CENTRAL BANK OF BOSNIA AND HERZEGOVINA

INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2018

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Responsibility of the Management and the Governing Board for the preparation and approval of the annual financial statements

The Management is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Central Bank of Bosnia and Herzegovina (the "Bank") and of the results of its operations and cash flows, in accordance with International Financial Reporting Standards ("IFRS"), as published by the International Accounting Standards Board ("IASB"). The Management is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. The Management has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Governing Board is responsible for selecting suitable accounting policies to conform to applicable legal requirements and the Management is responsible for their consistent application, making judgements and estimates that are reasonable and prudent and preparing the financial statements on a going concern basis.

The Management is responsible for the submission to the Governing Board of its annual financial statements, following which the Governing Board is required to approve the annual financial statements for submission to the Parliamentary Assembly of Bosnia and Herzegovina.

The accompanying financial statements set out on pages 5 to 80 were authorised by the Governing Board on 27 March 2019 and are signed, on its behalf by:

Senad Softić, Ph.D.
Chairman of the Governing Board

Edis Kovačević, M.Sc.

Head of Accounting and Finance Department

Independent Auditor's Report

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To the Governing Board of the Central Bank of Bosnia and Herzegovina

Opinion

We have audited the accompanying financial statements of the Central Bank of Bosnia and Herzegovina (hereinafter: the "Bank"), which comprise the Statement of financial position as at 31 December 2018 and the Statement of profit or loss, Statement of comprehensive income, Statement of changes in equity and Statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Central Bank of Bosnia and Herzegovina as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (hereinafter: "ISAs"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements of the Bank in the Bosnia and Hercegovina, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Responsibilities of the Management and the Governing Board of the Bank for the Financial Statements

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

In preparing the financial statements, the Management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

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

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

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

Aleksandar Džombić, PhD
Director
Grant Thornton d.o.o.

Banja Luka, 27 March 2019

Aleksandar Džombić, PhD
Certified Auditor
Grant Thornton d.o.o.

Banja Luka, 27 March 2019

Suzana Stavrikj, Partner
Grant Thornton d.o.o.

Skopje, 27 March 2019

Kledian Kodra, Partner
Grant Thornton sh.p.k.

Tirana, 27 March 2019

STATEMENT OF PROFIT OR LOSS

In thousands of KM	Note	For the year ended 31 December 2018	2017
Interest income		48,186	42,996
Interest expense		(24,393)	(21,022)
NET INTEREST INCOME	4	**23,793**	**21,974**
Fee and commission income		17,209	15,834
Fee and commission expenses		(636)	(562)
NET FEE AND COMMISSION INCOME	5	**16,573**	**15,272**
Net realised gains from sale of financial assets at fair value through other comprehensive income	6	4,277	-
Net realized gains from sale of available-for-sale financial assets	7	-	2,587
Net foreign exchange gains / (losses)	8	151	(560)
Other income	9	1,522	1,549
OPERATING INCOME		**46,316**	**40,822**
Personnel expenses	10	(19,034)	(19,019)
Administrative and other operating expenses	11	(8,250)	(7,583)
Depreciation and amortisation	20	(2,426)	(2,035)
OPERATING EXPENSES		**(29,710)**	**(28,637)**
FINANCIAL RESULT BEFORE PROVISIONS FOR EXPECTED CREDIT LOSSES		**16,606**	**12,185**
Provisions for expected credit losses, net	12	(8,175)	-
NET PROFIT FOR THE YEAR		**8,431**	**12,185**

The accompanying notes on pages 12 to 80 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

In thousands of KM	Note	2018	For the year ended 31 December 2017
NET PROFIT FOR THE YEAR		**8,431**	**12,185**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Available-for-sale financial assets			
Net change in fair value during the year	15	-	(15,890)
Reclassification to profit or loss	7	-	(2,587)
		-	**(18,477)**
Debt instruments at fair value through other comprehensive income			
Net change in fair value during the year	16	(6,390)	-
Net change in provisions for expected credit losses	12, 32.1.1	7,301	-
Reclassification to profit or loss	6	(4,277)	-
		(3,366)	**-**
Monetary gold			
Net change in fair value during the year	17	6,138	(1,194)
		6,138	**(1,194)**
Total other comprehensive income / (loss)		**2,772**	**(19,671)**
TOTAL COMPREHENSIVE INCOME / (LOSS) FOR THE YEAR		**11,203**	**(7,486)**

The accompanying notes on pages 12 to 80 are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION

In thousands of KM	Note	31 December 2018	As at 31 December 2017
ASSETS			
Foreign currency in cash	13	274,099	236,402
Deposits with foreign banks	14	2,911,448	2,698,650
Available-for-sale financial assets	15	-	6,202,071
Debt instruments at fair value through other comprehensive income	16	8,225,439	-
Monetary gold	17	209,996	203,908
Special Drawing Rights with the IMF	29, 34	2,236	1,531
Held-to-maturity investments	18	-	1,214,062
Other assets	19	10,554	11,656
Property and equipment	20	44,677	45,465
Intangible assets	20	1,342	1,072
Other investments	21	27,813	27,813
TOTAL ASSETS		**11,707,604**	**10,642,630**
LIABILITIES AND EQUITY			
LIABILITIES			
Currency in circulation	22	4,750,614	4,319,360
Deposits from banks	23	5,523,290	5,033,065
Deposits from the Government and other depositors	24	709,367	624,708
Provisions for liabilities and charges	25	1,259	1,650
Other liabilities	26	3,227	11,212
Total liabilities		**10,987,757**	**9,989,995**
EQUITY			
Initial capital		25,000	25,000
Reserves		694,847	627,635
Total equity	27	**719,847**	**652,635**
TOTAL LIABILITIES AND EQUITY		**11,707,604**	**10,642,630**

The accompanying notes on pages 12 to 80 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

In thousands of KM

	Initial capital	General reserves (Retained earnings)	Other reserves	Fair value reserves – financial assets at fair value through other comprehensive income	Provisions for expected credit losses	Fair value reserves – Available-for-sale financial assets	Fair value reserves – monetary gold	Total reserves	Total equity
As at 31 December 2017 - as stated	**25,000**	**542,766**	**31,300**	**-**	**-**	**93,120**	**(39,551)**	**627,635**	**652,635**
Impact of adopting IFRS 9 (Note 2.6. (c))	-	(36,477)	-	141,765	4,290	(93,120)	39,551	56,009	56,009
As at 1 January 2018 - restated	**25,000**	**506,289**	**31,300**	**141,765**	**4,290**	**-**	**-**	**683,644**	**708,644**
Total comprehensive income for the year	**-**	**8,431**	**-**	**(8,069)**	**4,703**	**-**	**6,138**	**11,203**	**11,203**
Net profit for the year (Note 28)	-	8,431	-	-	-	-	-	8,431	8,431
Other comprehensive income	-	-	-	(8,069)	4,703	-	6,138	2,772	2,772
Net unrealised negative changes in fair value for debt securities	-	-	-	*(6,390)*	-	-	-	*(6,390)*	*(6,390)*
Net realised positive changes in fair value for debt securities transferred to profit or loss	-	-	-	*(1,679)*	-	-	-	*(1,679)*	*(1,679)*
Net unrealised positive changes in provisions for expected credit losses for debt securities	-	-	-	-	*7,301*	-	-	*7,301.*	*7,301*
Net realised positive changes in provisions for expected credit losses transferred to profit or loss for debt securities	-	-	-	-	*(2,598)*	-	-	*(2,598)*	*(2,598)*
Net unrealised positive changes in fair value for monetary gold	-	-	-	-	-	-	*6,138*	*6,138*	*6,138*
Balance as at 31 December 2018	**25,000**	**514,720**	**31,300**	**133,696**	**8,993**	**-**	**6,138**	**694,847**	**719,847**

The accompanying notes on pages 12 to 80 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY (CONTINUED)

In thousands of KM

	Initial capital	General reserves (Retained earnings)	Other reserves	Fair value reserves – Available-for-sale financial assets	Fair value reserves – monetary gold	Total reserves	Total equity
As at 1 January 2017	25,000	537,892	31,300	111,597	(38,357)	642,432	667,432
Total comprehensive (loss) for the year	**-**	**12,185**	**-**	**(18,477)**	**(1,194)**	**(7,486)**	**(7,486)**
Net profit for the year	-	12,185	-	-	-	12,185	12,185
Other comprehensive (loss)	-	-	-	(18,477)	(1,194)	(19,671)	(19,671)
Net unrealised negative changes in fair value for debt securities	-	-	-	*(15,890)*	-	*(15,890)*	*(15,890)*
Net realised positive changes in fair value for debt securities transferred to profit or loss	-	-	-	*(2,587)*	-	*(2,587)*	*(2,587)*
Net unrealised negative changes in fair value for monetary gold	-	-	-	-	*(1,194)*	*(1,194)*	*(1,194)*
Distribution of profit							
Distribution of profit to the state budget (Note 28)	-	(7,311)	-	-	-	(7,311)	(7,311)
Balance as at 31 December 2017	**25,000**	**542,766**	**31,300**	**93,120**	**(39,551)**	**627,635**	**652,635**

The accompanying notes on pages 12 to 80 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

In thousands of KM	Note	For the year ended 31 December 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Net profit for the year		**8,431**	**12,185**
Adjusted for:			
Interest income	4	(48,186)	(42,996)
Interest expense	4	24,393	21,022
Provisions for expected credit losses, net	12	8,175	-
Net realised (gains) from sale of available-for-sale financial assets		-	(2,587)
Net realised (gains) from sale of debt instruments at fair value through other comprehensive income		(4,277)	-
Net foreign exchange (gains) / losses		(151)	560
Income from grants	9	(144)	(132)
Provisions for liabilities and charges	25	(222)	226
Net (gain) on disposal of property and equipment		(3)	(43)
Dividend income recognized in profit or loss	9	(589)	(763)
Depreciation and amortisation	20	2,426	2,035
Net cash flows from operating activities before changes in operating assets and liabilities		**(10,147)**	**(10,493)**
Changes in operating assets and liabilities			
(Increase) in term deposits with foreign banks over 3 months		(641,253)	(681,284)
(Increase) in debt instruments at fair value through other comprehensive income		(729,251)	-
(Increase) in available-for-sale financial assets		-	(1,175,774)
(Increase) in held-to-maturity investments		-	(69,113)
Decrease / (increase) in other assets		1,221	(7,222)
Increase in currency in circulation		431,254	252,556
Increase in deposits		580,668	802,663
(Decrease) in other liabilities		(566)	(1,088)
Payments from provisions for liabilities and charges		(169)	(187)
Interest received		60	29
Interest paid		(8,637)	(10,477)
Net cash from operating activities		**(376,820)**	**(900,390)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		5	46
Purchases of property, equipment and intangible assets		(1,910)	(3,100)
Dividends received		589	763
Net cash used in investing activities		**(1,316)**	**(2,291)**

STATEMENT OF CASH FLOWS (CONTINUED)

In thousands of KM	Note	For the year ended 31 December 2018	2017
CASH FLOWS FROM FINANCING ACTIVITIES			
Distribution of profit to the state budget		(7,311)	(8,437)
Net cash used in financing activities		**(7,311)**	**(8,437)**
Effect from changes in impairment for expected credit losses on cash and cash equivalents		336	-
Effects of exchange rate fluctuations on cash and cash equivalents held		187	(679)
Net (decrease) in cash and cash equivalents		**(384,924)**	**(911,797)**
Cash and cash equivalents at 1 January		**2,061,284**	**2,973,081**
Cash and cash equivalents at 31 December	29	**1,676,360**	**2,061,284**

The accompanying notes on pages 12 to 80 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

The Central Bank of Bosnia and Herzegovina (the "Bank") was established in accordance with the Law on the Central Bank of Bosnia and Herzegovina, which was adopted by the Parliamentary Assembly of Bosnia and Herzegovina ("BH") on 20 June 1997, according to the General Framework Peace Agreement in Bosnia and Herzegovina.

The Bank started its operations on 11 August 1997.

The main objectives and tasks of the Bank are:

- to define, adopt and control the implementation of monetary policy of BH through the issuance of local currency (Convertible Mark or "KM") with full coverage in free, convertible foreign exchange assets;
- to keep and manage the official foreign currency reserves of the Bank in a safe and profitable manner;
- to implement monetary policy in accordance with the Law on the Central Bank of Bosnia and Herzegovina;
- to establish and maintain adequate payment and settlement systems;
- to coordinate the activities of the banking agencies, who are in charge of issuing banking licences and supervising banks;
- to accept deposits from the state and public institutions of BH and deposits from commercial banks;
- to issue provisions and guidelines for the performance of the Bank's operations, in accordance with the Law on the Central Bank of Bosnia and Herzegovina;
- to take part in the operations of international organisations working on strengthening the financial and economic stability of the country;
- to represent BH in international organisations regarding monetary policy issues.

The highest body of the Bank is the Governing Board, which is in charge of defining monetary policy and the control of its implementation, and the organisation and the strategy of the Bank in accordance with the Law on the Central Bank of Bosnia and Herzegovina.

The Management of the Bank consists of the Governor and Vice-Governors, appointed by the Governor with the approval of the Governing Board. The Management operationally manages the Bank's activities.

According to the Law on the Central Bank of Bosnia and Herzegovina, the Governor, with the approval of the Governing Board, appoints the Chief Audit Executive and three Deputies.

The Bank operates through its Head Office, three main units located in Sarajevo, Mostar, and Banja Luka, and two branches, one in Brčko and other in Pale, the latter of which operates under the authorisation of the Main Bank of Republika Srpska of the Central Bank of Bosnia and Herzegovina in Banja Luka.

Head Office of the Bank is located in Sarajevo, Maršala Tita Street, No 25.

1. GENERAL INFORMATION (CONTINUED)

During the course of 2017 and 2018 and up to the date of this report, the Governing Board, Management, Office of the Chief Audit Executive and Audit Committee members are:

Governing Board

Senad Softić Ph.D.	Chairman
Ankica Kolobarić M.Sc.	Member
Šerif Isović M.Sc.	Member (from 1 November 2017)
Kemal Kozarić Ph.D.	Member (until 31 October 2017)
Trivo Marinković M.Sc.	Member
Ljubiša Vladušić Ph.D.	Member

Management

Senad Softić Ph.D.	Governor
Ernadina Bajrović M.Sc.	Vice-Governor
Milica Lakić Ph.D.	Vice-Governor (until 15 June 2017 and from 11 august 2017)
Radomir Božić Ph.D.	Vice-Governor (from 16 June 2017 until 10 August 2017)
Želimira Raspudić M.Sc.	Vice-Governor (from 1 July 2017)
Ankica Kolobarić M.Sc.	Vice-Governor (until 30 June 2017)

Office of the Chief Audit Executive

Anita Dujmović	Chief Audit Executive (from 24 October 2017)
Edis Kovačević M.Sc.	Chief Audit Executive (until 30 September 2017)
Marica Bulić	Deputy of the Chief Audit Executive (from 8 December 2017)
Angela Medić	Deputy of the Chief Audit Executive (until 30 November 2017)
Jasmina Novalija	Deputy of the Chief Audit Executive (until 10 August 2018 and from 18 December 2018)
Stojanka Šarović	Deputy of the Chief Audit Executive (from 4 September 2017)
Krstinja Tošović	Deputy of the Chief Audit Executive (until 21 August 2017)

Audit Committee

Elvir Čizmić Ph.D.	Member (from 1 September 2018)
Mila Gadžić Ph.D.	Member
Sead Kreso Ph.D.	Member (until 31 August 2018)
Radomir Repija	Member

2. BASIS OF PREPARATION

2.1. Statement of compliance

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

2. BASIS OF PREPARATION (CONTINUED)

2.2. Basis of measurement

These financial statements have been prepared on a historical cost, except for the following material items:

Item	Basis of measurement
Financial assets at fair value through other comprehensive income (applicable from 1 January 2018)	Fair value
Available-for-sale financial assets (applicable before 1 January 2018)	Fair value
Monetary gold	Fair value

Historical cost is generally based on the fair value of the consideration given in exchange for assets.

Fair value is the price that would be received to sell or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Bank takes into account the characteristics of the asset or liability which market participants would take into account when pricing the asset or liability at the measurement date.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

More detailed disclosures on fair value measurements of financial assets and liabilities are presented in Note 33.

2.3. Use of judgements and estimates

The preparation of financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure contingent assets and liabilities at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

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

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognized in the Bank's financial statements are included in Note 3.15.

2. BASIS OF PREPARATION (CONTINUED)

2.4. Functional and presentation currency

The Bank's financial statements are stated in the official national currency of Bosnia and Herzegovina which is the Convertible Mark (KM). All financial information has been rounded to the nearest thousand (unless otherwise stated).

The official exchange rate of KM to the Euro (EUR) has been defined by the Law on the Central Bank of Bosnia and Herzegovina as KM 1.95583 = EUR 1. As required by the Law, the Bank is obliged to purchase and sell KM for EUR on demand, without any restrictions, within the territory of Bosnia and Herzegovina, at the defined exchange rate.

The Bank's operational rule for issuing KM is disclosed in Note 30.

2.5. Standards, interpretations and amendments to published standards that are effective in the current period

The following standards, amendments to the existing standards and interpretations issued by the IASB are effective for the current period:

- IFRS 9: "Financial Instruments" (effective for annual periods beginning on or after 1 January 2018),
- IFRS 15: "Revenue from Contracts with Customers" (effective for annual periods beginning on or after 1 January 2018),
- IFRIC 22: "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018),
- Amendments to IFRS 15: "Revenue from Contracts with Customers" (effective for annual periods beginning on or after 1 January 2018),
- Amendments to IFRS 2: "Share – based Payment" - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- Amendments to IFRS 4: "Insurance Contracts" - Applying IFRS 9: „Financial Instruments" with IFRS 4 „Insurance Contracts" (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9:„ Financial Instruments" is first applied),
- Amendments to IAS 40: "Investment Property"- Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- Annual improvements to IFRSs 2014 – 2016 cycle – Amendments to IFRS 1: "First time adoption of International financial reporting standards" and IAS 28: "Investments in associates and joint ventures" (effective for annual periods beginning on or after 1 January 2018).

The application of these standards, amendments and interpretations has no significant impact on the financial statements of the Bank in the current period, expect for IFRS 9. More information about effects of application of IFRS 9 is provided bellow.

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies

From 1 January 2018, the Bank has adopted IFRS 9: "Financial instruments" and changed its accounting policy regarding the accounting treatment of monetary gold. Summary of changes in accounting policies is provided bellow:

(a) IFRS 9: "Financial instruments" (IFRS 9)

The Bank has adopted IFRS 9 as issued by IASB in July 2014, with the date of transition at 1 January 2018 which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. This standard replaces IAS 39: "Financial instruments: Recognition and measurement" (IAS 39). The adoption of IFRS 9 has resulted in changes in the Bank's accounting policies for recognition, classification, measurement and impairment of financial assets. There were no changes to the classification and measurement of financial liabilities.

As permitted by the transitional provisions of IFRS 9, the Bank elected not to restate the comparative figures. Because of transition method chosen by the Bank, comparative information throughout these financial statements has not generally been restated to reflect its requirements. Any adjustments to the carrying amounts of financial assets at the date of transition were recognised in the opening general reserves (retained earnings) and fair value reserves of the current period.

The full impact of adopting the standard is provided bellow:

(i) Classification and measurement of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table and the below accompanying notes present the reconciliation of the original classification under IAS 39 and new classification under IFRS 9 for each class of financial assets and financial liabilities of the Bank as at 1 January 2018. For more information about specific IFRS 9 accounting policies applied in the current period, see Note 3.2.

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

In thousands of KM

Financial asset	Measurement category under IAS 39	Measurement category under IFRS 9	Carrying amount under IAS 39 (1 January 2018)	Carrying amount under IFRS 9 (1 January 2018)
Foreign currency in cash	Loans and receivables	Amortised cost	236,402	236,402
Deposits with foreign banks	Loans and receivables	Amortised cost	2,698,650	2,697,015
Special drawing rights with the IMF	Loans and receivables	Amortised cost	1,531	1,531
Debt securities	Available-for-sale	Fair value through other comprehensive income	6,202,071	6,202,071
Debt securities	Held-to-maturity	Fair value through other comprehensive income	1,214,062	1,271,786
Equity securities	Available-for-sale	Fair value through other comprehensive income – irrevocable selection	27,813	27,813
Other financial assets	Loans and receivables	Amortised cost	2,728	2,698
TOTAL FINANCIAL ASSETS			10,383,257	10,439,316

In thousands of KM

Financial liabilities	Measurement category under IAS 39	Measurement category under IFRS 9	Carrying amount under IAS 39 (1 January 2018)	Carrying amount under IFRS 9 (1 January 2018)
Currency in circulation	Amortised cost	Amortised cost	4,319,360	4,319,360
Deposits from local banks	Amortised cost	Amortised cost	5,033,065	5,033,065
Deposits from the Government and other depositors	Amortised cost	Amortised cost	624,708	624,708
Other financial liabilities	Amortised cost	Amortised cost	10,510	10,510
TOTAL FINANCIAL LIABILITIES			9,987,643	9,987,643

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

(ii) Reconciliation of statement of financial position balances for financial assets from IAS 39 to IFRS 9

The Bank performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics under IFRS 9. For more information about business models, see Note 3.2.2.1.

The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

In thousands of KM

	Ref	IAS 39 carrying amount as at 31 December 2017	Reclassifications	Remeasurement	IFRS 9 carrying amount as at 1 January 2018
Financial assets					
Foreign currency in cash					
Opening balance under IAS 39 and closing balance under IFRS 9		236,402	-	-	236,402
Deposits with foreign banks					
Opening balance under IAS 39		2,698,650	-	-	2,698,650
Remeasurement: Expected credit loss allowance		-	-	(1,635)	(1,635)
Closing balance under IFRS 9					2,697,015
Special drawing rights with the IMF					
Opening balance under IAS 39		1,531	-	-	1,531
Remeasurement: Expected credit loss allowance		-	-	-	-
Closing balance under IFRS 9					1,531
Other financial assets					
Opening balance under IAS 39		2,728	-	-	2,728
Remeasurement: Expected credit loss allowance		-	-	(30)	(30)
Closing balance under IFRS 9					2,698
Total financial assets measured at amortised cost		**2,939,311**		**(1,665)**	**2,937,646**

All classes of financial assets in the table above are reclassified from their previous classification as loans and receivables under IAS 39 to financial assets measured at amortised cost under IFRS 9 as at 1 January 2018.

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

In thousands of KM

Financial assets	Ref	IAS 39 carrying amount as at 31 December 2017	Reclassifications	Remeasurement	IFRS 9 carrying amount as at 1 January 2018
Held-to-maturity investments under IAS 39					
Opening balance under IAS 39		1,214,062	(1,214,062)	-	-
Classification to:					
Debt instruments at fair value through other comprehensive income	A	-	1,214,062	57,724	1,271,786
Closing balance under IFRS 9		-	1,214,062	57,724	1,271,786
Available-for-sale financial assets under IAS 39					
Opening balance under IAS 39		6,229,884	(6,229,884)	-	-
Classification to:					
Debt instruments at fair value through other comprehensive income	B	-	6,202,071	-	6,202,071
Equity instruments at fair value through other comprehensive income	C	-	27,813	-	27,813
Closing balance under IFRS 9		-	6,229,884	-	6,229,884
Total held-to-maturity investments under IAS 39		**1,214,062**	**(1,214,062)**	**-**	**-**
Available-for-sale financial assets under IAS 39		**6,229,884**	**(6,229,884)**	**-**	**-**
Total financial assets measured at fair value through other comprehensive income under IFRS 9		**-**	**7,443,946**	**57,724**	**7,501,670**

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

The application of Bank's accounting policies resulted in the reclassifications explained below:

(A) Part of the debt securities were originally classified as held-to-maturity under IAS 39. The Bank has reclassified all debt securities into debt instruments subsequently measured at fair value through other comprehensive income under IFRS 9. The Bank considers that these debt securities are held within a business model whose objective is achieved by both collecting cash flows and selling.

(B) Part of the debt securities were originally classified as available-for-sale under IAS 39. The Bank has reclassified these debt securities into debt instruments subsequently measured at fair value through other comprehensive income under IFRS 9. The Bank considers that these debt securities are held within a business model whose objective is achieved by both collecting cash flows and selling.

(C) For equity securities that were classified as available-for-sale under IAS 39, the Bank irrevocably selected to present subsequent changes of their fair value in other comprehensive income under IFRS 9. The Bank's equity securities do not have active market and are initially recognized at cost (see Note 3.2.2.1. and Note 21).

(iii) Reconciliation of impairment allowance balance from IAS 39 to expected credit loss allowance under IFRS 9 for financial assets:

In thousands of KM

Measurement category	Loss allowance under IAS 39 as at 31 December 2017	Reclassification	Remeasurement	Expected credit loss allowance under IFRS 9 as at 1 January 2018
Loans and receivables (IAS 39) / Financial assets at amortised cost (IFRS 9)				
Deposits with foreign banks	-	-	1,635	1,635
Special drawing rights with the IMF	-	-	-	-
Other financial assets	600	(600)	30	30
Classification to:				
Loss allowance under IFRS 9	-	600	-	600
Total	**600**	**-**	**1,665**	**2,265**
Held to maturity investments (IAS 39) / Financial assets at fair value through other comprehensive income (IFRS 9)				
Debt securities	-	-	804	804
Total	**-**	**-**	**804**	**804**
Available-for-sale financial assets (IAS 39) / Financial assets at fair value through other comprehensive income (IFRS 9)				
Debt securities	-	-	3,486	3,486
Total	**-**	**-**	**3,486**	**3,486**
Total loss allowance	**600**	**-**	**5,955**	**6,555**

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

Loss allowance under IAS 39 in the amount of KM 600 thousand is related to the receivable associated with the fraud executed by the employee in the vault of the Bank's Main Unit in Sarajevo which was revealed on 8 December 2014. The Bank impaired receivable from employee in total.

Further information about the expected credit losses measurement under IFRS 9 is provided in Note 32.1.

(b) Monetary gold

The Bank has revised its accounting policy for monetary gold and changed the accounting treatment of monetary gold, effective from 1 January 2018. Accounting policy change for monetary gold has been applied prospectively as permitted by definition of „Impracticable" in IAS 8 refering to the requirement to determine the existance of assumptions about what Bank's intentions would have been for monetary gold in prior period for retrospective application. For more information about accounting policy for monetary gold see Note 3.3.

The following table presents the summary of accounting policies applied for monetary gold until 31 December 2017 and from 1 January 2018:

Initial recognition	**Subsequent measurement**	**Currency**	**Effects of subsequent measurement**	**Policy applied**
Fair value	Fair value	USD	Through other comprehensive income	Until 31 December 2017
Fair value	Fair value	EUR	Through other comprehensive income throughout the year, but in the event of negative balance at the end of the year, negative amount is transferred to profit or loss (Note 3.3.)	From 1 January 2018

The following table presents the reconciliation of carrying amounts for monetary gold due to accounting policy change as at 1 January 2018:

In thousands of KM

	Classification	Measurement	Carrying amount
Monetary gold			
As at 31 December 2017	-	-	203,908
New accounting policy implementation – foreign exchange differences	-	(50)	(50)
As at 1 January 2018	-	(50)	203,858

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

(c) Impact of accounting policy changes on the Bank's equity

The following tables present the impact of transition from IAS 39 to IFRS 9 and the change of accounting policy for monetary gold on the Bank's general reserves (retained earnings) and fair value reserves opening balances as at 1 January 2018:

In thousands of KM	Impact of the IFRS 9 implementation and the accounting policy change for monetary gold on the opening balance
General reserves (retained earnings)	
Recognition of expected credit losses under IFRS 9:	(5,955)
Provisions for expected credit losses for debt instruments	*(4,290)*
Loss allowances for financial assets at amortised cost	*(1,665)*
New effective interest rate method application under IFRS 9	9,079
New accounting policy implementation for monetary gold -fair value measurement	(39,551)
New accounting policy implementation for monetary gold –foreign exchange differences	(50)
Total impact as at 1 January 2018	**(36,477)**

As at 1 January 2018, The Bank decreased General reserves (Retained earnings) in the amount of KM 36,477 thousand related to IFRS 9 implementation and accounting policy change for monetary gold, which was made by the Decision of the Governing Board.

In thousands of KM	Impact of the IFRS 9 implementation on the opening balance
1. Fair value reserves - financial assets subsequently measured at fair value through other comprehensive income:	
Reclassification of available-for-sale financial assets into financial assets subsequently measured at fair value through other comprehensive income	93,120
Reclassification of held-to-maturity investments into financial assets subsequently measured at fair value through other comprehensive income	57,724
New effective interest rate method application under IFRS 9	(9,079)
Total fair value reserves for financial assets subsequently measured at fair value through other comprehensive income as at 1 January 2018	**141,765**
2. Provisions for expected credit losses for financial assets subsequently measured at fair value through other comprehensive income as at 1 January 2018	**4,290**

2. BASIS OF PREPARATION (CONTINUED)

2.6. Changes in accounting policies (continued)

In thousands of KM	Impact of the accounting policy change for monetary gold on the opening balance
3. Fair value reserves – monetary gold	
Balance as at 31 December 2017	(39,551)
New accounting policy implementation for monetary gold	39,551
Fair value reserves for monetary gold as at 1 January 2018	-

2.7. Standards and Interpretations in issue not yet adopted

As at the date of authorization of these financial statements the following standards, revisions and interpretations have been published by the IASB, but are not yet effective and have not been adopted early by the Bank:

- IFRS 16: "Leases" (effective for annual periods beginning on or after 1 January 2019),
- IFRS 17: "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021),
- IFRIC 23: "Uncertainty over 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 IFRS 10: "Consolidated Financial Statements" and IAS 28: "Investments in Associates and Joint Ventures" – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (effective for annual periods beginning on or after a date to be determined),
- Annual improvements to IFRS standards 2015-2017 Cycle (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 19: "Employee benefits – Plan amendments, curtailment or settlement" (effective for annual periods beginning on or after 1 January 2019),
- Amendments to references to the Conceptual framework in IFRS standards (effective for annual periods beginning on or after 1 January 2020),
- Amendments to IFRS 3: „Business combinations" – Definition of business (effective for annual periods beginning on or after 1 January 2020),
- Amendments to IAS 1: „Presentation of financial statements" and IAS 8: „Accounting policies, changes in accounting estimates and errors - definition of material" (effective for annual periods beginning on or after 1 January 2020).

The Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Bank anticipates that the adoption of these standards, revisions and interpretations will not have a significant impact on the financial statements of the Bank.

3. SIGNIFICANT ACCOUNTING POLICIES

Apart from the effects of the IFRS 9 adoption and accounting policy change for monetary gold, as explained in Note 2.6., accounting policies set out below have been applied consistently to all periods presented in these financial statements. Because the Bank did not restate the comparative figures due to accounting policy changes, both sets of significant accounting policies are disclosed where necessary.

3.1. Income and expense recognition

3.1.1. Interest income and expenses

Policy applicable in both periods

Effective interest rate
Interest income and expenses are recorded in profit or loss using the effective interest rate method. The "effective interest rate" is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- gross carrying amount of the financial assets or
- the amortised cost of the financial liability.

The "amortised cost" of a financial assets or financial liability is the amount at which the financial assets or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and, for financial assets, adjusted for any expected credit loss allowance.

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusted for any expected credit loss allowance.

When calculating the effective interest rate for financial instrument, the Bank estimates future cash flows considering all contractual terms of the financial instruments, but not expected credit losses. The calculation includes all fees and points paid or received between the Bank and other party that are an integral part of the effective interest rate, transaction costs, and all other discounts and premiums.

The effective interest rate method is the method that is used in the calculation of the amortised cost (gross carrying amount) of a financial assets or financial liabilities and allocation and recognition of interest income or expense in profit or loss over the relevant period.

The Bank's interest income and expense calculated using the effective interest rate method presented in the statement of profit or loss arise from deposits with foreign banks, debt instruments, Special drawing rights with the IMF, loans to employees and deposits from local banks.

3.1.2. Fee and commission income and expenses

Policy applicable in both periods

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

Other fee and commission income and expenses mainly comprise fees earned and spent on domestic and foreign payment transactions and are recognized in the statement of profit or loss as the relevant services are performed.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1. Income and expense recognition (continued)

3.1.3. Foreign currency transactions and exchange differences

Policy applicable in both periods

On initial recognition, a foreign currency transactions are recorded into the KM, by applying to the foreign currency amount the spot exchange rate between the KM and the foreign currency at the date of the transaction.

Monetary items denominated in foreign currencies are translated to the KM by applying the Bank's exchange rate at the reporting date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated by applying the exchange rate at the date of transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was measured.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous reporting date, are recognized in profit or loss when they arise. Due to Currency Board Arrangement, there are no exchange differences from monetary items denominated in EUR currency.

Middle exchange rate of most relevant currencies are provided below:

Middle exchange rate:	31 December 2018	31 December 2017
	KM	KM
USD	1.707552	1.63081
SDR	2.374847	2.322489

3.1.4. Dividend income

Policy applicable in both periods

Dividend income from equity securities is recognized in profit or loss when the Bank's right to receive income is established.

3.2. Financial instruments

3.2.1. Recognition and initial measurement of financial assets and financial liabilities

Policy applicable in both periods

Financial assets and financial liabilities are recognized in the statement of financial position when, and only when, the Bank becomes a party to the contractual provisions of the financial instruments.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities, except those classified at fair value through profit and loss, are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized directly in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.1. Recognition and initial measurement of financial assets and financial liabilities (continued)

All financial assets are initially recognised at the settlement date which is the date that an asset is obtained from, or delivered to, the Bank.

3.2.2. Classification and subsequent measurement

3.2.2.1. Financial assets

Policy applicable from 1 January 2018

From 1 January 2018, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Fair value through other comprehensive income
- Amortised cost.

As at 31 December 2018, the Bank did not have any financial assets categorised at fair value through profit or loss.

The classification of financial asset is determined by both:

- The Bank's business model for managing the financial asset
- The contractual cash flow characteristics of the financial assets.

Business model

The business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows or to collect both contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable, then the financial assets are classified as part of "Other" business model and measured at fair value through profit or loss. As at 31 December 2018, the Bank manages its assets through following business models:
1. "Hold to collect contractual cash flows" model for financial assets that generate contractual cash flows during its lifetime and
2. "Hold to collect contractual cash flows and sell" model for financial assets that generate contractual cash flows during its lifetime and by selling.

Contractual cash flows from debt securities can be managed by both business models. As at 31 December 2018, the Bank's objective is to collect both contractual cash flows and cash flows arising from the sale for all debt foreign government securities.

For financial assets that are managed through these models, the Bank assesses whether the contractual cash flows associated with the financial asset are solely payments of principal and interest on the principal amount outstanding. The assessment is made at a portfolio level because this best reflects the way the business is managed and information is provided to the Bank's Management and the Governing Board. For the purpose of assessment, "principal" is defined as fair value of the financial asset on initial recognition. "Interest" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time, and for other basic lending risks and costs related to the holding the financial asset.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.2. Classification and subsequent measurement (continued)

3.2.2.1. Financial assets (continued)

In assessing whether the contractual cash flows are "solely payment of principal and interest", the Bank considers the contractual cash flows of the instrument. Only financial assets that satisfies "solely payment of principal and interest" requirement can be classified into category of financial assets measured at amortised cost or financial assets measured at fair value through other comprehensive income.

On initial recognition, the Bank's financial assets are recognised at: amortised cost or at fair value through other comprehensive income based on assessments of the Bank's business model. Financial assets meet the "solely payment of principal and interest" requirement as at 31 December 2018.

Financial assets at amortised cost

Financial assets are measured at amortised cost if the assets meet the following conditions:
- they are held within the business model whose objective is to hold the financial assets and collect its contractual cash flows and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest of the principal amount outstanding.

After initial recognition, financial assets are measured at amortised cost using the effective interest rate method on the gross carrying amount of the asset. Effects of subsequent measurement of financial assets at amortised cost are recognised in profit or loss as interest income or interest expense in the period they occurred.

As at 31 December 2018, the Bank's giro accounts, foreign currency in cash, deposits with foreign banks, special drawing rights with the IMF and other financial assets fall into this category of financial instruments.

Financial assets at fair value through other comprehensive income

Financial assets are measured at fair value through other comprehensive income if the assets meet the following conditions:
- they are held within the business model whose objective is achieved by both collecting contractual cash flows and selling financial asset and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest of the principal amount outstanding.

Debt instruments

After initial recognition, debt instruments are measured at fair value through other comprehensive income using the effective interest rate method on the gross carrying amount of the asset and are adjusted to the fair value of the instrument at each reporting date. For the period of holding, effects of subsequent measurement of debt instruments at fair value through other comprehensive income are recognised as follows:
- Interest income or interest expense is recognised in profit or loss in the period they occurred
- Fair value adjustments are recognised in other comprehensive income in the period they occurred.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.2. Classification and subsequent measurement (continued)

3.2.2.1. Financial assets (continued)

When debt instruments at fair value through other comprehensive income are derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss, including previously recognised impairment gains or losses.

As at 31 December 2018, the Bank's debt instruments fall into this category of financial instruments.

Equity instruments

As permitted by IFRS 9, the Bank has made an irrevocable election to present in other comprehensive income subsequent changes in the fair value of equity instruments that are not held for trading due to their specific characteristics and absence of non-active market for trading. Equity instruments are initially measured at cost which is considered to be their fair value. For more information about fair value measurement of the Bank's equity instruments, see Note 33.

As at 31 December 2018, the Bank' all equity instruments (BIS and SWIFT shares) fall into this category of financial instruments.

Policy before 1 January 2018

Financial assets could be classified into the following specified categories:
- at fair value through profit or loss,
- available-for-sale,
- held-to-maturity investments, and
- loans and receivables.

The classification depended on the nature and purpose of the financial assets and was determined at the time of initial recognition. Up to 31 December 2017, the Bank had never had financial assets at fair value through profit or loss.

Loans and receivables

Receivables (including deposits with foreign banks) that had fixed or determinable payments that were not quoted in an active market were classified as loans and receivables.

Loans and receivables were initially recognized at fair value plus transaction costs.

After initial recognition, loans and receivables were measured at amortised cost using the effective interest rate method, less any impairment. Interest income and expense were recognized by applying the effective interest rate.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.2. Classification and subsequent measurement (continued)

3.2.2.1. Financial assets (continued)

Held-to-maturity investments

Government debt securities with fixed or determinable payments and fixed maturity dates that the Bank had the positive intent and ability to hold to maturity were classified as held-to-maturity investments. Held-to-maturity investments were recorded at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

Available-for-sale financial assets

Debt and equity securities held by the Bank were classified as being available-for-sale and were stated at fair value. Fair value was determined in the manner described in the Note 33. Unquoted equity instruments whose fair value could not be reliably determined were carried at cost, less impairment. Gains and losses arising from changes in fair value of debt and equity securities were recognized in other comprehensive income in the fair value reserve account with the exception of impairment losses, interest calculated using the effective interest rate method and foreign exchange gains and losses on financial assets, which were recognized directly in profit or loss. Where the investment was disposed of or was determined to be impaired, the cumulative gain or loss previously recognized in the fair value reserve account in other comprehensive income was included in profit or loss for the period.

Dividends on available-for-sale equity instruments were recognized in profit or loss when the Bank's right to receive payments was established.

The fair value of available-for-sale financial assets denominated in a foreign currency was determined in that foreign currency and translated at the middle exchange rate at the reporting period date. The change in fair value attributable to translation differences that resulted from a change in amortized cost of the asset was recognized in profit or loss and other changes were recognized in equity.

3.2.2.2. Financial liabilities

As the accounting treatment for financial liabilities remains largely the same under IFRS 9 compared to IAS 39, the Bank's financial liabilities were not impacted by the adoption of IFRS 9. However, for completeness, the accounting policy is disclosed below.

Policy from 1 January 2018

The Bank classifies all its financial liabilities as measured at amortised cost using the effective interest rate method. Interest income or interest expense from financial liabilities measured at amortised cost are recognised in profit or loss.

Financial liabilities measured at amortised cost include currency in circulation, deposits from the local banks, deposits from the Government and other depositors and other financial liabilities.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.2. Classification and subsequent measurement (continued)

3.2.2.2. Financial liabilities (continued)

Policy before 1 January 2018

Financial liabilities were classified as either financial liabilities at fair value through profit or loss or "other financial liabilities". As at 31 December 2017, the Bank had no financial liabilities at fair value through profit or loss.

Other financial liabilities

Other financial liabilities included currency in circulation, deposits from the local banks, deposits from the Government and other depositors and other financial liabilities.

Other financial liabilities were subsequently measured at amortized cost using the effective interest method, with interest income or expense recognized on an effective yield basis.

3.2.3 Impairment of financial assets

Policy applicable from 1 January 2018

IFRS 9's impairment requirements use more forward-looking information to recognise expected credit losses. Instruments within the scope of the new requirements include financial assets measured at amortised cost i.e. deposits with foreign banks, Special drawing rights with the IMF and debt instruments measured at fair value through other comprehensive income. The Bank uses a simplified approach in calculation of expected credit losses for other receivables. Equity instruments measured at fair value through other comprehensive income are not subject of impairment.

The Bank recognises a loss allowance for these losses at each reporting date. The measurement of expected credit losses reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes
- The time value of money and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Note 32.1.provides more information about how the expected credit loss allowance is measured.

Loss allowances for expected credit losses are calculated and presented in the statement of financial position as follows:

- Financial assets measured at amortised cost: Expected credit losses are calculated on the gross carrying amount of the assets and recorded as a deduction from the gross carrying amount of the assets and
- Debt instruments at fair value through other comprehensive income: Expected credit losses are calculated on the gross carrying amount of the assets, but loss allowance is recognised in other comprehensive income and does not reduce the carrying amount of the financial assets in the statement of financial position.

Impairment gains and losses are recorded in profit or loss regardless of classification of financial assets at each reporting date.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.3 Impairment of financial assets (continued)

Policy applicable before 1 January 2018

Financial assets were assessed for indicators of impairment at each reporting date. Financial assets were impaired where there was objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment had been impacted.

Objective evidence of impairment could include:

- significant financial difficulty of the counterparty; or
- default or delinquency in interest or principal payments; or
- it became probable that the borrower would enter bankruptcy or financial reorganisation.

Individually significant financial assets were tested for impairment on an individual basis. The remaining financial assets were assessed collectively. Those individually significant assets which were not identified as impaired were subsequently included in the basis for collective impairment assessment.

For the purposes of a collective evaluation of impairment, financial assets were grouped on the basis of similar credit risk characteristics.

For financial assets carried at amortized cost, the amount of the impairment was the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset was reduced through the use of an allowance account. When a receivable was considered uncollectible, it was written off against the allowance account. Subsequent recoveries of amounts previously written off were credited against the allowance account. Changes in the carrying amount of the allowance account were recognized in profit or loss.

With the exception of available-for-sale equity instruments, if, in a subsequent period, the amount of the impairment loss for debt securities classified as available-for-sale decreased and the decrease could be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss was reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment was reversed did not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of available-for-sale equity securities, any increase in fair value subsequent to an impairment loss was recognized in other comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial instruments (continued)

3.2.4. Derecognition of financial instruments

Applicable in both periods

3.2.4.1. Derecognition of financial assets

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

3.2.4.2. Derecognition of financial liabilities

A financial liability is derecognised when it is extinguished, discharged or expires.

3.3. Monetary gold

Policy applicable from 1 January 2018

Monetary gold is part of foreign currency reserves of the Bank and it is classified as a financial asset. Monetary gold is initially recognized at fair value, including transaction cost directly attributable to the acquisition of the gold.

After initial recognition, the gold is re-measured at fair value. Unrealized gains and losses arising from changes in fair value, referring to the price changes of monetary gold, are recognized in the fair value reserve account within other comprehensive income. In the event that unrealized losses exceed the balance in the fair reserve for monetary gold at the end of the financial year, the Bank shall charge the excess against the period's profit.

On the sale of gold, the Bank shall recycle existing unrealized gains and losses through profit and loss.

The fair value of monetary gold is expressed in EUR, converted at the fixed rate of KM at the reporting date, and it is measured at the last bid price for one ounce of gold (Oz) at the reporting date quoted on Reuters.

Policy applicable before 1 January 2018

Gold was initially recognized at cost, being the fair value of the consideration provided including acquisition charges associated with the investment. After initial recognition, the gold was re-measured at fair value. Gains and losses arising from changes in fair value, referring to price changes and foreign exchange differences from conversion from USD to Convertible Mark were recognized in the fair value reserve within other comprehensive income, until the gold was sold, when they were recognized as realized gains or losses in profit or loss.

The fair value of monetary gold was expressed in American dollars (USD), converted at the middle exchange rate as published by the Bank at the reporting date, and was measured at the last bid price for one ounce of gold (Oz) at the reporting date quoted on Reuters.

Foreign exchange gains and losses from conversion of prices of gold from USD to Convertible Mark were recognized as a part of fair value adjustments in the fair value reserve in other comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.4. Offseting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position on a net basis, only where there is a legally enforceable right to offset the recognized amounts and when there is an intention to present or settle the transactions on the net basis.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions.

3.5. Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents comprise the following categories: giro accounts, foreign currency in cash, foreign currency demand deposits, foreign currency deposits with maturity up to three months or less from the date of acquisition and Special drawing rights in the IMF.

3.6. Property, equipment and intangible assets

Properties, equipment and intangible assets consist of assets obtained from the Bank's own funds and cash and non-cash grants.

Properties, equipment and intangible assets are stated at cost, less accumulated depreciation/amortization and any recognized accumulated impairment losses. Cost includes the purchase price and all costs directly related to bringing the asset into operating condition for its intended use. Maintenance and repairs, replacements and improvements of minor importance are expensed as incurred. Significant improvements and replacement of assets are capitalized.

Assets in course of construction are reported at their cost of construction including costs charged by third parties. Upon completion, all accumulated costs of the asset are transferred to the relevant property, equipment and intangible assets category and subsequently subject to the applicable depreciation rates.

Depreciation and amortization is provided on all assets, except land and assets in the course of construction, on a straight-line basis at prescribed rate designed to write off the cost of the assets over their estimated useful lives. The estimated depreciation and amortization rates during 2017 and 2018 were as follows:

Software	20.0%
Other intangible assets	20.0%
Buildings	1.3% to 4.0%
Equipment	11.0% to 20.0%
Furniture	10.0% to 12.5%
Vehicles	15.5%

Gains and losses on disposal of property and equipment are recognized in profit or loss.

The useful life of the property, equipment and intangible assets is reviewed and adjusted on an annual basis at minimum, if necessary, and it is applied prospectively.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.7. Impairment of non-financial assets

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

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

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

3.8. Provisions for liabilities and charges

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and the risks specific to the liability.

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

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

3.9. Grants

Grants related to assets, including non-cash grants, are initially recognized as deferred income at fair value and are then recognized as income from grants on a systematic basis over the useful life of the assets. Grants that compensate the Bank for expenses incurred are recognized in profit or loss as income from grants on a systematic basis in the same periods in which the expenses are recognized.

3.10. Taxes

The Bank is obliged to pay Value Added Tax according to the Law on Value Added Tax for all goods and services purchased. These payables are part of the Bank's administrative and other operating expenses. According to the laws on income tax (both Federation of Bosnia and Herzegovina and Republika Srpska), the Bank is excluded from income tax payables.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11. Currency in circulation

The Bank administers the issue and withdrawal of domestic bank notes and coins. The corresponding liability from the issued currency in circulation is recorded in the statement of financial position.

When currency is withdrawn from circulation, it is recognized as a liability as part of currency in circulation, until the formal date of withdrawal. Any outstanding amount not withdrawn, after the formal due date, is recognized as income.

Costs related to the production and design of banknotes and coins are initially recognized as deferred costs which are subsequently amortised through other operating expenses. From February 2017 the Bank has increased the period for amortisation of these costs from three to five years.

3.12. Managed funds for and on behalf of third parties

The Bank maintains certain accounts in foreign currencies related to agreements concluded between the governments of Bosnia and Herzegovina and its constituent entities and foreign governments and financial organisations, as well as foreign currency accounts of state institutions and agencies, and of commercial banks, for which the Bank acts as an agent.

3.13. Employee benefits

Short-term employee benefits

In accordance with local regulations, on behalf of its employees, the Bank pays personal income tax and contributions for pension, disability, health and unemployment insurance, on and from salaries, which are calculated as per the set legal rates during the course of the year on the gross salary. The Bank pays those tax and contributions in the favour of the institutions of the Federation of Bosnia and Herzegovina (on federal and cantonal levels), Republika Srpska and Brčko District.

In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with the domestic legislation requirements. These expenses are recognized in profit or loss in the period in which the expense is incurred.

Long-term employee benefits

According to local legal requirements, employees of the Bank are entitled to receive a one-time benefit on retirement, provided legal conditions are met, such as the age or years of service, which in accordance with the Bank's internal Acts is based on six regular monthly salaries paid to the respective employee in the last six months.

Such payments are treated as long-term employee benefits which are calculated annually by independent actuaries using the projected unit credit method. The discount rate used in the calculation of the liability is based on interest rates of domestic corporate bonds and government bonds which exist on the market.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.14. Financial arrangements of Bosnia and Herzegovina with the International Monetary Fund

According to the financial arrangements made at the end of 2002 between Bosnia and Herzegovina and the International Monetary Fund ("IMF"), the statement of financial position of the Bank includes the following items related to Bosnia and Herzegovina's membership of the IMF: holdings of Special Drawing Rights ("SDRs"), accrued interest on such SDR holdings and the IMF No. 1 account and IMF No. 2 account.

Other assets and liabilities related to the IMF, belonging to or being the responsibility of Bosnia and Herzegovina, are recorded in a special Trust Fund within off-balance-sheet records (see also Note 34).

3.15. Assumptions and estimation uncertainties

Key assumptions and estimates relating to material statement of financial position items are presented below:

Applicable to 2018 only:

Business model

Note 3.2.2.1.: Determination of the business model within which the assets are held and assessment of contractual terms of financial assets regarding the "Solely payment of principal and interest" requirement. These assessments determine the classification of financial assets under IFRS 9.

Impairment of financial assets

From 1 January 2018, the Bank calculates the expected credit losses for certain classes of financial assets measured at amortised cost and debt instruments measured at fair value through other comprehensive income. Note 32.1 describes assumptions made in the determination of the inputs into the Expected credit losses measurement model, including the forward-looking view information that were used in 2018.

Applicable in both periods

Fair value of assets and liabilities

The Bank's policy is to disclose fair value information on those financial assets and financial liabilities for which public market information is readily available or such value may be calculated by applying some alternative valuation techniques, and whose fair value is materially different from their recorded amounts. According to the Bank's management, amounts presented in the financial statements reflect the most reliable and useful estimate of fair value for financial reporting purposes, in accordance with IFRS.

Depreciation and amortisation charge and rates applied

The calculation of depreciation and amortisation, as well as depreciation and amortisation rates are based on the assessed economic useful life of property, equipment and intangible assets. Once a year, the Bank assesses economic useful life based on current assumptions.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.16. Changes in presentation of financial statements

In preparing financial statements for the year ended 31 December 2018, the Bank has made certain changes in presentation of its primary financial statements line items and adjusted the comparative information as follows:

- Statement of profit or loss: different presentation of Net interest income line items and presentation of Financial result before provisioning for expected credit losses,
- Statement of cash flow: reclassification of investments in debt securities from investing activities to operating activities.

The table below summarizes the change in presentation of interest income and expense from financial assets available-for-sale:

In thousands of KM	Previously presented for the year ended 31 December 2017	Effect of change in presentation	Changed presentation for the year ended 31 December 2017
Interest income from available-for-sale financial assets	16,358	9,552	25,910
Interest expense from available-for-sale financial assets	-	(9,552)	(9,552)

Corresponding notes are adjusted for these changes. Other changes in presentation of these financial statements were immaterial and were performed to enhance and improve the useful information in financial statements.

The consequential amendments to IFRS 7: "Financial instruments: Disclosures" have also only been applied to the current period, but have not been applied to the comparative information.

4. NET INTEREST INCOME

In thousands of KM

	For the year ended 31 December 2018	2017
Interest income arising from:		
Debt instrument at fair value through other comprehensive income (Note 16)	42,334	-
Available-for-sale financial assets (Note 15)	-	25,910
Held-to-maturity investments (Note 18)	-	12,621
Effect of negative deposit interest rates on deposits from local commercial banks	5,784	4,425
Deposits with foreign banks	37	18
Other financial assets at amortised cost	31	22
Total interest income	**48,186**	**42,996**
Interest expense arising from:		
Effects of negative interest rates - debt instrument at fair value through other comprehensive income (Note 16)	(13,613)	-
Effects of negative interest rates - Available-for-sale financial assets (Note 15)	-	(9,552)
Effects of negative interest rates - Deposits with foreign banks	(10,780)	(11,470)
Total interest expense	**(24,393)**	**(21,022)**
Net interest income	**23,793**	**21,974**

4. NET INTEREST INCOME (CONTINUED)

Effects of negative interest rates from deposits with foreign banks include the amount of KM 8,507 thousand on term deposits and the amount of KM 2,273 thousand on demand deposits (2017: included the amount of KM 8,887 thousand on term deposits and the amount of KM 2,583 thousand on demand deposits).

The base for calculation of interest on deposits from commercial banks' includes the total deposits of commercial banks on reserve accounts during the settlement period, which consists of required reserve amounts and excess above the required reserves.

The base for the required reserve calculation for commercial banks consists of deposits and borrowings regardless of fund currency expressed. Also, the unique required reserve rate of 10% is established to be applied by the Bank on the base for the required reserve calculation.

The Bank does not calculate fee on the required reserve amount while the fee on the amount exceeding the required reserve is calculated at the rate equal to 50% of the European Central Bank rate applied on commercial bank deposits.

Effects of negative interest rates from interest-bearing financial assets are result of the negative interest rates calculated on deposits with foreign banks and debt securities that could not be avoided according to current market circumstances.

Effects of negative interest rates on deposits from local commercial banks are result of the negative interest rate on the amount exceeding the required reserve which amounted to 0.20% p.a. in the reporting periods.

5. NET FEE AND COMMISSION INCOME

	For the year ended 31 December	
In thousands of KM	**2018**	**2017**
Fee and commission income:		
from local commercial banks	16,047	14,720
from services for the Government and other non-banking clients	1,162	1,114
	17,209	**15,834**
Fee and commission expenses:		
transactions with foreign banks	(636)	(562)
	(636)	**(562)**
Net fee and commission income	**16,573**	**15,272**

6. NET REALISED GAINS FROM SALE OF FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	For the year ended 31 December
In thousands of KM	**2018**
Realised gains	4,277
Realised losses	-
Net realised gains from sale of financial assets at fair value through other comprehensive income	**4,277**

6. NET REALISED GAINS FROM SALE OF FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (CONTINUED)

As at 31 December 2018, net realised gains from sale of financial assets at fair value through other comprehensive income include net amount comprising from closing balance in fair value reserves in the amount of KM 1,679 thousand and in provisions for expected credit losses in the amount of KM 2,598 thousand for debt instruments at fair value through other comprehensive income (See Note 32.1.1.)

7. NET REALISED GAINS FROM SALE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

In thousands of KM	For the year ended 31 December 2017
Realised gains	2,587
Realised losses	-
Net realized gains from sale of Available-for-sale financial assets	**2,587**

8. NET FOREIGN EXCHANGE GAINS / (LOSSES)

In thousands of KM	For the year ended 31 December 2018	2017
Gains from foreign exchange differences	727	577
Losses from foreign exchange differences	(576)	(1,137)
Net foreign exchange gains / (losses)	**151**	**(560)**

9. OTHER INCOME

In thousands of KM	For the year ended 31 December 2018	2017
Dividend income (Note 21)	589	763
Income from grants	144	132
Other income	789	654
TOTAL	**1,522**	**1,549**

10. PERSONNEL EXPENSES

In thousands of KM	For the year ended 31 December 2018	2017
Salaries	10,515	10,280
Taxes and contributions	5,977	5,846
Other employee benefits	2,694	2,667
Net provisions for severance payments (Note 25)	(152)	226
TOTAL	**19,034**	**19,019**

10. PERSONNEL EXPENSES (CONTINUED)

Personnel expenses include KM 3,702 thousand (2017: KM 3,620 thousand) of defined pension contributions paid into the public pension funds in Bosnia and Herzegovina. Contributions are calculated as percentage of the gross salary. As at 31 December 2018 the Bank had 368 employees (2017: 372 employees).

11. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	For the year ended 31 December	
In thousands of KM	**2018**	**2017**
Maintenance costs	2,695	2,494
Expenses for production and design of banknotes and coins	1,751	1,429
Other administrative and operating expenses	3,804	3,660
TOTAL	**8,250**	**7,583**

12. PROVISIONS FOR EXPRECTED CREDIT LOSSES, NET

	For the year ended 31 December
in thousands of KM	**2018**
Gains from expected credit losses:	
- from financial assets subsequently measured at fair value through other comprehensive income	15,122
- from deposits with foreign banks	9,266
- from other financial assets	64
- from Special drawing rights with the IMF	3
	24,455
Losses from expected credit losses:	
- from financial assets subsequently measured at fair value through other comprehensive income	(22,423)
- from deposits with foreign banks	(10,165)
- from other financial assets	(39)
- from Special drawing rights with the IMF	(3)
	(32,630)
Net increase in provisions for expected credit losses	**(8,175)**

The Bank did not have gains and losses arising from impairment of financial assets according to IAS 39 in 2017.

13. FOREIGN CURRENCY IN CASH

Foreign currency in cash relates to:

In thousands of KM	31 December 2018	31 December 2017
Cash in vaults per currency:		
- EUR	274,025	236,330
- CHF	38	36
- USD	20	19
- GBP	16	17
TOTAL	**274,099**	**236,402**

14. DEPOSITS WITH FOREIGN BANKS

Term and demand deposits with foreign banks, analysed by type of currency, are as follows:

In thousands of KM	31 December 2018	31 December 2017
Term deposits:		
- EUR	2,118,444	2,027,067
Less impairment for expected credit losses	(2,064)	-
	2,116,380	**2,027,067**
Demand deposits:		
- EUR	788,997	666,153
- CHF	3,741	2,482
- USD	2,765	2,921
- GBP	36	27
Less impairment for expected credit losses	(471)	-
	795,068	671,583
TOTAL	2,911,448	2,698,650

Term deposits with foreign banks, analysed by remaining contractual maturity, are as follows:

In thousands of KM	31 December 2018	31 December 2017
Up to 1 month	777,266	993,768
From 1 to 2 months	349,106	136,200
From 2 to 3 months	583,230	449,303
From 3 to 4 months	155,532	117,154
From 4 to 12 months	253,310	330,642
Total	**2,118,444**	**2,027,067**
Less impairment for expected credit losses	(2,064)	-
TOTAL	2,116,380	2,027,067

14. DEPOSITS WITH FOREIGN BANKS (CONTINUED)

During 2018 the negative interest rates on demand deposits denominated in EUR ranged from 0.72% p.a. to 0.08% p.a. (2017: negative interest rates from 0.74% p.a. to 0.30% p.a.) and on term deposits negative interest rates ranged from 0.48% p.a. to 0.17% p.a. (2017: from 0.65% p.a. to 0.36% p.a.).

Deposits with foreign banks include negative accrued interest in the amount KM 2,395 thousand as at 31 December 2018 (2017: included negative accrued interest in the amount KM 1,580 thousand).

The average negative effective yield rate on deposits amounted to 0.42% p.a. (2017: average negative effective yield rate 0.43% p.a.).

Deposits with foreign banks analysed by the type of the bank invested in, are as follows:

In thousands of KM	31 December 2018	31 December 2017
Central banks	2,009,539	1,268,300
Commercial banks	904,444	1,430,350
Less impairment for expected credit losses (Note 32.1.1)	(2,535)	-
TOTAL	**2,911,448**	**2,698,650**

14. DEPOSITS WITH FOREIGN BANKS (CONTINUED)

Deposits with foreign banks can be analysed on a geographical basis as follows:

In thousands of KM		31 December 2018	31 December 2017
Luxembourg			
	Term deposits	1,224,011	837,201
	Demand deposits	234,620	156,307
		1,458,631	**993,508**
Switzerland			
	Term deposits	484,453	525,373
	Demand deposits	1,000	1,538
		485,453	**526,911**
Germany			
	Term deposits	-	-
	Demand deposits	479,941	434,215
		479,941	**434,215**
Great Britain			
	Term deposits	409,980	97,649
	Demand deposits	-	-
		409,980	**97,649**
France			
	Term deposits	-	469,182
	Demand deposits	78,206	78,137
		78,206	**547,319**
USA			
	Term deposits	-	-
	Demand deposits	1,772	1,386
		1,772	**1,386**
Netherlands			
	Term deposits	-	97,662
	Demand deposits	-	-
		-	**97,662**
Total term deposits		**2,118,444**	**2,027,067**
Total demand deposits		**795,539**	**671,583**
Less impairment for expected credit losses		(2,535)	-
TOTAL		2,911,448	2,698,650

15. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets were quality instruments with a high degree of marketability and liquidity, with a credit rating from AAA to BBB in 2017 (See Note 32.1.). The portfolio included short-term and long-term debt securities with a fixed interest rate, which are issued by the governments of other foreign countries. Available-for-sale financial assets were denominated in EUR.

15. AVAILABLE-FOR-SALE FINANCIAL ASSETS (CONTINUED)

The structure of the financial assets available-for-sale was as follows:

In thousands of KM	**31 December 2017**
Debt securities	6,143,154
Accrued interest	58,917
TOTAL	**6,202,071**

The average effective yield rate on financial assets available-for-sale amounted to 0.35% p.a.

Financial assets available-for-sale can be analysed on a geographical basis as follows:

	31 December 2017	
	In thousands of KM	**%**
France	1,654,622	26.67
Belgium	976,652	15.75
Germany	732,285	11.81
Spain	728,413	11.74
Austria	644,753	10.40
Netherlands	565,017	9.11
Italy	552,722	8.91
Finland	341,643	5.51
Slovakia	5,964	0.10
TOTAL	**6,202,071**	**100.00**

Movements in fair value of financial assets available-for-sale can be analysed as follows:

In thousands of KM	**2017**
As at 1 January	**5,025,829**
Purchases during the year	3,887,900
Sales during the year	(470,089)
Interest income recognized during the year (Note 4)	25,910
Effects of negative interest rates recognized during the year (Note 4)	(9,552)
Maturities of securities	(2,155,608)
Maturities of coupon	(86,429)
Fair value adjustment	(15,890)
As at 31 December	**6,202,071**

16. DEBT INSTRUMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

Debt instruments at fair value through other comprehensive income are quality instruments with a high degree of marketability and liquidity, with a credit rating from AAA to BBB (See Note 32.1.). The portfolio includes short-term and long-term debt securities with a fixed interest rate, which are issued by the governments of other foreign countries. Debt instruments at fair value through other comprehensive income are denominated in EUR.

16. DEBT INSTRUMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (CONTINUED)

The structure of debt instruments at fair value through other comprehensive income is as follows:

In thousands of KM	31 December 2018
Debt securities	8,153,320
Accrued interest	72,119
TOTAL	**8,225,439**

The average effective yield rate on debt instruments at fair value through other comprehensive income amounted to 0.41% p.a.

Debt instruments at fair value through other comprehensive income can be analysed on a geographical basis as follows:

	31 December 2018	
	In thousands of KM	**%**
France	2,211,257	26.87
Germany	1,504,585	18.29
Belgium	1,083,041	13.17
Austria	950,959	11.56
Spain	844,614	10.27
Netherlands	568,172	6.91
Italy	549,084	6.68
Finland	513,727	6.25
TOTAL	**8,225,439**	**100.00**

Movements in fair value of debt instruments at fair value through other comprehensive income can be analysed as follows:

In thousands of KM	2018
As at 1 January (Note 2.6 (a))	**7,473,857**
Purchases during the year	3,766,969
Sales during the year	(653,879)
Interest income recognized during the year (Note 4)	42,334
Effects of negative interest rates recognized during the year (Note 4)	(13,613)
Maturities of securities	(2,265,677)
Maturities of coupon	(118,162)
Fair value adjustment	(6,390)
As at 31 December	**8,225,439**

16. DEBT INSTRUMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (CONTINUED)

No expected credit loss allowance is recognised in the statement of financial position for debt instruments measured at fair value through other comprehensive income. Provisions for expected credit losses for debt instruments measured at fair value through other comprehensive income is part of the Bank's equity. Movements in provisions for expected credit losses for debt instruments measured at fair value through other comprehensive income during the year are provided in Note 32.1.1.

17. MONETARY GOLD

The Bank holds monetary gold with the bank in Switzerland which is physically held in a vault at the Bank of England. Fair value of the monetary gold as at 31 December 2018 amounts to KM 209,996 thousand, representing 96,000 ounces of gold at KM 2,187 per ounce (2017: KM 203,908 thousand representing 96,000 ounces of gold at KM 2,124 per ounce).

From 1 January 2018, the Bank has changed its accounting policy regarding the accounting treatment of monetary gold. For more information, see Note 2.6 and Note 3.3.

Movements in fair value of monetary gold can be analysed as follows:

In thousands of KM

	2018	2017
As at 1 January - as stated	**203,908**	**205,102**
Change in accounting policy	(50)	-
As at 1 January - restated	**203,858**	**205,102**
Purchases during the year	-	-
Fair value reserves for monetary gold (From 1 January 2018)	6,138	
Fair value reserves for monetary gold (Before 1 January 2018)	-	(1,194)
- Changes in prices of gold	-	*25,387*
- Foreign exchange (losses) from conversion USD / KM	-	*(26,581)*
As at 31 December	**209,996**	**203,908**

18. HELD-TO-MATURITY INVESTMENTS

All held-to-maturity investments were with credit rating from AAA to BBB (See Note 32.1.) and were denominated in EUR in 2017.

The structure of the held-to-maturity investments is presented as follows:

In thousands of KM	**31 December 2017**
Debt securities	1,206,306
Accrued interest	7,756
TOTAL	**1,214,062**

The average effective yield rate on held-to-maturity investments amounted to 1.04% p.a.

18. HELD-TO-MATURITY INVESTMENTS (CONTINUED)

Held-to-maturity investments can be analysed on a geographical basis as follows:

	31 December 2017	
	In thousands of KM	%
France	411,431	33.90
Italy	216,636	17.84
Belgium	203,629	16.77
Finland	180,686	14.88
Austria	161,278	13.28
Netherlands	40,402	3.33
TOTAL	**1,214,062**	**100.00**

Movements in held-to-maturity investments can be analysed as follows:

In thousands of KM	2017
As at 1 January	**1,132,328**
Purchases during the year	90,720
Interest income recognized during the year (Note 4)	12,621
Maturities of coupon	(21,607)
As at 31 December	**1,214,062**

19. OTHER ASSETS

In thousands of KM	31 December 2018	31 December 2017
Prepaid expenses	6,811	7,931
Receivables from domestic banks	1,735	1,690
Numismatic collections	741	764
Other miscellaneous assets	596	598
Giro accounts	553	436
Loans to employees	122	236
Advances	1	1
Receivables from employee based on domestic currency deficit	600	600
Less impairment of other receivables	(600)	(600)
Less impairment for expected credit losses	(5)	-
TOTAL	**10,554**	**11,656**

As at 31 December 2018, prepaid expenses include expenditure of KM 5,816 thousand incurred on the production of banknotes and coins (31 December 2017: KM 7,564 thousand incurred on the production of banknotes and coins). As explained in Note 3.11, starting from February 2017, such costs are initially deferred and subsequently amortized over a period of five years.

20. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

In thousands of KM	Land and buildings	Equipment and furniture	Vehicles	Other	Assets under construction	Property and equipment total	Software and other intangible assets	Intangible assets under construction	Intangible assets total
Cost									
As at 1 January 2017	**42,992**	**22,612**	**1,826**	**933**	**1,829**	**70,192**	**14,262**	**46**	**14,308**
Additions	-	-	-	-	2,550	2,550	-	550	550
Brought into use	162	1,257	425	45	(1,889)	-	313	(313)	-
Write offs and disposals	-	(396)	(327)	(9)	-	(732)	(121)	-	(121)
Transfers	1,214	553	-	41	(1,808)	-	46	(46)	-
As at 31 December 2017	**44,368**	**24,026**	**1,924**	**1,010**	**682**	**72,010**	**14,500**	**237**	**14,737**
Additions	-	-	-	-	1,322	1,322	-	588	588
Brought into use	-	1,190	34	36	(1,260)	-	353	(353)	-
Write offs and disposals	-	(333)	(59)	(5)	-	(397)	(24)	-	(24)
Transfers	-	704	11	-	(715)	-	188	(188)	-
As at 31 December 2018	**44,368**	**25,587**	**1,910**	**1,041**	**29**	**72,935**	**15,017**	**284**	**15,301**
Accumulated depreciation and amortization									
As at 1 January 2017	**4,122**	**18,967**	**1,739**	**683**	**-**	**25,511**	**13,514**	**-**	**13,514**
Charge for the year	518	1,111	80	54	-	1,763	272	-	272
Write offs and disposals	-	(393)	(327)	(9)	-	(729)	(121)	-	(121)
As at 31 December 2017	**4,640**	**19,685**	**1,492**	**728**	**-**	**26,545**	**13,665**	**-**	**13,665**
Charge for the year	755	1,198	97	58	-	2,108	318	-	318
Write offs and disposals	-	(331)	(59)	(5)	-	(395)	(24)	-	(24)
As at 31 December 2018	**5,395**	**20,552**	**1,530**	**781**	**-**	**28,258**	**13,959**	**-**	**13,959**
Net book value									
As at 1 January 2018	39,728	4,341	432	282	682	45,465	835	237	1,072
As at 31 December 2018	38,973	5,035	380	260	29	44,677	1,058	284	1,342

As at 31 of December 2018 and 2017, the Bank has no encumbrances over its property, equipment and intangible assets.

21. OTHER INVESTMENTS

The structure of equity instruments at fair value through other comprehensive income is as follows:

In thousands of KM	**31 December 2018**	**31 December 2017**
Equity securities:		
Shares in Bank for International Settlements (BIS), Basel (Note 27)	27,803	27,803
Shares in SWIFT	10	10
TOTAL	**27,813**	**27,813**

At 1 January 2018, the Bank designated these equity investments as equity instruments at fair value through other comprehensive income under IFRS 9. Up to 31 December 2017, these investments were classified as available-for-sale under IAS 39.

Equity securities are composed of ordinary Bank for International Settlements (hereinafter: BIS) shares with a nominal value of SDR 5,000 per share (paid up at 25% of their nominal value by former Yugoslavia). In accordance with the Statue of BIS, remaining 75% of the share's nominal value is payable upon call for payment from BIS by the Bank.

SWIFT shares are composed of two ordinary shares and their total value is KM 10 thousand.

BIS and SWIFT shares represent unquoted equity instruments whose fair value cannot be reliably determined and therefore are carried at cost.

During the year the Bank received dividend income from BIS in the amount of KM 589 thousand (2017: KM 763 thousand) (Note 9).

22. CURRENCY IN CIRCULATION

Currency in circulation can be analysed as follows:

In thousands of KM

	2018	2017
Currency placed into circulation - as at 1 January	**4,319,360**	**4,066,804**
Increase in currency in circulation during the year	431,254	252,556
Currency placed into circulation - as at 31 December	**4,750,614**	**4,319,360**

Of the total currency placed into circulation of KM 4,750,614 thousand as at 31 December 2018, KM 605 thousand was placed into circulation outside of Bosnia and Herzegovina (2017: KM 605 thousand out of KM 4,319,360 thousand).

22. CURRENCY IN CIRCULATION (CONTINUED)

	Nominal value	31 December 2018 Pieces	31 December 2018 Value in thousands of KM	31 December 2017 Pieces	31 December 2017 Value in thousands of KM
Coins	0.05	70,591,960	3,529	64,264,227	3,213
Coins	0.10	103,899,364	10,390	96,699,045	9,670
Coins	0.20	75,154,592	15,031	70,032,596	14,007
Coins	0.50	36,191,317	18,096	33,609,811	16,805
Coins	1	52,287,706	52,288	47,884,620	47,885
Coins	2	14,653,353	29,307	13,585,230	27,170
Coins	5	10,871,548	54,358	10,020,723	50,104
Banknotes	10	12,889,248	128,891	11,150,353	111,504
Banknotes	20	8,354,535	167,091	8,718,265	174,365
Banknotes	50	19,623,638	981,182	18,379,804	918,990
Banknotes	100	24,249,404	2,424,940	21,225,491	2,122,549
Banknotes	200	4,327,553	865,511	4,115,492	823,098
TOTAL		**433,094,218**	**4,750,614**	**399,685,657**	**4,319,360**

23. DEPOSITS FROM BANKS

The structure of deposits from banks is provided in the following table:

In thousands of KM	31 December 2018	31 December 2017
Deposits of local commercial banks	5,522,701	5,032,593
Reserve accounts of organizational units of the Bank	553	436
Special deposit of local commercial banks – blocked funds	36	36
TOTAL	**5,523,290**	**5,033,065**

Deposits of local domestic commercial banks are placed in accordance with obligatory reserve requirements for those banks to meet obligations for settling debts and for the transactions between commercial banks and the Bank. As at 31 December 2018 the total amount of KM 5,522,701 thousand represents deposits of 24 banks (2017: KM 5,032,593 thousand represented deposits of 24 banks).

Interest on deposits from local commercial banks is calculated according to the Law on the Central Bank of Bosnia and Herzegovina on the amount exceeding the required reserve. Calculation policy for interest rate on deposits placed by local commercial banks during the reporting periods is provided in Note 4.

Deposits from banks include negative accrued interest in the amount KM 513 thousand as at 31 December 2018 (31 December 2017: included negative accrued interest in the amount KM 449 thousand).

24. DEPOSITS FROM THE GOVERNMENT AND OTHER DEPOSITORS

The structure of deposits from the Government and other depositors is provided in the following table:

In thousands of KM	31 December 2018	31 December 2017
Deposits for the budget of BH Institutions	494,575	448,079
Deposits of public institutions	125,501	76,120
Deposits of other governments and government institutions	89,286	100,503
Deposit account under International Monetary Fund transactions	5	6
TOTAL	**709,367**	**624,708**

25. PROVISIONS FOR LIABILITIES AND CHARGES

Provisions for liabilities and charges relate to provisions for employees' severance payments and provisions for potential liabilities on litigations.

Litigations
The Bank is a defendant in one legal proceeding arising from its operations. The Bank contests this claim and based on legal advice considers that no material liabilities will be incurred.

Movement in provisions for liabilities and charges is presented below:

In thousands of KM

	Litigations	Severance payments	2018 Total
As at 1 January	150	1,500	1,650
Released provisions	(70)	(152)	(222)
Increase in provisions	-	-	-
Total recognised in profit or loss	**(70)**	**(152)**	**(222)**
Amounts paid	(80)	(89)	(169)
As at 31 December	-	**1,259**	**1,259**

In thousands of KM

	Litigations	Severance payments	2017 Total
As at 1 January	150	1,461	1,611
Released provisions	-	(12)	(12)
Increase in provisions	-	238	238
Total recognised in profit or loss	-	**226**	**226**
Amounts paid	-	(187)	(187)
As at 31 December	**150**	**1,500**	**1,650**

Based on the calculation for provisions for employees' severance payments made by independent actuary for 2018 year, the Bank decreased provisions for employee's severance payments and recognised actuarial gain in personnel expenses line item.

26. OTHER LIABILITIES

The structure of other liabilities is presented in the following table:

In thousands of KM	31 December 2018	31 December 2017
IMF Accounts No. 1 and 2 (Note 34)	1,628	1,593
Suppliers	1,036	1,533
World bank deposits	184	56
Accrued expenses and other liabilities	177	419
Deferred income	167	300
Liabilities to employees	35	-
Liabilities based on allocation of profit to the state budget (Note 28)	-	7,311
TOTAL	3,227	11,212

27. EQUITY

The structure of equity and reserves is presented in the following table:

In thousands of KM	31 December 2018	31 December 2017
Initial capital	25,000	25,000
General reserves (Retained earnings)	514,720	542,766
Other reserves	31,300	31,300
Fair value reserves – debt and equity instruments at fair value through other comprehensive income	133,696	-
Provisions for expected credit losses	8,993	-
Fair value reserves – financial assets available-for-sale	-	93,120
Fair value reserves – monetary gold (From 1 January 2018)	6,138	-
Fair value reserves – monetary gold (Until 1 January 2018)	-	(39,551)
TOTAL	719,847	652,635

Initial capital

Initial capital represents nominal capital paid in on 12 June 1998 in accordance with the Law on Central Bank of Bosnia and Herzegovina.

General reserves (Retained earnings)

General reserves (Retained earnings) comprise accumulated undistributed profits of the Bank since the beginning of its operations on 11 August 1997. Status of General reserves (Retained earnings) is in jurisdiction of the Bank's Governing Board. General reserves (Retained earnings) are primary used for the Bank's net loss allocation, as prescribed under the Article 28 of the Law on the Central bank of Bosnia and Herzegovina.

27. EQUITY (CONTINUED)

Other reserves

Other reserves relate to following:

- Special reserves from grants in the amount of KM 3,497 thousand, which relate to grants received in cash from the Council of Ministers of Bosnia and Herzegovina on 12 June 1998. The status of these reserves is regulated by the Decision of the Governing Board of the Bank with the approval of the Presidency of Bosnia and Herzegovina. The right to utilise the reserves from grants fall within the competence of the Governing Board of the Bank.
- Amounts received in accordance with the Succession Agreement of the former Yugoslavia in the amount of KM 27,803 thousand and relates to shares in Bank for International Settlements Brussels (BIS), Basel (see Note 21).

28. PROFIT ALLOCATION

The allocation of the net profit is carried out in accordance with the Law on the Central Bank of Bosnia and Herzegovina.

The provisions of the above mentioned Law define the criteria of the net profit allocation, according to which the Bank allocates 60% of the current profit to the account of the institution responsible for the Budget of Bosnia and Herzegovina, provided that the amount of the initial capital and general reserves (retained earnings) is equal to 5.00% of the total monetary liabilities.

This ratio, before the profit allocation in 2018 amounted to 4.84% (2017: 5.64%). According to the Decision of the Governing Board, total amount of net profit for the 2018 financial year in the amount of KM 8,431 thousand is allocated to the general reserves (retained earnings) of the Bank (2017: 60% of the net profit for the 2017 financial year in the amount of KM 7,311 thousand was allocated to the state budget, and 40%, i.e. the amount of KM 4,874 thousand was allocated to the general reserves (retained earnings) of the Bank.

2018

Before profit allocation

	(In thousands of KM)
Monetary liabilities	**10,983,271**
Initial capital and general reserves (retained earnings)	531,289
Ratio - initial capital and general reserves (retained earnings) / monetary liabilities	**4.84%**

Profit allocation

	(In thousands of KM)
Net profit before allocation	**8,431**
Allocation of profit to general reserves (retained earnings)	8,431

After profit allocation

	(In thousands of KM)
Monetary liabilities	**10,983,271**
Initial capital and general reserves (retained earnings)	539,720
Ratio - Initial capital and general reserves (retained earnings)/ monetary liabilities	**4.91%**

28. PROFIT ALLOCATION (CONTINUED)

2017

Before profit allocation

	(In thousands of KM)
Monetary liabilities	**9,977,133**
Initial capital and general reserves (retained earnings)	562,892
Ratio - initial capital and general reserves (retained earnings) / monetary liabilities	**5.64%**

Profit allocation

	(In thousands of KM)
Net profit before allocation	**12,185**
Allocation of profit to the state budget	7,311
Allocation of profit to general reserves (retained earnings)	4,874

After profit allocation

	(In thousands of KM)
Monetary liabilities	**9,977,133**
Initial capital and general reserves (retained earnings)	567,766
Ratio - Initial capital and general reserves (retained earnings) / monetary liabilities	**5.69%**

29. CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise of:

In thousands of KM	**31 December 2018**	**31 December 2017**
Foreign currency demand deposits	795,539	671,583
Foreign currency deposits with maturity up to three months or less from the date of acquisition	605,552	1,151,332
Foreign currency in cash	274,099	236,402
Special Drawing Rights with the IMF	2,236	1,531
Giro accounts	553	436
Total	**1,677,979**	**2,061,284**
Less impairment for expected credit losses	(1,619)	-
TOTAL	**1,676,360**	**2,061,284**

Movements in expected credit losses on cash and cash equivalents in 2018 are provided below:

In thousands of KM	**2018**
As at 1 January - stated	**-**
Effects from expected credit losses on cash and cash equivalents under IFRS 9	1,283
As at 1 January - restated	**1,283**
Foreign currency demand deposits	(92)
Foreign currency deposits with maturity up to three months or less from the date of acquisition	428
Foreign currency in cash	-
Special Drawing Rights with the IMF	-
Giro accounts	-
As at 31 December	**1,619**

30. CURRENCY BOARD ARRANGEMENT

The Law on the Central Bank of Bosnia and Herzegovina defines the operational rules for a "Currency Board" to be used for issuing KM, according to which KM is issued only with the purchase of convertible foreign exchange currency with full coverage in net foreign currency reserves.

Article 31 of The Law on the Central Bank of Bosnia and Herzegovina requires that the aggregate amount of its monetary liabilities shall at no time exceed its net foreign currency reserves.

Details of compliance with the rule are as follows:

In thousands of KM	31 December 2018	31 December 2017
Gross foreign currency reserves	**11,623,218**	**10,556,624**
Foreign currency in cash	274,099	236,402
Deposits with foreign banks	2,911,448	2,698,650
Available-for-sale financial assets	-	6,202,071
Debt instruments at fair value through other comprehensive income	8,225,439	-
Monetary gold	209,996	203,908
Special Drawing Rights with the International Monetary Fund	2,236	1,531
Held-to-maturity investments	-	1,214,062
Liabilities to non-residents	1,812	1,649
Net foreign currency reserves (gross foreign currency reserves less liabilities to non-residents)	**11,621,406**	**10,554,975**
Monetary liabilities	**10,983,271**	**9,977,133**
Currency in circulation	4,750,614	4,319,360
Deposits from banks	5,523,290	5,033,065
Deposits from the Government and other depositors	709,367	624,708
NET FOREIGN ASSETS (net foreign currency reserves less monetary liabilities)	**638,135**	**577,842**

31. RELATED PARTY TRANSACTIONS

In the normal course of its operations, the Bank enters into transactions with related parties. Having in mind that the Bank has been established by a Legal Act passed by Parliamentary Assembly of Bosnia and Herzegovina and that the initial capital has been paid up by the Council of Ministers of Bosnia and Herzegovina, transactions performed as part of regular operations of the Bank with the state and state institutions represent related party transactions. In addition, the Bank considers that it has an immediate related party relationship with its key management personnel, close family members of key management personnel, and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members.

31. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with the state and state institutions are disclosed in the following table:

In thousands of KM

2018	**Exposure**	**Liabilities**	**Income**	**Expenses**
State	-	505,897	-	-
State institutions				
Indirect taxation authority of Bosnia and Herzegovina	-	45,635	-	-
Deposit Insurance Agency of Bosnia and Herzegovina	-	90,975	-	-
TOTAL	**-**	**642,507**	**-**	**-**

In thousands of KM

2017	**Exposure**	**Liabilities**	**Income**	**Expenses**
State	-	492,837	-	-
State institutions				
Indirect taxation authority of Bosnia and Herzegovina	-	10,146	-	-
Deposit Insurance Agency of Bosnia and Herzegovina	-	45,879	-	-
TOTAL	**-**	**548,862**	**-**	**-**

Remuneration of key management members

The total remuneration of the members of the key personnel (members of Management and Governing Board) in 2018 amounted to KM 964 thousand, out of which KM 590 thousand was related to salaries and other remuneration and KM 374 thousand to taxes and contributions (in 2017 out of total amount of KM 991 thousand the amount of KM 626 thousand was related to salaries and other remuneration and KM 365 thousand was related to taxes and contributions).

32. FINANCIAL RISK MANAGEMENT

Financial instruments which represent the Bank's exposure to financial risks (credit risk, market risks and liquidity risk) are:

- Foreign currency in cash,
- Deposits with foreign banks (central banks, commercial banks and BIS bank),
- Special drawing rights with the IMF,
- Debt securities,
- Monetary gold
- Equity securities and
- Other financial assets (domestic banks' receivables, employees' loans and other receivables).

32.1. Credit risk

Applicable in both periods

Credit risk is the risk of financial loss to the Bank if counterparty to a financial instrument fails to meet its contractual obligation and arises principally from the Bank's deposits with other banks and investments into securities (foreign currency reserves). The management of this risk is performed through the selection of counterparties with sound credit ratings assigned by internationally recognized rating agencies, by limiting the maturity, and by controlling the volume and the dynamics of investment.

Composite credit rating is the average of current ratings assigned to a certain entity by at least two out of three rating agencies (Fitch, Standard and Poor's and Moody's). The credit ratings are monitored on a daily basis.

For the funds recorded in off-balance sheet records, the Bank is not exposed to credit risk, as all the risk, which may result from the investments of these funds, is to be borne contractually by the owners of these funds (see also Note 34).

Applicable from 1 January 2018

The adoption of IFRS 9, starting from 1 January 2018, affected the way of assessing the credit risk of the Bank. In a process of credit risk management, the Bank incorporated the expected credit losses requirement for financial assets covered by IFRS 9. The Bank's financial assets for which the expected credit losses are calculated includes: deposits with foreign banks, Special Drawing Rights with the IMF, debt securities, domestic banks' receivables, employees' loans and other receivables.

Expected credit loss measurement

During the credit risk assessment of the counterparty, the Bank uses composite credit rating as a criteria for determining the credit risk exposure limit. In the absence of credit rating, the Bank estimates the borrower's capacity to properly repay his contractual cash obligations.

IFRS 9 outlines a three stage model for impairment based on changes in credit quality since initial recognition as summarized below:

1. Stage 1 of exposure distribution – During initial recognition, all financial assets for which it is rated that impairment must be carried out, according to IFRS 9, are allocated in Stage 1.

2. Stage 2 of exposure distribution – If a significant increase in credit risk since initial recognition is identified, financial assets is moved to Stage 2.

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

3. Stage 3 of exposure distribution – The criteria for movement into the Stage 3 is assigning the default status to financial assets.

Financial instruments in Stage 1 have their expected credit losses measured on a 12-month basis, while financial instruments in Stage 2 and Stage 3 have their expected credit losses measured on a lifetime basis.

Significant increase in credit risk

The Bank considers that credit risk of financial instrument has not significantly increased in relation to the initially recognized credit risk, if it is established that financial instrument is a low risk instrument on a reporting date. The Bank considers that exposures, respectively financial instruments, have the low credit risk if the value of composite credit rating is AA minus (AA-) or higher, respectively if the Bank estimates that non-rated borrower has a high capacity to properly repay his contractual cash obligations.

The criteria for transfer of exposure into Stage 2, is decrease in composite credit rating for more than two notches in relation to initial recognition date and/or decrease in composite credit rating below investment level of composite credit rating, i.e. below the BBB minus (BBB-) rating.

If financial instrument is consisted of multiple tranches that were initially recognized (purchased) in different periods, and which in different periods had different composite credit ratings, by using the conservative approach the Bank will take as relevant the calculated increase in credit risk from the highest notch.

If the change in credit risk rating occurred due to the change in rating agency methodology and the significant increase in credit risk did not occur related to initially estimated risks, the exposures will not be classified into the Stage 2.

Based on its analysis, the Bank can determine the allocation of the financial instrument into the Stage 2 or Stage 3, for individual financial instruments.

The exposure can be reverted from Stage 2 to Stage 1 if the causes that led to the transfer in Stage 2 have been removed and at least 90 days after removal of the cause.

In addition to the criteria mentioned above, the rebuttable presumptions still apply, according to which if payment is delayed for 30 days, the financial instrument will transfer to the Stage 2 (underperforming), respectively if payment is delayed for 90 days, the financial instrument will transfer to Stage 3 (nonperforming), and in these cases it is considered that there has been a significant increase in credit risk.

Definition of default

Default criteria are objective evidences of impairment and especially:

- Significant financial difficulties of securities' issuers,
- Breach of contractual obligations in terms of delinquency on principal and interest,
- Any restructuring or modification of the existing terms of servicing obligations arising from financial instrument debt for reasons related to financial difficulties of the issuer,
- Probability of bankruptcy and/or liquidation or other form of financial reorganization,
- Disappearance of an active trading market.

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

Expected credit loss calculation

The Expected Credit Loss (ECL) is calculated on either a 12-month or lifetime basis depending on the composite credit rating level, depending on if the significant increase in the credit risk occurred from initial recognition of financial assets or depending on if the financial assets is credit-impaired. Expected credit losses are calculated as the product of three variables: the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD), defined as follows:

- Probability of Default (PD) is an estimate of the probability that an issuer/entity will not be able to meet its debt obligations. PD is calculated on a 12-month basis and lifetime basis. PD calculation in the year 2018 is based on the market prices of Credit Default Swap (CDS) or based on expert judgment.
- Loss Given Default (LGD) is an estimate of the percentage of exposure to the issuer/entity which cannot be collected if a default event occurs. For LGD the Bank uses constant value of one-year LGD, 45 per cent (45%), in accordance with the article 161. of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 (CRR).
- Exposure at Default (EAD) represents the book value of the financial instrument, i.e. the carrying amount at the date of the initial recognition/on the reporting date.

For impairment, according to IFRS 9, individual and collective approaches are used.

In accordance with IFRS 9, the Bank is required to calculate expected credit losses of financial instrument in a manner that reflects an objective and probability weighted amount determined by the evaluation of a number of possible outcomes/scenarios. For this reason, using the individual approach for impairment, the Bank will evaluate through three different scenarios.

In the measurement of expected credit losses, the Bank is not required to determine every possible scenario. However, it is required to consider the risk or the probability of credit loss occurrence in a manner that reflects the probability of credit loss occurrence and probability of credit loss absence, even if the probability of credit loss occurrence is very low.

Impairment amount for exposures that are the subject of individual evaluation approach is calculated as difference between the financial instrument carrying amount and probability weighted present value of the estimated cash flows, discounted at the effective interest rate. An effective interest rate is the rate at which the future cash flows are discounted during the expected period of financial assets or liabilities duration (or, as needed, during the shorter period) to its present value.

Regarding the portfolio structure and classification, the Bank will every exposure for which the objective impairment is determined, respectively the default is determined, consider as individually significant exposure and will use the individual estimation approach.

For the purpose of determining a significant increase in credit risk and the recognition of impairment provisions on a collective basis, financial instruments may be grouped on the basis of common credit risk characteristics to facilitate the timely analysis of significant increase in credit risk determination.

Impairment calculation on a collective basis for financial instruments allocated in Stage 1 is carried out on a 12-month basis, while for exposures allocated in Stage 2, the lifetime credit loss is calculated.

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

Forward-looking information incorporated in the ECL models

According to the IFRS 9, the purpose of the impairment is to recognize expected credit losses on a lifetime basis for financial instruments that had a significant increase in credit risk compared to initially estimated risks, whether the estimation is on individual or collective basis, taking into account all reasonable and substantiated information including those related to the future.

In accordance with the above, incorporation of forward-looking information in expected credit losses calculation is done by adjusting the probability of default.

Given that the Bank in its portfolio has financial instruments of issuers that are different by structure (e.g. governments and commercial banks), as well as by geographical distribution, the Bank relies on predicting changes in rating (outlook) for individual instruments (issuers) in its portfolio, in a way which incorporates the prediction of rating movement direction: positive, stable, negative.

32.1.1. Credit risk exposure

Applicable from 1 January 2018

Classes of financial instruments through which the Bank is most exposed to credit risk are deposits with foreign banks and debt instruments measured at fair value through other comprehensive income.

The following table shows the reconciliation from the opening to the closing balance of the loss allowance for financial assets in 2018:

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.1. Credit risk exposure (continued)

In thousands of KM

	Stage 1	Stage 2	Stage 3	Total
1. Debt instruments at fair value through other comprehensive income				
As at 1 January	**4,290**	**-**	**-**	**4,290**
Increases due to change in credit risk	22,423	-	-	22,423
Decreases due to change in credit risk	(13,841)	-	-	(13,841)
Decreases due to debt instruments matured	(1,281)	-	-	(1,281)
Net increase during the year	*7,301*	-	-	*7,301*
Decreases due to debt instruments sold	(2,598)	-	-	(2,598)
As at 31 December	**8,993**	**-**	**-**	**8,993**
2. Deposits with foreign banks				
As at 1 January	**1,635**	**-**	**-**	**1,635**
Increases due to change in credit risk	10,165	-	-	10,165
Decreases due to change in credit risk	(5,202)	-	-	(5,202)
Decreases due to derecognition of term deposits	(4,063)	-	-	(4,063)
As at 31 December	**2,535**	**-**	**-**	**2,535**
3. Special drawing rights with the IMF				
As at 1 January	**-**	**-**	**-**	**-**
Increases due to change in credit risk	3	-	-	3
Decreases due to change in credit risk	(3)	-	-	**(3)**
As at 31 December	-	-	-	-
4. Other financial assets				
As at 1 January	**30**	**-**	**600**	**630**
Increases due to change in credit risk	39	-	-	39
Decreases due to change in credit risk	(64)	-	-	(64)
As at 31 December	**5**	**-**	**600**	**605**
Total as at 1 January	**5,955**	**-**	**600**	**6,555**
Total as at 31 December	**11,533**	**-**	**600**	**12,133**

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.1. Credit risk exposure (continued)

Net increase in loss allowances for deposits with foreign banks in the amount of KM 900 thousands arises from (Note 16):

- net increase in deposits during the year in the amount of KM 215,333 thousands, since opening balance of the gross carrying amount for deposits with foreign banks as at 1 January 2018 amounted to KM 2,698,650 thousands and closing balance as at 31 December 2018 amounted to KM 2,913,983 thousands,
- increase of the probability of default for deposits with foreign banks (average probability of default arose from 0.13% as at 1 January to 0.19% as at 31 December).

Net increase in provisions for expected credit losses for debt instruments at fair value through other comprehensive income in the amount of KM 4,703 thousands arises from (Note 16):

- increase as a result of net purchases of debt securities made during the year in the amount of KM 3,113,090 thousands,
- decrease as a result of maturities of securities, including maturities of coupons, in the amount of KM 2,383,839 thousands,
- Increase as a result of increase of the probability of default of debt instruments (average probability of default arose from 0.13% as at 1 January to 0.24% as at 31 December).

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.2. Credit risk concentration

a) Maximum exposure to credit risk - financial instruments subject to impairment

The following table shows the maximum exposure to credit risk for the Bank's financial assets, analysed by the classes of financial instruments for which the expected credit losses are calculated and recognized.

In thousands of KM		2018			2017
Classes of financial instruments	Stage 1	Stage 2	Stage 3	Total	Total
Foreign currency in cash					
Gross carrying amount	274,099	-	-	274,099	236,402
Loss allowance	-	-	-	-	-
Carrying amount	274,099	-	-	274,099	236,402
Deposits with foreign banks					
Gross carrying amount	2,913,983	-	-	2,913,983	2,698,650
Loss allowance	(2,535)	-	-	(2,535)	-
Carrying amount	2,911,448	-	-	2,911,448	2,698,650
Available-for-sale financial assets	-	-	-	-	6,202,071
Debt instruments at fair value through other comprehensive income					
Gross carrying amount	8,225,439	-	-	8,225,439	-
Provisions for expected credit losses (recognized in other comprehensive income)	(8,993)	-	-	(8,993)	-
Carrying amount	8,225,439	-	-	8,225,439	-
Special drawing rights with the IMF					
Gross carrying amount	2,236	-	-	2,236	1,531
Loss allowance	-	-	-	-	-
Carrying amount	2,236	-	-	2,236	1,531
Held-to-maturity investments	-	-	-	-	1,214,062
Other financial assets					
Gross carrying amount	2,693	-	600	3,293	3,328
Loss allowance	(5)	-	(600)	(605)	(600)
Carrying amount	2,688	-	-	2,688	2,728

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.2. Credit risk concentration (continued)

As explained in Note 16, provisions for expected credit losses for debt instruments at fair value through other comprehensive income do not decrease their gross carrying amount and are recognized in other comprehensive income.

b) Maximum exposure to credit risk - financial instruments not subject to impairment

In thousands of KM	31 December 2018	31 December 2017
Carrying amounts		
Monetary gold	209,996	203,908
Other investments	27,813	27,813
TOTAL	**237,809**	**231,721**

The Bank does not hold any collateral or other credit enhancements to cover this credit risk. As at 31 December 2018 the Bank does not have any assets that are past due and does have impaired assets in the amount of KM 600 thousand (31 December 2017: the Bank had a claim amounted to KM 25 thousand which was past due and reimbursed at the beginning of 2018 year and impaired assets in the amount of KM 600 thousand).

Individual credit risk concentration

Deposits with foreign banks in total amounted to KM 2,911,448 thousand as at 31 December 2018 (2017: KM 2,698,650 thousand). The largest portion of these funds is invested in one foreign bank with individual exposure exceeding total equity and reserves of the Bank (2017: one foreign bank had individual exposure exceeding total equity and reserves of the Bank).

Individual credit risk concentration exceeding total capital and reserves of the Bank:

31 December 2018			31 December 2017		
Bank rating	In thousands of KM	% of total deposits	Bank rating	In thousands of KM	% of total deposits
AAA	1,457,747	50.07%	AAA	993,508	36.81%

Applicable in both periods

Concentration per credit rating

The table below presents an analysis of the Bank's concentration per credit rating for its financial assets as at 31 December 2018:

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.2. Credit risk concentration (continued)

In thousands of KM

31 December 2018

Credit rating	Foreign Currency in Cash	Deposits with foreign banks	Debt instruments at fair value through other comprehensive income	Monetary Gold	Special Drawing Rights in the IMF	Other financial assets	Other investments	Total
AAA	-	2,414,436	2,072,757	-	-	-	-	4,487,193
AA+	-	-	1,464,686	-	-	-	-	1,464,686
AA	-	78,140	2,211,257	-	-	-	-	2,289,397
AA-	-	-	1,083,041	-	-	-	-	1,083,041
A+	-	-	-	-	-	-	-	-
A	-	408,951	-	-	-	-	-	408,951
A-	-	-	844,614	-	-	-	-	844,614
II[1]	-	1,000	-	209,996	2,236	-	27,813	241,045
BBB+	-	8,921	-	-	-	-	-	8,921
BBB	-	-	549,084	-	-	-	-	549,084
Unrated	274,099	-	-	-	-	2,688	-	276,787
TOTAL	**274,099**	**2,911,448**	**8,225,439**	**209,996**	**2,236**	**2,688**	**27,813**	**11,653,719**

[1] International institutions

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.2. Credit risk concentration (continued)

The table below presents an analysis of the Bank's concentration per credit rating for its financial assets as at 31 December 2017:

In thousands of KM

									31 December 2017
Credit rating	Foreign Currency in Cash	Deposits with foreign Banks	Special drawing rights in the IMF	Available for Sale Financial Assets	Monetary Gold	Held to Maturity Investments	Other Investments	Other financial assets	Total
AAA	-	1,715,536	-	1,297,302	-	40,402	-	-	3,053,240
AA+	-	-	-	986,396	-	341,964	-	-	1,328,360
AA	-	78,137	-	1,654,622	-	411,431	-	-	2,144,190
AA-	-	97,662	-	976,652	-	203,629	-	-	1,277,943
A+	-	-	-	5,964	-	-	-	-	5,964
A	-	566,831	-	-	-	-	-	-	566,831
A-	-	238,946	-	-	-	-	-	-	238,946
II[2]	-	1,538	1,531	-	203,908	-	27,813	-	234,790
BBB+	-	-	-	728,413	-	-	-	-	728,413
BBB	-	-	-	552,722	-	216,636	-	-	769,358
Unrated	236,402	-	-	-	-	-	-	2,728	239,130
TOTAL	236,402	2,698,650	1,531	6,202,071	203,908	1,214,062	27,813	2,728	10,587,165

Geographical concentration of risks of financial assets with credit risk exposure

The following table breaks down the Bank's main credit risk exposure at their carrying amounts, as categorized by geographical region as at 31 December 2018 and 2017. For the purposes of this disclosure, the Bank has allocated exposures to regions based on the country of domicile of its counterparties:

[2] International institutions

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.1. Credit risk (continued)

32.1.2. Credit risk concentration (continued)

In thousands of KM	EU countries	Non-EU member countries	Bosnia and Herzegovina	Total
Foreign currency in cash	-	-	274,099	274,099
Deposits with foreign banks	2,424,518	486,930		2,911,448
Debt instruments at fair value through other comprehensive income	8,225,439	-	-	8,225,439
Monetary gold	-	209,996	-	209,996
Special drawing rights with the IMF	-	2,236	-	2,236
Other financial assets	-	-	2,688	2,688
Other investments	10	27,803	-	27,813
31 December 2018	**10,649,967**	**726,965**	**276,787**	**11,653,719**

In thousands of KM	EU countries	Non-EU member countries	Bosnia and Herzegovina	Total
Foreign currency in cash	-	-	236,402	236,402
Deposits with foreign banks	2,170,353	528,297	-	2,698,650
SDR with the IMF	-	1,531	-	1,531
Available-for-sale financial assets	6,202,071	-	-	6,202,071
Monetary gold	-	203,908	-	203,908
Held-to-maturity	1,214,062	-	-	1,214,062
Other investments	10	27,803	-	27,813
Other financial assets	-	-	2,728	2,728
31 December 2017	**9,586,496**	**761,539**	**239,130**	**10,587,165**

32.2. Market risk

The Bank monitors and manages both currency and interest rate risks as the basic market risk factors. Currency risk is a risk arising from decline of the value of the financial instrument denominated in foreign currency due to changes in exchange rates. The interest rate risk denotes a risk from reducing the market value of the financial instruments due to unfavourable movements of interest rates. The market risk management is performed by setting quantitative limits for foreign assets risk exposure acceptable for the Bank and they are monitored on a daily basis. The objective of market risk management is to manage and control market risk exposures with acceptable parameters, while optimising the return on risk.

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.2. Market risk (continued)

For the purpose of quantifying the market risks effect on the foreign reserves value, starting from 2017, the Bank applies the Value at Risk (VaR) concept. VaR represents a statistical methodology for assessing the maximum change in the foreign reserves value arising from differences in the financial instruments prices and the foreign exchange rates given a certain level of confidence and a particular time horizon. The Bank, when calculating VaR, applies a level of confidence of 99% and a 10-day horizon, as recommended in the Basel II Standard.

The fluctuation of the prices of the instruments and the foreign exchange rates are determined according to the historical changes in the prices and the foreign exchange rates for instruments and currencies comprising the foreign reserves at the end of the month.

As at 31 December 2018, the exposure of the foreign exchange reserves managed by the Bank (Value at Risk at a level of confidence of 99% for a 10-day horizon), in terms of fluctuations of the prices of instruments and foreign exchange rates against the KM equals to KM 37,739 thousands (2017: KM 36,836 thousand), or 0.32% of the total financial assets (2017: 0.35% of the total financial assets). VaR originates from the change in the prices of instruments in which the foreign reserves are invested, including change in the EUR price of monetary gold. There were no term deposits with foreign banks neither debt investments denominated in non-EUR currencies as at 31 December 2018, hence the Bank has no exposure to currency risk as at 31 December 2018 (2017: currency risk originated from change in the foreign exchange rate for the same horizon, on a diversified basis and included change in the USD price of monetary gold).

In thousands of KM	31 December 2018	31 December 2017
Currency risk	-	9,702
Interest rate risk	37,739	27,134
Total VaR	**37,739**	**36,836**

32.2.1. Foreign exchange risk

The Bank is exposed to currency risk through transactions in foreign currencies. This is the risk that the value of a financial instrument will fluctuate because of changes in foreign exchange rates. Foreign currency exposure arises from deposits and investment activities.

The control and management of the foreign exchange risk is based on the strict adherence to the provisions of the Law on the Central Bank of Bosnia and Herzegovina and the Guidelines of the Bank on investment of the foreign exchange reserves.

The above framework defines the limits for holding assets and liabilities in each foreign currency. The biggest part of monetary assets is held in EUR, and the maximum amount that can be held in other convertible currencies, subject to the changes in the market rate, must not exceed 50% of the total amount of the capital and the reserves of the Bank.

The Bank had the following foreign currency position as at 31 December 2018 and 31 December 2017:

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.2. Market risk (continued)

32.2.1. Foreign exchange risk (continued)

31 December 2018 **In thousands of KM**	EUR	USD	Other foreign currencies	KM	Total
Foreign currency in cash	274,025	20	54	-	274,099
Deposits with foreign banks	2,904,946	2,763	3,739	-	2,911,448
Debt instruments at fair value through other comprehensive income	8,225,439	-	-	-	8,225,439
Monetary gold	209,996	-	-	-	209,996
Special Drawing Rights with the IMF	-	-	2,236	-	2,236
Other financial assets	22	-	-	2,666	2,688
Other investments	10	-	-	27,803	27,813
Total financial assets	**11,614,438**	**2,783**	**6,029**	**30,469**	**11,653,719**
Currency in circulation	-	-	-	4,750,614	4,750,614
Deposits from banks	-	-	-	5,523,290	5,523,290
Deposits from the Government and other depositors	-	-	-	709,367	709,367
Other financial liabilities	586	13	-	2,294	2,893
Total financial liabilities	**586**	**13**	**-**	**10,985,565**	**10,986,164**
NET FOREIGN EXCHANGE POSITION	11,613,852	2,770	6,029	(10,955,096)	667,555

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.2. Market risk (continued)

32.2.1. Foreign exchange risk (continued)

31 December 2017 In thousands of KM	EUR	USD	Other foreign currencies	KM	Total
Foreign currency in cash	236,330	19	53	-	236,402
Deposits with foreign banks	2,693,220	2,921	2,509	-	2,698,650
Special drawing rights with the IMF	-	-	1,531	-	1,531
Financial assets available-for-sale	6,202,071	-	-	-	6,202,071
Monetary gold	-	203,908	-	-	203,908
Held-to-maturity investments	1,214,062		-	-	1,214,062
Other investments	10	-	-	27,803	27,813
Other financial assets	81	-	-	2,647	2,728
Total financial assets	**10,345,774**	**206,848**	**4,093**	**30,450**	**10,587,165**
Currency in circulation	-	-	-	4,319,360	4,319,360
Deposits from banks	-	-	-	5,033,065	5,033,065
Deposits from the Government and other depositors	-	-	-	624,708	624,708
Other financial liabilities	902	3	-	9,605	10,510
Total financial liabilities	**902**	**3**	**-**	**9,986,738**	**9,987,643**
NET FOREIGN EXCHANGE POSITION	**10,344,872**	**206,845**	**4,093**	**(9,956,288)**	**599,522**

The Bank is not exposed to EUR foreign currency risk due to Currency Board Arrangement aligning KM to EUR at fixed exchange rate of EUR 1: KM 1.95583.

32.2.2. Interest rate risk

The Bank's exposure to market risk for changes in interest rates is concentrated in its investment portfolio. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature or re-price at different time or in different amounts.

The Bank is exposed to interest rate risk through investment of foreign currency reserves. The Bank manages its investment portfolio with the aim to minimize interest rate risk. The investments bear different interest rates, depending on the time period of the investment, with the maximum term of investment being one year for deposits and ten years for securities.

The tables below summarize the Bank's exposure to interest rate risk at year-end.

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.2. Market risk (continued)

32.2.2. Interest rate risk (continued)

31 December 2018 In thousands of KM	Up to 3 months	From 3 to12 months	From 1 to 3 years	Over 3 Years	Non-interest bearing	Total
Foreign currency in cash	-	-	-	-	274,099	274,099
Deposits with foreign banks	1,399,725	1,514,118	-	-	(2,395)	2,911,448
Debt instruments at fair value through other comprehensive income	1,879,504	6,273,816	-	-	72,119	8,225,439
Monetary gold	-	-	-	-	209,996	209,996
Special Drawing Rights with the IMF	2,236	-	-	-	-	2,236
Other financial assets	20	43	59	-	2,566	2,688
Other investments	-	-	-	-	27,813	27,813
Total financial assets	**3,281,485**	**7,787,977**	**59**	**-**	**584,198**	**11,653,719**
Currency in circulation	-	-	-	-	4,750,614	4,750,614
Deposits from banks	3,037,591	-	-	-	2,485,699	5,523,290
Deposits from the Government and other depositors	-	-	-	-	709,367	709,367
Other liabilities	-	-	-	-	2,893	2,893
Total financial liabilities	**3,037,591**	**-**	**-**	**-**	**7,948,573**	**10,986,164**
INTEREST RATE GAP	243,894	7,787,977	59	-	(7,364,375)	667,555

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.2. Market risk (continued)

32.2.2. Interest rate risk (continued)

31 December 2017 In thousands of KM	Up to 3 months	From 3 to12 months	From 1 to 3 years	Over 3 Years	Non-interest bearing	Total
Foreign currency in cash	-	-	-	-	236,402	236,402
Deposits with foreign banks	1,824,495	875,735	-	-	(1,580)	2,698,650
Special Drawing Rights with the IMF	1,531	-	-	-	-	1,531
Available for sale financial assets	1,593,488	4,549,666	-	-	58,917	6,202,071
Monetary gold	-	-	-	-	203,908	203,908
Held-to-maturity investments	112,767	1,093,539	-	-	7,756	1,214,062
Other investments	-	-	-	-	27,813	27,813
Other financial assets	33	79	109	15	2,492	2,728
Total financial assets	**3,532,314**	**6,519,019**	**109**	**15**	**535,708**	**10,587,165**
Currency in circulation	-	-	-	-	4,319,360	4,319,360
Deposits from banks	2,550,518	-	-	-	2,482,547	5,033,065
Deposits from the Government and other depositors	-	-	-	-	624,708	624,708
Other liabilities	-	-	-	-	10,510	10,510
Total financial liabilities	**2,550,518**	**-**	**-**	**-**	**7,437,125**	**9,987,643**
INTEREST RATE GAP	**981,796**	**6,519,019**	**109**	**15**	**(6,901,417)**	**599,522**

32.3. Liquidity risk

Liquidity risk refers to the possible difficulties in liquidating a portion of assets quickly, possibly in a situation where market conditions are unfavorable and also with adverse price movement.
Liquid assets are defined as those assets whose conversion into cash causes minimal transaction costs and whose value is the closest to market value.

Considering the need of guaranteeing the KM convertibility, the daily liquidity should be provided by the maturity adjustment of the Bank foreign exchange reserves.

The liquidity framework should match the forecasted potential liquidity needs with identified liquid instruments. The liquidity of each financial instrument eligible for investment must be duly considered before the investment in the instrument is made.

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

32.3. Liquidity risk (continued)

Maturity analysis

Tables below present the financial liabilities of the Bank as at 31 December 2018 and 2017 classified into relevant maturity groupings based on the remaining period from the reporting date to the contractual maturity date.

Currency in circulation has been classified in the maturity period within three months.

31 December 2018 In thousands of KM	Up to 3 months	From 3 to 12 months	From 1 to 3 years	Over 3 years	Without specified maturity	Total
Currency in circulation	4,750,614	-	-	-	-	4,750,614
Deposits from banks	5,523,290	-	-	-	-	5,523,290
Deposits from the Government and other depositors	709,367	-	-	-	-	709,367
Other financial liabilities	2,893	-	-	-	-	2,893
TOTAL FINANCIAL LIABILITIES	**10,986,164**	**-**	**-**	**-**	**-**	**10,986,164**

31 December 2017 In thousands of KM	Up to 3 months	From 3 to 12 months	From 1 to 3 years	Over 3 years	Without specified maturity	Total
Currency in circulation	4,319,360	-	-	-	-	4,319,360
Deposits from banks	5,033,065		-	-	-	5,033,065
Deposits from the Government and other depositors	624,708	-	-	-	-	624,708
Other financial liabilities	3,199	7,311	-	-	-	10,510
TOTAL FINANCIAL LIABILITIES	**9,980,332**	**7,311**	**-**	**-**	**-**	**9,987,643**

33. FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The estimated fair values of the Bank's financial assets and financial liabilities have been determined using available market information, where it exists, and appropriate valuation methodologies, as explained in Note 2.2.

33.1. Financial assets measured at fair value

The following table analyses financial assets measured at fair value at each reporting date, by the level in the fair value hierarchy into which the fair value measurement is categorised. These amounts are based on the values recognised in the statement of financial position. In 2018 the Bank has changed its hierarchy level for fair value measurement of debt securities and classified them into Level 1 from Level 2. This change did not result in any gains or losses from transfer between levels.

In thousands of KM

	31 December 2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value				
Debt instruments	8,225,439	-	-	8,225,439
Monetary gold	209,996	-	-	209,996
TOTAL	**8,435,435**	**-**	**-**	**8,435,435**

In thousands of KM

	31 December 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value				
Debt instruments	6,202,071	-	-	6,202,071
Monetary gold	203,908	-	-	203,908
TOTAL	**6,405,979**	**-**	**-**	**6,405,979**

Financial assets are measured at fair value in statement of financial statement using the quoted bid prices in an active market which correspond to Level 1 hierarchy as at reporting dates.

33. FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

33.2. Financial assets and financial liabilities not measured at fair value

In thousands of KM

	31 December 2018	
	Carrying amount	Fair value
Financial assets		
Financial assets measured at amortized cost:		
Foreign currency in cash	274,099	274,099
Deposits with foreign banks	2,911,448	2,904,460
Special Drawing Rights with the IMF	2,236	2,236
Other financial assets	2,688	2,688
Other investments	27,813	27,813
Total	**3,218,284**	**3,211,296**
Financial liabilities		
Financial liabilities measured at amortized cost:		
Currency in circulation	4,750,614	4,750,614
Deposits from banks	5,523,290	5,512,943
Deposits from the Government and other depositors	709,367	708,038
Other financial liabilities	2,893	2,893
Total	**10,986,164**	**10,974,488**

In thousands of KM

	31 December 2017	
Financial assets		
Loans and receivables	Carrying amount	Fair value
- Foreign currency in cash	236,402	236,402
- Deposits with foreign banks	2,698,650	2,690,797
- Special Drawing Rights with the IMF	1,531	1,531
Held-to-maturity investments		
- Held-to-maturity investments	1,214,062	1,264,030
- Other financial assets	2,728	2,728
Other investments	27,813	27,813
Total	**4,181,186**	**4,223,301**
Financial liabilities		
Financial liabilities measured at amortized cost:		
- Currency in circulation	4,319,360	4,319,360
- Deposits from banks	5,033,065	5,021,274
- Deposits from the Government and other depositors	624,708	623,244
- Other financial liabilities	10,510	10,510
Total	**9,987,643**	**9,974,388**

33. FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

33.2. Financial assets and financial liabilities not measured at fair value (continued)

The Management considers that the carrying amounts of foreign currency in cash, Special Drawing Rights with the IMF, other financial assets, currency in circulation and other financial liabilities recognized in the financial statements approximate their fair values as at reporting dates.

As at reporting dates, fair values of financial assets and financial liabilities not measured at fair value are included in Level 2 category and have been determined in accordance with generally accepted pricing models based on a discounted cash flow analysis, with the most significant inputs being the discount rate that reflects the credit risk of counterparties. As discount rate, the Bank has used weighted average interest rate on corporate deposits for whole banking market in BH.

Up to 31 December 2017, the Bank's equity securities in the amount of KM 27,813 thousand were classified at Available-for-sale and measured at cost because their fair value was not considered to be reliably measurable. On the adoption of IFRS 9, these securities have been designated as at fair value through other comprehensive income. The Bank's equity instruments are neither redeemable nor transferable and there is no market for them, so the Bank considers that their carrying amounts approximates their fair values and corresponds to Level 3 category as at reporting dates (See Note 21).

34. OFF-BALANCE SHEET ITEMS

The Bank maintains certain accounts in foreign currencies related to agreements concluded between the governments of Bosnia and Herzegovina and foreign governments and financial organizations. As these accounts do not represent either assets or liabilities of the Bank, they have not been included within the Bank's statement of financial position.

Off-balance sheet items also include foreign currency accounts of the state institutions and agencies, as well as at commercial banks, for which the Bank acts as an agent.

34. OFF-BALANCE SHEET ITEMS (CONTINUED)

Off-balance sheet items consist of:

In thousands of KM	**31 December 2018**	**31 December 2017**
Deposits of USAID	3,042	2,825
Deposits of non-residents	**3,042**	**2,825**
Deposits of the Council of Ministers of BH:	30,964	28,785
Deposits of the Council of Ministers of BH on the basis of succession	*44*	*41*
Deposits of the Council of Ministers of BH regarding the servicing of foreign debt	*9,227*	*12,977*
Deposits of the Council of Ministers of BH regarding the Budget of BH institution	*1,543*	*758*
Other deposits of the Council of Ministers of BH	*20,150*	*15,009*
Deposits of other residents:	4,048	9,922
Deposits - Retirement allowance from Germany	*12*	*247*
Deposit accounts of banks	*4,036*	*9,675*
Deposits of residents	**35,012**	**38,707**
Investments related to securities – Deposit Insurance Agency of BH	37,499	2,034
Investments of residents related to securities	**37,499**	**2,034**
TOTAL	75,553	43,566

USAID Deposits

On the basis of the Agreement regarding financial assistance between Bosnia and Herzegovina and the United States of America for the financing of the reconstruction, special interest bearing accounts have been opened. The Bank does not charge and does not collect any interest or fees on these accounts.

Residents' investments related to securities

The Bank enabled the Deposit Insurance Agency of the Bosnia and Herzegovina to invest in securities by opening cash and custodian accounts in the name of the Bank and the Deposit Insurance Agency of the Bosnia and Herzegovina. All transactions on the accounts are performed between the Deposit Insurance Agency of the Bosnia and Herzegovina and the Asset Manager. The Bank does not charge any interest on such accounts.

Bosnia and Herzegovina membership with the IMF

According to arrangements concluded between Bosnia and Herzegovina and the IMF signed in December 2002, the Bank is designated as a fiscal agent and depository for BH membership with the IMF. The Bank's role as a fiscal agent is specific due to "Currency Board" arrangement. The Bank acts on behalf of the BH in dealing with the IMF but does not have any responsibility for assets and liabilities related to the membership.

The Bank maintains Special drawing rights with the IMF account, IMF account No.1 and IMF account No.2 in the statement of financial position. The Bank also provides a custody service for the BH Promissory notes issued to support IMF membership and repurchase obligations that are recorded off-balance.

34. OFF-BALANCE SHEET ITEMS (CONTINUED)

Special drawing rights with the IMF are demand funds denominated in SDR on the account opened with the IMF for the Bosnia and Herzegovina. The Bank holds Special drawing rights as a part of its foreign exchange reserve management function. These funds are interest-bearing for the Bank. As at 31 December 2018, Special drawing rights with the IMF include accrued interest in the amount KM 4 thousand (31 December 2017: accrued interest amounted to KM 2 thousand).

IMF account No. 1 is the IMF account with the Bank that is used for transactions with the IMF related to utilization and repayment of IMF loans. IMF account No. 2 is the IMF account with the Bank that is used by the IMF for receipts and administrative disbursements in KM in the territory of Bosnia and Herzegovina. These accounts are part of the Bank's liabilities and are expressed in KM.

The quota balance is a specific type of asset which represents BH's subscription as a member of the IMF, denominated in SDR. The quota represents BH's voting powers in the IMF, the limits to access to financial resources of the IMF and a BH's share in the allocation of SDRs which are the IMF's unit of account.

Promissory notes are issued by the Ministry of Finance and Treasury of BH and are substituted for KM. These securities are payable on demand by the IMF.

SDR allocation is also interest-bearing. Ministry of Finance and Treasury of BH pays interest on SDR allocation.

The Bank uses net method in presentation of BH financial position with the IMF which is provided bellow:

In thousands of KM

	31 December 2018	31 December 2017
Quota	629,809	615,924
Special drawing rights with the IMF	2,236	1,531
TOTAL ASSETS	**632,045**	**617,455**
IMF account No.1	1,575	1,540
IMF account No.2	53	53
Securities	1,042,166	1,205,738
SDR allocation	382,080	1,898
Accrued interest on SDR allocation	685	373,656
Accounts of payable charges	1,601	447
TOTAL LIABILITIES	**1,428,160**	**1,583,332**
BH NET POSITION WITH THE IMF	**796,115**	**965,877**

34. OFF-BALANCE SHEET ITEMS (CONTINUED)

As at reporting dates, BH quota with the IMF amounted to SDR 265,200 thousand. The quota does not earn interest.

Promissory notes account, IMF account No.1 and IMF account No. 2 are subject of valuation adjustments whenever the currency is used in financial transactions between the IMF and Bosnia and Herzegovina. At least once each year, at the end of the IMF's financial year (30 April), all IMF currency holding are revalued based on the prevailing SDR exchange rate. These valuation adjustments are included in account balances stated.

In 2018, the Bank received the second tranche under the Extended Fund Facility ("EFF") with the IMF in the amount of KM 145,829 thousand (equivalent to SDR 63,413 thousand). After increasing the above amount by the amount of the reimbursement of the IMF's commitment fee and reducing it by the IMF service charges, the total amount for the allocation of funds was KM 145,822 thousand which was distributed under prescribed ratio.

35. DOMESTIC PAYMENT AND SETTLEMENT SYSTEM

Pursuant to the law on the Central Bank of Bosnia and Herzegovina the Bank is responsible for the establishment and maintenance of domestic payment and settlement systems. The Bank has established two settlement systems from January 2001 in order to facilitate efficient settlement of domestic interbank payment transactions: Real Time Gross Settlement System („RTGS") and Giro Clearing System („GCS").

Credit risk

RTGS enables participants, i.e. the Bank and licensed commercial banks, to effect individual and prompt settlement of one by one (gross) payment by crediting and debiting settlement accounts held with the Bank in domestic currency. Through GCS the Bank provides clearing services arising from transmitted payment orders in accordance with the principle of multilateral clearing.
Each participant in the payment systems is obliged to cover its settlement account held with the Bank prior to settlement of payment orders and must meet certain technical requirements.

Pursuant to the role of the Bank as defined by the Law on the Central Bank of Bosnia and Herzegovina, the Bank does not provide any credits to RTGS and GCS participants which would provide liquidity to the system in any form.

Operational risk

With the aim of minimising operational risk within the domestic payment and settlement system, operating rules for RTGS and GCS have been issued, which define minimum security standards for operation of the systems.

Relevant security objectives, policies and procedures aim to ensure security measures and features. The computer systems and the networks are operated according to established objectives and policies. The security objectives and policies are reviewed periodically. Each direct participant is also required to have appropriate security measures and controls for processing payments.

35. DOMESTIC PAYMENT AND SETTLEMENT SYSTEM (CONTINUED)

The Bank has defined the following Contingency Settlement Procedures:

- **Contingency plans and measures**: the Bank has defined contingency measures in order to ensure continuity of reliable, correct and lawful operation of the payment and settlement systems in the event of disruption to the regular payment and settlement system, or other contingency events;
- **Backup location**: To support the primary location for the payment systems (RTGS, GCS and SWIFT) with redundant systems (if case of system falling, switching to another one on the primary location is done), the Bank has also established functional DR (Disaster Recovery) system located in Main Bank of Republika Srpska of the Central Bank of Bosnia and Herzegovina in Banja Luka.

Management of the Bank believes that the system has sufficient capacity to maintain operational reliability.

36. POST-REPORTING DATE EVENTS

The Bank has changed the methodology for Probability of Default calculation which, starting from 1 January 2019, is based on transition matrices. The Bank uses corporate transitional matrices to estimate the probability of default of foreign commercial banks, while for the exposures to foreign sovereigns (foreign central banks and governments), the Bank uses sovereign transitional matrices. As at 31 December 2018, total amount of provisions for expected credit losses amounted to KM 12,133 thousand. The change in accounting estimate resulted in recognition of release from provisions for expected credit losses in the total amount of KM 9,821 thousand in profit or loss in January 2019.

Except as disclosed above, no adjusting or other non-adjusting events have occurred between the 31 December 2018 and the date of authorization of these financial statements.