

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina

Financial Statements as at 31 December 2019



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

Intesa Sanpaolo Banka, d.d.
Financial statements as at 31 December 2019
Contents

	Page
Management Board's Report	2
Responsibilities of the Management and Supervisory Boards for the preparation and approval of the financial statements	3
Independent Auditors' Report	4
Statement of profit or loss and other comprehensive income	8
Statement of financial position	10
Statement of changes in shareholders' equity	11
Statement of cash flows	13
Notes to the financial statements	14
- Summary of accounting policies	15
- Critical accounting judgements and key sources of estimation uncertainty	30
- Financial risk management	32
- Fair value of financial instruments	56
- Operating segments	60
- Notes	65
- Events after the reporting date	85

The Management Board has pleasure in submitting its report for the year ended 31 December 2019.

Review of operations

The result for the year ended 31 December 2019 of the Bank is set out in the statement of profit or loss and other comprehensive income on page 8.

Supervisory Board, Management Board and Audit Committee

During the course of 2019 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board

Alessio Cioni	Chairman
Ivan Krolo	Vice-Chairman
Miroslav Halužan	Member
Gianluca Tiani	Member
Andrea Fazzolari	Member
Alden Bajgorić	Independent member
Massimo Lanza	Independent member

During the course of 2019 and up to the date of this report, the Audit Committee comprised:

Audit Committee

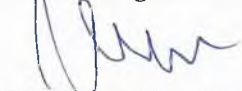
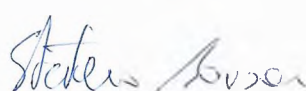
Dražen Karakašić	Chairman
Petar Sopek	Member
Zoltan Mogyorosi	Member
Ana Jadrešić	Member
Jadranko Grbelja	Member


As of 31 December 2019, the Management Board comprised a President and three Members, who served during the year and up to the date of this report as follows:

Management Board

Almir Krkalić	President of the Management Board
Edin Izmirlija	Management Board Member and Head of Risk Management and Controlling Division
Marko Filipčić	Management Board Member and Chief Financial Officer until 28.02.2019 Chief Financial Officer from 01.09.2019 and Management Board Member from 18.11.2019
Stefano Borsari	Management Board Member and Head of Retail Division
Amir Termiz	

On behalf of the Management Board

 _____ Almir Krkalić	 _____ Stefano Borsari
President of the Management Board	Member of the Management Board



Intesa Sanpaolo Banka, d.d. BiH
Responsibilities of the Management and Supervisory Boards for the preparation and approval of the financial statements

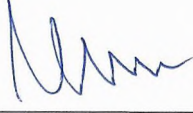

The Management Board is required to prepare financial statements, which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records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

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

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

The financial statements set out on pages 8 to 85 were authorised by the Management Board on 11 February 2020 for issue to the Supervisory Board, and are signed below to signify this, on behalf of the Bank, by:

For and on behalf of Management Board

	
_____ Almir Krkalic	_____ Stefano Borsari
President of the Management Board	Member of the Management Board

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
53
2

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Intesa Sanpaolo Banka d.d. Bosnia and Herzegovina

The report on the audit of the annual financial statements

Opinion

We have audited the annual financial statements of Intesa Sanpaolo Banka d.d. Bosnia and Herzegovina ("the Bank"), which comprise the statement of financial position of the Bank as at 31 December 2019, statement of profit or loss and comprehensive income, statement of cash flows and statement of changes in equity of the Bank for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

We performed the audit in accordance with the International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the annual financial statements section of our Independent Auditor's report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those which were, in our professional judgment, of the utmost importance for our audit of the annual financial statements of the current period and include most significant recognized risks of significant misstatement as a result of error or fraud with the greatest impact on our audit strategy, the allocation of our available resources and the time spent by the engaged audit team. We have dealt with these matters in the context of our audit of the annual financial statements as a whole and in forming our opinion about them, and we do not give an opinion on these matters.

We have determined that the following matter was the key audit matter and should be published in our Independent Auditor's report.

Key audit matters (continued)

Key audit matter	How we addressed the key audit matter
<p><i>Impairment of loans and advances to customers</i></p> <p>As at 31 December 2019 gross loans and advances to customers amount to 1.650.988 thousand BAM, related impairment allowance amounts to 63.455 thousand BAM and impairment loss recognised in the income statement amounts to 5.333 thousand BAM (31 December 2018: gross loans and advances: 1.503.825 thousand BAM, impairment allowance: 75.136 thousand BAM, impairment loss recognised in the income statement: 4.118 thousand BAM).</p>	
<p><i>Key audit matter</i></p> <p>Impairment allowances represent management's best estimate of risk of default and the expected credit losses within the loans and advances at the reporting date. We focused on this area due to the significance of the amounts involved and also because of the nature of the judgements and assumptions that management are required to make.</p> <p>IFRS requires management to make judgments about the future and various items in the financial statements are subject to estimation uncertainty. The estimates required for credit loss allowances for loans and advances to customer are significant estimates.</p> <p>The key areas of judgement uncertainty associated with credit loss allowances for loans and advances to customer are the identification of loans that are deteriorating, the assessment of significant increase in credit risk, forecasts of future cash flows as well as expected proceeds from the realization of collateral and the determination of the expected credit losses of loans and advances to customer which are all inherently uncertain.</p> <p>The impairment allowance is measured as either 12 months expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk since initial recognition.</p> <p>For defaulted loans that are considered to be individually significant or non-performing exposures exceeding 50 thousand BAM for corporate and 150 thousand for retail individually, the impairment assessment is based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. Related impairment allowances are determined on an individual basis by means of a discounted cash flows analysis.</p> <p>Impairment allowances for performing exposures to individuals and corporate and non-performing corporate exposures below 50 thousand BAM individually and retail exposures below 150 thousand BAM individually</p>	<p><i>Audit Procedures</i></p> <p>Our audit procedures in this area included, among others:</p> <ul style="list-style-type: none"> • reviewing the methodology of the Bank for the calculation of the expected credit loss and assessing its compliance with the relevant requirements of IFRS 9, • obtaining an understanding of the impairment allowance for loans and advances, IT applications used, as well as assumptions for data used in the expected credit loss model, • evaluating the design, implementation and operational effectiveness of controls in credit risk management and lending processes, and tested key controls related to the approval, recording and monitoring of loans and advances, • testing the design, implementation and operational effectiveness of key controls in the areas of customer rating in appropriate risk groups, as well as the controls relating to the identification of loss events and default, appropriateness of classification of exposures between performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the impairment allowances, • testing, on a sample basis, whether the definition of default and the staging criteria were consistently applied in accordance with relevant policies, • evaluating the overall modelling approach of calculation of expected credit losses (ECLs), including the calculation of main risk parameters and macroeconomic factors (probability of default (PD), loss given default (LGD) and exposure at default (EAD), • testing the adequacy of individual loan loss allowances, on a sample basis, with focus on those with the greatest potential impact on the financial statements due to their magnitude and risk characteristics, as well as lower value items, which we independently assessed as high-risk, • conducting an evidentiary test of the selected sample to assess the correctness of the loan and advance classification,

Key audit matter	How we addressed the key audit matter
<p>are determined by modelling techniques (together “collective impairment allowance”).</p> <p>Historical experience, identification of exposures with a significant deterioration in credit quality, forward-looking information and management judgment are incorporated into the model assumptions. The Bank is continuously recalibrating the model parameters which also requires our increased attention in the audit.</p> <p>Related disclosures accompanying the annual financial statements</p> <p>For additional information see notes 3. Z) to financial statements (Significant accounting policies) and 4. (Critical accounting judgements and key sources of estimation uncertainty) and notes 23. (Loans and advances to customers) and 5.1. (Credit risk section of the note Financial risk management policies).</p>	<ul style="list-style-type: none"> • in certain cases, we used our own judgment to determine the parameters for calculating impairment losses on loans and advances and compared our calculations with the impairment of the value calculated by the Bank, • evaluating the accuracy and completeness of the financial statement disclosures.

Other Matter

The annual financial statements of the Bank for the year ended 31 December 2018 were audited by KPMG B-H d.o.o., Sarajevo who expressed in Independent Auditor's report an unmodified opinion on those annual financial statements on 14 February 2019.

Other information in the Annual Report

Management is responsible for the other information. The other information comprises of information included in the Annual Report, but does not include the annual financial statements and our Independent auditor's report.

Our opinion on the financial statements does not include other information and, we do not express any kind of assurance conclusion with on them.

In relation with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or with our knowledge obtained in the audit. If, based on the work we have performed, we conclude that there is a material misstatement of this other information we are required to report that fact. In this sense, we do not have anything to report.

Responsibilities of Management and those charged with Governance for the Annual Financial Statements

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with IFRS, and for such internal controls as the Management determines necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's Responsibility for the Audit of the Annual Financial Statements

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a higher level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if,

individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made based on these annual financial statements.

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

- identify and assess the risks of material misstatement of the annual 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 the Management.
- make conclusion 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 annual 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 annual financial statements, including the disclosures, and whether the annual 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.

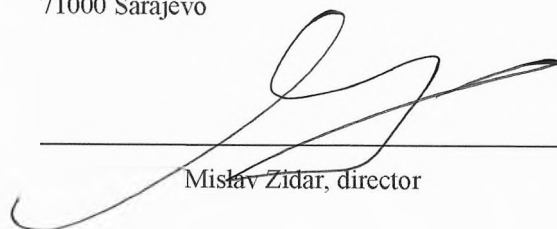
We also give a statement to those charged with governance that we have acted in accordance with relevant ethical requirements regarding independence and that we will communicate with them on all relationships and other issues that can reasonably be considered to affect our independence as well as, where applicable, about related protections.

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

Among the matters we are communicating with those charged with governance, we determine those matters that are of utmost importance in the audit of financial statements for the current period and are therefore key audit matters. We describe these matters in our independent auditor's report unless the law or regulations prevents public disclosure or when, in exceptionally rare circumstances, we decide that the matter should not be reported in our independent auditor's report as it can reasonably be expected that the negative effects of the announcement will surpass the welfare of public interest in such disclosure.

In Sarajevo, 24 February 2020

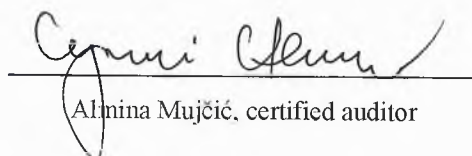
BDO BH d.o.o. Sarajevo
Fra Andela Zvizdovića broj 1
71000 Sarajevo



Mislav Zidar, director



BDO BH d.o.o.
Sarajevo
Društvo za reviziju



Almina Mujčić, certified auditor

Intesa Sanpaolo Banka, d.d. BiH
Statement of profit or loss and other comprehensive income
for the year ended 31 December
(all amounts are expressed in thousands of BAM, unless otherwise stated)

	<i>Notes</i>	2019	2018
		_____	_____
Interest income	8	78,039	76,673
Interest expense	9	(12,873)	(12,118)
		_____	_____
Net interest income		65,166	64,555
		_____	_____
Fee and commission income	10	33,208	29,974
Fee and commission expense	11	(7,044)	(5,850)
		_____	_____
Net fee and commission income		26,164	24,124
		_____	_____
Net trading income	12	2,768	1,947
Other operating income/(expense)	13	(5,970)	(6,470)
		_____	_____
Other operating expenses, net		(3,202)	(4,523)
		_____	_____
Total operating income, net		88,128	84,156
		_____	_____
Personnel expenses	14	(21,224)	(21,091)
Administrative expenses	15	(17,624)	(18,841)
Depreciation and amortisation		(5,759)	(3,768)
		_____	_____
Operating expenses		(44,607)	(43,700)
		_____	_____
Profit before impairment losses and other provisions and income tax		43,521	40,456
Net impairment gains/(losses) and other provisions	16	(5,487)	106
		_____	_____
Profit before tax		38,034	40,562
Income tax expense	17	(4,111)	(4,222)
		_____	_____
Net profit for the year		33,923	36,340
		=====	=====

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

Intesa Sanpaolo Banka, d.d. BiH
Statement of profit or loss and other comprehensive income
for the year ended 31 December
(all amounts are expressed in thousands of BAM, unless otherwise stated)

	<u>2019</u>	<u>2018</u>
Profit for the year	33,923	36,340
Other comprehensive income for the year		
<u>Items that may be reclassified subsequently to profit or loss</u>		
<i>Fair value reserves (Financial assets at fair value through OCI)</i>		
Change in fair value, net of deferred tax	(4)	(132)
<i>Fair value reserves (Financial assets available for sale)</i>		
Change in fair value, net of deferred tax	-	-
<u>Items that will not be reclassified to profit or loss</u>		
<i>Revaluation of property (property classified as IAS 16)</i>		
Change in fair value, net of deferred tax	-	74
Other comprehensive income	(4)	(58)
Total comprehensive income for the year	33,913	36,282
Basic and diluted earnings per share (BAM)	75.76	81.16
	<i>18</i>	

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

Statement of financial position

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

	<i>Notes</i>	31 December 2019	31 December 2018
Assets			
Cash and cash equivalents	19	499,752	406,414
Reserves with Central Bank	20	191,510	172,979
Placements with other banks	21	68	21,594
Financial assets at fair value through other comprehensive income	22 a)	126	701
Financial assets at fair value through profit or loss	22 b)	790	412
Financial assets at amortized cost	22 c)	6,134	-
Loans and receivables from customers	23	1,587,533	1,428,689
Income tax prepayment		3,356	1,425
Deferred tax assets	32	332	255
Other assets	24	9,641	9,826
Property and equipment	25	26,506	12,943
Intangible assets	26	4,780	5,582
		-----	-----
Total assets		2,330,528	2,060,820
		=====	=====
Liabilities			
Due to banks and other financial institutions	27	466,814	456,407
Due to customers	28	1,518,913	1,290,085
Financial liabilities at fair value through profit or loss	22 c)	574	165
Other liabilities	29	29,649	33,430
Provisions for liabilities and charges	30	4,993	5,063
Deferred tax liabilities	31	51	50
		-----	-----
Total liabilities		2,020,994	1,785,200
		=====	=====
Equity			
Share capital	32	44,782	44,782
Share premium		57,415	57,415
Regulatory reserves for credit losses		18,286	18,286
Other reserves and fair value reserves		1,513	1,522
Retained earnings		187,538	153,615
		-----	-----
Total equity		309,534	275,620
		-----	-----
Total liabilities and equity		2,330,528	2,060,820
		=====	=====

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

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2019	44,782	57,415	18,286	980	542	153,615	275,620
Net profit for the year	-	-	-	-	-	33,923	33,923
Debt instruments at FVOCI – net change in fair value	-	-	-	-	(5)	-	(5)
Other comprehensive income							
Net loss from change in fair value of financial assets through other comprehensive income	-	-	-	-	(4)	-	(4)
Deferred tax assets	-	-	-	-	-	-	-
<i>Total other comprehensive income</i>	-	-	-	-	(4)	-	(4)
Total comprehensive income	-	-	-	-	(5)	33,923	33,914
Balance as at 31 December 2019	44,782	57,415	18,286	980	533	187,538	309,534

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

Intesa Sanpaolo Banka, d.d. BiH

Statement of changes in shareholders' equity for the year ended 31 December 2018

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

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2018	44,782	57,415	18,286	980	594	147,259	269,316
First time adoption IFRS 9	-	-	-	-	2,781	(29,984)	(27,203)
Balance as at 1 January 2018 (remeasured)	44,782	57,415	18,286	980	3,375	117,275	242,113
Net profit for the year	-	-	-	-	-	36,340	36,340
Debt instruments at FVOCI – net change in fair value	-	-	-	-	(2,775)	-	(2,775)
Other comprehensive income							
Net loss from change in fair value of financial assets through other comprehensive income	-	-	-	-	(146)	-	(146)
Deferred tax assets	-	-	-	-	14	-	14
Net gain from change in fair value of property	-	-	-	-	82	-	82
Deferred tax liabilities	-	-	-	-	(8)	-	(8)
<i>Total other comprehensive income</i>	-	-	-	-	(58)	-	(58)
Total comprehensive income	-	-	-	-	(2,833)	36,340	33,507
Balance as at 31 December 2018	44,782	57,415	18,286	980	542	153,615	275,620

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

Intesa Sanpaolo Banka, d.d. BiH

Statement of cash flows

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

	Notes	31 December 2019	31 December 2018
Cash flows from operating activities			
Profit for the year		33,923	36,340
<i>Adjustments for:</i>			
- depreciation and amortisation	25, 26	5,759	3,768
- net impairment losses and provisions	16	5,487	(106)
- net change in provisions for liabilities and charges		1,559	615
- net interest income		(65,166)	(64,555)
- net change in fair value of financial assets and liabilities at fair value through profit or loss	12	215	(19)
- net gain / loss from disposal of property and equipment	13	(29)	(55)
- other comprehensive income		4	-
- income tax expense	17	4,111	4,222
		(14,137)	(19,790)
<i>Changes in:</i>			
- placements with other banks		21,516	(6,958)
- loans and receivables from customers		(170,617)	(180,129)
- other assets		(473)	1,861
- obligatory reserve with the Central Bank		(18,531)	(25,526)
- financial assets and liabilities at fair value through profit or loss		(184)	193
- due to banks		10,476	133,384
- due to customers		215,150	49,925
- other liabilities		(3,790)	5,450
- provisions for liabilities and charges		(1,120)	(253)
		(28,290)	(41,843)
Income tax paid		(6,119)	(2,977)
Interest received		78,345	77,247
Interest paid		(13,420)	(13,671)
Net cash from operating activities		97,096	18,756
Cash flows from investing activities			
Acquisition of property and equipment		(1,198)	(122)
Proceeds from the sale of property and equipment		145	28
Acquisition of intangible assets		(1,191)	(1,027)
Proceeds from financial assets at fair value through other comprehensive income		576	65,257
Net cash from investing activities		(1,668)	64,136
Cash flows from financing activities			
Lease outflow		(2,090)	-
Repayment of subordinated debt		-	(121)
Net cash flow used in financing activities		(2,090)	(121)
Net increase in cash and cash equivalents		93,338	82,771
Cash and cash equivalents at the beginning of the year	19	406,414	323,643
Cash and cash equivalents at the end of the year	19	499,752	406,414

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

1. GENERAL

Incorporation and registered activities

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

The Bank’s main operations are as follows:

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

2. BASIS OF PREPARATION

Basis of accounting

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). These financial statements were authorised by the Management Board on 11 February 2020 for submission to the Supervisory Board.

Functional and presentation currency

These financial statements are presented in thousands of convertible marks (‘000 BAM) which is the functional currency of the Bank.

Use of estimates and judgments

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

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

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

Change in accounting policy and implementation of new accounting standard

From January 1 2019, the Bank has implemented International Financial Reporting Standard (IFRS) 16 Leases, which result in changes of accounting policies.

As allowed by the Standard, the Bank has not restated its comparative data for 2018.

3. SUMMARY OF ACCOUNTING POLICIES

Except for the changes abovementioned, the Bank has consistently applied the accounting policies as set out in Note 3 to all periods presented in these financial statements.

(a) Foreign currency transactions

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

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

31 December 2018	EUR 1= BAM 1.95583	USD 1 = BAM 1.70755
31 December 2019	EUR 1= BAM 1.95583	USD 1 = BAM 1.74799

(b) Net trading income

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

(c) Lease payments

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

(d) Income tax expense

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(d) Income tax expense (continued)

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

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

(e) Property and equipment

Recognition and measurement

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

Buildings are stated at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

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

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

Depreciation

Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Bank will obtain ownership by the end of the lease term. Land is not depreciated.

The depreciation rates used by the Bank are as follows:

	2019	2018
Computers	20%	20%
Furniture and equipment	10%-15%	10%-15%
Business premises	5%	5%
Leasehold improvements	20%	20%

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(f) Intangible assets

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

Amortization is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The amortization rates used by the Bank were applied consistently in 2018 and 2019:

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

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

(g) Assets repossessed from disbursement of loans

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

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

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

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

(h) Assets held for sale

Non-current assets are classified as held-for-sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use.

Such assets are generally measured at the lower of their carrying amount and fair value less costs to sell. Impairment losses on initial classification as held-for-sale and subsequent gains and losses on remeasurement are recognised in profit or loss.

Once classified as held-for-sale, intangible assets and property, plant and equipment are no longer amortised or depreciated, and any equity-accounted investee is no longer equity accounted.

(i) Impairment of non-financial assets

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

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

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

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(j) Employee benefits

Short-term benefits

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

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

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

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

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

Share-based payments

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

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

(k) Provisions for liabilities and charges

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

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

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

(l) Equity

Issued share capital

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

Regulatory reserve for credit losses

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(l) Equity (continued)

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

Based on the Decision of Minimum Standards for Capital Management and Asset Classification issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. Accordingly, the balance of the regulatory reserve presented in the financial statements as of 31 December 2012 has been carried forward unchanged to 31 December 2019.

Retained earnings

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

Fair value reserve

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

Other reserves

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

Dividends

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

(m) Off-balance sheet commitments and contingent liabilities

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

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

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

(o) Segment reporting

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

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

3. SUMMARY OF ACCOUNTING POLICIES (*continued*)

(v) Interest income and expense

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

(a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset

(b) Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the expected credit loss provision).

(w) Fee and commission income and expenses

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

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

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

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

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

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

(x) Net income from other financial instruments at fair value through profit or loss

Net income from other financial instruments at FVTPL relates to non-trading derivatives held for risk management purposes that do not form part of qualifying hedging relationships, financial assets and financial liabilities designated as at FVTPL and, from 01 January 2018, also non-trading assets mandatorily measured at FVTPL. The line item includes fair value changes, interest, dividends and foreign exchange differences.

(y) Dividend income

Dividends on equity instruments designated as at FVOCI that clearly represent a recovery of part of the cost of the investment are presented in OCI.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(z) Financial assets and financial liabilities

1. Recognition and initial measurement

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

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

2. Classification and subsequent measurement

Financial assets

The Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Financial assets measured at amortised cost
- Financial assets measured through other comprehensive income
- Financial assets at fair value through profit or loss

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

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables.

Classification and subsequent measurement of debt instruments depend on:

- (i) The purpose of managing financial assets (business model)
- (ii) The contractual characteristics of cash flows (Solely Payments of Principle and Interest, further "SPPI test" or "SPPI")

Based on these factors, the Bank classifies its debt instruments into one of the following three measurement categories:

- **Financial assets measured at amortized cost**

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVTPL, are measured at amortized cost. After initial recognition, the carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in Note 3(w)(6). Interest income from these financial assets is included in "Interest income" using the effective interest rate method.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables occur when the Bank grants cash to customers without the intent to trade these receivables and includes placements and loans to banks, given loans and receivables from customers and assets with the Central Bank.

- **Financial assets measured through other comprehensive income**

Fair value through other comprehensive income (FVOCI) financial assets, that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at fair value through other comprehensive income (FVOCI).

Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss.

When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss and recognised in "Net trading income". Interest income from these financial assets is included in "Interest income" using the effective interest rate method.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(z) Financial assets and financial liabilities (continued)

2. Classification and subsequent measurement (continued)

• Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss have two sub-categories: financial instruments held for trading (including derivatives) and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category only if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term for the purpose of short-term profit taking or designated as such by management at initial recognition.

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

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

Financial assets at fair value through profit or loss include derivative financial instruments classified as financial instruments held for trading and equity instruments designated by management at fair value through profit or loss.

Purpose of managing financial assets (Business model)

The business model reflects how the Bank manages the assets in order to generate cash flows.

Business models of the Bank are:

- Business model whose objective is to hold assets for the collection of contractual cash flows - it includes all financial assets held for the purpose of collection of contractual cash flows over the lifetime of the financial instrument. For the purpose of classification in this business model, financial assets goes through the SPPI (Solely payment of principal and interest) test, and the following financial assets are allocated to this model:
 - Deposits with banks,
 - Loans.
 - Other receivables.

Credit risk is the underlying risk that is managed under this business model.

- Business model aimed to collect the contractual cash flows and sale of financial assets – it includes financial assets held for the purpose of collecting the agreed cash flows and sale of financial assets.
The following financial assets are allocated to the business model for collection and sale:
 - Debt securities (pass SPPI test),
 - Equity securities (fail SPPI test),

Liquidity risk is the underlying risk that is managed under this business model.

- The business model within which financial assets are measured at fair value through profit and loss - combines all financial assets that are not held under the two previously mentioned business models. Financial assets in this business model are managed in order to realize cash flows by selling assets and making short-term profits.

Contractual cash flow characteristics (SPPI)

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

3. SUMMARY OF ACCOUNTING POLICIES *(continued)*

(z) Financial assets and financial liabilities *(continued)*

2. Classification and subsequent measurement *(continued)*

Contractual cash flow characteristics (SPPI) (continued)

The SPPI test is performed:

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

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

The Bank subsequently measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Bank's right to receive payments is established.

Gains and losses on equity investments at FVTPL are included in the "Net trading income" line in the statement of profit or loss.

- **Financial liabilities**

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL.

3. Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

Any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(z) Financial assets and financial liabilities (continued)

4. Modifications of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method.

The Bank as at 31.12.2019 has no financial assets measured at amortised cost or FVOCI that were modified and the modification would not result in derecognition. All past modifications resulted in derecognitions of the original financial assets and recognitions of new financial assets.

Financial liabilities

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

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

5. Offsetting

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

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(z) Financial assets and financial liabilities (continued)

6. Impairment

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

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

IFRS 9 requires entities to enter the expected losses at the level of losses expected in the next 12 months (Stage 1) from the initial entry of the financial instrument. The time horizon for calculating the expected loss becomes the entire remaining life of the asset that is the subject of the valuation where the credit quality of the financial instrument has experienced a "significant" deterioration in relation to the initial measurement (Stage 2) or in case the asset is partially or fully non-performing (Stage 3). More specifically, the introduction of new impairment provisions includes:

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

The following table summarizes claims for impairment under IFRS 9.

	Stage 1	Stage 2	Stage 3
Deterioration in credit risk	Initial recognition (non-performing loans a origination are included in Stage 3)	Credit risk has increased significantly since initial recognition and is not considered "low"	Credit risk has increased to the point where it is considered that the value of the instrument is impaired.
Recognition of the provisioning in the balance sheet IFRS 9	12-month expected loss	Lifetime expected loss	Lifetime expected loss (as it was under IAS 39 but increased for Add-on)
Current classification	Performing	Performing	Non-performing
Current provision	Incurred loss	Incurred loss	Lifetime expected loss

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- *financial assets that are not credit-impaired at the reporting date:* as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- *financial assets that are credit-impaired at the reporting date:* as the difference between the gross carrying amount and the present value of estimated future cash flows;
- *undrawn loan commitments:* as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- *financial guarantee contracts:* the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(z) Financial assets and financial liabilities (continued)

6. Impairment (continued)

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

See also Note 5.1.2.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in "impairment losses on financial instruments" in the statement of profit or loss and OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

The Bank wrote off a loan or an investment in debt security, either partially or in full, and any related allowance for impairment losses, when Bank's Credit determined that there was no realistic prospect of recovery.

7. Designation at fair value through profit or loss

Financial assets

At initial recognition, the Bank has designated certain financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, which would otherwise arise.

The Bank also designated certain financial assets as at FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

Financial liabilities

The Bank has designated certain financial liabilities as at FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Note 22 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(aa) Loans and receivables from customers

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

- loans and receivables measured at amortised cost (see Note 23); they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

(ab) Investment securities

The “investment securities” caption in the statement of financial position includes:

- debt securities measured at FVOCI; and
- equity investment securities designated as at FVOCI.

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

(ac) Financial guarantees and loan commitments

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

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured as follows:

- At the higher of the loss allowance determined in accordance with IFRS 9 (see Note 3(w)(6) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15; and

The Bank has issued no loan commitments that are measured at FVTPL.

For other loan commitments:

- The Bank recognises a loss allowance

Liabilities arising from financial guarantees and loan commitments are included within provisions.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(ad) New standards and interpretations

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Bank has not early adopted them in preparing these financial statements.

A. IFRS 16 Leases

Of the Standards that been applied from January 1 2019, IFRS 16 has significant impact on Financial Statements.

On May 24, 2017, the Association of Accountants, Auditors and Financial Persons of the Federation of Bosnia and Herzegovina adopted the Decision on the Disclosure and Application of International Financial Reporting Standards (IFRS) - IFRS 16 - Leases.

The first application is governed by the Decision of 7 November 2017, which stipulates that it will be applied in the preparation of financial statements relating to periods beginning on or after 1 January 2019.

A lessee is allowed to adopt the Standard either retrospectively or with a modified retrospective approach (IFRS 16.C5).

If a lessee decides to apply the Modified Retrospective Approach, it is not required to restate comparatives. The lessee recognises the cumulative effect of initially applying the Standard as an adjustment to equity at the date of initial application (IFRS 16.C7).

In particular, for leases previously classified as operating leases under IAS 17, the lessee shall recognise a lease liability at the date of initial application. The lessee shall measure that lease liability at the present value of the remaining (future) lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application (IFRS 16.C8).

On the other hand, the lessee has to recognise a Right of Use Asset (RoU Asset) at the date of initial application, choosing, on a lease-by-lease basis, to measure that RoU Asset at either:

- A. Its carrying amount, as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application (Modified Retrospective, Option A); or
- B. An amount equal to the Lease Liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application (Modified Retrospective, Option B).

Intesa Sanpaolo Bank BiH has opted for Option B - Modified Retrospective Approach, as confirmed by the Intesa Group Guidelines.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

The Bank uses the interest rate obtained in accordance with the Fund Transfer Pricing (FTP) Policy to calculate the Right of Use Assets.

The Intesa Sanpaolo Group and therefore ISP BiH has decided to exclude non recoverable VAT from the calculation of the RoU Asset and the Lease Liability.

Details of assets recognized in accordance with IFRS 16 are included in Note 25.

B. Other standards

- Amendments to IFRS 9: Financial Instruments – Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IAS 19 Employee Benefits - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after January 1, 2019),
- Amendments to IAS 28 Investments in Associates and Joint Ventures - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019);

- Amendments to various standards resulting from "IFRS Improvements (cycle 2015-2017)" resulting from the IFRS annual qualitative improvement project (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily through eliminating inconsistencies and clarifying content (effective for annual periods beginning on or after January 1, 2019),
- IFRIC 23: "Uncertainty over income tax treatments" (effective for annual periods beginning on or after January 1, 2019).

The adoption of these new standards, amendments to existing standards and interpretations did not lead to any material changes in the Bank's financial statements.

C. New standards and amendments to existing standards that have been published and have not yet been adopted

- IFRS 17: "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021),
- Amendments to IFRS 3: "Business Combinations" - Definition of business (effective for business combinations for which the date of acquisition is on or after the beginning of the first annual reporting period beginning on or after January 1, 2020 and for acquisitions of assets that occur on or after the beginning of that period),
- Amendments to IFRS 9 "Financial Instruments", IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" - reform of the reference interest rate (effective for annual periods beginning on or after January 1, 2020.),
- Amendments to IFRS 10: Consolidated Financial Statements and IAS 28: Investments in Associates and Joint Ventures - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective for an indefinite period until a research project on the equity method is concluded),
- Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" - Definition of material (effective for annual periods beginning on or after January 1, 2020)

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

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

(a) Impairment losses on loans and receivables

The Bank continuously monitors the creditworthiness of its clients. The need for impairment of the Bank's balance sheet and off-balance sheet credit risk exposures is assessed on a monthly basis.

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

- Applicable to 2018 only:
 - Note 3 (z) and Note 22 (d): classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding.
 - Note 5.1.2: establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

(b) Taxation

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

(c) Regulatory requirements

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

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

The following table summarizes impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2019 are calculated in accordance with the methodology, as explained in Note 3 (l):

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

(c) Regulatory requirements *(continued)*

Summary of impairment allowances	31 December 2019	31 December 2018
Provisions for total balance-sheet items (Agency)	87,160	97,939
Provisions for total off-balance-sheet items (Agency)	8,019	8,003
	<u>95,179</u>	<u>105,942</u>
Impairment allowances under IFRS (including Other assets impairment)	<u>65,984</u>	<u>77,579</u>
Excess at the year end	<u><u>29,195</u></u>	<u><u>28,363</u></u>

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

As presented in the above table, total Agency provisions exceeded provisions recognised under IFRS by BAM 29,195 thousand as at 31 December 2019 (31 December 2018: BAM 28,363 thousand). Out of this amount, BAM 18,286 thousand has been recognised as a regulatory reserve for credit losses within equity as at 31 December 2019 (31 December 2018: BAM 18,286 thousand). The remaining amount of BAM 10,909 thousand (31 December 2018: 10,077), which represents the current year end shortfall, in line with the Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be recorded as a reduction of regulatory capital, for capital adequacy calculation.

(d) Litigation and claims

The total amount of litigations and claims amounts to BAM 13,494 thousand (2018: BAM 12,915 thousand).

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

As stated in Note 30, the Bank provided BAM 2,504 thousand (2018: BAM 2,016 thousand), which management estimates as sufficient. Since the estimate is made considering the specifics of each individual case based on the likelihood and magnitude of an outflow of resources.

5. FINANCIAL RISK MANAGEMENT

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

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

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

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

5.1 Credit risk

5.1.1 Risk limit control and mitigation policies

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

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

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. 'Settlement risk' is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transaction, the Bank mitigates this risk by conducting settlements through a settlement/clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval/limit monitoring process described earlier. Acceptance of settlement risk on free-settlement trades requires transaction-specific or counterparty-specific approvals from Bank Risk.

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

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

Off-balance-sheet credit instruments

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

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

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt instruments and available-for-sale debt assets. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively.

Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 3 (z).

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

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

	2019			2018	
	Stage 1	Stage 2	Stage 3	Total	Total
<i>Placements with other banks at amortized cost</i>					
Performing – Stage 1	68	-	-	68	21,595
Total Gross	68	-	-	68	21,595
Less: impairment allowance	-	-	-	-	(1)
Carrying amount	68	-	-	68	21,594
<i>Loans and receivables from customers at amortized cost</i>					
Performing – Stage 1	1,528,975	-	-	1,528,975	1,368,750
Performing – Stage 2	-	63,411	-	63,411	76,197
Past due impaired unlikely to pay	-	-	19,923	19,923	12,684
doubtful	-	-	31,126	31,126	44,195
	-	-	7,553	7,553	1,999
Total Gross	1,528,975	63,411	58,602	1,650,988	1,503,825
Less: impairment allowance	(16,098)	(11,402)	(35,955)	(63,455)	(75,136)
Carrying amount	1,512,877	52,009	22,647	1,587,533	1,428,689
<i>Debt instruments at FVOCI</i>					
Performing - Stage1	-	-	-	-	579
Total Gross	-	-	-	-	579
Loss allowance	-	-	-	-	-
Carrying amount	-	-	-	-	579
<i>Debt instruments at amortized cost</i>					
Performing - Stage1	6,203	-	-	6,203	-
Total Gross	6,203	-	-	6,203	-
Loss allowance	69	-	-	69	-
Carrying amount	6,134	-	-	6,134	-

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

5.1 Credit risk (continued)

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

<i>Contingent liabilities</i>					
Stage 1	139,102	-	-	139,102	118,909
Stage 2	-	2,645	-	2,645	2,572
Stage 3	-	-	36	36	-
Total Gross	139,102	2,645	36	141,783	121,481
Less: impairment allowance	(176)	(119)	(5)	(300)	(228)
Carrying amount	138,926	2,526	31	141,483	121,253
<i>Loan commitments</i>					
Stage 1	206,804	-	-	206,804	219,454
Stage 2	-	2,736	-	2,736	6,828
Stage 3	-	-	1,063	1,063	522
Total Gross	206,804	2,736	1,063	210,603	226,804
Less: impairment allowance	(849)	(159)	(356)	(1,364)	(2,014)
Carrying amount	205,955	2,577	707	209,239	224,790

5. FINANCIAL RISK MANAGEMENT (*continued*)

5.1 Credit risk (*continued*)

5.1.3 Collateral held and other credit enhancements

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

The Bank's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Bank since the prior period.

Residential mortgage lending

The following tables stratify credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in house price indices. For credit-impaired loans the value of collateral is based on the most recent appraisals.

	<i>Note</i>	31 December 2019	31 December 2018
LTV ratio			
Less than 50%		31,661	29,310
51–70%		41,940	53,827
71–90%		48,071	28,924
91–100%		11,471	6,743
More than 100%		208	-
Total		133,351	118,804

	2019	2018
Credit-impaired loans		
Less than 50%	881	547
51–70%	818	557
More than 70%	950	1,038
Total	2,649	2,142

Assets obtained by taking possession of collateral

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

	2019	2018
Property	1,752	971
Other	-	45
Total	1,752	1,016

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.4 Amounts arising from ECL

(i) Significant increase in credit risk (SICR)

The Bank considers a financial instrument to have experienced a significant increase in credit risk when one or more of the quantitative or qualitative criteria have been met. Criteria for determining a significant increase in credit risk are defined for the proper allocation of exposure in "Stage 1" or "Stage 2".

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

- Default probability change in relation to the moment of initial entry of the financial instrument in the financial statements. It is therefore an assessment implemented by adopting the "relative" criterion, which is configured as the main criteria;
- Eventual presence of due amount which remains overdue over 30 days. In the event of such case the credit risk of such exposure is considered "significantly increased" and is classified to Stage 2;
- Existence of "forbearance" measures;
- Qualitative information on credit quality deterioration due to which the client is included in the monitoring list;
- Certain indicators of the internal credit risk monitoring system and early warning system

Determining whether the specific factor is relevant, as well as its significance in relation to other factors, depends on the type of products and characteristics of the financial instrument. Consequently, it is not possible to define a unique set of factors that determine whether there has been a significant increase in credit risk.

(ii) Definition of default

Staging criteria are selected in line with IFRS9, and based on risk parameters available in the Bank. Main indicators that are used are transaction classification, Days past due, Forbearance, PCEM (watch list) Indicator and/or Early Warning System (EWS) model for Micro Business, SME and Large Corporate portfolios. Considering that, Stage 3 is equal to Non-performing status of the loan, the key element in Stage assignment is recognition of increasing credit risk of a financial instrument. Significant increase of credit risk could be highlighted by qualitative indicators as:

- - Past Due days
- - Forborne status
- - Early warning signals and/or Proactive Credit Management watch list status of the customer

In addition, forbearance measures could represent a significant increase in credit risk since they consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments.

Stage assignment for Loans:

Loan exposures towards Legal entities:

Condition - business condition (event) for assignment of stage	Stage
Risk class is Past Due, Unlikely to pay or Doubtful	3
DPD >30 above the absolute and relative materiality threshold	2
Early warning system shows significant deterioration in credit risk	2
Contract is Forborne	2
Exposures with credit deterioration: Lifetime PD Comparison (used for Sovereign, PSE, Banks – not for others segments)	2

Loan exposures towards Retail:

Condition - business condition (event) for assignment of stage	Stage
Risk class is Past Due, Unlikely to pay or Doubtful	3
DPD >30 above the absolute and relative materiality threshold	2
Early warning signals for retail exposures show significant deterioration in credit risk: - Bank used local risk class = B***, - flag indicating that Customer has canceled Overdraft with due amount of principal	2
Contract is Forborne	2

5. FINANCIAL RISK MANAGEMENT (continued)

5.1.4 Amounts arising from ECL (continued)

(iii) Inclusion of forward looking element

Projection of Lifetime credit risk parameters under IFRS 9 requires inclusion of forward looking macroeconomic elements, in order to estimate future point-in-times risk drivers.

Inclusion of forward looking macroeconomic effect is based on EBA stress test coefficients. EBA stress test coefficients are used for creation of scenario for the three years, relative to the starting point of every bank. Stress test coefficient are multipliers for risk parameters: PD, LGD and LR-Loss rate. This step includes calculation of PD conditioned by EBA Stress Test coefficients. Since EBA releases only Baseline and Adverse coefficients, Best scenario coefficients have to be estimated in order to include add-on component into Lifetime PD.

(iv) Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 3(w).

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Bank renegotiates loans to customers in financial difficulties (referred to as "forbearance activities") to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank Credit Committee regularly reviews reports on forbearance activities.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired (see Note 3(w)(6)). A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to Stage 1.

(v) Expected Credit Loss Measurement

The assessment of credit risk, and the estimation of ECL, are unbiased and probability-weighted, and incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. In general, the Bank calculates ECL using three main components: a probability of default ("PD"); a loss given default ("LGD"); and the exposure at default ("EAD").

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities.

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.4 Amounts arising from ECL (continued)

The following tables show reconciliation from the opening to the closing balance of the loss allowance by class of financial instruments for Loans and advances to customers at amortized cost.

	2019				2018			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January	18,750	11,930	44,456	75,136	5,629	902	56,998	63,529
First time adoption of IFRS 9	-	-	-	-	12,131	12,829	742	25,702
Transfer to Stage 1	17,785	-15,521	-2,264	0	21,839	-15,510	-6,329	0
Transfer to Stage 2	-1,251	1,942	-691	0	-1,424	2,672	-1,248	0
Transfer to Stage 3	-215	-5,649	5,864	0	-236	-5,229	5,465	0
Net remeasurement of loss allowance	-20,989	21,354	10,239	10,604	-21,747	13,665	13,921	5,839
New financial assets originated or purchased	8,771	2,158	2,870	13,799	10,837	6,987	2,717	20,541
Financial assets that have been derecognized	-6,753	-4,812	-7,505	-19,070	-8,265	-4,382	-9,615	-22,262
Write off-s	-	-	-3,656	-3,656	-1	0	-17,442	-17,443
Unwinding the discount	-	-	-205	-205	-	-	-372	-372
Sale and other movements	-	-	-13,153	-13,153	-13	-4	-381	-398
Balance at 31 December	16,098	11,402	35,955	63,455	18,750	11,930	44,456	75,136

5.1.5 Impaired financial assets

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

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

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

	Retail loans			Total	Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	Total
31 December 2019							
Standard monitoring	421,219	187,263	48,693	657,175	484,435	415,375	899,810
31 December 2018							
Standard monitoring	403,416	171,011	54,536	628,963	497,974	293,663	791,637

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.5 Impaired financial assets (continued)

b) Past due but not impaired loans

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

	Gross amount	Until 30 days	Past due days		
			31 – 60 days	61 – 90 days	Over 90 days
31 December 2019					
Corporate loans					
- Large	-	-	-	-	-
- Other	250	250	-	-	-
	<u>250</u>	<u>250</u>	<u>-</u>	<u>-</u>	<u>-</u>
Retail loans					
- Consumer	17.847	15.056	2.208	583	-
- Housing	6.228	4.945	1.048	235	-
- Credit Cards and overdrafts	11.076	8.819	1.788	469	-
	<u>35,151</u>	<u>28,820</u>	<u>5,044</u>	<u>1,287</u>	<u>-</u>
Total	<u>35,401</u>	<u>29,069</u>	<u>5,044</u>	<u>1,287</u>	<u>-</u>

	Gross amount	Until 30 days	Past due days		
			31 – 60 days	61 – 90 days	Over 90 days
31 December 2018					
Corporate loans					
- Large	-	-	-	-	-
- Other	775	450	-	325	-
	<u>775</u>	<u>450</u>	<u>-</u>	<u>325</u>	<u>-</u>
Retail loans					
- Consumer	14,236	11,633	2,092	388	123
- Housing	6,940	5,536	1,085	242	77
- Credit Cards and overdrafts	2,396	93	1,825	452	26
	<u>23,572</u>	<u>17,262</u>	<u>5,002</u>	<u>1,082</u>	<u>226</u>
Total	<u>24,347</u>	<u>17,712</u>	<u>5,002</u>	<u>1,407</u>	<u>226</u>

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.5 Impaired financial assets – Comparative information under IAS 39 (continued)

c) Non-performing loans

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

	Retail loans			Total	Corporate loans		Total
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	
31 December 2019							
Gross exposure	38,480	2,649	4,036	45,165	-	13,437	13,437
Impairment	(24,878)	(796)	(2,734)	(28,408)	-	(7,547)	(7,547)
Net	13,602	1,853	1,302	16,757	-	5,890	5,890
Rate of impairment	65%	30%	68%	63%	-	56%	56%
Estimated value of collateral							
Mortgage	147	5,333	-	5,480	-	5,631	5,631
Total	147	5,333	-	5,480	-	5,631	5,631

	Retail loans			Total	Corporate loans		Total
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	
31 December 2018							
Gross exposure	26,282	5,762	3,301	35,345	2,411	21,122	23,533
Impairment	(19,193)	(2,020)	(2,424)	(23,637)	(2,411)	(18,408)	(20,819)
Net	7,089	3,742	877	11,708	-	2,714	2,714
Rate of impairment	73%	35%	73%	67%	100%	87%	88%
Estimated value of collateral							
Mortgage	46	3,739	-	3,785	-	2,059	2,059
Total	46	3,739	-	3,785	-	2,059	2,059

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.6 Credit risk management and policies for impairment and provisions

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

Loans and receivables with renegotiated terms

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

The Bank renegotiates loans to customers in financial difficulties to maximise collection opportunities and minimise the risk of default (rescheduling). Rescheduling is mainly performed in response to initial deterioration of the clients' financial position or for the prevention of further deterioration of the clients' financial position. The revised terms usually include extending the maturity, changing the timing of interest payments and when possible obtaining additional instruments of collateral. Following the restructuring the loans remain graded as restructured until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash-flows and there are no other indicators of impairment. Gross carrying amount of loans with renegotiated terms amount to BAM 1,479 thousand for corporate loans and BAM 11,253 thousand for retail loans as at 31 December 2019 (2018: BAM 6,552 thousand for corporate and BAM 9,617 for retail loans.)

The breakdown of the gross and net exposure of renegotiated loans are as follows:

	Retail loans			Total	Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	Total
31 December 2019							
Gross exposure	9,670	1,583	-	11,253	-	1,479	1,479
Impairment	(6,732)	(233)	-	(6,965)	-	(1,479)	(1,479)
Net	2,938	1,350	-	4,288	-	-	-
<i>Rate of impairment</i>	70%	15%	-	62%	-	100%	100%

	Retail loans			Total	Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts		Large	Other	Total
31 December 2018							
Gross exposure	8,583	1,034	-	9,617	-	6,552	6,552
Impairment	(5,236)	(150)	-	(5,387)	-	(5,808)	(5,808)
Net	3,347	884	-	4,230	-	744	744
<i>Rate of impairment</i>	61%	15%	-	56%	-	89%	89%

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

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.7 Concentration of credit risk per geographic location

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

	Bosnia and Herzegovina	EU countries	Non-EU countries	Total
As at 31 December 2019				
Current accounts with the Central Bank and other banks	367,776	83,388	13,387	464,551
Reserves with the Central Bank	191,510	-	-	191,510
Placements with other banks	-	68	-	68
Financial assets at FVOCI	57	69	-	126
Financial assets at Amortized Cost	6,134	-	-	6,134
Loans and receivables from customers	1,587,533	-	-	1,587,533
Income tax prepayment	3,556	-	-	3,556
Other assets (without fixed assets)	4,665	3,011	-	7,676
	2,161,031	86,536	13,387	2,260,954
As at 31 December 2018				
Current accounts with the Central Bank and other banks	311,125	57,876	2,932	371,933
Obligatory reserves with the Central Bank	172,979	-	-	172,979
Placements with other banks	-	21,594	-	21,594
Debt securities available for sale	65,836	-	-	65,836
Loans and receivables from customers	1,428,689	-	-	1,428,689
Income tax prepayment	1,425	-	-	1,425
Other assets (without fixed assets)	6,444	2,640	-	9,084
	1,921,294	82,179	2,932	2,006,405

5. FINANCIAL RISK MANAGEMENT (continued)

5.2 Liquidity risk management

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

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

The following tables show the remaining contractual maturities of the Bank's assets and liabilities as at 31 December 2019 and 31 December 2018, except for financial assets at fair value through other comprehensive income which have been classified in accordance with their secondary liquidity characteristic as maturing within one month and obligatory reserves which have been classified in the maturity period within one month. Other items of assets and liabilities that have no contractual maturities are classified as having a remaining maturity of over 5 years.

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2019						
Assets						
Cash and cash equivalents	499,752	-	-	-	-	499,752
Reserves with the Central Bank	191,510	-	-	-	-	191,510
Placements with other banks	68	-	-	-	-	68
Financial assets at fair value through other comprehensive income	-	-	-	-	126	126
Financial assets at fair value through profit or loss	637	-	153	-	-	790
Financial assets at Amortized Cost	-	-	-	6,134	-	6,134
Loans and receivables from customers	88,890	118,082	428,831	664,097	287,653	1,587,533
Income tax prepayment and other assets	13,329	-	-	-	-	13,329
Property and equipment and intangible assets	-	-	-	-	31,286	31,286
Total assets	794,186	118,062	428,984	670,231	319,065	2,330,528
Liabilities and equity						
Due to banks and other financial institutions	21,545	73,426	251,231	94,383	26,229	466,814
Due to customers	880,006	40,705	174,075	407,350	16,777	1,518,913
Financial liabilities at fair value through profit or loss	508	-	66	-	-	574
Other liabilities and deferred tax	29,700	-	-	-	-	29,700
Provision for liabilities and charges	-	-	-	4,993	-	4,993
Share capital and reserves	-	-	-	-	309,534	309,534
Total liabilities and equity	931,759	114,131	425,372	506,726	352,540	2,330,528
Maturity gap	(137,573)	3,931	3,612	163,505	(33,475)	-

5. FINANCIAL RISK MANAGEMENT (continued)

5.2 Liquidity risk management (continued)

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2018						
Assets						
Cash and cash equivalents	406,414	-	-	-	-	406,414
Reserves with the Central Bank	172,979	-	-	-	-	172,979
Placements with other banks	21,594	-	-	-	-	21,594
Financial assets available for sale	-	-	579	-	122	701
Financial assets at fair value through profit or loss	2	247	-	-	163	412
Loans and receivables from customers	71,627	106,602	345,298	626,737	278,425	1,428,689
Income tax prepayment and other assets	11,506	-	-	-	-	11,506
Property and equipment and intangible assets	-	-	-	-	18,525	18,525
Total assets	684,122	106,849	345,877	626,737	297,235	2,060,820
Liabilities and equity						
Due to banks and other financial institutions	35,204	148,659	174,632	74,746	23,166	456,407
Due to customers	718,325	41,351	181,038	330,617	18,754	1,290,085
Financial liabilities at fair value through P&L	2	163	-	-	-	165
Subordinated debt	-	41	80	-	-	121
Other liabilities	27,916	-	-	-	114	28,030
Provisions for liabilities and charges	-	-	-	-	4,701	4,701
Share capital and reserve	-	-	-	-	275,620	275,620
Total liabilities and equity	786,818	190,173	355,670	405,363	322,796	2,060,820
Maturity gap	(102,696)	(83,324)	(9,793)	221,374	(25,561)	-

5. FINANCIAL RISK MANAGEMENT (continued)

5.2 Liquidity risk management (continued)

Future cash flows for interest bearing liabilities

The estimated future cash flows for the Bank's interest bearing liabilities, including expected interest as at 31 December 2018 and as at 31 December 2017 are shown in the following table:

	Total expected outflow 3 months					Total	Carrying value
	Up to 1 month	1 to 3 months	to 1 year	1 to 5 years	Over 5 years		
31 December 2019							
Liabilities							
Due to banks and other financial institutions	31,257	41,772	176,414	413,044	13,693	676,180	466,814
Due to customers	878,194	77,890	261,644	85,939	30,266	1,333,933	1,518,913
Total expected outflow	909,451	119,662	438,058	498,983	43,959	2,010,113	1,985,727

	Total expected outflow 3 months					Total	Carrying value
	Up to 1 month	1 to 3 months	to 1 year	1 to 5 years	Over 5 years		
31 December 2018							
Liabilities							
Due to banks and other financial institutions	24,842	130,583	165,204	115,784	24,272	460,685	456,407
Due to customers	718,322	42,533	184,868	343,588	19,278	1,308,589	1,290,085
Subordinated debt	-	41	81	-	-	122	121
Total expected outflow	743,164	173,116	350,072	459,372	43,550	1,769,274	1,746,492

The following table sets out the components of the Bank's liquidity reserves:

	2019	2018
Balance with central banks	367,776	310,292
Cash and balances with other banks	96,818	61,674
Other cash and cash equivalents	35,201	34,480
Total liquidity reserves	499,796	406,446

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk

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

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

5.3.1 Foreign exchange risk

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

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

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

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

The main model assumptions are:

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

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

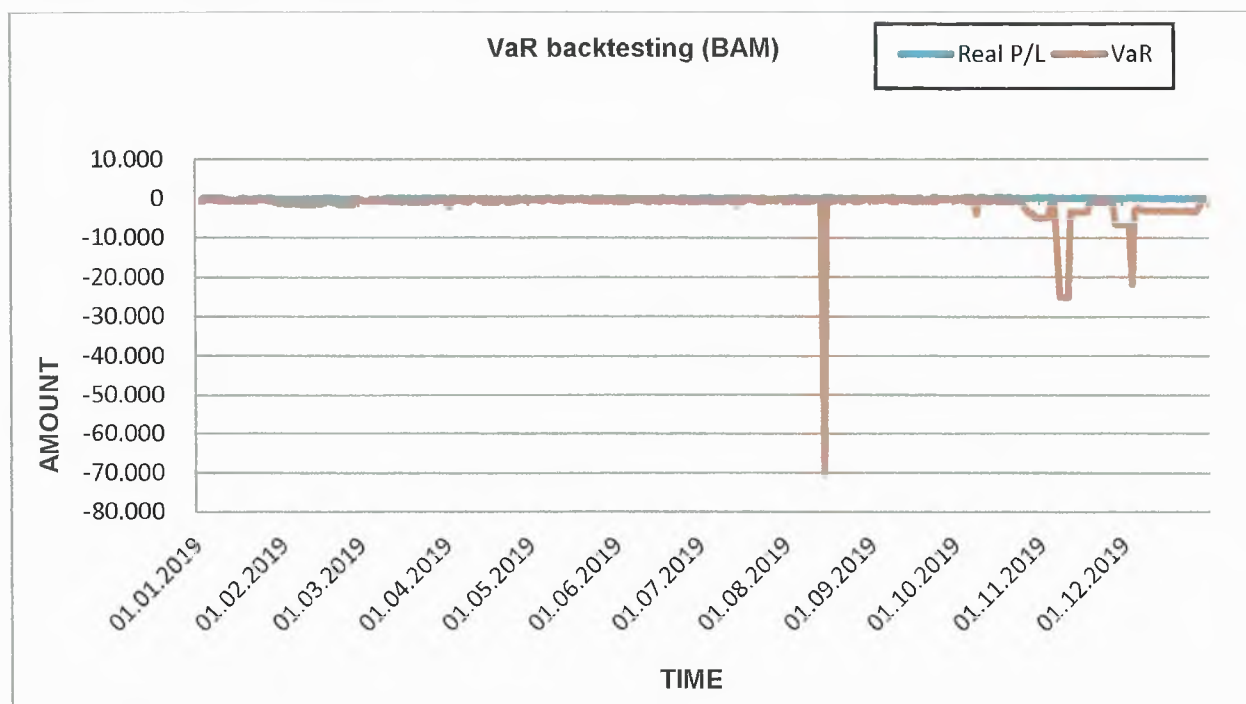
The model can compute VaR at different aggregation levels – from a single position to any sub-portfolio level. Therefore, the model allows a detailed analysis of risk profiles for the multi-level portfolio hierarchy and diversity effects occurring. Furthermore, VaR measurement can be expounded based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

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)



During 2019, the Bank improved the model for calculation of VaR in accordance with best practices and as a result, the Bank did not record any back-testing exceptions (results for 2018: 3 exceptions) when actual losses exceeded the daily VAR amount.

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

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

31 December 2019

Currency	Open position (in BAM)	Stress Test	
		10% Move Up	10% Move Down
CHF	(6,201)	620	(620)
GBP	8,698	(870)	870
USD	(23,935)	2,393	(2,393)
HRK	(793)	79	(79)
CAD	6,973	(697)	697
SEK	5,399	(540)	540
Other	16,019	(1,602)	1,602
EUR	28,545,103	-	-

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)

31 December 2018

Currency	Open position (in BAM)	Stress Test	
		10% Move Up	10% Move Down
CHF	60,135	(6,014)	6,014
GBP	(3,667)	367	(367)
USD	(15,396)	1,540	(1,540)
HRK	(18,949)	1,895	(1,895)
CAD	11,784	1,178	(1,178)
SEK	5,468	(547)	547
other	26,894	(2,689)	2,689
EUR	876,511	-	-

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

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

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

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

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)

Foreign exchange position

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2019 and 31 December 2018. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by currency. The Bank has a number of agreements governed by a foreign currency clause. The BAM value of principal in such agreements is determined by the movement in foreign exchange rates. The principal balance of the related exposure is included in the table below in the column "EURO linked".

The Bank had the following significant currency positions:

31 December 2019	EURO	EURO linked	EURO total	USD	Other FX	BAM	Total
Assets							
Cash and cash equivalents	79,793	-	79,793	12,095	11,708	396,156	499,752
Reserves with the Central Bank	-	-	-	-	-	191,510	191,510
Placement with other banks	68	-	68	-	-	-	68
Financial assets at fair value through other comprehensive income	74	-	74	-	-	52	126
Financial assets at fair value through profit or loss	32	-	32	-	-	758	790
Financial assets at Amortized Cost	-	-	-	-	-	6,134	6,134
Loans and receivables from customers	-	935,274	935,274	-	-	652,259	1,587,533
Income tax prepayment	-	-	-	-	-	3,356	3,356
Deferred tax assets	-	-	-	-	-	332	332
Other asset	2,868	-	2,868	29	-	6,744	9,641
Property and equipment and intangible assets	-	-	-	-	-	31,286	31,286
Total assets	82,835	935,274	1,018,109	12,124	11,708	1,288,587	2,330,528
Liabilities and equity							
Due to banks and other financial Institutions	458,138	7,000	465,138	-	458	1,218	466,814
Due to customers	409,887	142,321	552,208	26,086	11,138	929,481	1,518,913
Financial liabilities at fair value through profit or loss	-	-	-	-	-	574	574
Other liabilities	3,405	-	3,405	15	11	6,218	29,649
Provision for liabilities and charges	-	-	-	-	-	4,993	4,993
Deferred tax liabilities	-	-	-	-	-	51	51
Share capital and reserves	-	-	-	-	-	309,534	309,534
Total liabilities and equity	871,430	149,321	1,020,751	26,101	11,607	1,272,069	2,330,528
Net foreign exchange position	(788,595)	785,953	(2,642)	(13,977)	101	16,518	-

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)

31 December 2018	EURO	EURO linked	EURO total	USD	Other FX	BAM	Total
Assets							
Cash and cash equivalents	59,120	-	59,120	2,441	8,765	336,088	406,414
Obligatory reserves with the Central Bank	-	-	-	-	-	172,979	172,979
Placements with other banks	5	-	5	20,150	1,439	-	21,594
Financial assets available for sale	69	-	69	-	-	632	701
Financial assets at fair value through profit or loss	-	-	-	-	249	163	412
Loans and receivables from customers	3	865,194	865,197	-	-	563,492	1,428,689
Income tax prepayment	-	-	-	-	-	1,425	1,425
Deferred tax assets	-	-	-	-	-	255	255
Other asset	2,418	-	2,418	28	-	7,380	9,826
Property and equipment and intangible assets	-	-	-	-	-	18,525	18,525
Total assets	61,615	865,194	926,809	22,619	10,453	1,100,939	2,060,820
Liabilities and equity							
Due to banks and other financial institutions	446,811	-	446,811	-	1,040	8,556	456,407
Due to customers	434,306	105,014	539,320	22,563	8,997	719,205	1,290,085
Financial liabilities at fair value through profit or loss	165	-	165	-	-	-	165
Subordinated debt	-	-	-	-	-	-	-
Other liabilities	3,149	-	3,149	44	10	30,227	33,430
Provision for liabilities and charges	-	-	-	-	-	5,063	5,063
Deferred tax liability	-	-	-	-	-	50	50
Share capital and reserves	-	-	-	-	-	275,620	275,620
Total liabilities and equity	884,431	105,014	989,445	22,607	10,047	1,038,721	2,060,820
Net foreign exchange position	(822,816)	760,180	(62,636)	12	406	62,218	-

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.2 Interest rate risk

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

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

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

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

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

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

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

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

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

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

The shift sensitivity of fair value measures the changes in economic value of a financial portfolio resulting from a parallel shift in the discount curves. The total value of shift sensitivity is broken down by time bucket (bucket analysis), in order to identify the distribution of risk over the time axis. The operating limit currently in force for shift sensitivity of fair value (by +100 bp parallel shift of yield curves) amounts to BAM 5,867 / BAM -15,647 thousand (EUR 3,000 / EUR 8,000 thousand). The limit is set up by the Bank with the aim of keeping exposure within low levels which are compatible with self-imposed risk parameters.

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.2 Interest rate risk (continued)

If changes in interest rates had been 100 basis points higher and all other variables were held constant at 31 December 2019, the effect, in terms of economic value of interest risk-sensitive balance-sheet portfolios, would have been BAM -11,959 thousand (31 December 2018: BAM -9,630 thousand).

In 2018 the Bank established the limit by time-buckets on the following way:

Shift Sensitivity Limit (+100 bp)

TOTAL	0-18 months	18 months - 5 years	above 5 years
BAM 5,867 thousand / BAM -15,647 thousand	+/- BAM 3,912 thousand	BAM 5,867 thousand / BAM -7,823 thousand	BAM 5,867 thousand / BAM -9,779 thousand
(3 mio EUR / -8 mio EUR)	(+/- 2 mio EUR)	(3 mio EUR / -4 mio EUR)	(3 mio EUR / -5 mio EUR)

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

Shift Sensitivity (+100b.p)	31 December 2019				31 December 2018			
	TOTAL	0-18 month h	18 months - 5 years	over 5 years	TOTAL	0-18 month	18 months -5 years	over 5 years
EUR	(4,895)	(53)	1,345	(6,188)	(4,632)	(111)	807	(5,328)
USD	282	40	180	61	220	55	160	5
CHF	12	9	3	-	13	8	5	-
BAM	(7,396)	(181)	(3,012)	(4,203)	(5,232)	(148)	(2,062)	(3,022)
Other currencies	3	2	1	-	1	1	-	-
Total	(11,995)	(183)	(1,482)	(10,330)	(9,630)	(195)	(1,090)	(8,345)

The sensitivity of the interest margin quantifies instead the short-term (twelve months) impact on the interest margin of a parallel, instantaneous and permanent shock in the interest rate curve. This measure highlights the effect of changes in interest rates on the portfolio being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a predictor of the future levels of the interest margin. The operating limit currently in force for shift sensitivity of interest margin (by -50 bp parallel shift of yield curves) amounts to BAM -5,867 thousand (EUR -3,000 thousand).

The result of shift sensitivity of the interest margin, if changes in interest rates market moving had been 100 basis points higher and all other variables were held constant at 31 December 2019 is an increase of BAM 4,240 thousand (31 December 2018: BAM 2,422 thousand), while if changes in interest rates market moving had been 100 basis points lower the result is decrease of BAM 3,046 thousand as of 31 December 2019 (31 December 2018: decrease of BAM 4,053 thousand). In addition, the Bank also prepares shift sensitivity of the interest margin based on the sensitivity range of +50/-50 bps. Increase by 50 bps of interest rates would increase the result for the year by BAM 2,150 thousand, while a decrease by 50 bps in interest rates would decrease result for the year by BAM 2,706 thousand as of 31 December 2019 (31 December 2018: BAM 1,234 thousand for +50 bps and decrease of BAM 1,914 thousand for -50 bps).

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.4 Capital management

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

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

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

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

- Tier 1 Capital or Core Capital: share capital (net of the carrying value of treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; amount of revaluation reserves arising from the effects of changes in the fair value of assets and audited profit for the current period, upon approval and retention by the General Shareholders Assembly;
- Tier 2 Capital or Supplementary Capital: qualifying principal amounts of subordinated loan capital, collective impairment allowances in accordance with FBA regulation and Adjustment for shortfall in regulatory reserve.
- Deductible items.

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.4 Capital management (continued)

The table below summarises the computation of regulatory capital and the capital adequacy ratio of the Bank as of 31 December 2019 and 31 December 2018, taken from the calculations submitted to the Agency in respect of those periods.

	31 December 2019	31 December 2018
Tier 1 capital		
Share capital	44,776	44,782
Share premium	57,415	57,415
Retained earnings and other reserves	154,268	134,858
Intangible assets	(4,780)	(5,582)
	<hr/>	<hr/>
Total qualifying Tier 1 Capital	251,679	231,473
	<hr/>	<hr/>
Tier 2 capital		
General provisions – FBA regulations	17,457	17,081
Priority shares	6	-
Adjustment for shortfall in regulatory reserve	(10,909)	(10,077)
	<hr/>	<hr/>
Total qualifying Tier 2 Capital	6,554	7,004
	<hr/>	<hr/>
Total regulatory capital	258,233	238,477
	<hr/>	<hr/>
Capital requirements (*)		
Risk weighted assets	1,396,593	1,366,467
Operational risk	163,017	156,495
	<hr/>	<hr/>
Total	1,559,610	1,522,962
	<hr/>	<hr/>
Capital adequacy ratio	16.56%	15.66%
	<hr/> <hr/>	<hr/> <hr/>

(*) Capital requirements stated above are calculated in accordance with FBA regulatory requirements.

In accordance with the Agency regulations, Tier 1 capital does not include the balance on the regulatory reserve for credit losses (BAM 18,286 thousand at 31 December 2019) which is part of net equity in the statement of financial position. However, general provisions calculated in accordance with Agency rules (BAM 17,457 thousand at 31 December 2019) are included as Tier 2 capital.

In addition, an adjustment is made for the shortfall in regulatory reserves in respect of any additional requirements calculated at the reporting date (date of submission of the capital adequacy calculation to the Agency, which, in accordance with local regulations, is performed on a quarterly basis). For 2019 this amounted to BAM 10,909 thousand (2018: 10,077 thousand).

In accordance with the Agency regulations, the Decision on minimum standards for capital management of banks and capital protection dated 24 October 2018 (Official Gazette of the Federation of BiH 81/17), Article 6(3) audited profit for the year is included in the calculation of regulatory capital from the date when the audited financial statements for the period have been issued and approved by the General Shareholders Assembly. If current year profit would be included in Retained earnings, CAR would be 18.73% (16.93%).

Given the structure of Core and Supplementary capital, Core Capital ratio is almost equivalent to total CAR and reached 16.14% at the end of 2019 (minimum level: 9.0%). Leverage ratio reached 10.26% as of 31 December 2019 (regulatory limit: 6.0%).

5. FINANCIAL RISK MANAGEMENT (continued)

5.4 Capital management (continued)

During 2019, Federal Banking Agency adopted the Decision on Credit Risk Management and determination of Expected Credit Losses.

The FBA Decision regulates the rules for classification of financial instruments based of International Financial Reporting Standard 9: Financial Instruments (IFRS 9), with the introduction of some specific characteristics for the BiH market.

The key changes required by the Decision on Credit Risk Management and determination of Expected Credit Losses are in largely consistent with the Guidelines issued by the European Banking Supervisory Authority (EBA).

The Decision, like the Guidelines, prescribe automatically classification clients who are significantly late in setting their financial obligations for more than 90 days into the default status.

Significant delay in settlement of financial liabilities is the total amount of receivables due from:

- a) Individual - 200 KM and 1% of total debtor balance exposure;
- b) Legal entity - KM 1,000 and 1% of total debtor balance sheet exposure.

The significant delay is in line with that prescribed by the EBA Guidelines. Intesa Sanpaolo Bank has applied unique materiality thresholds of € 100 and € 500.

According to the FBA Decision, all financial instruments, in accordance with IFRS9, are classified into three stages (stages) of impairment of a financial instrument:

- Stage 1 - Low credit risk (performing)
- Stage 2 - Increased credit risk (underperforming)
- Stage 3 - Non-performing Exposures

The FBA's decision comes into force on 1.1.2020. The current classification of financial instruments will be abandoned and replaced by the new Stage three classification rules as stated in the previous paragraph.

The effect of the first application of the FBA Decision is presented below

	<i>Notes</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Assets					
Cash and cash equivalents	19	450	0	0	450
Reserves with Central Bank	20	192	0	0	192
Loans and receivables from customers	23	1,459	114	4,950	6,522
Other assets	24	22	1	278	301
Total Assets		2,122	115	5,228	7,464
Liabilities					
Provisions for liabilities and charges	30	261	30	18	309
Total effect		2,383	145	5,245	7,773

In accordance with Article 34 of the aforementioned Decision, the effect of the first application shall be calculated on the existing balance as at 31 December 2019 and recorded on the positions of capital, as a decrease of positions of Tier 1 capital.

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

6.1 Valuation models

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

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

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

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

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

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

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

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

6.2 Financial instruments at fair value – fair value hierarchy

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

31 December 2019	Note	Level 1	Level 2	Level 3	Total
Financial assets at fair value through other comprehensive income	<i>22 a)</i>				
Equity securities issued by non-resident legal entities		-	72	-	72
Equity securities issued by resident legal entities		-	54	-	54
Financial assets available at fair value through profit and loss	<i>22 b)</i>				
Equity shares		33	-	-	33
Derivatives held for trading – OTC product		-	757	-	757
Total		33	883	-	916
Financial liabilities available at fair value through profit and loss	<i>22 c)</i>				
Derivatives held for trading – OTC product		-	574	-	574
Total		-	574	-	574
31 December 2018	Note	Level 1	Level 2	Level 3	Total
Financial assets available for sale	<i>22 a)</i>				
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina		-	579	-	579
Equity securities issued by non-resident legal entities		-	69	-	69
Equity securities issued by resident legal entities		-	52	-	52
Financial assets available at fair value through profit and loss	<i>22 b)</i>				
Equity shares		163	-	-	163
Derivatives held for trading – OTC product		-	249	-	249
Total		163	949	-	1,112
Financial liabilities available at fair value through profit and loss	<i>22 c)</i>				
Derivatives held for trading – OTC product		-	165	-	165
Total		-	165	-	165

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

6.3 Financial instruments not measured at fair value

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

31 December 2019	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	35,201	464,551	499,752	499,752
Reserves with the Central Bank	-	-	191,510	191,510	191,510
Placements with other banks	-	68	-	68	68
Financial assets at amortized cost	-	6,134	-	6,134	6,134
Loans and receivables from customers	-	290,562	1,279,326	1,569,888	1,587,533
Total	-	331,965	1,935,387	2,267,352	2,284,997
Liabilities					
Due to banks and other financial institutions	-	294,266	135,538	429,804	466,814
Due to customers	-	905,837	600,632	1,506,479	1,518,913
Total	-	1,200,103	736,170	1,936,273	1,985,727
31 December 2018					
	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	34,480	371,934	406,414	406,414
Reserves with the Central Bank	-	-	172,979	172,979	172,979
Placements with other banks	-	21,594	-	21,594	21,594
Loans and receivables from customers	-	220,156	1,202,746	1,422,899	1,428,689
Total	-	276,227	1,747,659	2,023,886	2,029,676
Liabilities					
Due to banks and other financial institutions	-	266,860	178,485	445,345	456,407
Due to customers	-	766,146	523,646	1,289,792	1,290,085
Total	-	1,033,006	702,131	1,735,137	1,746,492

6. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

6.3 Financial instruments not measured at fair value (continued)

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

Cash and cash equivalents

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

Placements with other banks

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

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

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

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

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

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

7. OPERATING SEGMENTS

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

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

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

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

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

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information for the year ending 31 December 2019

	Retail	Corporate	Treasury	Total
Interest income	51,108	26,051	880	78,039
Interest expense	(6,700)	(4,609)	(1,564)	(12,873)
Net interest income	44.408	21.441	(683)	65.166
Fee and commission income	23.529	9.287	392	33.208
Fee and commission expense	(6.052)	(761)	(231)	(7.044)
Net fee and commission income	17.477	8.526	161	26.164
Net profit of trading activities and foreign exchange	-	-	2,768	2,768
Other operating income/expense	(4,009)	(1,691)	(270)	(5,970)
Operating income/expense	(4,009)	(1,691)	2,498	(3,202)
Personnel expense	(15,929)	(4,777)	(518)	(21,224)
Other administrative expense	(12,916)	(3,564)	(1,144)	(17,624)
Depreciation expense	(4,922)	(790)	(47)	(5,759)
Operating expense	(33,767)	(9,131)	(1,709)	(44,607)
Profit before impairment losses, and other provisions and income tax	24,109	19,145	267	43,521
Reversal of Impairment / (Impairment losses) and provisions	(4,134)	(1,224)	(129)	(5,487)
PROFIT BEFORE INCOME TAX	19,975	17,921	138	38,034
Income tax				(4,111)
NET PROFIT FOR THE YEAR				33,923

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information as at 31 December 2019

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	35,201	-	464,550	499,752
Obligatory reserves with the Central Bank	-	-	191,510	191,510
Placements with other banks	-	-	68	68
Financial assets at fair value through other comprehensive income	-	-	126	126
Financial assets at fair value through profit or loss	-	-	790	790
Financial assets at amortized cost	-	-	6,134	6,134
Loans and receivables from customers	693,533	894,000	-	1,587,533
Other unallocated amounts	-	-	-	44,615
	<u>728,734</u>	<u>894,000</u>	<u>663,178</u>	<u>2,330,528</u>
TOTAL ASSETS				
Due to banks and other financial institutions	-	20,015	446,799	466,814
Due to customers	692,349	826,564	-	1,518,913
Financial liabilities at fair value through profit or loss	-	-	574	574
Other unallocated amounts	-	-	-	34,693
	<u>692,349</u>	<u>846,579</u>	<u>447,373</u>	<u>2,020,994</u>
TOTAL LIABILITIES				

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information for the year ending 31 December 2018

	Retail	Corporate	Treasury	Total
Interest income	49,934	26,175	564	76,673
Interest expense	(7,903)	(3,692)	(523)	(12,118)
Net interest income	42,031	22,483	41	64,555
Fee and commission income	21,483	8,128	363	29,974
Fee and commission expense	(5,035)	(793)	(22)	(5,850)
Net fee and commission income	16,448	7,335	341	24,124
Net profit of trading activities and foreign exchange	-	-	1,947	1,947
Other operating income/expense	(3,712)	(2,421)	(337)	(6,470)
Operating income/expense	(3,712)	(2,421)	1,610	(4,523)
Personnel expense	(15,886)	(4,594)	(611)	(21,091)
Other administrative expense	(14,485)	(3,540)	(816)	(18,841)
Depreciation expense	(3,259)	(452)	(57)	(3,768)
Operating expense	(33,630)	(8,586)	(1,484)	(43,700)
Profit before impairment losses, and other provisions and income tax	21,137	18,811	508	40,456
Impairment losses and provisions	(8,442)	5,727	2,821	106
PROFIT BEFORE INCOME TAX	12,695	24,538	3,329	40,562
Income tax				(4,222)
NET PROFIT FOR THE YEAR				36,340

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information as at 31 December 2018

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	34,480	-	371,934	406,414
Obligatory reserves with the Central Bank	-	-	172,979	172,979
Placements with other banks	-	-	21,594	21,594
Financial assets available for sale	-	-	65,952	65,952
Financial assets at fair value through profit or loss	-	-	412	412
Loans and receivables from customers	645,569	783,120	-	1,428,689
Other unallocated amounts	-	-	-	30,031
TOTAL ASSETS	680,049	783,120	567,620	2,060,820
Due to banks and other financial institutions	-	26,681	429,726	456,407
Due to customers	631,448	658,637	-	1,290,085
Financial liabilities at fair value through profit or loss	-	-	165	165
Other unallocated amounts	-	-	-	38,543
TOTAL LIABILITIES	631,448	685,318	429,891	1,785,200

8. INTEREST INCOME

	2019	2018
Retail clients	48,147	47,440
Corporate clients	29,276	28,621
Banks and other financial institutions	493	411
Interest on amortized cost assets	116	-
Interest on financial assets through other comprehensive income	7	201
	<u>78,039</u>	<u>76,673</u>

9. INTEREST EXPENSE

	2019	2018
Retail clients	5,855	6,944
Corporate clients	3,959	3,204
Banks and other financial institutions	2,961	1,967
Other	98	3
	<u>12,873</u>	<u>12,118</u>

10. FEE AND COMMISSION INCOME

	2019	2018
Credit card business	10,222	8,825
Domestic payment transactions	5,880	5,556
Account service fee	4,376	4,250
Foreign payment transactions	3,769	3,204
Guarantees	2,293	2,225
Loans to clients	2,567	2,305
FX transactions	1,712	1,669
Agency services	74	79
Other	2,315	1,862
	<u>33,208</u>	<u>29,974</u>

Other fee and commission income includes ATM and mobile banking fees from retail customers.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of BAM, unless otherwise stated)

11. FEE AND COMMISSION EXPENSE

	2019	2018
Credit card operations	5,485	4,458
Banks services	783	750
Domestic payment transactions	269	293
Other	507	349
	<u>7,044</u>	<u>5,850</u>

12. NET TRADING INCOME

	2019	2018
Net gains from foreign exchange spot trading	2,544	1,904
Net gains on equity securities	9	24
Net gains/losses on financial instruments at fair value through profit or loss – Equity shares	32	(70)
Net gains/losses on financial instruments at fair value through profit or loss - Derivatives held for trading – OTC product	183	89
	<u>2,768</u>	<u>1,947</u>

13. OTHER OPERATING INCOME / (EXPENSE)

	2019	2018
Savings deposit insurance	(2,802)	(2,783)
Card intermediation expenses	(2,457)	(2,266)
Consultancy and the Federal Banking Agency expenses	(1,455)	(1,295)
Net charge to profit or loss statement (Note 24)	165	(664)
Other income / (expense)	1	(19)
Income from claims settled by insurance companies and recharges from customers	607	502
(Loss) / Gain on sale and write off of property and equipment	(29)	55
	<u>(5,970)</u>	<u>(6,470)</u>

14. PERSONNEL EXPENSES

	2019	2018
Net salaries	13,442	13,546
Tax and contributions	7,213	7,121
Provisions for liabilities and charges (Note 30)	30	80
Other expenses	539	344
	<u>21,224</u>	<u>21,091</u>

Personnel expenses include BAM 3,735 thousand (31 December 2018: BAM 3,511 thousand) of defined pension contributions paid into the State pension plan. Contributions are calculated as percentage of the gross salary paid. The Bank had 556 employees as at 31 December 2019 (562 as at 31 December 2018).

15. ADMINISTRATIVE EXPENSES

	2019	2018
Maintenance expenses	4,461	4,355
Rent and other rent-related expense	1,607	3,880
Telecommunication and post expense	2,934	2,951
Security and transport costs	2,339	2,351
Consultancy expenses	953	933
Representation and marketing expense	845	874
Material expenses	702	838
Energy	776	743
Net of provisions for liabilities and charges (Note 30)	1,529	535
Other insurance charges	535	526
Other costs	943	855
	<u>17,624</u>	<u>18,841</u>

The item " Rent and other rent-related expense " is lower than in 2018 due to the application of IFRS 16 and presentation rent cost, as required by Standard, as depreciation in the Note 25 – Property and equipment.

16. NET IMPAIRMENT LOSSES AND OTHER PROVISIONS

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

	2019	2018
Net impairment losses and provisions		
- for cash and cash equivalents (Note 19)	(11)	54
- for loans to customers (Note 23)	(5,333)	(4,118)
- for other assets (Note 24)	(595)	(231)
- for off-balance sheet items (Note 30)	509	1,626
- for financial assets at fair value through other comprehensive income	(57)	2,775
	<u>(5,487)</u>	<u>106</u>

17. INCOME TAXES

	2019	2018
Current tax	4,179	4,299
Deferred tax (Note 31)	(67)	(77)
Total Income tax	<u>4,111</u>	<u>4,222</u>

Income tax recognised in the profit or loss statement comprises current tax. Official corporate income tax rate is 10% (2018: 10%).

	2019	2018
Profit before income tax	38,034	40,562
Tax calculated at rate of 10%	3,803	4,056
Non-deductible expenses	308	167
Non-taxable income	-	(1)
Income tax expense	<u>4,111</u>	<u>4,222</u>
Average effective income tax rate	<u>10.8%</u>	<u>10.4%</u>

18. BASIC AND DILUTED EARNINGS PER SHARE

	2019	2018
Net profit (BAM'000)	33,923	36,340
Weighted average number of ordinary shares outstanding	447,760	447,760
Basic and diluted earnings per share (BAM)	<u>75.76</u>	<u>81.16</u>

19. CASH AND CASH EQUIVALENTS

	31 December 2019	31 December 2018
Current account with the Central Bank	367,776	310,292
Current accounts with other banks	96,818	61,674
Cash in hand in domestic currency	27,968	24,990
Cash in hand in foreign currency	7,234	9,490
	<u>499,796</u>	<u>406,446</u>
Less: impairment allowance	(43)	(32)
	<u>499,753</u>	<u>406,414</u>

20. RESERVES WITH THE CENTRAL BANK

	31 December 2018	31 December 2017
Obligatory reserve	191,510	172,979
	<u>191,510</u>	<u>172,979</u>

The minimum obligatory reserve is calculated as a percentage of the average balance of total deposits and borrowed funds for each business day during the 10 calendar days, in arrears. The obligatory reserve rate is 10% at deposits and borrowed funds regardless of the currency in which the funds are denominated.

The interest rate (negative) on minimum reserve requirements is 0.5% in 2019. Cash held as an obligatory reserve in the account with the CBBH is not available for use without the special approval of the CBBH and the Banking Agency of the Federation of Bosnia and Herzegovina (FBA).

21. PLACEMENTS WITH OTHER BANKS

	31 December 2019	31 December 2018
Placements with banks	68	21,594
	<u>68</u>	<u>21,594</u>

As at 31 December 2019, the Bank had placement as follows:

Placement with bank:	Original currency	Original currency	BAM	Maturity	Interest rate
Intesa Sanpaolo S.p.A.	EUR	34	68	01.01.2020	-
			<u>68</u>		

22. FINANCIAL ASSETS AND LIABILITIES

(a) Financial assets at fair value through other comprehensive income

	31 December 2019	31 December 2018
<i>Debt instruments</i>		
Bonds and Treasury bills issued by the Federation of Bosnia and Herzegovina	-	579
	<u>-</u>	<u>579</u>
<i>Equity instruments</i>		
Equity securities at fair value	126	122
	<u>126</u>	<u>122</u>
	<u>126</u>	<u>701</u>

(b) Financial assets at fair value through profit or loss

	31 December 2019	31 December 2018
<i>Financial assets</i>		
Equity shares designated at fair value through profit or loss	33	163
Derivatives held for trading	757	249
	<u>790</u>	<u>412</u>

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

	31 December 2019 Notional amount	31 December 2019 Fair value	31 December 2018 Notional amount	31 December 2018 Fair value
<i>Financial assets</i>				
<i>Derivatives classified as held for trading – OTC products</i>				
Forward foreign exchange contracts	71,913	757	9,353	249
	<u>71,913</u>	<u>757</u>	<u>9,353</u>	<u>249</u>

22. FINANCIAL ASSETS AND LIABILITIES (continued)

(c) Financial assets at amortized cost

	31 December 2019	31 December 2018
<i>Debt instrument</i>		
Bonds issued by the Canton	6,134	-
	<u>6,134</u>	<u>-</u>

The interest rate on Canton bonds is 2.3%.

(d) Financial liabilities at fair value through profit or loss

	31 December 2019	31 December 2018
<i>Financial liabilities</i>		
Derivatives held for trading	574	165
	<u>574</u>	<u>165</u>

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

Financial liabilities	31 December 2019	31 December 2019	31 December 2018	31 December 2018
	Notional amount	Fair value	Notional amount	Fair value
<i>Derivatives classified as held for trading – OTC products</i>				
Forward foreign exchange contracts	57,202	574	9,074	165
	<u>57,202</u>	<u>574</u>	<u>9,074</u>	<u>165</u>

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

23. LOANS AND RECEIVABLES FROM CUSTOMERS

	31 December 2019	31 December 2018
Short-term loans		
<i>Corporate</i>		
- in BAM and BAM linked to foreign currency	322,117	241,869
- in foreign currency	-	1,415
<i>Retail</i>		
- in BAM and BAM linked to foreign currency	76,407	70,431
- in foreign currency	-	5
	<u>398,524</u>	<u>313,720</u>
Long-term loans		
<i>Corporate</i>		
-in BAM and BAM linked to foreign currency	591,380	572,244
-in foreign currency	-	417
<i>Retail</i>		
-in BAM and BAM linked to foreign currency	661,071	617,431
-in foreign currency	13	13
	<u>1,252,464</u>	<u>1,190,105</u>
Total loans	1,650,988	1,503,825
Less: impairment allowance	(63,455)	(75,136)
	<u>1,587,533</u>	<u>1,428,689</u>

Loans and receivables from customers are presented including accrued interest in the amount of BAM 5,097 thousand (2018: BAM 5,609 thousand), and net of up-front fees in the amount of BAM 11,795 thousand (2018: BAM 10,493 thousand).

As of 31 December 2019, the net amount of short-term and long-term loans in domestic currency includes loans disbursed and repayable in domestic currency index-linked to the BAM:EUR exchange rate in the amount of BAM 177,908 thousand and BAM 788,722 thousand, respectively (31 December 2018: BAM 115,081 thousand and BAM 791,815 thousand, respectively).

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

	2019	2018
Balance as at 1 January	<u>75,136</u>	<u>63,529</u>
Impact of first time adoption – IFRS 9	-	25,702
Net charge to profit or loss statement (Note 16)	5,333	4,118
Unwinding of discount	(205)	(372)
Sales and others	(13,153)	(397)
Write-offs	(3,656)	(17,444)
Balance as at 31 December	<u>63,455</u>	<u>75,136</u>

23. LOANS AND RECEIVABLES FROM CUSTOMERS (continued)

Concentration of credit risk by industry:

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

	31 December 2019	31 December 2018
Trade	331,534	257,724
Manufacturing, agriculture, forestry, mining and energy	272,938	269,778
Services, finance, sport, tourism	75,260	65,763
Construction industry	74,567	73,789
Administrative and other public institutions	70,496	64,052
Transport and telecommunications	48,541	48,650
Other	40,161	36,189
Citizens	737,491	687,880
	<u>1,650,988</u>	<u>1,503,825</u>

24. OTHER ASSETS

	31 December 2019	31 December 2018
Receivables from card operations	3,953	3,439
Prepaid expenses	2,068	2,065
Fees receivable	1,107	1,093
Assets held for sale	1,031	1,031
Assets acquired upon foreclosure of loans	1,752	1,016
Other assets	1,318	3,107
Total other assets	<u>11,229</u>	<u>11,751</u>
Less: impairment allowance	(1,588)	(1,925)
	<u>9,641</u>	<u>9,826</u>

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

Balance as at 1 January	1,925	2,505
Impact of first time adoption – IFRS 9	-	36
Net charge to profit or loss statement (Note 16)	595	231
Net charge to profit or loss statement - Assets acquired upon foreclosure of loans (Note 13)	(165)	664
Transfers – other	(329)	(114)
Write-offs and sale of property	(438)	(1,397)
Balance as at 31 December	1,588	1,925

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

25. PROPERTY AND EQUIPMENT

Cost	Land and buildings	Computers and other equipment	Assets in the course of construction	Leasehold improvements	Total
At 1 January 2018	11,576	21,394	524	9,854	43,348
Additions	14	-	108	-	122
Disposals	-	(1,668)	-	-	(1,668)
Other comprehensive income	74	-	-	-	74
Transfers	-	486	(590)	104	-
At 31 December 2018	11,664	20,212	42	9,958	41,876
Additions	-	-	1,197	-	1,197
Assets with Right of Use – IFRS 16	15,445	454	-	-	15,899
Disposals	-	(1,914)	-	(1,428)	(3,342)
Transfers	-	821	(1,063)	242	-
At 31 December 2019	27,109	19,573	176	8,772	55,630
Accumulated depreciation					
At 1 January 2018	2,839	16,926	-	9,006	28,771
Charge for the year	320	1,185	-	249	1,754
Disposals	-	(1,592)	-	-	(1,592)
At 31 December 2018	3,159	16,519	-	9,255	28,933
Charge for the year	321	1,080	-	258	1,659
Charge for the year – IFRS 16	2,024	116	-	-	2,140
Disposals	(265)	(1,944)	-	(1,397)	(3,606)
At 31 December 2019	5,239	15,771	-	8,116	29,126
Carrying Value					
At 31 December 2018	8,505	3,693	42	703	12,943
At 31 December 2019	21,870	3,802	176	658	26,506

25. PROPERTY AND EQUIPMENT (continued)

Movement of Assets with Right of Use, in accordance with IFRS 16 – Leasing, effective from 1 January 2019 are as below:

Cost	Buildings	Computers and other equipment	Total
At 31 December 2018	-	-	-
First time adoption of IFRS 16	10,720	472	11,192
Movements during the year	4,725	(18)	4,707
At 31 December 2019	15,445	454	15,899
Accumulated depreciation			
At 31 December 2018	-	-	-
Charge for the year – IFRS 16	2,024	116	2,140
Movements during the year	(264)	(37)	(301)
At 31 December 2019	1,760	79	1,839
Carrying Value			
At 31 December 2018	-	-	-
At 31 December 2019	13,685	375	14,060

26. INTANGIBLE ASSETS

	Software and licence	Assets in the course of construction	Total
Cost			
At 1 January 2018	15,528	224	15,752
Additions	-	1,027	1,027
Disposals	(575)	-	(575)
Transfers	552	(552)	-
At 31 December 2018	15,505	699	16,204
Additions	-	1,191	1,191
Disposals	(894)	-	(894)
Transfers	1,085	(1,085)	-
At 31 December 2019	15,696	805	16,501
Amortisation			
At 1 January 2018	9,178	-	9,178
Charge for the year	2,014	-	2,014
Disposals	(570)	-	(570)
At 31 December 2018	10,622	-	10,622
Charge for the year	1,960	-	1,960
Disposals	(861)	-	(861)
At 31 December 2019	11,721	-	11,721
Carrying Value			
At 31 December 2018	4,883	699	5,582
At 31 December 2019	3,975	805	4,780

27. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	31 December 2019	31 December 2018
Due to banks		
Current accounts and term deposits		
Demand deposits		
-in BAM	1,218	3,556
-in foreign currencies	5,045	12,719
	<hr/>	<hr/>
Term deposits		
-in BAM	7,000	5,000
-in foreign currencies	288,004	245,584
	<hr/>	<hr/>
	301,267	266,859
	<hr/>	<hr/>
Borrowings		
Long-term borrowings		
-foreign banks	145,535	162,867
	<hr/>	<hr/>
	145,535	162,867
	<hr/>	<hr/>
Total Due to Banks	446,802	429,726
	<hr/>	<hr/>
Due to other financial institutions		
Long-term borrowings		
-in foreign currencies	20,012	26,681
	<hr/>	<hr/>
Total borrowings from other financial institutions	20,012	26,681
	<hr/>	<hr/>
Total Due to Banks and other financial institutions	466,814	456,407
	<hr/>	<hr/>

Current accounts, deposits and borrowings from banks presented above include accrued interest in the amount of BAM 137 thousand (2018: BAM 166 thousand).

Borrowings from other financial institutions are presented including accrued interest in the amount of BAM 127 thousand (2018: BAM 168 thousand).

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements (continued)
(all amounts are expressed in thousands of BAM, unless otherwise stated)

28. DUE TO CUSTOMERS

	31 December 2019	31 December 2018
Demand deposits:		
Retail clients:		
-in BAM	207,812	165,085
-in foreign currencies	74,711	71,938
Corporate clients:		
-in BAM	508,180	362,541
-in foreign currencies	64,128	94,464
	-----	-----
Total demand deposits	854,831	694,028
	-----	-----
Term deposits:		
Retail clients:		
-in BAM	140,573	133,916
-in foreign currencies	269,249	260,505
Corporate clients:		
-in BAM	201,330	162,678
-in foreign currencies	39,024	38,958
	-----	-----
Total term deposits	650,176	596,057
	-----	-----
Liabilities based on Asset with Right of Use – IFRS 16		
- Obligation for renting office space	13,545	-
- Obligation for renting other equipment	361	-
	-----	-----
Total Liabilities	13,906	-
	-----	-----
Total Due to customers	1,518,913	1,290,085
	=====	=====

Amounts due to customers are presented including accrued interest in the amount of BAM 6,020 thousand (2018: BAM 6,402 thousand).

In Retail banking, interest rates on demand deposits are 0.05% (2018: 0.05%). The interest rates on time deposits are in the range of 0.01% to 2.00% (2018: 0.01% to 2.10%).

For Small Corporate clients, interest rates on demand deposits range from 0.00% to 1.00% (2018: from 0.00% to 1.00%). The interest rates on time deposits are in the range of 0.00% to 2.30% (2018: 0.00% to 0.25%).

In Corporate banking, interest rates on demand deposits are 0.05% (2018: 0.05%). The interest rates on time deposits are in the range of 0.00% to 2.55% (2018: 0.00% to 2.55%).

29. OTHER LIABILITIES

	31 December 2019	31 December 2018
Liabilities to shareholders	8,194	8,194
Loan repayments before due dates	7,004	5,700
Credit card liabilities	3,720	3,299
Liabilities for employees' bonuses	2,440	2,450
Liabilities to vendors	1,935	1,813
Liabilities in respect of managed funds (Note 36)	1	3
Other liabilities	6,355	11,971
	<u>29,649</u>	<u>33,430</u>

30. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2019	31 December 2018
Provisions for off-balance-sheet credit risk	1,664	2,242
Provisions for legal proceedings	2,504	2,016
Provisions for retirement employee benefits	825	805
	<u>4,993</u>	<u>5,063</u>

Movement in provisions for liabilities and charges for the year ended 31 December 2019 are summarized as follows:

	Provisions for legal proceedings (Note 15)	Provisions for retirement employee benefits (Note 14)	Provisions for off-balance- sheet credit risk (Note 16)	Total
Balance at 1 January 2018	1,485	771	2,445	4,701
Impact of first time adoption-IFRS 9	-	-	1,431	1,431
Net charge/(benefit) to profit or loss statement	535	80	(1,627)	(1,012)
Reductions arising from payments	(4)	(46)	(7)	(57)
Balance at 31 December 2019	<u>2,016</u>	<u>805</u>	<u>2,242</u>	<u>5,063</u>
Balance at 1 January 2019	2,016	805	2,242	5,063
Net charge to profit or loss statement	1,529	30	(509)	1,050
Reductions arising from payments	(1,041)	(10)	(69)	(1,120)
Balance at 31 December 2019	<u>2,504</u>	<u>825</u>	<u>1,664</u>	<u>4,993</u>

The calculation of provisions for retirement benefits of BAM 540 thousand as of 31 December 2018 (2018: BAM 528 thousand) is performed by an independent actuary, applying a discount rate of 5% over the working life and average salary of each employee.

Provisions for unused days of vacation of BAM 285 thousand as of 31 December 2018 (2018: BAM 276 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

31. DEFERRED TAX BALANCES

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

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

	Deferred tax liabilities	Deferred tax assets
As at 1 January 2018	42	178
<i>Recognised in other comprehensive income</i>		
Increase in deferred tax liabilities	8	-
Increase in deferred tax assets	-	14
<i>Recognised in profit or loss</i>		
Decrease in deferred tax assets for provisions for litigations	-	45
Increase in deferred tax assets for other provisions	-	18
As at 31 December 2018	50	255
As at 1 January 2019	50	255
<i>Recognised in other comprehensive income</i>		
Decrease in deferred tax liabilities	(8)	-
<i>Recognised in profit or loss</i>		
Increase in deferred tax assets for provisions for litigations	-	91
Decrease in deferred tax assets for other provisions	-	(14)
Increase in deferred tax liabilities for other provisions	10	-
As at 31 December 2019	51	332

32. SHARE CAPITAL

	31 December 2019 and 31 December 2018		
	Class ES Ordinary shares	Class EP Preference shares	Total
Number of shares	447,760	60	447,820
Pair value (BAM)	100	100	100
Total	44,776	6	44,782

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

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

The shareholding structure of the Bank as at 31 December 2019 is as follows:

- Privredna banka Zagreb d.d. 99.99%
- Other 0.01%

The shareholding structure of the Bank as at 31 December 2018 was as follows:

- Privredna banka Zagreb d.d. 99.99%
- Other 0.01%

33. SHARE-BASED PAYMENTS

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

During 2019, part of the shares have been transferred to the beneficiaries (35,935). As of 31 December 2019 the Bank has 7,054 equity shares of Intesa Sanpaolo SpA left in its portfolio of financial assets at Fair Value through Profit and Loss (with fair value measured based on equity shares quotation on the Milan Stock Exchange). The residual shares will be assigned to beneficiaries when vesting conditions are met.

34. FINANCIAL COMMITMENTS AND CONTINGENCIES

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

	31 December 2019	31 December 2018
Contingent liabilities		
Performance guarantees	90,275	74,574
Payment guarantees	50,616	40,837
Letters of credit	892	6,070
Total contingent liabilities	141,783	121,481
Commitments		
Undrawn lending commitments	210,603	226,804
Total commitments	210,603	226,804
Total contingent liabilities and commitments	352,386	348,285

The following tables show reconciliation from the opening to the closing balance of the loss allowance by class of financial instruments for Contingents and Commitments.

	2019				2018			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January	1,315	709	218	2,242	1,877	148	420	2,445
First time adoption of IFRS 9	-	-	-	-	-579	2,016	-6	1,431
Transfer to Stage 1	1,974	-1,601	-373	0	3,825	-2,927	-898	0
Transfer to Stage 2	-150	178	-28	0	-245	352	-107	0
Transfer to Stage 3	-4	-159	163	0	-4	-265	269	0
Net remeasurement of loss allowance	-2,359	1,277	526	-556	-4,072	3,010	895	-167
New financial assets originated or purchased	1,267	333	257	1,857	1,918	603	232	2,753
Financial assets that have been derecognized	-1,017	-389	-404	-1,810	-1,405	-2,228	-580	-4,213
Other transfers	-	-	69	-69	-	-	-7	-7
Stanje 31.12.	1,026	279	359	1,664	1,315	709	218	2,242

35. RELATED-PARTY TRANSACTIONS

The Bank is a member of the Intesa Sanpaolo S.p.A Group (“Intesa Sanpaolo Group”). The key shareholder of the Bank is Privredna banka Zagreb d.d. 99.99% (2018: Privredna banka Zagreb d.d. 99.99%) of the Bank’s shares and the ultimate parent company is Intesa Sanpaolo S.p.A. The Bank considers that it has an immediate related-party relationship with its key shareholders and their subsidiaries; its associates; Supervisory Board members and Management Board members and other executive management (“key management personnel”); and close family members of key management personnel.

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

The overview of related party transactions as at 31 December 2019 and 31 December 2018 is presented below:

	31 December 2019	31 December 2018
Assets		
Receivables from key management personnel and their close family members	265	690
Bank accounts and loans – Intesa Sanpaolo Group	51,685	37,136
Financial assets at fair value through profit or loss – Intesa Sanpaolo Group	-	2
Other receivables – Intesa Sanpaolo Group	17	194
	<u>51,967</u>	<u>38,022</u>
Liabilities		
Deposits – key management personnel and their close family members	3,340	1,474
Borrowings and term deposits – Intesa Sanpaolo Group	284,380	244,779
Financial liabilities at fair value through profit or loss – Intesa Sanpaolo Group	508	163
Other liabilities – Intesa Sanpaolo Group	423	300
	<u>288,651</u>	<u>246,716</u>
Financial commitments and contingencies		
Financial Guarantees	-	7,970
Undrawn lending commitments – key management personnel and close family members	142	151
	<u>142</u>	<u>8,121</u>

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of BAM, unless otherwise stated)

36. RELATED-PARTY TRANSACTIONS *(continued)*

	2019	2018
Income		
Interest income – key management personnel and close family members	24	38
Interest income – Intesa Sanpaolo Group	125	163
Other Income – Intesa Sanpaolo Group	194	193
	<u>343</u>	<u>394</u>
Expenses		
Interest expense – key management personnel and close family members	19	18
Interest expense – Intesa Sanpaolo Group	234	39
Other expenses – Intesa Sanpaolo Group	2,423	2,154
	<u>2,676</u>	<u>2,211</u>

The remuneration of key management personnel was as follows:

	2019	2018
Net salaries for key management personnel	1,044	1,188
Taxes and contributions on net salaries	627	727
Bonuses to management	675	580
Other management benefits	252	137
	<u>2,598</u>	<u>2,632</u>

36. MANAGED FUNDS

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

	31 December 2019	31 December 2018
Liabilities		
Banks and insurance companies	65,143	64,817
Government organisations	7,918	7,970
Associations and Agencies	801	1,060
Other	423	428
	<hr/>	<hr/>
Total	72,285	74,275
	<hr/>	<hr/>
Assets		
Loans to companies	72,002	73,958
Loans to citizens	282	314
	<hr/>	<hr/>
Total	72,284	74,272
	<hr/>	<hr/>
Amounts due to original creditors – managed funds (Note 29)	1	3
	<hr/> <hr/>	<hr/> <hr/>

37. EVENTS AFTER THE REPORTING DATE

After the Balance Sheet date and until the date these Financial Statements were signed, there were no significant events that would require reconciliation or disclosure in the Financial Statements.