ZAPAD BANKA AD, PODGORICA

Financial Statements for the Year Ended 31 December 2017

and

Independent Auditor's Report

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This is an English translation of Independent Auditor's Report and 2017 Separate Financial Statements originally issued in the Montenegrin language

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This is an English translation of the Independent Auditor's Report
Originally issued in the Montenegrin language

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Zapad banka AD Podgorica

Report on Financial Statements

We have audited the accompanying financial statements of Zapad Banka a.d. Podgorica (the "Bank") which comprise the balance sheet as of 31 December 2017 and the income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting regulations prevailing in Montenegro, based on the Law on Accounting ("Official Gazette of Montenegro", no. 052/16 of 9 August 2016) and the regulations of the Central Bank of Montenegro governing the financial reporting of banks, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance the Law on Accounting prevailing in Montenegro and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with the accounting regulations prevailing in Montenegro and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Zapad banka AD Podgorica (Continued)

Other Matters

The financial statements of the Company for the year ended 31 December 2016 were audited by another auditor, who expressed an unqualified opinion on these financial statements in its report of 25 May 2017.

Report on Other Legal and Regulatory Requirements

Management of the Bank is responsible for the preparation and fair presentation of the accompanying annual business report in accordance with the requirements of the Law on Accounting ("Official Gazette of Montenegro", no. 052/16). Our responsibility is to express an opinion on the consistency of the Bank's annual business report for the year ended 31 December 2017 with the audited separate financial statements for the same year. Our procedures in this regard were performed in accordance with the applicable Standard on Auditing 720 "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements", and are only limited to the assessment of the consistency of financial information disclosed in the annual business report with the audited separate financial statements.

In our opinion, financial information disclosed in the Bank's annual business report for the year ended 31 December 2017 is consistent, in all material respects, with the audited financial statements of the Bank for the year ended 31 December 2017 and prepared in accordance with the Law on Accounting.

Podgorica, 4 May 2018

Društvo za reviziju BDO d.o.o. Podgorica

Milovan Popović
Certified Auditor

ZAPAD BANKA A.D. PODGORICA

FINANCIAL SATEMENTS AS AT 31 DECEMBER 2017

TRANSLATION NOTE: This is a translation of the original document issued in the Montenegrin language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Montenegrin version of the document shall prevail.

FINANCIAL STATEMENTS for 2017

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(All amounts are in EUR thousand unless otherwise stated)

INCOME STATEMENT

	Note	2017	2016
Interest income and other income	3	3,125	2,649
Interest expense and other expenses	3	(1,235)	(961)
NET INTEREST INCOME		**1,890**	**1,688**
Impairment expenses	4	(61)	(121)
Provision costs	4	3	(2)
Fee and commission income	5	1,226	1,167
Fee and commission expense	5	(447)	(300)
FEE AND COMMISSION INCOME NET		**779**	**867**
Net gains/losses from investment securities		110	
Foreign exchange gains, net		325	135
Employee benefits expense	6	(1,673)	(1,441)
Overhead and administrative costs	7	(1,167)	(921)
Amortisation/Depreciation	8	(182)	(139)
Other expenses		(5)	(3)
Other income		10	
OPERATING PROFIT/(LOSS)		**29**	**63**
Income tax	9	(12)	(5)
NET PROFIT/ (LOSS)		**17**	**58**

Notes in the following pages represent the integral part of these financial statements.

In Podgorica,

4 May 2018

Vesna Kovačević
Head of Finance

Zapad Banka AD Podgorica

Mladen Rabrenović
CEO

Dmytro Likhota
Executive Director

(All amounts are in EUR thousand unless otherwise stated)

BALANCE SHEET

	Note	31 December 2017	31 December 2016
ASSETS			
Cash and deposits with central banks	10	11,750	7,793
Loans and receivables from banks	11	15,577	9,122
Loans and receivables from customers	12	39,715	38,050
Investment securities available for sale	13	-	2,010
Property, plant and equipment	14	811	487
Intangible assets	15	361	368
Other financial receivables		57	47
Other operating receivables		36	38
TOTAL ASSETS		**68,307**	**57,915**
LIABILITIES			
Deposits due to banks	16	3	-
Deposits due to customers	16	54,538	45,145
Funds borrowed from other clients	17	3,739	3,828
Reserves		13	16
Current tax liabilities		10	-
Deferred tax liabilities		20	18
Other liabilities	18	324	268
Subordinated debt	19	2,007	1,003
TOTAL LIABIITIES		**60,654**	**50,279**
EQUITY			
Share capital	20	8,500	8,500
Accumulated loss		(864)	(922)
Profit/(Loss) for the year		17	58
TOTAL EQUITY		**7,653**	**7,636**
TOTAL LIABILITIES AND EQUITY		**68,307**	**57,915**
OFF BALANCE SHEET ITEMS	**21**	**97,514**	**76,891**

Notes in the following pages represent the integral part of these financial statements.

In Podgorica,

4 May 2018

Vesna Kovačević
Head of Finance

Zapad Banka AD Podgorica

Mladen Rabrenović
CEO

Dmytro Likhota
Executive Director

(All amounts are in EUR thousand unless otherwise stated)

CASH FLOW STATEMENT

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and similar income inflows	3,101	2,645
Interest and similar income outflows	(1,218)	(942)
Fee and commission received	1,258	1,212
Fees and commissions paid	(447)	(300)
Salaries, wages and employee benefits and cost of suppliers	(2,834)	(2,408)
Increase in loans and other assets	(1,739)	(18,846)
Proceeds arising from deposits and other payables	4,988	52
Other inflows	9	-
Cash inflows/(outflow) from operating activities, Net	**3,118**	**(18,586)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(431)	(203)
Purchase of intangible assets	(67)	(140)
Treasury bills	2,110	(2,000)
Cash outflow from investing activities, Net	**1,612**	**(2,343)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in borrowing	(88)	2,739
Issue of ordinary shares	-	2,000
Inflows from financing activities, Net	**(88)**	**4,739**
Foreign exchange difference effect on cash and cash equivalents	325	135
Net increase /(decrease) in cash and cash equivalents	**4,967**	**(16,055)**
Cash and cash equivalents, beginning of the year	16,875	32,930
Cash and cash equivalents, end of the year	**21,842**	**16,875**

Notes in the following pages represent the integral part of these financial statements.

In Podgorica,

4 May 2018

Vesna Kovačević
Head of Finance

Zapad Banka AD
Podgorica

Mladen Rabrenović
CEO

Dmytro Likhota
Executive Director

(All amounts are in EUR thousand unless otherwise stated)

STATEMENT OF CHANGES IN EQUITY

	Share capital	Retained earnings/ (Accumulated losses)	TOTAL
As at 31 December 2015	**6,500**	**(922)**	**5,579**
Share issue	2,000	-	2,000
Current period loss	-	58	58
Balance as at 31 December 2016	**8,500**	**(864)**	**7,636**
Share issue			
Current period profit	-	17	17
Balance as at 31 December 2017	**8,500**	**(847)**	**7,653**

Notes in the following pages represent the integral part of these financial statements.

In Podgorica,

4 May 2018

Vesna Kovačević
Head of Finance

Zapad Banka AD
Podgorica

Mladen Rabrenović
CEO

Dmytro Likhota
Executive Director

1. The establishment of the Bank and its operational

Zapad banka AD Podgorica (hereinafter: the Bank) was established on 24 February 2015. On 6 March 2015 it was registered as joint stock entity with the Central Registry of the Commercial Court in Podgorica under No. 4-0009448.

With the Securities Commission, the Bank is registered in the Registry of Securities Issuers under No. 531 (Decision number 02/3-1/2-15 dated 25 March 2015).

The Bank performs its financial operations via a drawing account no. 907-57001-31 held with the Central Bank of Montenegro - Payment operations.

Under the Law on Banks, the Founding Act, the Bank's Articles of Association and the Central Bank of Montenegro Decision No. 0101-4014/67-3 dated 30 January 2015, the Bank may perform along with its banking activities operations such as:

- Issuing guarantees and undertaking other off-balance sheet activities;
- Purchase, sale and collection of receivables (factoring, forfeiting, etc.);
- Issuing, processing and recording payment instruments;
- Domestic and foreign payment operations;
- Finance lease;
- Securities transactions;
- Trading for own account and in their own name, or on account of the client:
  - in foreign currency, inclusive of foreign exchange transactions
  - with financial derivatives;
- Repurchasing transactions;
- Analysis, information and advisory services relating to company or entrepreneur creditworthiness, and other operating issues;
- Safe deposit box rental services.

The Bank is registered in Podgorica, at no/2b/7th floor, Moskovska Street.

As at 31 December 2017, the Bank had 38 employees (as at 31 December 2016, the Bank had 32 employees).

The Bank is managed by its shareholders based on their share capital, in accordance with the Law and the Bank's Articles of Associations. The Bank's managing bodies are the Shareholders' Assembly, comprising shareholders and the Board of Directors appointed by the Shareholders' Assembly. The Board of Directors has five members, the majority of which is not employed with the Bank. One member of the Board of Directors has the role of Executive Director.

The members of the Board of Directors as at 31 December 2017 are:

- Vadym Morokhovskyy, President
- Volodymyr Kostelman, Deputy President
- Oleksandr Kuperman, member
- Dejan Marinović, member
- Valentyna Grechko, member

1. The establishment of the Bank and its operational policies (Continued)

The managing authorities and bodies are:

- The Audit Committee
- The Assets and Liabilities Committee (ALCO),
- Credit Risk Management Committee (The Credit Committee),
- Information Technologies Committee.

The Bank has 3 executive directors of whom one is the CEO. CEO represents the Bank and is responsible to coordinate and supervise, on daily basis, the execution of operations in the Bank and the work of Executive Directors of the Bank.

As at 31 December 2017 the Executive Directors of the Bank are:

Mladen Rabrenović, CEO
Oleksandr Kuperman, Executive Director for sales
Dmytro Likhota, Executive Director for business support operations

2. Summary of key accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below.

2.1. Basis of preparation

The Financial statements have been prepared in accordance with accounting regulations applicable to financial reporting in Montenegro.

The Bank is required to maintain records and prepare financial statements in accordance with the Law on Accounting (MNE Official Gazette, No. 52/16), and the Central Bank of Montenegro regulations governing financial reporting of banks.

The Bank's financial statements have been prepared under the Decision on the contents, deadlines and manner of preparing and submitting the financial statements of banks (MNE Official Gazette No. 15/2012 and 18/2013).

In the preparation of these financial statements, the Bank applied policies complying with the regulations of the Central Bank of Montenegro but deviating from the requirements of IFRS and IAS with respect to the recognition of receivables that qualify for derecognition from the Bank's balance sheet and the format of presentation of financial statements as at 31 December 2017.

In accordance with the Law on Accounting of Montenegro, International Accounting Standards ("IAS") and International Financial Reporting Standards ("IFRS") published by the International Accounting Standards Board, should be adopted and published by a respective competent authority of Montenegro who got the right on translation and publishing from the International Federation of Accountants (IFAC). Therefore, only IFRS and IAS officialy adopted and published by the respective and competent authority of Montenegro may be applicable. The last officially translated IAS and IFRS are those translated in 2009 (except for IFRS 7) and newly adopted IFRS 10, 11, 12 and 13, which are applicable from 2013.

The financial statements have been prepared under the historical cost convention, unless otherwise stated in the accounting policies. In preparing these financial statements the Bank applied accounting principles disclosed in Note 2.

The official currency of Montenegro and the Bank's presentation currency is the Euro (EUR).

2. Summary of key accounting policies (Continued)

2.1. Basis of preparation (Continued)

The preparation of financial statements in accordance with the Law on Accounting of Montenegro, and pursuant to the regulations of the Central Bank of Montenegro relevant for the financial reporting of banks requires the use of certain key critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2.19.

2.2 Comparative figures

Comparative figures, opening balances, are the data comprised in financial statements for the year 2016.

2.3 Going concern concept

The financial statements are prepared in accordance with the going concern concept, which assumes that the Bank will continue its operations for the foreseeable future.

2.4 Interest and commission income and expense

Interest income and expense for all interest-bearing debt instruments, are recognized in the income statement on a time-proportion basis using the effective interest method, in accordance with the terms and conditions contracted between the Bank and the client.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fee and commission income and expense from rendering and using bank services are recognised in the income statement at the time when the service is provided or used.

Origination fees are considered to be an integral part of generating an involvement with the resulting financial instrument, recognised as an adjustment to the effective interest rate over the loan period using the effective interest rate method.

Fee and commission income and expense comprise guarantee fees and letters of credit issued by the Bank in favour of the client, domestic and foreign payment operations fees, fees for mediation and other services provided by the Bank. Fee and commission expense comprises expenses for deposit insurance.

2.5 Foreign currency translation

a) Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates (the 'functional currency').

The financial statements are presented in EUR, which is the functional and presentation currency.

2. Summary of key accounting policies (Continued)

2.5 Basis of preparation (Continued)

b) Transactions and balances

Foreign currency transactions are translated into EUR using the interbank middle exchange rate prevailing at the date of transaction.

Foreign currency assets and liabilities as at the balance sheet date are translated in EUR using the middle interbank exchange rate prevailing at that date.

Net foreign exchange gains and losses arising on foreign currency transactions and translations of foreign currency items included in the balance sheet are credited or charged to the Income statement.

2.6 Income tax

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

Current tax

Income tax is calculated and paid in accordance with the Law on Corporate Income Tax (Republic of Montenegro Official Gazette No. 65/01, 12/02, 80/04, MNE Official Gazette No. 80/04, 40/08, 86/09, 14/12, 61/13 and 55/16). The income tax rate is a flat 9% rate of the tax base.

The Company's taxable profit is determined based on profit presented in the Bank's Income Statements, as adjusted by income and expenses under the Corporate Income Tax Law (Articles 8 and 9 for adjustment of income, and Articles 10 to 20 for adjustment of expenses), and the Decision on the new Chart of Accounts of the Central Bank of Montenegro (MNE Official Gazette No. 55/12). Income tax expense is calculated using the straight-line rate of 9% on taxable income (2016: 9%).

Capital losses may be offset against capital gains realized in the same year. Where, upon offsetting capital loss against capital gains realized in the same year capital loss remains, the taxpayer may carry it forward and set against the next gains over a five year period.

The Montenegrin tax regulations do not envisage the possibility of using the current period tax loss as a basis for the recovery of tax paid in prior periods. However, current period losses presented in the tax balance sheet may be used to reduce the future tax base for up to 5 years.

Deferred tax

Deferred taxes are calculated on all temporary differences between tax base of assets and liabilities and their carrying amounts recorded in the Bank's financial statements.

Deferred tax liabilities are recognized for all taxable temporary differences arising between the tax base of assets and liabilities as at the balance sheet date and the amounts presented for reporting purposes, which will result in future period taxable amounts.

Deferred tax assets are calculated for all deductible temporary differences, unused tax credits and unused tax losses to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences, unused tax credits and unused tax losses can be utilised. The deferred tax assets are calculated at the balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised.

The deferred tax is calculated by applying a 9% rate.

2. Summary of key accounting policies (Continued)

2.7 Earnings per share

The Bank calculates and discloses earning per share in accordance with IAS 33. Basic earnings per share is calculated by dividing profit attributable to the Bank's shareholders by the weighted average number of ordinary shares for the period.

The Bank has no dilutive potential ordinary shares such as convertible debt and share options.

2.8 Cash and cash equivalents

Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and deposits with the Central Bank of Montenegro and deposits held with local and foreign banks.

The Bank shows deposits held with other banks such as foreign banks, via which it performs foreign payment operations, and local banks, via which it performs payment transactions. The Bank calculates the mandatory reserve under the Central Bank's regulations, and records the use of mandatory reserve.

a) Mandatory reserve

The calculation, the allocation and the use of mandatory reserves with the Central Bank of Montenegro is prescribed by the Decision on the mandatory reserve with the Central Bank of Montenegro ("Official Gazette of MNE", no. 40/10, 46/10, 06/13 and 70/17) became effective, based on which the mandatory reserve is calculated by applying a 7.5% rate to the base comprising demand deposits and deposits with a maturities of up to one year, i.e. up to 365 days, 6.5% - - to the base comprising deposits with maturities exceeding one year , i.e. over 365 days. A 7.5% rate is applied to deposits with over the 1-year, or 365 days maturity range with clauses allowing early deposit redemption i.e. redemption within the period shorter than 365 days.

The calculated mandatory reserve of the bank is allocated to the account of the obligatory reserve in the country and / or to the accounts of the Central Bank abroad and cannot be separated and held in another form. Banks can use up to 50% of allocated funds of the reserve requirement to maintain daily liquidity.

2.9 Financial instruments

The Bank has classified its financial assets into the loans and receivables category.

a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, which the Bank does not intend to sell immediately or in the near future. They arise when the Bank directly provides the funds or provides services to a debtor with no intention of trading with receivables. Loans and receivables comprise advances granted to customers and advances granted to banks.

Loans and receivables are initially measured at fair value plus transaction costs, and subsequently at amortised cost using the effective interest method. Amortised cost is calculated by taking into consideration all loan origination costs and all other discounts or premiums. Loans and receivables are presented in net amount, less the individual and collective impairment amount.

2. Summary of key accounting policies (Continued)

2.9 Financial instruments (Continued)

b) Provisions and impairment of loans and advances

Under the Central Bank of Montenegro Decision on minimum standards for credit risk management in banks (MNE Official Gazette No.22/12, 55/12, 044/17, 57/13 and 082/17) the following has been established: elements of credit risk management, minimum criteria for and the manner of classification of assets and off balance sheet exposures to credit risk, as well as the manner of making provisions with a view to covering contingent losses arising from the Bank's credit risk exposure. In terms of this Decision, the Bank's risk-weighted assets comprise loans, advances, interest, fees, leasing receivables, deposits held at banks, advances and other risk-weighted balance sheet assets, guarantees, sureties, letters of credit and loans granted but not used, as well as other off-balance sheet items standing as the Bank's contingent liabilities.

Under the applicable Decision on minimum standards for credit risk management in banks (MNE Official Gazette No.22/12, 55/12, 044/17, 57/13 and 082/17), for its balance sheet and off-balance sheet risk weighted assets the Bank is obliged to perform at least quarterly an impairment assessment (for balance sheet assets), and a loss assessment (for off-balance sheet items) and to have them classified adequately in accordance with such Decision. Additionally, the Bank is obliged to determine the methodology for assessing impairment of balance sheet assets and contingent loss in accordance with IAS 39.

For the purpose of calculating a provision for loan receivables, the Bank applies its own method that complies with IAS requirements.

The International Accounting Standards require an individual assessment of individually significant receivables and a collective assessment of receivables that are not individually significant. Accordingly, the Bank identifies balance sheet assets and contingent losses based on off-balance sheet items and calculates appropriate impairment or contingent loss on: an individual basis (individual assessment of individually significant receivables); a collective basis (collective assessment for receivables that are not individually significant); and on a collective basis (collective assessment of individually significant items that have been first individually assessed but have not been individually impaired).

The Bank is obliged to perform at least monthly the classification of balance sheet and off/balance sheet items based on their risk exposure and make provisions for estimated losses.

Under the Decision on minimum standards for credit risk management in banks (MNE Official Gazette No.22/12, 55/12, 57/13, 044/17 and 082/17), loans and other risk exposed assets are required to be classified in one of the following categories:

- Category A (good assets) - items for which has been assessed that they will be fully collected in accordance with the agreement,
- Category B (assets with specific notification) - with subcategories B1 and B2, - assets with a low probability of loss making risk but requiring special attention, since inadequate attention paid to these assets could lead to lower prospects for their collection,
- Category C (substandard assets) - with subcategories C1 and C2 -assets with high loss making risk potential, since weaknesses jeopardising their collection have been inadequately determined,
- Category D (doubtful assets) - items unlikely to be collected, having in mind the creditworthiness of the borrower, the value of the asset and the possibility to have the collateral realised,
- Category E (loss) - fully or partially non-collectable receivables.

2. Summary of key accounting policies (Continued)

2.9 Financial instruments (Continued)

Based on the classification of the balance sheet assets and off-balance sheet items the Bank calculates provision for potential losses at a monthly level, using the percentages prescribed by the Decision of the Central Bank of Montenegro on the Minimum Standards for Credit Risk Management in Banks ("Official Gazette of Montenegro" no.. 22/12, 55/12 i 57/13, 44/17 and 082/17). The basis for the calculation of provisions for potential losses is the carrying amount of receivables, excluding impairment for value adjustments.

The Bank is obliged to determine the difference between the provision for contingent losses, calculated in accordance with the above table and total provision for balance sheet and off-balance sheet items calculated in accordance with the Decision prescribing the manner of measuring assets under the International Accounting Standards.

The gain on calculated provisions for contingent losses and total provisions for balance sheet and off-balance sheet items represents the required reserve for estimated losses.

2.10 Investment in securities

Securities are initially measured at purchase value equalled to paid amount for the asset increased for acquisition costs.

In the moment of securities acquisition it is important to determine its purpose. Based on this all financial assets are classified into following categories:

- Securities held for trade. Those are securities bought in order to obtain gains in short period of time due to price or profit margin fluctuations.
- Financial assets available for sale. Those are securities that are intended to be held for an indefinite period and may be sold due to the need for providing liquidity or changes in interest rates, foreign exchange rates, etc. Subsequent evaluation of securities that are available for sale shall be based on the changes in fail value due to the fluctuation of prices on the regulated market and on the basis of impairment caused by the existence of objective evidence of depreciation of financial assets.
- Financial assets held to maturity. Those are securities held until the maturity date by the Bank.

2.11 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of property, plant and equipment.

Subsequent costs are included in the asset’s carrying amount or recognised as a separate asset only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

2. Summary of key accounting policies (Continued)

2.11. Property, plant and equipment (Continued)

Land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

	Years
Buildings	33.3
Computers and computer equipment	5
Office furniture	9
Vehicles	6.7
Other equipment	6.7

The start date of depreciation for any fixed asset is the first day of the month following the month of the acquisition. Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised in the Income statement.

2.12 Intangible assets

Licenses

Acquired licences are shown at historical cost. Licences have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of licenses over their estimated useful lives (5 years).

Computer software

The cost of computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (5 years).

2.13 Borrowings

Borrowings are recognised initially at the fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the Income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Bank has an unconditional right to defer settlement of the liability for at least 12 months after the Balance Sheet date.

2.14 Share capital

The Bank’s paid in share capital relates to cash paid by shareholders for all ordinary shares. The Bank’s share capital comprises ordinary shares, which are stated as a separate line item in the Balance Sheet.

Dividends from shares are recognized as liabilities in the period in which a decision on dividend distribution was made.

2. Summary of key accounting policies (Continued)

2.15 Provisions for liabilities and charges

Provisions for liabilities and charges are recognised when all the following conditions have been satisfied:

- The Bank has a present legal or constructive obligation resulting from past events;
- It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation;
- The amount of obligation has been reliably estimated.

Provisions are measured at the present value of the expected cash outflows required to settle the obligation using a discount rate that reflects current market assessments of the time value of money.

Provisions are reviewed at each Balance Sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed in the Income Statement.

a) Employee benefits

Short-term employee benefits include wages and salaries and taxes and contributions for social insurance. They are recognized as an expense in the period when they are incurred.

The Bank and its employees are obliged to pay taxes and contributions to Montenegrin Pension and Disability Insurance Fund in accordance with defined contribution plans. The Bank is not obliged to pay reimbursements to employees which are the responsibility of the National Fund. Taxes and contributions on defined benefit obligations are expensed as incurred.

2.16 Off-balance sheet contingencies and commitments

As part of its regular business activities, the Bank has assumed contractual commitments and off-balance sheet contingencies such as guarantees, borrowings and letters of credit, and transactions with financial instruments. These financial instruments are recorded in the Balance Sheet if and when they are payable.

Provisions for potential losses arising from commitments and contingencies are created based on the estimates of potential losses, in accordance with the criteria defined in the Decision on Minimum Standards for Credit Risk Management in Banks and the methodology of the Bank.

2.17 Related party transactions

The Bank’s related parties are:

- Members of the (management) bodies of the Bank, shareholders, employees, and their immediate family (spouse and children);
- Legal entities in which the owner of a qualified share also has a qualified share in the Bank;
- Legal entities in which one of the persons referred to in lines 1 and 2 above has significant influence, or a person referred to in the above line 1 is a director or a member of the Board of Directors or other body of such legal entities;
- Persons holding at least 50% of the capital or voting rights of the legal entity which has a qualified share in the Bank;

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.

2. Critical accounting estimates and judgements (Continued)

2.18 Fair value

International Accounting Standard 32 - "Financial Instruments: Disclosure and Presentation" provides for the disclosure of the fair value of financial assets and financial liabilities in notes to the financial statements. For these purposes, fair value is defined as the amount for which an asset can be exchanged, or an obligation settled, in an arm's length transaction. The Bank's obligation is to disclose all information regarding the fair value of assets, receivables and liabilities for which there is available market information and for which a material significant difference between the carrying amounts and the fair (fair) value is identified.

In Montenegro there is not enough market experience, stability and liquidity in the purchase and sale of financial assets and liabilities, as well as other financial instruments, and official market information is not readily available. Therefore, a fair value cannot be reliably determined in the absence of an active market, as required by IAS and IFRS. In the opinion of the management, the amounts disclosed in the financial statements reflect the real value that in the given circumstances is the most reliable and useful for reporting purposes.

2.19 Critical accounting estimates and judgements

The Bank makes estimates and assumptions that will affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

2.19.1 Impairment losses arising from on and off balance sheet items

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. The Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from the loan portfolio which can be identified with individual exposures and which can affect the Income Statement.

The methodology and assumptions used for estimating the impairment provision are disclosed in Note 2.9.

2.19.2 Fair value of financial instruments

The fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.

The fair value of financial instruments that are not traded in an active market is determined by applying a valuation technique. Valuation techniques include: comparison with prices achieved in the latest transactions, use of discounted future cash flows, measurement based on the pricing methods, and other techniques.

These techniques reflect current market conditions at the measurement date which may differ from market conditions either before or after the measurement date. As at the Balance Sheet date the Bank performs the review of its valuation techniques to verify whether they reflect current market conditions, including liquidity and corresponding credit spreads.

2.19.3 Litigations

The Bank's management assesses the amount of provisions for outflows based on litigations. The assessment is based on the estimated probability of future cash outflows, arising from past contractual or legal obligation.

(All amounts are in EUR thousand unless otherwise stated)

3. Interest income and expense

	2017	2016
Interest income		
Banks	596	749
Government	78	10
Legal entities	2,301	1,805
Individuals	100	58
Entrepreneurs	3	
Other	47	27
Total interest income	**3,125**	**2,649**
Interest expense		
Government	(74)	(47)
Banks	-	(1)
Legal entities	(731)	(517)
Individuals	(393)	(396)
State-owned companies	(37)	-
Total interest expense	**(1,235)**	**(961)**
Net interest income	**1,890**	**1,688**

4. Impairment and provision costs

	2017	2016
Impairment of loans	49	121
Total impairment of balance sheet items	12	-
Total impairment of balance sheet items	**61**	**121**
Provision for guarantees and commitments	(3)	2
Total provision for off-balance sheet items	**(3)**	**2**
Total	**58**	**123**

Movements within impairment allowance and provision were as follows:

	Loans	Interest	Other assets	Off-balance sheet items	Total
As at 1 January 2016	**34**	**-**	**-**	**6**	**40**
Increase in impairment allowance	172	5	-	14	191
Reversal of impairment	(51)	(4)	-	(12)	(67)
As at 31 December 2016	**155**	**1**		**8**	**164**
Increase in impairment allowance	217	5	13	16	251
Reversal of impairment	(169)	(5)	-	(19)	(193)
As at 31 December 2017	**203**	**1**	**13**	**5**	**222**

(All amounts are in EUR thousand unless otherwise stated)

5. Fee and commission income and expense

	2017	2016
Fee and commission income		
Payment operations	945	338
Loan origination fees	136	694
Off-balance sheet operation fees	42	28
Card and ATM operations	3	
Other fees	100	107
Total fee and commission income	**1,226**	**1,167**
Fee expense		
Payment operations	(143)	(58)
Deposit insurance	(246)	(230)
Card and ATM operations	(33)	
Other	(25)	(12)
Total fee and commission expense	**(447)**	**(300)**
Net fee and commission income	**779**	**867**

6. Employee benefits expense

	2017	2016
Cost of net salaries	864	784
Taxes, surtaxes, and contributions on salaries	613	555
Fees to members of the Board of Directors and the Audit Committee	30	40
Taxes, surtaxes and contributions on fees to members of the Board of Directors and the Audit Committee	15	15
Other personnel expenses-retirement benefits	114	-
Staff training	4	2
Travel costs and daily allowances	22	31
Other expenses	16	14
Total	**1,673**	**1,441**

(All amounts are in EUR thousand unless otherwise stated)

7. Overhead and administrative costs

	2017	2016
Rental cost	461	247
Costs of control of the CBMNE	101	93
Software maintenance	88	107
Legal services	14	93
One-year license charge	59	47
Hardware maintenance	38	38
Postal, telephone and communication network charges	56	52
Security costs	43	31
Translation costs	9	14
SWIFT maintenance costs	26	21
UBCG membership fees	16	16
Maintenance costs	20	18
Costs of office and supplies	10	9
Electricity and heating costs	12	11
Audit fee	17	17
Insurance costs	5	5
Advertising costs	10	5
Plastic cards issuing costs	1	14
Representation costs	22	-
Consulting services	44	-
Plastic cards issuing costs	34	-
Other operating costs	81	83
Total	**1,167**	**921**

8. Amortisation/Depreciation

	2017	2016
Amortisation of software	74	61
Depreciation of IT equipment	73	68
Depreciation of office furniture	12	1
Depreciation of plant and equipment	6	5
Depreciation of other material assets	8	3
Vehicle depreciation	9	1
Total	**182**	**139**

9. Income tax

	2017	2016
Current tax expense	10	-
Deferred tax expense	2	5
Total	**12**	**5**

Deferred tax expense of EUR 2 thousand was incurred based on a deferred tax liability for all temporary differences arising between the accounting and the tax value of fixed assets and intangible assets. Based on that, deferred tax liabilities, as at 31 December 2017 amount to EUR 20 thousand.

9. Income tax (Continued)

The Bank's income tax calculation is presented below:

	2017	2016
Current tax		
Gain/(loss) before tax recorded in the income statement	28	63
Tax rate	9%	9%
Tax rate of 9%	3	6
Tax effect of non-deductible expenses	4	(3)
(Utilized tax losses up to amount of taxable income)/Unrecognized deferred tax assets from tax losses	**(7)**	**(3)**
Capital gains	**110**	
Transferred capital losses	**-**	
Tax expense for the period	**10**	**-**
Tax effect of temporary differences		
Tax effect of temporary differences concerning PPE and intangible assets	**2**	**5**
Deferred tax expense	**2**	**5**
Total	**2**	**5**

Earnings per share

Basic earnings per share is calculated by dividing the net profit by weighted average number of ordinary shares issued during the year.

	2017	2016
Net profit in EUR 000	17	58
Weighted average number of ordinary shares issued during the year	80,000	80,000
Basic gain per share (in EUR per share)	**0.21**	**0.73**

10. Cash and deposits with central banks

	2017	2016
Cash funds and deposit accounts		
Mandatory reserves held with the Central Bank of Montenegro	4,215	5,037
Cash held with the account at CBMNE	7,535	2,756
Total cash	**11,750**	**7,793**
Non-interest bearing deposit accounts with the CBMNE		
Mandatory reserves held with the Central Bank of Montenegro	2,108	3,778
Total non-interest bearing deposit accounts	**2,108**	**3,778**
Interest bearing deposit accounts with the CBMNE		
Mandatory reserves held with the Central Bank of Montenegro	2,107	1,259
Total interest bearing deposit accounts	**2,107**	**1,259**
Total foreign currency mandatory reserves held with the CBMNE	**4,215**	**5,037**

(All amounts are in EUR thousand unless otherwise stated)

10. Cash and deposits with central banks (Continued)

The Bank sets aside the mandatory reserve under the Decision on Banks' Mandatory Reserve Held with the Central Bank of Montenegro (Official Gazette of MNE, No. 40/10, 46/10, 06/13 and 70/17). Under this decision, banks shall set aside the mandatory reserve at the rates of 7.5% - to the base comprising demand deposits and deposits with maturities of up to one year, i.e. up to 365 days; and 6.5% - to the base comprising deposits with maturities exceeding one year , i.e. over 365 days without an option to cancel the deposit.

11. Loans and receivables from banks

	2017	2016
Correspondent accounts held with foreign banks	8,415	2,844
Term deposits with banks and other depository institutions in MNE	1,682	1,699
Term deposits with banks and other depository institutions abroad	5,430	4,538
Interest receivables based on deposits	50	41
Total	**15,577**	**9,122**

As at 31 December 2017, the Bank had deposits on foreign currency accounts held with the following banks**:**

	2017	2016
PJSC VOSTOK BANK	323	649
VERSOBANK AS	1,858	1,687
AKTIF YATIRIM BANKASI A.S.	1,838	508
ALFA-BANK	1,040	-
SBERBANK	224	-
TRANSKAPITALBANK	1,282	-
INTESA SANPAOLO BANKA	1,850	-
Total	**8,415**	**2,844**

As at 31 December 2017, the Bank had term deposits on a foreign currency account held with PJSC Vostok Bank and Sberbank with maturity of up to 12 months.

(All amounts are in EUR thousand unless otherwise stated)

12. Loans and receivables from customers

Short-term and long-term loans by client category were as follows:

	2017			2016		
	Short-term	Long-term	Total	Short-term	Long-term	Total
Private companies	5,324	24,602	29,926	1,397	23,897	25,294
Entrepreneurs	-	54	54	-	-	-
Legal entities – non-residents	578	6,748	7,326	159	10,212	10,371
Non-governmental and non-profit organisations	-	575	575	-	870	870
Individuals - residents	6	1,804	1,810	32	1,418	1,450
Other	-	320	320	300	-	300
Total gross loans	**5,908**	**34,103**	**40,011**	**1,888**	**36,397**	**38,285**
Receivables for interest and fees	21	101	122	2	96	98
Accruals	(20)	(194)	(214)	(8)	(169)	(177)
Less: Provision (Note 4)	67	137	204	10	146	156
Loans Net	**5,842**	**33,873**	**39,715**	**1,872**	**36,178**	**38,050**

Short-term loans were granted mostly to private companies for the period of one month to one year, at rates ranging between 5.00 % to 9% p.a.

Long-term loans were granted mostly for investment purposes. These loans were mostly granted for the period of 13 - 120 months, at fixed interest rates ranging between 4% - 9.9% p.a.

Movements within loan portfolio were as follows:

	2017	2016
Opening balance	38,285	19,440
Net loans and advances increase	1,726	18,845
As at 31 December	**40,011**	**38,285**

13. Investment securities

Balance of investment securities available for sale:

	2017	2016
Montenegro Government treasury bills	-	2,000
Interest receivables based on financial assets available for sale	-	10
Total	**-**	**2,010**

The Bank sold the treasury bills of the Ministry of Finance of the Government of Montenegro in December, with a capital gain amounting to EUR 110 thousand.

(All amounts are in EUR thousand unless otherwise stated)

14. Property, plant and equipment

	Equipment	Construction in progress	Total
Cost			
Balance as at 1 January 2016	399	-	399
Additions	207	-	207
Disposals and write-offs	(5)	-	(5)
Balance as at 31 December 2016	601	-	601
Increase	43	389	432
As at 31 December 2017	**644**	**389**	**1,033**
Depreciation and impairment			
Balance as at 1 January 2016	(36)	-	(36)
Depreciation charge	(79)	-	(79)
Disposals and write-offs	1	-	1
As at 31 December 2016	**(114)**	**-**	**(114)**
Current year depreciation charge (Note 8)	(108)	-	(108)
As at 31 December 2017	**(222)**	**-**	**(222)**
Net book value as at 31 December 2016	**487**	**-**	**487**
Net book value as at 31 December 2017	**421**	**389**	**811**

15. Intangible assets

	Software	Assets under construction	Total
Cost			
Balance as at 1 January 2016	302	15	317
Additions	2	138	140
Balance as at 31 December 2016	**304**	**153**	**457**
Increase	204	(137)	67
Balance as at 31 December 2017	**508**	**16**	**524**
Amortisation and impairment			
Balance as at 1 January 2016	(29)	-	(29)
Amortisation (Note 8)	(60)	-	(60)
Balance as at 31 December 2016	**(89)**	**-**	**(89)**
Current year amortisation charge (Note 8)	(74)	-	(74)
Balance as at 31 December 2017	**(163)**	**-**	**(163)**
Net book value as at 31 December 2016	**215**	**153**	**368**
Net book value as at 31 December 2017	**345**	**16**	**361**

(All amounts are in EUR thousand unless otherwise stated)

16. Deposits due to customers and banks

	2017	2016
Demand deposits	23,156	18,058
Term deposits	31,366	27,079
Interest payable	19	1
Accruals	-	7
Total	**54,541**	**45,145**

Demand deposits	2017	2016
Resident state owned companies	203	2
Privately owned companies	1,859	415
Entrepreneurs	48	42
Non-resident companies	17,594	16,699
State funds	1,759	87
Resident non-governmental and non-profit organisations	159	255
Resident individuals	171	86
Non-resident individuals	1,358	470
Other resident depository institutions	2	2
Banks	3	
Total demand deposits	**23,156**	**18,058**

Term deposits	2017	2016
Resident state owned companies	7,000	-
Privately owned companies	601	478
Non-resident companies	14,518	15,863
Resident individuals	88	15
Non-resident individuals	9,159	10,723
Total term deposits	**31,366**	**27,079**
Total deposits	**54,522**	**45,137**

17. Funds borrowed from other clients

	2017	2016
Borrowings	3,735	3,823
Interest payable on borrowings	4	5
Total	**3,739**	**3,828**

(All amounts are in EUR thousand unless otherwise stated)

17. Funds borrowed from other clients (Continued)

a) Borrowings:

	2017	2016
INVESTMENT AND DEVELOPMENT FUND OF MONTENEGRO AD	3,735	3,823
Total	**3,735**	**3,823**

	2017	2016
Payable within 12 months from the balance sheet date	545	252
Payable within 1-5 years	1,963	1,501
Payable within the period exceeding 5 years	1,227	2,070
Total	**3,735**	**3,823**

Loans used by the Bank are long-term credit lines granted by the Investment and Development Fund of Montenegro which are due to mature in 2028. Loans granted by the Investment and Development Fund of Montenegro are repaid at the interest rate in range from 1% to 2%.

18. Other liabilities

	2017	2016
Advances received	80	59
Tax liabilities	8	5
Card operations	6	
Other liabilities	56	12
Temporary account	132	165
Trade payables	42	27
Total	**324**	**268**

19. Subordinated debt

Subordinated debt balance:

	2017	2016
Private legal entity – non-resident	2,000	1,000
Subordinated debt interest	7	3
Total	**2,007**	**1,003**

On 13 February 2017, the Bank signed the subordinated debt agreement with the legal entity non- resident in amount of EUR 1,000 thousand for the period of six years and interest rate of 4.5%.

(All amounts are in EUR thousand unless otherwise stated)

20. Equity

	2017	2016
Issued share capital – ordinary shares	8,500	8,500
Accumulated loss	(864)	(922)
Current year profit	17	58
Total	**7,653**	**7,636**

Share capital comprises ordinary shares bearing the same rights which were issued in kind and entered into the Central Depository Agency (CDA) on securities' owners accounts. Shareholders have the right to participate in the management of the bank, the right to a percentage of profits (dividend), and the right to an appropriate portion of assets in the event of liquidation or bankruptcy, in accordance with law.

The Bank's share capital as at 31 December 2017 comprised 85,000 shares with a par value of EUR 100.00 per share.

Under the Law on Banks (MNE Official Gazette, No. 17/2008, 44/2010, 40/2011), which came into force on 8 August 2011, the minimum cash portion of a bank's share capital amounts to EUR 5,000 thousand.

The ownership structure as at 31 December 2017 is presented in the table below:

	2017	% share
Volodymyr Kostelman	5,000	58.82%
Liya Morokhovska	2,950	34.71%
Vadym Morokhovskyy	550	6.47%
Total	**8,500**	**100%**

21. Off-balance sheet items

	2017	2016
Irrevocable commitments - loans granted	1,047	1,219
Issued guarantees	1,269	1,601
Issued guarantees payable	618	1,338
Issued performance bonds	551	258
Other guarantees	100	5
Collateral for loans and receivables	95,198	74,071
Total off-balance sheet items	**97,514**	**76,891**

a) Guarantees provided to companies, both resident and non-resident, comprise payable guarantees, tender guarantees and performance bonds. The Bank created provision for off-balance sheet losses amounting to EUR 5 thousand for guarantees and other commitments (Note 4).

(All amounts are in EUR thousand unless otherwise stated)

21. Off-balance sheet items (Continued)

b) Collateral for accounts receivable relates to assets received as collateral amounting to EUR 95,198 thousand.

Assets received as collateral are presented in the table below:

	2017	2016
Property	60,921	48,181
Cash collateral	24,169	22,491
Pledged assets	10,108	3,399
Total	**95,198**	**74,071**

22. Related party transactions

A number of banking transactions are entered into with related parties in the normal course of business. Under the Law on Banks, the Bank's related parties are:

- Members of the (management) bodies of the Bank, shareholders, employees, and their immediate family (spouse and children),
- Legal entities in which the owner of a qualified share also has a qualified share in the Bank,
- Legal entities in which members of the (management) bodies of the Bank, shareholders, employees, and their immediate family have significant influence, or any of the above persons is a director or a member of the Board of Directors or other body of such legal entities,
- Persons holding at least 50% of the capital or voting rights of the legal entity which has a qualified share in the Bank.

Related party transactions are carried out at arm's length.

(All amounts are in EUR thousand unless otherwise stated)

22. Related party transactions (Continued)

The volume of related party transactions, assets and liabilities as at 31 December 2017 and related income and expenses are presented in the table below:

	Volodymyr Kostelman Shareholder	Liya Morokhovska Shareholder	Calyptra Invest	Vostok banka	Graal doo	Other related legal entities	Related individuals	Total
			Jointly controlled entities					
Receivables								
Foreign currency accounts	-	-	-	323	-	-	-	323
Fixed term deposits with banks	-	-	-	4,533	-	-	-	4,533
Loans granted	-	-	-	-	156	-	797	953
Other receivables	-	-	-	48	-	-	-	48
Total receivables	**-**	**-**	**-**	**4,904**	**156**	**-**	**797**	**5,857**
Liabilities								
Demand deposits	4	289	126	-	14	172	87	692
Term deposits	-	9,101	9,318	-	-	1	13	18,433
Subordinated debt	-	-	2,000	-	-	-	-	2,000
Other liabilities	-	-	-	-	-	-	-	-
Total liabilities	**4**	**9,390**	**11,444**	**-**	**14**	**173**	**100**	**21,125**
Net receivables/(payables)	**(4)**	**(9,390)**	**(11,444)**	**4,904**	**142**	**(173)**	**(697)**	**(15,268)**
First-class collateral	-	-	-	4,500	-	-	-	4,500
Net receivables/ (payables) impairment for the first-class collateral)	**(4)**	**(9,390)**	**(11,444)**	**404**	**142**	**(173)**	**(697)**	**(10,768)**

23. Related party transactions

	Liya Morokhovska Shareholder	Calyptra Invest	Vostok bank	Graal doo	Other related parties	Related individuals	Total
			Jointly controlled entities				
Income							
Interest income	-	-	582	11	-	37	630
Fee and commission income	1	9	-	-	12	3	25
Total income	**1**	**9**	**582**	**11**	**12**	**40**	**655**
Expenses							
Interest expense	392	457	-	-	-	-	849
Commission expense	-	-	22	-	-	-	22
Rentals	-	-	-	-	-	54	54
Total expenses	**392**	**457**	**22**	**-**	**-**	**54**	**925**
Net income/(expenses)	**(391)**	**(448)**	**560**	**11**	**12**	**(14)**	**(270)**

(All amounts are in EUR thousand unless otherwise stated)

23. Related party transactions (Continued)

Salaries paid to related parties - individuals in 2017 were as follows:

	Bank management	Key management	Board members	Total
Salaries and other short-term benefits	480	521	-	1,001
Board membership fees	-	-	38	38
Total	**480**	**521**	**38**	**1,039**

The volume of related party transactions, assets and liabilities as at 31 December 2016 and related income and expenses are presented in the table below:

	Liya Morokhovska Shareholder	Calyptra Invest	Vostok banka	Graal doo	Other related parties	Related individuals	Total
			Jointly controlled entities				
Receivables							
Foreign currency accounts	-	-	649	-	-	-	649
Fixed term deposits with banks	-	-	4,538	-	-	-	4,538
Loans granted	-	-	-	75	-	679	754
Other receivables	-	-	40	-	1	-	41
Total receivables			**5,227**	**75**	**1**	**679**	**5,982**
Liabilities							
Demand deposits	116	35	-	17	76	64	308
Term deposits	10,723	8,568	-	-	330	5	19,626
Subordinated debt	-	1,000	-	-	-	-	1,000
Other liabilities	-	-	-	-	6	-	6
Total liabilities	**10,839**	**9,603**	**-**	**17**	**412**	**69**	**20,940**
Net receivables /(payables)	**(10,839)**	**(9,603)**	**5,227**	**58**	**(411)**	**610**	**(14,958)**

	Liya Morokhovska Shareholder	Calyptra Invest	Vostok bank	Graal doo	Other related parties	Related individuals	Total
			Jointly controlled entities				
Income							
Interest income	-	-	749	5	-	23	777
Fee and commission income	5	12	-	-	10	2	29
Total income	**5**	**12**	**749**	**5**	**10**	**25**	**806**
Expenses							
Interest expense	396	221	-	-	7	-	624
Commission expense	-	-	32	-	-	-	32
Total expenses	**396**	**221**	**32**	**-**	**7**	**-**	**656**
Net income/(expenses)	**(391)**	**(209)**	**717**	**5**	**3**	**25**	**150**

24. Risk management

24.1. Liquidity risk

Adequate liquidity risk management is the basic requirement for safe and efficient operations of a bank. The quality of liquidity risk management depends on the Bank's balance sheet structure and cash flow (inflows and outflows) matching. Required liquidity is achieved through rational management of assets and liabilities in order to maintain an adequate proportion of liquid assets and unstable liabilities.

At 2017 year end, deposits comprise mainly deposit accounts of non-residents 78.16% (i.e. EUR 42,629 thousand), of which EUR 19,310 thousand relates to deposits with maturity of up to one year, whereas EUR 23,319 thousand relates to deposits over one year.

Based on the results of measurement and monitoring of basic liquidity ratios, both internally prescribed and those required by the Central Bank of Montenegro, all ratios were above the prescribed minimum, meaning that the Bank managed adequately both operating and structural liquidity.

The table below provides an overview of assets and liabilities maturity dates based on contractual payment terms.

The contractual maturities of assets and liabilities are determined based on the period remaining to the contractual maturity date at the Balance Sheet date. Regarding the balance sheet positions, the maturity compliance model does not include the business premises and other fixed assets (EUR 811 thousand) and value adjustments on other asset items (EUR 14 thousand), while the position of other assets is reduced by the amount of intangible assets (EUR 361 thousand).

Likewise, the liability items are distributed according to the remaining agreed maturity, i.e. the agreed payment deadline. Regarding the position of the balance sheet positions, deposits include deposits from banks and clients' deposits, but do not include reserves in the amount of EUR 13 thousand. The position of other financial liabilities (from the maturity match) is the sum of the positions of the current tax liability, deferred tax liabilities and other liabilities from the Balance Sheet.

For the analysis of the maturity of assets and liabilities of the Bank in terms of expected maturities, asset positions are distributed according to the expected maturity, which can be equally agreed, but in most cases it is different from the contracted. When reporting the inflow from the loan collection, the Bank's real expectations regarding the collection are taken into account, based on the information received from the clients. In order to present the expected outflows in real terms, the stability of the deposit is examined and presented in the columns according to the expected outflows. The Bank has developed and applied the Methodology for determining the stable level of demand deposits. The stable level of demand deposits is determined as 70% of the minimum demand deposits (minus the sight deposits of all clients who make commissions) for the last 12 months. The stable amount of the deposit is allocated in the column 91-180 days.

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.1. Liquidity risk (Continued)

The assets and liabilities maturity structure as at 31 December 2017 was as follows:

	1-7 days	8-15 days	16-30 days	31-90 days	91-180 days	181-365 days	1-5 years	Over 5 years	Total
Assets									
Cash and deposits with deposit institutions	19,735	896	4,500	-	-	-	2,141	5	27,277
Loans and other receivables	421	250	41	5,547	1,947	7,753	18,461	5,591	40,011
Securities available for sale	-	-	-	-	-	-	-	-	-
Other financial assets	230	-	48	(25)	(12)	(32)	(100)	(45)	64
Total	**20,386**	**1,146**	**4,589**	**5,522**	**1,935**	**7,721**	**20,502**	**5,551**	**67,352**
Liabilities									
Deposits	23,176	-	2	4,800	57	7,496	12,227	6,785	54,543
Borrowings and other loans payable	44	-	-	122	83	301	1,936	1,253	3,739
Subordinated debt	7	-	-	-	-	-	-	2,000	2,007
Other financial liabilities	142	140	42	10	-	-	20	-	354
Total	**23,369**	**140**	**44**	**4,932**	**140**	**7,797**	**14,183**	**10,038**	**60,643**
Maturity gap (1)- (2)	**(2,983)**	**1,006**	**4,545**	**590**	**1,795**	**(76)**	**6,319**	**(4,487)**	**6,709**
Cumulative gap	**(2,983)**	**(1,976)**	**2,569**	**3,159**	**4,953**	**4,877**	**11,196**	**6,709**	**-**
% of total available cash funds	**(4.9%)**	**(3.3%)**	**4.2%**	**5.2%**	**8.2%**	**8.0%**	**18.5%**	**11.1%**	**-**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.1. Liquidity risk (Continued)

The assets and liabilities maturity structure as at 31 December 2017 was as follows:

	1-7 days	8-15 days	16-30 days	31-90 days	91-180 days	181-365 days	1-5 years	Over 5 years	Total
Assets									
Cash and deposits with deposit institutions	19,735	896	4,500	-	-	-	2,141	5	27,277
Loans and other receivables	168	118	426	3,047	1,947	7,489	21,225	5,591	40,011
Securities available for sale	-	-	-	-	-	-	-	-	-
Other financial assets	230	-	48	(25)	(12)	(32)	(100)	(45)	64
Total	**20,133**	**1,014**	**4,974**	**3,022**	**1,935**	**7,457**	**23,266**	**5,551**	**67,352**
Liabilities									
Deposits	14,491	-	2	4,800	8,742	7,496	12,227	6,785	54,543
Borrowings and other loans payable	44	-	-	122	83	301	1,936	1,253	3,739
Subordinated debt	7	-	-	-	-	-	-	2,000	2,007
Other financial liabilities	142	140	42	10	-	-	20	-	354
Total	**14,684**	**140**	**44**	**4,932**	**8,825**	**7,797**	**14,183**	**10,038**	**60,643**
Maturity gap (1)- (2)	**5,449**	**874**	**4,930**	**(1,910)**	**(6,890)**	**(340)**	**9,083**	**(4,487)**	**6,709**
Cumulative gap	**5,449**	**6,323**	**11,253**	**9,343**	**2,453**	**2,113**	**11,196**	**6,709**	**-**
% of total available cash funds	**9.0%**	**10.4%**	**18.6%**	**15.4%**	**4.0%**	**3.5%**	**18%**	**11.1%**	**-**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.1. Liquidity risk (Continued)

The assets and liabilities maturity structure as at 31 December 2016 was as follows:

	1-7 days	8-15 days	16-30 days	31-90 days	91-180 days	181-365 days	1-5 years	Over 5 years	Total
Assets									
Cash and deposits with deposit institutions	12,337	-	-	-	-	-	4,538	-	16,875
Loans and other receivables	101	-	-	8,990	549	3,919	17,830	6,896	38,285
Securities available for sale	-	-	-	-	-	-	2,000	-	2,000
Other financial assets	185	-	39	(27)	(8)	(14)	(76)	(43)	56
Total	**12,623**	**-**	**39**	**8,963**	**541**	**3,905**	**24,292**	**6,853**	**57,216**
Liabilities									
Deposits	14,761	1,652	991	661	7,637	610	12,925	5,907	45,145
Borrowings and other loans payable	24	-	-	58	39	136	1,469	2,102	3,828
Subordinated debt	3	-	-				-	1,000	1,003
Other financial liabilities	71	170	26	-	-	-	18	-	286
Total	**14,859**	**1,822**	**1,017**	**719**	**7,676**	**746**	**14,412**	**9,009**	**50,261**
Maturity gap (1)- (2)	**(2,236)**	**(1,822)**	**(978)**	**8,244**	**(7,135)**	**3,159**	**9,880**	**(2,156)**	**6,956**
Cumulative gap	**(2,236)**	**(4,058)**	**(5,036)**	**3,208**	**(3,927)**	**(768)**	**9,112**	**6,956**	**-**
% of total available cash funds	**(4.4%)**	**(8.1%)**	**(10.0%)**	**6.4%**	**(7.8%)**	**(1.5%)**	**18.1%**	**13.8%**	**-**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.2 Interest rate risk

The sensitivity of assets, liabilities and off-balance sheet items to interest rate changes affects the amount of net interest income and the market value of certain financial instruments (interest rate sensitive funds and investments), which consequently affects the market value of the bank's capital.

The Bank's exposure to interest rate risk as at 31 December 2017 is presented in the table below. In 2017, the Bank did not grant loans with floating interest rates, therefore, the table includes assets and liabilities presented by maturity dates.

Balance as at 31 December 2017	1-30 days	31-90 days	91-180 days	181-365 days	Over 1 year	Total
Assets						
Interest-bearing deposits with other institutions	7,361	-	-	-	1,054	8,415
Securites	-	-	-	-	-	-
Loans	712	5,547	1,947	7,753	24,052	40,011
Other interest sensitive assets	173	-	-	-	-	173
Total	**8,246**	**5,547**	**1,947**	**7,753**	**25,106**	**48,599**
% of total interest - bearing assets	**16.97%**	**11.41%**	**4.01%**	**15.95%**	**51.66%**	**-**
Liabilities						
Interest-bearing deposits	8,358	4,800	55	7,091	18,869	39,173
Interest-bearing financial assets	40	122	83	301	3,189	3,735
Subordinated debt	-	-	-	-	2,000	2,000
Other sensitive liabilities	30	-	-	-	-	30
Total	**8,428**	**4,922**	**138**	**7,392**	**24,058**	**44,938**
% of total interest - bearing liabilities	**18.76%**	**10.95%**	**0.31%**	**16.45%**	**53.54%**	**-**
Gap	**(182)**	**625**	**1,809**	**361**	**1,048**	**3,661**
Cumulative gap	**(182)**	**443**	**2,252**	**2,613**	**3,661**	**-**
Cumulative gap/total assets %	**(0.27%)**	**0.65%**	**3.3%**	**3.83%**	**5.36%**	**-**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.2 Interest rate risk (Continued)

Balance as at 31 December 2016	1-30 days	31-90 days	91-180 days	181-365 days	Over 1 year	Total
Assets						
Interest-bearing deposits with other institutions	1,907	-	-	-	4,538	6,445
Securities	-	-	-	-	2,000	2,000
Loans	101	8,990	549	3,919	24,726	38,285
Other interest sensitive assets	138	-	-	10	-	148
Total	**2,146**	**8,990**	**549**	**3,929**	**31,264**	**46,878**
% of total interest-bearing assets	**4.6%**	**19.2%**	**1.2%**	**8.4%**	**66.7%**	**-**
Liabilities						
Interest-bearing deposits	4,806	-	7,637	10	18,762	31,215
Interest-bearing borrowings	24	58	39	136	3,571	3,828
Subordinated debt	-	-	-	-	1,000	1,000
Other sensitive liabilities	3	-	-	-	-	3
Total	**4,833**	**58**	**7,676**	**146**	**23,333**	**36,046**
% of total interest-bearing liabilities	**13.4%**	**0.2%**	**21.3%**	**0.4%**	**64.7%**	**-**
Gap	**(2,687)**	**8,932**	**(7,127)**	**3,783**	**7,931**	**10,832**
Cumulative gap	**(2,687)**	**6,245**	**(882)**	**2,901**	**10,832**	**-**
Cumulative gap/total assets %	**(4.6%)**	**10.8%**	**(1.5%)**	**5.0%**	**18.7%**	**-**

Sensitivity analysis

Liquidity risk management is accompanied by monitoring the sensitivity of the Bank's Income Statement to different scenarios for interest rate changes. Income Statement sensitivity is the impact of assumed changes in interest rates on the annual net interest income.

The Bank regularly performs stress testing of interest rate risk in the banking book. The impact on net interest income (NII) for individual GAP is calculated using this formula:

Impact on annual NII = (periodic GAP)*(gap time period (year/s))*(interest rate change in base points)

Considering the maturity matching between interest-bearing assets and liabilities, or mainly positive periodic GAPs of up to one year, the impact on the annual net interest income in the event of reduced interest rates will be negative.

24. Risk management (Continued)

24.2 Interest rate risk (Continued)

Sensitivity analysis (Continued)

A review of Income Statement sensitivity to changes in interest rates as at 31 December 2017 is presented in the table below:

Interest rate increase	Impact on income statement in 000 EUR	Interest rate decrease	Impact on income statement in EUR
+100 bp	16	-100 bp	(16)

A review of income statement sensitivity to changes in interest rates as at 31 December 2016 is presented in the table below:

Interest rate increase	Impact on income in 000 EUR	Interest rate decrease	Impact on income statement in '000' EUR
+100 bp	14	-100 bp	(14)

24.3 Foreign exchange risk

Foreign exchange risk is the risk that the value of assets and liabilities will change as a result of changes in foreign exchange rates.

Assets and liabilities by currencies as at 31 December 2017 were as follows:

	USD	GBP	Other	Total
LONG POSITIONS				
F/X assets	32,544	171	2	32,717
TOTAL	**32,544**	**171**	**2**	**32,717**
SHORT POSITIONS				
F/X liabilities	32,506	172	-	32,678
TOTAL	**32,506**	**172**	**-**	**32,678**
NET POSITION				
NET LONG (SHORT) POSITIONS (1) - (2)	**38**	**(1)**	**2**	**-**
% of basic capital	**1.00%**	**(0.00%)**	**0.00%**	**-**
Foreign currencies – aggregate	**39**	**-**	**-**	**-**
% of basic capital	**0.64%**	**-**	**-**	**-**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.3 Foreign exchange risk (Continued)

Assets and liabilities by currencies as at 31 December 2016 were as follows:

	USD	GBP	Other	Total
LONG POSITIONS				
F/X assets	32,197	1	2	32,200
TOTAL	**32,197**	**1**	**2**	**32,200**
SHORT POSITIONS				
F/X liabilities	32,156	2	-	32,158
TOTAL	**32,156**	**2**	**-**	**32,158**
NET POSITION				
NET LONG (SHORT) POSITIONS (1) - (2)	**41**	**(1)**	**2**	
% of basic capital	**0.65%**	**(0.02%)**	**0.03%**	
Foreign currencies – aggregate	**42**			
% of basic capital	**0.67%**			

24.4 Credit risk

Credit risk is managed on an individual loan basis and for the whole portfolio.

In order to provide the preconditions for adequate credit risk management, risk exposure is considered (i) on an individual loan basis - the Bank determines the creditworthiness and upper debt limit of a client or a group of clients, and (ii) for the whole portfolio, on the basis of:

- Portfolio structure by category of loans (corporate loans, loans to state institutions, retail loans, off-balance sheet exposures);
- Portfolio structure by solvency group (movements between individual solvency categories, migration matrices, coverage ratio);
- Portfolio structure by timely settlement of liabilities;
- Portfolio structure by industry;
- Concentration of clients with large exposures (clients or groups of related clients with exposure exceeding 10% of the venture capital,
- Concentration of loans to individuals by type of product;

The Bank performs on a quarterly basis an impairment assessment (balance sheet assets) and a contingent loss assessment (off-balance sheet items) based on which it is exposed to credit risk, under the policy disclosed in Note 2.9.

On a monthly basis, the Bank performs a classification of items of balance sheet assets and off-balance sheet items based on which it is exposed to credit risk and calculates provisions for estimated losses. Provisions for credit risk are calculated in accordance with the valid regulations of the Central Bank of Montenegro (see Note 2.9.)

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.4 Credit risk (Continued)

In order to effectively manage credit risk, the Bank prepares credit risk stress scenarios and monitors the impact of the weakening of the credit portfolio on the Bank's liquidity, profitability and capital adequacy.

A review of the credit risk exposure is presented below.

Maximum exposure to credit risk without taking into account any collateral:

	2017 Maximum credit risk exposure	2016 Maximum credit risk exposure
Loans and receivables from banks	**15,577**	**9,122**
Loans and receivables from customers	**39,715**	**38,050**
Loans to legal entities	37,757	36,539
Loans to individuals	1,783	1,414
Loans to entrepreneurs	54	-
Interest and other receivables	121	97
Total balance sheet items:	**55,293**	**47,172**
Off-balance sheet items		
Guarantees	1,269	1,601
Other contingent liabilities	1,047	1,218
Less: provisions for potential losses on off-balance sheet items	(5)	(8)
Total	**2,311**	**2,811**
	57,604	**49,983**

Share of top 3 largest exposures and top 10 largest exposures in the total maximum exposure to credit risk, not taking into account the collateral as at 31 December 2017 and 31 December 2016 is presented as follows:

	2017		2016	
	Amount	**%**	**Amount**	**%**
Top 3 largest exposures	17,601	30.56%	19,255	38.52%
Top 10 largest exposures	33,940	58.92%	30,351	60.72%
Maximum exposure to credit risk	**57,604**		**49,983**	

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.4 Credit risk (Continued)

From the point of geographical concentration, the exposure in Montenegro refers to 62.55%, in the United Arab Emirates 8.34%, in Ukraine 8.51%, in Bosnia and Herzegovina 5.16%, in other countries – 15.44%.

Country	2017 Maximum exposure to credit risk	2017 Geographical concentration (%)	2016 Maximum exposure to credit risk	2016 Geographical concentration (%)
Montenegro	36,034	62.55%	31,224	62.47%
Estonia	2,686	4.66%	2,157	4.32%
Croatia	75	0.13%	74	0.15%
Cyprus	127	0.22%	-	0.00%
Latvia	251	0.44%	-	0.00%
Germany	698	1.21%	2,203	4.41%
Serbia	897	1.56%	1,312	2.62%
UAE	4,800	8.33%	7,278	14.56%
Ukraine	4,904	8.51%	5,227	10.46%
Russia	2,325	4.04%	-	0.00%
Bosnia and Herzegovina	2,970	5.16%	-	0.00%
Turkey	1,837	3.19%	508	1.02%
Total	**57,604**	**100%**	**49,983**	**100%**

Overview of collateral by type of collateral as at 31 December 2017 is presented as follows:

	Amount	Residential real estate	Business real estate	Land	Other mortgages	Pledge	Term deposit	Collateral - total
Loans and receivables from banks	15,577	-	-	-	-	-	4,500	4,500
Loans and receivables from clients	39,716	7,400	35,202	17,860	160	9,844	19,119	89,585
Total balance sheet items	**55,293**	**7,400**	**35,202**	**17,860**	**160**	**9,844**	**23,619**	**94,085**
Total off-balance sheet items	**2,311**	**233**	**66**	**-**	**-**	**264**	**550**	**1,113**
Total	**57,604**	**7,633**	**35,268**	**17,860**	**160**	**10,108**	**24,169**	**95,198**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.4 Credit risk (Continued)

Overview of collateral by type of collateral as at 31 December 2016 is presented as follows:

	Amount	Residential real estate	Business real estate	Land	Pledge	Term deposit	Collateral - total
Loans and receivables from banks	9,122	-	-	-	-	-	-
Loans and receivables from clients	38,050	3,216	30,292	14,631	3,167	21,491	72,797
Total balance sheet items	**47,172**	**3,216**	**30,292**	**14,631**	**3,167**	**21,491**	**72,797**
Total off-balance sheet items	**2,811**	**42**	**-**	**-**	**232**	**1,000**	**1,274**
Total	**49,983**	**3,258**	**30,292**	**14,631**	**3,399**	**22,491**	**74,071**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.4 Credit risk (Continued)

Loan Analysis by Sectors	2017 Gross loans	2017 Provisions	2017 Net loans	2017 %	2016 Gross loans	2016 Provisions	2016 Net loans	2016 %
Retail	1,810	(17)	1,793	4.50%	1,450	(31)	1,419	3.72%
Construction	15,396	(120)	15,276	38.37%	12,174	(78)	12,096	31.72%
Traffic and warehousing	9,685	(25)	9,660	24.27%	10,284	(18)	10,266	26.92%
Trade	1,873	(13)	1,860	4.67%	1,204	(7)	1,197	3.14%
Professional, scientific and technical activities	364	(2)	362	0.91%	205	(1)	204	0.54%
Administrative and support service activities	4,947	(1)	4,947	12.43%	7,538	(2)	7,536	19.76%
Other service activities	575	(2)	573	1.44%	-	-	-	-
Agriculture, forestry and fishing	320	(2)	318	0.80%	-	-	-	-
Manufacturing industry	1,029	(1)	1,028	2.58%	-	-	-	-
Services, tourism and hospitality	1,992	(9)	1,983	4.98%	2,060	(10)	2,050	5.38%
Health and social security	320	(4)	316	0.79%	300	(3)	297	0.78%
Electricity supply	1,700	(7)	1,693	4.25%				
Other					3,070	(5)	3,065	8.04%
Total	**40,011**	**(203)**	**39,808**	**100%**	**38,285**	**(155)**	**38,130**	**100%**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.4 Credit risk (Continued)

	2017 Loans	2016 Loans
Loans not in default for which no provision is made	12,790	10,167
Loans in default for which no provision is made	-	-
Loans for which provision is made	27,221	28,118
Loans Gross	**40,011**	**38,285**
Less: Provision	(203)	(155)
Loans Net	**39,808**	**38,130**

Loans not in default for which no provision is made:

	2017 Loans outstanding	2016 Loans outstanding
Loans to individuals	**294**	**37**
- Cash non-specific purpose loans	109	19
- Housing loans	42	18
- Framework loans	-	-
- Vehicle loans	-	
- Other loans to individuals	143	-
	12,496	**10,130**
Loans to legal entities		
- Loans to large companies	5,505	-
- Loans to small, medium-sized and micro enterprises	1,482	2,901
- Loans to non-residents	5,509	7,229
	12,790	**10,167**
Total	**12,790**	**10,167**

(All amounts are in EUR thousand unless otherwise stated)

24. Risk management (Continued)

24.4 Credit risk (Continued)

Impaired loans by type

	2017			2016		
	Gross loans	Provision	Net loans	Gross loans	Provision	Net loans
Loans to state government	-	-	-	-	-	-
Loans to financial organisations	-	-	-	-	-	-
Loans to individuals	**1,516**	**(17)**	**1,499**	**1,413**	**(31)**	**1,382**
- cash non-specific purpose loans	430	(1)	429	484	(14)	470
- housing loans	557	(10)	547	579	(11)	568
- other loans to individuals	529	(6)	523	350	(6)	344
Loans to legal entities	**25,651**	**(186)**	**25,465**	**26,705**	**(124)**	**26,581**
- Loans to large companies	1,041	(7)	1,034	7,419	(6)	7,413
- Loans to small and medium-sized enterprises	22,792	(166)	22,626	16,144	(112)	16,032
- Loans to non-residents	1,818	(13)	1,805	3,142	(6)	(3,136)
Loans to entrepreneurs	**54**	**-**	**54**	**3,142**	**(6)**	**3,136**
Total loans	**27,221**	**(203)**	**27,018**	**28,118**	**(155)**	**27,963**

25. Capital management

The Bank manages its capital, which is a broader concept than equity in the Balance Sheet, in order to:

- comply with capital requirements set by the Central Bank of Montenegro
- secure a capital adequacy ratio that will enable it to continue as a going concern and
- retain the capital adequacy ratio that will enable further development of operations.

The capital adequacy and the use of capital is monitored by the Bank's management on a quarterly basis. The Central Bank of Montenegro has defined the following capital requirement limits:

- Minimum capital cash portion of EUR 5 million and the
- Capital adequacy ratio of 10%.

The Bank's total capital, i.e. own funds, consists of Tier 1 and Tier 2 capital and deductibles:

Basic capital comprises: Paid-in share capital measured at nominal value, exclusive of cumulative preference shares; collected share premium, exclusive of share premium for preference cumulative shares, required reserve for estimated losses at regulatory request, set aside in accordance with the decision prescribing minimum standards for credit risk management in banks; reserves created and charged to profit after taxation (legal, statutory and other reserves); prior years retained earnings for which the Shareholders' Assembly has decided to include in basic capital, less income tax and other expected expenses; current year profit, provided the following conditions have been met: the Shareholders' Assembly, or the Board of Directors with the approval of the Shareholder's Assembly passed a Decision that current year profit in its full or less than full amount shall be allocated to reserves as an increase in share capital, so as to cover prior years' losses and/or to retained earnings, and presented in the form of a percentage (profit is reduced for related income tax and other expected expenses; profit is confirmed by an independent auditor; the Bank received approval from the Central Bank to incorporate profit in its basic capital).

Deductibles from Tier 1 capital comprise: Prior year's loss; current year loss; intangible assets such as goodwill, licenses, patents, trademarks and concessions; nominal value of acquired own shares, exclusive of cumulative preference shares; unrealised loss arising from fair value adjustments of financial assets available for sale; the gain on calculated provisions for contingent losses and total provisions for balance sheet and off-balance sheet items; the amount exceeding the limit for investments in immovable property and fixed assets determined by special regulations prescribed by the Central Bank.

Additional capital comprises: Nominal value of cumulative preference shares; collected share premium for preference cumulative shares; general reserves, not exceeding 1.25% of total risk weighted assets; subordinated debt and hybrid instruments, which meet the requirements of Article 6 and Article 7 of the Decision on capital adequacy for inclusion into additional capital. Deductibles from Additional Capital comprise: Acquired own cumulative preference shares; receivables and potential payables secured by hybrid instruments or the Bank's subordinated loan in the amount not exceeding the value of the instruments included in additional capital.

Capital requirements are determined on an individual basis for each type of risk - credit risk, operating risk - market risk and other risks in accordance with applicable regulations. Major capital requirements relate to capital used to cover credit risk and country risk. In this respect, credit risk weighted assets are calculated using ponders ranging between 0% do 150% depending on the type and the level of credit risk specific for each risk exposure. Another major capital requirement relates to country risk. Capital to cover country risk is calculated using ponders ranging between 0% and 300%.

(All amounts are in EUR thousand unless otherwise stated)

25. Capital management (Continued)

The Banks total capital structure as at 31 December 2017 and 31 December 2016 and the capital adequacy ratio are presented in the table below.

	2017	2016
Basic capital		
Paid-in share capital measured at nominal value, exclusive of cumulative preference shares	8,500	8,500
Collected share premium	-	-
Reserves created and charged to profit after taxation (legal,statutory and other)	-	-
Prior years' retained earnings	-	-
Basic capital	**8,500**	**8,500**
Prior year loss	864	921
Current year loss	-	-
Intangible assets	361	368
Gains on the difference between calculated reserve for contingent losses and the provision made	1,160	904
Deductibles on the calculation of Tier 1 capital	**2,385**	**2,193**
Basic capital	**6,115**	**6,307**
Additional capital	**2,000**	**1,000**
The Bank's funds	**8,115**	**7,307**
Weighted balance sheet assets	27,751	18,336
Weighted off-balance sheet assets	1,444	1,305
Total credit risk weighted assets	**29,195**	**19,641**
Capital required to cover market risks	-	-
Capital required to cover operational risks	309	107
Capital required to cover country risk	1,809	448
Capital required to cover other risks	-	-
Capital adequacy	**23.80%**	**34.53%**

26. Application of International Financial Reporting Standard 9

IFRS 9 - Financial Instruments replaces International Accounting Standard - IAS 39 Financial Instruments: Recognition and Measurement. Compared to IAS 39, IFRS 9 introduces a new model for the classification of financial instruments, because instead of the concept of incurred credit losses, the concept of expected credit losses is introduced, which includes macroeconomic valuation models and macroeconomic scenarios.

26. Application of International Financial Reporting Standard 9 (Continued)

Standard MSFI 9 defines the conditions under which a financial asset can be valued at amortised costs, i.e., there are two tests to be completed – a business model test and a characteristics of the given asset model, which has as a result the change in the manner of measuring and disclosing many instruments, depending on their purpose and nature. In accordance with the requirements of IFRS 9, the Bank classifies financial assets in the following manner:

- Debt financial assets, i.e. assets measured at amortised cost and
- Equity financial assets measured at fair value.

A bank recognizes a financial asset or a financial liability in its balance sheet only when it becomes one of the contractual parties to the instrument.

Initially, financial asset is measured at fair value. For financial assets that are measured at fair value through other comprehensive income, fair value comprises transaction costs. Subsequent measurement of financial assets is carried out:

- at amortised cost,
- at fair value:
  - through other comprehensive income and
  - through profit or loss.

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

- the way in which financial assets are managed (a business model that reflects the goals that the management wants to achieve by holding the given financial resources); and
- the characteristics of the contracted cash flow of a given financial asset (cash flows may be such that they consist only of principal and interest payments on the outstanding principal, but the amount of contracted cash flows may vary depending on other factors that do not have interest characteristics, such as market prices, etc.).

In the case of a business model that implies that financial assets are held for the purpose of collecting the contracted cash flows and if the contractual cash flows constitute inflows from the principal and interest payments, which reflect the time value and credit risk associated with the outstanding principal, such financial assets are valued at amortized cost.

Financial assets that are equity instruments are also subsequently measured through profit or loss:

- held for trading
- derivatives; and
- investments in unquoted equity instruments.

Financial assets that are an equity instrument, and for which there is an intention to hold them for a longer period, are subsequently measured as financial assets at fair value through other comprehensive income.

In the subsequent assessment of such property, changes in fair values do not affect the result, but equity through other comprehensive income.

Impairment testing is carried out only for financial assets that are measured at amortized cost and financial assets that are valued at fair value through other comprehensive income.

IFRS 9 introduces a new model for the recognition of impairment losses - A model of expected credit losses, in comparison to the incurred losses in accordance with IAS 39.

26. Application of International Financial Reporting Standard 9 (Continued)

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

In case the criteria are fulfilled, i.e. that a significant increase in risk is identified, the expected losses for the period of 12 months are replaced by the expected losses to the maturity of the asset, i.e. for the whole period of the instrument.

The Bank has adopted the Methodology of impairment of financial instruments in accordance with IFRS 9. The scope of the Methodology applies to all accounts of the Bank of the following groups, i.e. subject to impairment in accordance with IFRS 9:

- balance sheet exposures: (all types of loans, activated guarantees and syndicated loans, factoring and forfeiting arrangements, interest due, fees and other balance sheet receivables, deposits with banks and other financial institutions, securities held-to-maturity (HTM) and other receivables) and
- off-balance sheet exposures: (issued guarantees, issued overdrafts, letters of credit and other).

During the off-balance sheet exposures assessment, the Bank uses a credit conversion factor (CCF) in accordance with the Decision on Capital Adequacy in Banks of the Central Bank of Montenegro (CBM).

The basic principle of the model of expected credit losses is to present a general model of deterioration or improvement of the credit rating of financial instruments. The amount of expected credit losses (ECL) that is recognized as the cost of the provision depends on the volume of credit impairment from initial recognition. There are two grounds for calculation:

- Expected loss for a period of 12 months (Stage 1), which applies to all assets (from initial recognition) until there is a significant deterioration in the credit rating,
- The expected loss over the entire duration of the loan (Stages 2 and 3), which is applied when there is a significant increase in credit risk on an individual or collective basis.

Stages 2 and 3 differ in the way in which interest income is recognized. In Stage 2, interest income is accounted for at gross carrying amount. In Stage 3, interest income is calculated on the net book value.

At each reporting date, an assessment is made of whether there has been a significant increase in the credit risk from initial recognition and whether the financial asset is impaired for each portfolio in order to determine the applicable provisioning (for 12 months or for the entire life of the asset); and type of basis for recognition of interest income (gross book value or net book value).

The expected credit loss is estimated on the basis of an individual or collective assessment. Financial assets are grouped into segments by category (loans to legal entities, loans to individuals), time category (bucket) and staging. Subsequently, the impairment calculation was carried out on the basis of an individual or collective assessment. The combination of these four criteria (client type / bucket / stage / estimation method) determines the parameters and method of estimating the provision for credit losses. The Bank distinguishes between two types of clients: Legal entities (LE) and Individuals (I).

At the reporting date, an assessment is made as to whether there has been a significant increase in credit risk in relation to the date of initial recognition and whether the financial asset has been impaired in order to determine the applicable calculation of the provision (for 12 months or for the entire life of the asset). A loan is allocated to Stage 1, if the conditions for Stage 2 or Stage 3 are not met.

26. Application of International Financial Reporting Standard 9 (Continued)

An estimate of a significant deterioration in creditworthiness in relation to initial recognition is made through the assessment of the following parameters: the days of default are more than 30 days but less than 90 days; CBM's rating is worsened compared to initial recognition and expert opinion by analysts at the Bank. If at least one of the above parameters is met, the product is classified in Stage 2.

The Bank considers that a financial instrument has become impaired (Stage 3 classification) if one or more criteria have been adversely affected, which have a negative impact on the estimated future cash flows: receivables from the client are in default for over 90 days, with exposure amounts above a certain materiality threshold; adverse changes in operating conditions; financial reorganization of debtors; bankruptcy or insolvency of the client; restructuring of loans (significant changes in conditions, interest rate cuts, partial grace periods (freezing and payment of interest only) necessary due to credit (financial) worthiness, lack of cooperation by the client in case of repayment of debts and receivables from the parent company or related party are considered impaired (consideration at the group level) .

For the purposes of documenting the impairment criteria, except for the criteria for the default, the Bank uses questionnaires on the existence of objective evidence of impairment, for individuals and legal entities separately.

The appraisal method applied by the Bank relates to an individual and collective assessment. The Bank has prescribed by the Methodology the criteria on the basis of which fulfilment of whether the asset is subject to an individual or collective assessment is determined.

At the moment, the Bank is not able to estimate the PD of the useful life, due to the lack of sufficient amount of historical data. Therefore, by the time the available amount of data allows the development of a collective assessment model, the Bank will use data at the level of the Montenegrin banking system, published by the CBM.

The calculation of impairment on an individual basis for securities is based on the assessment of several scenarios weighted by the probability of outcome for the duration of the securities, whereby as the probability weight PD is taken in accordance with the international rating, as stated above. If the maturity is up to 3 months, the annual PD is reduced by interpolation to the quarterly PD.

The impairment allowance for short-term exposures to the state of Montenegro is the minimum percentage of impairment that the Bank uses for all exposures, in cases where (individual or collective) consideration of impairment leads to the conclusion that the amount of expected credit losses is equal to zero.

The calculation of impairment on an individual basis for assets with banks is based on the assessment of several scenarios weighted by the probability of outcome during the duration of the exposure, with a probability of being taken as a PD in accordance with the international rating published by Standard & Poor's, Fitch and Moody's. If the maturity is up to 3 months, the annual PD is reduced by interpolation to the quarterly PD.

For loans for which the expected amount of credit losses is estimated to be zero, the Bank uses the % of impairment that was obtained by assessing long-term exposures to the state of Montenegro. In the event that the maturity is up to 3 months, or the exposure is fully covered by cash collateral, the Bank applies a minimum percentage of impairment.

Due to the fact that the Bank does not have a sufficiently long history of data, the Bank uses the value of the LGD parameters prescribed by Basel II (for exposures before default, the Bank applies a LGD of 45%, LGD of 60% for loans in default for more than 180 days, LGD of 80% for loans in default for more than 270 days and LGD of 100% for loans in default for more than 270 days, since the collection of loans from other sources, other than collaterals, is no longer expected).

26. Application of International Financial Reporting Standard 9 (Continued)

The estimated negative impact of the first application of IFRS 9 standard by category: securities, loans, etc. (in EUR thousand) is presented as follows:

Securities:	-
Loans and other receivables:	EUR 171
TOTAL:	**EUR 171**

The stated amount of effects of the first application is the result of calculating the expected loss as at 31 December 2017. It is not expected to change the amount stated after posting, except for possible technical reasons, where in any case no material differences are expected.

27. Contingent liabilities

As at 31 December 2017 there were three legal proceedings against the Bank:

1. Commercial court of Montenegro P No. 1014/15 in the legal subject matter of the Plaintiff, VTK BANKA Austria AG, Vienna - Action to nullify the following documents: Loan Agreement UZZ No. 581 /2015 dated 4 August 2015, Escrow Account Agreement UZZ No. 585/2015 dated 4 August 2015 , Lien Statement UZZ No. 588/2015 dated 4 August 2015 , Lien Statement UZZ No. 589/2015 dated 4 August 2015 , Approval of the registry of mortgage of the second and third rank UZZ No. 587/2015 dated 4 August 2015. The value of the subject matter amounts to EUR 13,980 thousand.
2. Commercial Court of Montenegro P No. 1018/15 in the legal subject matter of the Plaintiff, Ceac Holding Limited, Nikosia, Cyprus - Action to nullify the following documents: Loan Agreement UZZ No. 581 /2015 dated 4 August 2015 , Escrow Account Agreement UZZ No. 585/2015 dated 4 August 2015, Lien Statement UZZ No. 588/2015 dated 4 August 2015, Lien Statement UZZ No. 589/2015 dated 4 August 2015, Approval of the registry of mortgage of the second and third rank ZZ No. 587/2015 dated 4 August 2015. The value of the subject matter amounts to EUR 14,000 thousand.
3. Commercial Court of Montenegro P No. 1016/15 in the legal subject matter of the Plaintiff, EN+GROUP LIMITED, Channel Islands - Action to nullify the following documents: Loan Agreement UZZ No. 581 /2015 dated 4 August 2015, Escrow Account Agreement UZZ No. 585/2015 dated 04. August 2015, Lien Statement UZZ No. 588/2015 dated 4 August 2015, Lien Statement UZZ No. 589/2015 dated 4 August 2015, and Approval of the registry of mortgage of the second and third rank ZZ No. 587/2015 dated 4 August 2015. The value of the subject matter amounts to EUR 13,980 thousand.

The management believes that these claims will be settled in favour of the Bank therefore, no provisions have been made.

28. Events after the balance sheet date

There have been no significant events subsequent to the reporting date for the year ended 31 December 2017 which could affect the operating results presented in the financial statements for the year ended as at 31 December 2017.

In Podgorica,

4 May 2018

Vesna Kovačević
Head of Finance

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