INTESA SANPAOLO BANKA
Bosna i Hercegovina

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina

Financial Statements as at 31 December 2016

Contents

The Management Board has pleasure in submitting its report for the year ended 31 December 2016.

Review of operations

The result for the year ended 31 December 2016 of the Bank is set out in the income statement on page 6.

Supervisory Board, Management Board and Audit Committee

During the course of 2016 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board

Vojko Čok	Chairman
Adriano Arietti	Vice-Chairman until 12.12.2016
Marco Fabris	Member
Gabriele Pace	Member
Ivan Krolo	Member
Alan Galavić	Member
Miroslav Halužan	Member

During the course of 2016 and up to the date of this report, the Audit Committee comprised:

Audit Committee

Dražen Karakašić	Chairman, from 01.01.2017
Mirella Klarić	Member, from 01.01.2017
Petar Sopek	Member, from 01.01.2017
Zoltan Mogyorosi	Member, from 01.01.2017
Andrea Tondo	Member
Andrea Nani	Chairman, until 31.12.2016
Tunde Barabas	Member, until 31.12.2016
Dario Bertoncini	Member, until 31.12.2016
Santino Naselli	Member, until 31.12.2016

As of 31 December 2016 the Management Board comprised a director and two executive directors, who served during the year and up to the date of this report as follows:

Management Board

Almir Krkalić	Director and Chief Executive Officer
Dario Grassani	Executive Director and Chief Financial Officer
Amir Termiz	Executive Director and Head of Retail Division

On behalf of the Management Board

Almir Krkalić
Director

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Bosna i Hercegovina
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Dario Grassani
Executive Director

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 6 to 82 were authorised by the Management Board on 13th February 2017 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 Krkalić

Director

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Dario Grassani

Executive Director

We have audited the accompanying financial statements of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina (the "Bank"), which comprise the statement of financial position as at 31 December 2016, the income statement and the statement of comprehensive income, the statements of changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Standards on Auditing applicable in the Federation of Bosnia and Herzegovina. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG B-H d.o.o. za reviziju
Registered Auditors
Zmaja od Bosne 7-7A/III
71000 Sarajevo
Bosnia and Herzegovina

13 February 2017

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

On behalf of KPMG B-H d.o.o. za reviziju:

Manal Bećirbegović
Executive director

Vedran Vukotić
FBiH registered auditor
Licence number: 3090017124

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

	Notes	**2016**	**Reclassified 2015**
Interest income	*8*	78,140	80,864
Interest expense	*9*	(16,682)	(21,061)
Net interest income		**61,458**	**59,803**
Fee and commission income	*10*	23,906	21,727
Fee and commission expense	*11*	(4,117)	(3,652)
Net fee and commission income		**19,789**	**18,075**
Net trading income	*12*	2,468	2,480
Other operating income/expense	*13*	(5,407)	(5,758)
Other operating income/expense		**(2,939)**	**(3,278)**
Total operating income		**78,308**	**74,600**
Personnel expenses	*14*	(20,320)	(19,225)
Administrative expenses	*15*	(17,179)	(15,626)
Depreciation and amortisation		(3,508)	(3,107)
Operating expenses		**(41,007)**	**(37,958)**
Profit before impairment losses and other provisions and income tax		**37,301**	**36,642**
Net impairment losses and other provisions	*16*	(7,097)	(7,505)
Profit before tax		**30,204**	**29,137**
Income tax expense	*17*	(3,106)	(3,031)
Net profit for the year		**27,098**	**26,106**
Basic and diluted earnings per share (KM)	*18*	**60.52**	**58.30**

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

	2016	2015
Profit for the year	**27,098**	**26,106**
Other comprehensive income for the year		
Items that may be reclassified subsequently to profit or loss		
Fair value reserves (available-for-sale financial assets)		
Change in fair value, net of deferred tax	(9)	364
Other comprehensive income, net of tax	**(9)**	**364**
Total comprehensive income for the year	**27,089**	**26,470**

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

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

	Notes	**31 December 2016**	**31 December 2015**
Assets			
Cash and cash equivalents	*19*	165,443	162,376
Reserves with Central Bank	*20*	251,305	151,221
Placements with other banks	*21*	47,135	29,881
Financial assets available for sale	*22 a)*	89,094	41,226
Financial assets at fair value through profit or loss	*22 b)*	1,746	210
Loans and receivables from customers	*23*	1,192,613	1,130,325
Income tax prepayment		2,207	1,607
Deferred tax assets	*32*	229	-
Other assets	*24*	9,756	8,329
Property and equipment	*25*	16,383	14,997
Intangible assets	*26*	6,595	5,120
Total assets		**1,782,506**	**1,545,292**
Liabilities			
Due to banks and other financial institutions	*27*	231,099	229,636
Due to customers	*28*	1,266,381	1,060,148
Financial liabilities at fair value through profit or loss	*22 c)*	1,546	-
Subordinated debt	*29*	281	442
Other liabilities	*30*	18,161	17,592
Provisions for liabilities and charges	*31*	4,979	4,464
Deferred tax liabilities	*32*	-	40
Total liabilities		**1,522,447**	**1,312,322**
Equity			
Share capital	*33*	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		1,227	1,236
Retained earnings		138,349	111,251
Total equity		**260,059**	**232,970**
Total liabilities and equity		**1,782,506**	**1,545,292**

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

(all amounts are expressed in thousands of KM, 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 2016	**44,782**	**57,415**	**18,286**	**980**	**256**	**111,251**	**232,970**
Net profit for the year	-	-	-	-	-	27,098	27.098
Other comprehensive income							
Net loss from change in fair value of financial assets available for sale	-	-	-	-	(10)	-	(10)
Deferred tax	-	-	-	-	1	-	1
Total other comprehensive income	-	-	-	-	*(9)*	-	*(9)*
Total comprehensive income	**-**	**-**	**-**	**-**	**(9)**	**27,098**	**27,089**
Balance as at 31 December 2016	**44,782**	**57,415**	**18,286**	**980**	**247**	**138,349**	**260,059**

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

(all amounts are expressed in thousands of KM, 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 2015	**44,782**	**57,415**	**18,286**	**6,305**	**(108)**	**79,820**	**206,500**
Net profit for the year	-	-	-	-	-	26,106	26,106
Other comprehensive income							
Net loss from change in fair value of financial assets available for sale	-	-	-	-	404	-	404
Deferred tax	-	-	-	-	(40)	-	(40)
Total other comprehensive income	-	-	-	-	*364*	-	*364*
Total comprehensive income	**-**	**-**	**-**	**-**	**364**	**26,106**	**26,470**
Transfer from Other reserves to Retained earnings based on Decision of the Bank Assembly	-	-	-	(5,325)	-	5,325	-
Balance as at 31 December 2015	**44,782**	**57,415**	**18,286**	**980**	**256**	**111,251**	**232,970**

Based on Banking Agency of the FBiH's Letter to the Banking industry n.03-3-4593/14 dated 17 December 2014, the Supervisory Board of the Bank on its 32nd meeting held on 3 March 2015 adopted the Decision to reclassify Retained Earnings and part of Other Reserves cumulated from previous years as available for unconditional, permanent and full coverage of potential future losses, which allows computation of such amounts into Regulatory Capital and, on the other side, prevents the Bank to use such funds for future dividend payment to shareholders. The table above shows inter alia the consequent transfer of KM 5,325 thousand from Other Reserves to Retained Earnings.

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

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

	Notes	31 December 2016	31 December 2015
Cash flows from operating activities			
Profit for the year		27,098	26,106
Adjustments for:			
- depreciation and amortisation		3,508	3,107
- net impairment losses and provisions		7,097	8,496
- net change in provisions for liabilities and charges		549	415
- net interest income		(61,458)	(59,803)
- net change in fair value of financial assets and liabilities at fair value through profit or loss		(96)	(42)
- net gain / losse from disposal of property and equipment		96	(19)
- tax expense		3,106	3,031
		(20,100)	(18,709)
Changes in:			
- placements with other banks		(17,354)	25,785
- loans and receivables from customers		(67,846)	(62,523)
- other assets		(1,680)	1,917
- obligatory reserve with the Central Bank		(100,084)	(69,529)
- financial assets and liabilities at fair value through profit or loss		10	(62)
- due to banks		1,611	(28,745)
- due to customers		206,494	104,372
- other liabilities		529	6,332
- provisions for liabilities and charges		(290)	(337)
		1,290	(41,499)
Income tax paid		(3,935)	(2,667)
Interest received		77,177	78,768
Interest paid		(17,091)	(22,928)
Net cash from operating activities		57,441	11,674
Cash flows from investing activities			
Acquisition of property and equipment		(3,612)	(810)
Proceeds from the sale of property and equipment		82	480
Acquisition of intangible assets		(2,902)	(1,868)
Proceeds from financial assets available for sale		(47,781)	(15,726)
Net cash used in investing activities		(54,213)	(17,924)
Cash flows from financing activities			
Repayment of subordinated debt		(161)	(161)
Net cash flow used in financing activities		(161)	(161)
Net increase/(decrease) in cash and cash equivalents		3,067	(6,411)
Cash and cash equivalents at the beginning of the year	*19*	162,376	168,787
Cash and cash equivalents at the end of the year	*19*	165,443	162,376

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 in Sarajevo is Obala Kulina Bana 9a

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

Statement of compliance

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

These financial statements were authorised by the Management Board on 13th February 2017 for submission to the Supervisory Board.

Basis of measurement

The financial statements have been prepared on the historical or amortised cost basis except for financial assets available for sale and financial assets and liabilities at fair value through profit or loss.

Functional and presentation currency

These financial statements are presented in thousands of convertible mark ('000 KM) 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.

Changes in presentation of the financial statements for the year ended 31 December 2015

Certain items within the Income Statement for the year ended 31 December 2015 have been reclassified when compared to the issued Financial Statements of the Bank for the year ended 31 December 2015. The reclassification was implemented during 2016 exclusively for presentation purposes and to provide the reader of the Financial Statements an interpretation of the bank's results closer to the way the Banks' operations are monitored and evaluated by the management.

The reclassifications relate to the following:

The Bank reclassified cost of processing card transactions from Fee and commission expense to Other operating income/expense in the amount of KM 1,816 thousand.

2. BASIS OF PREPARATION (CONTINUED)

The Bank reclassified from Personnel expenses to Other operating income/expense amount of KM 248 thousand related to other consultancy services and to Administrative expenses amount of KM 33 thousand related to expenses not connected to employee benefits.

The Bank reclassified from Administrative expenses to Other operating income/expense consultancy and Federal Banking Agency expense in the amount of KM 978 thousand, saving deposit insurance expenses in the amount of KM 2,173 thousand and other expenses in the amount of KM 47 thousand.

The Bank reclassified to Other operating income/expense Impairment losses provisions for repossessed assets in the amount KM 991 thousand.

These reclassifications are only presentational by nature and have no impact on the result for the year or the Banks' equity.

3. SUMMARY OF ACCOUNTING POLICIES

The accounting policies set our below have been consistently applied for all periods presented in these financial statements.

(a) Foreign currency transactions

Transactions in currencies other than Convertible Marks ("KM") are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities are translated at the rates prevailing on the 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 income statement for the period.

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

31 December 2015	EUR 1= KM 1.95583	USD 1 = KM 1.790070
31 December 2016	EUR 1= KM 1.95583	USD 1 = KM 1.855450

(b) Interest income and expense

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

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

Interest income and expense recognized in the income statement include interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest rate method.

(c) 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 recognized in the income statement upon performance of the relevant service.

(d) 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.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(e) Dividend income

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

(f) Lease payments

Payments made under operating leases are recognized in the income statement on a straight-line basis over the term of the lease.

(g) Income tax expenses

The income tax charge is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized directly in other comprehensive income, in which case it is recognized 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.

The amount of deferred tax is calculated using the balance sheet liability method whilst taking into account 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 recognized 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 recognized 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 unrecognized potential deferred tax assets and the carrying amount of recognized deferred tax assets for indications of potential impairment.

(h) Financial instruments

Recognition

Loans and receivables and other financial liabilities are recognized when advanced to borrowers or received from lenders (settlement date).

The Bank recognizes financial assets available for sale and financial assets and liabilities at fair value through profit or loss on the trade date which is the date when the Bank commits to purchase or sell the instruments.

Classification

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

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determined payments that are not quoted in an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with these receivable and include placements with and loans to other banks, loans and receivables from customers and balances with the Central Bank.

ii) Financial assets available for sale

Financial assets available for sale are non-derivatives that are either designated in this category or not classified into any of the other categories. Financial assets classified as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates or equity prices. Financial assets available for sale include equity and debt securities.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

iii) Financial assets and financial liabilities at fair value through profit or loss

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

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

- the assets or liabilities 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 or liability contains an embedded derivative that significantly modified the cash flows that would otherwise be required under the contract.

Financial assets and financial liabilities 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. Management has designated equity instruments at fair value through profit or loss because the designation eliminates or significantly reduces an accounting mismatch related to share-based payments, which would otherwise arise.

iv) Other financial liabilities

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

Initial and subsequent measurement

Loans and receivables are initially recognized at fair value. After initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment.

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

Gains and losses from changes in the fair value of available-for-sale financial assets are recognized directly in other comprehensive income until derecognition or impairment, when the cumulative amount previously recognized in other comprehensive income is transferred to the income statement. Interest income calculated using the effective interest rate method is recognized in the income statement.

Foreign exchange gains and losses on available-for-sale equity instruments are part of the fair value of these instruments and are recognized in other comprehensive income. Dividend income on available-for-sale equity securities is recognized in profit or loss when the right to receive payment has been established.

Financial assets and liabilities at fair value through profit or loss are initially recognized at fair value. All transaction costs are immediately expensed. Subsequent measurement is also at fair value. Gains and losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognized in the income statement.

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

Derecognition

The Bank derecognizes financial assets (in full or partially) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realized, surrendered or have expired.

The Bank derecognizes financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognizing that liability and will instantaneously recognize a new financial liability with new terms and conditions.

Fair value measurement

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

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (Level 1 of the fair value hierarchy).

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs (Level 2 and Level 3 of the fair value hierarchy). The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognized in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or liability measured at fair value has a bid price and an ask price, the Bank measures assets and long positions at the bid price and liabilities and short positions at the ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustments of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand.

Spot exchange transactions are always considered contributed instruments. Forward currency contracts are not contributed and are treated as financial derivatives pursuant to IAS 39.

The Bank recognizes transfers between levels of the fair value hierarchy as of the reporting period during which the change occurred.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

Identification and measurement of impairment of financial assets

i) Financial assets carried at amortized cost

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has (or have) an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

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

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

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

i) Financial assets carried at amortized cost (continued)

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrences that cause impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses with be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss rate and the expected rate of recovery at each reporting date, to ensure accurate reporting.

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

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

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

The provisions calculated on the basis of the preceding paragraph ("the FBA provisions") are not recognized in these financial statements of the Bank. However, if the FBA provisions are greater than the impairment allowance calculated in accordance with IFRS, the difference is presented as an appropriation within regulatory reserves for credit losses.

ii) Financial assets available for sale

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the investment below its acquisition cost is considered in determining whether the assets are impaired.

If any such evidence exists for financial assets available for sale, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the income statement, is removed from other comprehensive income and recognized in the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognized in other comprehensive income.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

iii) Financial assets carried at cost

Financial assets carried at cost include equity securities classified as available for sale for which there is no reliable measure of fair value. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

An impairment loss is calculated as the difference between the carrying amount of the financial asset and the present value of expected future cash flows discounted by the current market interest rate for similar financial assets. Impairment losses on such instruments, recognized in the income statement, are not subsequently reversed through the income statement.

Specific financial instruments

i) Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to foreign exchange risks arising from operating, financing and investing activities. The Bank does not hold or issue derivative financial instruments for speculative trading purposes. All derivatives are classified as financial instruments at fair value through profit or loss. Hedge accounting is not applied.

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

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

ii) Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank and current accounts with other banks.

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

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

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

iv) Loans and receivables from customers

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

v) Equity securities

Equity securities are classified as available for sale and carried at fair value, unless there is no reliable measure of the fair value, in which case equity securities are stated at cost, less impairment.

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

vi) Debt securities

Debt securities are classified as available-for-sale financial assets and carried at fair value.

vii) Borrowings and subordinated debt

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

viii) Current accounts and deposits from banks and customers

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

(i) Property and equipment

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

Depreciation is provided on all property and equipment except for land and 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 depreciation rates used by the Bank are as follows:

	2015	**2016**
Computers	20%	20%
Furniture and equipment	10% – 20%	10%-15%
Business premises	1.3%-3%	3%
Leasehold improvements	20%	20%

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

The Bank has revised its estimate of the remaining useful life of property and equipment as specified in the table above, which are applicable as of 1 January 2016. From that date, the property and equipment is depreciated under the new rates. This change in accounting estimate resulted in an increase of the annual depreciation in the amount of KM 294 thousand.

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

(j) 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 are as follows:

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

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(k) 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 balance sheet at their fair value, the repossessed assets classified according to IAS 16 or IAS 40 shall be measured at cost (amortized and periodically tested for impairment). 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.

(l) 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 recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognized in the income 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 recognized.

(m) 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 income statement in the period in which the salary expense is incurred.

Obligations for contributions to defined contribution pension plans are recognized as an expense in income 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.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(m) Employee benefits (continued)

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 recognized 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 recognized as a personnel expense in the income statement.

(n) Provisions for liabilities and charges

Provisions are recognized 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 recognized at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

(o) Equity

Issued share capital

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

Regulatory reserve for credit losses

The regulatory reserve for credit losses represents the surplus of impairment allowances calculated in accordance with regulations as prescribed by the Agency over impairment allowances recognized 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.

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 2016.

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.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(o) Equity

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 recognized as a liability until payment to beneficiaries in the period in which they are approved by the Bank's shareholders.

(p) 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.

(q) 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.

(r) 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.

(s) New standards and interpretations

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2016 and earlier application is permitted; however the Bank has not early adopted the following new or amended standards in preparing these financial statements.

- IFRS 15 (*Revenue from Contracts with Customers*) establishes a comprehensive framework for determining whether, how much and when revenue is recognized. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programs. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 15.

- IFRS 9 (Financial instruments) published in July 2014, replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance of recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(s) New standards and interpretations (continued)

Given the impacts of IFRS 9, both on business and of organizational and reporting type, Intesa Sanpaolo Banka dd BiH has initiated a project aimed at defining qualitative and quantitative impacts of the standard, as well as at identifying and implementing application and organizational interventions necessary for a coherent adoption. All this within the framework of and in alignment with a broader project activated by the ultimate parent group, Intesa Sanpaolo, and the direct parent company PBZ Bank.

The implementation project

The project is developed by following the three directives in which the standard is structured: Classification and Measurement (C&M), Impairment and Hedge Accounting.

For each of the three directives, the same declined methodological approach is used: analysis and preliminary choices, computer simulations and design of the target operating model, IT development and definition of operational processes.

With regard to the Classification and Measurement, in order to respect the provisions of IFRS 9 - which introduces a model for which the classification of financial assets is managed, on one side, by the contractual characteristics of cash flows of the instruments and, on the other, by the management intent with which they are held - the ongoing activities are mainly aimed at defining the business models to expand and at declining the method of test run of the contractual characteristics of cash flows (the so-called SPPI Test).

With regard to the SPPI test of financial assets, the internal methodology has been defined, which is based on decision trees and is in the process of finalizing the analysis of the composition of portfolios of securities and credits currently in effect, in order to identify for them the appropriate classification at the moment of the First-Time Adoption (FTA) of the new standard.

As for debt securities, a detailed examination of the characteristics of cash flows of instruments classified in the category of financial assets available for sale in accordance with IAS 39 has been carried out, in order to identify activities which, if they don't pass the SPPI test, shall be measured at fair value with impacts on profit or loss according to IFRS 9. From the analysis conducted on the abovementioned perimeter, it was revealed that none of the debt securities in portfolio fail the SPPI test.

As for loans, differentiated approaches were used for retail and corporate credit (loan) portfolios. In case of retail loans, which can be mainly attributable to standard contracts (current or historical product catalogue), the analysis was carried out on clusters of homogeneous loans. In case of corporate loans, which cannot be mainly attributable to standard contracts, the ongoing in-depth analyses include the execution of a spot test on individual loans, identified based on the representative samples of operations.

As for the second classification driver of financial assets (business model), the analysis and the registration of current business models have been mainly completed and the identification of the business model to expand was initiated. In this regard the operational rules are currently being prepared for the execution of the business model assessment and for an on-going monitoring of portfolios affected by the requirements IFRS 9. Based on the analyses performed, with regard to debt securities currently classified as available-for-sale assets the identification of a business model Hold to Collect and Sell for most portfolios is being assumed.

In general terms, the current credit management method, both to retail and corporate counterparts, is attributable to a business model Hold to Collect; however, the identification of the classification category will be subject to confirmation in the light of the methods of management of the financial instruments at the date of initial application of IFRS 9.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(s) New standards and interpretations (continued)

In summary, with reference to the effects expected from the new standard for the C&M directive, according to the in-depth analyses conducted so far, no significant impacts at the stage of the first application are expected, specifically in terms of possible increase of instruments to be assessed at fair value through profit or loss and of consequent increase in profit or loss volatility in subsequent fiscal years.

As for the directive concerning impairment (of which specific aspects of the projects were developed both for transactions in credits and for transactions in securities), the main elements that may be mentioned in this context are the following: the parameters for the determination of material deterioration of credit risk, for the purposes of the proper allocation of performing exposures in the stage 1 or in the stage 2 are expected to reach soon the final definition.

However, with reference to the impaired exposures, the alignment of definitions of accounting and regulatory default - already present to date - allows to consider identical the current logics of classification of exposures among "non-performing"/"impaired" exposures compared to the future logics of classification of exposures within the stage 3; the models - which include the forward-looking information - for staging (regarding the use of PD lifetime as a relative indicator of non-performance) and for calculating the expected credit loss (ECL) to one year (to be applied to exposures in stage 1) and lifetime (to be applied to exposures in stage 2 and stage 3), are in advanced stage of finalization.

With reference to the so-called "tracking" of the credit quality, the elements that will constitute the main drivers to be taken into account for the purposes of the assessments on "steps" between different stages are as follows: the variation in the probability of default lifetime in relation to the moment of initial budgeting of the financial instrument. Therefore, it relates to an assessment carried out by adopting a "relative" criterion, which is configured as the main "driver"; the potential presence of an overdue that - without prejudice to the materiality thresholds established by the regulation - turns out to be of at least 30 days. In case of such particular case, in other words, the credit exposure riskiness is presumptively deemed "significantly increased" and, therefore, it is followed by the "passage" to the stage 2 (where the exposure was previously included in the stage 1); the potential presence of other conditions (e.g.: a renegotiation with the characteristics for the qualification between the "forbearance measures") which - always on a presumptive basis - involve the qualification of exposure whose credit risk turns out to be "significantly increased" compared to the initial recognition.

The rules on impairment introduced by IFRS 9 undoubtedly represent a considerable change compared to the logics of IAS 39. As regards the new metrics of exposure assessment, it is estimated that for the Bank the impact of the first application of the standard - which is to be detected in counterpart of equity - will not result in any case critical compared to the current capital levels. More specifically, it was not possible to provide specific indications of quantitative impact because the estimates available at the time of preparing these Financial Statements show a non-marginal width of the range within which it was expected for the capital impact of the new rules on impairment to be situated, depending, obviously, on the composition of the loan portfolios at the transition date, on the macroeconomic forecasts for future fiscal years that will be prepared at the date of transition to IFRS 9, as well as on the elements not yet fully defined, with regard to the finalization both of certain interpretation of the regulations and their implementation (still the subject of a debate at national and international level) both of certain choices regarding the organizational and information systems, which will be completed in the near future. In this context, therefore, the diffusion of an actual "impact assessment" would not be of use to the readers of the financial statements, as it does not indicate neither the current situation - well represented in the appropriate sections of this document - neither the consolidated choices able to influence future results. In this regard, it is noted that the methods of management of this particular case for prudential purposes are still under the definition phase.

According to standard parameters, the following can be envisaged: a greater profit or loss volatility, due to the passage of financial instruments from the stage 1 to stage 2 and vice versa, because of the different methods for determining the adjustments and write-downs compared to the current methodologies; the impact on the measurement of impairment for the determination of the "lifetime" expected loss on performing loans classified at the stage 2.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(s) New standards and interpretations (continued)

As for Hedge Accounting, no impact is revealed with respect to the current portfolio and business operations of the Bank, since hedge accounting is not currently applied.

The process of a rational and effective implementation of the changes introduced by IFRS 9 regarding the Classification and Measurement and, above all, the Impairment, implies interventions extremely impacting on the area of Information Technology. For this purpose, analyses aimed at identifying the main areas of impact have been carried out, with the aim, on the one hand, to outline the target application architectures to be implemented and, on the other, to identify the applications and the procedures to be adapted (and, where appropriate, to be purchased), as well as the amendments to be made.

The ongoing interventions on the systems - which have as their aim the compliance with the new requirements established by the standard in terms of portfolio classification, tracking and measurement of credit risk, accounting and disclosure - concern, therefore, both the implementation, within the already existing procedures, of the functionalities required for this purpose, both the identification and preparation/integration of new software applications required for more efficient and effective management of the issues in question.

The following new or amended standards are not expected to have a significant impact of the Bank's financial statements:

- *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*
- *IFRS 16 Leases*
- *Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)*
- *Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12).*
- *Disclosure Initiative (Amendments to IAS 7).*

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

Impairment losses are made mainly against the carrying value of loans to corporate and retail customers (as disclosed in Note 23) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 35) and other assets (Note 24).

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

The Bank first assesses whether objective evidence of impairment exists individually for assets that are individually significant (corporate exposures above KM 50 thousand and retail exposures above KM 150 thousand) and collectively for assets that are not individually significant. However, assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics and then assessed collectively for impairment.

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

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

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

(a) Impairment losses on loans and receivables (continued)

	31 December 2016	31 December 2015
Summary of impairment allowances:		
Impairment allowance for Loans and receivables from customers, including IBNR (Note 23)	84,519	89,862
Provisions for off-balance-sheet items, including IBNR (Note 31)	2,222	2,029
	86,741	**91,891**

As at 31 December 2016 and 31 December 2015, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognized were as follows:

	31 December 2016			31 December 2015		
	Corporate	**Retail**	**Total**	**Corporate**	**Retail**	**Total**
Gross exposure	72,705	33,620	**106,325**	80,499	31,487	**111,986**
Impairment allowance	(54,121)	(22,756)	**(76,877)**	(58,124)	(21,676)	**(79,800)**
Impairment rate	74%	68%	**72%**	72%	69%	**71%**

An increase in the impairment rate of 1 percentage point of the gross non-performing exposure presented above as at 31 December 2016, would lead to the recognition of an additional impairment loss of KM 1,063 thousand (2015: KM 1,120 thousand).

In addition to identified losses on impaired loans, as described above, the Bank also recognizes impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified ("IBNR"). Amounts, for which specific impairment losses have been identified, are excluded from this calculation.

The amount of IBNR as at 31 December 2016 amounted to KM 7,642 thousand for balance sheet exposure and KM 1,878 thousand for off-balance-sheet exposure (2015: KM 10,061 thousand for balance sheet exposure and KM 1,733 thousand for off-balance-sheet exposure). The total IBNR provision amounted to 0.65% (2015: 0.85%) of the relevant on and off-balance-sheet exposure.

(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 recognized in accordance with IFRS, the Bank also calculates impairment losses in accordance with the Agency regulations for capital adequacy calculation purposes.

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

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

(c) Regulatory requirements (continued)

The following table summarizes impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2016 are calculated in accordance with the new methodology, as explained in Note 3(o):

Summary of impairment allowances	**31 December 2016**	**31 December 2015**
Provisions for total balance-sheet items (Agency)	122,736	125,599
Provisions for total off-balance–sheet items (Agency)	7,206	6,400
	129,942	**131,999**
Impairment allowances under IFRS (including Other assets impairment)	87,669	92,649
Excess at the year end	**42,273**	**39,350**

Prior to 2012, any increase in allowance in accordance with the Agency regulations over amounts recognized 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(o), 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 recognized under IFRS by KM 42,273 thousand as at 31 December 2016 (31 December 2015: KM 39,350 thousand). Out of this amount, KM 18,286 thousand has been recognized as a regulatory reserve for credit losses within equity as at 31 December 2016 (31 December 2015: KM 18,286 thousand). The remaining amount of KM 23,987 thousand, 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 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 31, the Bank provided KM 1,975 thousand (2015: KM 1,742 thousand), which management estimates as sufficient. Since the estimate is made considering the specifics of each individual case, it is not practicable for management to evaluate the financial impact of changes to the assumptions based on which provisions are quantified as at the reporting date.

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, interest rate and other price 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 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.

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

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

	Maximum exposure	
	31 December 2016	**31 December 2015**
Included in the statement of financial position		
Current accounts with Central Bank and other banks	134,859	128,652
Reserves with the Central Bank	251,305	151,221
Placements with other banks	47,135	29,881
Debt securities available for sale	88,974	41,114
Loans and receivables from customers	1,192,613	1,130,325
Income tax prepayment	2,207	1,607
Other assets excluding repossessed assets	9,589	8,001
Off-balance-sheet exposure		
Undrawn lending commitments	195,492	196,866
Financial guarantees and letters of credit	108,625	83,979
Total	**2,030,799**	**1,771,646**

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

The above table represents the maximum credit risk exposure of the Bank as at 31 December 2016 and 31 December 2015, without taking into account any collateral held or other credit enhancements attached.

The Bank holds collateral against loans and receivables to customers in the form of mortgages and other securities over assets and guarantees. Collateral value estimates are based on assessments by chartered court surveyors at the time of loan approval, reduced by a haircut at certain fixed percentages. In order to verify the adequacy of the impairment allowance on a continuous basis, collateral reassessments are regularly performed and back-tested in accordance with the principles and rules of the collateral management system, taking into proper consideration the volatility of collateral value and the time needed for its realisation, influenced by the local and global economic trend. Collateral is not held for loans and placements to banks.

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

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)

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 and vehicles. 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 gross amount of repossessed assets is presented in the following table:

	31 December 2016	31 December 2015
Other assets (Note 24)	2,239	2,406
	2,239	**2,406**

5.1.3 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 KM 28,689 thousand for corporate loans and KM 4,732 thousand for retail loans as at 31 December 2016 (2015: KM 32,912 thousand for corporate and KM 1,436 for retail loans.)

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 recognized.

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.3 Credit risk management and policies for impairment and provisions (continued)

The analysis of the loan portfolio according to the above-stated categories is presented below:

	31 December 2016	31 December 2015
Corporate		
Loans to customers that are neither past due nor impaired	612,280	569,883
Past due but not impaired loans	5,914	21,668
Non-performing loans (impaired loans)	72,705	80,499
Gross exposure	**690,899**	**672,050**
Less: impairment allowance	(57,604)	(65,269)
Net exposure	**633,295**	**606,781**
Retail		
Loans to customers that are neither past due nor impaired	525,572	489,135
Past due but not impaired loans	27,041	27,514
Non-performing loans (impaired loans)	33,620	31,487
Gross exposure	**586,233**	**548,136**
Less: impairment allowance	(26,915)	(24,592)
Net exposure	**559,318**	**523,544**
Total gross exposure	**1,277,132**	**1,220,186**
Portfolio impairment allowance (IBNR)	(7,642)	(10,061)
Specific impairment allowances	(76,877)	(79,800)
Net exposure	**1,192,613**	**1,130,325**

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.3 Credit risk management and policies for impairment and provisions (continued)

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				Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
31 December 2016							
Standard monitoring	331,653	143,142	50,777	**525,572**	369,263	243,017	**612,280**
31 December 2015							
Standard monitoring	305,571	132,862	50,702	**489,135**	351,873	218,010	**569,883**

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.3 Credit risk management and policies for impairment and provisions (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:

				Past due days	
	Gross amount	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2016					
Corporate loans					
- Large	4,897	3,254	1,643	-	-
- Other	1,017	1,017	-	-	-
	5,914	**4,271**	**1,643**	**-**	**-**
Retail loans					
- Consumer	13,733	11,951	1,515	255	12
- Housing	10,594	8,927	1,333	334	-
- Credit Cards and overdrafts	2,714	119	2,016	374	205
	27,041	**20,997**	**4,864**	**963**	**217**
Total	**32,955**	**25,268**	**6,507**	**963**	**217**

				Past due days	
	Gross amount	**Until 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2015					
Corporate loans					
- Large	21,124	18,814	2,310	-	-
- Other	544	540	4	-	-
	21,668	**19,354**	**2,314**	**-**	**-**
Retail loans					
- Consumer	14,092	12,169	1,496	349	78
- Housing	11,225	9,965	995	219	46
- Credit Cards and overdrafts	2,197	102	1,807	281	7
	27,514	**22,236**	**4,298**	**849**	**131**
Total	**49,182**	**41,590**	**6,612**	**849**	**131**

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.3 Credit risk management and policies for impairment and provisions (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				Corporate loans		
31 December 2016	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
Gross exposure	22,459	8,070	3,091	**33,620**	17,867	54,838	**72,705**
Impairment	(17,686)	(2,547)	(2,523)	**(22,756)**	(13,094)	(41,027)	**(54,121)**
Net	4,773	5,523	568	**10,864**	4,773	13,811	**18,584**
Rate of impairment	*79%*	*32%*	*82%*	*68%*	*73%*	*75%*	*74%*
Estimated value of collateral							
Cash deposit	-	48	-	**48**	-	-	**-**
Mortgage	237	5,488	-	**5,725**	4,080	13,597	**17,677**
Total	237	5,536	-	**5,773**	4,080	13,597	**17,677**

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.3 Credit risk management and policies for impairment and provisions (continued)

c) Non-performing loans (continued)

	Retail loans				**Corporate loans**		
31 December 2015	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
Gross exposure	19,649	8,082	3,756	**31,487**	17,830	62,669	**80,499**
Impairment	(16,156)	(2,512)	(3,008)	**(21,676)**	(10,157)	(47,967)	**(58,124)**
Net	3,493	5,570	748	**9,811**	7,673	14,702	**22,375**
Rate of impairment	*82%*	*31%*	*80%*	*69%*	*57%*	*77%*	*72%*
Estimated value of collateral							
Cash deposit	9	10	-	**19**	-	-	**-**
Mortgage	434	7,895	-	**8,329**	11,100	31,623	**42,723**
Total	443	7,905	-	**8,348**	11,100	31,623	**42,723**

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.1 Credit risk (continued)

5.1.4 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 2016				
Current accounts with the Central Bank and other banks	97,770	35,956	1,133	**134,859**
Reserves with the Central Bank	251,305	-	-	**251,305**
Placements with other banks	-	47,135	-	**47,135**
Debt securities available for sale	88,974	-	-	**88,974**
Loans and receivables from customers	1,192,613	-	-	**1,192,613**
Income tax prepayment	2,207	-	-	**2,207**
Other assets (without repossessed assets)	7,268	2,321	-	**9,589**
	1,640,137	**85,412**	**1,133**	**1,726,682**
As at 31 December 2015				
Current accounts with the Central Bank and other banks	108,142	19,746	764	**128,652**
Obligatory reserves with the Central Bank	151,221	-	-	**151,221**
Placements with other banks	-	29,881	-	**29,881**
Debt securities available for sale	41,114	-	-	**41,114**
Loans and receivables from customers	1,130,325	-	-	**1,130,325**
Income tax prepayment	1,607	-	-	**1,607**
Other assets (without repossessed assets)	6,259	1,742	-	**8,001**
	1,438,668	**51,369**	**764**	**1,490,801**

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

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 2016 and 31 December 2015, except for financial assets available for sale 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 2016						
Assets						
Cash and cash equivalents	165,443	-	-	-	-	**165,443**
Reserves with the Central Bank	251,305	-	-	-	-	**251,305**
Placements with other banks	47,135	-	-	-	-	**47,135**
Financial assets available for sale	88,974	-	-	-	120	**89,094**
Financial assets at fair value through profit or loss	17	1,431	-	-	298	**1,746**
Loans and receivables from customers	80,182	91,072	327,595	490,075	203,689	**1,192,613**
Income tax prepayment and other assets	12,192	-	-	-	-	**12,192**
Property and equipment and intangible assets	-	-	-	-	22,978	**22,978**
Total assets	**645,248**	**92,503**	**327,595**	**490,075**	**227,085**	**1,782,506**
Liabilities and equity						
Due to banks and other financial institutions	37,924	16,387	39,454	127,795	9,539	**231,099**
Due to customers	668,710	30,733	161,126	383,319	22,493	**1,266,381**
Financial liabilities at fair value through profit or loss	8	1,538	-	-	-	**1,546**
Subordinated debt	-	41	120	120	-	**281**
Other liabilities	18,047	-	-	-	114	**18,161**
Provision for liabilities and charges	-	-	-	-	4,979	**4,979**
Share capital and reserves	-	-	-	-	260,059	**260,059**
Total liabilities and equity	**724,689**	**48,699**	**200,700**	**511,234**	**297,184**	**1,782,506**
Maturity gap	**(79,441)**	**43,804**	**126,895**	**(21,159)**	**(70,099)**	**-**

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

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 2015						
Assets						
Cash and cash equivalents	162,376	-	-	-	-	**162,376**
Obligatory reserve with the Central Bank	151,221	-	-	-	-	**151,221**
Placements with other banks	29,881	-	-	-		**29,881**
Financial assets available for sale	41,114	-	-	-	112	**41,226**
Financial assets at fair value through profit or loss	-	-	-	210	-	**210**
Loans and receivables from customers	83,880	117,169	299,247	441,707	188,322	**1,130,325**
Income tax prepayment and other assets	9,936	-	-	-	-	**9,936**
Property and equipment and intangible assets	-	-	-	-	20,117	**20,117**
Total assets	**478,408**	**117,169**	**299,247**	**441,917**	**208,551**	**1,545,292**
Liabilities and equity						
Due to banks and other financial institutions	23,706	7,939	44,161	129,788	24,042	**229,636**
Due to customers	484,665	54,730	209,813	295,987	14,953	**1,060,148**
Subordinated debt	-	1	160	281	-	**442**
Other liabilities	17,478	-	-	-	114	**17,592**
Provision for liabilities and charges	-	-	-	-	4,464	**4,464**
Deferred tax liability	40	-	-	-	-	**40**
Share capital and reserve	-	-	-	-	232,970	**232,970**
Total liabilities and equity	**525,889**	**62,670**	**254,134**	**426,056**	**276,543**	**1,545,292**
Maturity gap	**(47,481)**	**54,499**	**45,113**	**15,861**	**(67,992)**	**-**

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

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 2016 and as at 31 December 2015 are shown in the following table:

	Total expected outflow						
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Carrying value
31 December 2016							
Liabilities							
Due to banks and other financial institutions	42,624	11,920	40,199	129,414	9,600	**233,757**	**231,099**
Due to customers	669,360	31,307	166,458	399,771	23,427	**1,290,323**	**1,266,381**
Subordinated debt	-	42	124	122	-	**288**	**281**
Total expected outflow	**711,984**	**43,269**	**206,781**	**529,307**	**33,027**	**1,524,368**	**1,497,761**

	Total expected outflow						
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Carrying value
31 December 2015							
Liabilities							
Due to banks and other financial institutions	23,747	9,872	41,646	134,668	24,331	**234,264**	**229,636**
Due to customers	485,433	56,218	217,567	314,637	16,346	**1,090,201**	**1,060,148**
Subordinated debt	-	43	127	287	-	**457**	**442**
Total expected outflow	**509,180**	**66,133**	**259,340**	**449,592**	**40,677**	**1,324,922**	**1,290,226**

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 of the Bank.

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.

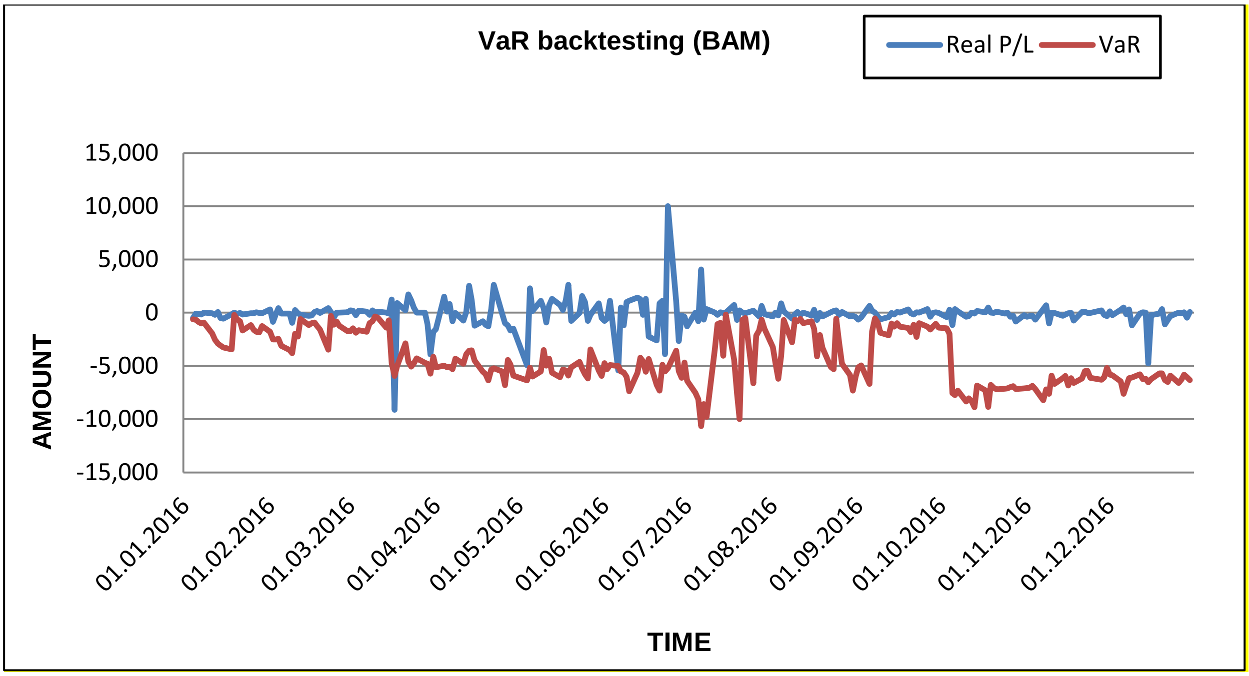
The quality of the implemented risk measurement model is constantly assessed. The Bank performs back-testing of the computed VaR measures with the actual gain and losses for the same period.

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)



During 2016, the Bank improved the model for calculation of VaR in accordance with best practices and as a result, the Bank recorded 2 back-testing exceptions (re-tested results for 2015: 9 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 = KM 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 2016

Currency	**Open position (in KM)**	**Stress Test**	
		10% Move Up	**10% Move Down**
CHF	16,643	(1,664)	1,664
GBP	542	(54)	54
USD	(12,812)	1,281	(1,281)
HRK	17,875	(1,787)	1,787
CAD	21,114	(2,111)	2,111
SEK	12,259	(1,226)	1,226
other	24,813	(2,481)	2,481
EUR	1,700,176	-	-

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)

31 December 2015

Currency	**Open position (in KM)**	**Stress Test**	
		10% Move Up	**10% Move Down**
CHF	15,709	1,571	(1,571)
GBP	2,198	220	(220)
USD	(9,028)	(903)	903
HRK	13,670	1,367	(1,367)
CAD	9,537	954	(954)
AUD	11,381	1,138	(1,138)
other	50,021	5,002	(5,002)
EUR	34,020,991	-	-

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 KM, 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 KM, 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.

(all amounts are expressed in thousands of KM, 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 2016 and 31 December 2015. 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 KM 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 2016	EURO	EURO linked	EURO total	USD	Other FX	KM	Total
Assets							
Cash and cash equivalents	31,563	-	31,563	1,335	11,830	120,715	**165,443**
Reserves with the Central Bank	-	-	-	-	-	251,305	**251,305**
Placement with other banks	-	-	-	44,971	2,164	-	**47,135**
Financial assets available for sale	58	-	58	-	-	89,036	**89,094**
Financial assets at fair value through profit or loss	1,729	-	1,729	17	-	-	**1,746**
Loans and receivables from customers	385	739,044	739,429	-	-	453,184	**1,192,613**
Income tax prepayment	-	-	-	-	-	2,207	**2,207**
Deferred Tax Assets	-	-	-	-	-	229	**229**
Other asset	1,733	-	1,733	31	-	7,992	**9,756**
Property and equipment and intangible assets	-	-	-	-	-	22,978	**22,978**
Total assets	**35,468**	**739,044**	**774,512**	**46,354**	**13,994**	**947,646**	**1,782,506**
Liabilities and equity							
Due to banks and other financial Institutions	195,291	-	195,291	25,556	4,592	5,660	**231,099**
Due to customers	471,167	135,329	606,496	20,975	11,283	627,627	**1,266,381**
Financial liabilities fair value through profit or loss	-	-	-	8	1,538	-	**1,546**
Subordinated debt	-	-	-	-	-	281	**281**
Other liabilities	2,497	-	2,497	71	28	15,565	**18,161**
Provision for liabilities and charges	-	-	-	-	-	4,979	**4,979**
Share capital and reserves	-	-	-	-	-	260,059	**260,059**
Total liabilities and equity	**668,955**	**135,329**	**804,284**	**46,610**	**17,441**	**914,171**	**1,782,506**
Net foreign exchange position	**(633,487)**	**603,715**	**(29,772)**	**(256)**	**(3,447)**	**33,475**	**-**

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

5. FINANCIAL RISK MANAGEMENT (continued)

5.3 Market risk (continued)

5.3.1 Foreign exchange risk (continued)

31 December 2015	**EURO**	**EURO linked**	**EURO total**	**USD**	**Other FX**	**KM**	**Total**
Assets							
Cash and cash equivalents	20,825	-	20,825	977	6,930	133,644	**162,376**
Obligatory reserves with the Central Bank	-	-	-	-	-	151,221	**151,221**
Placements with other banks	489	-	489	28,086	1,306	-	**29,881**
Financial assets available for sale	50	-	50	-	-	41,176	**41,226**
Financial assets at fair value through profit or loss	210	-	210	-	-	-	**210**
Loans and receivables from customers	389	780,861	781,250	-	-	349,075	**1,130,325**
Income tax prepayment	-	-	-	-	-	1,607	**1,607**
Other asset	1,420	-	1,420	37	-	6,872	**8,329**
Property and equipment and intangible assets	-	-	-	-	-	20,117	**20,117**
Total assets	**23,383**	**780,861**	**804,244**	**29,100**	**8,236**	**703,712**	**1,545,292**
Liabilities and equity							
Due to banks and other financial institutions	206,300	-	206,300	9,878	272	13,186	**229,636**
Due to customers	474,170	103,120	577,290	19,185	7,840	455,833	**1,060,148**
Subordinated debt	-	-	-	-	-	442	**442**
Other liabilities	4,628	-	4,628	46	21	12,897	**17,592**
Provision for liabilities and charges	-	-	-	-	-	4,464	**4,464**
Deferred tax liability	-	-	-	-	-	40	**40**
Share capital and reserves	-	-	-	-	-	232,970	**232,970**
Total liabilities and equity	**685,098**	**103,120**	**788,218**	**29,109**	**8,133**	**719,832**	**1,545,292**
Net foreign exchange position	**(661,715)**	**677,741**	**16,026**	**(9)**	**103**	**(16,120)**	**-**

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 KM 5,867 thousand (EUR 3,000 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.

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

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 2016, the effect, in terms of economic value of interest risk-sensitive balance-sheet portfolios, would have been KM 1,816 thousand (31 December 2015: KM 3,775 thousand).

In 2015 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
+/- KM 5,867 thousand	+/- KM 5,867 thousand	+/- KM 5,867 thousand	+/- KM 5,867 thousand
(3 mio EUR)	(3 mio EUR)	(3 mio EUR)	(3 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 (+100 bp)	31 December 2016				31 December 2015
	TOTAL	0-18 months	18 months - 5 years	above 5 years	TOTAL
EUR	**3,591**	(551)	4,386	(244)	3,552
USD	**118**	49	69	-	85
CHF	**12**	8	4	-	15
KM	**(1,912)**	(1,541)	(580)	209	121
Other currencies	**7**	6	1	-	2
Total	**1,816**	**(2,029)**	**3,880**	**(35)**	**3,775**

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 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 2016 is an increase of KM 2,416 thousand (31 December 2015: KM 3,245 thousand), while if changes in interest rates market moving had been 100 basis points lower the result is decrease of KM 35 thousand as of 31 December 2016 (31 December 2015: decrease of KM 58 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 KM 1,538 thousand, while a decrease by 50 bps in interest rates would increase result for the year by KM 1 thousand as of 31 December 2016 (31 December 2015: KM 1,322 thousand for +50 bps and decrease of KM 38 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 negative 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 and amount of positive revaluation reserves arising from the effects of changes in the fair value of assets.
  From 31.12.2015, according to the Decision on the minimum standards for capital of banks and capital protection (Official Gazette of Federation of BiH 46/14, Article 9), the amount of subordinated loan is recognized in accordance with the amortization plan, in line with the methodology prescribed by the FBA Instruction dating from November 2015. According to the same Decision, collective impairment allowances cannot be higher than 1.25% of the Total weighted Risk (2015: 1.625%).
- Deductible items.

Risk-weighted assets are measured by means of a hierarchy of four weightings 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.

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

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 2016 and 31 December 2015, taken from the calculations submitted to the Agency in respect of those period-ends.

	31 December 2016	31 December 2015
Tier 1 capital		
Share capital	**44,782**	44,782
Share premium	**57,415**	57,415
Statutory and other reserves	**614**	614
Retained earnings brought forward	**111,251**	85,144
Deferred tax assets	**(228)**	-
Intangible assets	**(6,595)**	(5,119)
Total qualifying Tier 1 Capital	**207,239**	182,836
Tier 2 capital		
General provisions – FBA regulations	**17,868**	21,661
Fair value reserves, positive	**246**	403
Subordinated debt	**34**	108
Audited profit for the period	**-**	-
Total qualifying Tier 2 Capital	**18,148**	22,172
Adjustment for shortfall in regulatory reserve	**(23,987)**	(21,064)
Total regulatory capital	**201,400**	183,944
Risk weighted assets (*)		
On balance sheet	**1,167,334**	1,098,566
Off balance sheet	**172,936**	148,291
Total	**1,340,270**	1,246,857
Operational risk	**89,148**	86,156
Total weighted risk	**1,429,418**	1,333,013
Capital adequacy ratio	**14.09%**	13.80%

(*) Risk weighted assets amounts 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 (KM 18,286 thousand at 31 December 2016) which is part of net equity in the statement of financial position. However, general provisions calculated in accordance with Agency rules (KM 17,868 thousand at 31 December 2016) 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 2016 this amounted to KM 23,987 thousand (2015: 21,064 thousand).

5. FINANCIAL RISK MANAGEMENT (continued)

5.4 Capital management (continued)

In accordance with the Agency regulations, the Decision on minimum standards for capital management of banks and capital protection dated 30 May 2014 (Official Gazette of the Federation of BiH 46/14), 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. Should the profit for the year ended 31 December 2016 be entirely retained, the Capital Adequacy Ratio (CAR) as of 31 December 2016 would be 15.99%.

Given the structure of Core and Supplementary capital, Core Capital ratio is almost equivalent to total CAR and reached 14,50% at the end of 2016 (minimum level: 9,0%). Leverage ratio reached 9,7% as of 31 December 2016 (regulatory limit: 6,0%).

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 as available for sale 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.

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

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 recognized in the statement of financial position.

31 December 2016	Note	Level 1	Level 2	Level 3	Total
Financial assets available for sale	*22 a)*				
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina		-	88,974	-	**88,974**
Equity securities issued by non-resident legal entities		-	58	-	**58**
Financial assets available at fair value through profit and loss	*22 b)*				
Equity shares		298	-	-	**298**
Derivatives held for trading – OTC product		-	1,448		**1,448**
Total		**298**	**90,480**	**-**	**90,778**
Financial liabilities available at fair value through profit and loss	*22 c)*				
Derivatives held for trading – OTC product		-	1,548	-	**1,548**
Total		**-**	**1,548**	**-**	**1,548**

31 December 2015		Level 1	Level 2	Level 3	Total
Equity securities issued by non-resident legal entities	*22 a)*	-	50	-	**50**
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina	*22 a)*	-	41,114	-	**41,114**
Equity shares	*22 b)*	209	-	-	**209**
Derivatives held for trading – OTC product	*22 b)*	-	1	-	**1**
Total		**209**	**41,165**	**-**	**41,374**

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

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 2016	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	30,585	134,858	**165,443**	**165,443**
Reserves with the Central Bank	-	-	251,305	**251,305**	**251,305**
Placements with other banks	-	47,135	-	**47,135**	**47,135**
Loans and receivables from customers	-	244,651	930,275	**1,174,926**	**1,192,613**
Total	**-**	**322,371**	**1,316,438**	**1,638,809**	**1,656,496**
Liabilities					
Due to banks and other financial institutions	-	42,621	183,883	**226,504**	**231,099**
Due to customers	-	692,378	572,854	**1,265,232**	**1,266,381**
Subordinated debt	-	-	284	**284**	**281**
Total	**-**	**734,999**	**757,021**	**1,492,020**	**1,497,761**

31 December 2015	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and cash equivalents	-	33,724	128,652	**162,376**	**162,376**
Reserves with the Central Bank	-	-	151,221	**151,221**	**151,221**
Placements with other banks	-	29,881	-	**29,881**	**29,881**
Loans and receivables from customers	-	261,372	847,275	**1,108,647**	**1,130,325**
Total	**-**	**324,977**	**1,127,148**	**1,452,125**	**1,473,803**
Liabilities					
Due to banks and other financial institutions	-	30,598	185,900	**216,498**	**229,636**
Due to customers	-	527,599	536,041	**1,063,640**	**1,060,148**
Subordinated debt	-	-	442	**442**	**442**
Total	**-**	**558,197**	**722,383**	**1,280,580**	**1,290,226**

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.

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

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

7. OPERATING SEGMENTS (continued)

Segmental information for the year ending 31 December 2016

	Retail	**Corporate**	**Treasury**	**Total**
Interest income	48,728	28,640	772	78,140
Interest expense	(10,980)	(5,332)	(370)	(16,682)
Net interest income	**37,748**	**23,308**	**402**	**61,458**
Fee and commission income	16,559	7,141	206	23,906
Fee and commission expense	(3,535)	(508)	(74)	(4,117)
Net fee and commission income	**13,024**	**6,633**	**132**	**19,789**
Net profit of trading activities and foreign exchange	-	-	2,468	2,468
Other operating income/expense	(4,114)	(1,023)	(270)	(5,407)
Operating income/expense	**(4,114)**	**(1,023)**	**2,198**	**(2,939)**
Personnel expense	(15,319)	(4,411)	(590)	(20,320)
Other administrative expense	(13,509)	(2,996)	(674)	(17,179)
Depreciation expense	(3,045)	(409)	(54)	(3,508)
Operating expense	**(31,873)**	**(7,816)**	**(1,318)**	**(41,007)**
Profit before impairment losses, and other provisions and income tax	**14,785**	**21,102**	**1,414**	**37,301**
Impairment losses and provisions	(6,556)	(395)	(146)	(7,097)
PROFIT BEFORE INCOME TAX	**8,229**	**20,707**	**1,268**	**30,204**
Income tax				(3,106)
NET PROFIT FOR THE YEAR				**27,098**

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

7. OPERATING SEGMENTS (continued)

Segmental information as at 31 December 2016

	Retail	**Corporate**	**Treasury**	**Total**
Cash and cash equivalents	30,585	-	134,858	165,443
Obligatory reserves with the Central Bank	-	-	251,305	251,305
Placements with other banks	-	-	47,135	47,135
Financial assets available for sale	-	-	89,094	89,094
Financial assets at fair value through profit or loss	-	-	1,746	1,746
Loans and receivables from customers	559,731	632,882	-	1,192,613
Other unallocated amounts	-	-	-	35,170
TOTAL ASSETS	**590,316**	**632,882**	**524,138**	**1,782,506**
Due to banks and other financial institutions	-	18,094	213,005	231,099
Due to customers	573,805	692,576	-	1,266,381
Subordinated debt	-	-	281	281
Other unallocated amounts	-	-	-	24,686
TOTAL LIABILITIES	**573,805**	**710,670**	**213,286**	**1,522,447**

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

7. OPERATING SEGMENTS (continued)

Segmental information for the year ending 31 December 2015

	Retail	Corporate	Treasury	Total
Interest income	45,860	34,375	629	80,864
Interest expense	(13,440)	(7,424)	(197)	(21,061)
Net interest income	**32,420**	**26,951**	**432**	**59,803**
Fee and commission income	14,770	6,751	206	21,727
Fee and commission expense	(3,099)	(520)	(33)	(3,652)
Net fee and commission income	**11,671**	**6,231**	**173**	**18,075**
Net profit of trading activities and foreign exchange	-	-	2,480	2,480
Other operating income/expense	(3,967)	(1,621)	(170)	(5,758)
Operating income	**40,124**	**31,561**	**2,915**	**74,600**
Personnel expense	(14,455)	(4,142)	(628)	(19,225)
Other administrative expense	(12,439)	(2,650)	(537)	(15,626)
Depreciation expense	(2,681)	(372)	(54)	(3,107)
Operating expense	**(29,575)**	**(7,164)**	**(1,219)**	**(37,958)**
Profit before impairment losses, and other provisions and income tax	**10,549**	**24,397**	**1,696**	**36,642**
Impairment losses and provisions	(2,977)	(4,436)	(92)	(7,505)
PROFIT BEFORE INCOME TAX	**7,572**	**19,961**	**1,604**	**29,137**
Income tax				(3,031)
NET PROFITFOR THE YEAR				**26,106**

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

7. OPERATING SEGMENTS (continued)

Segmental information as at 31 December 2015

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	33,724	-	128,652	162,376
Obligatory reserves with the Central Bank	-	-	151,221	151,221
Placements with other banks	-	-	29,881	29,881
Financial assets available for sale	-	-	41,226	41,226
Financial assets at fair value through profit or loss	-	-	210	210
Loans to customers	523,544	606,781	-	1,130,325
Other unallocated amounts	-	-	-	30,053
TOTAL ASSETS	**557,268**	**606,781**	**351,190**	**1,545,292**
Due to banks and other financial institutions	-	25,200	204,436	229,636
Due to customers	538,798	521,350	-	1,060,148
Subordinated debt	-	-	442	442
Other unallocated amounts	-	-	-	22,096
TOTAL LIABILITIES	**538,798**	**546,550**	**204,878**	**1,312,322**

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

8. INTEREST INCOME

	2016	2015
Retail clients	46,158	43,870
Corporate clients	31,164	36,365
Banks and other financial institutions	201	98
Interest on available-for-sale financial assets	617	531
	78,140	**80,864**

9. INTEREST EXPENSE

	2016	2015
Corporate clients	4,591	6,279
Retail clients	10,126	12,344
Banks and other financial institutions	1,929	2,415
Other	36	23
	16,682	**21,061**

10. FEE AND COMMISSION INCOME

	2016	2015
Credit card activities	6,601	6,133
Domestic payment transactions	4,915	4,452
Other	4,356	3,589
Foreign payment transactions	2,975	2,871
Guarantees	1,905	1,748
FX transactions	1,609	1,732
Loans to clients	1,425	1,050
Agency services	120	152
	23,906	**21,727**

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

11. FEE AND COMMISSION EXPENSE

	2016	**Reclassified 2015**
Credit card operations	3,031	2,582
Banks services	460	406
Domestic payment transactions	278	305
Other	348	359
	4,117	**3,652**

12. NET TRADING INCOME

	2016	**2015**
Net gains from foreign exchange spot trading	3,217	3,149
Net gains on equity securities	8	150
Net gains on financial instruments at fair value through profit or loss	(96)	42
Net foreign exchange losses from the translation of monetary assets and liabilities	(661)	(861)
	2,468	**2,480**

13. OTHER OPERATING INCOME / EXPENSE

	2016	**Reclassified 2015**
Card intermediation expenses	(1,923)	(1,816)
Consultancy and the Federal Banking Agency expenses	(1,282)	(1,226)
Savings deposit insurance	(2,377)	(2,173)
Provisions for repossessed assets	(301)	(991)
Income from claims settled by insurance companies and recharges from customers	348	290
Gain on sale of property	96	19
Other income / expense	32	139
	(5,407)	**(5,758)**

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

14. PERSONNEL EXPENSES

	2016	Reclassified 2015
Net salaries	13,403	13,042
Tax and contributions	6,474	5,829
Provisions for liabilities and charges (Note 31)	106	113
Other expenses	337	241
	20,320	**19,225**

Personnel expenses include KM 3,864 thousand (31 December 2015: KM 3,302 thousand) of defined pension contributions paid into the State pension plan. Contributions are calculated as percentage of the gross salary paid. The Bank had 561 employees as at 31 December 2016 (537 as at 31 December 2015).

15. ADMINISTRATIVE EXPENSES

	2016	Reclassified 2015
Rent and other rent-related expense	3,562	3,426
Telecommunication and post expense	3,030	2,787
Maintenance expenses	3,479	2,720
Other insurance charges	523	450
Security and transport costs	2,216	1,825
Consultancy expenses	772	824
Material expenses	916	1,009
Other costs	901	950
Energy	758	779
Representation and marketing expense	579	554
Provisions for liabilities and charges (Note 31)	443	302
	17,179	**15,626**

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

16. NET IMPAIRMENT LOSSES AND OTHER PROVISIONS

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

Net impairment losses and provisions	2016	Reclassified 2015
-for loans to customers (Note 23)	6,521	6,826
-for other assets (Note 24)	320	85
-for off-balance sheet items (Note 31)	256	594
	7,097	**7,505**

17. INCOME TAXES

	2016	2015
Current tax	3,334	3,031
Deferred tax (Note 32)	(228)	-
Total Income tax	**3,106**	**3,031**
Deferred tax recognized in the statement of comprehensive income (Note 32)	**(1)**	**40**

Income tax recognized in the income statement comprises current tax. Official corporate income tax rate is 10% (2015: 10%).

	2016	2015
Profit before income tax	30,204	29,137
Tax calculated at rate of 10%	3,020	2,914
Non-deductible expenses	87	124
Non-taxable income	(1)	(7)
Income tax expense	**3,106**	**3,031**
Average effective income tax rate	**10.3%**	**10.4%**

18. BASIC AND DILUTED EARNINGS PER SHARE

	2016	2015
Net profit (KM'000)	27,098	26,106
Weighted average number of ordinary shares outstanding	447,760	447,760
Basic and diluted earnings per share (KM)	**60.52**	**58.30**

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

19. CASH AND CASH EQUIVALENTS

	31 December 2016	31 December 2015
Current account with the Central Bank	97,548	107,884
Cash in hand in domestic currency	22,945	25,503
Cash in hand in foreign currency	7,640	8,221
Current accounts with other banks	37,310	20,768
	165,443	**162,376**

20. RESERVES WITH THE CENTRAL BANK

	31 December 2016	31 December 2015
Obligatory reserve	149,629	94,277
Special reserve	101,676	56,944
	251,305	**151,221**

The minimum obligatory reserve as of 31 December 2016 is calculated in the amount of 10% of deposits and borrowings with maturity up to one year and 7% of deposits and borrowings with maturity over one year, and is calculated on a daily basis, and updated every ten calendar days, in arrears. Local inter-bank deposits, and short-term and long-term deposits and borrowings from non-residents are excluded from the calculation.
In October 2015 the Federal Banking Agency issued an Instruction Letter, based on Law of banks, based on which banks are obliged to calculate and keep additional special reserves with the Central Bank. The amount of this additional special reserve is calculated as 50% of daily balance of a vista and term deposits belonging to entities financed and managing the State Budget funds.

21. PLACEMENTS WITH OTHER BANKS

	31 December 2016	31 December 2015
Placements with banks	**47,135**	**29,881**

As at 31 December 2016, the Bank had several placements with other banks in GBP, USD and CAD. Amounts of the placements were as follows:

- 13,500,000 USD, maturity 4 Janurary 2017, interest rate 4.2% p.a.,
- 5,800,000 USD, maturity 4 Janurary 2017, interest rate 0.5% p.a.,
- 5,000,000 USD, maturity 5 Janurary 2017, interest rate 1.5% p.a.,
- 730,000 GBP, maturity 4 Janurary 2017, interest rate 0.3% p.a. and
- 360,000 CAD, maturity 4 Janurary 2017, interest rate 0.2% p.a.

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

22. FINANCIAL ASSETS AND LIABILITIES

a) Financial assets available for sale

	31 December 2016	31 December 2015
Debt instruments		
Bonds issued by the Federation of Bosnia and Herzegovina	88,974	41,114
	88,974	41,114
Equity instruments		
Equity securities at cost	62	62
Equity securities at fair value	58	50
	120	112
	89,094	**41,226**

b) Financial assets at fair value through profit or loss

	31 December 2016	31 December 2015
Financial assets		
Equity shares designated at fair value through profit or loss	298	209
Derivatives held for trading	1,448	1
	1,746	**210**

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

Financial assets	**31 December 2016 Notional amount**	**31 December 2016 Fair value**	**31 December 2015 Notional amount**	**31 December 2015 Fair value**
Derivatives classified as held for trading – OTC products				
Forward foreign exchange contracts	19,811	1,448	219	1
	19,811	**1,448**	**219**	**1**

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

22. FINANCIAL ASSETS AND LIABLITIES (continued)

c) Financial liabilities at fair value through profit or loss

	31 December 2016	31 December 2015
Financial liabilities		
Derivatives held for trading	1,546	-
	1,546	**-**

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

Financial liabilities	31 December 2016 Notional amount	31 December 2016 Fair value	31 December 2015 Notional amount	31 December 2015 Fair value
Derivatives classified as held for trading – OTC products				
Forward foreign exchange contracts	20,282	1,546	-	-
	20,282	**1,546**	**-**	**-**

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

23. LOANS AND RECEIVABLES FROM CUSTOMERS

	31 December 2016	31 December 2015
Short-term loans		
Corporate		
- in KM and KM linked to foreign currency	282,532	299,548
- in foreign currency	1,090	1,387
Retail		
- in KM and KM linked to foreign currency	64,368	63,828
- in foreign currency	68	68
	348,058	**364,831**
Long-term loans		
Corporate		
-in KM and KM linked to foreign currency	406,164	367,248
-in foreign currency	1,113	2,254
Retail		
-in KM and KM linked to foreign currency	521,742	485,807
-in foreign currency	55	47
	929,074	**855,356**
Total loans	1,277,132	1,220,187
Less: impairment allowance	(84,519)	(89,862)
	1,192,613	**1,130,325**

Loans and receivables from customers are presented including accrued interest in the amount of KM 7,773 thousand (2015: KM 8,639 thousand), and net of up-front fees in the amount of KM 7,796 thousand (2015: KM 6,689 thousand).

As of 31 December 2016, 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 KM:EUR exchange rate in the amount of KM 28,838 thousand and KM 710,206 thousand, respectively (31 December 2015: KM 19,579 thousand and KM 817,534 thousand, respectively).

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

	2016	2015
Balance as at 1 January	**89,862**	**88,529**
Net charge to income statement (Note 16)	6,521	6,826
Unwinding of discount	(1,827)	(2,428)
Transfers – other	48	18
Write-offs	(10,085)	(3,083)
Balance as at 31 December	**84,519**	**89,862**

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

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 2016	31 December 2015
Trade	274,032	241,086
Manufacturing, agriculture, forestry, mining and energy	214,950	225,348
Services, finance, sport, tourism	32,381	51,186
Administrative and other public institutions	61,066	51,038
Construction industry	55,145	50,101
Transport and telecommunications	47,649	32,539
Other	5,676	20,799
Citizens	586,233	548,090
	1,277,132	**1,220,187**

24. OTHER ASSETS

	31 December 2016	31 December 2015
Receivables from card operations	2,971	2,428
Assets acquired upon foreclosure of loans	2,239	2,406
Prepaid expenses	3,186	2,137
Fees receivable	1,079	1,080
Other assets	3,101	3,064
Total other assets	12,576	11,115
Less: impairment allowance	(2,820)	(2,786)
	9,756	**8,329**

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

Balance as at 1 January	**2,786**	**1,132**
Net charge to income statement (Note 16)	320	85
Charge to income statement (Repossessed assets)	-	991
Transfer from property and equipment impairment (Note 25)	-	2,190
Transfers – other	(135)	-
Write-offs and sale of property	(151)	(1,612)
Balance as at 31 December	**2,820**	**2,786**

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

25. PROPERTY AND EQUIPMENT

	Land and buildings	Computers and other equipment	Assets in the course of construction	Leasehold improvements	Total
Cost					
At 1 January 2015	**17,576**	**21,386**	**213**	**8,859**	**48,034**
Additions	-	-	810	-	810
Transfer from other assets	(4,690)	-	-	-	(4,690)
Disposals	(64)	(3,405)	-	26	(3,443)
Transfers	47	737	(891)	107	-
At 31 December 2015	**12,869**	**18,718**	**132**	**8,992**	**40,711**
Additions	-	-	3,612	-	3,612
Disposals	(140)	(292)	-	(44)	(476)
Transfers	367	2,256	(3,358)	735	-
At 31 December 2016	**13,096**	**20,682**	**386**	**9,683**	**43,847**
Accumulated depreciation					
At 1 January 2015	**4,585**	**16,380**	**-**	**8,465**	**29,430**
Charge for the year	168	1,565	-	133	1,866
Transfer to other assets (note 24), depreciation	(410)	-	-	-	(410)
Transfer to other assets (note 24), impairments	(2,190)	-	-	-	(2,190)
Disposals	(16)	(2,966)	-	-	(2,982)
At 31 December 2015	**2,137**	**14,979**	**-**	**8,598**	**25,714**
Charge for the year	530	1,372	-	179	2,081
Disposals	(19)	(282)	-	(30)	(331)
At 31 December 2016	**2,648**	**16,069**	**-**	**8,747**	**27,464**
Net Book Value					
At 31 December 2015	**10,732**	**3,739**	**132**	**394**	**14,997**
At 31 December 2016	**10,448**	**4,613**	**386**	**936**	**16,383**

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

26. INTANGIBLE ASSETS

	Software	Assets in the course of construction	Total
Cost			
At 1 January 2015	**9,163**	**1,194**	**10,357**
Additions	-	1,868	1,868
Transfers	2,416	(2,416)	-
At 31 December 2015	**11,579**	**646**	**12,225**
Additions	-	2,902	2,902
Transfers	1,372	(1,372)	-
At 31 December 2016	**12,951**	**2,176**	**15,127**
Amortisation			
At 1 January 2015	**5,864**	**-**	**5,864**
Charge for the year	1,241	-	1,241
At 31 December 2015	**7,105**	**-**	**7,105**
Charge for the year	1,427	-	1,427
At 31 December 2016	**8,532**	**-**	**8,532**
Net Book Value			
At 31 December 2015	**4,474**	**646**	**5,120**
At 31 December 2016	**4,419**	**2,176**	**6,595**

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

27. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	31 December 2016	31 December 2015
Due to banks		
Current accounts and term deposits		
Demand deposits		
-in KM	760	1,249
-in foreign currencies	15,865	10,327
Term deposits		
-in KM	4,500	-
-in foreign currencies	25,495	19,022
	46,620	**30,598**
Borrowings		
Long-term borrowings		
-foreign banks	166,384	173,838
	166,384	**173,838**
Total Due to Banks	**213,004**	**204,436**
Due to other financial institutions		
Long-term borrowings		
-in KM	2,401	2,405
-in foreign currencies	15,694	22,795
Total borrowings from other financial institutions	**18,095**	**25,200**
Total Due to Banks and other Financial Institutions	**231,099**	**229,636**

Current accounts, deposits and borrowings from banks presented above include accrued interest in the amount of KM 193 thousand (2014: KM 347 thousand).
Borrowings from other financial institutions are presented including accrued interest in the amount of KM 129 thousand (2015: KM 123 thousand).

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

28. DUE TO CUSTOMERS

	31 December 2016	31 December 2015
Demand deposits:		
Retail clients:		
-in KM	125,501	114,330
-in foreign currencies	59,724	65,142
Corporate clients:		
-in KM	369,602	218,206
-in foreign currencies	100,727	78,215
Total demand deposits	**655,554**	**475,893**
Term deposits:		
Retail clients:		
-in KM	112,447	91,197
-in foreign currencies	276,134	268,129
Corporate clients:		
-in KM	155,406	135,356
-in foreign currencies	66,840	89,573
Total term deposits	**610,827**	**584,255**
Total Due to customers	**1,266,381**	**1,060,148**

Amounts due to customers are presented including accrued interest in the amount of KM 8,444 thousand (2015: KM 8,705 thousand).

29. SUBORDINATED DEBT

	31 December 2016	31 December 2015
Ministry of Finance of Bosnia and Herzegovina	**281**	**442**

With the approval of the Banking Agency of Federation of Bosnia and Herzegovina and in accordance with the provisions of the FBA Decision on Minimum Standards for Capital Management of banks and capital protection, the subordinated debt is included in Tier 2 capital in the calculation of capital adequacy.

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

30. OTHER LIABILITIES

	31 December 2016	31 December 2015
Loan repayments before due dates	5,352	4,463
Credit card liabilities	2,788	2,258
Liabilities to vendors	1,546	1,554
Liabilities for employees' bonuses	1,710	1,404
Liabilities to shareholders	135	140
Liabilities in respect of managed funds (Note 37)	8	13
Other liabilities	6,622	7,760
	18,161	**17,592**

31. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2016	31 December 2015
Provisions for off-balance-sheet credit risk	2,222	2,029
Provisions for legal proceedings	1,975	1,742
Provisions for retirement employee benefits	782	693
	4,979	**4,464**

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

31. PROVISIONS FOR LIABILITIES AND CHARGES (continued)

Movement in provisions for liabilities and charges for the year ended 31 December 2016 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 2015	**1,717**	**640**	**1,435**	**3,792**
Net charge/(benefit) to income statement	302	113	594	1.009
Reductions arising from payments	(277)	(60)	-	(337)
Balance at 31 December 2015	**1,742**	**693**	**2,029**	**4,464**
Balance at 1 January 2016	**1,742**	**693**	**2,029**	**4,464**
Net charge to income statement	443	106	256	805
Reductions arising from payments	(210)	(17)	(63)	(290)
Balance at 31 December 2016	**1,975**	**782**	**2,222**	**4,979**

The calculation of provisions for retirement benefits of KM 491 thousand as of 31 December 2016 (2015: KM 438 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 KM 291 thousand as of 31 December 2016 (2015: KM 255 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

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

32. DEFERRED TAX BALANCES

The deferred tax liability relates to taxable temporary differences arising on fair value adjustments of financial assets available for sale. The effect of the fair value adjustment, net of relating tax is recognized in equity. Deferred tax assets relate to temporary differences arising on provisions that will be recognized 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 2015	13	-
Increase in liabilities recognized in the statement of comprehensive income	27	-
As at 31 December 2015	**40**	**-**
As at 1 January 2016	**40**	-
Decrease in liabilities recognized in the statement of comprehensive income	(41)	-
Deferred tax assets recognized in the statement of comprehensive income	-	1
Deferred tax assets for provisions for IAS 19 – retirements	-	7
Deferred tax assets for provisions for litigations	-	75
Deferred tax assets for other provisions	-	146
As at 31 December 2016	**-**	**229**

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

33. SHARE CAPITAL

	31 December 2016 and 31 December 2015		
	Class ES Ordinary shares	**Class EP Preference shares**	**Total**
Number of shares	447,760	60	447,820
Pair value (KM)	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 2016 is as follows:

- Privredna banka Zagreb dd 94.94%
- Other 5.06%

The shareholding structure of the Bank as at 31 December 2015 was as follows:

- Privredna banka Zagreb dd 94.94%
- Other 5.06%

34. 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 shared-based payment transaction, insofar the transaction occurred between entities belonging to the same group.

During 2016, part of the shares have been transferred to the beneficiaries and as of 31 December 2016 the Bank has 62,768 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.

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

35. 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 2016	31 December 2015
Contingent liabilities		
Payment guarantees	43,759	23,562
Performance guarantees	60,202	57,616
Letters of credit	5,252	3,434
Total contingent liabilities	**109,213**	**84,612**
Commitments		
Undrawn lending commitments	197,127	198,262
Total commitments	**197,127**	**198,262**
Total contingent liabilities and commitments	**306,340**	**282,874**

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

36. 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. 94.94% (2015: Privredna banka Zagreb d.d. 94.92%) 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 2016 and 31 December 2015 is presented below:

	31 December 2016	**31 December 2015**
Assets		
Receivables from key management personnel and their close family members	686	980
Bank accounts and loans – Intesa Sanpaolo Group	46,703	29,806
Financial assets at fair value through profit or loss – Intesa Sanpaolo Group	10	-
Other receivables – Intesa Sanpaolo Group	236	182
	47,635	**30,968**
Liabilities		
Deposits – key management personnel and their close family members	2,172	2,003
Borrowings and term deposits – Intesa Sanpaolo Group	11,446	15,536
Financial liabilities at fair value through profit or loss – Intesa Sanpaolo Group	1,536	-
Other liabilities – Intesa Sanpaolo Group	491	506
	15,645	**18,045**
Financial commitments and contingencies		
Financial Guarantees	3,400	11,200
Undrawn lending commitments – Intesa Sanpaolo Group	-	1
Undrawn lending commitments – key management personnel and close family members	154	151
	3,554	**11,352**

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

36. RELATED-PARTY TRANSACTIONS (continued)

	2016	2015
Income		
Interest income – key management personnel and close family members	59	65
Interest income – Intesa Sanpaolo Group	79	72
Other Income – Intesa Sanpaolo Group	199	217
	337	**354**
Expenses		
Interest expense – key management personnel and close family members	69	86
Interest expense – Intesa Sanpaolo Group	49	16
Other expenses – Intesa Sanpaolo Group	3,060	3,482
	3,178	**3,584**

The remuneration of key management personnel were as follows:

	2016	2015
Net salaries for key management personnel	1,144	980
Taxes and contributions on net salaries	685	763
Bonuses to management	456	381
Compensation for Supervisory Board members	72	88
Other management benefits	253	227
	2,610	**2,439**

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

37. MANAGED FUNDS

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

	31 December 2016	**31 December 2015**
Liabilities		
Banks and insurance companies	33,237	11,623
Government organisations	8,737	8,693
Associations and Agencies	1,331	1,334
Other	427	429
Total	**43,732**	**22,079**
Assets		
Loans to companies	43,375	21,692
Loans to citizens	349	374
Total	**43,724**	**22,066**
Amounts due to original creditors – managed funds (Note 30)	**8**	**13**