API BANK a.d. BELGRADE

Financial Statements as of and for the Year Ended 31 December 2018

and

Independent Auditor's Report

CONTENTS

This is an English translation of Independent Auditor's Report and 2018 Financial Statements originally issued in the Serbian language

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INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDER AND THE BOARD OF DIRECTORS OF API BANK a.d. BELGRADE

Report on Financial Statements

We have audited the accompanying financial statements of API Bank a.d. Belgrade (hereinafter: the "Bank"), which comprise the balance sheet as of 31 December 2018 and the income statement, statement of other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Law on Auditing ("RS Official Gazette", no. 62/2013 and 30/2018) and Standards on Auditing applicable in the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are 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 the auditor's 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 present fairly, in all material respects, the financial position of the Bank as of 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDER AND THE BOARD OF DIRECTORS OF API BANK a.d. BELGRADE (Continued)

Report on Financial Statements (Continued)

Emphasis of Matter

We draw attention to Notes 2.3. and 37(a) to the financial statements, which disclose that the Bank's regulatory capital calculated in accordance with the National Bank of Serbia's Decision on Capital Adequacy of Banks ("RS Official Gazette", no. 103/2016) amounts to RSD 1,550,943 thousand or EUR 13,121,945 as of 31 December 2018, translated at the official median exchange rate at the reporting date, and it is above the minimum amount of EUR 10 million prescribed by the Law on Banks ("RS Official Gazette", no. 107/2005, 91/2010 and 14/2015). The Bank used the opportunity envisaged by the amendments to the Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items ("RS Official Gazette", no. 69/2016 and 114/2017) and stated the required reserve for estimated losses on balance sheet assets and off-balance sheet items in the amount of RSD 109,792 thousand as a deductible item from the capital, instead of the calculated amount of reserve of RSD 218,971 thousand.

In 2018, the shareholder of the Bank was changed. Pursuant to the effected share purchase and sale transaction, and based on prior consent of the National Bank of Serbia, the company "AZRS INVEST" d.o.o. Belgrade, whose owner is a physical person, Andrey Zakharovich Shlyakhovoy, became the sole owner of the Bank. The Bank's management and the new owner are preparing a Capital Management Plan which will enable the implementation of further activities related to the capital increase in order to permanently provide the amount of capital sufficient to cover all risks that the Bank will be exposed to in its business in the upcoming period. The Bank's management deems that in the given circumstances they undertake all the necessary measures in cooperation with its owner in order to enable the Bank to continue as a going concern. Our opinion is not qualified in respect of this matter.

Report on Other Legal and Regulatory Requirements

Management of the Bank is responsible for the preparation and fair presentation of the annual business report in accordance with the requirements of the Law on Accounting of the Republic of Serbia. Pursuant to the Law on Audit and Decision on External Bank Audit, our responsibility is to express an opinion on the consistency of the Bank's annual business report for the year ended 31 December 2018 with the audited financial statements for the same year. Our procedures in this regard were performed in accordance with the applicable Standard on Auditing 720 "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements", and are only limited to the assessment of the consistency of financial information disclosed in the annual business report with the audited financial statements.

In our opinion, financial information disclosed in the Bank's annual business report for the year ended 31 December 2018 is consistent, in all material respects, with the audited financial statements of the Bank for the year ended 31 December 2018.

Belgrade, 16 April 2019

Ksenija Ristic Kostic
Certified Auditor

Društvo za reviziju BDO d.o.o. Beograd

INCOME STATEMENT
For the Year Ended 31 December 2018

	Note	2018	In RSD thousand 2017
Interest income	5	388,023	398,227
Interest expense	5	(111,020)	(117,782)
Net interest income		**277,003**	**280,445**
Fee and commission income	6	81,579	78,835
Fee and commission expense	6	(31,999)	(27,196)
Net fee and commission income		**49,580**	**51,639**
Net gains from derecognition of financial instruments measured at fair value		-	4,524
Net (losses)/gains from hedging	7	(1,104)	1,527
Net foreign exchange gains and effects of contracted foreign currency clause	8	311,068	167,587
Net impairment loss on financial assets not measured at fair value through profit or loss	10	(114,123)	(225,695)
Other operating income	9	1,466	52
TOTAL NET OPERATING INCOME		**523,890**	**280,079**
Salaries, compensations and other personal expenses	11	(211,270)	(166,593)
Amortisation and depreciation expense	12	(23,241)	(24,573)
Other income	13	11,217	6,770
Other expenses	14	(271,896)	(269,660)
PROFIT/(LOSS) BEFORE TAX		**28,700**	**(173,977)**
INCOME TAXES	15		
Deffered tax income		1,658	221
PROFIT/(LOSS) FOR THE YEAR		**30,358**	**(173,756)**

The notes on pages 8 to 118
are an integral part of these financial statements.

Signed on behalf of the Bank's management on 15 April 2019, by:

Andjelka Stankovic Responsible for financial statements preparation	Marija Stepina Executive Board President	Andrey Zakharovich Shlyakhovoy Board of Directors President

AKCIONARSKO DRUŠTVO BEOGRAD API BANK
API Bank a.d. Beograd
API bank
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Beograd

STATEMENT OF OTHER COMPREHENSIVE INCOME
For the Year Ended 31 December 2018

In RSD thousand

	2018	2017
PROFIT/(LOSS) FOR THE YEAR	**30,358**	**(173,756)**
Other comprehensive income:		
Items of other comprehensive income that can be reclassified to profit or loss:		
Positive effects of change in value of debt instruments measured at fair value through other comprehensive income, net	1,383	9,892
Total other comprehensive income, net of tax	**1,383**	**9,892**
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR	**31,741**	**(163,864)**

The notes on pages 8 to 118 are an integral part of these financial statements.

Andjelka Stankovic Responsible for financial statements preparation	Marija Stepina Executive Board President	Andrey Zakharovich Shlyakhovoy Board of Directors President

AKCIONARSKO DRUŠTVO API BANK BEOGRAD
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BALANCE SHEET
As of 31 December 2018

	Note	31 December 2018	In RSD thousand 31 December 2017
ASSETS			
Cash and balances with central bank	17	1,969,175	1,603,452
Securities	18	1,856,532	913,736
Loans and advances to banks and other financial organisations	19	1,996,367	1,756,505
Loans and advances to customers	20	3,912,191	5,873,639
Changes in fair value of items subject to hedging		-	1,309
Intangible assets	21	50,790	38,900
Property, plant and equipment	22(a)	26,564	29,020
Investment property	22(b)	19,873	20,135
Deferred tax assets	15(c)	5,491	3,833
Non-current assets held for sale and discontinued operations	23	375.484	382,238
Other assets	24	43,712	48,593
TOTAL ASSETS		**10,256,179**	**10,671,360**
LIABILITIES			
Deposits and other financial liabilities to banks, other financial organisations and central bank	25	15,674	203,206
Deposits and other financial liabilities to other customers	26	8,414,173	8,592,080
Changes in fair value of items subject to hedging		-	206
Subordinated liabilities	27	115,760	134,215
Provisions	28	14,626	17,578
Deferred tax liabilities	15(d)	1,434	1,746
Other liabilities	29	56,861	87,335
TOTAL LIABILITIES		**8,618,528**	**9,036,366**
EQUITY	30		
Share capital		3,672,407	3,672,407
Profit		30,358	-
Loss		(2,076,389)	(2,047,305)
Reserves		11,275	9,892
TOTAL EQUITY		**1,637,651**	**1,634,994**
TOTAL LIABILITIES AND EQUITY		**10,256,179**	**10,671,360**

The notes on pages 8 to 118
are an integral part of these financial statements.

AKCIONARSKO DRUŠTVO API Bank a.d. Beograd API bank BEOGRAD Beograd

Andjelka Stanković Responsible for financial statements preparation	Marija Stepina Executive Board President	Andrey Zakharovich Shlyakhovoy Board of Directors President

STATEMENT OF CHANGES IN EQUITY
For the Year Ended 31 December 2018

In RSD thousand

	Share capital	Reserves	Profit/ (Loss)	Total equity
Opening balance as of 1 January 2017	**3,672,407**	**-**	**(1,873,549)**	**1,798,858**
Loss for the year	-	-	(173,756)	(173,756)
Other comprehensive income:				
Positive effects of change in fair value of financial assets available-for-sale	-	11,638	-	11,638
Related deferred taxes recognised in equity (Note 15(d))	-	(1,746)	-	(1,746)
Balance as of 31 December 2017	**3,672,407**	**9,892**	**(2,047,305)**	**1,634,994**
Effects of application of IFRS 9 (Note 2.1(a)/i/)	-	-	(29,084)	(29,084)
Restated opening balance as of 1 January 2018	**3,672,407**	**9,892**	**(2,076,389)**	**1,605,910**
Profit for the year	-	-	30,358	30,358
Other comprehensive income:				
Negative effects of changes in fair values of debt securities measured at fair value through other comprehensive income	-	(2,079)	-	(2,079)
Deferred taxes credited to equity (Note 15(d))	-	312	-	312
Allowance for impairment of financial assets measured through other comprehensive income	-	3,150	-	3,150
Balance as of 31 December 2018	**3,672,407**	**11,275**	**(2,046,031)**	**1,637,651**

The notes on pages 8 to 118
are an integral part of these financial statements.

Andjelka Stankovic
Responsible for financial statements preparation

Marija Stepina
Executive Board
President

Andrey Zakharovich Shlyakhovoy
Board of Directors
President

API BANK AKCIONARSKO DRUŠTVO BEOGRAD
API Bank a.d. Beograd
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Beograd

STATEMENT OF CASH FLOWS
For the Year Ended 31 December 2018

In RSD thousand

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash inflow from operating activities	**504,520**	**619,017**
Interest receipts	411,994	527,514
Fee and commission receipts	82,961	80,157
Receipts from other operating activities	9,565	11,346
Cash outflow from operating activities	**(633,281)**	**(590,265)**
Interest paid	(108,301)	(128,937)
Fees and commission paid	(31,999)	(26,254)
Salaries, compensations and other personal expenses	(209,738)	(164,278)
Taxes, contributions and other duties paid	(41,955)	(30,665)
Outflow for other operating expenses	(241,288)	(240,131)
Net cash (used in)/from before increase or decrease in placements and deposits	**(128,761)**	**28,752**
Decrease in placements and increase in deposits and other liabilities	*2,431,792*	*436,584*
Decrease in loans and other placements to banks, other financial organizations, central bank and customers	2,204,887	128,115
Increase in deposits from banks, other financial organizations, central bank and customers	226,905	308,469
Increase in placements and decrease in deposits and other liabilities	*(668,091)*	*(2,633,887)*
Increase in loans and other placements to banks, other financial organizations, central bank and customers	(54,112)	(1,570,242)
Decrease in deposits from and other liabilities to banks, other financial organizations, central bank and customers	(613,979)	(1,063,645)
Net cash from/(used in) operating activities	*1,634,940*	*(2,168,551)*
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash inflow from investing activities	**-**	**164,158**
Proceeds from investment securities	-	164,158
Cash outflow from investing activities	**(970,224)**	**(45,598)**
Purchase of investment securities	(944,565)	-
Purchase of intangible assets and property, plant and equipment	(25,659)	(45,598)
Other outflows from investing activities	-	-
Net cash (used in)/from investing activities	*(970,224)*	*118,560*
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash inflow from financing activities	**51,783**	**-**
Proceeds from borrowings	51,783	-
Cash outflow from financing activities	**(24,012)**	**(97,458)**
Decrease in subordinated loans		-
Repayment of borrowings	(24,012)	(97,458)
Net cash from/(used in) financing activities	*27,771*	*(97,458)*
Net increase /(decrease) in cash and cash equivalents	**692,487**	**(2,147,449)**
Cash and cash equivalents at the beginning of the year	1,826,732	3,806,557
Net foreign exchange gains	291,510	169,115
Cash and cash equivalents at the end of the year (Note 17)	**2,810,729**	**1,828,223**

The notes on pages 8 to 118 are an integral part of these financial statements.

Andjelka Stankovic Responsible for financial statements preparation	Marija Stepina Executive Board President	Andrey Zakharovich Shlyakhovoy Board of Directors President

1. CORPORATE INFORMATION

API BANK a.d. BELGRADE, former VTB Banka a.d. Belgrade (hereinafter referred to as the "Bank") was established on 11 July 2008 pursuant to the Decision of the National Bank of Serbia no. 2158 dated 3 March 2008.

The founder and the sole shareholder of the Bank until 2011 was the Joint Stock Commercial Bank – Bank of Moscow, Moscow, Russian Federation (hereinafter referred to as the "Bank of Moscow, Moscow"). In 2011, there was a change in the ownership structure of the Bank's sole shareholder, therefore, as of that date, 95% of shares of the Bank of Moscow, Moscow were held by the Joint Stock Company "VTB Bank", Saint Petersburg, Russian Federation or its subsidiaries.

On 16 May 2013, the Agreement on Sale and Purchase of Shares was signed between the Bank of Moscow, Moscow, as the seller and the Joint Stock Company "VTB Bank", Saint Petersburg as the buyer. The subject of this transaction pursuant to the above Agreement was the sale of the Bank's shares. The agreement was implemented on the same day when the new shareholder of the Bank's shares – Joint Stock Company "VTB Bank", Saint Petersburg, Russian Federation, was registered with the Central Securities Depository and Clearing House.

Pursuant to the amendments to the Articles of Association dated 30 August 2013, and the Decision no. BD 99529/201, on 13 September 2013 the Bank was registered in the Company Register under the name of VTB Banka a.d. Belgrade. The Public Joint Stock Company "VTB Bank", Saint Petersburg, Russian Federation (hereinafter "JSC VTB Bank, Saint Petersburg") became the sole shareholder of the Bank.

Based on the transaction of sale of shares realised on 26 July 2018, the Central Securities Depository and Clearing House conducted a change of ownership over 100% of VTB Bank a.d. Belgrade shares, so that the company "AZRS INVEST" d.o.o. Belgrade, registration number 20988592, became the sole owner of the shares of the Bank. The change of ownership was made on the basis of the prior approval of the National Bank of Serbia, pursuant to the Decision G 2182 dated 22 March 2018. Based on the Decision of the Shareholders Assembly as of 24 September 2018, the Articles of Association and the Memorandum of Association were amended and the new business name of the Bank - API Bank a.d. Belgrade was established, as well as the sole owner of the Bank's shares ("AZRS INVEST" d.o.o. Belgrade). The ultimate owner of the Bank is a physical person - Andrey Zakharovich Shlyakhovoy. Changing the business name of the Bank into API Bank a.d. Belgrade was registered with the Serbian Business Registers Agency on 18 October 2018.

The Bank is registered in the Republic of Serbia for provision of a wide range of banking services related to payment transfers, credit and deposit activities in the country and abroad. In accordance with the Law on Banks, the Bank is obliged to operate under the principles of liquidity, security of placements and profitability.

The Bank's registration number is 20439866. Its tax identification number is 105701111.

The Bank's Head Office is located in Belgrade, no. 2, Balkanska Street.

On 3 June 2009, the Bank opened its first branch in Belgrade, in no. 2, Balkanska Street, the status of which was changed in affiliate by the end of 2010.

On 22 November 2010, the Bank opened its first affiliate in Novi Sad, in no. 12, Narodnog fronta Street. On 24 September 2013, the Bank opened its new branch in Belgrade, in no. 57, Kralja Milutina Street. Pursuant to the Decision of the Executive Board of the Bank dated 15 November 2016, the above mentioned branch was discontinued on 15 December 2016.

The Bank had 81 employees at 31 December 2018 (at 31 December 2017: 69 employees).

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.1. Basis of Preparation and Presentation of the Financial Statements

The accompanying financial statements of the Bank as of and for the year ended 31 December 2018 have been prepared in accordance with International Financial Reporting Standards (IFRSs).

In accordance with the Law on Accounting ("RS Official Gazette", no. 62/2013 and 30/2018), banks are obliged to keep books of account and prepare financial statements in accordance with translated IFRSs, while, pursuant to the Law on Banks ("RS Official Gazette", no. 107/2005, 91/2010 and 14/2015), Article 50 paragraph 2, it is prescribed that, when compiling annual financial statements, banks should apply IFRSs as of the date the competent international authority determined as the date of application of these standards.

IFRSs include the following: Conceptual Framework for Financial Reporting, International Accounting Standards - IAS, International Financial Reporting Standards - IFRS and related amendments and interpretations issued by the International Accounting Standards Board (IASB) and/or the International Financial Reporting Interpretations Committee (IFRIC).

The accompanying financial statements have been prepared under the historical cost convention, except for financial assets measured at fair value through other comprehensive income.

The accompanying financial statements have been prepared in the form prescribed under the National Bank of Serbia Decision on Form and Content of Items in the Financial Statements for Banks ("RS Official Gazette", no. 101/2017, 38/2018 and 103/2018).

The Bank's financial statements are stated in thousands of Dinars, unless otherwise stated. The Dinar (RSD) is the functional and official reporting currency in the Republic of Serbia. All transactions in currencies that are not functional currency are considered to be transactions in foreign currency.

In the preparation of the accompanying financial statements the Bank used accounting policies disclosed in Note 3.

The accounting policies and estimates adopted in the preparation of these financial statements are consistent with those followed in the preparation of the Bank's annual financial statements for the year ended 31 December 2017, except for newly adopted amended IAS, IFRS and interpretations (IFRIC) presented below.

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018

A number of new standards, IFRIC interpretations and amendments to existing standards are mandatory for the first time for the financial year beginning on 1 January 2018. Out of these standards, IFRS 9 "Financial Instruments" has the most significant impact on changes in the Bank's accounting policies, the effect on the accompanying financial statements of the Bank, and the classification and valuation of financial instruments".

- **IFRS 9 "Financial Instruments"**

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 "Financial Instruments". IFRS 9 "Financial Instruments" has replaced IAS 39 "Financial Instruments: Recognition and Measurement".

IFRS 9 is based on a new approach to the classification and measurement of financial assets, which reflects a business model used to manage a particular asset, as well as the characteristics of the contracted cash flows.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

Classification – Financial Assets

In accordance with the requirements of IFRS 9 "Financial Instruments", as of 1 January 2018, the Bank classifies financial assets into one of the following categories:

- Financial assets at amortised cost (the business model is the collection of cash flows and cash flows represent only the payment of principal and interest on the outstanding principal amount);
- Financial assets at fair value through other comprehensive income - equity (the business model is the collection of cash flows and sales and cash flows represent only the payment of principal and interest on the outstanding principal amount); and
- Financial assets at fair value through profit or loss – all other financial instruments.

The classification in the above categories is carried out according to the following criteria:

- A business model for financial assets management; and
- The characteristics of the contracted cash flows of financial assets.

Initially, financial assets are valued at fair value, plus transaction costs which are directly related to the asset acquisition transaction, except in case of FVTPL financial assets where the indicated costs are recognised through profit and loss.

Subsequent measurement of financial instruments is directly influenced by the business model used in financial asset management and the characteristics of the contracted cash flows.

Financial assets held-for-trading are not subject to an *SPPI* test (solely payments of principal and interest), as well as derivatives, and are always measured at fair value.

When a financial asset is derecognised, the cumulative gain or loss previously recognised in the other comprehensive income is reclassified from equity to the income statement. Interest calculated using the effective interest rate is recognised in the income statement.

When estimating whether the contracted cash flows represent solely payments of principal and interest, the Bank took into consideration the contractual terms and conditions of financial instruments and whether they contain provisions that might change the time or amount of the contracted cash flows, which would result in the measurement of instruments at fair value. According to the analysis, the Bank has no products whose contractual terms and conditions do not result in such cash flows that represent solely payments of principal and interest on the outstanding principal on certain dates and which would require measurement at fair value.

New classification requirements did not have a material effect on the accounting treatment of receivables, loans, investment in debt securities and equity investments.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

Classification – Financial Liabilities

IFRS 9 mostly retains the existing requirements in IAS 39 in respect of the classification of financial liabilities. Financial liabilities are classified as:

- Financial liabilities measured at amortised cost; and
- Financial liabilities measured at fair value through profit and loss.

Impairment - Financial Assets and Contract Assets

IFRS 9 introduces the concept of *"expected credit losses"* that the Bank identifies and recognises on the basis of all financial assets under the scope of this standard, rather than the *"incurred loss"* model according to the previously valid IAS 39. The new impairment model is applied to financial assets measured at amortized cost or at fair value though other comprehensive income (FVOCI).

Pursuant to IFRS 9, impairment is measured according to:

- Expected 12-month credit losses – expected credit losses incurred in case of default event within 12 months after the reporting date, and
- Lifetime expected losses – expected credit losses resulted due to probable events of default during the total expected lifetime of a financial instrument.

The expected credit loss model that relates to financial assets valued at amortised cost requires the accounting for the expected credit losses and a change in the above mentioned expected credit losses on each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to occur in order to recognise a credit loss - impairment.

In accordance with IFRS 9 requirements, the Bank defined criteria for the classification of financial instruments under impairment levels depending on an increase in credit risk since the initial recognition. The subjects of the mentioned classification are financial instruments measured at amortised cost, as well as financial instruments measured at fair value through other comprehensive income (FVOCI).

Level 3 corresponds to non-performing loans (NPL), whereas Level 1 and Level 2 relate to performing receivables. The criteria defined by the Bank for identifying receivables with a significantly higher credit risk are: past due over 30 days, a forborne status, a change in the client's status to PNPL – internal status, a significant increase in the probability of default and continuous account blockage from 10 to 30 days.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

Impairment - Financial Assets and Contract Assets (Continued)

The Bank calculates 12-month expected credit losses for Level 1 receivables, while lifetime expected credit losses are calculated for Level 2 and Level 3 receivables. In accordance with standard requirements, the Bank has developed an internal methodology and calculated risk parameters (EAD, PD, LGD) in line with IFRS 9 requirements. The discount rate used in the calculation is the effective interest rate of an individual contract.

Since the exposure at default (EAD) represents a key component of credit risk parameters for the calculation of expected credit losses, the Bank has developed a methodology for identifying EAD for all periods until the final maturity of the financial instrument, taking into consideration the profile of the contracted cash flows, as well as additional withdrawals from the approved credit lines before the default occurs. The maximum period that the Bank takes into consideration during the measurement of expected credit losses is the maximum contract period during which the Bank is exposed to credit risk.

The existing PD models are used as a basis for the calculation of lifetime PD parameters. The Bank uses the following approach during the calculation: the Bank applies the following adjustments during the development of PD parameters used for the calculation of allowance for impairment in order to comply with IFRS 9:

- Point-in-time adjustment;
- Taking into consideration future information on macroeconomic conditions ("forward-looking"); and
- Perennial PDs are obtained using the Markov principle by multiplying the appropriate matrices for the required period under each sub-segment in the Bank.

The loss given default (LGD) parameter represents a loss assessment of an individual financial instrument provided that default occurs. The Bank applies the concept of separate secured and unsecured LGD depending on the secured level of an individual placement.

The LGD parameter is calculated based on average historical rates for defined segments. As for receivables that are subject to an individual estimate, different scenarios (probability-weighted) are introduced for estimated future cash flows during the calculation of expected losses.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

Impairment - Financial Assets and Contract Assets (Continued)

For the purpose of calculating the expected credit losses, the Bank has made the following portfolio segmentation:

- Corporate clients – loans;
- Corporate clients – off-balance sheet items;
- Retai clients – loans;
- Retail clients – cards and overdrafts;
- State institutions; and
- Financial institutions.

For the exposures toward countries and financial organisations, the Bank does not have an adequate history of migrations and information on default of exposures to countries and financial institutions and during the calculation of allowance for impairment and default risk exposure arising from financial instruments of countries, state authorities and financial institutions, it relies on researches and data of renowned external rating agencies (Fitch, Moody's, S&P).

Furthermore, for the purpose of calculating allowance for impairment, the Bank uses LGD in accordance with Basel regulations. The Bank will monitor and confirm to which extent the determined and applied LGD factors correspond to the actual realisation of losses in appropriate segments. In order to classify and calculate expected credit losses the Bank uses the application solution "IFRS 9 Impairment Solution", developed by the company Asseco.

First-time Adoption of IFRS 9

Balance sheet items are reclassified to comply with the new Decision of the National Bank of Serbia on the forms and content of items in the financial statements for banks. The reclassified balance sheet as at 1 January 2018 is fully in line with the requirements of the regulatory body.

The opening balance as at 1 January 2018 differs from the outstanding balance as at 31 December 2017 for the effects of the application of IFRS 9 presented in the column "Changes in valuation".

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

First-time Adoption of IFRS 9 (Continued)

/i/ Effects of the First-time Adoption of IFRS 9 on the Balance Sheet as of 1 January 2018

In RSD thousand

Presentation in line with IAS 39	Closing balance as of 31 December 2017 in accordance with IAS 39	Presentation in accordance with IFRS 9	Changes in valuation	Reclassifications	Opening balance as of 1 January 2018 in accordance with IFRS 9
ASSETS					
Cash and balances with central bank	1,603,452		-	-	1,603,452
Financial assets at fair value through profit or loss held for trading	-		-	-	-
		Securities	-	-	-
Financial assets available-for-sale	913,736	Financial assets at fair value through other comprehensive income	-	(913,736)	-
		Securities	-	913,736	913,736
Loans and advances to banks and other financial organizations	1,756,505		(813)	-	1,755,692
Loans and advances to customers	5,873,639		(37,574)	-	5,836,065
Changes in fair value of items subject to hedging	1,309		-	-	1,309
Intangible assets	38,900		-	-	38,900
Property, plant and equipment	29,020		-	-	29,020
Investment property	20,135		-	-	20,135
Deferred tax assets	3,833		-	-	3,833
Non-current assets held for sale and discontinued operations	382,238		-	-	382,238
Other assets	48,593		689	-	49,282
TOTAL ASSETS	**10,671,360**		**(37,698)**	**-**	**10,633,662**

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

First-time Adoption of IFRS 9 (Continued)

/i/ Effects of the First-time Adoption of IFRS 9 on the Balance Sheet as of 1 January 2018 (Continued)

In RSD thousand

Presentation in line with IAS 39	Closing balance as of 31 December 2017 in accordance with IAS 39	Presentation in accordance with IFRS 9	Changes in valuation	Reclassifications	Opening balance as of 1 January 2018 in accordance with IFRS 9
LIABILITIES					
Deposits and other financial liabilities to banks, other financial organizations and central bank	203,206		-	-	203,206
Deposits and other financial liabilities to customers	8,592,080		-	-	8,592,080
Changes in fair value of items subject to hedging	206		-	-	206
Subordinated liabilities	134,215		-	-	134,215
Provisions	17,578		(11,643)	-	5,935
Deferred tax liabilities	1,746		-	-	1,746
Other liabilities	87,335		-	-	87,335
TOTAL LIABILITIES	**9,036,366**		**(11,643)**	**-**	**9,024,723**
EQUITY					
Share capital	3,672,407		-	-	3,672,407
Reserves	9,892		3,029	-	12,921
Accumulated losses	(2,047,305)		(29,084)	-	(2,076,389)
Total equity	**1,634,994**		**(26,055)**	**-**	**1,608,939**
TOTAL LIABILITIES AND EQUITY	**10,671,360**		**(37,698)**	**-**	**10,633,662**

The total effect of the first adoption of IFRS 9 that increased accumlated losses as of 1 January 2018, amounts to RSD 29,084 thousand and results from an increase in the impairment of financial assets for the same amount. The Bank recorded the effect of the first adoption of IFRS 9 as adjustment of the accumulated losses opening balance, with the effect on total equity.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

First-time Adoption of IFRS 9 (Continued)

/i/ Effects of the First-time Adoption of IFRS 9 on the Balance Sheet as of 1 January 2018 (Continued)

The table below shows the classification of financial instruments in accordance with IFRS 9 in comparison with the classification in accordance with previosly valid IAS 39:

In RSD thousand

Financial instrument	*Financial instrument category*		Balance as of 31/12/2017	Balance as of 1/1/2018
	IAS 39	*IFRS 9*	*IAS 39*	*IFRS 9*
Financial assets				
Cash and balances with central bank	Financial assets at amortised cost	Financial assets at amortised cost	1,603,452	1,603,452
Securities	Financial assets at fair value through profit or loss held for trading	Financial assets at fair value through profit or loss	-	-
Securities	Financial assets available for sale	Financial assets at fair value through other comprehensive income	913,736	913,736
Loans and advances to banks and other financial organizations	Loans and advances	Financial assets at amortised cost	1,756,505	1,755,692
Loans and advances to customers	Loans and advances	Financial assets at amortised cost	5,873,639	5,836,065
Investments into subsidiaries	Financial assets at fair value through profit or loss	Financial assets at fair value through profit or loss	-	-
Other assets	Loans and advances	Financial assets at amortised cost	48,593	49,282
Deposits and other financial liabilities to banks, other financial organizations and central bank	Financial liabilities at amortised cost	Financial liabilities at amortised cost	203,206	203,206
Deposits and other financial liabilities to other customers	Financial liabilities at amortised cost	Financial liabilities at amortised cost	8,592,080	8,592,080
Subordinated liabilities	Financial liabilities at amortised cost	Financial liabilities at amortised cost	134,215	134,215
Other liabilities	Financial liabilities at amortised cost	Financial liabilities at amortised cost	87,335	87,335

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **MSFI 9 "Finansijski instrumenti" (Nastavak)**

First-time Adoption of IFRS 9 (Continued)

/ii/ Reclassification of the Bank's income statement items in the comparative period from 1 January to 31 December 2017, in order to comply with the new presentation in accordance with the requirements of IFRS 9 and the Decision of the National Bank of Serbia, is presented in the table below:

In RSD thousand

Presentation in accordance with IAS 39	Presentation in accordance with IFRS 9	2017	Reclassifi-cations	2017
Interest income		398,227	-	398,227
Interest expense		(117,782)	-	(117,782)
Net interest income		**280,445**	**-**	**280,445**
Fee and commission income		78,835	-	78,835
Fee and commission expense		(27,196)	-	(27,196)
Net fee and commission income		**51,639**	**-**	**51,639**
Net gains from financial assets held for trading	Net gains from changes in the fair value of financial instruments	-	-	-
Net loss from financial assets available for sale	Net gains from derecognition of financial instruments measured at fair value	4,524	-	4,524
Net gain from hedging		1,527	-	1,527
Net foreign exchange gains and effects of contracted foreign currency clause		167,587	-	167,587
Other operating income		6,822	(6,770)	52
Net impairment loss on financial assets and provision for credit risk-weighted off-balance sheet items	Net impairment loss on financial assets not measured at fair value through profit or loss	(225,695)	-	(225,695)
TOTAL NET OPERATING INCOME		**286,849**	**(6,770)**	**280,079**
Salaries, compensations and other personal expenses		(166,593)	-	(166,593)
Amortisation and depreciation expense		(24,573)	-	(24,573)
	Other income	-	6,770	6,770
Other expenses		(269,660)	-	(269,660)
Profit/(loss) before tax		**(173,977)**	**-**	**(173,977)**

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

– **IFRS 9 "Financial Instruments" (Continued)**

First-time Adoption of IFRS 9 (Continued)

/iii/ An overview of the impact of the first-time adoption of IFRS 9 on the Bank's performance indicators (with amounts expressed in RSD thousand):

	31 December 2017 IAS 39	1 January 2018 IFRS 9
Basic share capital	3,672,407	3,672,407
Basic capital	1,586,202	1,472,946
Capital	1,636,245	1,607,160
Risk-weighted assets based on exposure to credit risk	6,512,949	6,483,865
Risk-weighted assets based on exposure to market risk	14,494	14,494
Risk-weighted assets based on exposure to operating risk	1,034,235	1,034,235
Total risk-weighted assets	7,561,678	7,532,594
Common Equity Tier 1 capital ratio	19.86%	19.55%
Tier 1 capital ratio	19.86%	19.55%
Capital adequacy ratio	21.64%	21.34%
Exposure to one counterparty or a group of counterparties	18.01%	18.41%
Sum of all great exposures	93.39%	84.72%
Total investment of the Bank	1.69%	1.69%
Net open foreign exchange position	14.391	28.436
Foreign exchange risk indicator	0.31%	1.77%
% NPL	12.68%	9.44%
NPL coverage with total adjustments	77.00%	82.00%
NPL coverage with NPL adjustments	59.37%	58.76%

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(a) New Standards, Amendments and Interpretations to Existing Standards Mandatory for the First Time for the Financial Year Beginning on 1 January 2018 (Continued)

Other Standards

The application of other standards, IFRIC interpretations and amendments to the existing standards mandatory for the first time for the financial year beginning on 1 January 2018, did not result in substantial changes to the Bank's accounting policies and did not have an impact on the Bank's accompanying financial statements:

- IFRS 15 "Revenue from Contracts with Customers" and subsequent amendments.
- Amendment to IAS 40 "Investment Property" regarding the transfers of investment property.
- Conceptual Framework for Financial Reporting (Revised) - effective from March 2018.
- Annual Improvements to IFRSs, "2014-2016 Cycle" - IFRS 1 and IAS 28, published by the IASB in December 2016.
- Amendments to IFRS 2 "Share-based Payment" – Classification and Measurement of Share-based Payment Transactions.
- Amendments to IFRS 4 "Insurance Contracts" regarding the implementation of IFRS 9 "Financial Instruments".
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration".

(b) New Standards, Amendments and Interpretations to Existing Standards that are Not Yet Effective and Have Not Been Early Adopted by the Bank

There are a number of new and amended standards and IFRIC interpretations, which have been issued by the IASB that are not effective for the annual periods beginning on 1 January 2018. They have not been early adopted by the Bank and the Bank intends to adopt them when they become effective.

- IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019).
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019).
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019).
- Amendments to IAS 19 "Employee Benefits" – Plan Amendments, Curtailments or Settlements (effective for annual periods beginning on or after 1 January 2019).
- Annual Improvements to IFRSs, "2015-2017 Cycle" - IFRS 3, IFRS 11, IAS 12 and IAS 23, published by the IASB in December 2017 (effective for annual periods beginning on or after 1 January 2019).
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" – Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019).

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation (Continued)

(b) New Standards, Amendments and Interpretations to Existing Standards that are Not Yet Effective and Have Not Been Early Adopted by the Bank (Continued)

- Amendments to IFRS 3 “Businees Combinations” (effective for annual periods beginning on or after 1 January 2020).
- Amendments to IAS 1 and IAS 8 related to the definition of material (effective for annual periods beginning on or after 1 January 2020).
- Amendments to IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22 and SIC-32 due to compliance with the new Framework in financial reporting (effective for annual periods beginning on or after 1 January 2020).
- IFRS 17 “Insurance Contracts” (effective for annual periods beginning on or after 1 January 2021).

The management envisages that the adoption of these new standards, amendments to existing standards and new interpretations will not have a material impact on the Bank’s financial statements in the period of their first-time adoption, except for the effect of the application of IFRS 16 “Leases” which enters into force on 1 January 2019.

Impact Assessment of IFRS 16 “Leases”

IFRS 16 brings major changes for lessees and will have a significant effect on any entity that has entered into material amounts of what are currently accounted for as operating leases. In contrast, for lessors, the accounting requirements have largely been carried forward unchanged from IAS 17.

IFRS 16 specifies how an entity will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value.

The key novelty for lessees is that in most cases a lease will result in an asset being capitalised (a “right of use” asset) together with the recognition of a liability for the corresponding lease payments. This will result in changes to key financial ratios and has the potential to affect borrowing costs (interest expenses).

As at the beginning of lease, a lessee recognizes a lease liability and an asset representing the right to use that asset during the period of lease (a “right of use” asset). Interest expense on lease liability and depreciation of the right of use asset should be separately recognized, as required.

It is necessary to remeasure the lease liability upon the occurrence of certain events (changes in lease term, future payments due to changes in index or rate applied to calculate those payments). Lessor recognizes the amount of remeasured lease liability as adjustment of value of a right of use asset.

In the case of operating leases terminating in the period of 12 months or less after the date of the first application of IFRS 16, there shall be no change in the accounting treatment, as well as to leases of low value. In such cases, the Bank will recognize the cost of leasing using a straight line basis, as permissible by the standard.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation (Continued)

(b) New Standards, Amendments and Interpretations to Existing Standards that are Not Yet Effective and Have Not Been Early Adopted by the Bank (Continued)

Impact Assessment of IFRS 16 "Leases" (Continued)

On transition, there is a choice of two approaches:

- Fully retrospective application under which IFRS 16 is applied with the cumulative effect being recognized as an adjustment of opening balance of the entity's equity on 1 January 2018 with comparative information being restated; or
- Modified retrospective approach under which IFRS 16 is applied with the cumulative effect being recognized as an adjustment of the opening balance of the entity's equity at the date of initial application i.e. on 1 January 2019 with comparative information not being restated.

The Bank's activities regarding the implementation of IFRS 16 are in progress, in order to apply it in full after its entry into force as of 1 January 2019.

The Bank chose the "modified retrospective approach" according to which the Bank will not restate its comparative data.

Preliminary estimates indicate that in addition to short-term leases and leasing of assets of low value, the Bank will recognize assets (property) with the right of use in the amount of RSD 92,294 thousand, in accordance with the application of IFRS 16 in the balance sheet as of 1 January 2019, and the corresponding lease liability to all these leases.

The assessment of the effects on the income statement in 2019 is a reduction in rental costs by RSD 38,550 thousand, an increase in depreciation costs by RSD 37,247 thousand and an increase in interest expense by RSD 1,845 thousand.

The summary of the estimated financial impact of the first adoption of IFRS 16 is presented in the table below:

In RSD thousand	1/1/2019	In RSD thousand 31/12/2019
Right of use asset	92,294	
Lease liabilities	92,294	
Anticipated impact on the Bank's income statement:		
– Increase in depreciation costs		37,247
– Increase in interest expense		1,845
– Decrease in rental costs		38,550
Anticipated impact on the Bank's cash flow statement:		
– Increase in net cash flows from the Bank's operating activities		36,704
– Decrease in net cash flows from the Bank's financial activities		1,846

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.1. Basis of Preparation (Continued)

(b) New Standards, Amendments and Interpretations to Existing Standards that are Not Yet Effective and Have Not Been Early Adopted by the Bank (Continued)

Impact Assessment of IFRS 16 "Leases" (Continued)

The Bank decided to use the following practical solutions in assessing lease liabilities:

- use of a uniform discount rate on the lease portfolio with similar characteristics; and
- a lease that ends within a period of up to 12 months from the date of first adoption of the standard is characterised as a short-term lease.

Disclosed quantitative information could be subject to further changes in 2019. The above estimate is preliminary, since the activities of standard implementation in the Bank are still in progress. The final effect of IFRS 16 application as of 1 January 2019 may differ from the estimated effect due to the following key facts:

- IFRS 16 requires that the Bank should modify internal processes, internal acts and internal controls, and the changes thereof are still in progress;
- The new software module for lease recognition in line with IFRS 16 requires the expected stabilization period and possible changes/tuning/upgrade; and
- New accounting policies, assumptions and estimates may be subject to changes until the preparation of the first following separate financial statements which include the date of the first adoption.

2.2. Comparative Figures

Comparative figures represent the audited financial statements of the Bank as of and for the year ended 31 December 2017, prepared in accordance with IFRS.

Considering that the Bank has used the opportunity of an exemption permitting not to restate the comparative data for prior years based on changes relating to the classification and valuation of financial assets and financial liabilities, as well as impairment of financial assets, comparative data for 2017 have not been adjusted, but presented using the former accounting policies. Differences in the carrying amounts of financial assets and financial liabilities arising from the application of IFRS 9 in relation to the period prior to the first adoption are recognised in equity as an adjustment to the opening balance of accumulated losses as of 1 January 2018.

As disclosed in Note 2.1(a)/i/, comparative data in the balance sheet – with the balance as of 31 December 2017, have been reclassified to align the presentation with the requirements of IFRS 9 and the Decision on the Content and Layout of Forms of Financial Statements for banks of the National Bank of Serbia ("RS Official Gazette", no. 101/2017, 38/2018 and 103/2018).

Comparative data for the income statement items comprise the data contained in the income statement for the period from 1 January to 31 December 2017, which have been reclassified in order to reconcile them with the presentation of data for the current reporting period (*see* Note 2.1(a)/ii/).

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)

2.3. Going Concern

The accompanying financial statements of the Bank are prepared in accordance with the going concern principle, which assumes that the Bank will continue its operations in the foreseeable future, which includes a period of at least twelve months from the date of the financial statements.

In 2018, the Bank generated a net profit of RSD 30,358 thousand (2017: net loss in the amount of RSD 173,756 thousand).

In 2018, the Bank changed its owner, and accordingly the sole owner of the Bank's shares is the Company “AZRS INVEST” d.o.o. Belgrade, whose ultimate owner intends to strenghten the Bank's capital base in the following periods.

As of 31 December 2018, the regulatory capital of the bank calculated in accordance with the Decision on Capital Adequacy of Banks (“RS Official Gazette”, no. 103/2016) amounts to RSD 1,550,943 thousand, i.e. EUR 13,121,945 according to the official median exchange rate prevailing as of the reporting date and is above the minimum amount of capital of EUR 10 million, prescribed by the Law on Banks (“RS Official Gazette”, no. 107/2005, 91/2010 and 14/2015).

The management of the Bank is preparing an adequate Capital Management Plan in terms of processes for an internal assessment of capital adequacy, which will enable the implementation of further activities regarding a capital increase with the aim of increasing credit activities of the Bank and permanent provision of capital sufficient to cover all risks that the Bank will be exposed to in the ordinary course of business in the coming period.

Considering the foregoing, the management believes that the Bank has adequate resources and support from the owner to continue its operations for the foreseeable future.

2.4. Use of Estimates

The preparation of financial statements in accordance with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank’s accounting policies. These estimates and related assumptions are based on information available as of the date of preparation of the financial statements. Actual results could differ from those estimates.

These estimates and underlying assumptions are reviewed on an ongoing basis, and changes in estimates are recognised in the periods in which they have become known.

The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest Income and Expense

Interest income and expense, including penalty interest and other income and other expenses from interest bearing assets, i.e., liabilities are recognised on an accrual basis based on obligatory terms defined by a contract signed between the Bank and a customer.

From 1 January 2018, interest income and expense are recognised in the income statement using the effective interest method, which represents a rate that accurately discounts the estimated future payments or receipts through the expected life of the financial instrument, to:

- Gross carrying amount of a financial asset (amortised cost net of expected credit losses); or
- the amortized value of a financial liability.

When calculating the effective interest rate for financial instruments that have not been credit impaired at the time of approval, nor have they undergone significant modification of contracted cash flows as purchased or originated credit-impaired (POCI), the Bank estimates future cash flows taking into account all contractual terms of a financial instrument, but excluding expected credit losses. In the case of loans that are POCI, an effective interest rate adjusted for credit risk, using estimated future cash flows that include expected credit losses is calculated.

Interest income is recognized for financial assets that are measured at amortised cost as well as debt instruments at fair value through other comprehensive income.

Loan origination fee, which constitutes a part of the effective interest rate, is recorded in income and interest expense. Loan origination fees, that are calculated and charged on a one-off basis in advance, are deferred and discount using the effective interest method, over the life of the loan.

Interest expense is recognized for financial liabilities that are measured at amortised cost. Interest expense on deposits is deferred and recognized in the income statement in the period to which it relates.

Until 31 December 2017, in accordance with the previously valid accounting policy, for all interest-bearing financial instruments, interest income or interest expenses are recorded in the income statement using the effective interest rate applicable, which is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, over the shorter period, to the net carrying amount of the financial asset or financial liability.

Fees from approved loans are deferred over the period of loans, on the proportional basis, over the repayment period, and recognised in the income statement within interest income.

If a financial asset is impaired on the basis of impairment loss, interest income continues to be calculated using the effective interest rate used to discount future cash flows for the purpose of measuring and calculating the impairment loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.2. Fee and Commission Income and Expense

The Bank earns/pays fee and commission from rendering and using the banking services. Fees and commissions are generally recognised on an accrual basis when the service has been provided, i.e. rendered.

Fees and commissions mostly comprise fees for payment operations services, issued guarantees and other banking services.

Fees and commission expenses are mainly related to fees based on transactions and services performed and are recorded at the time of receiving the service.

Fee income can be divided into the following two categories:

/i/ Fee Earned from Services that are Provided over a Certain Period of Time

Fees earned for the provision of services over time are accrued over that period.

/ii/ Fee from Providing Transaction Services

Fees or components of fees that are linked to provision of certain services are recognised after fulfilling the corresponding criteria.

Income and expenses from fees and commissions that are an integral part of the effective interest rates of financial assets or liabilities are included in determining the effective interest rate and are recognised in the income statement as interest income.

Income from fees and commissions for banking services are recognised on an accrual basis and recognised in the period when they are realised or when the service is provided. Fees and commissions mostly comprise fees for payment services, buying and selling of foreign currency, the fee for the account maintenance and other banking services.

The fees for the issuance of guarantees and other warranties are deferred over the period of guarantees or warranties using the proportional accounting method and recognised in the income statement as income from fees.

3.3. Foreign Currency Translation

The items included in the Bank’s financial statements are valued by using currency of the Bank’s primary economic environment (functional currency).

The accompanying financial statements are stated in thousands of Dinars (RSD), which represents the functional and official reporting currency in the Republic of Serbia.

Transactions denominated in foreign currency are translated into Dinars at the official median exchange rate determined in the Interbank Foreign Currency Market, prevailing at the transaction date.

Monetary assets and liabilities denominated in foreign currency at the balance sheet date are translated into Dinars at the official median exchange rates published by the National Bank of Serbia, prevailing at the reporting date (Note 40).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Foreign Currency Translation (Continued)

Foreign exchange gains or losses arising upon the translation of balance sheet items denominated in foreign currencies and transactions in foreign currencies are credited or charged as appropriate, to the income statement, as foreign exchange gains or losses (Note 8).

Gains and losses arising on translation of financial assets and liabilities indexed with the contracted foreign currency clause are recorded in the income statement within foreign exchange gains/losses and effects of contracted foreign currency clause (Note 8).

Commitments and contingencies denominated in foreign currency are translated into Dinars at the official median exchange rate determined on the Interbank Foreign Currency Market, prevailing at the balance sheet date.

3.4. Financial Instruments

3.4.1. Initial Recognition

All financial instruments are initially recognised at fair value including any directly attributable incremental costs of acquisition or issue, except for financial assets and financial liabilities at fair value through profit and loss.

Financial assets and financial liabilities are recognised in the Bank's balance sheet on the date upon which the Bank becomes counterparty to the contractual provisions of a specific financial instrument.

Regular purchase or sale of financial assets is recognised by applying calculation on the date of settlement, i.e., the date when the asset is delivered to the counterparty.

3.4.2. Derecognition of Financial Assets and Financial Liabilities

Financial assets cease to be recognised when the Bank loses control of the contractual rights governing such instruments, which occurs when the rights and risks of use of such instruments have been transferred, or did not transfer or retained all risks and rights in relation to the assets, but has transferred the control over it.

Apart from the aforementioned criteria, implementation of IFRS 9 from 1 January 2018 specifies additional criteria that lead to derecognition of financial assets. Financial asset is derecognised when it is written-off. Also, derecognition of a financial asset will occur if subsequent changes of contractual terms of financial assets arisen, leading to significant modification of financial asset's cash flows.

A financial liability is derecognized when the obligation under the liability is fulfilled, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, while the difference in the respective carrying amounts is recognized in profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.2. Derecognition of Financial Assets and Financial Liabilities (Continued)

In addition to the above mentioned criteria, implementation of IFRS 9 from 1 January 2018 specifies additional criteria for derecognition of financial liability when the contractual terms are modified, while cash flows of modified liability are significantly changed. In that case, new financial liability is based on the modified terms and is recognised at fair value. Difference between carrying amount of financial liability and new financial liability with modified terms is recognised in profit or loss.

3.4.3. Classification of Financial Instruments

From 1 January 2018, in accordance with IFRS 9, the classification of financial assets into individual categories sets out the rules for their initial recognition and subsequent measurement of the value of those assets, as well as the accounting treatment of the effects of the change in value upon subsequent measurement and impairment of the value of financial assets, based on two criteria that have the same importance in determining the category for classification:

- business model of the Bank for managing financial assets; and
- contracted characteristics of cash flows for the specific financial assets.

The classification of financial assets is based on the Bank's business model for managing these assets. The business model for managing financial assets reflects the way in which the Bank manages funds to generate cash flows.

In accordance with IFRS 9, financial assets are classified into one of the following categories:

- financial assets that are subsequently measured at amortised cost - the business model is the collection of cash flows and cash flows represent only the payment of principal and interest on the outstanding principal amount;
- financial assets subsequently measured through other comprehensive result (FVTOCI) - the business model is the collection of cash flows, and sales and cash flows represent only the payment of principal and interest on the outstanding principal amount;
- financial assets subsequently measured at fair value through profit or loss (FVTPL) - all other financial instruments.

At initial recognition, IFRS 9 permits to indicate that a particular financial asset is measured at fair value through profit or loss, if it eliminates or significantly reduces the accounting non-compliance.

In accordance with IFRS 9, the following business models are defined:

1. a business model aimed at holding funds for the collection of contracted cash flows;
2. a business model aimed at collecting contracted cash flows as well as selling financial assets; and
3. a business model that refers to the financial assets acquired for the purpose of generating an inflow through their sale (financial assets traded).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.3. Classification of Financial Instruments (Continued)

A business model whose purpose is to hold funds for the collection of contracted cash flows mainly relates to debit/credit funds, since cash flows are realized by collecting contractual principal and interest payments over the life of a financial instrument. This business model also implies the possible sale of financial assets when there is an increase in the credit risk of the asset or for other reasons determined by proven information.

A business model aimed at collecting contracted cash flows as well as selling financial assets implies that the management has made the decision that the collection of contracted cash flows and the sale of financial assets constitute an integral part of achieving the goal within the business model. The goal of this business model can be management in the way of providing funds for the needs of current liquidity or maintaining the expected interest yield.

A business model that relates to the financial assets that are acquired to generate inflows through sale essentially relates to financial assets traded.

Cash Flow Characteristics

The Bank classifies its financial assets based on the characteristics of its contracted cash flows. The characteristics of cash flows that the financial assets will generate are determined by the type of contract and the contractual provisions based on which these assets are acquired. These characteristics differ in certain credit, debt and equity instruments.

If financial assets are held within the first two business models, it is first necessary to determine whether the contractual terms of the financial asset on specified dates generate cash flows that exclusively constitute payments of principal and interest calculated on the remaining portion of the principal.

Principal is the fair value of the financial asset at initial recognition. Depending on the agreed arrangement, the amount of the principal may change over the life of the financial asset when the principal is repaid.

Interest consists of compensation for the time value of money, for credit risk attributable to the remaining principal amount over a specified period of time and for other basic risks and costs of the loan (loan), as well as for the profit margin.

The time value of money is an element of interest that provides compensation only for the flow of time, i.e., the element of time value of money does not provide compensation for other risks or costs associated with holding a financial asset.

Until 31 December 2017, in accordance with the then valid IAS 39, the Bank classified its financial assets into the following categories:

- loans and receivables;
- financial assets available for sale;
- financial assets held to maturity; and
- financial assets at fair value through profit or loss (including the categories of assets held for trading or designated as FTVPL).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.4. Measurement of Financial Instruments

Initial Recognition of Financial Instruments

All financial instruments are initially measured at fair value increased/decreased by transaction costs, except for financial assets or financial liabilities at fair value through profit or loss. For financial assets that are measured at fair value through other comprehensive income, fair values include transaction costs.

Subsequent Measurement of Financial Instruments

Subsequent measurement of financial instruments is directly influenced by the fulfilment of the following criteria: the business model used in the management of financial assets and the characteristics of contracted cash flows.

Financial assets are classified into three categories:

1. financial assets that are subsequently measured at amortized cost;
2. financial assets that are subsequently measured at fair value through profit or loss (FVTPL); and
3. financial assets that are subsequently measured through other comprehensive income (FVOCI).

Financial Assets that are Subsequently Measured at Amortised Cost

Financial assets are subsequently measured at amortized cost when both of the following conditions are met:

(a) Asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest, calculated on the remaining portion of the principal.

This category includes financial assets with fixed or determinable amounts of payment and with fixed maturity for which there is the Bank's intention and ability to hold to maturity, such as: loans and receivables, bonds or notes, time deposits and other financial assets not intended for sale, although sales that are not frequent and in non-significant amounts are not in contrast to the business model.

The depreciated value of a financial asset or financial liability is defined as the amount at which the financial asset or financial liability is measured at initial recognition, net of principal payments, plus the addition or subtraction of cumulated depreciation using the effective interest method for all differences between the initial amount and the amount on the maturity date, with an adjustment for losses provisions (impairment losses).

To determine whether a financial asset meets the conditions for measurement at the amortized cost, the SPPI test is used to assess the contractual characteristics contained in a financial instrument in the sense that the contractual cash flows must be exclusively for principal and interest payments. This test is performed for each instrument separately. Equity instruments or capital instruments cannot be classified in this category because they do not contain elements of principal and interest.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.4. Measurement of Financial Instruments (Continued)

Subsequent Measurement of Financial Instruments (Continued)

Financial Assets that are Subsequently Measured at Amortised Cost (Continued)

The test is used to determine contractual characteristics that deviate from the criteria for paying only principal and interest. The SPPI test includes an assessment of whether a financial asset contains a contractual provision that can alter the amount or dynamics of contractual cash flows in a manner that does not comply with the above mentioned condition. When contractual terms introduce risk or variation in a way that does not comply with the underlying lending arrangement, that financial asset is measured at fair value through profit and loss account (FVTPL).

An effective interest rate is the rate that accurately discounts the estimated future cash payments or receipts over the expected term of the financial asset or financial liability to the gross carrying amount of the financial asset or the depreciable amount of the financial liability.

Fees that are an integral part of the effective interest rate of a financial instrument are treated as adjustments to the effective interest rate, except when the financial instrument is measured at fair value, whereby the change in fair value is recognized in the income statement. In such cases, fees are recognized as income or expense in the initial recognition of the instrument.

Expected losses for assets classified at amortised cost are recognized as allowance for impairment/impairment of these assets. The impairment of assets classified according to the amortized value is described in detail in Note 2.1(a).

Until 31 December 2017, in accordance with previouly valid IAS 39, the Bank considered objective evidence of the impairment of the balance of receivables and/or the assumed contingent liability for off-balance sheet items, on the basis of the information obtained and the financial operations report, as well as on the basis of qualitative criteria, both at the individual asset level and at the collective level. Impairment losses were recognized only if there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and when they had a negative impact on the estimated future cash flows of the financial asset or group of financial assets.

The amount of the allowance for balance sheet receivables was determined as the difference between the carrying amount of the receivable and the carrying value of the expected future cash flows. In order to determine the present value of the expected future cash flows, the Bank used as the discount factor the effective interest rate from the agreement on the approval of the engagement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.4. Measurement of Financial Instruments (Continued)

Subsequent Measurement of Financial Instruments (Continued)

Financial Assets that are Subsequently Measured through Other Comprehensive Income (FVOCI)

A financial asset is measured at fair value through other comprehensive income when both of the following requirements are met:

(a) The assets is held within the business model whose objective is achieved by both collecting contractual cash flows and selling contractual assets, and

(b) The contractual terms of the financial asset give rise on specified fates to cash flows that are solely payments of principal and interest on the outstanding principal.

Equity and debt instruments can be classified under certain conditions in this category of financial assets. By applying this model, the management decides for each specific financial instrument to ensure that the holding of debt assets generates an inflow by collecting contracted cash flows (principal and interest), and for equity or capital instruments - a dividend inflow, i.e. when an inflow from selling assets is realised.

Expected losses that are determined for the financial assets based on the amortised value are included in the other comprehensive income. At each reporting date, provision for impairment losses for a financial instrument is carried out for the amount of expected loan losses over the life of the instrument, or during the expected twelve-month credit losses.

For financial assets classified in the category of measurement through other comprehensive income, the equity accounts reflect the effects of changes in their fair value, and for credit assets on these accounts, provisions for expected losses on credit risk are disclosed, other than gains and losses due to impairment values and exchange rate differences, until the end of recognition or reclassification of a financial asset.

In the event that a financial asset is derecognised, the accumulated gain or loss previously recognized in other comprehensive income is transferred from equity to the income statement as reclassification due to adjustments. Interest calculated using the effective interest method is recognised in the income statement.

Financial Assets Measured at Fair Value Through Profit or Loss (FVTPL)

These financial instruments are classified as all other instruments or the business model is collection of cash flows through trading instruments.

A financial asset should be measured at fair value through profit or loss unless it is measured at amortised cost or at fair value through other comprehensive income. However, the Bank may make an irrevocable choice when initially recognising certain investments in equity instruments that would otherwise be measured at fair value through profit or loss, subsequently showing changes in fair value in other comprehensive income.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.4. Measurement of Financial Instruments (Continued)

Subsequent Measurement of Financial Instruments (Continued)

Financial Assets Measured at Fair Value Through Profit or Loss (FVTPL) (Continued)

A financial asset classified as at fair value through profit and loss is initially measured at fair value - the transaction price, while transaction costs are not included in fair value, but are treated as expense of the period.

Subsequent measurement of these assets is made at each reporting date by comparing the fair value of a financial asset with its carrying amount, while differences in fair value change are recorded as gains or losses through the income statement.

Equity Instruments

All equity instruments in accordance with IFRS 9 should be measured at fair value through profit or loss, except for those investments in equity for which it is selected to be displayed through the statement of other comprehensive income.

For equity instruments held for trading, it is compulsory to be measured at fair value, whereby any difference between the carrying amount (being the last established fair value) and the fair value at the reporting date is the profit or loss that is included in the income statement.

Financial assets that are an equity instrument that the management intends to hold for a longer period may irrevocably be recognised at initial recognition as financial assets at fair value through other comprehensive income (FVTOCI). In the subsequent measurement of the fair value change, it does not affect the result. The amounts recognized through equity are never reclassified through the income statement, but they can be transferred within equity.

IFRS 9 requires that all investments in equity instruments and contracts for such investments are measured at fair value. However, paragraph B5.2.3 states that in limited circumstances, cost may be an appropriate estimate of fair value. This can be the case if insufficient information from a close past is available for fair value measurement, or if there is a wide range of possible fair value measurements that makes the purchase price the best estimate of fair value in that range.

Cost can never be used to determine the fair value of investments in quoted equity instruments or quoted equity instruments contracts.

Derivatives and Hybrid Financial Assets

Derivatives are measured at fair value, and gains/losses on the change in fair value are recorded in the income statement. Hybrid financial assets are always assessed and presented as a whole. Hybrid financial assets are measured at amortised cost if the cash flows generated by the asset represent repayments of principal and interest payments, i.e. at fair value if this is not the case.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.4. Measurement of Financial Instruments (Continued)

Subsequent Measurement of Financial Liabilities

Financial liabilities are classified as:

- financial liabilities measured at amortised cost; and
- financial liabilities measured at fair value through profit or loss (FVTPL).

Liabilities that are irrevocably classified as at fair value through profit or loss at initial recognition are related to the credit risk of a liability in respect of the accounting treatment of the effects of changes in that credit risk.

The amount of a change in the fair value of a financial liability that may be attributable to changes in the credit risk of that liability may be reported in other comprehensive income, and the remaining amount should be presented in the income statement unless this would result in an accounting inconsistency in the income statement.

The Bank has classified its liabilities into the category of financial liabilities that are measured at amortised cost.

3.4.5. Reclassification of Financial Assets

Reclassification is required only if the business model goal changes so that its previous assessment can no longer be applied to financial assets measured as FVTPL, FVTOCI and at amortised cost. Reclassification is made only for debt instruments while it is not envisaged for equity instruments, as well as reclassification of financial liabilities.

Reclassification is not allowed for equity instruments measured as FVTOCI, or in any circumstances in which the fair value option is applied to financial assets or financial liabilities.

Reclassification should be applied prospectively from the date of reclassification which is defined as the first day of the first reporting period after the change in the business model.

If the financial assets are reclassified from the model in which they are measured at amortized cost to the category at which they will be measured at fair value through profit or loss, then their fair value must be determined on the date of reclassification. Any gain or loss arising from the difference between the amortised and fair value is recognized in the income statement.

If a financial asset is reclassified from a business model in which it is valued at fair value in a business model in which it will be valued at amortised cost, then its last fair value is considered its current value.

Any reclassification carried out should be published with reference to: the date of reclassification and the value of the reclassified assets in each of the categories, the reasons for the reclassification and the quantification of the impact of the reclassification on the reported financial and yield position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.6. Interest Income Arising from Financial Instruments

Interest income in accordance with IFRS 9 is recognized differently according to the status of a financial asset in relation to the expected credit losses.

In the case of financial assets not purchased or initially recognized impaired, and for which there is no clear evidence of impairment on the reporting date, interest income is recognized using the effective interest rate method to the gross carrying amount of a financial asset.

In the case of financial assets not purchased or impaired at initial recognition, and for which there have been significant decrease in their credit quality, interest income is recognised using the effective interest rate method to the gross carrying amount of a financial asset.

In the case of the impaired financial assets, including purchased or impaired at initial recognition, and which contained objective evidence of impairment at initial recognition, interest income is recognized using the effective interest rate method on amortised cost (net base of the financial asset).

3.4.7. Write-off

The Bank shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event.

3.4.8. Modification of Contractual Cash Flows

When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, an entity shall recalculate the gross carrying amount of the financial asset and recognise a modification gain or loss in profit or loss.

The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset’s original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Until 31 December 2017, in accordance with the previously valid IAS 39, if there was a subseqent change in the contractual terms of a financial asset, the Bank assessed whether the cash flows of the modified asset are significantly different. If so, the contractual rights to cash flows of the original financial asset were considered expired. In this case, the accounting recognition of the original financial asset ceased and the new financial asset was recognised at fair value.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Financial Instruments (Continued)

3.4.9. Gains or Losses on Financial Instruments

A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in profit or loss unless, it is part of a hedging, it is an investment in an equity instrument and related gains and losses are presented within other comprehensive income, when it is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's credit risk in other comprehensive income or it is a financial asset measured at fair value through other comprehensive income and the entity is required to recognise certain changes in fair value in other comprehensive income.

Gain or loss on a financial asset that is measured at fair value through other comprehensive income is recognized in comprehensive income, except for gains or losses due to impairment and foreign exchange gains and losses, until the derecognition or reclassification of a financial asset. Upon the cessation of recognition of a financial asset, the accumulated profit or loss previously recognized in other comprehensive income is reclassified from equity to the income statement as reclassification due to adjustments.

If a financial asset is reclassified from the fair value measurement through other comprehensive income category, the accumulated profit or loss previously recognised in other comprehensive income should be recorded. Interest calculated using the effective interest method is recognised in the income statement. If a financial asset is measured at fair value through other comprehensive income, the amounts recognized in the income statement are the same as the amounts that would be recognized in the income statement had the financial asset been measured at amortised cost.

If a financial instrument is designated at fair value through profit or loss after its initial recognition, or if it had not previously been recognized, the difference between the carrying amount and the fair value, if any, should be recognised immediately in the income statement.

For financial assets that are measured at fair value through other comprehensive income, accumulated gains or losses previously recognised in other comprehensive income should be immediately reclassified from equity to income statement as a reclassification due to adjustments.

3.5. Reserves for Estimated Losses on Bank Balance Sheet Assets and Off-balance Sheet Items

Reserves for estimated losses on balance sheet assets and off-balance sheet items are calculated in accordance with the National Bank of Serbia's Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items ("RS Official Gazette", no. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017 and 114/2017).

Total receivables (balance sheet and off-balance sheet exposure) from a single borrower are classified in categories A, B, V, G and D in accordance with the timely settlement criterion, i.e., default in settling the obligations towards the Bank, based on the assessment of the borrower's financial position and creditworthiness and quality of the collateral. All receivables from the same borrower are classified into one category, determined based on the receivable which has been classified least favourably, except for the receivables secured by the first class or adequate collateral.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Reserves for Estimated Losses on Bank Balance Sheet Assets and Off-balance Sheet Items (Continued)

In accordance with the classification of receivables and pursuant to the aforementioned decision of the National Bank of Serbia, the amount of the reserves for potential losses is calculated by applying the following percentages: A - 0%, B - 2%, V - 15%, G - 30% and D - 100%.

Base for the calculation of the reserves for estimated losses is equal to the gross carrying value of receivables reduced by: the amount of unfunded commitments of credit lines and other placements subject to unconditional cancellation by the Bank without prior notice or that effectively provide for automatic cancellation due to deterioration in the borrower’s financial position, and/or creditworthiness; 80% of the amount of unfunded commitments of credit lines with effective maturity of up to one year; 50% of the amount of unfunded commitments of credit lines and other placements with effective maturity of over one year and 50% of the value of bid bonds and tender guarantees, performance bonds, customs guarantees and guarantees for settlement of liabilities, as well as performance guarantees.

Through its internal enactments, the Bank has defined the criteria and methodology for determining the reserves for estimated losses in accordance with the aforesaid decision of the National Bank of Serbia, based on an assessment of the borrower’s financial position and creditworthiness, borrower’s defaults in the settlement of liabilities and adequacy of collaterals.

The required reserve for the estimated losses is the sum total of positive differences between the reserve for estimated losses calculated in accordance with the above mentioned decision and the determined amount of the allowance for impairment of balance sheet assets and provision for potential losses on off-balance sheet items at borrower level, which are, in line with the Bank’s accounting policy disclosed in Note 2.1.(a) charged to the income statement (Note 10).

The required reserve for the estimated losses on balance sheet assets and off-balance sheet items represents a deductible item from the Bank’s capital in accordance with the Decision on Capital Adequacy of Banks. The Bank is obliged to constantly maintain capital at a level that is required to cover all risks to which the Bank is exposed and to maintain the capital adequacy ratio at a level that is above 8%.

Subsequent to the amendments to the Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items (“RS Official Gazette”, no. 69/2016 and 114/2017), Article 21b paragraph 3 and Article 34a relating to the calculation of the reserve required for the purposes of calculating the regulatory capital, in the last quarter of 2017 and as of 31 December 2018, the Bank applied the above mentioned amendments to the Decision and disclosed the estimated amount of the required reserve as a deductible from capital (Note 37(a)).

3.6. Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and sight deposits (gyro account and foreign currency accounts) with banks in the country and abroad and cash equivalents consisting of highly liquid short-term investments that can be cashed immediately with insignificant risk of reduced value, deposits with the National Bank of Serbia and short-term securities for refinancing with the National Bank of Serbia.

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash on hand, gyro account with the National Bank of Serbia and current accounts with other banks and instruments in the collection procedure.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Repurchase Agreements

Securities bought under agreements to repurchase at a specified future date ('repos') are recognised in the balance sheet. The corresponding cash given, including accrued interest is recognised in the balance sheet. The difference between the sale and repurchase prices is treated as interest income and is accrued over the life of the agreement.

3.8. Intangible Assets

Intangible assets comprise software, licenses and other intangible assets.
Intangible assets are initially recognised at cost.

After the initial recognition, intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses, if any.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite useful lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least once a year, at the financial year-end.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

The amortisation of intangible assets with finite useful lives is recognised in the income statement (Note 12).

Amortisation of intangible assets is calculated using the straight-line method to write down the cost of intangible assets over their estimated useful lives, as follows:

- Software licenses	3 to 5 years
- Other intangible assets	3 to 5 years

Costs associated with developing and maintaining computer software programs are recognised as an expense as incurred.

3.9. Property, Plant and Equipment and Investment Property

/i/ Property, Plant and Equipment

Property, plant and equipment of the Bank at 31 December 2018 comprise equipment and leasehold improvements.

Items of property, plant and equipment which fulfil the requirements to be recognised as assets are initially recognised at cost, which includes all directly attributable costs of bringing the assets to the location and condition necessary to function.

After the initial recognition, property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, if any.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Property, Plant and Equipment and Investment Property (Continued)

/i/ Property, Plant and Equipment (Continued)

All other repairs and maintenance are charged to income statement of the financial period in which they are incurred.

Depreciation is provided for on a straight-line basis to the cost of fixed assets, using the following prescribed annual rates, in order to write them off over their useful lives:

- Computer equipment	up to 4 years
- Other equipment	7 to 14 years

The useful lives of the assets are reviewed and adjusted if necessary at each balance sheet date. Changes in the expected useful lives of assets are accounted for as changes in the accounting estimates.

Calculation of depreciation of equipment commences at the beginning of month following the month when an asset is put into use. Assets under construction are not depreciated. Depreciation charge is recognised as an expense for the period when incurred (Note 12).

The calculation of the depreciation of property, plant and equipment and amortisation of intangible assets for tax purposes is determined by the Corporate Income Tax Law of the Republic of Serbia (“RS Official Gazette”, no. 25/2001, 80/2002, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014, 142/2014, 91/2015, 112/2015, 113/2017 and 95/2018) and the Rules on the Manner of Fixed Assets Classification in Groups and Depreciation for Tax Purposes (“RS Official Gazette”, no. 116/2004 and 99/2010). Different depreciation methods used for the financial reporting purposes and the tax purposes give raise to deferred taxes (Note 15(c)).

Gains or losses arising on the disposal or sale of equipment are credited/debited to the income statement, as part of other operating income or other expenses, in the amount of the difference between the cash inflow and the carrying amount of the asset.

/ii/ Investment Property

Investment property is a property held by the Bank for the purpose of generating profit from its lease or increasing the capital value or both, but not for administrative operations or to be sold in the ordinary course of business.

After the initial recognition at cost, subsequent measurement of the investment property is performed at cost less accumulated depreciation.

3.10. Impairment of Non-financial Assets

In accordance with the adopted accounting policy, at each balance sheet date, the Bank’s management reviews the carrying amounts of the Bank’s intangible assets and property, plant and equipment. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

If the recoverable amount of an asset is estimated to be lower than its carrying value, the carrying amount of the asset is reduced to its recoverable amount, being the higher of an asset’s fair value less costs to sell and value in use.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.10. Impairment of Non-financial Assets (Continued)

Impairment losses, representing a difference between the carrying amount and the recoverable amount of property, plant and equipment and intangible assets, are recognised in the income statement as required by IAS 36 "Impairment of Assets".

Non-financial assets (other than goodwill) that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

3.11. Repossessed Property

Property which is repossessed following the foreclosure on loans that are impaired is reported within other assets. Assets acquired through the collection of receivables are temporarily held for liquidation and are stated at the lower of carrying amount and fair value less costs to sell.

3.12. Non-current Assets Held for Sale

Non-current assets (or disposal groups) are recognised as held for sale if the Bank expects to recover their carrying value principally through a sale transaction rather than through continuing use, and when the general recognition criteria for recognition in accordance with the requirements of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" are met.

A non-current asset is classified as held for sale if the following criteria are met:

- An asset (or disposal group) is available for immediate sale in its current condition;
- There is an adopted plan of sale of fixed assets and the activities on the achievement of the sales plan have been initiated;
- There is an active market for such asset and the asset is already active in this market; and
- The probability of sale if very high, or there is an expectation that a sales transaction will be realised within a period of one year from the date of classification of the asset as held for sale.

Non-current asset held for sale is initially measured at the lower of the carrying value or market (fair) value less costs to sell. From the moment of classification of an asset as held for sale, the calculation of depreciation of these assets shall cease.

If there is a change in the plan of sales, the non-current asset ceases to be classified as held for sale and, in that case, the non-current asset is valued at the lower of the following two values:

- Carrying value of the asset, prior to being classified as held for sale, adjusted for the calculated depreciation and impairment which would have been recognised if the non-current asset had not been classified as held for sale; and
- Recoverable values as of the date of the subsequent decision not to sell the asset.

Gains and losses from disposal of non-current assets held for sale are recognised by deducting the carrying value of an asset and related costs of sales from the disposal proceeds (sales price).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.13. Leases

The determination of whether an arrangement is a lease, or contains lease elements, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or group of assets and whether the arrangement conveys a right to use the assets. There are two main types of lease:

(a) Finance Lease – Bank as a Lessee

Finance leases, which transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in property, plant and equipment with the corresponding liability to the lessor included in other liabilities.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the assets and the lease term, if there is no reasonable certainty that the Bank will obtain ownership by the end of the lease term. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in interest expense.

As of 31 December 2018, the Bank had no assets under the finance lease.

(b) Operating Lease – Bank as a Lessee

A lease is classified as an operating lease if it does not transfer to the Bank substantially all the risks and rewards incidental to ownership. The total payments made under operating leases are charged to other expenses in the income statement (at the inception) on a straight-line basis over the period of the lease (Note 14).

3.14. Provisions and Contingencies

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation (Note 28).

In order to be maintained, the best possible estimates of provisions are considered, determined and, if necessary, adjusted at each balance sheet date. Provision is measured at present value of outflow necessary to settle the liabilities, using the discount rate which reflects the current market estimate of the time value of money.

When the outflow of the economic benefits is no longer probable in order to settle legal or constructive liabilities, provisions are derecognised in income. Provisions are taken into account in accordance with their type and they can be used only for the expenses they were recognised initially for. Provisions are not recognised for future operating losses.

Contingent liabilities are not recognised in the accompanying financial statements. They are disclosed in the notes to the financial statements, unless the possibility of an outflow of resources embodying economic benefits is remote (Note 38(b) and (c)).

Contingent assets are not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.15. Subordinated Liabilities

Borrowings on which interest is payable and subordinated liabilities are classified as other financial liabilities and are initially recognised at fair value less attributable costs. They are subsequently measured at amortised cost over the life of the obligation using the effective interest method.

3.16. Equity

Equity consists of share capital (ordinary share), reserves (arising from financial assets measured at fair value through other comprehensive income), accumulated losses and current year profit (Note 30).

3.17. Employee Benefits

(a) Employee Taxes and Contributions for Social Security

In accordance with the regulations prevailing in the Republic of Serbia, the Bank has an obligation to pay tax and contributions to various state social security funds. These obligations involve the payment of contributions on behalf of the employee, by the employer in an amount calculated by applying the specific, legally-prescribed rates.

The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on their behalf to transfer the withheld portions directly to the appropriate government funds. The Bank has no legal obligation to pay further benefits due to its employees by the Pension Fund of the Republic of Serbia upon their retirement.

These taxes and contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

(b) Liabilities arising from Other Benefits – Retirement Benefits

In accordance with the Labour Law, the Bank is obligated to pay retirement benefits in an amount equal to two gross monthly salaries in Republic of Serbia, based on the average salary in the Republic of Serbia, according to the latest published information of the state authority responsible for statistics. Expenses and liabilities for these plans are not provided by the funds.

Provisions for the benefits and related expenses are recognised in the amount of present value of expected future cash flows using the projected unit credit actuarial valuation method (Note 28). Past service costs are recognised in the income statement when incurred, while actuarial gains and losses are recognised in the statement of other comprehensive income (unless materially insignificant, when recognised in the income statement).

Long-term provisions for retirement benefits upon retirement after fulfilling the prescribed conditions in accordance with the Labour Law, stated as of 31 December 2018, are determined using the following assumptions:

- Discount rate	3.5%
- Annual salary growth rate	3.0%
- Employee fluctuation rate	3.0%
- Disability rate	0.1%
- Mortality tables (SORS) for the years	2010 – 2012

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.17. Employee Benefits (Continued)

(c) Short-Term Compensated Absences

Accumulating compensated absences may be carried forward and used in future periods if the current period's entitlement has not been fully used. The expected cost of accumulated compensated absences is recognised in the amount that is expected to be paid as a result of the unused entitlement that has accumulated as of the balance sheet date. In the instance of non-accumulating compensated absences, no liability or expense is recognised until the time of the absence.

The Bank does not have its own pension funds or share-based remuneration options, and therefore there are no identified liabilities with respect to these benefits as of 31 December 2018.

3.18. Financial Guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of payment guarantees and performance bonds, letters of credit, acceptances and other warranties. Financial guarantees are contracts which obligate the issuer of a guarantee to perform the payment or compensate the loss to the holder of a guarantee, incurred if a certain creditor fails to settle its liabilities in due time as required under the terms of the contract.

Financial guarantees are initially recognised in the financial statements at fair value as of the date the guarantee is given. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligations arising as a result of the guarantee.

Any increase in the liability relating to the financial guarantees is recognised in the income statement. The premium received is recognised in the income statement within net fees and commissions income on a straight-line basis over the life of the guarantee.

3.19. Funds Managed on Behalf of Third Parties

The funds that the Bank manages on behalf of and for the account of third parties for a fee are disclosed within off-balance sheet items. The Bank bears no risk in respect of repayment of these placements.

3.20. Taxes and Contributions

(a) Income Taxes

Current Income Tax

Current income tax is calculated and paid in accordance with the effective Corporate Income Tax Law of the Republic of Serbia ("RS Official Gazette", no. 25/2001, 80/2002, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014, 142/2014, 91/2015, 112/2015, 113/2017 and 95/2018) and relevant by-laws.

Income tax is calculated at the rate of 15% (2017: 15%) on the tax base reported in the annual corporate income tax return, and can be reduced by any applicable tax credits.

The tax return is submitted to the Tax Authority 180 days after the date of expiry of the tax liability. During the year, the Bank pays income taxes in monthly instalments, estimated on the basis of the tax return for the prior year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.20. Taxes and Contributions

(a) Income Taxes (Continued)

Current Income Tax (Continued)

Pursuant to the Law on Amendments and Supplements to the Corporate Income Tax Law ("RS Official Gazette", no. 108/2013), starting from determining the income tax for 2014, the tax payers are no longer able to use the tax incentive in the form of a tax credit for investment in fixed assets. A taxpayer who had qualified for the right to a tax incentive - tax credit by 31 December 2013 and presented details in the tax return for 2013 is entitled to use that right until the expiry of the deadline prescribed by the Law (not more than ten years).

The tax regulations in the Republic of Serbia do not provide for the possibility that any tax losses of the current period are used to recover taxes paid within a specific previous period. Losses recognised in the tax return in the current accounting period may be transferred to the account of profit determined in the annual tax return from the future accounting periods, but not longer than five ensuing years.

Deferred Income Tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax liabilities are recognised on all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forwards of unused tax credits and unused tax losses can be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on the official tax rates and regulations that have been enacted or substantively enacted as of the balance sheet date. The tax rate of 15% is used for calculation of deferred income tax: 15%).

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Current and deferred taxes are recognised as income or expense and are included in net profit/(loss) for the period. Deferred income taxes related to items that are recorded directly in equity are also recognised in equity.

(b) Taxes, Contributions and Other Duties Not Related to Operating Result

Taxes, contributions and other duties that are not related to the Bank's operating result include employer contributions on salaries, and various other taxes and contributions paid pursuant to republic and municipal regulations. These taxes and contributions are included within other expenses (Note 14).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.21. Related Party Disclosures

For the purpose of these financial statements related legal entities are those entities when one legal entity has a possibility to control another entity or has the right to govern the financial and business operations of the entity, as defined by IAS 24 “Related Party Disclosures”.

Relations between the Bank and its related parties are regulated at contractual basis. Outstanding balances of receivables and liabilities at the reporting date, as well as transactions occurred during the reporting periods with related parties are disclosed separately in notes to the financial statements (Note 32).

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the financial statements requires the Bank’s management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as income and expenses for the reporting period.

These estimations and related assumptions are based on information available as of the date of preparation of the financial statements. Actual results could differ from those estimates. These estimates and underlying assumptions are reviewed on an ongoing basis, and changes in estimates are recognised in the income statement for the periods in which they become known.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Impairment of Financial Assets

Starting from 1 January 2018, the Bank assesses at each reporting date the quality of receivables (other than those measured at fair value through profit or loss) in order to estimate expected credit losses in accordance with IFRS 9 "Financial Instruments”.

Unlike impairment assessment in accordance with IAS 39 “Financial Instruments: Recognition and Measurement” in effect until 31 December 2017, when impairment losses were recognized only if there was objective evidence of impairment as a result of one or more events that occurred subsequent to the initial recognition of the asset (loss event) and when the loss event affected the estimated future cash flows of a financial asset or group of financial assets that could be reliably estimated, in accordance with IFRS 9 on impairment of financial instruments an objective evidence of impairment is not required in order for the credit loss to be recognised. Expected credit losses are also recognised for unimpaired financial assets.

Expected credit losses are recalculated at each reporting date in order to reflect the change in the credit risk since the initial recognition of a financial instrument, which previously identifies the expected losses.

12-month ECLs are recognised for all exposures where there was no increase in credit risk from initial recognition of a financial asset (Level 1), while for exposures in which there was an increase in credit risk, the calculation of lifetime ECLs is performed (Level 2).

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (*Continued*)

(a) Impairment of Financial Assets (Continued)

Level 3 includes financial assets where there is objective evidence of impairment at the reporting date, i.e., non-performing financial assets and lifetime ECLs are calculated for them.

When calculating ECLs, the Bank uses future information and macroeconomic factors, i.e., understandable and supportive information, including projections of future economic conditions in calculating ECLs, both on an individual and group basis. The provisioning levels for losses will increase as the projected economic conditions deteriorate, i.e. they will decrease as projected economic conditions become more favourable.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Determination of Fair Value of Financial Instruments

The fair value of financial instruments traded in active markets as of the balance sheet date is based on their quoted market prices, without any deductions for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined using the appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which observable market prices exist and other relevant valuation models. When market inputs are not available, they are determined by estimates that include a certain degree of assumptions in the estimate of fair value (Note 35).

Valuation models reflect the current market conditions as of the measurement date and do not necessarily represent market conditions before or after the date of measurement. Consequently, all valuation techniques are revised periodically, in order to appropriately reflect the current market conditions.

(c) Useful Lives of Intangible Assets, Property, Plant and Equipment

Intangible assets and property, plant and equipment are amortised/depreciated over their estimated useful lives. The determination of the useful lives of intangible assets, property, plant and equipment is based on an estimate of the length of the period during which these assets will generate income. The Bank's management makes periodic reviews and adequate changes are made, if needed, by the Bank's management. Changes in estimates could lead to significant changes in the present value of the amounts recorded in the income statement in certain periods. For example, if the Bank reduced the useful life of the above mentioned assets by 10%, this would result in additional amortisation/depreciation charge on an annual basis in the amount of RSD 2,324 thousand.

(d) Impairment of Non-financial Assets

At each reporting date, the Bank's management reviews the carrying amounts of the Bank's intangible assets and property, plant and equipment presented in the financial statements. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

(d) Impairment of Non-financial Assets (Continued)

An impairment review requires management to make subjective judgments concerning the cash flows, growth rates and discount rates of the cash generating units under review.

(e) Deferred Tax Assets

Deferred tax assets are recognised for all unused tax losses and/or tax credits to the extent to which taxable profit will be available against which the unused tax losses /credits can be utilised.

Significant estimate of the management is necessary to determine the amount of deferred tax assets which can be recognised, based on the period in which it was created and the amount of future taxable profits and the tax policy planning strategy (Note 15(c)).

(f) Employee Retirement Benefits

The costs of defined employee benefits payable upon the termination of employment, i.e. retirement in accordance with the legal requirements are determined based on the actuarial valuation. The actuarial valuation includes an assessment of the discount rate, future movements in salaries, mortality rates and employee fluctuation rates.

As these plans are long-term ones, significant uncertainties influence the outcome of the assessment. Actuarial assumptions are disclosed in Note 3.17(b) to the financial statements.

Were the discount rate used to differ by 1 percentage point (higher/lower) from management's estimates, the provision for retirement benefits would be by an estimated RSD 714 thousand lower or RSD 897 thousand higher than the provision stated in the Company's financial statements as of 31 December 2018.

(g) Provisions for Litigation

The Bank is subject to a certain number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The Bank routinely assesses the likelihood of any adverse outcomes to these matters as well as ranges of probable or reasonable estimated losses.

Reasonable estimates involve judgement made by the Bank's management after considering information including notifications, settlements, estimates performed the by Legal Department, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience.

A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made of the obligation after careful analysis of the individual matter (Note 38(b)). The required provision may change in the future due to new developments and as additional information becomes available.

Matters that are either possible obligations or do not meet the recognition criteria for a provision are disclosed, unless the possibility of transferring economic benefits is remote.

5. INTEREST INCOME AND EXPENSE

In RSD thousand

	2018	2017
Interest income		
Banks	21,118	22,112
National Bank of Serbia	19,865	34,162
Corporate customers	222,221	231,341
Retail customers	76,243	69,430
State institutions	48,576	41,182
Total	**388,023**	**398,227**
Interest expense		
Banks	(11,059)	(21,691)
Corporate customers	(41,729)	(32,900)
Retail customers	(58,154)	(62,956)
State institutions	(78)	(235)
Total	**(111,020)**	**(117,782)**
Net interest income	**277,003**	**280,445**

Interest income and expense by type of financial instruments are presented as follows:

In RSD thousand

	2018	2017
Interest income		
Loans and advancements to banks	21,118	22,112
Repo placements with the National Bank of Serbia	2,761	13,514
Obligatory reserve with the National Bank of Serbia	8,469	10,775
Other placements and deposits with the National Bank of Serbia	8,635	9,873
Loans to corporate customers	222,422	231,341
Loans to retail customers	76,243	69,430
Loans to state institutions	48,375	41,182
Total	**388,023**	**398,227**
Interest expense		
Subordinated loans	(14,776)	(18,418)
National Bank of Serbia	(2,018)	(3,273)
Other banks	(108)	-
Deposits from corporate customers	(35,886)	(32,900)
Deposits from retail customers	(58,154)	(62,956)
Deposits and borrowings from state institutions	(78)	(235)
Total	**(111,020)**	**(117,782)**
Net interest income	**277,003**	**280,445**

6. FEE AND COMMISSION INCOME AND EXPENSE

In RSD thousand

	2018	2017
Fee and commission income		
Domestic payment traffic operations	38,616	35,517
Purchase and sale of foreign currencies	4,350	3,031
Credit activities	12,163	16,556
Other fees and commissions	26,450	23,731
Total	**81,579**	**78,835**
Fee and commission expense		
Domestic payment traffic operations	(16,346)	(14,171)
Foreign payment traffic operations	(15,653)	(13,025)
Total	**(31,999)**	**(27,196)**
Net fee and commission income	**49,580**	**51,639**

7. NET (LOSSES)/GAINS FROM HEDGING

In RSD thousand

	2018	2017
Gains from changes in value of derivatives intended for hedge accounting	-	1,527
Losses from changes in value of derivatives intended for hedge accounting	(1,104)	-
Net (losses)/gains	**(1,104)**	**1,527**

8. NET FOREIGN EXCHANGE GAINS AND EFFECTS OF CONTRACTED FOREIGN CURRENCY CLAUSE

In RSD thousand

	2018	2017
Foreign exchange gains and positive effects of contracted foreign currency clause application	1,299,133	1,499,400
Foreign exchange losses and negative effects of contracted foreign currency clause application	(988,065)	(1,331,813)
Net foreign exchange gains and effects of contracted foreign currency clause	**311,068**	**167,587**

9. OTHER OPERATING INCOME

In RSD thousand

	2018	2017
Rental income	1,434	-
Reimbursement of costs	12	-
Other income	20	52
Total	**1,466**	**52**

10. NET IMPAIRMENT LOSS ON FINANCIAL ASSETS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

(a) (Charged)/Credited to the Income Statement

In RSD thousand

	2018	2017
Impairment losses and provisions		
Impairment losses on financial assets:		
- loans and advances to banks	(16,375)	(16,884)
- loans and advance to customers	(445,833)	(560,320)
- other assets	(134)	(779)
Provisions for credit risk-weighted off-balance sheet items	(3,956)	(21,192)
Total (Note 10(b))	*(466,298)*	*(599,175)*
Impairment of securities measured at fair value through other comprehensive income	(3,150)	-
Total expenses	*(469,448)*	*(599,175)*
Reversal of impairment losses		
Reversal of impairment losses on financial assets:		
- loans and advances to banks	11,090	14,477
- loans and advance to customers	338,845	347,348
- other assets	729	1,485
	350,664	**363,310**
Release of provisions for:		
- credit risk-weighted off-balance sheet items	4,661	10,170
Total income (Note 10(b))	*355,325*	*373,480*
Net impairment loss	**(114,123)**	**(225,695)**

10. NET IMPAIRMENT LOSS ON FINANCIAL ASSETS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS (Continued)

(b) Movements in the Allowance for Impairment of Financial Assets and Provision for Credit Risk-weighted Off-balance Sheet Items

In RSD thousand

	Loans and advances to banks (Note 19)	Loans and advances to customers (Note 20)	Other assets (Note 24)	Provision for credit risk-weighted off-balance sheet items (Note 28)	Total
Balance as of 1 January 2017	**1,075**	**1,508,008**	**736**	**3,322**	**1,513,141**
Charge for the year (Note 10(a))	16,884	560,320	779	21,192	599,175
Reversal of impairment losses and release of provision (Note 10(a))	(14,477)	(347,348)	(1,485)	(10,170)	(373,480)
Accounting write-off (Note 31(b))	-	(1,232,438)	-	-	(1,232,438)
Foreign exchange gains and losses and other movements	(448)	(55,325)	906	(456)	(55,323)
Balance as of 31 December 2017	**3,034**	**433,217**	**936**	**13,888**	**451,075**
Adjustment to the opening balance in accordance with IFRS 9 (Note 2.1(a)/i/)	813	37,574	(689)	(11,643)	26,055
Adjusted opening balance as of 1 January 2018	**3,847**	**470,791**	**247**	**2,245**	**477,130**
Charge for the year (Note 10(a))	16,375	445,833	134	3,956	466,298
Reversal of impairment losses and release of provision (Note 10(a))	(11,090)	(338,845)	(729)	(4,661)	(355,325)
Accounting write-off (Note 31(b))	-	(110,604)	-	-	(110,604)
Foreign exchange gains and losses and other movements	(62)	7,639	690	(4)	8,263
Balance as of 31 December 2018	**9,070**	**474,814**	**342**	**1,536**	**485,762**

11. SALARIES, COMPENSATIONS AND OTHER PERSONAL EXPENSES

In RSD thousand

	2018	2017
Gross salaries and compensations	143,889	118,810
Payroll taxes and contributions	49,453	42,623
Provisions for unused vacations	8,892	1,827
Other personal expenses	7,504	2,845
Provision for retirement benefits (Note 28(d))	1,532	488
Total	**211,270**	**166,593**

12. AMORTISATION AND DEPRECIATION EXPENSE

In RSD thousand

	2018	2017
Amortisation of intangible assets (Note 21)	13,438	14,373
Depreciation of property, plant and equipment (Note 22(a))	9,541	10,157
Depreciation of investment property	262	43
Total	**23,241**	**24,573**

13. OTHER INCOME

In RSD thousand

	2018	2017
Reversal of provisions for holiday allowances	5,995	-
Term deposits termination	398	738
Reimbursement of costs of the Bank’s employees	2,148	1,573
Other income	2,676	4,459
Total	**11,217**	**6,770**

14. OTHER EXPENSES

In RSD thousand

	2018	2017
Rental costs	48,393	52,755
Maintenance costs	58,177	55,072
Professional services	37,574	47,722
Advertising and representations costs	8,285	4,157
Postal and telecommunication costs	6,872	5,376
Insurance premiums	47,711	53,172
Taxes	5,375	4,683
Contributions	32,152	26,346
Other compensations to employees	6,020	6,804
Cost of material	8,522	8,093
Provisions for litigations (Note 28(d))	8,395	479
Other expenses	4,420	5,001
Total	**271,896**	**269,660**

15. INCOME TAXES

(a) Components of Income Taxes

The total income tax for the period includes:

In RSD thousand

	2018	2017
Current income tax	-	-
Deferred tax income	(1,658)	(221)
Total tax income of the period	**(1,658)**	**(221)**

(b) Numerical Reconciliation of Income Tax Recognised in the Income Statement and Result for the Year Before Tax Multiplied by the Statutory Income Tax Rate

In RSD thousand

	2018	2017
Profit/(loss) before income tax	**28,700**	**(173,977)**
Income tax at statutory rate of 15%	**4,305**	**(26,096)**
Reconciliation of expenses/income	(5,963)	2,832
Unrecognized deferred tax assets on current year tax losses	-	23,043
Total tax income reported in the income statement	**(1,658)**	**(221)**

15. INCOME TAXES (Continued)

(c) Deferred Tax Assets

Deferred tax assets as of 31 December 2018 relate to:

- the temporary difference arising from the provision for employee retirement benefits in the amount of RSD 712 thousand (31 December 2017: RSD 482 thousand), due to different periods of recognising the provision for accounting and tax purposes;
- the temporary difference between the carrying value of property, plant and equipment and intangible assets and their tax basis in the amount of RSD 3,453 thousand (31 December 2017: RSD 3,269 thousand); and
- other temporary differences in the amount of RSD 1,326 thousand (31 December 2017: RSD 82 thousand).

Movements in **deferred tax assets** during the year were as follows:

In RSD thousand

	2018	2017
Balance as of 1 January	**3,833**	**3,611**
Effects of temporary differences arising from employee benefits credited to the income statement	230	74
Effects of temporary differences arising from different amortization/depreciation rates credited to the income statement	184	66
Other temporary differences	1,244	82
Balance as of 31 December	**5,491**	**3,833**

(d) Deferred Tax Liabilities

Deferred tax liabilities as of 31 December 2018 relate to temporary differences arising from income from changes in the value of debt securities at fair value through other comprehensive income (i.e., securities available for sale in the prior year).

Movements in **deferred tax liabilities** during the year are presented below:

In RSD thousand

	2018	2017
Balance as of 1 January	**1,746**	**-**
Effects of temporary differences arising from securities (credited)/debited to equity	(312)	1,746
Balance as of 31 December	**1,434**	**1,746**

15. INCOME TAXES (Continued)

(e) Tax Losses and Tax Credits

The Bank has tax loss and tax credit carry forwards from previous years, which can be used in the following fiscal years as presented below.

	In RSD thousand
Tax loss carry forwards:	
- up to one year	56,414
- one to five years	169,245
Tax credit carry forwards:	
- over five years	8,721

As of 31 December 2018 the Bank did not recognise deferred tax assets related to the aforementioned tax loss carry forwards due to uncertainty of sufficient amounts of the future taxable income against which tax loss carry forwards can be used.

16. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit/(loss) attributable to ordinary equity holders of the Bank by the weighted average number of ordinary shares outstanding during the period.

Pursuant to the Serbian Business Registers Agency Decision no. BD 119077/2008 dated 11 July 2008, the Bank is a joint-stock company whose shares are not publicly traded, and therefore, it is not obliged to calculate and disclose the earnings per share as required by IAS 33 “Earnings per Share”.

17. CASH AND BALANCES WITH CENTRAL BANK

In RSD thousand

	31 December 2018	31 December 2017	Adjust-ments	Opening balance as of 1 January 2018
In Dinars				
Current and gyro accounts	877,392	500,060	-	500,060
Deposited liquid funds	-	206,180	-	206,180
Cash on hand	58,133	18,164	-	18,164
Accrued income on cash and balances with central banks	260	449	-	449
	935,785	**724,853**	**-**	**724,853**
In foreign currency				
Obligatory reserve	827,362	751,117	-	751,117
Cash on hand	206,028	127,482	-	127,482
	1,033,390	**878,599**	**-**	**878,599**
Balance as of	**1,969,175**	**1,603,452**	**-**	**1,603,452**

The obligatory reserve in local currency – Dinars (RSD) represents the minimal reserve in foreign currency allocated in line with the Decision on Banks' Required Reserves with the National Bank of Serbia ("RS Official Gazette", no. 3/2011, 31/2012, 57/2012, 78/2012, 87/2012, 107/2012, 62/2013, 125/2014, 135/2014, 4/2015, 78/2015, 102/2015 and 76/2018).

The Bank calculates the obligatory reserve against liabilities in respect of dinar deposits, credits and securities, as well as other dinar liabilities, excluding dinar deposits received under transactions performed on behalf of and for the account of third parties that are not in excess of the amount of the Bank's placements made from such deposits.

The Bank is required to calculate and allocate the obligatory reserves in RSD by applying 5% rate (2017: 5%) to the amount of the average daily balance of the dinar funds with the agreed maturity of up to two years, i.e. (0% rate on a portion of the dinar base with the agreed maturity of over two years, i.e., over 730 days) during the preceding calendar month to their gyro account with the National Bank of Serbia (foreign currency clause-indexed deposits in dinars are part of the foreign currency base of the obligatory reserve).

The calculated dinar obligatory reserve is the sum of calculated dinar obligatory reserve of 5% and 38% of the dinar equivalent of calculated obligatory reserve in foreign currency and the sum of 0% of the dinar obligatory reserve and 30% of the dinar equivalent of calculated reserve in foreign currency.

The Bank allocates the calculated dinar obligatory reserves to its gyro account in Dinars.

In 2018, the National Bank of Serbia paid interest at a rate of 1.75% per annum on the average balance of the calculated obligatory reserve in Dinars until April 2018, and from April – 1.15% (2017: 1.75%).

As of 31 December 2018, the calculated obligatory reserve in Dinars amounted to RSD 542,179 thousand (31 December 2017: RSD 539,871 thousand).

17. CASH AND BALANCES WITH CENTRAL BANK (Continued)

Pursuant to the Decision on Banks' Required Reserves with the National Bank of Serbia, the Bank calculates and allocates the obligatory foreign currency reserve in accordance with the prescribed rates on the foreign currency base, which is the daily average of foreign currency liabilities and the daily average of foreign currency clause-indexed dinar liabilities in the prior calendar month.

The Bank calculates the obligatory foreign currency reserve against liabilities in respect of foreign currency deposits, credits and securities and against other foreign currency liabilities, as well as deposits, credits and other foreign currency funds received from abroad under transactions performed on behalf and for the account of third parties.

In accordance with the above mentioned Decision, the Bank calculates and allocates the obligatory foreign currency reserve against foreign currency accounts of the National Bank of Serbia at a rate of 20% (2017: 20%) on the amount of the average daily balance of foreign currency funds in the preceding calendar months for the funds with the agreed maturity of up to two years, i.e., 730 days, and 13% (2017: 13%) on the portion of the foreign currency base with the agreed maturity of over 2 years, i.e., 730 days.

The percentage of allocation of the obligatory foreign currency reserve amounts to 100% (2017:100%) to foreign currency clause-indexed liabilities arising from dinar deposits, loans, securities and other dinar liabilities. Out of the total calculated foreign currency reserve 62% is allocated in EUR, and the remaining portion of 38% in dinars, for funds with the agreed maturity of up to two years, i.e., up to 730 days, and 70% is allocated in EUR for foreign currency funds with the agreed maturity of over two years, i.e., over 730 days, while the remaining 30% is allocated in dinars to the gyro account.

The dinar equivalent of the calculated obligatory reserve in Euros is determined by applying the official median exchange rate of RSD applicable on the day of calculation of the obligatory reserve, i.e. on the 17th day of the month.

The Bank calculates the obligatory reserve on the 17th day of the month and that reserve is valid from 18th day of the current month until 17th day of the following month ("accounting period"). The Bank is obligated to maintain for the accounting period the average daily balance of dinar obligatory reserve in the amount of calculated dinar obligatory reserve.

As of 31 December 2018, the Bank's obligatory foreign currency reserve was in compliance with the aforementioned Decision of the National Bank of Serbia.

The National Bank of Serbia does not pay interest on the obligatory reserve in foreign currency.

17. CASH AND BALANCES WITH CENTRAL BANK (Continued)

Overview of the differences between cash stated in the Statement of Cash Flows and Balance Sheet as of 31 December 2018 and 31 December 2017 is presented in the table below:

In RSD thousand

	2018		
	Balance sheet	Cash flow statement	Difference
In RSD			
Current and gyro accounts	877,392	877,392	-
Cash on hand	58,133	58,133	-
Prepayments and accrued income	260	-	260
	935,785	**935,525**	**260**
In foreign currency			
Cash on hand	206,028	206,028	-
Foreign currency accounts (Note 19(a))	-	1,674,664	(1,674,664)
Obligatory reserve	827,362	-	827,362
	1,033,390	**1,880,692**	**(847,302)**
Less: Allowance for impairment of foreign currency accounts	-	(5,488)	5,488
Balance as of 31 December	**1,969,175**	**2,810,729**	**(841,554)**

In RSD thousand

	2017		
	Balance sheet	Cash flow statement	Difference
In RSD			
Current and gyro accounts and deposited surpluses	706,240	500,060	206,180
Cash on hand	18,164	18,164	-
Prepayments and accrued income	449	-	449
	724,853	**518,224**	**206,629**
In foreign currency			
Cash on hand	127,482	127,482	-
Foreign currency accounts (Note 19(a))	-	1,183,968	(1,183,968)
Obligatory reserve	751,117	-	751,117
	878,599	**1,311,450**	**(432,851)**
Less: Allowance for impairment of foreign currency accounts	-	(1,451)	1,451
Balance as of 31 December	**1,603,452**	**1,828,223**	**(224,771)**

Movements in **liabilities arising from financing activities** – loans received in the Cash Flow Statement

In RSD thousand

	2018	2017
Balance as of 1 January	**159,023**	**246,394**
Settlement of liabilities arising from loans received	(24,012)	(97,458)
Foreign exchange gains/losses, net	(18,455)	10,087
Balance as of 31 December	**116,556**	**159,023**

18. SECURITIES

In RSD thousand

	31 December 2018	31 December 2017	Adjustments	Opening balance 1/1/2018
Government bonds:				
– in RSD	904,119	913,736	-	913,736
– In foreign currency	952,413	-	-	-
Balance as of	**1,856,532**	**913,736**	**-**	**913,736**

Securities in the amount of RSD 904,119 thousand relate to bonds denominated in Dinars, whose maturity dates are 22 February 2019, with the interest rate of 4.78% per annum, and 5 April 2020, with the interest rate of 4.9% per annum.

Securities in the amount of RSD 952,413 thousand relate to bonds denominated in EUR, whose maturity dates are 18 April 2023 with the interest rate of 1.78% per annum, and 22 November 2020 with the interest rate of 0.95% per annum.

19. LOANS AND ADVANCES TO BANKS AND OTHER FINANCIAL ORGANIZATIONS

(a) Summary per Type of Loans

In RSD thousand

	31 December 2018	31 December 2017	Adjustments	Opening balance 1/1/2018
In RSD				
Receivables from the National Bank of Serbia arising from repurchase (repo) transactions	-	300,000	-	300,000
Other placements	111	58	-	58
	111	**300,058**	**-**	**300,058**
In foreign currency				
Current accounts	1,674,664	1,183,968	-	1,183,968
Other deposits	330,662	275,513	-	275,513
	2,005,326	**1,459,481**	**-**	**1,459,481**
Gross loans and advances	**2,005,437**	**1,759,539**	**-**	**1,759,539**
Less: Allowance for impairment (Note 10(b))	(9,070)	(3,034)	(813)	(3,847)
Balance as of	**1,996,367**	**1,756,505**	**(813)**	**1,755,692**

As of 31 December 2018, the Bank did not have funds invested into treasury bills of the National Bank of Serbia.

19. LOANS AND ADVANCES TO BANKS AND OTHER FINANCIAL ORGANIZATIONS (Continued)

(a) Summary per Type of Loans (Continued)

Outstanding balance on the current accounts in foreign currency mostly relates to funds on the foreign currency account held with the National bank of Serbia in amount of RSD 1,475,065 thousand (31 December 2017: RSD 963,292 thousand).

Other deposits in foreign currency in the amount of RSD 330,662 thousand as of 31 December 2018 mainly relate to the guarantee deposit of EUR 40,000 with the Central Securities Depository and Clearing House, a short-term deposit with AO Raiffeisen Bank, Moscow in the amount of RSD 148,410 thousand and a short-term deposit with JSC VTB Bank, Saint Petersburg in the amount of RSD 132,085 thousand.

(b) Maturity Structure of Loans and Receivables

The maturity structure of gross loans and advances to banks and other financial organizations, based on the remaining maturity period, outstanding as of 31 December 2018 and 2017, is as follows:

In RSD thousand

	31 December 2018	31 December 2017
Up to 30 days	1.965.252	1.741.677
Over 1 year	40.185	17.862
Total	**2.005.437**	**1.759.539**

20. LOANS AND ADVANCES TO CUSTOMERS

(a) Summary per Type of Customers

In RSD thousand

	31 December 2018	31 December 2017	Adjustments	Opening balance as of 1 January 2018
Short-term loans in Dinars:				
- Corporate customers	1,089,283	1,838,248	-	1,838,248
- Retail customers	24,130	24,759	-	24,759
	1,113,413	**1,863,007**	**-**	**1,863,007**
Long-term loans in Dinars:				
- Corporate customers	2,493,459	3,652,646	-	3,652,646
- Retail customers	750,858	739,858	-	739,858
	3,244,317	**4,392,504**	**-**	**4,392,504**
Long-term loans in foreign currency:				
- Corporate customers	-	-	-	-
Receivables for accrued interest:				
- Corporate customers	39,991	54,578	-	54,578
- Retail customers	2,016	1,074	-	1,074
	42,007	**55,652**	**-**	**55,652**
Receivables for accrued interest:				
- Corporate customers	125	16,337	-	16,337
- Retail customers	1,227	3,038	-	3,038
	1,352	**19,375**	**-**	**19,375**
Deductible items in RSD - accruals and deferrals:				
- Corporate customers	(9,204)	(16,538)	-	(16,538)
- Retail customers	(4,880)	(7,144)	-	(7,144)
	(14,084)	**(23,682)**	**-**	**(23,682)**
Gross loans and advances	**4,387,005**	**6,306,856**	**-**	**6,306,856**
Less: Allowance for impairment (Note 10(b))	(474,814)	(433,217)	(37,574)	(470,791)
Balance as of	**3,912,191**	**5,873,639**	**(37,574)**	**5,836,065**

As of 31 December 2018, gross loans in Dinars include loans with the contracted foreign currency clause in the amount of RSD 3,214,876 thousand (31 December 2017: RSD 4,656,714 thousand).

The loans are secured by the first class collaterals that amount to RSD 56,080 thousand as of 31 December 2018 (31 December 2017: RSD 131,998 thousand).

Short-term loans have been granted to corporate customers for financing business activities in trading, processing industry and for other purposes, at the rates ranging from 3.0% to 6.98% per annum for loans with foreign currency clause, i.e. at rates ranging from 8.4% to 12% per annum for loans in Dinars.

20. LOANS AND ADVANCES TO CUSTOMERS (Continued)

(a) Summary per Type of Customers (Continued)

The interest rates on short-term retail loans in Dinars ranged from 5.9% to 11% per annum.

The interest rates on long-term retail loans ranged from 6.9% to 18.5% per annum for cash and refinancing loans in Dinars.

(b) Structure of Loan Portfolio by Loan Type

The structure of the gross loan portfolio by loan type, as of 31 December 2018 and 2017 is as follows:

In RSD thousand

	31 December 2018	31 December 2017
Overdraft on current accounts	26,261	27,042
Cash loans	760,651	750,261
Loans for working capital	1,260,985	2,196,785
Investment loans	58,871	31,999
Other loans	2,280,237	3,300,769
Total	**4,387,005**	**6,306,856**

Other loans as of 31 December 2018 in the gross amount of RSD 2,280,237 thousand (31 December 2017: RSD 3,300,769 thousand) mostly relate to loans granted to corporate customers for funding their business activities.

20. LOANS AND ADVANCES TO CUSTOMERS (Continued)

(c) Maturity Structure of Loan Portfolio

The maturity structure of the gross loan portfolio, based on the remaining maturity period, outstanding as of 31 December 2018 and 2017 is as follows:

	31 December 2018	In RSD thousand 31 December 2017
Up to 30 days	626,879	721,671
From 1 to 3 months	155,159	238,965
From 3 to 12 months	730,662	980,038
Over 1 year	2,874,305	4,366,182
Total	**4,387,005**	**6,306,856**

(d) Industry Concentration of Loan Portfolio

As of 31 December 2018 and 2017 the gross loan portfolio is concentrated on the following sectors:

	31 December 2018	In RSD thousand 31 December 2017
Processing industry and manufacturing	2,267,553	3,432,898
Trade	979,241	1,812,642
Transportation and warehousing	131,160	194,907
Retail customers	773,351	761,585
Entrepreneurs	4	26,183
Other	235,696	78,641
Total	**4,387,005**	**6,306,856**

21. INTANGIBLE ASSETS

In RSD thousand

	Licenses and software	Total
COST		
Balance as of 1 January 2017	**187,322**	**187,322**
Additions during the year	8,454	8,454
Balance as of 31 December 2017	**195,776**	**195,776**
Additions during the year	25,328	25,328
Balance as of 31 December 2018	**221,104**	**221,104**
ACCUMULATED AMORTISATION		
Balance as of 1 January 2017	**142,503**	**142,503**
Amortisation charge (Note 12)	14,373	14,373
Balance as of 31 December 2017	**156,876**	**156,876**
Amortisation charge (Note 12)	13,438	13,438
Balance as of 31 December 2018	**170,314**	**170,314**
CARRYING VALUE AS OF:		
- 31 December 2018	**50,790**	**50,790**
- 31 December 2017	**38,900**	**38,900**

The carrying value of intangible assets as of 31 December 2018 relates to software in the amount of RSD 49,251 thousand (31 December 2017: RSD 38,025 thousand) and licenses in the amount of RSD 1,539 thousand (31 December 2017: RSD 875 thousand).

Additions in intangible assets in 2018 completely relate to the purchase of software/modules in the amount of RSD 25,328 thousand.

Based on the Bank's management estimate, intangible assets at 31 December 2018 are not impaired.

22. PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTY

(a) Property, Plant and Equipment

In RSD thousand

	Equipment	Intangible assets under construction	Leasehold improve-ments	Total
COST				
Balance as of 1 January 2017	**101,826**	**-**	**33,774**	**135,600**
Additions during the year	10,212	-	-	10,212
Balance as of 31 December 2017	**112,038**	**-**	**33,774**	**145,812**
Additions during the year	7,012	73	-	7,085
Disposals and write-offs	(2,362)	-	-	(2,362)
Balance as of 31 December 2018	**116,688**	**73**	**33,774**	**150,535**
ACCUMULATED DEPRECIATION				
Balance as of 1 January 2017	**72,861**	**-**	**33,774**	**106,635**
Depreciation charge (Note 12)	10,157	-	-	10,157
Balance as of 31 December 2017	**83,018**	**-**	**33,774**	**116,792**
Depreciation charge (Note 12)	9,541	-	-	9,541
Disposals and write-offs	(2,362)	-	-	(2,362)
Balance as of 31 December 2018	**90,197**	**-**	**33,774**	**123,971**
CARRYING VALUE AS OF:				
- 31 December 2018	**26,491**	**73**	**-**	**26,564**
- 31 December 2017	**29,020**	**-**	**-**	**29,020**

The carrying value of equipment as of 31 December 2018 mostly relates to computer and telecommunication equipment and office furniture.

Based on the Bank's management estimate, property, plant and equipment at 31 December 2018 are not impaired.

(b) Investment Property

Pursuant to the Executive Board's Decision no. 228/2017 dated 26 October 2017, the Bank classified property acquired during the enforcement procedure against the enforcement debtor "Nafta" a.d. Belgrade in the amount of RSD 20,135 thousand as an investment property. Pursuant to the Lease Agreement for Business Premises no. 57 concluded on 6 February 2018 and Annex no. 2 signed on 1 October 2018, the Bank rented the mentioned property to the company "RK Mountain" d.o.o. Zlatibor.

The carrying value of investment property as of 31 December 2018 amounted to RSD 19,873 thousand.

23. NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

In RSD thousand

	31 December 2018	31 December 2017
Non-current assets held for sale	375,484	382,238
Balance as of	**375,484**	**382,238**

Assets acquired pursuant to the Agreement on the Sale and Purchase of Immovable and Movable Assets concluded with the legal entity FSH “Komponenta” d.o.o. Cuprija – in bankruptcy arising from the granted loan due for payment, the Bank classified in accordance with the Decision of the Executive Board dated 12 April 2016 as non-current assets held for sale. The Bank has advertised the above mentioned assets for sale and expects its sale in the near future.

Pursuant to the Executive Board’s Decision dated 19 December 2017, in 2017 the Bank classified the property acquired during the enforcement procedure against debtor “Derma” d.o.o. Kragujevac in a public sale in the amount of RSD 6,754 thousand as non-current assets held-for-sale. Pursuant to an Agreement on the Sale and Purchase of Immovable Assets, the Bank sold the concerned property to the buyer “Duga” d.o.o. Petlovaca on 26 March 2018.

24. OTHER ASSETS

In RSD thousand

	31 December 2018	31 December 2017	Adjust-ments	Opening balance as of 1 January 2018
Other receivables				
Receivables from employees	-	10	-	10
Advances paid	8,200	16,024	-	16,024
Receivables for overpaid taxes	115	115	-	115
Other receivables	30,368	27,838	-	27,838
	38,683	**43,987**	**-**	**43,987**
Prepayments and accrued income				
Prepaid expenses in RSD	5,371	5,542	-	5,542
	5,371	**5,542**	**-**	**5,542**
Gross other assets	**44,054**	**49,529**	**-**	**49,529**
Less: Allowance for impairment (Note 10(b))	(342)	(936)	689	(247)
Balance as of	**43,712**	**48,593**	**689**	**49,282**

25. DEPOSITS AND OTHER FINANCIAL LIABILITIES TO BANKS, OTHER FINANCIAL ORGANISATIONS AND CENTRAL BANK

In RSD thousand

	31 December 2018	31 December 2017
In Dinars		
Transaction accounts	9,378	23,334
Other deposits	-	82,000
Accrued interest liability	-	28
	9,378	**105,362**
In foreign currency		
Transaction accounts	1,095	3,641
Other deposits	5,201	94,083
Interest payable on loans, deposits and other financial liabilities	-	1
Accrued interest liability	-	119
	6,296	**97,844**
Balance as of	**15,674**	**203,206**

Transaction deposits of banks and other financial institutions in Dinars as of 31 December 2018 mainly relate to the balance on the RSD transaction accounts of quite a number of insurance and finance companies, such as "Digital finance international" d.o.o. Belgrade, "Sogaz" a.d. Novi Sad, etc. The Bank does not pay interest on the balances on these accounts.

Other deposits of banks and other financial institutions in foreign currencies as of 31 December 2018 relate to the term deposits of "Sogaz" a.d. Novi Sad in the total amount of RSD 5,201 thousand (31 December 2017: RSD 94,083 thousand), with the term period of one year and interest rate of 1.3% per annum.

26. DEPOSITS AND OTHER FINANCIAL LIABILITIES TO CUSTOMERS

In RSD thousand

	31 December 2018	31 December 2017
In Dinars		
Transaction accounts	781,383	1,024,701
Savings deposits	98,009	94,572
Special-purpose deposits	17,587	31,633
Other deposits	584,028	814,885
Interest payable on loans, deposits and other financial liabilities	165	565
Accrued interest liability	2,740	5,102
	1,483,912	**1,971,458**
In foreign currency		
Transaction accounts	1,876,074	1,800,901
Savings deposits	4,351,387	4,009,203
Special-purpose deposits	83,479	125,302
Other deposits	583,771	649,207
Borrowings	796	24,808
Other financial borrowings	22,287	4,260
Interest payable on loans, deposits and other financial liabilities	1,185	373
Accrued interest liability	11,282	6,568
	6,930,261	**6,620,622**
Balance as of	**8,414,173**	**8,592,080**

On fixed-term deposits in Dinars and foreign currency of customers, the Bank pays interest at rates ranging from 1.00% to 3.1% per annum, depending on the currency and the period the funds have been deposited for.

A vista saving deposits in RSD do not earn interest, while the Bank pays interest on *a vista* saving deposits in USD at an annual rate of 1% and 2% for *a vista* saving deposits in EUR.

The interest rates on the short-term retail customers' deposits in Dinars range from 2.2% to 4.2% per annum, depending on the period the funds have been deposited for.

The interest rates on the short-term retail customers' deposits in foreign currency range from 0.1% to 1.77% per annum, depending on the currency and the period the funds have been deposited for.

Long-term deposits placed by retail customers in foreign currency earn interest at rates ranging from 0.5% to 1.82% per annum for deposits in EUR, depending on the period that the funds have been deposited for.

27. SUBORDINATED LIABILITIES

In RSD thousand

	31 December 2018	31 December 2017
Subordinated liabilities in a foreign currency	115,760	134,215
Balance as of	**115,760**	**134,215**

The outstanding balance of subordinated liabilities of RSD 115,760 thousand as of 31 December 2018 relates to the subordinated loan in the amount of RUB 78,000,000. The loan was initially obtained from the previous parent bank VTB Bank OAD, Saint Petersburg. The principal of the loan is to be repaid in full upon expiry of 7 years from the drawdown date. The contracted interest rate on this loan is 11.15% per annum (i.e. 12.38% per annum including withholding tax). The loan funds were withdrawn completely on 28 December 2017.

Pursuant to Annex no. 1 as of 26 June 2018 to the Subordinated Loan Agreement concluded on 27 December 2016, signed between VTB Bank OAD, Saint Petersburg and VTB Banka a.d. Belgrade, VTB Bank OAD, Saint Petersburg is entitled to assign or otherwise transfer its rights under the Agreement in accordance with the terms and conditions and the manner stipulated by the relevant regulations of the Republic of Serbia.

Pursuant to the Agreement on the Assignment of Receivables concluded on 2 July 2018, VTB Bank OAD, Saint Petersburg assigned all its rights under the subordinated loan agreement to a new shareholder “AZRS INVEST” d.o.o. Belgrade, which became the sole owner of the Bank with a changed name - API Bank a.d. Belgrade, in the process of sale of VTB Banka a.d. Belgrade.

28. PROVISIONS

In RSD thousand

	31 December 2018	31 December 2017	Adjustment	Opening balance as of 1 January 2018
Provision for credit risk-weighted off-balance sheet items (a)	1,536	13,888	(11,643)	2,245
Provision for retirement benefits (b)	4,743	3,211	-	-
Provision for litigation (c)	8,347	479	-	-
Balance as of	**14,626**	**17,578**	**(11,643)**	**2,245**

(a) According to the Bank’s internal policy, the provision for commitments and other credit risk-weighted off-balance sheet items (guarantees, acceptances, undrawn credit facilities etc.) is established when it is probable that an outflow of resources will be required to settle the obligation arising from the Bank’s commitment, and when the objective evidence of such probability exists.

28. PROVISIONS (Continued)

(a) Evidence based on which the Bank performs the individual assessment of impairment are: payments effected on the Bank's accounts with respect to commitments arising from guarantees, bills of guarantees, etc., and that the customer has been classified in accordance with the Bank's classification criteria into the categories G and D. Individual assessment of impairment of off-balance sheet items is performed in the same manner as for the balance sheet assets.

Contingent liabilities for which the Bank does not expect any outflow of resources and/or it estimates that in the case of an outflow of resources all receivables will be fully collected are not provided for.

Furthermore, the Bank does not calculate the provision for risk-weighted off-balance sheet items (undrawn credit facilities) for all unfunded commitments subject to unconditional cancellation by the Bank due to deterioration in the borrower's financial position.

(b) The provision for retirement benefits has been recorded in the Bank's financial statements on the basis of an independent actuary's calculation as of 31 December 2018, and it is stated in the amount of the present value of the future defined benefit obligation.

When determining the present value of the expected outflows the following assumptions were used: the discount rate of 3.5%, average salary increase rate of 3% per annum, employee fluctuation rate of 3% and disability rate of 0.1% per annum.

(c) The Bank established a provision for litigations in which it acted as a defendant and for which adverse outcome was expected according to the estimate of the Legal Department (Note 38(b)).

(d) Movements in provisions during the year were as follows:

		In RSD thousand
	2018	2017
Provision for credit risk-weighted off-balance sheet items		
Balance as of 1 January	13,888	3,322
Effects of first-time adoption of IFRS 9 (Note 2.1(a)/i/)	(11,643)	-
Charge for the year (Note 10(b))	3,956	21,192
Release of provision (Note 10(b))	(4,661)	(10,170)
Other movements	(4)	(456)
	1,536	**13,888**
Provision for retirement benefits		
Balance as of 1 January	3,211	2,723
Charge for the year (Note 11)	1,532	488
	4,743	**3,211**
Provisions for litigations		
Balance as of 1 January	479	-
Charge for the year (Note 14)	8,395	479
Payments based on lost lawsuits	(527)	-
	8,347	**479**
Balance as of 31 December	**14,626**	**17,578**

28. OTHER LIABILITIES

In RSD thousand

	31 December 2018	31 December 2017
Trade payables	12,703	8,441
Liabilities for value added tax	582	929
Liabilities for other taxes and contributions	74	4,081
Accrued interest expense	3,490	2,707
Deferred other income	3,265	2,487
Liabilities to employees	8,892	6,108
Other liabilities	27,855	62,582
Balance as of	**56,861**	**87,335**

Other liabilities in the amount of RSD 27,855 thousand as of 31 December 2018 mostly relate to accrued liabilities in RSD (for loan repayment by physical and legal entities) in the amount of RSD 9,227 thousand and liabilities for factoring transactions amounting to RSD 14,276 thousand.

30. EQUITY

In RSD thousand

	31 December 2018	31 December 2017	Adjustment	Initial balance as of 1 January 2018
Share capital – ordinary shares	3,672,407	3,672,407	-	3,672,407
Reserves	11,275	9,892	-	9,892
Prior years' accumulated losses	(2,076,389)	(1,873,549)	(29,084)	(2,076,389)
Profit/(loss) for the year	30,358	(173,756)	-	-
Balance as of	**1,637,651**	**1,634,994**	**(29,084)**	**1,605,910**

During 2018 the shareholders of the Bank changed. As disclosed in Note 1, the company registered in Serbia "AZRS INVEST" d.o.o. Belgrade became the Bank's owner and, accordingly, as of 31 December 2018, it is the sole shareholder participating with 100% in share capital of the Bank. The ultimate owner of "AZRS INVEST" d.o.o. Belgrade and the Bank respectively is a natural person - Andrey Zakharovich Shlyakhovoy.

As of 31 December 2018, subscribed and fully paid in share capital of the Bank consists of 7,344,813 ordinary shares (31 December 2017: 7,344,813 ordinary shares), with the nominal value per share of RSD 500.

Reserves in the amount of RSD 11,275 thousand as of 31 December 2018 include positive effects of the change in the value of securities measured at fair value through other comprehensive income (net of accompanying deferred taxes) in the amount of RSD 8,125 thousand and their accompanying allowance for impairment in the amount of RSD 3,150 thousand.

The Bank recorded the effect of the first-time adoption of IFRS 9 (an increase in the impairment of financial assets), amounting to RSD 29,084 thousand, as an adjustment to the opening balance of accumulated losses.

31. OFF-BALANCE SHEET ITEMS

In RSD thousand

	31 December 2018	31 December 2017
Guarantees and other irrevocable commitments (a)	793,289	2,153,148
Other off-balance sheet items (b)	10,153,879	12,874,728
Balance as of	**10,947,168**	**15,027,876**

(a) Guarantees and Other Irrevocable Commitments

In RSD thousand

	31 December 2018	31 December 2017
Payment guarantees:		
- in Dinars	413,900	454,274
- in foreign currency	77,027	168,826
	490,927	**623,100**
Performance guarantees:		
- in Dinars	301,528	459,382
- in foreign currency	834	17,416
	302,362	**476,798**
Uncovered letters of credit:		
- in foreign currency	-	14,335
	-	**14,335**
Irrevocable commitments:		
- in Dinars	-	18,535
	-	**18,535**
Total guarantees and other irrevocable commitments	*793,289*	*1,132,768*
Swap transactions and purchase of foreign currencies for RSD	-	1,020,380
Balance as of	**793,289**	**2,153,148**

The Bank establishes a provision for potential losses from other credit risk-weighted off-balance sheet items in accordance with the accounting policy disclosed in Note 28(a) to the financial statements. As of 31 December 2018, the provision against losses on guarantees and other irrevocable commitments recognised in the Bank's financial statements, amounts to RSD 1,536 thousand (31 December 2017: RSD 13,888 thousand).

As of 31 December 2018 the Bank did not have uncovered letters of credit and irrevocable commitments.

31. OFF-BALANCE SHEET ITEMS (Continued)

(b) Other Off-balance Sheet Items

	31 December 2018	In RSD thousand 31 December 2017
Received securities	-	300,000
Loro guarantees	3,860,494	1,752,867
Revocable commitments	618,732	1,153,014
Material collaterals, mortgages and pledges	3,664,033	7,778,814
Accounting write-off	1,343,042	1,232,438
Other off-balance sheet items	667,578	657,595
Balance as of	**10,153,879**	**12,874,728**

Revocable commitments amounting to RSD 618,732 thousand as of 31 December 2018 mostly relate to long-term credit lines in Dinars approved to corporate customers.

Revocable commitments arising from unused overdrafts on citizens' current accounts amount to RSD 3,559 thousand (31 December 2017: RSD 5,714 thousand), while permitted credit limits on citizens' credit cards amount to RSD 7,191 thousand (31 December 2017: RSD 6,755 thousand).

In 2018, within material collaterals, mortgages and, the Bank presents all collatterals based on the loans granted (and not only first-ranking morgages). In 2018, the Bank also derecognised material collaterals for all the clients for which accounting write-off was performed.

Pursuant to the National Bank of Serbia's Decision on Accounting Write-off of Bank Balance Sheet Assets issued on 10 August 2017 in effect since 30 September 2017, on 31 December 2018 the Bank transferred all the NPLs, in cases where the allowance for impairment equaled 100% of their gross book value, from balance sheet assets to off-balance sheet items in the amount of RSD 110,604 thousand (31 December 2017: RSD 1,232,438 thousand (Note 10(b)).

In 2018 the Bank recorded the remaining portion of imovable property based on the Factoring Agreement signed with Erste Bank a.d. Novi Sad within other off-balance sheet items.

(c) Credit Risk-weighted Off-balance Sheet Items

The breakdown of credit risk-weighted off-balance sheet items of the Bank that are subject to the National Bank of Serbia classification as of 31 December 2018 and 2017 is presented in the table below:

	31 December 2018	In RSD thousand 31 December 2017
Guarantees and uncovered letters of credit	793,289	1,114,233
Commitments - irrevocable and revocable	618,732	1,171,549
Balance as of	**1,412,021**	**2,285,782**

32. RELATED PARTY DISCLOSURES

A number of banking transactions are entered into with the shareholder and other related parties in the ordinary course of business which is presented in the following tables. These transactions were carried out at commercial terms and conditions and at the market rates.

Related parties of the Bank until 26 July 2018 were members of the Group to which the Bank belonged - VTB Group, and onwards from that date, the Bank's related party is "AZRS INVEST" d.o.o. Belgrade.

On 26 July 2018 the Central Securities Depository and Clrearing House changed the ownership of the 100% of the shares of VTB Banka a.d. Belgrade and the sole owner of Bank's shares became company "AZRS INVEST" d.o.o. Belgrade, with registration number 20988592. The ownership change was made on the basis of the previously obtained approval from the National Bank of Serbia in accordance with the Decision G 2182 dated 22 March 2018. A new business name - API Bank a.d. Belgrade – was establsihed according to amendments to the Articles of Association, Memorandum of Association and a Decision adopted by the General Assembly dated 24 September 2018.

Parties related with the Bank are persons who can have a significant impact on making financial and business decisions of the Bank. Parties related with the Bank are management of the Bank, the Board of Directors and the Executive Board members, their close relatives and legal entities in their ownership or under their control, as well as legal entities whose financial or business decisions are influenced by these persons.

(a) Outstanding balance of **receivables and payables** as of 31 December 2018 and 2017 resulting from transactions with shareholders and other Bank's related parties are presented in the following table:

In RSD thousand

	31 December 2018	31 December 2017
Placements with banks:		
Nostro accounts	-	104,548
Other placements	-	170,687
	-	**275,235**
Loans:		
Loans approved to the Bank's management	-	1,395
Less: Allowance for impairment		(9)
	-	**1,386**
Total	**-**	**276,621**
Deposits and borrowings:		
Transaction deposits of shareholders	3,371	20,262
Subordinated loans from shareholders	115,760	134,215
Deposits of individuals related to the Bank in the sense of the Law that governs banks' operations	20,305	24,283
Total	**139,436**	**178,760**

32. RELATED PARTY DISCLOSURES (Continued)

(b) In 2018 the Bank generated **interest income** from related parties' transactions in the amount of RSD 13,035 thousand (2017: RSD 21,177 thousand).

Interest expense on deposits and borrowings from the shareholders and other related parties for the year ended 31 December 2018 amounted to RSD 18,955 thousand (2017: RSD 26,205 thousand).

(c) A summary of transactions with related parties from the VTB Group in 2018 and 2017 and the new shareholder "AZRS INVEST" d.o.o. Belgrade since 26 July 2018 is presented in the following table:

In RSD thousand

	Income	Expenses	Receivables	Payables
2018				
VTB Bank OAD, Saint Petersburg	12,683	11,720	-	-
VTB Bank Europe SE, Frankfurt*	352	1,393	-	-
AZRS INVEST d.o.o. Belgrade	-	5,842	-	119,131
Total	**13,035**	**18,955**	**-**	**119,131**

	Income	Expenses	Receivables	Payables
2017				
Bank of Moscow, Moscow				
VTB Bank OAD, Saint Petersburg	20,520	24,335	220,348	154,477
VTB Bank Europe SE, Frankfurt*	657	1,870	54,887	-
Total	**21,177**	**26,205**	**275,235**	**154,477**

* In December 2017, VTB Deutschland AG, Frankfurt changed its name into VTB Bank (Europe) SE, due to the decision of VTB Group concerning reorganisation of its activities in Europe. The change has been valid since 29 December 2017.

(d) **Salaries and other benefits** of the Executive Board members and other key management personnel of the Bank (stated in the gross amount) in 2018 and 2017 are presented in the following table:

In RSD thousand

	2018	2017
Members of the Executive Board	32,963	29,476
Members of the Board of Directors	5,681	800
Directors of Departments	34,285	29,740
Total	**72,929**	**60,016**

33. RISK MANAGEMENT

Risk is inherent in banking activities, but it is managed through a process of ongoing identification, measurement and monitoring, establishing risk limits and applying other controls.

Owing to the nature of its activities, the Bank is exposed to the following major risks: credit risk, liquidity risk, interest rate risk and market risk (which includes the currency risk and other market risks).

The Bank is also subject to operational risks (including the legal risk, risks arising from the introduction of new products, activities, processes and systems, as well as the risk of entrusting activities to third parties, i.e. outsourcing and the information system risk), interest risk in the banking book, exposure risk to one entity or a group of related parties, risk of the Bank's investments in other legal entities and property, plant and equipment, as well as the impact of risk related to the country of origin of the entity to which the Bank is exposed and the risk of early repayment, which the Bank continuously monitors.

The Board of Directors and the Executive Board are ultimately responsible for the overall approach to risk management, as well as approval of the strategy and principles of risk management. In addition, the Bank has established separate independent bodies for managing and monitoring risks.

The Bank's bodies, authorized for risk management, constantly monitor changes in the legislation, while analysing their influence on the level of risks at the level of the Bank. They undertake necessary measures to bring the Bank's business activities and procedures in line with new procedures within the scope of controlled risk.

Risk Management Sector

In order to establish an integrated system of risk management and enable functional and organizational segregation of risk management activity and regular operating activities, the Bank has established the Risk Management Sector.

Liquidity risk management, as well as management of interest rate risk in the banking book, foreign exchange and other market risks, managing the risk of the Bank's exposure to a single entity or a group of related parties, management of investments in other legal entities and in fixed assets, management of the risk of exposure towards the country of a client's origin, operational risk and development of internal methodology for the evaluation, measurement and management of the risks that the Bank is exposed to, are included in the scope of activities of this Sector.

Credit risk management and providing recommendations for the Bank's exposures that are under the influence of credit risk, as well as monitoring and collection of the non-performing assets, i.e. bad assets within the department for operations with non-standard assets are also included in the scope of this Sector's activities.

Treasury and Liquidity Sector and Assets and Liabilities Managing Committee

The Treasury and Liquidity Sector is responsible for managing assets and liabilities and the overall financial structure of the Bank. Furthermore, it is responsible for the funding and liquidity of the Bank. The Assets and Liabilities Managing Committee is responsible for monitoring and managing liquidity risk.

33. RISK MANAGEMENT (Continued)

Internal Audit

Risk management processes throughout the Bank are audited at least annually by the internal audit function, which examines both the adequacy of the procedures and the Bank's compliance with the adopted procedures. Internal audit discusses the results of own assessments with the Bank's management and reports its findings and recommendations to the Audit Committee.

Risk Management and Reporting Systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the current economic environment. The Bank also runs worst case scenarios that would arise in the event of the extreme events, which are unlikely to occur.

Monitoring and control of the risks is primarily based on establishing limits. The limits reflect the business strategy and market environment of the Bank, as well as the level of risks the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information collected from all operating activities is examined and processed in order to identify, analyse and control early risks. This information is presented and explained to the Board of Directors, Executive Board, Risk Management Sector and heads of all business units. The reports contain the total credit exposure, investment forecasts, departure from established limits, market risk measurement, liquidity ratios and changes in risk profiles.

The Bank's management assesses the adequacy of impairment of placements on quarterly basis. The Bank quarterly presents to the Audit Committee an extensive report that includes all the relevant information needed to estimate the risks the Bank is exposed to.

Special reports on risk management are prepared for each level in the Bank to ensure that all organizational units have access to comprehensive, necessary and updated information.

33.1. Credit Risk

Credit risk is the risk from occurrence of adverse effects to the financial performance and equity of the Bank due to inability of credit beneficiaries to fulfil contractual obligations to the Bank.

The Bank's credit risk is caused by the debtor's credit capacity, good credit history, as well as quality of collaterals, and is being identified, measured, estimated and monitored in accordance with the internal by-laws for credit risk management, as well as in accordance with decisions that regulate the classification of the balance sheet assets and off-balance sheet items, i.e. capital adequacy of the Bank.

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

In accordance with the Bank's Risk management policy, the procedures for managing credit risk and procedures for granting, effecting and collecting the placements, the process of credit risk management of individual placements and risks at the portfolio level, i.e., the procedures of identification, measurement and monitoring (control) of placements, especially those with increased risk levels, have been defined. In accordance with the aforementioned procedures, the Bank engages in activities with customers who have the appropriate creditworthiness and the risk levels estimated as acceptable, considering the ratio and connection of the categories of risk and profitability.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, as well as by monitoring exposures in relation to these risks. Exposure to credit risk is continuously monitored by periodical assessments of the credit beneficiaries' abilities to settle their liabilities to the Bank and other creditors.

The Bank has established a credit quality review process to ensure early identification of possible changes in the creditworthiness of counterparties, including regular collateral review and revision.

Counterparty limits are established by the use of a credit risk classification system, which classifies every counterparty according to certain credit rank as well as according to the internal methodology, which defines the level of exposure that the Bank is willing to accept toward an individual customer or the group of related parties. The classification of counterparties is subject to regular reviews. The credit quality review process allows the Bank to assess the potential loss as a result of the risk to which it is exposed and take corrective actions.

According to the Bank's policy, making decisions on exposure to credit risk is centralized and concentrated in the Credit Committee for corporate and retail customers. Decisions of the Credit Committee are made upon consideration of proposals provided by competent sectors included in the process of granting loans and the Risk Management Sector.

The terms for approval of each corporate loan are determined individually depending on client type, loan's purpose, estimated creditworthiness, offered collateral and current market situation. Type of collateral that accompanies each loan is also determined according to the client creditworthiness analysis, type of credit risk exposure, term of the placement as well as the amount of a particular loan. All of the Bank's placements are based on relevant approvals, which determine the terms and other conditions for their implementation.

Reporting on credit risk is based on permanent monitoring at the level of the total portfolio of the Bank as well as at the individual client level. In accordance with the shareholder's request, credit risk is reported on monthly basis, when the overview of portfolio, defaults, movements in provisions and equity of the Bank is presented.

The Bank assesses impairment of financial assets as described in Note 2.1(a) IFRS 9 "Financial Instruments": Impairment – Financial Assets and Contract Assets.

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

Credit-related Risks

The Bank issues guarantees and letters of credit to its customers, and, consequently, it has a contingent liability to perform payments in favour of third parties. Thus, the Bank is exposed to credit-related risks, which can be mitigated by control processes and procedures used for mitigating credit risks.

Derivative Financial Instruments

Credit risk arising from derivative financial instruments is, at any time, limited to the instruments with positive fair value, as recorded in the balance sheet. Such credit risk is limited by determining the maximum fair value of the total derivatives' portfolio, as well as determination of the maximum positive fair value of each individual transaction. The Bank is not exposed to this risk, since it does not have significant derivative financial instruments.

(a) Maximum Exposure to Credit Risk by Balance Sheet Assets and Off-balance Sheet Items

The table below represents the maximum credit risk exposure as of 31 December 2018 and 2017, presented in the gross amount, without taking into account collaterals:

In RSD thousand

	31 December 2018	31 December 2017
	Gross maximum exposure	Gross maximum exposure
The exposure related to balance sheet assets		
Securities*	1,856,532	913,736
Loans and advances to banks and other financial institutions	530,372	796,696
Loans and advances to customers	4,387,005	6,306,856
Other assets	14,421	47,886
Total balance sheet assets	*6,788,330*	*8,065,174*
The exposure related to off-balance sheet items		
Payment guarantees	490,927	623,100
Performance bonds	302,362	476,798
Uncovered letters of credit	-	14,335
Irrevocable commitments	618,732	1,171,549
Total off-balance sheet items	*1,412,021*	*2,285,782*
Total	**8,200,351**	**10,350,956**

* *Securities as of 31 December 2018 completely relate to treasury bonds and from the Bank's point of view do not represent risky balance sheet items, and are, therefore, excluded from further analysis of the Bank's exposure to credit risk (i.e. risky placements – portfolios) presented in the tables below.*

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(a) Maximum Exposure to Credit Risk by Balance Sheet Assets and Off-balance Sheet Items (Continued)

As presented in the table above, as of 31 December 2018, 53.5% of the maximum exposure to credit risk relates to loans and advances to customers (31 December 2017: 60.9%), 7.5% to irrevocable commitments (31 December 2017: 11.3%) and 6,5% to loans and advances to banks and other financial institutions (31 December 2017: 7.7%).

The table below shows balance and off-balance sheet items classified under credit risk levels – 1, 2 and 3.

In RSD thousand

	31 December 2018		
	Gross exposure	**Allowance for impairment and provisions**	**Net exposure**
Loans and advances to banks and other financial organisations			
Regular placements	**530,372**	**(9,069)**	**521,303**
Level 1	530,372	(9,069)	521,303
Loans and advances to customers and other assets			
Regular placements	**3,511,290**	**(74,458)**	**3,436,832**
Level 1	3,165,576	(55,274)	3,110,302
Level 2	345,714	(19,184)	326,530
Non-performing placements - Level 3	**890,136**	**(400,699)**	**489,437**
Estimated at group level	101,322	(6,491)	94,831
Individually estimated	788,814	(394,208)	394,606
Securities – Level1*	1,856,532	(3,150)	1,853,382
Total balance sheet exposures	**6,788,330**	**(487,376)**	**6,300,954**
Off-balance sheet exposures			
Regular placements	**1,411,032**	**(1,536)**	**1,409,496**
Level 1	1,411,032	(1,536)	1,409,496
Level 2	-	-	-
Default placements - Level 3	**989**	**-**	**989**
Estimated at group level	989	-	989
Individually estimated	-	-	-
Total off-balance sheet exposures	**1,412,021**	**(1,536)**	**1,410,485**

* *The allowance for impairment of securities in the amount of RSD 3,150 thousand as of 31 December 2018 is recognised under reserves based on the securities measured at fair value through other comprehensive income under equity, not as a deductible item from these financial assets.*

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(a) Maximum Exposure to Credit Risk by Balance Sheet Assets and Off-balance Sheet Items (Continued)

An analysis of the effects of the first-time adoption of IFRS 9 "Financial Instruments" on the impairment of financial assets and provisions for off-balance sheet items

In RSD thousand

	31 December 2017			Effects of first-time adoption of IFRS	1 January 2018		
	Gross exposure	Allowance for impairment	Net exposure		Gross exposure	Allowance for impairment	Net exposure
Gross exposure							
Regular investments	**6,015,014**	**(93,268)**	**5,921,746**	**1,856**	**6,015,014**	**(91,412)**	**5,923,602**
Level 1	XXXXX	XXXXX	XXXXX	13,695	5,401,567	(63,960)	5,337,607
Level 2	XXXXX	XXXXX	XXXXX	(11,839)	613,447	(27,452)	585,995
Default investments - Level 3	**1,136,424**	**(343,919)**	**792,505**	**(39,554)**	**1,136,424**	**(383,473)**	**752,951**
Securities – Level 1*	913,736	-	913,736	(3,029)	913,736	(3,029)	910,707
Assets acquired through the collection of receivables							
Total balance sheet exposures	**8,065,174**	**(437,187)**	**7,627,987**	**(40,727)**	**8,065,174**	**(477,914)**	**7,587,260**
Off-balance sheet exposures							
Regular investments	**2,280,082**	**(13,888)**	**2,266,194**	**11,643**	**2,280,082**	**(2,245)**	**2,277,837**
Level 1	XXXXX	XXXXX	XXXXX	11,643	2,280,082	(2,245)	2,277,837
Level 2	XXXXX	XXXXX	XXXXX	-	-	-	-
Default investments - Level 3	**5,700**	**-**	**5,700**		**5,700**	**-**	**5,700**
Total off-balance sheet exposures	**2,285,782**	**(13,888)**	**2,271,894**	**11,643**	**2,285,782**	**(2,245)**	**2,283,537**

* *The effect of the first-time adoption of IFRS – an increase in the allowance for impairment of debt securities in the amount of RSD 3,029 thousand as of 1 January 2018 is recorded under reserves based on the securities measured at fair value through other comprehensive income under equity, not as a deductible item from these financial assets.*

Concentration of risk is managed by setting the limits by customer/counterparty, by geographical region and by industry sector. In order to avoid excessive risk concentration, the Bank's policies and procedures contain specific guidelines for the development and preservation of diversified portfolio. Accordingly, the Bank controls and manages identified concentrations of credit risks.

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(a) Maximum Exposure to Credit Risk by Balance Sheet Assets and Off-balance Sheet Items (Continued)

The analysis of the Bank's credit risk exposure by industry sectors with the balance as of 31 December 2018 and 2017 is presented in Note 20(d).

The structure of the Bank's credit risk exposure stated at the gross book value of the **total risky placements** as of 31 December 2017, grouped by geographical sectors, is presented in the table below:

In RSD thousand

	Serbia	Europe	Other	Total
Loans and advances:				
- Banks and financial institutions	14,624	129,532	386,212	530,368
- Corporate customers	3,628,099	3	-	3,628,102
- Retail customers	770,111	42	3,171	773,324
- Entrepreneurs	4	-	-	4
Guarantees and other irrevocable commitments	1,411,406	615	-	1,412,021
Balance as of 31 December 2018	**5,824,244**	**130,192**	**389,383**	**6,343,819**
Balance as of 31 December 2017	**9,043,817**	**55,590**	**337,813**	**9,437,220**

The analysis of the Bank's credit risk exposure by industry sectors, before and after allowance for impairment of financial assets and provisions for risk, as of 31 December 2018 and 2017, is presented in the table below:

In RSD thousand

	Gross maximum exposure 2018	Net maximum exposure 2018	Gross maximum exposure 2017	Net maximum exposure 2017
Processing industry	2,455,117	2,295,412	3,320,989	3,233,111
Transportation and warehousing	162,402	160,263	234,023	232,847
Trade	1,443,393	1,315,802	2,552,869	2,438,832
Finance	551,647	542,578	796,696	793,662
Retail customers	785,435	745,747	772,828	744,993
Entrepreneurs	4	3	41,182	40,506
Other	945,821	798,252	1,718,633	1,502,194
Total	**6,343,819**	**5,858,057**	**9,437,220**	**8,986,145**

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(b) Portfolio Quality

The Bank manages portfolio quality using the internal classification of placements.

The following tables present the quality of portfolio (gross placements and off-balance sheet exposure) as of 31 December 2018 and 2017, which is based on the Bank's grading system.

In RSD thousand

	Customer placements			Bank placements			Total 2018	Total 2017
Category	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Placements to customers and banks	Placements to customers and banks
A	2,236,859	24,048	70,912	179,089	-	-	2,510,908	4,550,245
B	1,988,500	91,614	1,374	351,283	-	-	2,432,771	3,280,413
V	338,178	156,340	27,636	-	-	-	522,154	463,851
G	8,247	60,310	244,298	-	-	-	312,855	404,598
D	4,826	13,401	546,904	-	-	-	565,131	738,113
Total	**4,576,610**	**345,713**	**891,124**	**530,372**	**-**	**-**	**6,343,819**	**9,437,220**

The structure of allowances for impairment and provisions, established in accordance with the Bank's internal methodology, was as follows as of 31 December 2018 and 2017:

	Allowances for impairment and provisions for customers			Allowances for impairment and provisions for banks			Total 2018	Total 2017		Total 2017
Category	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Placements to customers and banks	I Placement s to customers and banks	Adjust-ments of allowance for impairment	Placements to customers and banks
A	14,121	1,123	542	1,468	-	-	17,254	31,093	(3,381)	27,712
B	29,233	9,060	625	7,797	-	-	46,715	58,002	(12,360)	45,642
V	13,131	5,843	3,093	-	-	-	22,067	22,032	6,558	28,590
G	61	2,993	67,286	-	-	-	70,340	21,479	7,548	29,027
D	68	165	329,153	-	-	-	329,386	318,469	27,690	346,159
Total	**56,614**	**19,184**	**400,699**	**9,265**	**-**	**-**	**485,762**	**451,075**	**26,055**	**477,130**

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(b) Portfolio Quality (Continued)

An aging analysis of unimpaired loans and advances to customers and an overview of undue and unimpaired placements as of 31 December 2018 and 31 December 2017 were as follows:

In RSD thousand

	Investments to customers and banks			Total	Total
	Level 1	Level 2	Level 3	2018	2017
Non-defaulted receivables	292,889	139,969	995	433,853	117,097
Defaulted receivables:					
- 1-30 days	12,005		-	12,005	3,184
- 31-60 days	-	1,941	-	1,941	4,730
- 61-90 days	-	4	-	4	11,003
- over 90 days	-	-	-	-	50
Total	**304,894**	**141,914**	**995**	**447,802**	**136,064**

The structure of the **risky balance sheet assets and off-balance sheet items and allowances for impairment/provision**, determined in accordance with the Bank's internal methodology, as of 31 December 2018 and 2017, is as follows.

As of 31 December 2018:

In RSD thousand

	Individual assessment		Group assessment		Total 2018	
	Balance sheet assets	Allowance for impairment	Balance sheet assets	Allowance for impairment	Balance sheet assets	Allowance for impairment
Retail customers	26,285	12,353	752,560	27,334	778,845	39,687
Banks and corporate customers	762,529	381,855	3,390,420	62,683	4,152,949	444,538
Entrepreneurs	-	-	4	1	4	1
	788,814	**394,208**	**4,142,984**	**90,018**	**4,931,798**	**484,226**

	Individual assessment		Group assessment		Total 2017	
	Off-balance sheet items	Provision	Off-balance sheet items	Provision	Off-balance sheet items	Provision
Retail customers	-	-	-	-	-	-
Banks and corporate customers	-	-	1,412,021	1,536	1,412,021	1,536
Entrepreneurs	-	-	-	-	-	-
	-	**-**	1,412,021	1,536	**1,412,021**	**1,536**
Total	**788,814**	**394,208**	**5,555,005**	**91,554**	**6,343,819**	**485,762**

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(b) Portfolio Quality (Continued)

As of 31 December 2017:

In RSD thousand

	Individual assessment		Group assessment		Total 2017	
	Balance sheet assets	Allowance for impairment	Balance sheet assets	Allowance for impairment	Balance sheet assets	Allowance for impairment
Retail customers	28,550	11,625	740,201	16,211	768,751	27,836
Banks and corporate customers	1,053,916	325,217	5,302,548	83,458	6,356,464	408,675
Entrepreneurs	-	-	26,223	676	26,223	676
	1,082,466	**336,842**	**6,068,972**	**100,345**	**7,151,438**	**437,187**

	Individual assessment		Group assessment		Total 2017	
	Off-balance sheet items	Provision	Off-balance sheet items	Provision	Off-balance sheet items	Provision
Retail customers	-	-	11,222	178	11,222	178
Banks and corporate customers	-	-	2,259,560	13,710	2,259,560	13,710
Entrepreneurs	-	-	15,000	-	15,000	-
	-	**-**	**2,285,782**	**13,888**	**2,285,782**	**13,888**
Total	**1,082,466**	**336,842**	**8,354,754**	**114,233**	**9,437,220**	**451,075**

An allowance for impairment on a group and individual level is calculated according to the National Bank of Serbia Decision on Classification of Balance Sheet Assets and Off-balance Sheet Items, IFRS 9 “Financial Instruments” and the Bank’s methodology for calculating allowance for impairment of financial assets on the basis of the internal procedure for calculating allowance for impairment.

The impairment assessment is performed on group and individual levels. The group assessment is performed for Level 1 and 2 placements, whereas the individual assessment is carried out when there is objective evidence of impairment of placements, i.e. for Level 3 placements.

The amount of the impairment loss is individually assessed as the difference between the carrying amount and the present value of estimated future cash flows, determined by discounting the expected cash inflow, using the latest effective interest rate, except for loans to private individuals for which the impairment is determined based on experience.

The major factors considered in the individual assessment of impairment of financial assets are default in servicing the debt principal or interests overdue for more than 90 days for material receivables, observed deterioration of the client’s financial position, downgrade, breach of the original terms of the loan contract, amended terms of loan repayment or evidence of bankruptcy likelihood.

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(b) Portfolio Quality (Continued)

Impairment of materially less significant placements are assessed collectively for each segment separately (groups: corporate loans, corporate off-balance sheet items, retail loans, retail cards and overdraft, state and financial institutions), due to their similar characteristics in terms of credit risk based on statistical analysis of historical patterns of cash flows of that part of the portfolio. Elements of group calculation are: PD (probability of default – classification based on the creditworthiness adjusted for default in settlement of liabilities on the assessment date and for forward looking information), LGD, discount factor, collateral and calculation of exposure (EAD).

The amount of impairment of balance sheet assets is determined as the difference between the carrying amount and the present value of expected future cash flows regarding this claim. Impairment of loans, which reduces the value of placements, is recorded in the allowance account in the balance sheet, while the impairment of financial assets measured at fair value through other comprehensive income is recorded under reserves (equity) and recognised as an expense in the income statement.

Pursuant to the regulatory requirements of the National Bank of Serbia, the Bank also calculates required reserve for estimated losses that may arise on the basis of balance sheet assets and off-balance sheet items in accordance with its internal methodology, which is based on the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items.

Rescheduled and Restructured Loans

In order to protect against the risk of default in operations with debtors, the Bank takes the following measures to regulate receivables: rescheduling, restructuring, taking over properties in order to collect receivables, initiating court proceedings and other measures. The Bank grants rescheduling and restructuring to debtors with problems in operations in accordance with the conditions from the Decision on classification of balance sheet assets and off-balance sheet items.

As of 31 December 2018 the Bank had 4 rescheduled and 15 restructured loans of corporate customers, as well as 6 rescheduled and 65 restructured loans of retail customers.

As of 31 December 2017, the Bank had 7 rescheduled and 19 restructured loans of corporate customers, as well as 9 rescheduled and 58 restructured loans of retail customers.

In RSD thousand

31 December 2018	Rescheduled		Restructured	
	Gross	Net	Gross	Net
Corporate customers	166,860	53,780	658,877	545,448
Retail customers	884	857	25,843	15,729
Total	**167,744**	**54,637**	**684,720**	**561,177**

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(b) Portfolio Quality (Continued)

Rescheduled and Restructured Loans (Continued)

In RSD thousand

31 December 2017	Rescheduled		Restructured	
	Gross	Net	Gross	Net
Corporate customers	279,466	118,057	1,096,106	1,058,365
Retail customers	1,549	1,524	23,549	21,034
Total	**281,015**	**119,581**	**1,119,655**	**1,079,399**

Collaterals and Other Credit Enhancements

The amount and type of the collateral required depends on an assessment of the credit risk of each customer. Terms of protection with respect to each placement are determined by the analysis of customers' creditworthiness, type of exposure to the credit risk, placements' maturity, as well as by the amount of the particular loan.

Using its internal methodology, the Bank determines the types of collaterals and the parameters of their valuation. Standard collaterals accepted by the Bank are as follows:

- For corporate loans - real estate mortgages, pledges over inventories and receivables, and
- For retail customers - promissory notes, joint and several guarantee, attachment of salary and authorization for account debit.

The Bank's management monitors the movements in the fair value of collaterals, demands additional collaterals in accordance with the relevant contracts, and monitors the fair value of collateral arrived at by considering the adequacy of the allowance for impairment.

The fair value of collaterals in the form of mortgages as of 31 December 2018 amounts to RSD 2,722,619 thousand (31 December 2017: RSD 6,598,575 thousand), in the form of pledges on inventory and receivables RSD 1,097,004 thousand (31 December 2017: RSD 3,882,573 thousand), while the fair value of other forms of collaterals amounted to RSD 3,275 thousand (31 December 2017: RSD 420,136 thousand).

During 2018 and 2017 the Bank did not approve housing loans to retail customers, and, consequently, does not have mortgages as collaterals arising with respect to these loans.

(c) Default Receivables

The Bank pays special attention to default receivables by monitoring total outstanding balance and the trend of these loans and receivables. Corporate customers' loans get default status when they get NPL status. Retail customers' loans get default status in case of delay in payment of more than 90 days.

Default receivables are monitored at the Bank level, and in accordance with the product criteria (for retail customers) and the industrial sector the customers belongs to, as well as the maturity structure (for corporate clients and entrepreneurs).

33. RISK MANAGEMENT (Continued)

33.1. Credit Risk (Continued)

(c) Default Receivables (Continued)

In RSD thousand

	Gross exposure	Default receivables
Corporate sector	5,006,733	509,235
Retail sector	785,435	16,305
Entrepreneurs' sector	4	-
Finance and insurance sector	551,647	-
Total as of 31 December 2018	**6,343,819**	**525,540**
Total as of 31 December 2017	**9,437,220**	**585,969**

33.2. Liquidity Risk

Liquidity risk is the risk of adverse effects on the Bank's financial result and equity due to its inability to fulfil its liabilities when due arising from:

- Withdrawal of the existing sources of financing, i.e., inability to obtain new sources of funding (liquidity risk of sources of funding) and/or
- Difficulties in converting assets into liquid assets due to disturbances in the market (market liquidity risk).

The main objective of liquidity risk management is to maintain the level of liquid assets in order to settle the outstanding liabilities arising with respect to the balance sheet and off-balance sheet activities at the Bank level in a proper and timely manner.

Liquidity risk management involves the management of all assets and liabilities of the Bank which may affect the Bank's inability to meet its outstanding liabilities.

In order to decrease or limit this risk, the Bank's management strives to arrange diversified funding sources in addition to its core deposit base, to manage balance sheet assets from the liquidity standpoint, and to monitor future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows, and the availability of high grade collaterals which could be used to secure additional funding, if required.

The Bank has established a unique process of liquidity risk management that identifies and assesses the impact of the Bank's activities on its exposure to liquidity risk, i.e., identifies and assesses their impact on the Bank's performance and equity.

33. RISK MANAGEMENT (Continued)

33.2. Liquidity Risk (Continued)

The Bank's liquidity risk management involves an integrated process that includes:

1. Identifying the liquidity risk;
2. Measurement or liquidity risk assessment;
3. Mitigation of liquidity risk;
4. Monitoring and control of liquidity risk; and
5. Reporting on liquidity risk.

Identification of causes or early warning signals of liquidity crisis identification is implemented by the Treasury and Liquidity Sector, in cooperation with the Risk Management Sector and the Financing and Planning Sector, based on the information provided by the organizational units responsible for cooperation with corporate and retail clients, as well as by bodies responsible for liquidity risk management (the Board of Directors and/or Executive Board) and the members of the Assets and Liabilities Managing Committee (the "ALCO Committee").

Measurement or liquidity risk assessment is a quantitative and/or a qualitative assessment of the identified liquidity risk and it is the responsibility of the Risk Management Sector. Measurement and liquidity risk assessment involve the application of the GAP analysis, ratio analysis and stress testing.

Mitigation of liquidity risk implies determining measures and rules for mitigating risks by establishing a system of limits, i.e., maintaining the acceptable level of risk for the Bank's risk profile. The acceptable level of the Bank's risk exposure depends on: structure of assets and their ability to be converted into liquid assets, concentration of the funding sources, as well as the currency structure of assets and sources of funding, based on which limiting the adverse effects to the financial result and the capital of the Bank is enabled, i.e. the sufficient level of liquid funds to meet the outstanding liabilities and to finance the increase in assets is provided.

Mitigation of liquidity risk involves defining:

1. The limits of exposure to liquidity risk (basic and additional limits); and
2. Safeguards against liquidity risk.

Monitoring of liquidity risk defines the process of analysis of the status, changes and trends in liquidity risk exposure. The Risk Management Sector manages the liquidity risk by using defined internal limits within regulatory limits and prescribed measures for protection from critically low liquidity level, i.e. monitors compliance with the defined limits.

The Treasury and Liquidity Sector, in cooperation with other organizational units, carries out the measures for reducing/mitigating the liquidity risk and notifies the Risk Management Sector and ALCO Committee. The ALCO Committee decides whether and up to what extent the proposed measures will be carried out, i.e., whether the liquidity risk exposure is acceptable, considering the effects on the Bank's risk profile indicators – liquidity appetite.

The method of handling and resolving temporary and long-term liquidity crises is defined in more details by the Liquidity Crisis Plan and recovery options, further described through the Bank's Recovery Plan for 2018.

33. RISK MANAGEMENT (Continued)

33.2. Liquidity Risk (Continued)

For the purpose of managing the Bank's short-term liquidity the analyses of the maturity of inflows and outflows on the basis of different items of assets and liabilities are used. Managing medium-term and long-term liquidity is performed by projections of the balance sheet structure based on the planned operating activities and the Strategy of the Bank.

The ALCO Committee is responsible for liquidity risk management, establishing the control mechanisms for monitoring liquidity risk exposure, as well as for adopting relevant conclusions for minimizing risk exposure, adopting draft decisions for decision-making of the Bank's Executive Board – especially the matters regarding liquidity policy and raising funds, as well as other matters related to managing the Bank's assets and liabilities, which are significant for the financial stability of the Bank.

The Bank manages its assets and liabilities in such a way that it can fulfil its due obligations at all times, as well as to have customers disposing with their pecuniary assets in the Bank in accordance with the agreed deadlines.

Main liquidity parameters are monitored daily by the Treasury and Liquidity Sector in order to coordinate inflows and outflows of pecuniary assets, so that daily liquidity parameters remain within the limits prescribed by the National Bank of Serbia.

The coordination of maturity of placements with their sources is the basis for adequate management and provision of necessary liquidity level. The decision-making process on maturity of placements is based on the information on the maturity of deposits, especially on the one referring to the movement in the deposits of important clients, particularly their short-term needs. When deciding, the Bank is making sure that pecuniary assets from short-term sources of funding are not used for long-term placements.

The level of the Bank's liquidity is presented by the liquidity ratio, the narrow liquidity ratio and the liquidity coverage ratio (LCR).

The liquidity ratio is the ratio of the sum of the first and second degree of the Bank's liquid assets (cash, assets on accounts with other banks, deposits with the National Bank of Serbia, cheques and other monetary receivables in the process of realization, irrevocable credit lines approved to the Bank, quoted financial instruments and other receivables due within a month from the date of calculating liquidity radios), on one hand, and the sum of the Bank's sight liabilities or liabilities without determined maturity and liabilities with fixed maturity up to one month from the date of calculation of the liquidity ratio, on the other hand.

The narrow liquidity ratio of the Bank is the ratio between the sum of the Bank's liquid first-degree receivables, on one hand, and the sum of the Bank's sight liabilities or liabilities without determined maturity and the Bank's liabilities with maturity within one month from the date of liquidity ratio calculation, on the other hand.

The liquidity coverage ratio (LCR) is the ratio between the protective layer of the Bank's liquidity and net outflows of liquid assets that would occur within the ensuing 30 days from the day of calculating this ratio under the assumed stress conditions, in aggregate in all the currencies and it is maintained at the level not lower than 100%.

33. RISK MANAGEMENT (Continued)

33.2. Liquidity Risk (Continued)

The liquidity ratios in 2018 and 2017 were as follows:

	2018	2017
Average during the period	3.65	4.18
Highest	6.34	5.83
Lowest	2.36	1.86
As of 31 December	6.34	2.74

As of 31 December 2018, **the narrow liquidity ratio** amounted to 5.44, while **LCR** amounted to 632.39% and it was above the prescribed limit.

During 2018 and 2017 the Bank maintained its liquidity level above the minimal prescribed limits established by the National Bank of Serbia.

Sources of financing are permanently monitored in order to maintain the diversification of sources of financing by currency, geographical origin, the source provider, products and maturity.

The table below presents Bank's financial liabilities based on *expected cash flows* established on the Bank's historical experience of deposit retention (share of transaction deposits retained is 70%, while the share of deposit renewals is - 80%). The table includes *the interest and the principal of the cash flows.*

In RSD thousand

	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
31 December 2018						
Deposits and other financial liabilities to banks, other financial organizations and central bank	15,678	-	-	-	-	15,678
Deposits and other financial liabilities to customers	3,410,708	724,796	2,516,436	921,510	840,723	8,414,173
Subordinated liabilities	-	3,077	9,831	167,212	-	180,120
Other liabilities	56,861	-	-	-	-	56,861
Total	**3,483,247**	**727,873**	**2,526,267**	**1,088,722**	**840,723**	**8,666,832**
31 December 2017						
Deposits and other financial liabilities to banks, other financial organizations and central bank	27,123	-	85,526	95,495	-	208,144
Deposits and other financial liabilities to customers	3,099,168	1,278,675	1,961,354	1,294,455	1,035,564	8,669,216
Subordinated liabilities	-	3,649	10,947	60,188	149,097	223,881
Other liabilities	87,335	-	-	-	-	87,335
Total	**3,213,626**	**1,282,324**	**2,057,827**	**1,450,138**	**1,184,661**	**9,188,576**

33. RISK MANAGEMENT (Continued)

33.2. Liquidity Risk (Continued)

Until 1 October 2018 the Bank had an approved liquidity management limit by VTB Bank OAD, Saint Petersburg, in the amount of RUB 497,000,000 with a six-month maturity, but the limit was cancelled after this date. The settlement limit of SWAP and FX transactions remained in effect on the basis of the pre-paid settlement, i.e. the Bank should be the first one to supply available funds during an exchange of cash flows.

As of 31 December 2018 the Bank did not have any funds withdrawn from the limits that were effective until 1 October 2018.

Additionally, the Bank has short-term limits approved by domestic banks that operate in the banking sector of the Republic of Serbia in the amount of EUR 3,000,000.

The maturity structure of commitments for undrawn loans and limits, received guarantees and letters of credit based on the remaining contractual maturity dates as of 31 December 2018 and 2017 is presented in the table below:

In RSD thousand

	Up to 1 year	From 1 to 5 years	Total
31 December 2018			
Guarantees	495,723	297,566	793,289
Commitments for undrawn loans and limits	20,953	597,779	618,732
Total	**516,676**	**895,343**	**1,412,021**
31 December 2017			
Guarantees	996,473	103,425	1,099,898
Uncovered letters of credit	14,335	-	14,335
Commitments for undrawn loans and limits	18,556	1,152,993	1,171,549
Total	**1,029,364**	**1,256,418**	**2,285,782**

The Bank does not expect that all of the irrevocable commitments will be withdrawn before they expire.

The table below provides an analysis of maturities of assets and liabilities based on the agreed terms of payment. The contractual maturities of assets and liabilities are determined based on the remaining period at the balance sheet date to the contractual maturity date.

33. RISK MANAGEMENT (Continued)

33.2. Liquidity Risk (Continued)

The maturity structure of assets and liabilities at their carrying value at 31 December 2018, by remaining maturity as of the balance sheet is presented as follows:

In RSD thousand

	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
ASSETS						
Cash and balances with central bank	1,969,175	-	-	-	-	1,969,175
Securities	-	694,300		1,162,232	-	1,856,532
Loans and advances to banks and other financial organizations	1,957,871	-	-	-	38,496	1,996,367
Loans and advances to customers	334,631	154,449	718,894	2,045,228	658,989	3,912,191
Intangible assets	-	-	-	50,790	-	50,790
Property, plant and equipment	-	-	-	26,564	-	26,564
Investment property	-	-	-	19,873	-	19,873
Deferred tax assets	-	-	-	5,490	-	5,490
Non-current assets held for sale	-	-	375,484	-	-	375,484
Other assets	43,713	-	-	-	-	43,713
Total assets	**4,305,390**	**848,749**	**1,094,378**	**3,310,177**	**697,485**	**10,256,179**
LIABILITIES AND EQUITY						
Deposits and other financial liabilities to banks, other financial organizations and central bank	15,674	-	-	-	-	15,674
Deposits and other financial liabilities to customers	3,423,296	742,180	2,516,445	1,732,252	-	8,414,173
Subordinated liabilities	-	-	-	-	115,760	115,760
Provisions	-	-	14,626	-	-	14,626
Deferred tax liabilities	1,434	-	-	-	-	1,434
Other liabilities	56,861	-	-	-	-	56,861
Total liabilities	**3,497,265**	**742,180**	**2,531,071**	**1,732,252**	**115,760**	**8,618,528**
Equity	**-**	**-**	**-**	**-**	**1,637,651**	**1,637,651**
Total liabilities and equity	**3,497,265**	**742,180**	**2,531,071**	**1,732,252**	**1,753,411**	**10,256,179**
Maturity mismatch as of:						
- 31 December 2018	**808,125**	**106,569**	**(1,436,693)**	**1,577,925**	**(1,055,926)**	
- 31 December 2017	**(420,981)**	**(1,036,913)**	**(776,420)**	**3,293,493**	**(1,059,179)**	

33. RISK MANAGEMENT (Continued)

33.3. Interest Rate Risk

Interest rate risk is defined as the risk of the possible occurrence of adverse effects to the financial result and equity of the Bank based on the items in the banking book due to the changes in interest rates.

The subjects of the interest rate risk management are all items in the banking book which may cause an adverse effect to the result and capital of the Bank due to the change in interest rates.

The Bank controls interest risk by monitoring the relation between interest-bearing assets/liabilities and their participation in the total assets/liabilities. The Assets and Liabilities Managing Committee monitors the risk of changes in interest rates on all interest-bearing items of assets, liabilities and off-balance sheet items, interest rates' ranges and impact of changes in interest rates on the Bank's revenue, expenses and capital.

By entering into floating interest rates' agreements, the Bank largely impacts on the decrease in risk of changes of interest rates. In practice, the Bank's exposure to interest risk is limited, due to the possibility of harmonizing rates of the loans and deposits, upon the written agreement of retail customers for changing the obligatory agreement elements.

The Bank has established a unique process of interest rate risk management that identifies and assesses the impact of the Bank's activities on its interest rate risk exposure, i.e. identifies and assesses their impact on the Bank's performance and equity.

The Bank's interest risk management involves an integrated process that includes:

1. Identifying the interest rate risk;
2. Measurement or interest rate risk assessment;
3. Mitigation of interest rate risk;
4. Monitoring and control of interest rate risk; and
5. Reporting on interest rate risk.

Identification of the interest rate risk comprehensively identifies causes that lead to the occurrence of the interest rate risk/factors in a timely manner, which involves the determination of the current exposure to interest rate risk (interest-bearing assets and liabilities) and optional risk and exposure to interest rate risk on the bases of new business products and activities, on positions carried in the banking book.

Identification of the interest rate risk causes/factors is performed by the Treasury and Liquidity Sector in cooperation with the Risk Management Sector and the Finance and Planning Sector.

Measurement of interest rate risk is a quantitative and a qualitative assessment of the interest risk exposure using the GAP analysis, ratio analysis, Black-Scholes model (for risk options) and stress testing, which are conducted at least on a monthly basis in the ordinary course of business and are the responsibility of the Risk Management Sector.

33. RISK MANAGEMENT (Continued)

33.3. Interest Rate Risk (Continued)

The Risk Management Sector analyses the impact of changes in interest rates or interest rate repricing pursuant to the Methodology for interest sensitive asset and liability items on a monthly basis and measures the effects of a standard interest rate shock of 200bp on the economic value of the Bank in relation to the Basel limit of 20% of regulatory capital (Tier 1 + Tier 2), which at the same time represents the maximal limit of the acceptable risk by the Bank.

Mitigation of interest rate risk represents the determination of measures and policies to mitigate interest rate risk, i.e., maintaining the risk at acceptable level for the Bank's risk profile.

By monitoring the interest rate risk the process of current status, changes and trends in risk exposure is defined. The Risk Management Sector monitors compliance with the defined limits.

In 2018, the Bank continued the control activities and measuring the interest rate risk applying the standard interest rate shock of 200bp to the items in the banking book on the major currencies individually and for all other currencies on a group basis; the results are presented in the table below.

The Bank's exposure to risk of changes in interest rate (Repricing Gap Report) as of 31 December 2018 with comparative presentation of effects for 2017 is presented in the table below.

Change in economic value in the banking book - total (in aggregate)					
	Marginal gap			Effect on economic value in the banking book	
Time period	Total in RSD	Total in EUR	Weighting factor	Total in RSD	Total in EUR
Up to 1 m	1,135,400,486	9,606,196	0.08%	908,320	7,685
1 - 3 m	39,499,178	334,188	0.32%	126,397	1,069
3 - 6 m	(468,844,271)	(3,966,715)	0.72%	(3,375,679)	(28,560)
6 - 12 m	(1,856,178,877)	(15,704,430)	1.43%	(26,543,358)	(224,573)
1 - 2 y	342,881,523	2,900,991	2.77%	9,497,818	80,357
2 - 3 y	(396,629,583)	(3,355,734)	4.49%	(17,808,668)	(150,672)
3 - 4 y	110,853,918	937,893	6.14%	6,806,431	57,587
4 -5 y	330,570,453	2,796,832	7.71%	25,486,982	215,636
5 -7 y	193,626,254	1,638,199	10.15%	19,653,065	166,277
7 - 10 y	318,649,947	2,695,977	13.26%	42,252,983	357,487
10 - 15 y	-	-	17.84%	-	-
Total	**(250,170,972)**	**(2,116,603)**		**57,004,291**	**482,293**
Regulatory capital as of 31 December 2018:				1,550,943,000	13,121,945
Effect of standard shock impact of +200bp				**+3.68%**	**+3.68%**
Stress test results as of 31 December 2017:					
Regulatory capital as of 31 December 2017				1,636,245,000	13,811,156
Effect of standard shock impact of +200bp				**+1.73%**	**+1.73%**

33. RISK MANAGEMENT (Continued)

33.3. Interest Rate Risk (Continued)

Standard interest rate shock of 200bp on the banking book positions of all major currencies individually (EUR and RSD) and for other currencies in total (USD, CHF, GBP, and RUB) was applied for calculation of the Bank's exposure to interest rate risk.

Interest sensitive positions of the banking book are positioned in time zones in a way presented in the following tables while weighting factors used are based on estimated interest rate rise of 200bp and estimated modified duration for each time zone taken from Basel documents named *"Principles for the Management and Supervision of Interest Rate Risk".*

Positions with fixed interest rate are placed in time zones according to a time to maturity, while positions with variable interest rate are placed in time zones according to date of next interest rate change (repricing).

The Risk Management Sector conducts at least monthly the stress testing of materially significant risks, including the effects of changes in interest rates, in accordance with the nature and level of risks the Bank is exposed to, on income and economic value of the Bank, i.e., the impact on the regulatory capital and capital adequacy, using the interest rate repricing analysis, as presented in the table below:

In RSD thousand

Scenario	Change in market interest rates	Interest rate risk 2018
1	1%	28,502
2	2%	57,004
3	-1%	(28,502)
4	-2%	(57,004)

In RSD thousand

Scenario	Change in market interest rates	Interest rate risk 2017
1	1%	14,209
2	2%	28,418
3	-1%	(14,209)
4	-2%	(28,418)

33. RISK MANAGEMENT (Continued)

33.3. Interest Rate Risk (Continued)

According to the results of stress testing changes the economic value of the banking book for 200 bp, i.e. for standard shock as defined by the Basel Committee, at the end of the year would be as follows:

1. Under the influence of the standard shock on the economic value of individual major currencies (materially significant), they would have a positive effect of 0.35% for the marginal gap in EUR and the positive effect of 3.93% for the marginal gap in RSD, a negative effect of -0.04% for USD and a negative effect of -0.56% for other immaterial currencies (in relation to the regulatory capital).
2. According to the impact of the standard shock on the economic value in total, they would have a positive effect of 3.68% for the marginal gap in respect of the regulatory capital.

In both cases of stress testing (1 and 2), the effect of the standard shock (increase in interest rates of 2% (200 bp) on the economic value (total regulatory capital of the Bank) in the banking book is under the Basel limit of 20%, as well as for the entire period during the year.

33.4. Market Risks

Market risk is the possibility of adverse effects to the financial result and capital of the Bank arising from changes in the value of balance sheet and off-balance sheet items of the Bank due to fluctuations in market prices.

Market risks include: foreign currency risk, price risk (on debt and equity securities) and commodity risk.

The Bank is not exposed to the risk of changes in equity instruments price and the price of goods. Except for the concentration of foreign currency risk, the Bank has no significant concentration of market risk for other items.

33.4.1. Foreign Currency Risk

Foreign currency risk is the risk of adverse effects to the financial result and capital of the Bank due to changes in foreign exchange rates. The Bank is exposed to the foreign currency risk based on the items recorded in the banking and trading books.

The ALCO Committee has established the limits for foreign currency position for each materially significant foreign currency. The positions are monitored on a daily basis to ensure positions are maintained within the established limits.

In accordance with the National Bank of Serbia’s requirements, the Bank regularly maintains its foreign currency position – foreign currency risk indicator within maximal regulatory limits, determined in relation to the regulatory capital. The foreign currency risk indicator is the ratio between the total open net foreign currency position (including the absolute value of the net open position in gold) and the Bank’s capital, which are calculated in accordance with the decision regulating the Bank’s capital adequacy.

The Bank maintains the relation between assets and liabilities in such a manner that its total net open foreign currency position (including the absolute value of the net open position in gold) at the end of each working day does not exceed 20% of the capital.

33. RISK MANAGEMENT (Continued))

33.4. Market Risks (Continued)

33.4.1. Foreign Currency Risk (Continued)

During 2018 the Bank strictly paid attention to reconcile the foreign currency risk indicator with the prescribed limit, where this indicator was mostly at the level below the limit for the whole period during the year.

The objective of foreign currency risk management is to ensure the safe operations of the Bank, by minimizing the adverse effects of the exchange rates fluctuations to the financial result and capital of the Bank, for the positions maintained in the banking and trading books.

The Bank has established a unified process of currency risk management which identifies and assesses the impact of the Bank's activities on its exposure to foreign exchange risk, i.e. identifies and assesses their impact on the result and equity.

The Bank's foreign currency risk management involves an integrated process that includes:

1. Identifying the foreign currency risk;
2. Measurement or foreign currency risk assessment;
3. Mitigation of foreign currency risk;
4. Monitoring and control of foreign currency risk; and
5. Reporting on foreign currency risk.

By identifying foreign currency risk, the Bank in a comprehensive and timely manner identifies the causes/factors that lead to emergence of foreign currency risk, which includes determining the current exposure and currency risk exposure arising from new business products and activities. This activity is the responsibility of the Risk Management Sector, in cooperation with the Financing and Planning Sector and the Treasury and Liquidity Sector.

Measurement of the foreign currency risk represents a quantitative and qualitative assessment of the Bank's exposure to foreign currency risk using the GAP analysis (currency structure), ratio analysis, VaR methodologies of the Group, Black–Scholes model (delta-weighted position) and stress testing. The Risk Management Sector applies on a daily basis the measurement techniques for foreign currency risk indicators and OCP exposures and the stress testing is performed at least quarterly.

The Risk Management Sector performs the stress testing of the sensitivity of the Bank's positions to changes in foreign currency rates at least quarterly, and informs the Bank's Executive Board, ALCO Committee, Audit Committee, Board of Directors and the shareholder "AZRS INVEST" d.o.o. Belgrade.

33. RISK MANAGEMENT (Continued)

33.4. Market Risks (Continued)

33.4.1. Foreign Currency Risk (Continued)

The following tables present the currencies in which the Bank has significant exposure of its non-trading monetary assets and liabilities to foreign currency risk as of 31 December 2018 and 2017.

The analysis presented calculates the effect of the reasonable changes in the exchange rates in relation to RSD, with other variables held constant. Negative values refer to potential decreases in the result of operations (profit/loss) or equity, while the positive values refer to their increase.

In RSD thousand

Currency	Changes in foreign exchange rate (%) 2018	Effect to result before tax 2018
EUR	-20%	22,553
CHF	-20%	(1,682)
USD	-20%	(488)

In RSD thousand

Currency	Changes in foreign exchange rate (%) 2017	Effect to result before tax 2017
EUR	-20%	(498)
CHF	-20%	(113)
USD	-20%	(412)

33. RISK MANAGEMENT (Continued)

33.4. Market Risks (Continued)

33.4.1. Foreign Currency Risk (Continued)

The following table presents the Bank's exposure to foreign currency risk (including a foreign currency clause) as of **31 December 2018**. The table includes assets and liabilities at their carrying amounts.

In RSD thousand

	EUR	USD	CHF	Other currencies	Total sub-balance sensitive to changes in foreign exchange rate	Sub-balance not sensitive to changes in foreign exchange rate	Total
ASSETS							
Cash and balances with central bank	996,230	24,904	8,012	4,244	1,033,390	935,785	1,969,175
Securities	952,413	-	-	-	952,413	904,119	1,856,532
Loans and advances to banks and other financial organizations	1,180,947	452,682	64,507	298,120	1,996,256	111	1,996,367
Loans and advances to customers	2,812,860	165,731	-	-	2,978,591	933,600	3,912,191
Changes in fair value of items subject to hedging	-	-	-	-	-	50,790	50,790
Intangible assets	-	-	-	-	-	26,564	26,564
Property, plant and equipment	-	-	-	-	-	19,873	19,873
Investment property	-	-	-	-	-	5,491	5,491
Deferred tax assets	-	-	-	-	-	375,484	375,484
Non-current assets held for sale	-1,950	-	-	-	-1,950	45,662	43,712
Total assets	**5,940,500**	**643,317**	**72,519**	**302,364**	**6,958,700**	**3,297,479**	**10,256,179**
LIABILITIES AND EQUITY							
Deposits and other financial liabilities to banks, other financial organizations and central bank	6,253	43	-	-	6,296	9,378	15,674
Deposits and other financial liabilities to customers	6,041,013	634,231	70,077	184,940	6,930,261	1,483,912	8,414,173
Subordinated liabilities	-	-	-	115,760	115,760	-	115,760
Provisions	814	48	-	-	862	13,764	14,626
Deferred tax liabilities	-	-	-	-	-	1,434	1,434
Other liabilities	372	589	-	-	961	55,900	56,861
Total liabilities	**6,048,452**	**634,911**	**70,077**	**300,700**	**7,054,140**	**1,564,388**	**8,618,528**
Equity	**-**	**-**	**-**	**-**	**-**	**1,637,651**	**1,637,651**
Total equity and liabilities	**6,048,452**	**634,911**	**70,077**	**300,700**	**7,054,140**	**3,202,039**	**10,256,179**
Net foreign currency position as of:							
-31 December 2018	**(107,952)**	**8,406**	**2,442**	**1,664**	**(95,440)**		
-31 December 2017	**11,768**	**2,060**	**564**	**(519)**	**13,873**		

33. RISK MANAGEMENT (Continued)

33.5. Exposure Risk (Concentration Risk)

Concentration risk is the risk that directly or indirectly arises from the Bank's exposure to the same or a similar source of risk, i.e., the same or similar type of risk.

The concentration risk relates to:

- Large exposures;
- Exposure group with the same or similar risk factors, such as economic sectors, geographic regions, product types and the like; and
- Credit protection instruments, including the maturity and currency mismatch between the large exposures and credit protection instruments of these exposures.

Monitoring the Bank's exposure risk to a single party or a group of related parties falls within the competence of an organizational unit responsible for approving the placements. Monitoring the Bank's exposure to this risk is a compulsory part of the procedures in the phase of granting loans in the sense that the committee approving the Bank's placements has the information regarding the total amount of the Bank's exposure to a single party or a group of related parties in relation to the Bank's capital.

Control of concentration risk is done by establishing appropriate exposure limits that allow diversification of the loan portfolio. In addition to the regulatory-defined method of measuring concentration risk (over the limit), the Bank uses two commonly used measures of concentration: the concentration ratio and the Herfindahl-Hirschman Index (HHI).

The concentration ratio – CR5 (a measure of the concentration of the five largest exposures for which applies: low concentrations of 0-50%, the middle concentration of 50-80% and a high concentration of 80-100%) represents the sum of number of the largest percentage shares of exposure in regulatory capital, while the Herfindahl-Hirschman index is the sum of the squares of all percentage shares of exposure in regulatory capital. For both measures the following relations apply: the more diversified the credit portfolio is (lower concentration), the lower are the values of these measures.

Mitigation of concentration of risks is conducted by the Bank by active management of the credit portfolio, as well as by adapting the established limits.

In 2018 the Bank maintained the exposure risk indicators within the prescribed values. By implementing appropriate activities anticipated by the relevant procedures and decisions on credit approval, the Bank has strived to ensure the scope and the structure of its operations and risky placements to be reconciled with the performance indicators prescribed by the National Bank of Serbia.

In accordance with the Risk management policies and regulations, the Board of Directors approves the exposures and limits, i.e. the loan concentration on certain legal entities or a group of related parties, and persons related to the Bank.

33. RISK MANAGEMENT (Continued)

33.5. Exposure Risk (Concentration Risk) (Continued)

Additional supervision of the exposure risk indicators is performed in the Risk Management Sector, which reports to the Bank's management. The procedures of exposure risk management are subject to controls of the internal audit and compliance function.

The Risk Management Sector is in the process of implementation of the Methodology of the manner of determination, revision and abolishing of the internal limits to banks and other financial institutions (counterparty risk).

Counterparty risk is monitored through the process of managing credit risk and market risks. The Risk Management Sector monitors the exposure to financial institutions in terms of internal and regulatory limits on concentration risk. The movement reports are presented to the Treasury and Liquidity Sector and the ALCO Committee.

The Risk Management Sector creates quarterly reports on the concentration of receivables in relation to individual borrowers, groups of related borrowers, industries, countries or geographical areas and in relation to other parameters of importance for managing credit risk, on which it regularly reports to the Bank's Executive Board in the prescribed form.

33.6. Investment Risk

The Bank's investment risks include equity investments of the Bank in the other legal entities' capital and in property, plant and equipment.

In accordance with the National Bank of Serbia legislation, the Bank monitors its permanent investments and their relation to the regulatory capital. The Bank also ensures that the investment of the Bank in a single non-financial sector entity does not exceed 10% of its capital, while the total investments of the Bank in non-financial entities and in property, plant and equipment cannot exceed 60% of its capital.

Exposure to the risk of investments into other legal entities and property, plant and equipment is monitored by the organizational unit or the Bank's body competent for procurement of tangible assets and investing in legal entities familiar with the current exposure and the amount of capital for the purposes of acting in timely manner in accordance with the prescribed limits.

Additional supervision of the exposure risk indicators is performed in the Risk Management Sector, which reports to the Bank's management on the matter. The procedures of investment risk management are subject to controls of the internal audit and compliance function.

In 2018 the Bank maintained the permanent investments indicator within the prescribed limits and ensured that investments were reconciled with the ratios prescribed by the National Bank of Serbia.

As of 31 December 2018, the Bank did not have investments into non-financial sector entities, while the indicator of investments into property, plant and equipment amounted to 1.71% of the Bank's regulatory capital.

33. RISK MANAGEMENT (Continued)

33.7. Country Risk

The risk related to the Bank's exposure to counterparty's country of origin includes adverse effects which may influence financial result and capital of the Bank, as the Bank might not be able to collect receivables from this counterparty, as a result of political, economic or social situation in the country of origin.

Country risk includes the following risks:

- *Political and economic risk,* which means the probability of loss due to the inability to collect Bank's receivables due to the limitations established by acts of government or other authority in the country of origin of the debtor, as well as general and systemic conditions in that country; and
- *Transfer risk,* which implies the possibility of realizing a loss due to the inability to collect receivables denominated in a currency that is not the official currency of the debtor's country of origin. This may result from imposed limitations on payment of obligations to foreign creditors in a particular currency which is determined by the acts of government and other debtors of the country of origin.

The Risk Management Sector is responsible for managing the Bank's exposure to country risk.

The Bank's limits of exposure to the country risk are determined individually by debtors' country of origin. In case of a concentration of exposures by geographic regions, limits are established on a regional basis.

In determining the level of the allowance for impairment and provision for risks per states, the Bank takes into account the country risk.

The Bank conducts the major part of its business operations and in particular granting activities on the territory of the Republic of Serbia and to the local customers, while it is exposed to the country risk in the portion of assets it keeps on the accounts with foreign banks.

The Bank has implemented the policy of the country risk management in such a way that it constantly monitors its exposure to this type of the risk compared to adopted limits which are determined based on the rating of countries determined by competent institutions (OECD), regularly informing the management on such exposures.

The Bank also mitigates the country risk by deploying the policy of placing funds abroad, primarily by depositing funds on a short-term basis with the first class foreign banks.

33. RISK MANAGEMENT (Continued)

33.8. Operational Risk

Operational risk is the risk of adverse effects to the financial result and capital of the Bank due to failures in performance of operating activities (unintentional and intentional) in the work of employees, inadequate internal procedures and processes, inadequate management of the information and other systems in the Bank, as well as due to unforeseen external events. This definition includes legal risk, but excludes strategic and reputation risk.

Operational risk also includes: legal risk, risk arising from introduction of new products, activities, processes and systems, as well as the risk of outsourcing activities to third parties and information system risk.

Furthermore, operational risk includes regulatory (compliance) risk, as a part of the unique procedure of the Risk Management Sector and Department for Operations Compliance Control and AML, according to their competencies, in the sense of creating a joint base of operational and regulatory risks, monitoring unique limits of risk appetite, as well as management and reporting on risks the Bank is exposed to in its operations.

The operational risk management process assumes the involvement of the Board of Directors, Executive Board, Operational Risks Management Committee, Audit Committee and all other organizational units of the Bank.

The Bank has established a unified process of operational and regulatory risk management, which identifies and assesses the impact of the Bank's activities on its exposure to the above mentioned risks, i.e., identifies and assesses their impact on the result and equity of the Bank.

The Bank’s operational and regulatory risk management involves an integrated process that includes:

1. Identifying the risk;
2. Measurement or risk assessment;
3. Mitigation of the risk;
4. Monitoring and control of the risk; and
5. Reporting on the risk.

By identifying the operational and regulatory risk, the Bank identifies the causes/factors that lead to the arising of the risk in a comprehensive and timely manner, further implementing risk classification for data collection on operational and regulatory risks and losses (OR base), which involves determining the current exposure and the exposure to the risk of introducing the products/services of the Bank and/or outsourcing of activities/services to third parties.

The database containing the information on events based on which losses occurred or may have occurred, in accordance with the prescribed limit, as a consequence of operational or regulatory risk by categories determined in accordance with the loss sources and other criteria for description and classification of events, is loaded with data entry based on the identified risks by types of activities, by the employees responsible for certain operational processes in the Bank by reporting on the risks to the Risk Management Sector for further processing.

The Bank identifies the operational risk retroactively (through entries in the data base on events) and proactively through the periodical self-assessments of the operational risk.

33. RISK MANAGEMENT (Continued)

33.8. Operational Risk (Continued)

Measurement and assessment of operational risk exposure represents the quantitative and/or qualitative assessment of risk identified by the Risk Management Sector, through the application of the methodology for self-assessment of the risks, analysis of the impact on business operations and exposure indicators using the basic indicator – at least annually, as well as by the frequency of movement of key risk indicators (KRI) and stress testing on a quarterly basis.

On assuming the operational risk the Bank is guided by the following principles:

- The analysis of key risk indicators that lead to the occurrence of the operational risk events; and
- The current exposure to operational risk is measured and exposure is assessed based on the introduction of new products and activities and entrusting the activities/services to third parties for the purposes of minimizing the operational risk event.

By the process of mitigating the operational risk, the Bank determines the measures for mitigating the operational risk, which include the following:

- Defining exposure limits;
- Defining key indicators for monitoring and control of exposure; and
- Application of mechanism for transfer of risk.

The Bank has defined and adopted the Policy on Business Continuity and revised Business Continuity Plan (BCP), which also includes Disaster Recovery Plan (DRP), that, along with the accompanying appendices enable smooth and continuous operations of all relevant systems and processes of the Bank, as well as limiting the loss in emergency situations. These plans were adequately tested during 2018.

The process of monitoring and reporting on the effects of the realization of implemented measures and techniques for mitigating the operational risk is performed by the Risk Management Sector through regular reporting to the Operational and Compliance Risk Management Committee and the Executive Board. The Department for Operations Compliance Control and AML performs identification, monitoring and reporting on the effects of realisation of the applied measures and regulatory (*compliance*) risk mitigation techniques.

The system of reporting on operational risk includes the timely reporting on operational risk events by type of event and lines of business, causes and sources of events, importance of events, exposure trend, measures intended to be undertaken or have been undertaken in order to mitigate and limit the consequences of the events and activities the Bank entrusted to third parties, as well as limits for the new products.

Decision on outsourcing or the change of the provider of a service and introduction of a new product, and procedures for its change is in the hands of the Executive Board of the Bank, based on the Operational and Compliance Risk Management Committee proposal.

Measurement and management of the process of outsourcing is based on the identification and assessment of all the risks associated with the activities of the assignment of activities to third parties (externalization), which may have an impact on: the continuity of operations of the Bank; costs, financial results, liquidity, solvency and capital; the Bank's risk profile; service quality and reputation of the Bank. The introduction of new products/services is treated in an analogous way.

33. RISK MANAGEMENT (Continued)

33.8. Operational Risk (Continued)

During 2018 the Risk Management Sector reported to the Operational and Compliance Risk Management Committee, the Executive Board of the Bank and the former Parent Bank (until Bank's shares were sold to other shareholder) by submitting periodical reports on the recorded operational events that may have adverse effects to the capital and capital adequacy with the proposal of measures to be undertaken for their elimination/mitigation. It also communicated the deadlines and conclusions reached by the Committee to the responsible personnel. Likewise, the Risk Management Sector monitors the execution of related tasks and informs the Committee thereon.

On a quarterly basis, data on capital requirement for operational risk under the BIA approach with data on exposure indicator that enters into the basis for calculation are submitted to the National Bank of Serbia. In addition, at the request of the National Bank of Serbia, the data about the Base of operational events and the Minutes of meetings of the Operational and Compliance Risk Management Committee are submitted.

In 2018, potential operational events related to credit risk originating from prior periods were recorded in the Base of operational losses (Note 38(b)).

33.9. Risk of Early Repayment

The risk of early repayment is the risk that the Bank will realize a financial loss if customers repay their obligations to the Bank or require repayment before or after the expected deadline.

The effect on the net interest income, i.e., annual profit/(loss) before income tax and equity, assuming that 10% of the financial instruments are to be prepaid at the beginning of the year, with other variables held constant, is as follows:

In RSD thousand

Currency	Effect to the net interest income 2018	Effect to the net interest income 2017
EUR	(1,355)	(2,774)
Other currencies	(2,789)	(3,671)

34. INFORMATION SYSTEM RISK

The information system (IS) risk, as a component of the operational risk, is the possibility of adverse effects on the financial performance and capital, achieving the business results, business operations in accordance with the regulations and reputation of the Bank due to inadequate management of the information system or any other system weakness that adversely affects the functionality or safety of the system and/or jeopardizes business continuity.

The Bank manages IS risks through an integrated process of Bank's operational risk and business continuity management, which defines the identification, assessment, analysis and monitoring of operational risks and the associated risks - the IS risk, as well as measures for their mitigation, prevention and control in accordance with the legal regulations and internal documents.

IS risk assessment is carried out at least once a year as part of a comprehensive self-assessment of operational risks in the Bank on the processes containing the information component and according to the dynamics of assessment of the Analysis of the influence on operations, which includes the process in which the organizational units of the Bank, in collaboration with the Risk Management Sector, observe the IS risk register and indicate the extent to which they are exposed to certain IS risks.

IS risk assessment allows process owners to timely identify and assess the risks that affect the processes for which they are responsible. After the completion of the regular risk assessment of IS, the Risk Management Sector creates the IS risk assessment report as an integral part of self-assessment of operational risk in the Bank, which is submitted to the Bank's bodies for review and approval.

35. FAIR VALUE MEASUREMENT

The fair value presented in financial statements is the amount for which an asset may be exchanged, or a liability settled, between informed, willing parties in an arm's length transaction. Fair value is calculated using market information available as at the reporting date as well as the individual assessment methods of the Bank.

The fair value of a financial instrument presented at nominal value is approximately equal to its carrying value. This includes cash as well as liabilities and receivables without defined maturity or fixed interest rate.

For other liabilities and receivables the expected future cash flows are discounted up to their present value by means of current interest rate. Considering that the variable interest rates are contracted for the majority of Bank assets and liabilities, changes in the current interest rates lead to changes in the contracted interest rates.

Quoted market prices are used for trading securities. The fair value of other securities is calculated as net present value of the future expected cash flows.

Fair value of irrevocable commitments and contingent liabilities equals their carrying value.

35. FAIR VALUE MEASUREMENT (Continued)

Measurement of Financial Instruments

The Bank measures fair value by means of the following fair value hierarchy reflecting the importance of the inputs used in measurement:

- **Level 1**: Quoted market prices (uncorrected) in active markets for identical instrument.
- **Level 2**: Assessment techniques based on the observable inputs that are not the quoted prices from the level 1, whether directly (as prices) or indirectly (derived from prices). This category includes instruments valued through their use: quoted prices in active markets for similar instruments; stated prices for same or similar instruments in the markets considered as less active; or other assessment techniques in which all important inputs are directly or indirectly observable from the market data.
- **Level 3**: Assessment techniques used for non-observable inputs. This category includes all instruments relative to which the valuation techniques include inputs not based on observable data and non-observable inputs that have a significant effect on the valuation of the instruments. This category includes instruments valued on the basis of quoted prices of similar instruments with significant non-observable adjustments or assumptions necessary to maintain the difference between the instruments.

Fair value of financial assets and liabilities traded in active markets is based on quoted market prices or prices quoted by dealers. For all other financial instruments the Bank determines fair value by means of assessment techniques.

Assessment techniques include net present value and discounted cash flow models, comparisons with similar instruments for which there is an observable market price and other assessment models. Assumptions and inputs used in assessment techniques include risk free and benchmark interest rates, loan margins and other premiums used in assessment of discount rate, bond and share prices, foreign currency exchange rates, capital and capital indexed prices and expected oscillations of the prices and correlations.

The aim of assessment techniques is to determine the fair value which reflects the price of a financial instrument as at the reporting date that would be defined by market participants in free transactions carried out at an arm's length.

The Bank uses widely accepted assessment models in determining the fair value of common and simpler financial instruments such as interest rates and currency swaps which make use only of observable market data and require little judgement and assessment by the management. Quoted prices and model inputs are usually (relatively) available in the market for quoted debt and proprietary securities, trading derivatives and simple derivatives such as interest rate swaps.

The availability of the observable market prices and model inputs decreases the need for assessment by management and reduces the uncertainty arising from determining the fair value. The availability of the observable market data and inputs varies based on the product and market and is prone to change due to particular occurrences and general condition of the future markets.

35. FAIR VALUE MEASUREMENT (Continued)

The following table presents the fair value of financial instruments not measured at fair value and analyses them according to the fair value hierarchy within which the fair value measurement takes place:

In RSD thousand

	31 December 2018		31 December 2017			
	Carrying value	Fair value	Carrying value	Adjustment for the effects of IFRS 9 application	Opening balance as of 1 January 2018	Fair value
Financial (monetary) assets						
Cash and balances with central bank	1,969,175	1,969,175	1,603,452	-	1,603,452	1,603,452
Securities	1,856,532	1,856,532	913,736	-	913,736	913,736
Loans and advances to banks and other financial organizations	1,996,367	1,996,367	1,756,505	(813)	1,755,692	1,668,680
Loans and advances to customers	3,912,191	3,289,733	5,873,639	(37,574)	5,836,065	5,579,957
Other assets	43,172	43,172	48,593	689	49,282	48,593
Total	**9,777,437**	**9,154,979**	**10,195,925**	**(37,698)**	**10,158,227**	**9,814,418**
Financial (monetary) liabilities						
Deposits and other financial liabilities to banks and other financial organizations	15,674	15,674	203,206	-	-	203,206
Deposits and other financial liabilities to customers	8,414,173	8,492,983	8,592,080	-	-	8,592,080
Subordinated liabilities	115,760	176,542	134,215	-	-	134,215
Other liabilities	56,861	56,861	87,335	-	-	87,335
Total	**8,602,468**	**8,742,060**	**9,016,836**	**-**	**-**	**9,016,836**

35. FAIR VALUE MEASUREMENT (Continued)

Fair Value Hierarchy Analysis

In RSD thousand

31 December 2018	Level 1	Fair value Level 2	Level 3	Total
Assets				
Financial assets at fair value through other comprehensive income	1,856,532	-	-	1,856,532
Loans and advances to banks and other financial organizations	-	1,996,367	-	1,996,367
Loans and advances to customers	-	3,289,733	-	3,289,733
Total	**1,856,532**	**5,286,100**	**-**	**7,142,632**
Liabilities				
Deposits and other financial liabilities to banks and other financial organizations	-	15,674	-	15,674
Deposits and other financial liabilities to customers	-	8,492,983	-	8,492,983
Subordinated liabilities	-	176,542	-	176,542
Total	**-**	**8,685,199**	**-**	**8,685,199**

In RSD thousand

31 December 2017	Level 1	Fair value Level 2	Level 3	Total
Assets				
Financial assets available for sale	913,736	-	-	913,736
Loans and advances to banks and other financial organisations	-	1,668,680	-	1,668,680
Loans and advances to customers	-	5,579,957	-	5,579,957
Total	**913,736**	**7,248,637**	**-**	**8,162,373**
Liabilities				
Deposits and other financial liabilities to banks and other financial organizations	-	203,206	-	203,206
Deposits and other financial liabilities to customers	-	8,592,080	-	8,592,080
Subordinated liabilities	-	134,215	-	134,215
Total	**-**	**8,929,501**	**-**	**8,929,501**

35. FAIR VALUE MEASUREMENT (Continued)

Where possible, fair value of loans and advances is based on the observable market transactions. If observable market transactions are not available, fair value is assessed by means of assessment models such as cash flow discount techniques.

Assessment technique inputs include the expected credit losses over the course of loan duration, interest rates, advances, and source data or secondary market data. For collateral dependant reduced (impaired) loans, fair value is measured based on the value of the related collateral. Model inputs may include data by third party brokers based on the OTC trading activity, and information obtained from other market participants which include observable primary and secondary transactions.

In order to improve the accuracy of assessment of retail loans and smaller commercial loans, homogenous loans are grouped into portfolios according to similar characteristics such as origin, LTV ratios, quality of collateral, type of product and debtor, advances and non-performance rates, and standard probability.

Fair value of clients and banks' deposits is determined by using discounted cash flows technique by applying rates offered for deposits of similar maturity and conditions. Fair value of a vista deposits is the amount for payment as at the reporting date.

Table below presents Bank classification for each class of financial assets and liabilities at carrying value and their fair value as of **31 December 2018**:

In RSD thousand

	Measured at fair value	FVOCI securities	Amortised cost	Total carrying value	Fair value
Cash and balances with central bank	1,969,175	-	-	1,969,175	1,969,175
Financial assets at fair value through other comprehensive income	-	1,856,532	-	1,856,532	1,856,532
Loans and advances to banks and other financial organizations	-	-	1,996,367	1,996,367	1,996,367
Loans and advances to customers	-	-	3,912,191	3,912,191	3,289,733
Other assets	-	-	43,172	43,172	43,172
Total assets	**1,969,175**	**1,856,532**	**5,908,558**	**9,777,437**	**9,154,979**
Deposits and other financial liabilities to banks and other financial organizations	-	-	15,674	15,674	15,674
Deposits and other financial liabilities to customers		-	8,414,173	8,414,173	8,492,983
Subordinated liabilities	-	-	115,760	115,760	176,542
Other liabilities	-	-	56,861	56,861	56,861
Total liabilities	**-**	**-**	**8,602,468**	**8,602,468**	**8,742,060**

35. FAIR VALUE MEASUREMENT (Continued)

Table below presents Bank's classification for each class of financial assets and liabilities at carrying value and their fair value as of **31 December 2017** (in compliance with the previously applicable classification of financial instruments according to IAS 39):

In RSD thousand

	Carried at fair value	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying value	Fair value
Cash and balances with central bank	-	-	1,603,452	-	-	1,603,452	1,603,452
Financial assets available-for-sale	-	-	-	913,736	-	913,736	913,736
Loans and advances to banks and other financial organizations	-	-	1,756,505	-	-	1,756,505	1,668,680
Loans and advances to customers	-	-	5,873,639	-	-	5,873,639	5,579,957
Other assets	-	-	-	-	48,593	48,593	48,593
Total assets	**-**	**-**	**9,233,596**	**913,736**	**48,593**	**10,195,925**	**9,814,418**
Deposits and other financial liabilities to banks and other financial organizations	-	-	-	-	203,206	203,206	203,206
Deposits and other financial liabilities to customers	-	-	-	-	8,592,080	8,592,080	8,592,080
Subordinated liabilities	-	-	-	-	134,215	134,215	134,215
Other liabilities	-	-	-	-	87,335	87,335	87,335
Total liabilities	**-**	**-**	**-**	**-**	**9,016,836**	**9,016,836**	**9,016,836**

Methodology and assumptions used in determining fair value of those financial instruments not yet recorded at fair value in the financial statements are described below.

Assets whose Fair Value Approximates their Carrying Value

For financial assets and liabilities that are liquid or have short term maturity (less than one year), the assumption is that their carrying value approximates their fair value. This assumption is also applied to *a vista* deposits, non-term savings accounts, and financial instruments with variable rate.

Financial Instruments with Fixed Rate

Fair value of financial assets and liabilities with fixed rate recorded at amortised value is assessed by comparison with market interest rates at initial recognition based on the current market rates offered for similar financial instruments.

The assessed fair value of deposits with fixed interest rate is based on the discount of cash flows by applying the prevailing interest rates to money market debt with similar risk and maturity.

36. INTERNAL ASSESSMENT OF CAPITAL ADEQUACY

Internal assessment of capital adequacy is the process of assessment of all significant risks to which the Bank is or might be exposed in its operations. The process of internal assessment of capital adequacy includes the following phases:

1) Identification of the material significance of the risk;
2) Calculation of the amount of internal capital requirements for individual risks;
3) Determining total internal capital requirements; and
4) Comparison of the following elements:
    - The amount of capital calculated in accordance with the National Bank of Serbia's Decision governing the banks capital adequacy and available internal capital;
    - Minimum capital requirements calculated in accordance with the National Bank of Serbia's Decision governing the banks capital adequacy and internal capital requirements for individual risks; and
    - Sum of minimal capital requirements calculated in accordance with the National Bank of Serbia's Decision governing the banks capital adequacy and total internal capital requirements.

The analysis of the risk profile of the Bank identified the risks for which the Bank will calculate capital requirements in the process of internal capital adequacy assessment, such as: credit risk, market risk, operational risk, liquidity risk, interest rate risk in the banking book, concentration risk, strategic risk, credit and foreign exchange risk and other material risks.

For other types of risks the Bank is exposed to in its operations, the Bank will calculate capital requirements if they are identified as material, by applying adequate linear percentage on the basis of the subjective assesment of the management of the Bank. The Bank manages the above mentioned risks using the techniques for mitigation/risk transfer and has set forth certain procedures for risk management and other internal regulations.

Determination of the total internal capital available for risk coverage is performed by adding up capital requirements for individual materially significant risks.

Comparison of the amount of the required internal capital to the amount of capital calculated in accordance with the National Bank of Serbia's Decision governing the capital adequacy is performed quarterly, through the preparation and analysis of reports regarding the process of internal assessment of capital adequacy. The report is prepared by the Risk Management Sector.

The Risk Management Sector informs the Executive Board, the Assets and Liabilities Management Committee, the Audit Committee and the Bank's Board of Directors on the calculated internal assessment of capital adequacy.

37. CAPITAL MANAGEMENT

(a) Regulatory Capital

The Bank permanently manages its capital, which is a broader concept than “equity” stated in the balance sheet, in order to:

- Comply with the capital requirements set by the National Bank of Serbia;
- Ensure the ability to continue as a going concern on a long-term basis, together with providing a profit to shareholders and benefits to other stakeholders; and
- Maintain an adequate capital base to support the development of its business.

The Bank’s management monitors regularly the Bank’s capital adequacy ratios and other performance indicators established by the National Bank of Serbia and delivers to the National Bank of Serbia quarterly reports on achieved (realised) indicators.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristic of its activities. The Bank's capital management strategy defines the relationship to capital in a way that ensures capital management on an ongoing and long-term basis.

The aim of the strategy of capital management is to ensure by its implementation the forming and maintenance of an adequate level and structure of internal capital, as well as strengthening the capital base of the Bank. The Bank's capital management strategy remained unchanged compared to the previous year.

The National Bank of Serbia has defined the following capital limits:

- The minimum amount of the regulatory capital of EUR 10 million in dinar counter value at the official middle exchange rate; and
- The capital adequacy ratio of at least 8%.

In accordance with the Decision on Capital Adequacy of Banks (“RS Official Gazette”, no. 113/2016), the method of calculating capital adequacy ratios has been determined. The capital adequacy ratio of the Bank equals to the ratio between the Bank’s capital and the sum of risk-weighted assets of the Bank. The Bank’s equity consists of the aggregate of basic capital and supplementary capital, net of deductible items defined by the above decision.

Risk-weighted assets represent the sum total of credit risk-weighted balance sheet assets and capital requirement for market risks and capital requirement for operational risk determined in the manner prescribed by the aforementioned decision, multiplied by the reciprocal value of the capital adequacy ratio.

For the calculation of the credit and market (foreign currency) risk-weighted assets the Bank uses the standardised approach (SA), while for the calculation of the exposure indicators (operating risk) it uses the method of basic indicators (BIA). Credit risk-weighted assets of the Bank are the sum of credit risk-weighted balance sheet assets and credit risk-weighted off-balance sheet items.

37. CAPITAL MANAGEMENT (Continued)

(a) Regulatory Capital (Continued)

Risk-weighted balance sheet items of the Bank, in terms of credit risk exposure, represent the sum total of gross carrying values of the Bank's balance sheet items less allowances for impairment and the required reserve for estimated losses. Risk-weighted off-balance sheet items of the Bank, in terms of credit risk exposure, represent the sum total of gross carrying values of the Bank's off-balance sheet items less provision for losses on off-balance sheet items and the required reserve for estimated losses, multiplied by the appropriate credit conversion factors.

In accordance with the Decision on Capital Adequacy of Banks, the Bank is obliged to, in addition to the minimum amount of capital of EUR 10 million, maintain at all times its capital at the level sufficient to cover all risks the Bank is exposed to or may be exposed to in its operations, at least in the amount of the of the following capital requirements:

- Capital requirement for credit risk, capital requirement risk of the decrease of the value of purchased receivables and capital requirement for counterparty risk for all the Bank's transactions and capital requirement for settlement/delivery risk for activities from the trading book;
- Capital requirement for price risk for activities from the trading book;
- Capital requirement for foreign exchange risk and commodity risk for all transactions of the Bank;
- Capital requirement for credit valuation adjustment risk for all the operations of the Bank (CVA); and
- Capital requirement for operational risk for all activities of the Bank.

For the purposes of determining the regulatory capital and the capital adequacy ratio, the Bank's core (basic) capital at the reporting date includes the paid-in share capital, while supplementary capital comprises subordinated liabilities. Deductions from capital are losses from prior years, loss for the current year, intangible assets and the amount of required reserves for estimated losses on the balance sheet assets and off-balance sheet items of the Bank.

The reserve for estimated losses arising from credit risk contained in the credit portfolio of the Bank, is calculated in accordance with the National Bank of Serbia Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items ("RS Official Gazette", no. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017, 114/2017 and 103/2018).

As of 31 December 2018, the required reserve for potential losses that may arise on balance sheet assets and off-balance sheet items amounted to RSD 109,792 thousand (31 December 2017: RSD 84,172 thousand).

The total calculated required reserve stated in the Report on Classification of Balance Sheet Assets and Off-balance Sheet Items of the Bank as of 31 December 2018 amounts to RSD 218,971 thousand, out of which RSD 214,089 thousand relates to the required reserve for balance sheet assets and the amount of RSD 4,882 thousand relates to required reserve for off-balance sheet items. In the last quarter of 2017 the Bank applied certain articles of the Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items, subsequent to the amendments to the Decision ("RS Official Gazette", no. 69/2016 and 114/2017), i.e. Article 21b, paragraph 3 and Article 34a, which relate to the calculation of the required reserve for the purpose of calculation of regulatory capital.

37. CAPITAL MANAGEMENT (Continued)

(a) Regulatory Capital (Continued)

Pursuant to the application of the above mentioned articles, the Bank has calculated and stated the required reserve in the amount of RSD 109,792 thousand when calculating the regulatory capital as of 31 December 2018, as presented in the table below.

The table below summarizes the structure of the Bank's regulatory capital as of 31 December 2018 and 2017, as well as the capital adequacy ratio:

In RSD thousand

	31 December 2018	31 December 2017
Regulatory capital		
Core capital		
Nominal value of the paid-up shares, excluding cumulative preference shares	3,672,407	3,672,407
Accumulated losses	(2,076,389)	(1,873,549)
Loss for the year		(173,756)
Intangible assets	(50,790)	(38,900)
	1,545,228	1,586,202
Supplementary capital - subordinated liabilities	**115,507**	**134,215**
Total core and supplementary capital	**1,660,735**	**1,720,417**
Deductible items:		
Required reserve for estimated losses on balance sheet assets and off-balance sheet items	(109,792)	(84,172)
Total capital (1)	**1,550,943**	**1,636,245**
Risk exposure		
Credit risk exposure – standardized approach	4,708,795	6,512,949
Operational risk exposure	1,038,588	1,034,235
Market risk exposure	114,240	14,494
Total (2)	**5,861,623**	**7,561,678**
Capital adequacy ratio - Basic share capital	*24.49%*	*19.86%*
Capital adequacy ratio - Core capital	*24.49%*	*19.86%*
Capital adequacy ratio (1/2 x 100)	*26.46%*	*21.64%*

As of 31 December 2018, the Bank's regulatory capital amounts to RSD 1,550,943 thousand, i.e. EUR 13,121,945 translated at the official median exchange rate as of the balance sheet date (31 December 2017: RSD 1,636,245 thousand, i.e. EUR 13,811,156). The capital adequacy ratio of the Bank amounting to 26.46% is above the prescribed minimum of 8%.

Tier 1 Leverage Ratio representing the ratio of core capital and the amount of the Bank's exposure as of 31 December 2018 amounted to 13.37%.

37. CAPITAL MANAGEMENT (Continued)

(a) Regulatory Capital (Continued)

Pursuant to the National Bank of Serbia's Official Letter on the Bank's Supervision Assessment and Accompanying Recommendations dated 30 May 2018, the Bank is recommended to maintain the regulatory capital at 17.22% of the risky assets, representing total supervision capital requirement that needs to be increased by the calculated combined protection capital tier on a relevant date.

As of 31 December 2018 the overall capital requirement amounted to 21.45% of the risky assets, calculated as the sum of the total supervision capital requirements and combined protection capital tier on that day.

Pursuant to the Decision of the National Bank of Serbia on Bank Capital Adequacy, as of 31 December 2018 the Bank had sufficient level of capital to meet the minimum requirements of the National Bank of Serbia.

(b) Performance Indicators – Compliance with Legal Requirements

The Bank is obliged to reconcile the scope and the structure of its operations and risky placements with the performance indicators prescribed by the Law on Banks and the relevant decisions of the National Bank of Serbia issued on the basis of the aforementioned Law.

The Bank's performance indicators as at 31 December 2018 were as follows:

Performance indicators	Prescribed	Realized
1. Regulatory capital	Minimum EUR 10 milion	13,121,945
2. Capital adequacy ratio	Minimum 8%	26.46%
3. Capital adequacy ratio of basic share capital	Minimum 4.5%	24.49%
4. Capital adequacy ratio - Core capital	Minimum 6%	24.49%
5. Bank's investments	Maximum 60% of the capital	1.71%
6. Exposure to a single party or a group of related parties	Maximum 25% of the capital	22.12%
7. The total sum of all large exposures of the Bank in relation to capital	Maximum 400%	32.81%
8. Liquidity ratios as of the last date:		
- in the first month of the last quarter of 2018	Minimum 1	2.68
- in the second month of the last quarter of 2018	Minimum 1	3.91
- in the third month of the last quarter of 2018	Minimum 1	6.34
9. Narrow liquidity coverage ratio	Minimum 0.5	5.44
10. Liquidity coverage ratio (LCR)	Minimum 100%	632.39%
11. Foreign currency risk indicator	Maximum 20% of the capital	7.06%

As of 31 December 2018 the Bank complied all its performance indicators with the prescribed ones.

38. COMMITMENTS AND CONTINGENT LIABILITIES

(a) Operating Lease Commitments

The Bank has entered into commercial operating leases on certain business premises and vehicles.

The future minimum lease payments under operating irrevocable commitments on the basis of operating leases are as follows:

In RSD thousand

	31 December 2018	31 December 2017
Up to 1 year	41,719	39,527
From 1 to 5 years	112,359	8,569
Total	**154,078**	**48,096**

(b) Litigations

As of 31 December 2018 the Bank acts as a defendant in 28 litigations. The total estimated amount of the related claims equals RSD 11,688 thousand.

According to the estimate of the Legal Department and the legal advisers of the Bank positive outcome is expected for the majority of the litigations. As disclosed in the Note 28 to the financial statements, as of 31 December 2018, the Bank established the provision for potential losses that may arise from the above litigations in the total amount of RSD 8,347 thousand.

The Bank's management believes that no material losses shall arise on the basis of the outcome of the remaining litigations in progress in excess of the amount for which the provisions were made.

(c) Tax Risks

Tax system in the Republic of Serbia is undergoing continuous amendments. Tax period in the Republic of Serbia is considered to be open for the five-year period. In different circumstances, tax authorities could have different approach to some problems, and could detect additional tax liabilities together with related penalty interest and fines. The Bank's management believes that tax liabilities recognised in the accompanying financial statements are fairly presented.

39. RECONCILIATION OF OUTSTANDING BALANCES WITH COUNTERPARTIES

In accordance with Article 18 of the Law on Accounting, the Bank is obliged to perform reconciliation of receivables and payables with its debtors and customers, and it maintains credible documentation on the circularization process.

The Bank submitted 580 confirmations (IOS forms) to its debtors and customers with the outstanding balance of receivables/payables as of 31 October 2018, out of which 252 confirmations were returned and according to which the unreconciled receivables amounted to RSD 35 thousand, and the unreconciled liabilities amounted to RSD 35 thousand and were reconciled with creditors and suppliers by the end of 2018.

Based on the exchanged confirmations, there are neither disputed confirmations for loans and advances to customers nor for liabilities.

Since the confirmations (IOS form) include a clause stating that “If the recipient does not return the confirmation within a certain period of time, the balance of receivables and payables shall be deemed reconciled”, the Bank considers that the outstanding balances stated in the remaining unreturned confirmations, are also reconciled.

40. EXCHANGE RATES

The official median exchange rates of the National Bank of Serbia, determined at the Interbank Foreign Currency Market, used in the translation of balance sheet items denominated in foreign currencies, as of 31 December 2018 and 2017 into the functional currency (RSD), for the major foreign currencies were as follows:

		U RSD
	2018	**2017**
EUR	118.1946	118.4727
USD	103.3893	99.1155
CHF	104.9779	101.2847
RUB	1.4841	1.7207

41. EVENTS AFTER THE REPORTING PERIOD

(a) In February 2019 the members of the Executive Board changed. A new member Ina Zarina was introduced, while Vesna Tomasevic left the Executive Board of the Bank.

(b) In February 2019 the Bank initiated a market value assessment of shares with the aim of the Bank’s recapitalisation planned to be done during 2019. Accordingly, on 1 March 2019 the Bank's Executive Board brought the decision on the selection of consultants in respect of this procedure.

Belgrade, 15 April 2019

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