profit before tax adjusted for the effects of income and expense adjustments and any adjustments to the tax payable for prior years, in accordance with the tax legislation of the Republic of Srpska.

*Deferred Tax*

Deferred tax is recognized taking into account the temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and the amounts used for tax calculation purposes. Deferred taxes are not recognized on temporary differences at initial recognition of assets and liabilities in a transaction other than a business combination and which does not affect accounting or taxable profit. The amount of deferred tax asset or liability is recognized using the tax rate that is expected to be applied to taxable profit for the period in which realization or settlement of the carrying values of the assets or liabilities is expected, based on the tax rates applicable at the reporting date.

Measurement of deferred tax liabilities and assets reflects the tax effects that would result from the manner in which the Bank expects, at the reporting date, to recover or settle the net carrying values of these assets and liabilities.

Deferred tax assets and liabilities are offset only if they relate to the same tax jurisdiction and if there is a legal right to offset current tax assets and liabilities. 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 assets are recognized only to the extent that it is probable that they could be utilized as tax relief. At each reporting date, the Bank reassesses unrecognized contingent deferred tax assets and tests the carrying values of the recognized deferred tax assets for impairment and is reduced to the extent that it is no more likely that the recognized tax assets can be utilized.

## 4.11. Regulatory Requirements

The Banking Agency of the Republic of Srpska (BARS) is authorized to perform regulatory inspection of the Banks' operations and can request adjustments to the carrying values of assets and liabilities in accordance with the relevant regulations.

During 2018 and 2019, BARS adopted a new Law on Banks and a series of bylaws aimed to harmonize the regulatory framework for banking operations in the Republic of Srpska with the regulatory framework of the European Union.

# 4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

## 4.12. Litigations

The Bank performs an individual assessment of all court cases and makes provisions according to the assessment. The assessment is performed by a special Commission of three members, two of whom are employees of the Bank's Legal Affairs, and one is from the Human Resources. Heads of the Legal Affairs, Human Resources, Accounting and Reporting and Payment Systems and Account Administration verify proposals for provisions after the assessment, and the decision on creating the provisions is made by the Bank's Management Board.

At the reporting date, there were 45 legal suits instigated against the Bank, 22 of which included damage claims filed. According to the Decision of the Bank's Management Board, at the proposal of the Commission for risk assessment of liabilities for litigations against the Bank, for the suits that the Bank believes could be lost or significant costs may be incurred thereon, provisions were formed in the total amount of BAM 1,857 thousand, of which BAM 1,811 thousand relates to provisions for other legal suits and BAM 46 thousand relates to old savings in foreign values (2018: BAM 2,037 thousand for other legal suits) (Notes 15 and 29).

# 5. SEGMENT REPORTING

Segments recognized for the purposes of segment reporting in accordance with UniCredit Group methodology comprise the following:
1. “Retail”: private individuals, entrepreneurs, micro and small companies;
2. “Corporate and Investment Banking” (CIB): large and medium-sized companies and public sector;
3. “Other”: capital and reserves, Assets and Liability Management, other centralized services and other assets and liabilities not associated with other segments.

Segment reports were prepared in accordance with internal Bank’s management reports and additionally reconciled with the financial statements within these notes.

When measuring operating results, internal funding prices are applied based on specific prices of products and services reflecting currencies and maturities in accordance with the methodology of the Group.

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

Statement of profit or loss and other comprehensive income by segment

| Year Ended December 31, 2019 | Corporate and Investment Banking BAM ‘000 | Retail BAM ‘000 | Other BAM ‘000 | Total by segment reports BAM ‘000 | Adjustments BAM ‘000 | Total by financial statements BAM ‘000 |
|---|---|---|---|---|---|---|
| **Net interest income** | **17,650** | **27,597** | **3,476** | **48,723** | **-** | **48,723** |
| **Net fee and commission income** | **4,501** | **12,437** | **(534)** | **16,404** | **-** | **16,404** |
| Dividend and profit sharing income | - | - | 10 | 10 | - | 10 |
| Net foreign gains/losses on translation of monetary assets and liabilities | 998 | 645 | - | 1,643 | - | 1,643 |
| Gains on investments | - | - | - | - | - | - |
| **Total operating income** | **23,149** | **40,679** | **2,952** | **66,780** | **-** | **66,780** |
| Personnel expenses | (1,258) | (6,702) | (9,249) | (17,209) | - | **(17,209)** |
| Tangible assets amortization costs | (173) | (1,429) | (677) | (2,279) | - | **(2,279)** |
| Intangible assets amortization costs | (93) | (700) | (554) | (1,347) | - | **(1,347)** |
| Other administrative expenses | (1,180) | (5,532) | (3,689) | (10,401) | (1,859) | **(12,260)** |
| Indirect and other allocated expenses | (3,988) | (9,510) | 13,498 | - | - | **-** |
| **Total operating expenses** | **(6,692)** | **(23,873)** | **(671)** | **(31,236)** | **(1,859)** | **(33,095)** |
| **Profit before impairment and provisions** | **16,457** | **16,806** | **2,281** | **35,544** | **(1,859)** | **33,685** |
| **Net loan impairment losses/recoveries** | **(2,784)** | **(1,844)** | **868** | **(3,760)** | **2,900** | **(860)** |
| a) Financial assets at amortized cost | (2,784) | (1,844) | 868 | (3,760) | 1,927 | **(1,833)** |
| b) Financial assets at fair value through other comprehensive income | - | - | - | - | 973 | **973** |
| **Provisions for risks and expenses** | **(978)** | **(1,017)** | **31** | **(1,964)** | **67** | **(1,897)** |
| a) Provisions for credit risk on commitments and financial guarantees given | (993) | (1,032) | 31 | (1,994) | 67 | **(1,927)** |
| b) Provisions for retirement benefits | 15 | 15 | - | 30 | - | **30** |
| c) Provisions for litigations | - | - | - | - | - | - |
| Other operating income and expenses | 847 | 457 | 144 | 1,448 | (134) | **1,314** |
| Gains/losses on the sales of tangible assets | 926 | 172 | 5 | 1,103 | (973) | **130** |
| **Profit before tax** | **14,468** | **14,574** | **3,329** | **32,371** | **1** | **32,372** |
| Income tax expense | (1,248) | (1,257) | (286) | (2,791) | - | **(2,791)** |
| **Profit for the year** | **13,220** | **13,317** | **3,043** | **29,580** | **1** | **29,581** |
| **Statement of other comprehensive income** | | | | | | |
| **Profit for the year** | **13,220** | **13,317** | **3,043** | **29,580** | **1** | **29,581** |
| **Other comprehensive income, net of income taxes** | **-** | **-** | **-** | **-** | - | **-** |
| Items that can be subsequently reclassified to gains or losses: | - | - | - | - | - | - |
| - (Losses)/gains on financial assets at fair value through other comprehensive income | **-** | - | 2,092 | 2,092 | - | 2,092 |
| **Total comprehensive income for the year** | **13,220** | **13,317** | **5,135** | **31,672** | 1 | **31,673** |

## 5. SEGMENT REPORTING (CONTINUED)

*Statement of profit or loss and other comprehensive income by segment (Continued)*

| Year Ended December 31,2018 | Corporate and Investment Banking BAM '000 | Retail BAM '000 | Other BAM '000 | Total by segment reports BAM '000 | Adjustments BAM '000 | Total by financial statements BAM '000 |
|---|---|---|---|---|---|---|
| **Net interest income** | **21,359** | **27,580** | **2,604** | **51,543** | - | **51,543** |
| **Net fee and commission income** | 3,858 | 12,274 | (506) | 15,626 | - | 15,626 |
| Dividend and profit sharing income | - | - | 10 | 10 | - | 10 |
| Net foreign gains/losses on translation of monetary assets and liabilities | 1,080 | 663 | - | 1,743 | - | 1,743 |
| Gains on investments | - | - | - | - | - | - |
| **Total operating income** | **26,297** | **40,517** | **2,108** | **68,922** | **-** | **68,922** |
| Personnel expenses | (1,145) | (6,415) | (9,187) | (16,747) | - | (16,747) |
| Tangible assets amortization costs | (119) | (870) | (606) | (1,595) | - | (1,595) |
| Intangible assets amortization costs | (62) | (434) | (383) | (879) | - | (879) |
| Other administrative expenses | (1,299) | (5,988) | (4,056) | (11,343) | (1,641) | (12,984) |
| Indirect and other allocated expenses | (3,236) | (10,320) | 13,556 | - | - | - |
| **Total operating expenses** | **(5,861)** | **(24,027)** | **(676)** | **(30,564)** | **(1,641)** | **(32,205)** |
| **Profit before impairment and provisions** | **20,436** | **16,490** | **1,432** | **38,358** | **(1,641)** | **36,717** |
| **Net loan impairment losses/recoveries** | **(1,113)** | **(3,488)** | **(607)** | **(5,208)** | **(589)** | **(5,797)** |
| a) Financial assets at amortized cost | (1,113) | (3,488) | (607) | (5,208) | 506 | (4,702) |
| b) Financial assets at fair value through other comprehensive income | - | - | - | - | (1,095) | (1,095) |
| **Provisions for risks and expenses** | **(1,158)** | **(979)** | **21** | **(2,116)** | **1,242** | **(874)** |
| a) Provisions for credit risk on commitments and financial guarantees given | (681) | (576) | 12 | (1,245) | 731 | (514) |
| b) Provisions for retirement benefits | 13 | 11 | - | 24 | (14) | 10 |
| c) Provisions for litigations | (490) | (414) | 9 | (895) | 525 | (370) |
| Other operating income and expenses | - | - | (90) | (90) | (104) | (194) |
| Gains/losses on the sales of tangible assets | (744) | 102 | 61 | (581) | 1,094 | 513 |
| **Profit before tax** | **17,421** | **12,125** | **817** | **30,363** | **2** | **30,365** |
| Income tax expense | (1,488) | (1,036) | (70) | (2,594) | - | (2,594) |
| **Profit for the year** | **15,933** | **11,089** | **747** | **27,769** | **2** | **27,771** |
| **Statement of other comprehensive income** | | | | | | |
| **Profit for the year** | **15,933** | **11,089** | **747** | **27,769** | **2** | **27,771** |
| **Other comprehensive income, net of income taxes** | | | | | | |
| Items that can be subsequently reclassified to gains or losses: | | | | | | |
| - (Losses)/gains on financial assets at fair value through other comprehensive income | **-** | **-** | **650** | **650** | - | **650** |
| **Total comprehensive income for the year** | **15,933** | **11,089** | **1,397** | **28,419** | **2** | **28,421** |

Income and results per segment presented in the tables above (for the years ended December 31st, 2019 and 2018) represent income generated from products sold and services rendered to customers within these segments.

Accounting policies of the reporting segments are identical to the Bank's accounting policies described in Note 3. Segment profit represents the profit of each segment with included all allocated costs and revenues. The aforesaid is the criterion used for reporting to the managers in charge of key decision making for the purpose of allocating adequate resources to the segments and analysis of their results.

The Bank's revenues from its core services are disclosed in detail in Notes 6 and 8 to the financial statements.

# 5. SEGMENT REPORTING (CONTINUED)

*Statement of financial position*

| December 31, 2019 | Corporate and Investment Banking BAM '000 | Retail BAM '000 | Other BAM '000 | Total by segment reports BAM '000 | Adjustments BAM '000 | Total by financial statements BAM '000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | - | - | 143,893 | 143,893 | - | 143,893 |
| Financial assets held for trading | - | - | 244 | 244 | - | 244 |
| Financial assets at fair value through other comprehensive income | 213,873 | - | 5,015 | 218,888 | - | 218,888 |
| Financial assets at amortized cost | 500,223 | 525,895 | 231,131 | 1,257,249 | - | 1,257,249 |
| a) Obligatory reserve with the Central Bank | - | - | 127,016 | 127,016 | - | 127,016 |
| b) Loans and receivables due from banks | - | - | 104,115 | 104,115 | - | 104,115 |
| c) Loans and receivables due from customers | 500,223 | 525,895 | - | 1,026,118 | - | 1,026,118 |
| Property and equipment | - | - | 23,715 | 23,715 | - | 23,715 |
| Intangible assets | - | - | 10,530 | 10,530 | - | 10,530 |
| Deferred tax assets | - | - | 6 | 6 | - | 6 |
| Other assets | - | - | 7,105 | 7,105 | - | 7,105 |
| **Total assets** | **714,096** | **525,895** | **421,639** | **1,661,630** | **-** | **1,661,630** |
| **Liabilities** | | | | | | |
| Financial liabilities at amortized cost | 503,113 | 532,552 | 353,857 | 1,389,522 | 3,076 | 1,392,598 |
| a) Deposits and borrowings due to banks | - | - | 353,857 | 353,857 | - | 353,857 |
| b) Deposits and borrowings due to customers | 503,113 | 532,552 | - | 1,035,665 | - | 1,035,665 |
| c) Lease liabilities | - | - | - | - | 3,076 | 3,076 |
| Financial liabilities held for trading | - | - | - | - | - | - |
| Tax liabilities | - | - | 645 | 645 | (1) | 644 |
| a) Current tax liabilities | - | - | 382 | 382 | (1) | 381 |
| b) Deferred tax liabilities | - | - | 263 | 263 | - | 263 |
| Other liabilities | - | - | 21,630 | 21,630 | (3,075) | 18,555 |
| Provisions for liabilities and costs | - | - | 5,038 | 5,038 | - | 5,038 |
| a) Provisions for credit risk on commitments and financial guarantees given | - | - | 2,959 | 2,959 | - | 2,959 |
| b) Provisions for retirement benefits | - | - | 222 | 222 | - | 222 |
| c) Provisions for litigations | - | - | 1,857 | 1,857 | - | 1,857 |
| **Total liabilities** | **503,113** | **532,552** | **381,170** | **1,416,835** | **-** | **1,416,835** |
| **Equity and reserves** | | | | | | |
| Share capital | - | - | 97,055 | 97,055 | - | 97,055 |
| Share premium | - | - | 373 | 373 | - | 373 |
| Legal reserves | - | - | 9,706 | 9,706 | - | 9,706 |
| Capital reserves | - | - | 42,846 | 42,846 | - | 42,846 |
| Regulatory reserves for credit losses | - | - | - | - | - | - |
| Fair value reserves | - | - | 4,488 | 4,488 | - | 4,488 |
| Retained earnings | - | - | 60,746 | 60,746 | - | 60,746 |
| Net profit for the year | 13,220 | 13,317 | 3,044 | 29,581 | - | 29,581 |
| **Total equity and reserves** | **13,220** | **13,317** | **218,258** | **244,795** | **-** | **244,795** |
| **Total liabilities, equity and reserves** | **516,333** | **545,869** | **599,428** | **1,661,630** | **-** | **1,661,630** |

# 5. SEGMENT REPORTING (CONTINUED)

*Statement of financial position*

| December 31, 2018 | Corporate and Investment Banking BAM '000 | Retail BAM '000 | Other BAM '000 | Total by segment reports BAM '000 | Adjustments BAM '000 | Total by financial statements BAM '000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | - | - | 225,492 | 225,492 | - | 225,492 |
| Financial assets held for trading | - | - | 1 | 1 | - | 1 |
| Financial assets at fair value through other comprehensive income | 187,564 | - | 9,701 | 197,265 | - | 197,265 |
| Financial assets at amortized cost | 460,289 | 477,085 | 269,892 | 1,207,266 | - | 1,207,266 |
| a) Obligatory reserve with the Central Bank | - | - | 125,877 | 125,877 | - | 125,877 |
| b) Loans and receivables due from banks | - | - | 144,015 | 144,015 | - | 144,015 |
| c) Loans and receivables due from customers | 460,289 | 477,085 | - | 937,374 | - | 937,374 |
| Property and equipment | - | - | 17,761 | 17,761 | - | 17,761 |
| Intangible assets | - | - | 8,115 | 8,115 | - | 8,115 |
| Deferred tax assets | - | - | 77 | 77 | - | 77 |
| Other assets | - | - | 6,254 | 6,254 | - | 6,254 |
| **Total assets** | **647,853** | **477,085** | **537,293** | **1,662,231** | **-** | **1,662,231** |
| **Liabilities** | | | | | | |
| Financial liabilities at amortized cost | 532,184 | 474,467 | 415,669 | 1,422,320 | - | **1,422,320** |
| a) Deposits and borrowings due to banks | - | - | 415,669 | 415,669 | - | 415,669 |
| b) Deposits and borrowings due to customers | 532,184 | 474,467 | - | 1,006,651 | - | 1,006,651 |
| Financial liabilities held for trading | - | - | - | - | - | - |
| Tax liabilities | - | - | 178 | 178 | - | 178 |
| a) Current tax liabilities | - | - | 178 | 178 | - | 178 |
| b) Deferred tax liabilities | - | - | - | - | - | - |
| Other liabilities | - | - | 17,737 | 17,737 | - | 17,737 |
| Provisions for liabilities and costs | - | - | 3,321 | 3,321 | - | 3,321 |
| a) Provisions for credit risk on commitments and financial guarantees given | - | - | 1,032 | 1,032 | - | 1,032 |
| b) Provisions for retirement benefits | - | - | 252 | 252 | - | 252 |
| c) Provisions for litigations | - | - | 2,037 | 2,037 | - | 2,037 |
| **Total liabilities** | **532,184** | **474,467** | **436,905** | **1,443,556** | **-** | **1,443,556** |
| **Equity and reserves** | | | | | | |
| Share capital | - | - | 97,055 | 97,055 | - | 97,055 |
| Share premium | - | - | 373 | 373 | - | 373 |
| Legal reserves | - | - | 9,706 | 9,706 | - | 9,706 |
| Capital reserves | - | - | 39,242 | 39,242 | - | 39,242 |
| Regulatory reserves for credit losses | - | - | 3,604 | 3,604 | - | 3,604 |
| Fair value reserves | - | - | 2,447 | 2,447 | - | 2,447 |
| Retained earnings | - | - | 38,477 | 38,477 | - | 38,477 |
| Net profit for the year | 15,932 | 11,087 | 752 | 27,771 | - | 27,771 |
| **Total equity and reserves** | **15,932** | **11,087** | **191,656** | **218,675** | - | **218,675** |
| **Total liabilities, equity and reserves** | **548,116** | **485,554** | **628,561** | **1,662,231** | - | **1,662,231** |

# 6. INTEREST INCOME AND SIMILAR INCOME

*a) Breakdown by type of financial asset*

| | Debt securities 2019 BAM '000 | Loans 2019 BAM '000 | Total 2019 BAM '000 | Total 2018 BAM '000 |
|---|---|---|---|---|
| 1. Financial assets at fair value through other comprehensive income | 7,504 | - | 7,504 | 8,837 |
| 2. Financial assets at amortized cost | - | 49,709 | 49,709 | **51,753** |
| a) Obligatory reserve with the Central Bank | - | - | - | - |
| b) Loans and receivables due from banks | - | 599 | 599 | 459 |
| c) Loans and receivables due from customers | - | 49,110 | 49,110 | 51,294 |
| **Total** | **7,504** | **49,709** | **57,213** | **60,590** |
| *Of which: interest income on non-performing portfolio* | - | *664* | ***664*** | *487* |

*b) Breakdown by sectors:*

| | Year Ended December 31, 2019 BAM '000 | 2018 BAM '000 |
|---|---|---|
| Private individuals | 29,903 | 29,871 |
| Companies and entrepreneurs | 10,330 | 12,821 |
| Banks | 599 | 459 |
| Public sector | 16,381 | 17,439 |
| | **57,213** | **60,590** |

# 7. INTEREST EXPENSES AND SIMILAR EXPENSES

*a) Breakdown by type of financial liabilities*

| | Deposits 2019 BAM '000 | Borrowings 2019 BAM '000 | Total 2019 BAM '000 | Total 2018 BAM '000 |
|---|---|---|---|---|
| Financial liabilities at amortized cost | | | | |
| a) Deposits and borrowings due to banks | 1,841 | 285 | 2,126 | 2,667 |
| b) Deposits and borrowings due to customers | 5,680 | 684 | 6,364 | 6,380 |
| **Total** | **7,521** | **969** | **8,490** | **9,047** |

# 7. INTEREST EXPENSES AND SIMILAR EXPENSES (CONTINUED)

*b) Breakdown by sectors:*

| | Year Ended December 31, | |
|---|---|---|
| | 2019 BAM '000 | 2018 BAM '000 |
| Private individuals | 2,996 | 2,915 |
| Companies and entrepreneurs | 1,436 | 1,491 |
| Banks | 2,126 | 2,667 |
| Public sector | 336 | 306 |
| Other organizations | 1,596 | 1,668 |
| | **8,490** | **9,047** |

# 8. FEE AND COMMISSION INCOME

| | Year Ended December 31, | |
|---|---|---|
| | 2019 BAM '000 | 2018 BAM '000 |
| Domestic payment transactions | 7,103 | 6,955 |
| Foreign payment transactions | 2,010 | 2,007 |
| Payment of foreign pensions and remittances of individuals | 1,791 | 1,780 |
| Issuance of guarantees and other sureties | 1,456 | 1,445 |
| Card operations | 2,703 | 2,102 |
| Loan origination fees | 3,077 | 2,537 |
| Foreign exchange spot trading gains and cash operations | 1,311 | 1,357 |
| Other fees and commissions | 487 | 434 |
| | **19,938** | **18,617** |

# 9. FEE AND COMMISSION EXPENSES

| | Year Ended December 31, | |
|---|---|---|
| | 2019 BAM '000 | 2018 BAM '000 |
| Card operations | 2,128 | 1,767 |
| Domestic payment transactions | 671 | 700 |
| Foreign payment transactions | 247 | 203 |
| Cash operations | 102 | 18 |
| Loan origination/processing fees | 96 | 96 |
| Other fees and commissions | 290 | 207 |
| | **3,534** | **2,991** |

## 10. DIVIDEND AND PROFIT SHARING INCOME

| | Year Ended December 31, | |
|---|---|---|
| | 2019<br>BAM '000 | 2018<br>BAM '000 |
| Dividend income | 10 | 10 |
| | **10** | **10** |

## 11. FOREIGN EXCHANGE GAINS UPON TRANSLATION OF MONETARY ASSETS AND LIABILITIES

| | Year Ended December 31, | |
|---|---|---|
| | 2019<br>BAM '000 | 2018<br>BAM '000 |
| Net foreign exchange gains upon translation of monetary assets and liabilities | 1,643 | 1,743 |
| | **1,643** | **1,743** |

## 12. PERSONNEL EXPENSES

| | Year Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| | BAM '000 | BAM '000 |
| Fixed payments - gross salaries | 13,678 | 13,116 |
| Variable payments - bonuses | 1,716 | 1,572 |
| Other personnel costs | 1,444 | 1,479 |
| Severance pays and retirement benefits | 195 | 392 |
| Other costs (service contracts) | 176 | 188 |
| **Total personnel expenses** | **17,209** | **16,747** |

Personnel expenses include contributions for pension and disability insurance paid in 2019 in the amount of BAM 3,499 thousand (2018: BAM 2,898 thousand).

## 13. OTHER ADMINISTRATIVE EXPENSES

| | Year Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| | BAM '000 | BAM '000 |
| Information & communication technology expenses | 3,827 | 3,847 |
| Sundry operating expenses | 2,726 | 2,488 |
| Real estate expenses(*) | 1,190 | 1,851 |
| Consulting & professional services | 1,584 | 1,755 |
| Security and cash management | 1,099 | 1,018 |
| Advertising & marketing expenses | 454 | 699 |
| Back office expenses | 459 | 500 |
| Other personnel expenses | 376 | 422 |
| Indirect taxes and contributions | 279 | 300 |
| Loans collection | 266 | 104 |
| | **12,260** | **12,984** |

(*) business premises lease costs in 2019 in the amount of BAM 627 thousand, in accordance with IFRS 16, are shown within the line item of depreciation charge (2018: within the real estate expenses).

## 14. NET IMPAIRMENT LOSSES / REVERSAL GAINS AND PROVISIONS FOR CREDIT RISK

| | Year Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| | BAM '000 | BAM '000 |
| Financial assets at fair value through other comprehensive income | (973) | 1,095 |
| Loans and receivables due from banks | (868) | 605 |
| Loans and receivables due from customers | 2,701 | 4,097 |
| | **860** | **5,797** |

## 15. PROVISIONS FOR RISKS AND EXPENSES

| | Year Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| | BAM '000 | BAM '000 |
| Provisions for credit risk per commitments and guarantees | 1,927 | 514 |
| Provisions for employee retirement benefits | (30) | (10) |
| Provisions for litigations | - | 370 |
| | **1,897** | **874** |

# 16. INCOME TAX

Income tax charged to the statement of profit or loss comprises current and deferred taxes.

*a) Income tax expense recognized within the statement of profit or loss*

| | Year Ended December 31, 2019 BAM '000 | 2018 BAM '000 |
|---|---|---|
| Current income tax expense | 2,786 | 2,622 |
| Deferred income tax (Note 27) | 5 | (28) |
| **Total** | **2,791** | **2,594** |

*b) Reconciliation of the income tax expenses*

| | Year Ended December 31, 2019 BAM '000 | 2018 BAM '000 |
|---|---|---|
| **Profit before tax** | **32,372** | **30,365** |
| Income tax at the rate of 10% | 3,237 | 3,037 |
| Decrease of the income tax for tax-exempt income | (774) | (972) |
| Increase of the income tax for impairment losses on loans and other assets which are not deductible for tax purposes | 298 | 369 |
| Increase of the income tax for other expenses not deductible for tax purposes | 30 | 160 |
| **Income tax expense** | **2,791** | **2,594** |
| **Average effective income tax rate** | **8.62%** | **8.54%** |

The effective tax regulations stipulate expenses and income recognized for the purpose of taxable income calculation as well as the amount of impairment losses on loans deductible for tax purposes to the maximum amount that is prescribed by the Banking Agency of the Republic of Srpska for B, C, D, and E categories.

Tax liabilities are recognized in accordance with the tax returns prepared by the Bank. However, the Bank may be subject to subsequent inspection by the tax authorities over a period of five years following the year for which the tax return was issued. The Bank's Management Board is not aware of any circumstances, which may give rise to a potential material liability in this respect.

# 17. CASH AND CASH EQUIVALENTS

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Cash in the local currency | 22,501 | 20,105 |
| Funds held with the Central Bank – gyro account | 115,101 | 199,745 |
| Cash in foreign currencies | 6,291 | 5,642 |
| | **143,893** | **225,492** |

# 18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

*a) Financial assets at fair value through other comprehensive income by type:*

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| ***Equity securities*** | | |
| Domestic insurance companies | - | 8 |
| Other domestic companies | 234 | 101 |
| Foreign companies | 8 | 8 |
| | **242** | **117** |
| | | |
| Quoted | - | 8 |
| Unquoted | 242 | 109 |
| | **242** | **117** |
| ***Debt securities*** | | |
| Bonds of the Republic of Srpska | 218,646 | 197,148 |
| Treasury bills of the Republic of Srpska | - | - |
| | **218,646** | **197,148** |
| | | |
| Quoted | 218,646 | 197,148 |
| Unquoted | - | - |
| | **218,646** | **197,148** |
| **Total financial assets at fair value through other comprehensive income** | **218,888** | **197,265** |

*b) Breakdown of the financial assets at fair value through other comprehensive income by level of fair value:*

| | Level 1 '000 BAM | Level 2 '000 BAM | Level 3 '000 BAM | Total '000 BAM |
|---|---|---|---|---|
| **December 31, 2019** | | | | |
| Equity securities | - | - | 242 | **242** |
| Bonds of the Republic of Srpska | - | 218,646 | - | **218,646** |
| Treasury bills of the Republic of Srpska | - | - | - | **-** |
| | | | | |
| Total | **-** | **218,646** | **242** | **218,888** |
| December 31, 2018 | | | | |
| Equity securities | - | - | 117 | 117 |
| Bonds of the Republic of Srpska | - | 197,148 | - | 197,148 |
| Treasury bills of the Republic of Srpska | - | - | - | **-** |
| | | | | |
| Total | **-** | **197,148** | **117** | **197,265** |

After collecting and analyzing detailed data on turnover and debt security prices on the market of the Republic of Srpska, it was decided at the level of UniCredit Group that debt securities in the Bank's portfolio ought to be classified within hierarchy Level 2.

# 18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (CONTINUED)

*c) External rating of the debt securities*

As for the external rating of debt securities, the external credit rating of the state of Bosnia and Herzegovina was applied, which, according to the Agency for Credit Rating Standard & Poor's was "B / Positive Outlook", and according to Moody's Investors Service "B 3 / Stable Outlook."

# 19. OBLIGATORY RESERVE WITH THE CENTRAL BANK

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Obligatory reserve with the Central Bank in domestic currency | 127,484 | 127,181 |
| Cash impairment | (468) | (1,304) |
| | | |
| | **127,016** | **125,877** |

The Central Bank of Bosnia and Herzegovina (the "Central Bank") has prescribed a method for calculating and maintaining obligatory reserves, as well as the amount and manner of payment of fees for the amount of obligatory reserve and on the amount of funds in excess of the obligatory reserve held on the account with the Central Bank.

The basis for the calculation of the obligatory reserve is the average amount of deposits and borrowed funds in BAM and foreign currencies (denominated in BAM, at the exchange rate of the Central Bank effective over the calculation period). The basis for calculation of the obligatory reserve excludes deposits placed with the Bank by domestic banks and domestic banks in bankruptcy.

Obligatory reserve rate of 10% is applied to the above sad basis amount. From 1 July 2016 on, the Central Bank did not calculate the fee on the amount of obligatory reserve funds.

The Central Bank calculated the fee on the amount of funds in excess of the obligatory reserve at the rate applied by the European Central Bank on deposits of commercial banks (deposit facility rate) as follows: in period from January 1 until April 30 2019 at 50% of this rate, and in period from May 1 until December 31, 2019 at full rate.

The rate of this fee throughout 2019 equated to: 0.2% in period from January 1 until April 30 2019; 0.4% in period from May 1 until September 20 2019 and 0.5% in period from September 21 until December 31, 2019.

# 20. LOANS AND RECEIVABLES DUE FROM BANKS

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Loans to foreign banks | 88,239 | 128,171 |
| Loans to domestic banks | 16,009 | 16,009 |
| Impairment allowance of loans | (133) | (165) |
| | | |
| | **104,115** | **144,015** |

Of loans and receivables due from banks totaling BAM 104,115 thousand as of December 31, 2019, the amount of BAM 28,476 thousand relates to loans and receivables due from related banks (2018: BAM 18,840 thousand).

## 21. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

*a) Breakdown by product*

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| **Corporate customers** | | |
| - in BAM | 316,891 | 326,518 |
| - in foreign currencies | 38,440 | 58,192 |
| - with foreign currency clause | 201,271 | 150,403 |
| **Total gross** | **556,602** | **535,113** |
| Impairment allowance of loans | (13,301) | **(39,696)** |
| | **543,301** | **495,417** |
| **Retail customers** | | |
| - in BAM | 245,208 | 180,827 |
| - in foreign currencies | 13 | 31 |
| - with foreign currency clause | 259,294 | 294,730 |
| **Total gross** | **504,515** | **475,588** |
| Impairment allowance of loans | (21,698) | (33,631) |
| | **482,817** | **441,957** |
| **Total gross loans** | **1,061,117** | **1,010,701** |
| **Total net loans** | **1,026,118** | 937,374 |

*b) Movements on impairment allowance of loans and interest*

| | Loans Corporate BAM '000 | Loans Retail BAM '000 | Interest Corporate BAM '000 | Interest Retail BAM '000 | Total BAM '000 |
|---|---|---|---|---|---|
| **Balance at January 1, 2018** | **43,272** | **29,983** | **2,561** | **747** | **76,563** |
| | | | | | |
| First-time adoption of IFRS 9 | (1,650) | (177) | 9 | 4 | **(1,814)** |
| Net losses/(recoveries) recognized in the statement of profit or loss (Note 14) | 713 | 3,384 | (11) | 11 | **4,097** |
| Write-offs/transfers and rounding | (4,094) | (341) | (1,104) | 20 | **(5,519)** |
| | | | | | |
| **Balance at December 31, 2018** | **38,241** | **32,849** | **1,455** | **782** | **73,327** |
| Net losses/(recoveries) recognized in the statement of profit or loss (Note 14) | (115) | 2,823 | (4) | (3) | **2,701** |
| Accounting write offs | (17,096) | (14,198) | (770) | - | **(32,064)** |
| Write offs – NPE sales | (6,687) | - | (580) | - | **(7,267)** |
| Write offs – others | (1,143) | (13) | - | (542) | **(1,698)** |
| | | | | | |
| **Balance at December 31, 2019** | **13,200** | **21,461** | **101** | **237** | **34,999** |

## 22. TANGIBLE ASSETS

| | Land and buildings BAM '000 | Equipment and other assets BAM '000 | Investment in progress BAM '000 | Re-possessed assets BAM '000 | Lease IFRS 16 BAM '000 | Total tangible assets BAM '000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **Balance at January 1, 2018** | **25,566** | **15,284** | **1,862** | **-** | **-** | **42,712** |
| Additions | - | - | 2,304 | 584 | - | 2,888 |
| Transfers | 772 | 1,842 | (2,614) | - | - | - |
| Sales and write-offs | - | (406) | - | - | - | (406) |
| **Balance at December 31, 2018** | **26,338** | **16,720** | **1,552** | **584** | **-** | **45,194** |
| | | | | | | |
| **Cost** | **26,338** | **16,720** | **1,552** | **584** | **3,077** | **48,271** |
| **Balance at January 1, 2019** | | | | | | |
| Revaluation | 2,628 | - | - | - | - | 2,628 |
| Additions | - | - | 1,792 | 338 | 602 | 2,732 |
| Transfers | 92 | 1,893 | (1,985) | - | - | - |
| Sales and write-offs | (466) | (493) | - | - | - | (959) |
| **Balance at December 31, 2019** | **28,592** | **18,120** | **1,359** | **922** | **3,679** | **52,672** |
| | | | | | | |
| **Accumulated depreciation** | | | | | | |
| **Balance at January 1, 2018** | **13,042** | **13,202** | **-** | **-** | **-** | **26,244** |
| Charge for the year | 571 | 1,024 | **-** | **-** | - | 1,595 |
| Sales and write-offs | - | (406) | **-** | **-** | **-** | (406) |
| **Balance at December 31, 2018** | **13,613** | **13,820** | **-** | **-** | **-** | **27,433** |
| | | | | | | |
| **Balance at January 1, 2019** | **13,613** | **13,820** | **-** | **-** | **-** | **27,433** |
| Charge for the year | 558 | 1,094 | - | - | **627** | 2,279 |
| Sales and write-offs | (335) | (420) | - | - | - | (755) |
| **Balance at December 31, 2019** | **13,836** | **14,494** | **-** | **-** | **627** | **28,957** |
| Net book value: | | | | | | |
| **Balance at December 31, 2018** | **12,725** | **2,900** | **1,552** | **584** | **-** | **17,761** |
| **Balance at December 31, 2019** | **14,756** | **3,626** | **1,359** | **922** | **3,052** | **23,715** |

The carrying value of non-depreciable land within the class of land and buildings amounted to BAM 3,393 thousand (2018: BAM 3,159 thousand).

Investments in progress in the amount of BAM 1,359 thousand as of December 31, 2019 (2018: BAM 1,552 thousand) relate to real estate reconstruction and equipment not yet placed into use.

As at December 31, 2019 the Bank has registered one pledge in favor of the pledgee of the Government of Republic of Srpska on the basis of the loan "IFAD 449 BA PROJECT_IFAD 772-BA" (liabilities under this loan amounted to BAM 262 thousand as of December 31, 2019).

Except for the above pledge the Bank had no other mortgages assigned on property and equipment as at December 31, 2019.

As at December 31, 2019, the Bank changed its real estate valuation policy by moving from the cost model to the fair value model, as described in Note 2 section *Change in the Valuation Model of Property used for the Bank's own Business.*

## 23. INTANGIBLE ASSETS

| | Software | Other | Investments in progress | Total intangible assets |
|---|---|---|---|---|
| | BAM '000 | BAM '000 | BAM '000 | BAM '000 |
| **Cost** | | | | |
| Balance as at January 1, 2018 | **18,546** | **4,632** | **3,655** | **26,833** |
| Additions | - | - | 3,108 | 3,108 |
| Transfers | 2,009 | 584 | (2,593) | - |
| **Balance as at December 31, 2018** | **20,555** | **5,216** | **4,170** | **29,941** |
| **Balance as at January 1, 2019** | **20,555** | **5,216** | **4,170** | **29,941** |
| Additions | - | - | 3,762 | **3,762** |
| Transfers | 1,962 | 311 | (2,273) | **-** |
| Sales and write-offs | - | - | (1) | **(1)** |
| **Balance as at December 31, 2019** | 22,**517** | **5,527** | **5,658** | **33,702** |
| **Accumulated amortization** | | | | |
| **Balance as at January 1, 2018** | **16,380** | **4,566** | **-** | **20,946** |
| Charge for the year | **680** | **199** | - | 879 |
| Sales and write-offs | **-** | 1 | - | 1 |
| **Balance as at December 31, 2018** | **17,060** | **4,766** | **-** | **21,826** |
| Balance as at January 1, 2019 | **17,060** | **4,766** | **-** | **21,826** |
| Charge for the year | **1,032** | **315** | - | 1,347 |
| Sales and write-offs | (1) | - | - | (1) |
| **Balance as at December 31, 2019** | **18,091** | **5,081** | **-** | **23,172** |
| Net book value: | | | | |
| **Balance as at December 31, 2018** | **3,495** | **450** | **4,170** | **8,115** |
| **Balance as at December 31, 2019** | **4,426** | **446** | **5,658** | **10,530** |

Intangible assets – investments in progress amounting to BAM 5,658 thousand as of December 31t, 2019 (2018: BAM 4,170 thousand) relate to the software and other intangible assets not yet placed into use.

As at December 31, 2019, the Bank had no internally generated intangible assets.

## 24. OTHER ASSETS

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Fee receivables in the local currency | 135 | 192 |
| Receivables for employee salaries | 1,565 | 1,372 |
| Receivables from card operations | 3,567 | 3,135 |
| Receivables per cheque payments | 7 | 21 |
| Leasehold improvements | 1,050 | 843 |
| Receivables from operating activities | 714 | 1,050 |
| Other receivables | 1,089 | 1,077 |
| | 8,127 | 7,690 |
| Impairment allowance | (1,022) | (1,436) |
| **Total other assets** | **7,105** | **6,254** |

*Movements on impairment allowance for other assets:*

| | Total BAM '000 |
|---|---|
| Balance as at January 1, 2018 | **1,373** |
| Net losses/(recoveries) recognized in the statement of profit or loss | 103 |
| Write-offs and transfers | (40) |
| **Balance as at December 31, 2018** | **1,436** |
| Net losses/(recoveries) recognized in the statement of profit or loss | (355) |
| Write-offs, transfers and rounding | (59) |
| **Balance as at December 31, 2019** | **1,022** |

## 25. DEPOSITS AND BORROWINGS DUE TO BANKS

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| **Demand deposits** | | |
| - in BAM | 3 | - |
| - in foreign currencies | 392 | 1,520 |
| | **395** | **1,520** |
| **Term deposits** | | |
| - in BAM | 16,421 | 15,570 |
| - in foreign currencies | 296,362 | 352,282 |
| | | |
| **Total deposits** | **313,178** | **369,372** |
| **Borrowings** | | |
| - in foreign currencies | 40,679 | 46,297 |
| | **40,679** | **46,297** |
| **Total borrowings** | | |
| **Total deposits and borrowings due to banks** | **353,857** | **415,669** |

Deposits and borrowings due to banks include the amount of BAM 312,786 thousand (2018: BAM 367,852 thousand), which pertains to the deposits and borrowings due to related parties.

## 26. DEPOSITS AND BORROWINGS DUE TO CUSTOMERS

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| LEGAL ENTITIES (CORPORATE CUSTOMERS) AND ENTREPRENEURS | | |
| **Demand deposits** | | |
| - in BAM | 280,803 | 345,314 |
| - in foreign currencies | 50,646 | 57,445 |
| | **331,449** | **402,759** |
| | | |
| **Term deposits** | | |
| - in BAM | 67,328 | 28,498 |
| - with foreign currency clause | 110,626 | 105,162 |
| - in foreign currencies | 14,101 | 11,625 |
| | **192,055** | **145,285** |
| | | |
| **Total deposits due to legal entities and entrepreneurs** | **523,504** | **548,044** |
| RETAIL CUSTOMERS - PRIVATE INDIVIDUALS | | |
| **Demand deposits** | | |
| - in BAM | 178,752 | 166,927 |
| - with foreign currency clause | 45 | 87 |
| - in foreign currencies | 95,618 | 101,556 |
| | **274,415** | **268,570** |
| | | |
| **Term deposits** | | |
| - in BAM | 67,857 | 49,049 |
| - with foreign currency clause | 54 | 42 |
| - in foreign currencies | 125,154 | 98,962 |
| | **193,065** | **148,053** |
| | | |
| **Total deposits due to private individuals** | **467,480** | **416,623** |
| | | |
| **TOTAL DEPOSITS** | **990,984** | **964,667** |
| | | |
| **Borrowings due to customers** | | |
| - in BAM | - | - |
| - with foreign currency clause | 41,673 | 35,945 |
| - in foreign currencies | 3,008 | 6,039 |
| **Total borrowings due to customers** | **44,681** | **41,984** |
| | | |
| **Total deposits and borrowings due to customers** | **1,035,665** | **1,006,651** |

# 26. a) LEASE LIABILITIES

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Lease liabilities to legal entities | 1,271 | - |
| Lease liabilities to private individuals | 1,805 | - |
| **Total lease liabilities** | **3,076** | **-** |

# 27. DEFERRED TAX ASSETS AND LIABILITIES

*Deferred tax assets and liabilities, net of tax*

Deferred taxes are calculated for temporary differences according to the balance sheet liability method using the legally prescribed income tax rate of 10% (2018: 10%).

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| **Deferred tax assets** | | |
| Fair value reserve | - | 65 |
| Deferred tax assets based on differences in the depreciation method and different depreciation rates | 6 | 12 |
| | | |
| | **6** | **77** |
| | | |
| **Deferred tax liabilities** | | |
| Deferred tax liabilities based on change of real estate fair value | 263 | - |
| | | |
| | **257** | **77** |

*Movements on deferred taxes*

| | Deferred tax assets BAM '000 | Deferred tax liabilities BAM '000 |
|---|---|---|
| | | |
| **Balance at January 1, 2018** | **16** | **(16)** |
| | | |
| Gains on the increase indeferred tax assets and decrease indeferred tax liabilities in respect of the differences in the depreciation method and different depreciation rates in the profit or loss | 12 | 16 |
| Decrease in deferred tax liabilities in respect of the calculation of the fair value changes through the other comprehensive income | 49 | |
| | | |
| **Balance at December 31, 2018** | **77** | **-** |
| | | |
| **Balance at January 1, 2019** | **77** | **-** |
| | | |
| Losses on the decrease indeferred tax assets in respect of the differences in the depreciation method and different depreciation rates in the profit or loss | (5) | - |
| Decrease in deferred tax liabilities in respect of the calculation of the fair value changes through the other comprehensive income | (66) | - |
| (Decrease)/incease in deferred tax assets/liabilities | - | 263 |
| **Balance at December 31, 2019** | **6** | **263** |

## 28. OTHER LIABILITIES

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Liabilities to employees | 4,441 | 4,323 |
| Advances received for foreclosure of assets - NPLs | 115 | 23 |
| Liabilities to suppliers | 2,884 | 3,824 |
| Liabilities per litigation | 2,962 | - |
| Provisions for jubilee awards | 193 | 202 |
| Liabilities for realization of payment orders in the country | 1,689 | 1,407 |
| Liabilities for non-nominated deposits | 657 | 661 |
| Accruals and deferred income | 308 | 560 |
| Liabilities from card operations | 2,333 | 1,706 |
| Liabilities for insured unpaid deposits | 1,044 | 2,223 |
| VAT payable | 596 | 704 |
| Other liabilities | 1,333 | 2,104 |
| | **18,555** | **17,737** |

## 29. PROVISIONS FOR LIABILITIES AND EXPENSES

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Provisions for credit risk on commitments and financial guarantees given | 2,959 | 1,032 |
| Provisions for retirement benefits | 222 | 252 |
| Provisions for litigations | 1,857 | 2,037 |
| | **5,038** | **3,321** |

Movements of provisions for risks and expenses

| | Retirement benefits BAM '000 | Litigations BAM '000 | Contingent liabilities and guaranties BAM '000 | Total BAM '000 |
|---|---|---|---|---|
| Balance as at January 1, 2018 | **263** | **1,803** | **1,596** | **3,662** |
| First-time adoption of IFRS 9 | - | - | (1,068) | **(1,068)** |
| Net gains/(losses) recognized in the statement of profit or loss (Notes 12 and 15) | (10) | 370 | 514 | **874** |
| Provisions released during the period and transfers | (1) | (136) | (10) | **(147)** |
| **Balance as at December 31, 2018** | **252** | **2,037** | **1,032** | **3,321** |
| Net gains/(losses) recognized in the statement of profit or loss (Notes 12 and 15) | (30) | - | 1,927 | **1,897** |
| Provisions released during the period and transfers | - | (180) | - | **(180)** |
| **Balance as at December 31, 2019** | **222** | **1,857** | **2,959** | **5,038** |

## 30. SHARE CAPITAL

| | Ordinary shares |
|---|---|
| | **BAM '000** |
| Balance as at January 1, 2018 | **97,055** |
| Changes | - |
| **Balance as at December 31, 2018** | **97,055** |
| Changes | **-** |
| **Balance as at December 31, 2019** | 97,055 |
| Nominal value per share (BAM) | 700 |
| Share count | 138,650 |

As at December 31, 2019, the shareholders of the Bank comprised of a single major and 60 minority shareholders; both domestic and foreign legal entities and individuals with the following equity interests:

| | % of equity interest |
|---|---|
| **UniCredit S.p.A. Italy** | **99,4252%** |
| Minority shareholders | 0,5748% |
| | 100,00% |

As at December 31, 2019, members of the Bank's Supervisory Board, Audit Committee and Management Board were not in possession of any shares of the Bank.

All the Bank's shares were quoted on Banja Luka Stock Exchange. In 2019, the price per share on the last trading day amounted to BAM 1,462.50 (December 31, 2018: BAM 1,201.00).

## 31. EARNINGS PER SHARE

| | 2019 | 2018 |
|---|---|---|
| Total number of shares | 138,650 | 138,650 |
| Weighted average number of shares outstanding | 138,650 | 138,650 |
| Total result (profit) in BAM '000 | **29.581** | **27,771** |
| **Earnings per share in BAM** | **213.35** | **200.30** |

In Q2 2019 the Bank paid dividend to the shareholders in the amount of BAM 5,553 thousand from the net profit realized in 2018. The total of 66 shareholders were entitled to dividend payment, and dividend per share amounted to BAM 40.05.

## 32. COMMITMENTS AND CONTINGENT LIABILITIES

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Payment guarantees: | | |
| - in BAM | 13,162 | 12,193 |
| - in foreign currencies | 21,896 | 20,656 |
| | | |
| Performance guarantees: | | |
| - in BAM | 40,063 | 44,967 |
| - in foreign currencies | 20,027 | 26,432 |
| | | |
| Contingent liabilities for undrawn loans and guarantees: | | |
| - in BAM | 121,929 | 115,031 |
| - in foreign currencies | 50 | 1,615 |
| | | |
| Letters of credit in foreign currencies | 4,051 | 997 |
| | | |
| **Total** | **221,178** | **221,891** |

As at December 31, 2019, provisions for credit risk on commitments and financial guarantees issued amounted to BAM 2,959 thousand (2018: BAM 1,032 thousand). Movements on these provisions are presented in Note 29.

## 33. TRANSACTIONS WITH RELATED PARTIES

In compliance with International Accounting Standard (IAS) 24, parties related to the Bank and the Bank's key management members are as follows:

| IAS 24.19 | Name | Description |
|---|---|---|
| IAS 24.19 (a),(b) | Parent company and entities with joint control or significant impact on w Bank | UniCredit S.p.A. Italy |
| IAS 24.19 (c) | Subsidiaries and other entities within the same Group | Related banks and other legal entities within UniCredit Group |
| IAS 24.19 (c), (e) | Associates and joint ventures | The Bank did not have associates or joint ventures in 2019 |
| IAS 24.19 (f) | Key management of the institution or its parent entity | Members of the Supervisory Board and Management Board; members of the Supervisory Board and Management Board of the parent entity, key Bank management personnel and persons related to the specified members |
| IAS 24.19 (g) | Other related parties | The Bank did not have other related parties in 2019 |

# 33. TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

*Balances of assets and liabilities arising from transactions performed with members of UniCredit Group were as follows:*

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Assets | | |
| ***Foreign currency demand deposits:*** | | |
| - UniCredit Bank Austria AG Vienna | 4,412 | 1,435 |
| - UniCredit Bank Serbia a.d. Beograd | 3,761 | 92 |
| - Zagrebačka Banka d.d. Zagreb | 414 | 548 |
| - UniCredit Bank AG Munich | 3,061 | 626 |
| - UniCredit S.p.A. Italy | 826 | 137 |
| - UniCredit Bank d.d. Mostar | 2 | 2 |
| | **12,476** | **2,840** |
| ***Term deposits:*** | | |
| - UniCredit Bank d.d. Mostar | 16,000 | 16,000 |
| | **16,000** | **16,000** |
| ***Other receivables*** | | |
| - UniCredit Bank AG Munich | 516 | 34 |
| - UniCredit S.p.A. Italy | 554 | 414 |
| - UniCredit Bank d.d. Mostar | 7 | 2 |
| - UniCredit Bank Serbia a.d. Beograd | 155 | 273 |
| | **1,232** | **723** |
| | | |
| Total assets | **29,708** | **19,563** |
| | | |
| Liabilities | | |
| ***Sight deposits:*** | | |
| - UniCredit Bank Austria AG Vienna | 3 | - |
| | **3** | **-** |
| ***Received term deposits:*** | | |
| - UniCredit Bank d.d. Mostar | 16,421 | 15,570 |
| - UniCredit S.p.A. Italy | 296,362 | 352,282 |
| | **312,783** | **367,852** |
| ***Other liabilities*** | | |
| - UniCredit Bank d.d. Mostar | 344 | 214 |
| - UniCredit S.p.A Italy | 121 | 171 |
| - UniCredit Services GmbH Austria | 643 | 2,321 |
| - Zagrebačka Banka d.d. Zagreb | 199 | 323 |
| - UniCredit Bulbank AD Sofia | 43 | 44 |
| | **1,350** | **3,073** |
| | | |
| Total liabilities | **314,136** | **370,925** |
| | | |
| Liabilities, net | **(284,428)** | **(351,362)** |

# 33. TRANSACTIONS WITH RELATED PARTIES (Continued)

*Income and expenses from related party transactions were as follows:*

| | Year Ended December 31, | |
|---|---|---|
| | 2019 BAM '000 | 2018 BAM '000 |
| **Items included in the statement of comprehensive income:** | | |
| **Interest income:** | | |
| - UniCredit Bank Austria AG Vienna | 6 | - |
| - UniCredit Bank d.d. Mostar | 365 | 92 |
| - UniCredit S.p.A. Italy | 99 | 315 |
| | | |
| **Total interest income** | **470** | **407** |
| | | |
| **Fee and commission income:** | | |
| - UniCredit Bank Austria AG Vienna | 3 | 3 |
| - UniCredit Bank AG Munich | - | 2 |
| - UniCredit S.p.A. Italy | 6 | 22 |
| - UniCredit Slovenia | 22 | - |
| | | |
| **Total fee and commission income** | **31** | **27** |
| | | |
| **Interest expenses:** | | |
| - UniCredit Bank d.d. Mostar | 415 | 103 |
| - UniCredit Bank Moscow AO | - | 1,039 |
| - UniCredit S.p.A. Italy | 666 | 804 |
| | | |
| **Total interest expenses** | **1,081** | **1,946** |
| | | |
| **Fee and commission expenses:** | | |
| - UniCredit Bank Austria AG Vienna | 2 | 9 |
| - UniCredit S.p.A. Italy | 63 | 13 |
| - Zagrebačka Banka d.d. Zagreb | 204 | 321 |
| - UniCredit Bank AG Munich | 1 | 3 |
| - UniCredit Services S.C.p.A Italy | 78 | 88 |
| | | |
| **Total fee and commission expenses** | **348** | **434** |
| | | |
| **Operating expenses** | | |
| - UniCredit Services GmbH Austria | 1,099 | 1,438 |
| - UniCredit Bank d.d. Mostar | 314 | 106 |
| - Zagrebačka Banka d.d. Zagreb | 30 | 11 |
| - UniCredit S.p.A. Italy | 148 | 149 |
| - I-FABER S.p.A. | - | 6 |
| **Total operating expenses** | **1,591** | **1,710** |
| **Expenses, net** | **(2,519)** | **(3,656)** |

## 33. TRANSACTIONS WITH RELATED PARTIES (Continued)

Salaries and remunerations paid to the members of the Bank's Supervisory Board, Management Board, and other key management personnel are presented below:

| | Year Ended December 31, | |
|---|---|---|
| | 2019 BAM'000 | 2018 BAM'000 |
| **Supervisory Board** | 69 | 46 |
| | **69** | **46** |
| **Management Board** | | |
| ***Short-term remuneration*** | | |
| Gross salaries disbursed in the current year for the current year | 1,015 | 929 |
| Bonuses disbursed in the current year for the previous year - gross | 173 | 149 |
| ***Long-term remuneration*** | | |
| Insurance policies paid in the current year - gross | 28 | 28 |
| Disbursements in the current year for prior years - gross | 163 | 91 |
| **Total Management Board** | **1,379** | **1,197** |
| **Other key management personnel** | | |
| ***Short-term remuneration*** | | |
| Gross salaries disbursed in the current year for the current year | 636 | 471 |
| Bonuses disbursed in the current year for the previous year - gross | 131 | 97 |
| ***Long-term remuneration*** | | |
| Insurance policies paid in the current year - gross | 15 | 15 |
| Disbursements in the current year for prior years - gross | - | - |
| **Total other key management personnel** | **782** | **583** |

The Supervisory Board consists of 5 members, 2 of which are employed within the Group, 1 is a former employee of the Group and 2 are independent members. The remunerations were paid only to those members that are not employed with the Group. Members of the Supervisory Board do not exercise the right to a variable remuneration in accordance with the Remuneration Policy.

The Bank's Management Board consists of 5 members. Amount in score of long term remunerations to Board members, for gross salaries during the current year based on earlier periods does not include payouts to former Board members.

in 2019, other key management personnel comprised of 7 employees of the Bank, whereas in 2018 there were 6 members.

The amount of salaries and remuneration disbursed to the members of the Management Board and key management includes the amount of BAM 400 thousand (2018: BAM 329 thousand) of contributions for pension and disability insurance with the prescribed amounts of contributions, payable to the mandatory pension funds at the prescribed rates.

Within the regular transactions, transactions with related parties are performed under fair market terms, which are deemed to be arm's length transactions, and our estimate is that the Bank bears no risk in respect of transfer prices.

## 33. TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

Loans and deposits, and income and expenses per loans and deposits of the members of the Bank's Supervisory Board, Management Board and other key management personnel and their related parties were as follows:

| | 2019<br>BAM '000 | 2018<br>BAM '000 |
|---|---|---|
| **Supervisory Board:** | | |
| - Loans as at December 31 | - | - |
| *- Interest income for the year* | - | - |
| - Deposits as at December 31 | 43 | 33 |
| *- Interest expense for the year* | - | 1 |
| | | |
| **Management Board:** | | |
| - Loans as at December 31 | 71 | 76 |
| *- Interest income for the year* | *3* | *4* |
| - Deposits as at December 31 | 621 | 400 |
| *- Interest expense for the year* | 12 | 11 |
| | | |
| **Other key management:** | | |
| - Loans as at December 31 | 118 | 122 |
| *- Interest income for the year* | 8 | 6 |
| - Deposits as at December 31 | 625 | 384 |
| *- Interest expense for the year* | 2 | 9 |
| | | |
| **Total key management** | | |
| | | |
| **- Loans as at December 31** | ***189*** | ***198*** |
| ***- Interest income for the year*** | ***11*** | ***10*** |
| | | |
| **- Deposits as at December 31** | ***1,289*** | ***817*** |
| ***- Interest expense for the year*** | ***14*** | ***21*** |

# 34. RISK MANAGEMENT

The Bank's management of risks assumed in operating activities is conducted through a system of strategies, policies, programs, work procedures and defined limits, which are continuously upgraded in accordance with changes in legislation, changes in business activities based on market trends and development of new products, as well as through the adoption of risk management standards of Group. The Group has in place a comprehensive risk management system based on defined risk appetite, risk strategies and operating policies and procedures and set risk limits.

The Supervisory Board and Management Board of the Bank prescribe overall risk management principles and adopt risk strategies covering this area. The Risk Management Board considers, and reports to the Supervisory Board, on the strategy implementation, adequacy and manner of implementation of the adopted policies and other risk management procedures, as well as adequacy and reliability of the overall risk management system.

In accordance with the Group's policies, the Bank has implemented a standard approach to credit risk according to the Basel III Accord, through an IT platform, which is aligned with the requirements of these standards.

Risk management is within the competence of the Chief Risk Officer and is organized into the following organizational units:

- Underwriting,
- Credit Risk Monitoring and Special Credit Management, and
- Strategic, Market and Operational Risk Management.

Within the Special Credit Management there are two departments: Corporate Special Credit Management and Retail Special Credit Management. Within Strategic, Market and Operational Risk Management, there are also two departments: Credit Risk Control and Basel II and Market and Operational Risk Management. The function of collateral management, policies and procedures is the function that operates within the Strategic, Market and Operational Risk Management.

The most significant types of risks the Bank is exposed to are:

- Credit risk
- Market risk and
- Operational risk.

## 34.1. Credit Risk

The Bank is exposed to credit risk, which can be defined as the possibility that a borrower may fail to perform the liabilities defined in the respective loan agreements, resulting in a financial loss for the Bank. Assumption of credit risk is managed in accordance with the specific rules and principles defined by the Group for areas of credit strategies, policies, modeling, risk concentration, new product introduction, monitoring and reporting. Credit risk exposure is managed in accordance with the Bank's strategies and policies in force, as well as other internal bylaws prescribed by the Supervisory Board and the Management Board. Credit risk strategies define the main strategic goals, and determine the limits of credit risk assumption within business operations with all customer segments.

General principles and rules of credit risk management have been established by the Group through a General crediting policy, which the Bank applies in its business operations in accordance with the requirements of the local regulator, Group standards and best practices.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.1. Credit risk (CONTINUED)

*a) Credit Risk Measurement*

The following factors are taken into account in credit risk measurement: risk of loss resulting from insolvency of the borrower and risk of loss resulting from a change in the customer risk rating. Factors that are also taken into account are overall credit risk exposure including the balance sheet and off-balance-sheet items of the Bank and the quality and value of collaterals.

Credit risk is measured at the level of individual borrower/transaction and at the level of the total portfolio.

With the support of the Group, the Bank is developing and establishing both a system of credit risk measurement on the portfolio basis applying the Basel III basic parameters of credit risk for calculation of expected loss from the loan portfolio, and the calculation of the internal capital requirements to cover potential losses due to the credit risk on the basis of calculation of loan value at risk (VaR). As the measure of economic/internal capital, loan VaR is also the basic input for defining crediting strategies, analysis of credit limits and risk concentration.

The established system of reporting analyzes the main triggers and components of credit risk and their dynamics in order to undertake corrective activities if necessary and on time. Reports contain the information about changes in the size and quality of the loan portfolio at the customer segment level and for the Bank.

*b) Risk Control Policies*

The Bank manages, limits and controls credit risk concentrations, wherever such risk concentrations have been identified, particularly with regard to specific clients and/or groups of clients, and industry sectors.

The Bank sets the credit risk level, which it assumes by setting limits for the amount of risk accepted in relation to one borrower or group of borrowers, or industry segments. Such risks are monitored on a regular quarterly basis via a report to the Credit Committee of the Bank on credit risk concentration per industry and compliance with the adopted industry strategy. Additionally, through regular monthly Report for the Credit Committee, the Risk Management reports to the Credit Committee on defined limits on the Bank level.

The Credit Committee, Management Board and the Supervisory Board of the Bank are regularly informed of all significant changes in the value and quality of the portfolio.

Credit risk is also managed through the regular analysis of the ability of borrowers and potential borrowers to settle liabilities for principal repayment and interest payment, and change in credit limits where necessary.

## 34. RISK MANAGEMENT (CONTINUED)

### 34.1. Credit risk (CONTINUED)

*b) Risk Control Policies (Continued)*

In order to minimize the risks from lending activities, the Bank has set up a system with policies for definition, assessment and treatment of collaterals serving as security for collection of receivables, where it demands acceptable collaterals for collection of its receivables. Acceptable collateral is a pledge over an asset which has a known active market and stable price, whose value is satisfactory relative to the Bank's receivables and which is sufficient to protect the Bank from possible loss of principal, interest, fees and collection costs.

### 34.1.1. Maximum exposure to credit risk for on and off-balance sheet items

| | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| **Balance sheet assets** | | |
| Cash and cash equivalents (Note 17) | 143,893 | 225,492 |
| Financial assets held for trading | 244 | 1 |
| Financial assets at fair value through other comprehensive income (Note 18) | 218,888 | 197,265 |
| Financial assets at amortized cost | 1,257,249 | 1,207,266 |
| *a) Obligatory reserve with the Central Bank (Note 19)* | 127,016 | 125,877 |
| *b) Loans and receivables due from banks (Note 20)* | 104,115 | 144,015 |
| *c) Loans and receivables due from customers (Note 21)* | 1,026,118 | 937,374 |
| Tangible Assets (Note 22) | 23,715 | 17,761 |
| Other assets (Note 24) | 7,105 | 6,254 |
| **Total balance sheet items exposed to credit risk** | **1,651,094** | **1,654,039** |
| **Off-balance sheet items** | | |
| Guarantees and other sureties | 99,199 | 105,245 |
| Approved overdraft, framework loans and guarantees | 121,979 | 116,646 |
| **Total off-balance-sheet exposure to credit risk** | **221,178** | **221,891** |
| **Balance as at December 31** | **1,872,272** | **1,875,930** |

The Bank obtains collaterals securitizing loans and receivables in the form of mortgages assigned over real estate, and other forms of security over the assets and guarantees. Initial appraisals of the value of collaterals, or real estate, are performed already upon loan approval, i.e. they are an integral part of the process of customer loan request approval.

Revaluations are performed in accordance with the principles and rules of the collateral management system. For the purpose of alignment with the Group's techniques for credit risk mitigation, the Bank has implemented functional automatic monitoring of the expired insurance policies for real estate and introduced adjusting factors in cases of currency mismatch of collaterals and loans. The adjusting factors are not applied if the collateral is an item of property or movable assets with the value stated in EUR/BAM currency during the effectiveness of the Currency Board regime. Collaterals are not obtained for loans and receivables due from banks and financial assets available for sale.

In view of the impact of the general financial and economic crisis, there is considerable uncertainty related to the fair market value of such collaterals, along with the time needed to realize the sale thereof.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.1. Credit risk (CONTINUED)

### 34.1.2. Credit risk management and policies for impairment and provisions

*Impairment*

At each reporting date, the Bank checks the existence of objective evidence of impairment of financial assets, as previously explained in Note 2.7.

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

- Stages 1 and 2 - Performing loans and
- Stage 3- Non-performing loans.

For the purpose of determining impairment of loans and receivables, the Bank distinguishes two approaches:

- Loans assessed on an individual basis,
- Loans assessed on a portfolio basis.

*Loans assessed on an individual basis*

Individually significant loans are assessed on an individual basis in order to determine the existence of objective evidence of impairment. Factors that can influence the ability and readiness of each individual debtor to fulfill their obligations toward the Bank, are as follows:

- failure to settle or delay in payment of interest or principal;
- failure to comply with the contractual terms and conditions;
- instigation of bankruptcy proceedings;
- any specific information about business difficulties (e.g., reflected in the insufficient liquidity of the borrower);
- significant changes in the customer's market environment; and
- global economic situation.

Detailed overview and description of the UTP terms is defined through the Guidelines on defining default cases.

*Loans assessed on a portfolio basis*

In order to assess the impairment of loans that are not individually significant, such loans are grouped based on the similar credit risk characteristics. The Bank has segmented the loan portfolio into the risk groups based on the credit rating for legal entities and based on the number of days past due for private individuals and, accordingly, applying credit risk parameters (probability of default, loss given default, amount that the Bank requires in instances of non-performance of obligations) determined by Basel III and in conformity with IFRS requirements, it impairs loans.

*Manual adjustments for clients with increased credit risk*

For clients for which significant increase in credit risk has been identified, i.e. clients classified in Stage 2, in particular cases where it has been determined that calculation based on portfolio does not reflect the identified level of credit risk, the Bank keeps the right of individual assessment of necessary provisions. This is particularly valid for clients identified as WL clients (PSC 600 i 601) and clients classified as Restructuring (PSC 651) which are still in performing portfolio.

Suggestion of the level of necessary provisions is determined by the Credit risk monitoring and special credit, during which the amount of provisions cannot be higher than the minimum defined amount of provisions for non performing exposures for which the provision calculation is determined of individual basis. Approval of provision level is in the Bank's Credit board competence.

## 34. RISK MANAGEMENT (Continued)

### 34.1. Credit risk (Continued)

### 34.1.2. Credit risk management and policies for impairment and provisions (Continued)

*Breakdown of the loan portfolio according to the above listed categories is provided below:*

| Financial assets at amortized cost – Loans and receivables due from customers | December 31, 2019 BAM '000 | | | December 31, 2018 BAM '000 | | |
|---|---|---|---|---|---|---|
| | Loans | Impairment | % | Loans | Impairment | % |
| Stage 1 and 2 | | | | | | |
| - Legal entities' loans | 548,633 | 5,353 | 1.0% | 496,409 | 3,651 | 0.7% |
| - Private individuals' loans | 488,260 | 8,121 | 1.7% | 445,923 | 7,112 | 1.6% |
| | **1,036,893** | **13,474** | **1.3%** | **942,332** | **10,763** | **1.1%** |
| Stage 3 | | | | | | |
| - Legal entities' loans | 7,969 | 7,948 | 99.7% | 38,705 | 36,045 | 93.1% |
| - Private individuals' loans | 16,255 | 13,577 | 83.5% | 29,664 | 26,519 | 89.4% |
| | **24,224** | **21,525** | **88.9%** | **68,369** | **62,564** | **91.5%** |
| Total loans | **1,061,117** | **34,999** | **3.3%** | **1,010,701** | **73,327** | **7.3%** |

Provision coverage of the non-performing portfolio amounts to 88.9% (2018: 91.5%).

*The table below presents the breakdown of gross and net loans and receivables due from customers:*

| Financial assets at amortized cost – Loans and receivables due from customers | December 31, 2019. '000 BAM | December 31, 2018. '000 BAM |
|---|---|---|
| **Legal entities – corporate customers** | | |
| Stage 1 and 2: Performing undue loans | 546,837 | 493,533 |
| Stage 1 and 2: Performing due loans | 1,796 | 2,876 |
| Stage 3: Non-performing loans | 7,969 | 38,704 |
| **Gross exposure (Stage 1, 2 and 3)** | **556,602** | **535,113** |
| Impairment (Stage 1, 2 and 3) | (13,301) | (39,696) |
| **Net exposure (Stage 1, 2 and 3)** | **543,301** | **495,417** |
| **Private individuals –retail customers** | | |
| Stage 1 and 2: Performing undue loans | 487,882 | 445,803 |
| Stage 1 and 2: Performing due loans | 378 | 125 |
| Stage 3: Non-performing loans | 16,255 | 29,660 |
| **Gross exposure (Stage 1, 2 and 3)** | **504,515** | **475,588** |
| Impairment (Stage 1, 2 and 3) | (21,698) | (33,631) |
| **Net exposure (Stage 1, 2 and 3)** | **482,817** | **441,957** |
| **Total gross exposure (corporate and retail)** | **1,061,117** | **1,010,701** |
| Stage 1 and 2: Performing loans – impairment | (13,474) | (10,763) |
| Stage 3: Non-performing loans – impairment | (21,525) | (62,564) |
| **Net exposure (corporate and retail)** | **1,026,118** | **937,374** |

# 34. RISK MANAGEMENT (CONTINUED)

## 34.1. Credit Risk (CONTINUED)

### 34.1.2. Credit risk management and policies for impairment and provisions (CONTINUED)

*a) Stages 1 and 2: Performing undue loans*

The quality of the portfolio of undue loans to customers can be estimated through the internal standard monitoring system. Loans to customers are regularly monitored and systematically reviewed in order to identify any irregularities or warning signals. These loans are subject to constant monitoring with the aim of taking timely action based on improvement/deterioration of the client risk profile.

Breakdown of gross exposure of undue loans to customers according to the type of loan is as follows:

| | Loans to private individuals | | | | Loans to legal entities | | | |
|---|---|---|---|---|---|---|---|---|
| | Consumer loans | Housing loans | Credit card loans and approved account overdrafts | Total | Public and financial sector and international client loans | Domestic corporate client loans | Entre-preneurial loans | Total |
| | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 |
| **December 31, 2019** | | | | | | | | |
| Stages 1 and 2 | | | | | | | | |
| Standard monitoring | 327,716 | 134,198 | 25,968 | 487,882 | 341,325 | 162,443 | 43,069 | 546,837 |
| | | | | | | | | |
| ***December 31, 2018*** | | | | | | | | |
| Stages 1 and 2 | | | | | | | | |
| *Standard monitoring* | 325,983 | 94,851 | 24,969 | 445,803 | 315,960 | 143,106 | 34,467 | 493,533 |

# 34. RISK MANAGEMENT (CONTINUED)

## 34.1. Credit Risk (CONTINUED)

### 34.1.2. Credit risk management and policies for impairment and provisions (CONTINUED)

*b) Stages 1 and 2: Performing due loans*

The gross amount of loans and receivables due from customers that were past due were as follows:

| | Loans to private individuals | | | | Loans to legal entities | | | |
|---|---|---|---|---|---|---|---|---|
| | Consumer loans | Housing loans | Credit card loans and approved account overdrafts | Total | Public and financial sector and international client loans | Domestic corporate client loans | Entre-preneurial loans | Total |
| December 31, 2019 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 |
| **Matured Stages 1 and 2:** | | | | | | | | |
| - up to 30 dpd | 59 | - | 170 | 229 | 6 | 1,216 | 145 | 1,367 |
| - 30 - 60 dpd | 47 | - | 29 | 76 | - | - | 11 | 11 |
| - 60 - 90 dpd | 13 | - | 60 | 73 | 252 | 166 | - | 418 |
| - over 90 dpd | - | - | - | - | - | - | - | **-** |
| **Total** | **119** | **-** | **259** | **378** | **258** | **1,382** | **156** | **1,796** |
| Collateral value | - | - | - | - | - | 218 | 28 | 246 |
| ***December 31, 2018*** | | | | | | | | |
| **Matured Stages 1 and 2:** | | | | | | | | |
| *- up to 30 dpd* | 76 | - | - | **76** | 153 | 1,239 | 1 | **1,393** |
| *- 30 - 60 dpd* | 20 | - | - | **20** | - | 1,483 | - | **1,483** |
| *- 60 - 90 dpd* | 29 | - | - | **29** | - | - | - | **-** |
| *- over 90 dpd* | - | - | - | **-** | - | - | - | **-** |
| ***Total*** | **125** | | | **125** | **153** | **2,722** | **1** | **2,876** |
| *Collateral value* | - | - | - | **-** | - | 915 | - | **915** |

### 34.1.2. Credit risk management and policies for impairment and provisions (CONTINUED)

*c) Stage 3: Non-performing loans*

The classification of non-performing loans to customers, together with the allocated value of associated collateral instruments, is as follows:

| | Loans to private individuals | | | | Loans to legal entities | | | |
|---|---|---|---|---|---|---|---|---|
| | Consumer loans | Housing loans | Credit card loans and approved account overdrafts | Total | Public and financial sector and international client loans | Domestic corporate client loans | Entre-preneurial loans | Total |
| | BAM '000 | BAM '000 | BAM'000 | BAM'000 | BAM'000 | BAM'000 | BAM'000 | BAM'000 |
| **December 31, 2019** | | | | | | | | |
| Non-performing loans-Stage 3 | 12,187 | 3,038 | 1,030 | **16,255** | 2,434 | 2,245 | 3,290 | **7,969** |
| Collateral value | 12 | 1,930 | 0 | **1,942** | 1,405 | 207 | 713 | **2,325** |
| ***December 31, 2019*** | | | | | | | | |
| Non-performing loans-Stage 3 | 23,151 | 3,993 | 2,516 | **29,660** | 5,844 | 17,905 | 14,955 | **38,704** |
| *Collateral value* | 820 | 2,098 | - | **2,918** | 1,810 | 4,186 | 1,263 | **7,259** |

The data shown in the table above are presented in gross amounts.

As at December 31, 2019, assets acquired in lieu of debt collection per loans amounted to BAM 922 thousand (2018: BAM 584 thousand).

# 34. RISK MANAGEMENT (CONTINUED)

## 34.1. Credit Risk (CONTINUED)

### 34.1.2. Credit risk management and policies for impairment and provisions (CONTINUED)

*d) Restructured loans and receivables*

During the year, the Bank restructured certain loans to customers in order to improve their ultimate recoverability. Restructuring is mainly performed in response to deterioration or for the prevention of further deterioration of the customer financial situation based on an analysis of the possibility of successful restructuring in order to remove difficulties in the client's operations within a defined time limit and return the client to the performing portfolio.

Restructured loans (exposure per all restructured loans irrespective of whether they belong to the remit of the Business Segments or Special Credit Management) amounted to a total of BAM 8,091 thousand as at December 31, 2019 (2018: BAM 24,740 thousand).

Decrease in total amount of exposure to restructured loans is a result of booking of accounting write-offs and sale of non performing exposures.

| | December 31, 2019<br>BAM'000 | December 31, 2018<br>BAM '000 |
|---|---|---|
| Restructured loans | 8,091 | 24,740 |
| Loan portfolio - gross | 1,061,117 | 1,010,701 |
| Share of restructured loans in the gross loan portfolio | 0.8% | 2.4% |

### 34.1.3. Credit risk concentration

*a) Geographic concentration of credit risk*

Geographic credit risk concentration of the loan portfolio relates entirely to the corporate clients, individuals and other entities located in Bosnia and Herzegovina.

*b) Concentration of credit risk by industry*

Breakdown of the Bank's loan portfolio as at December 31, 2019 and December 31, 2018 per industry is provided in the table below:

| | December 31, 2019<br>'000 BAM | December 31, 2018<br>'000 BAM |
|---|---|---|
| **Legal entities – corporate customers** | | |
| Agriculture, forestry and fishing | 6,900 | 8.471 |
| Mining and quarrying | 918 | 979 |
| Manufacturing | 100,634 | 90.516 |
| Electricity, gas, steam and air conditioning supply | 19,510 | 31.694 |
| Water supply and remediation activities | 1,819 | 896 |
| Construction | 39,791 | 35.289 |
| Wholesale and retail trade | 117,846 | 116.994 |
| Transporting and storage | 10,366 | 26.033 |
| Accommodation and food service activities | 631 | 959 |
| Information and communication | 48,791 | 24.978 |
| Financial and insurance activities | 5,710 | 3.224 |
| Real estate activities | 641 | 808 |
| Professional, scientific and technical activities | 2,687 | 5.041 |
| Administrative and support service activities | 17 | 183 |
| Public administration and defense; compulsory social security | 169,536 | 158.588 |
| Education | 129 | 94 |
| Human health and social work activities | 30,542 | 28.003 |
| Arts, entertainment and recreation | 22 | 26 |
| Other services activities | 112 | 2,337 |
| | **556,602** | **535,113** |
| Private individuals – retail customers | 504,515 | 475.588 |
| **Total gross loans** | **1,061,117** | **1.010.701** |
| **Impairment** | (34,999) | (73.327) |
| **Total net loans** | **1,026,118** | **937.374** |

The structure of the loan portfolio is regularly monitored by the Risk Management in order to recognize potential events that could have a significant impact on the loan portfolio (usual risk factors) and, if needed, to mitigate the Bank's exposure to certain industry sectors.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.1. Credit Risk (CONTINUED)

### 34.1.3. Credit risk concentration (CONTINUED)

*c) Large credit risk exposures*

| Large credit risk exposures | December 31, 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| **Number of clients with exposure over 10% of eligible capital** | 3 | 4 |
| Balance and off-balance credit exposure - gross | 91,047 | 102,258 |
| Impairment and provision for off-balance credit exposure | (71) | (1,642) |
| Balance and off-balance credit exposure - net | **90,976** | **100,616** |
| **Exposure to the Public Sector (Central Institutions)** | **December 31, 2019 BAM '000** | **December 31, 2018 BAM '000** |
| Balance and off-balance credit exposure - gross | 136,409 | 143,318 |
| Impairment and provision for off-balance credit exposure | (249) | (684) |
| Balance and off-balance credit exposure - net | **136,160** | **142,634** |
| Balance exposure - Securities | **218,646** | **197,148** |

## 34.2. Liquidity Risk

Liquidity risk represents a risk that the Bank will not be able to settle its financial liabilities fully and without any delay. In this respect, the main target of the Bank, when managing liquidity risk as the central risk inherent in banking operations, is to align its business activities and ensure optimal liquidity in accordance with the minimum standards and limits prescribed by the Banking Agency of the Republic of Srpska, BH Central Bank and the Group.

The Bank has access to various sources of financing, which include different types of deposits of retail and corporate customers, banks (within and out of the Group), and lines of credit. The aforesaid sources enable flexibility of funding sources and limit the dependence on any single source, thus providing a high level of their own sustainability in possible crises.

The Bank has implemented the liquidity policies of the Group, by which methods and procedures of liquidity parameter analysis have been defined which cover managing and control of liquidity risk, both in terms of regular business and in crisis situations. In accordance with the Group guidelines and local regulatory requirements, exposure to the liquidity risk is held at the level at which the Bank is able to fulfill its payment obligations on a regular basis, and in the crisis periods as well.

Regular business involves the usual daily activities for which it is usual for any phase from the Liquidity Policy in crisis situations not to be activated.

The most important activities are aimed at carrying out normal market transactions within the prescribed risk exposure limits in accordance with the defined financing plan, as well as decisions of the competent authorities and operational functions.

These activities are mainly focused on managing short-term and long-term liquidity, managing the execution of the financing plan, regular monitoring and analysis of the results of the testing of the liquidity risk stress resistance as well as the consistent application of the principle of determining internal prices.

## 34.2. Liquidity Risk (CONTINUED)

Short-term liquidity risk is measured through operational buckets of maturities of up to one year, through net cash flows (inflows/outflows) and through the liquidity coverage ratio (LCR) where the Bank is required to provide an adequate level of liquidity buffer to meet the scenario's liquidity stress test of 30 calendar days.

Short-term liquidity limits the exposures to all currencies as well as the total exposure. Structural liquidity measures seek to ensure an appropriate balance between assets and liabilities in the medium to long term (over a year), in order to ensure structural stability and limit the dependence on short-term and less stable financing.

The short-term liquidity stress testing measures whether the available liquidity reserves can ensure that the Bank endures a hypothetical shortage of short-term funds. The scenarios are based on the concept of maturity buckets of assets and their renewal. The relevant scenarios are defined in order to present possible events with a potentially negative impact on liquidity. Considering the nature of the liquidity stress test, as the tool for assessing different liquidity risks, the combined scenario is acceptable.

The Bank also adopted the Liquidity Management Policy in Emergency Situations consisting of the Liquidity Management Policy in Emergency Situations and the Emergency Action Plan.

The Bank is required to maintain liquidity within the ranges prescribed by the Banking Agency of the Republic of Srpska and the Central Bank of Bosnia and Herzegovina:

- Maintenance of the obligatory reserve
- Maintenance of ten-day and daily liquidity
- Maturity matching of financial assets and liabilities
- Liquidity coverage ratio (LCR).

Starting from 31 March 2019 the Bank is obliged to inform Banking agency of Republic of Srpska about Liquidity coverage ratio on a monthly bases

| | December 31, 2019. |
|---|---|
| **Liquidity coverage ratio (LCR) %** | 143% |

The following tables show the structure of the assets and liabilities at December 31, 2019 and December 31, 2018, which represents a breakdown of assets and liabilities by appropriate maturity buckets, based on the remaining period of agreed maturity, with the following exceptions:

1. Current and demand savings accounts and overdrafts per current accounts of legal entities and private individuals are mapped based on their estimated stability in compliance with BARS decisions and in accordance with the Group's standards;

2. Non-performing loans, other assets, equity and reserves are also mapped according to the Group's standard rules to the longest maturity term.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.2. Liquidity Risk (CONTINUED)

| December 31, 2019 | Up to a month BAM '000 | From 1 to 3 months BAM '000 | From 3 to 12 months BAM '000 | From 1 to 5 years BAM '000 | Over 5 years BAM '000 | Total BAM '000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 143,893 | - | - | - | - | 143,893 |
| Financial assets held for trading | 244 | - | - | - | - | 244 |
| Financial assets at fair value through other comprehensive income | 9,963 | 183 | 5,018 | 192,810 | 10,914 | 218,888 |
| ***Financial assets at amortized cost*** | | | | | | |
| a) Obligatory reserve with the Central Bank | 127,016 | - | - | - | - | 127,016 |
| b) Loans and receivables due from banks | 88,115 | - | - | 16,000 | - | 104,115 |
| c) Loans and receivables due from customers | 66,940 | 41,218 | 158,168 | 493,390 | 266,402 | 1,026,118 |
| Tangible assets | - | - | - | - | 23,715 | 23,715 |
| Intangible assets | - | - | - | - | 10,530 | 10,530 |
| Other assets | - | - | 7,105 | - | - | 7,105 |
| Deferred tax assets | | | 6 | | | 6 |
| **Total assets** | **436,171** | **41,401** | **170,297** | **702,200** | **311,561** | **1,661,630** |
| **Liabilities, equity and reserves** | | | | | | |
| ***Financial liabilities at amortized cost*** | | | | | | |
| a) Deposits and borrowings due to banks | 41,603 | 85,009 | 114,193 | 110,723 | 2,329 | 353,857 |
| b) Deposits and borrowings due to customers | 206 714 | 65 916 | 184 325 | 327 755 | 250 955 | 1 035 665 |
| c) Lease liabilities | 52 | 111 | 498 | 2 030 | 385 | 3 076 |
| Financial liabilities held for trading | - | - | - | - | - | - |
| Other liabilities | - | - | 18,555 | - | - | 18,555 |
| Provisions for risks and expenses | - | - | 5,038 | - | - | 5,038 |
| Income tax payable | - | - | 381 | - | - | 381 |
| Deferred tax liabilities | - | - | 263 | | | 263 |
| Equity and reserves | - | - | - | - | 244,795 | 244,795 |
| **Total liabilities, equity and reserves** | **248,369** | **151,036** | **323,253** | **440,508** | **498,464** | **1,661,630** |
| **Liquidity gap** | **187,802** | **(109,635)** | **(152,956)** | **261,692** | **(186,903)** | **-** |

# 34. RISK MANAGEMENT (Continued)

## 33.2. Liquidity Risk (Continued)

| December 31, 2018 | Up to a month BAM '000 | From 1 to 3 months BAM '000 | From 3 to 12 months BAM '000 | From 1 to 5 years BAM '000 | Over 5 years BAM '000 | Total BAM '000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 225,492 | - | - | - | - | 225,492 |
| Financial assets held for trading | - | - | 1 | - | - | 1 |
| Financial assets at fair value through other comprehensive income | - | 11,322 | 13,401 | 172,425 | 117 | 197,265 |
| **Financial assets at amortized cost** | | | | | | |
| a) Obligatory reserve with the Central Bank | 125,877 | - | - | - | - | 125,877 |
| b) Loans and receivables due from banks | 128,015 | - | - | - | 16,000 | 144,015 |
| c) Loans and receivables due from customers | 65,565 | 41,329 | 158,167 | 435,911 | 236,402 | 937,374 |
| Tangible assets | - | - | - | - | 17,761 | 17,761 |
| Intangible assets | - | - | - | - | 8,115 | 8,115 |
| Other assets | - | - | 6,254 | - | - | 6,254 |
| Deferred tax assets | - | - | 77 | - | - | 77 |
| **Total assets** | **544.949** | **52,651** | **177,900** | **608,336** | **278,395** | **1,662,231** |
| **Liabilities, equity and reserves** | | | | | | |
| **Financial liabilities at amortized cost** | | | | | | |
| a) Deposits and borrowings due to banks | 148,831 | 47,099 | 158,434 | 41,446 | 19,859 | 415,669 |
| b) Deposits and borrowings due to customers | 181,722 | 72,999 | 202,547 | 307,641 | 241,742 | 1,006,651 |
| Financial liabilities held for trading | - | - | - | - | - | - |
| Other liabilities | - | - | 17,737 | - | - | 17,737 |
| Provisions for risks and expenses | - | - | 3,321 | - | - | 3,321 |
| Income tax payable | - | 178 | - | - | - | 178 |
| Deferred tax liabilities | - | - | - | - | - | - |
| Equity and reserves | - | - | - | - | 218,675 | 218,675 |
| **Total liabilities, equity and reserves** | **330,553** | **120,276** | **382,039** | **349,087** | **480,276** | **1,662,231** |
| **Liquidity gap** | **214.396** | **(67,625)** | **(204,139)** | **259,249** | **(201,881)** | **-** |

# 34. RISK MANAGEMENT (CONTINUED)

## 34.3. Market Risk Management

Market risks arise from general and specific trends and changes of certain market variables (interest rates, prices of securities, exchange rate changes), which can affect the economic value the portfolio in the trading book and in the banking book. The Bank is exposed to market risks mainly because of items and business activities from the banking book.

Market risk exposure management includes the activities related to the operations of the Markets and Assets and Liabilities Management function, and it has been organized through a system of internal bylaws and the setting of defined limits and warning signals that are supervised on a daily basis. Market risk measuring is based on the VaR ("Value at Risk") methodology. VaR is the estimated potential overnight loss which occurs in the overall and in particular items of the balance sheet structure in a defined time period, based on numerous assumptions of changes in market conditions with a confidence level of 99%. The Group uses historic volatility simulation as an assessment model based on the last 500 daily return observations. VaR model quality is continuously monitored by back testing. Beside the VaR methodology, the Market Risk Management also uses open FX position limits and base point calculation as a supplement to the set VaR limits.

Factors, which are also of importance for assessment of the market risk impact on the Banks' portfolio, are stress-oriented warning levels and limits and the results are included in regular ALCO reports (reports presented to the Assets and Liabilities Management Committee of the Bank).

The Bank performs activities on market risk limit review closely cooperating with UniCredit Group. These activities are performed at least annually, and more frequently if necessary in accordance with business changes as a result of changes in legislation, development of business strategy goals as well as targeted risk profile.

The set of documents with rules for operations performed by the Markets and Market Risk Management is made in the form of a Financial Markets Rulebook and Market Risk Strategy. Only the permitted risk holders are enabled to enter into the risk-weighted items.

Overview of the Bank's aggregate VaR position:

| | 2019<br>BAM '000 | 2018<br>BAM '000 |
|---|---|---|
| - average for the period | 679 | 768 |
| - maximum for the period | 794 | 1,291 |
| - minimum for the period | 611 | 452 |

In addition to implementing the Group market risk techniques, methods and measuring models, the Bank is continuously working on the improvement of the business processes and data quality.

# 34. RISK MANAGEMENT (Continued)

## 34.3. Market Risk Management (Continued)

### 34.3.1. Currency Risk

Currency risk is the risk of a possible occurrence of adverse effects on the Bank's financial result and equity due to volatility in exchange rates. The exposure to foreign currency risk results from credit, deposit and trading activities and is controlled daily, according to legal and internal Group limits for particular currencies, and in total amount for all assets and liabilities denominated in foreign currencies or indexed to a foreign currency.

Currency risk management includes monitoring and control of individual items in foreign currencies and the total foreign exchange position of the Bank. The open position is determined on the basis of all on-balance and off-balance items. Foreign exchange risk limits restrict the maximum amount of open foreign currency position by currency. The Bank continuously monitors foreign exchange risk through the limits prescribed by local regulations and by the Group.

In accordance with the decision of the local regulator, which regulates the minimum standards for managing foreign currency risk, the Bank is required to maintain the relationship between assets and liabilities in each single currency so that its total open foreign currency position at the end of each working day does not exceed 30% of its recognized (regulatory) capital.

The Bank directs its business activities so as to minimize mismatch between items of assets and liabilities in foreign currencies or with a contracted currency clause, maintaining daily operations within the range of the set limits.

All sensitivities arising from items in or linked to foreign currencies are also covered by the general daily VaR limit, which among other risks, limits the maximum permitted loss of open positions in the foreign currencies.

| | 2019 | 2018 |
|---|---|---|
| **Currency risk ratios:** | | |
| - as at December 31 | 4.33% | 4.90% |
| - maximum for the period - month of December | 25.93% | 19.19% |
| - minimum for the period - month of December | 0.38% | 0.44% |

With regards to the presence of the Currency Board (regime of the Central Bank of Bosnia and Herzegovina) according to which the rate of the national currency to the euro is fixed, it can be considered that the Bank is not exposed to the currency risk related to EUR/BAM exchange rate.

The Bank protects itself from exposure to the currency risk per foreign currencies other than EUR by managing foreign currency position, within the Markets' strategy, in such a manner that the items opened through operations with customers are closed by opposite transactions, so that the open position of the Bank is reduced to the minimum.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.3. Market Risk Management (CONTINUED)

### 34.3.1. Currency Risk (CONTINUED)

The analysis of assets and liabilities stated in foreign currency amounts, as at December 31, 2019 and December 31, 2018 is presented in the following table.

| | EUR | EUR - linked items | USD | Other currencies | Total FX | BAM | Total |
|---|---|---|---|---|---|---|---|
| | BAM'000 | BAM'000 | BAM'000 | BAM'000 | BAM'000 | BAM'000 | BAM '000 |
| **December 31, 2019** | | | | | | | |
| **Assets** | | | | | | | |
| Cash and cash equivalents | 3,839 | - | 615 | 1,837 | **6,291** | 137,602 | 143,893 |
| Financial assets for trading | - | - | - | - | **-** | 244 | 244 |
| Financial assets at fair value through other comprehensive income | 66,520 | 151,402 | - | - | **217,922** | 966 | 218,888 |
| ***Financial assets at amortized cost*** | **111,144** | **449,367** | **1,020** | **9,802** | **571,333** | **685,916** | **1,257,249** |
| a) Obligatory reserve with the Central Bank | - | - | - | - | **-** | 127,016 | 127,016 |
| b) Loans and receivables due from banks | 77,375 | - | 1,020 | 9,802 | **88,197** | 15,918 | 104,115 |
| c) Loans and receivables due from customers | 33,769 | 449,367 | - | - | **483,136** | 542,982 | 1,026,118 |
| Property and equipment | - | - | - | - | **-** | 23,715 | 23,715 |
| Intangible assets | - | - | - | - | **-** | 10,530 | 10,530 |
| Other assets | 153 | - | 4 | 4 | **161** | 6,944 | 7,105 |
| Deferred tax assets | - | - | - | - | **-** | 6 | 6 |
| | | | | | | | |
| **Total assets** | **181,656** | **600,769** | **1,639** | **11,643** | **795,707** | **865,923** | **1,661,630** |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| ***Financial liabilities at amortized cost*** | **605,128** | **141,697** | **9,623** | **11,210** | **767,658** | **624,940** | **1,392,598** |
| a) Deposits and borrowings due to banks | 337,433 | - | - | - | **337,433** | 16,424 | **353,857** |
| b) Deposits and borrowings due to customers | 267,695 | 141,697 | 9,623 | 11,210 | **430,225** | 605,440 | **1,035,665** |
| c) Lease liabilities | - | - | - | - | **-** | 3,076 | **3,076** |
| Financial liabilities for trading | - | - | - | - | **-** | - | - |
| Other liabilities | 974 | 20 | 4 | 4 | **1,002** | 17,553 | **18,555** |
| Provisions for risks and expenses | 1,277 | 5 | - | - | **1,282** | 3,756 | **5,038** |
| Current income tax | - | - | - | - | - | 381 | **381** |
| Deferred tax liabilities | - | - | - | - | - | 263 | **263** |
| **Total liabilities** | **607,379** | **141,722** | **9,627** | **11,214** | **769,942** | **646,893** | **1,416,835** |
| **Equity and reserves** | **-** | **-** | - | - | **-** | **244,795** | **244,795** |
| | | | | | | | |
| **Total liabilities, equity and reserves** | **607,379** | **141,722** | **9,627** | **11,214** | **769,942** | **891,688** | **1,661,630** |
| | | | | | | | |
| **Net foreign currency position** | **(425,723)** | **459,047** | **(7,988)** | **429** | **25,765** | **(25,765)** | **-** |

# 34. RISK MANAGEMENT (Continued)

## 34.3. Market Risk Management (Continued)

### 34.3.1. Currency Risk (Continued)

| | EUR<br>BAM'000 | EUR - linked items<br>BAM'000 | USD<br>BAM'000 | Other currencies<br>BAM'000 | Total FX<br>BAM'000 | BAM<br>BAM'000 | Total<br>BAM '000 |
|---|---|---|---|---|---|---|---|
| **December 31, 2018** | | | | | | | |
| **Assets** | | | | | | | |
| Cash and cash equivalents | 3,282 | - | 323 | 2,038 | **5,643** | 219,849 | 225,492 |
| Financial assets for trading | - | - | - | - | **-** | 1 | 1 |
| Financial assets at fair value through other comprehensive income | 66,520 | 126,389 | - | - | **192,909** | 4,356 | 197,265 |
| ***Financial assets at amortized cost*** | | | | | | | |
| a) Obligatory reserve with the Central Bank | - | - | - | - | **-** | 125,877 | 125,877 |
| b) Loans and receivables due from banks | 108,484 | - | 9,679 | 9,852 | **128,015** | 16,000 | 144,015 |
| c) Loans and receivables due from customers | 47,143 | 424,820 | - | - | **471,963** | 465,411 | 937,374 |
| Property and equipment | - | - | - | - | **-** | 17,761 | 17,761 |
| Intangible assets | - | - | - | - | **-** | 8,115 | 8,115 |
| Other assets | 171 | - | 54 | 997 | **1,222** | 5,032 | 6,254 |
| Deferred tax assets | - | - | - | - | **-** | 77 | 77 |
| | | | | | | | |
| **Total assets** | **225,600** | **551,209** | **10,056** | **12,887** | **799,752** | **862,479** | **1,662,231** |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| ***Financial liabilities at amortized cost*** | | | | | | | |
| a) Deposits and borrowings due to banks | 400,099 | - | - | - | **400,099** | 15,570 | 415,669 |
| b) Deposits and borrowings due to customers | 254,685 | 141,236 | 10,049 | 10,892 | **416,862** | 589,789 | 1,006,651 |
| Financial liabilities for trading | - | - | - | - | **-** | - | - |
| Other liabilities | 865 | - | 6 | - | **871** | 16,866 | 17,737 |
| Provisions for risks and expenses | 331 | 1 | - | - | **332** | 2,989 | 3,321 |
| Current income tax | - | - | - | - | **-** | 178 | 178 |
| Deferred tax liabilities | - | - | - | - | **-** | - | - |
| **Total liabilities** | **655,980** | **141,237** | **10,055** | **10,892** | **818,164** | **625,392** | **1,443,556** |
| **Equity and reserves** | **1,523** | **1,468** | **-** | **-** | **2,991** | **215,684** | **218,675** |
| | | | | | | | |
| **Total liabilities, equity and reserves** | **657,503** | **142,705** | **10,055** | **10,892** | **821,155** | **841,076** | **1,662,231** |
| | | | | | | | |
| **Net foreign currency position** | **(431,903)** | **408,504** | **1** | **1,995** | **(21,403)** | **21,403** | **-** |

# 34. RISK MANAGEMENT (Continued)

## 34.3. Market Risk Management (Continued)

### 34.3.2.Interest Rate Risk

The Bank is exposed to a risk from interest rate fluctuations with an impact on the financial position of the Bank and its cash flows. The Bank's business operations are influenced by interest rates changes, to the extent that interest bearing assets and liabilities mature or their interest rates change at different times or in different amounts. Interest rate margins may grow as the result of those fluctuations, however, at the same time they may decrease and cause losses in the event of unexpected fluctuations.

The main sources of interest rate risk are as follows:

- repricing risk resulting from unfavorable changes in the fair value of assets and liabilities during the remaining period until the next interest rate change (items with fixed interest rate are classified according to the remaining maturity);
- risk of change in inclination and shape of the yield curve (yield curve risk);
- risk of different changes in lending and borrowing interest rates (basis risk) of instruments having identical maturities and denominated in identical currencies, where the interest rates are based on different reference rate types (e.g. EURIBOR vs. LIBOR); and
- optionality risk resulting from options, including embedded options in interest sensitive items (e.g. loans with early repayment possibility, deposits with early withdrawal possibility, and alike).

Exposure to the risk of interest rate changes is monitored by means of defined reports and in accordance with the Group guidelines.

Exposure to the interest rate risk will also be monitored in accordance with the requirements of the local regulator for significant currencies individually and for all other currencies in the aggregate by monitoring the changes in the economic value of the banking book for: items with a fixed interest rate, variable interest rate, a rate which changes according to the Bank's decision, total weighted position as well as the impact of interest rate risk on the net interest income.

The methodology used for risk assessment of interest rate changes is based on the gap analysis of time (maturity) differences. Differences between interest-bearing assets and liabilities in different time "buckets" show how two sides of the balance sheet may react differently to the change of interest rates:

- in case of a positive gap difference, the Bank is exposed to a risk of loss in the event that interest rates of given maturities for the relevant currency fall,
- in case of a negative gap difference, the Bank is exposed to a risk of loss in the event that interest rates of the given maturity for the relevant currency grow.

In accordance with the Group's requirements, interest rate risk is measured by calculating the change in the net present value of the portfolio in case of a fall in the reference rate curve by 0.01% (1 basis point) and it is limited by BPV limit (basis point value limit) as a sensitivity measure. BPV limits are defined in summary, per currency and per time buckets. Interest risk is also monitored through the specified VaR model.

Stress testing conducted by the Bank for interest rate risk category includes scenarios of various shocks on interest curves. Shocks include change in interest rate level (parallel shifts), curve rotations, change in curve inclination and peaks in specific segments of interest curves.

The review of the Bank's exposure to interest rate risk on December 31, 2019, and December 31, 2018 is shown in the following tables.

# 34. RISK MANAGEMENT (Continued)

## 34.3. Market Risk Management (Continued)

### 34.3.2. Interest Rate Risk (Continued)

*a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates*

Earnings will also be affected by the maturity structure of the Bank's assets and liabilities:

| | Up to a month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | Over 5 years | Non-interest bearing | Total | Fixed interest rate |
|---|---|---|---|---|---|---|---|---|
| | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 |
| **December 31, 2019** | | | | | | | | |
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 115,101 | - | - | - | - | 28,792 | **143,893** | - |
| Financial assets for trading | - | - | - | - | - | 244 | **244** | - |
| Financial assets at fair value through other comprehensive income | 9,963 | 183 | 5,018 | 192,810 | 10,914 | - | **218,888** | 218,888 |
| **Financial assets at amortized cost** | **88,757** | **365,785** | **489,384** | **126,810** | **59,497** | **127,016** | **1,257,249** | **446,982** |
| a) Obligatory reserve with the Central Bank | - | - | - | - | - | 127,016 | **127,016** | - |
| b) Loans and receivables due from banks | 88,115 | 16,000 | - | - | - | - | **104,115** | 88,115 |
| c) Loans and receivables due from customers | 642 | 349,785 | 489,384 | 126,810 | 59,497 | - | **1,026,118** | 358,867 |
| Property and equipment | - | - | - | - | - | 23,715 | **23,715** | - |
| Intangible assets | - | - | - | - | - | 10,530 | **10,530** | - |
| Other assets | - | - | - | - | - | 7,105 | **7,105** | - |
| Deferred tax assets | - | - | - | - | - | 6 | **6** | - |
| **Total assets** | **213,821** | **365,968** | **494,402** | **319,620** | **70,411** | **197,408** | **1,661,630** | **665,870** |
| **Liabilities** | | | | | | | | |
| **Financial liabilities at amortized cost** | **109,321** | **129,766** | **833,023** | **299,986** | **17,426** | 3,076 | **1,392,598** | **1,340,868** |
| a) Deposits and borrowings due to banks | 42,717 | 94,729 | 131,852 | 83,581 | 978 | - | **353,857** | 316,115 |
| b) Deposits and borrowings due to customers | 66,604 | 35,037 | 701,171 | 216,405 | 16,448 | - | **1,035,665** | 1,024,753 |
| c) Lease liabilities | - | - | - | - | - | 3,076 | **3,076** | - |
| Financial liabilities for trading | - | - | - | - | - | - | **-** | - |
| Other liabilities | - | - | - | - | - | 18,555 | **18,555** | - |
| Provisions for risks and expenses | - | - | - | - | - | 5,038 | **5,038** | - |
| Current tax liabilities | - | - | - | - | - | 381 | **381** | - |
| Deferred tax liabilities | - | - | - | - | - | 263 | **263** | - |
| **Total liabilities** | **109,321** | **129,766** | **833,023** | **299,986** | **17,426** | **27,313** | **1,416,835** | **1,340,868** |
| **Equity and reserves** | **-** | **-** | **-** | **-** | **-** | **244,795** | **244,795** | **-** |
| **Total liabilities, equity and reserves** | **109,321** | **129,766** | **833,023** | **299,986** | **17,426** | **272,108** | **1,661,630** | **1,340,868** |
| **Interest rate mismatch** | **104,500** | **236,202** | **(338,621)** | **19,634** | **52,985** | **(74,700)** | **-** | **(674,998)** |

# 34. RISK MANAGEMENT (CONTINUED)

## 34.3. Market Risk Management (CONTINUED)

### 34.3.2. Interest Rate Risk (CONTINUED)

*a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates (continued)*

| | Up to a month BAM '000 | From 1 to 3 months BAM '000 | From 3 to 12 months BAM '000 | From 1 to 5 years BAM '000 | Over 5 years BAM '000 | Non-interest bearing BAM '000 | Total BAM '000 | Fixed interest rate BAM '000 |
|---|---|---|---|---|---|---|---|---|
| **December 31, 2018** | | | | | | | | |
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 199,744 | - | - | - | - | 25,748 | 225,492 | |
| Financial assets for trading | - | - | - | - | - | 1 | 1 | - |
| Financial assets at fair value through other comprehensive income | 117 | 11,322 | 13,401 | 172,425 | - | - | 197,265 | 197,265 |
| **Financial assets at amortized cost** | **189,954** | **282,891** | **579,102** | **109,320** | **45,999** | **-** | **1,207,266** | **481,352** |
| a) Obligatory reserve with the Central Bank | - | - | 125,877 | - | - | - | 125,877 | - |
| b) Loans and receivables due from banks | 128,015 | 16,000 | - | - | - | - | 144,015 | 128,015 |
| c) Loans and receivables due from customers | 61,939 | 266,891 | 453,225 | 109,320 | 45,999 | - | 937,374 | 353,337 |
| Property and equipment | - | - | - | - | - | 17,761 | 17,761 | - |
| Intangible assets | - | - | - | - | - | 8,115 | 8,115 | - |
| Other assets | - | - | - | - | - | 6,254 | 6,254 | - |
| Deferred tax assets | - | - | - | - | - | 77 | 77 | - |
| **Total assets** | **389,815** | **294,213** | **592,503** | **281,745** | **45,999** | **57,956** | **1,662,231** | **678,617** |
| **Liabilities** | | | | | | | | |
| **Financial liabilities at amortized cost** | **175,820** | **67,903** | **962,819** | **172,579** | **43,199** | **-** | **1,422,320** | **1,403,003** |
| Deposits and borrowings due to banks | 154,272 | 41,848 | 173,370 | 30,622 | 15,557 | - | 415,669 | 409,838 |
| Deposits and borrowings due to customers | 21,548 | 26,055 | 789,449 | 141,957 | 27,642 | - | 1,006,651 | 993,165 |
| Financial liabilities for trading | - | - | - | - | - | - | - | - |
| Other liabilities | - | - | - | - | - | 17,737 | 17,737 | - |
| Provisions for risks and expenses | - | - | - | - | - | 3,321 | 3,321 | - |
| Current tax liabilities | - | - | - | - | - | 178 | 178 | - |
| Deferred tax liabilities | - | - | - | - | - | - | - | - |
| **Total liabilities** | **175,820** | **67,903** | **962,819** | **172,579** | **43,199** | **21,236** | **1,443,556** | **1,403,003** |
| **Equity and reserves** | **-** | **-** | **-** | **-** | **-** | **218,675** | **218,675** | **-** |
| **Total liabilities, equity and reserves** | **175,820** | **67,903** | **962,819** | **172,579** | **43,199** | **239,911** | **1,662,231** | **1,403,003** |
| **Interest rate mismatch** | **213,995** | **226,310** | **(370,316)** | **109,166** | **2,800** | **(181,955)** | **-** | **(724,386)** |

# 34. RISK MANAGEMENT (CONTINUED)

## 34.3. Market Risk Management (CONTINUED)

### 34.3.2. Interest Rate Risk (CONTINUED)

*a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates (continued)*

The estimated future cash flows for the Bank's interest bearing liabilities and non-interest bearing liabilities as at December 31, 2019 and 2018 are shown in the following table:

| | Up to a month BAM'000 | From 1 to 3 months BAM'000 | From 3 to 12 months BAM'000 | From 1 to 5 years BAM'000 | Over 5 years BAM'000 | Total BAM'000 |
|---|---|---|---|---|---|---|
| **December 31, 2019** | | | | | | |
| **Liabilities** | | | | | | |
| Transaction accounts and deposits of banks | 42,717 | 94,729 | 131,852 | 83,581 | 978 | 353,857 |
| Transaction accounts and deposits of customers | 66,604 | 35,037 | 701,171 | 216,405 | 16,448 | 1,035,665 |
| Lease liabilities | 52 | 111 | 498 | 2,030 | 385 | 3,076 |
| Other liabilities | 18,555 | - | - | - | - | 18,555 |
| | | | | | | |
| **Total liabilities** | **127,928** | **129,877** | **833,521** | **302,016** | **17,811** | **1,411,153** |
| | | | | | | |
| **December 31, 2018** | | | | | | |
| Transaction accounts and deposits of banks | 154,271 | 41,848 | 173,371 | 30,622 | 15,557 | 415,669 |
| Transaction accounts and deposits of customers | 21,547 | 26,055 | 789,449 | 141,957 | 27,643 | 1,006,651 |
| Other liabilities | 17,737 | - | - | - | - | 17,737 |
| | | | | | | |
| **Total liabilities** | **193,555** | **67,903** | **962,820** | **172,579** | **43,200** | **1,440,057** |

*b) Effective Interest Rates*

The following table presents the effective interest rates for management reporting purposes, calculated as a weighted average of the period: for financial instruments of assets, including interest expense on assets, and financial instruments of liabilities, including interest income on liabilities:

| | December 31, 2019 % | December 31, 2018 % |
|---|---|---|
| **Assets** | | |
| Funds in excess of the obligatory reserve held with the Central Bank | (0.36) | (0.20) |
| Loans and receivables due from banks | 0.14 | 0.04 |
| Loans and receivables due from customers | 4.79 | 4.99 |
| Financial assets at fair value through other comprehensive income | 3.56 | 4.26 |
| **Liabilities** | | |
| Deposits due to banks | (0.21) | (0.39) |
| Deposits due to customers | (0.62) | (0.65) |

# 34. RISK MANAGEMENT (CONTINUED)

## 34.3. Market Risk Management (CONTINUED)

### 34.3.3. Risk of Changes in Interest Rate Margin

Within market-risk-measuring techniques, the Bank measures the impact of interest rate margin changes in debt securities with fixed yield. The risk of change in debt securities price due to issuer credit risk change (margin perceived by the market) is measured and limited by CPV limit - basis point credit margin value limit (Credit Spread Point Value). This limit is similar to Basis Point Value (BPV) and limits the risk of change in the net present value of debt securities portfolio if the impact of interest margin change shifts by 0.01% (1 basis point). BPV limits the overall sensitivity of the Bank's items to changes in interest rates and CPV additionally limits investments in debt securities with regard to the volume and duration.

### 34.3.4. Interest Rate Risk in the Banking Book

Interest rate risk in the banking book is defined as the exposure of the Bank's financial position to undesirable changes in the movement of interest rates arising from assets and liabilities in the banking book.

The limitation system in accordance with the Group's rules is defined by classification of limits and warning levels depending on the type of limitation and the time required for corrective action in case of a limitation violation. The Bank's management and control of interest rate risk in the banking book is based on the analysis of metrics/indicators from two perspectives:

- economic value and
- earnings.
- The main restrictions by means of which the Bank monitors exposure to risk from the perspective of the economic value are:
- BP01 sensitivity – Overall sensitivity and sensitivity per time (maturity) buckets– is calculated as a change in the present value of interest sensitive items arising from the current shock for 1 basis point at each step along the curve. The sum of all sensitivities per time buckets along the curve is BP01.
- EV supervisory standardized shocks – For regulatory reasons, in addition to BP01 metrics, the Group calculates the sensitivity of the economic value as a result of the standard shock due to a sudden parallel displacement of the yield curve by +/- 200 basis points. The impact of the economic sensitivity is measured in relation to Tier 1 capital.
- From the perspective of earnings, the Bank monitors the risk exposure through the following limit:
- Sensitivity of the net interest income – The standard sensitivity of the net interest income is calculated based on the scenario of current parallel shocks at rates above the one-year time horizon and assuming a consistent balance and constant margin.

| Interest rate risk in the Banking Book indicators: | 2019 | 2018 |
|---|---|---|
| Economic value sensitivity (EV sensitivity) u % | (4.31%) | (9.14%) |
| Net interest income sensitivity (NII sensitivity) u % | (0.61%) | (0.57%) |
| BP01 in EUR | 58,863 | 71,958 |

## 34.4. Operational Risk

The Bank's management and the Group are regularly informed and receive reports on the aforementioned processes and indicators which constitute the operational risk management system and the operational risk management system is aligned with the standards of the Group and local and international regulations.

Operational risk is a risk of adverse effects on the Bank's financial performance and equity due to omissions made by employees during their work, inadequate internal procedures and processes, inadequate management of the Bank's IT and other systems, as well as a result of externally caused unpredictable events including legal risk.

Losses arising from the following events can be considered as operational risk: internal or external fraud, employee relations and safety at work, customer complaints, fines and penalties for regulatory breaches, damage to material assets of the Bank, system interruptions and system malfunctions, process management.

In accordance with the Group methodology as well as regulations of the RS Banking Agency, the Bank has established and is continuously improving the operational risk management system. The system includes tools and mechanisms for continuous monitoring of damages that the Bank bears due to operational risks and its exposure to operational risks, the assessment of operational risks within processes and products, monitoring of the key risk indicators and defining the ways to avoid, control or transfer operational risks to third parties, as well as a reporting system.

For operational risk loss data recording, recording and monitoring of risk indicators, the Bank uses Group's ARGO tool, whereas for reporting process and data analyses related to operational risks, the Bank uses Group's BO Tool (Business Object Tool).

Given that the Bank is exposed to operational risks in all its business activities and in order to raise awareness about the concept, significance of and responsibilities in process of operational risk management, the Bank has developed a system of electronic education for all its employees. Also, in cooperation with Human Resources, live trainings are organized for new Bank employees.

## 34.5. Reputation Risk

Taking into account significance of the reputation risk, which is defined as a risk of adverse effects on the Bank's financial performance (result) and equity due to loss of trust in the Bank's integrity triggered by unfavorable public opinion on the Bank's business practices or activities of the members of its bodies, irrespective of whether the grounds for such an opinion do or do not exist, the Bank manages the reputation risk by means the adopted and implemented special policies and procedures governing the area of the reputation risk management and acting with transactions in specific industries (nuclear energy, weapons industry, infrastructure water-dam, electricity production in coal-fired power plants, and mining sector), as well as by ongoing raising of the awareness of its employees of the significance of the reputation risk management using electronic and live trainings for all staff.

## 34.6. Capital Management

The Bank's objectives in capital management are:

- compliance with capital requirements set by regulators of banks and capital markets,
- maintenance of the Bank's ability to continue the business operations so that it could ensure return to shareholders and benefits for other stakeholders; and
- maintenance of a strong capital basis to support the development of its business activities.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.6. Capital Management (CONTINUED)

At the beginning of 2018, the new Banking Law of RS entered into force, and during 2018 and 2019 BARS enacted a number of by-laws on the operation of banks. The aim of the new regulations is to harmonize the regulations governing the business of the banking sector in the Republic of Srpska with Basel II and Basel III Standards.

The new regulations have significantly changed the method of calculating the capital requirements for credit, market and operational risks, the method of calculating capital, as well as the amount of capital ratios that the banks are obligated to maintain continuously, including capital buffers.

The Bank monitors the prescribed ratios and other capital adequacy indicators in accordance with BARS regulations.

The minimum prescribed rates and ratios that banks must meet at all times are as follows:

- Common Equity Tier 1 Capital Ratio of 6.75%;
- Common Equity Tier 1 Capital of 9%; and
- the regulatory capital adequacy ratio of 12%.

For each of the above ratios an ongoing maintenance of the capital buffers of 2.5% for preservation of the capital is prescribed.

In addition to the prescribed ratios, requirements are planned (still not prescribed) for other capital buffers, i.e. for the combined capital buffer representing the minimum ratio of the Common Equity Tier 1 Capital increased by the preservation of capital buffer and increased by the following buffers, depending on what is applicable, namely:

1. bank-specific countercyclical buffer;

2. buffer for a systemically important bank (prescribed in the range from 0% to 2%; it will be prescribed for each bank individually after BARS has ranked the banks according to the systemic importance); and

3. buffer for systemic risk.

# 34. RISK MANAGEMENT (CONTINUED)

## 34.6. Capital Management (CONTINUED)

The amount of regulatory core (T 1) and Common Equity Tier 1 Capital (CET 1), as well as their rates calculated in accordance with the BARS regulations are shown in the following table:

| Line | Number | Item | December 31, 2019 BAM 000 | December 31, 2018 BAM 000 |
|---|---|---|---|---|
| **10** | **1** | **REGULATORY CAPITAL** | **213.116** | **188,299** |
| **015** | **1.1** | **CORE CAPITAL** | **202.262** | **179,108** |
| **020** | **1.1.1** | **COMMON EQUITY TIER 1 CAPITAL** | **202.262** | **179,108** |
| 030 | 1.1.1.1 | Equity instruments recognized as regular core capital | 97.428 | 97,428 |
| 040 | 1.1.1.1.1 | Paid-in equity instruments | 97.055 | 97,055 |
| 060 | 1.1.1.1.3 | Share issue premiums | 373 | 373 |
| 130 | 1.1.1.2 | Retained earnings | 60.695 | 38,477 |
| 180 | 1.1.1.3 | Other comprehensive income | 2.123 | 2,448 |
| 200 | 1.1.1.4 | Other reserves | 52.552 | 48,947 |
| 340 | 1.1.1.11 | (–) Other intangible assets | (10.530) | (8,115) |
| 370 | 1.1.1.12 | (–) Deferred tax assets that are dependent on future profitability and do not arise from temporary differences minus related tax liabilities | (6) | (77) |
| **750** | **1.2** | **SUPPLEMENTARY CAPITAL** | **10.854** | **9,191** |
| 920 | 1.2.6 | General credit risk provisions in accordance with the standardized approach | 10.854 | 10,158 |
| 978 | 1.2.13 | Supplementary capital components or deductible items - other | | (967) |
| | | | | |
| 010 | 1 | Common Equity Tier 1 Capital ratio | 19,74% | 18.78% |
| 030 | 3 | Core capital ratio | 19,74% | 18.78% |
| 050 | 5 | Regulatory capital ratio | 20,80% | 19.74% |

## 34.7. Taxation Risks

The Republic of Srpska and Bosnia and Herzegovina currently have several tax laws in effect, as imposed by various governmental agencies. The applicable taxes include: value added tax, corporate income tax and payroll (social) taxes, among others.

Following their introduction, the regulations governing these taxes were not enforced for substantial periods of time; in contrast to similar legislation in more developed market economies. Moreover, the regulations defining the implementation of these laws are often unclear or non-existent. Hence, few precedents with regard to tax issues have been established in the Republic of Srpska. Often, contrary opinions pertaining to legal interpretations exist both among, and within, governmental ministries and organizations thus creating uncertainties.

Tax returns, along with other areas governed by the law (e.g., customs and currency control matters) are subject to review and investigation by a number of authorities that are legally enabled to impose extremely severe fines, penalties and interest charges. The interpretation of tax legislation by tax authorities as applied to the transactions and activities 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 Procedure of the Tax Administration of the Republic of Srpska, expiration period of the tax liability is five years. This virtually means that tax authorities could determine payment of the outstanding liability in the period of five years from the origination of the liability. The afore-described situation creates tax risks in the Republic of Srpska and Bosnia and Herzegovina that are substantially more significant than those typically existing in countries with more developed tax systems.

## 35. FUNDS MANAGED ON BEHALF AND FOR THE ACCOUNT OF THIRD PARTIES

The Bank manages funds related to transactions for the account and on behalf of third parties; it records these transactions and funds off balance sheet, separated from its own assets. The Bank charges fees for managing funds on behalf of third parties. Income and expenses per these funds are posted as income or expenses of the owner or user.

Investments related to the funds managed on behalf of third parties are presented in the table below:

| | December 31 2019 BAM '000 | December 31, 2018 BAM '000 |
|---|---|---|
| Consignment investments | 193 | 236 |

## 36. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value represents the amount for which an asset can be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. It can also be defined as the value at which it is possible to dispose of assets/liabilities, or the appraised value of the neutralization of the market risk arising from the assets/liabilities in the appropriate time-frame.

Assumptions used in assessing and measuring the fair values of financial instruments are based on application of centralized calculation developed at the Group level, which uses IFRS 13 as a unique source of guidelines to measure the fair value.

Financial instruments are considered as quoted on an active market if the quoted prices are easily and regularly available and if the prices represent actual and regular market transactions under common market terms.

All financial instruments are classified in accordance with classification criteria into three different hierarchy levels of fair values:

- Hierarchy Level 1: Fair value is determined on the basis of prices for identical assets or liabilities available as at the measurement date, i.e. if the financial instruments are present in an active market.
- Hierarchy Level 2: Fair value is determined based on a valuation model for which input data are obtained from an active market when it is not possible to use inputs used in assessment of Hierarchy Level 1.
- Hierarchy Level 3: Fair value is determined based on a valuation model for which input data are not present in an active market, i.e. when more significant adjustments are needed.

In its methodology, when determining hierarchy levels for performing loans and deposits of banks and customers, the Group uses the following additional criteria:

- Hierarchy Level 2: (risk-free rate, i.e., FV risk-free – adjusted rate for credit spread for the expected and unexpected loss, i.e., FV risk adjusted) / risk-free rate or FV risk-free $\leq$ 5%.
- Hierarchy Level 3: (risk-free rate, i.e., FV risk-free – adjusted rate for credit spread for expected and unexpected loss, i.e., FV risk adjusted) / risk-free rate or FV risk-free $>$ 5%.

The Bank classifies non-performing loans (NPL) in accordance with the Group Instructions in such a manner that it equals their carrying and fair values. All assets and liabilities of the Bank are classified into hierarchy Level 2 and Level 3.

The Bank classifies debt securities into Level 2 and the fair value adjustment is performed in accordance with the centralized calculation of the Group.

# 36. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

| | December 31, 2019 | | | | December 31, 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Fair value | Carrying value | Variance | | Fair value | Carrying value | Variance | |
| | BAM '000 | BAM '000 | BAM'000 | % | BAM '000 | BAM '000 | BAM '000 | % |
| Loans and receivables due from banks | 231,131 | 231,131 | - | 0.00% | 269,892 | 269,892 | - | 0.00% |
| Loans and receivables due from customers | 1,062,734 | 1,026,118 | 36,616 | 3.57% | 984,782 | 937,374 | 47,408 | 5.06% |
| **Total** | **1,293,865** | **1,257,249** | **36,616** | **2.91%** | **1,254,674** | **1,207,266** | **47,408** | **3.93%** |
| Deposits and borrowings due to banks | 353,140 | 353,857 | (717) | (0.20%) | 409,753 | 415,669 | (5,916) | (1.42%) |
| Deposits and borrowings due to customers | 1,029,918 | 1,035,665 | (5,747) | (0.55%) | 997,612 | 1,006,651 | (9,039) | (0.90%) |
| **Total** | **1,383,058** | **1,389,522** | **(6,464)** | **(0.47%)** | **1,407,365** | **1,422,320** | **(14,955)** | **(1.05%)** |

Levels of fair value of the Bank's assets and liabilities in accordance with IFRS 13 are presented in the table below:

| | December 31, 2019 | | | December 31, 2018 | | |
|---|---|---|---|---|---|---|
| | Fair value levels | | | Fair value levels | | |
| | Level 1 | Level 2 | Level 3 | Level 1 | Level 2 | Level 3 |
| | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 | BAM '000 |
| Loans and receivables due from banks | - | - | 336,105 | - | - | 269,892 |
| Loans and receivables due from customers | - | 430,713 | 632,022 | - | 418,626 | 566,156 |
| **Total** | **-** | **430,713** | **968,127** | **-** | **418,626** | **836,048** |
| Deposits and borrowings due to banks | - | 312,683 | 40,458 | - | 289,755 | 119,998 |
| Deposits and borrowings due to customers | - | - | 1,029,918 | - | - | 997,612 |
| **Total** | **-** | **312,683** | **1,070,376** | **-** | **289,755** | **1,117,610** |

# 37. EVENTS AFTER THE REPORTING PERIOD

After the reporting date, there have been no events that would require additional disclosures in or any adjustments to the financial statements (adjusting events) until the date of their issuance.

# 38. EXCHANGE RATES

The official exchange rates applied in translation of the statement of financial position components denominated in foreign currencies into BAM as at December 31, 2019 and 2018 for the following major currencies were:

| | December 31, 2019 | December 31, 2018 |
|---|---|---|
| USD | 1.747994 | 1.707552 |
| CHF | 1.799126 | 1.742077 |
| EUR | 1.955830 | 1.955830 |

# 39. ABBREVIATIONS

Bank – UniCredit Bank a.d. Banja Luka

Group – UniCredit Group

BARS – Banking Agency of Republic of Srpska

RS – Republic of Srpska

IAS – International Accounting Standards

IFRS - International Financial Reporting Standards

VAT – Value added Tax

EU – European Union

IFRIC – International Financial Reporting Interpretations Committee

RWA – Risk Weighted Asset

CET 1 – Common Equity Tier 1 Capital ratio

SPPI – Solely Payments of Principal and Interest

SE - Securities

PD – Probability of Default

LGD – Loss Given Default

EAD – Exposure at Default

TTC – Through The Cycle

ECL – Expected Credit Loss

FLI – Forward Looking Information

WL – Watch List

PSC – Performance Status Code

EBA - European Banking Authority

ICAAP – Internal Capital Adequacy Assessment Process

POCI – Purchased or Originated Credit Impaired

EIR – Effective Interest Rate

IT – Information technology

NPL – Non Performing Loans

ALCO – Asset - Liability Committee

VaR - Value at Risk

BPV - Basis Point Value

CPV – Credit Spread Point Value

FV – Fair value

EV – Economic value

# Capital and balance sheet management.

We will continue to take decisive actions to increase our flexibility, with a proactive approach to capital allocation, both top down and bottom up. In Team 23, one key commitment is to maintain a CET1 MDA buffer between 200 to 250 basis points.

# Business Network of UniCredit Bank a.d. Banja Luka as at 31.12.2019

| BRANCH/AGENCY | ADDRESS | CITY | PHONE NO. |
|---|---|---|---|
| TOLL-FREE PHONE NO. | | | 080/051-051 |
| BANJALUKA-PRIJEDOR REGION | | | |
| FILIJALA BANJA LUKA | Marije Bursać 7 | Banja Luka | 051/243-200 |
| FILIJALA BANJA LUKA 2 | Jevrejska 50 | Banja Luka | 051/246-662 |
| FILIJALA BANJA LUKA 3 | Carice Milice 2 | Banja Luka | 051/246-645 |
| FILIJALA BANJA LUKA 4 | Bulevar srpske vojske 8 | Banja Luka | 051/243-441 |
| FILIJALA ČELINAC | Kralja Petra I Karađorđevića 65 | Čelinac | 051/551-144 |
| FILIJALA KOTOR VAROŠ | Cara Dušana 28 | Kotor Varoš | 051/783-260 |
| FILIJALA MRKONJIĆ GRAD | Svetog Save 13 | Mrkonjić Grad | 050/211-190 |
| FILIJALA ŠIPOVO | Prve šipovačke brigada 1 | Šipovo | 050/371-337 |
| FILIJALA PRIJEDOR | Vožda Karađorđa 9 | Prijedor | 052/240-381 |
| FILIJALA KOZARAC | Maršala Tita bb | Kozarac | 052/346-052 |
| FILIJALA NOVI GRAD | Karađorđa Petrovića 33 | Novi Grad | 052/751-956 |
| FILIJALA KOZARSKA DUBICA | Svetosavska 41 | Kozarska Dubica | 052/416-346 |
| DOBOJ-GRADIŠKA REGION | | | |
| FILIJALA LAKTAŠI | Karađorđeva 63 | Laktaši | 051/532-215 |
| FILIJALA GRADIŠKA | Vidovdanska bb | Gradiška | 051/813-412 |
| FILIJALA SRBAC | Mome Vidovića 17 | Srbac | 051/740-251 |
| FILIJALA DOBOJ | Karađorđeva 1 | Doboj | 053/241-200 |
| FILIJALA TESLIĆ | Svetog Save 77 | Teslić | 053/431-501 |
| FILIJALA DERVENTA | Kralja Petra 1 Karađorđevića bb | Derventa | 053/312-211 |
| FILIJALA ŠAMAC | Svetosavska 9 | Šamac | 054/611-843 |
| FILIJALA BROD | Jovana Raškovića bb | Brod | 053/621-491 |
| FILIJALA PRNJAVOR | Svetog Save 25 | Prnjavor | 051/660-295 |
| SARAJEVO-BIJELJINA REGION | | | |
| FILIJALA BIJELJINA | Patrijarha Pavla 3a | Bijeljina | 055/221-280 |
| FILIJALA UGLJEVIK | Ulica Ćirila i Metodija bb | Ugljevik | 055/771-302 |
| FILIJALA ZVORNIK | Karađorđeva bb | Zvornik | 056/214-147 |
| FILIJALA SREBRENICA | Vase Jovanovića 32 | Srebrenica | 056/440-269 |
| FILIJALA BRATUNAC | Svetog Save bb | Bratunac | 056/490-178 |
| FILIJALA PALE | Milana Simovića bb | Pale | 057/203-022 |
| FILIJALA LUKAVICA | Spasovdanska 31 | Lukavica | 057/318-299 |
| FILIJALA SOKOLAC | Cara Lazara bb | Sokolac | 057/401 061 |
| FILIJALA ROGATICA | Srpski sloge bb | Rogatica | 058/420-092 |
| FILIJALA VLASENICA | Svetosavska 82 | Vlasenica | 056/734-318 |
| TREBINJE-FOČA REGION | | | |
| FILIJALA TREBINJE | Kralja Petra Prvog Oslobodioca br. 22 | Trebinje | 059/270-628 |
| FILIJALA BILEĆA | Kralja Aleksandra 14 | Bileća | 059/370-066 |
| FILIJALA GACKO | Trg Save Vladislavića bb | Gacko | 059/490 351 |
| FILIJALA NEVESINJE | Nevesinjskih ustanika 27 | Nevesinje | 059/610-471 |
| FILIJALA FOČA | Njegoševa 10 | Foča | 058/220 972 |

Banking that matters. UniCredit Bank Banja Luka