

**ZIRAAT BANK MONTENEGRO AD,
PODGORICA**

**Financial Statements
Year Ended December 31, 2019
and Independent Auditors' Report**

ZIRAAT BANK MONTENEGRO AD, PODGORICA

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This Report is translation of the Auditors' Report issued in the language officially used in Montenegro. In the case of any discrepancy between the version in language officially used in Montenegro and English version, the version in the language officially used in Montenegro shall prevail.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of Ziraat Bank Montenegro AD, Podgorica

Opinion

We have audited the accompanying financial statements (pages 5 to 71) of Ziraat Bank Montenegro AD, Podgorica (hereinafter: the „Bank”), which comprise the balance sheet as at December 31, 2019, income statement, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2019, and its financial performance and its cash flows for the year then ended in accordance with the accounting regulations of Montenegro and regulations of the Central Bank of Montenegro governing financial reporting of banks.

Basis for opinion

We conducted our audit in accordance with the International Standards on Auditing, Law on Auditing of Montenegro and Law on Accounting of Montenegro. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Montenegro, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

(Continued)

INDEPENDENT AUDITORS' REPORT (Continued)

Board of Directors and Shareholders of Ziraat bank Montenegro AD, Podgorica (Continued)

Key audit question	Appropriate audit procedure
Expected credit losses on loans and provisions under guarantees	
<p>Loan receivables and accounts receivable amounted to EUR 65,835 thousand as at December 31, 2019 (EUR 54,251 thousand as at December 31, 2018), while the total amount of the Bank's allowance for impairment was EUR 644 thousand as at December 31, 2019 (EUR 431 thousand as at December 31, 2018).</p> <p>Measuring the costs of loan impairment and provisions for guarantees is considered a key audit matter, since determining the assumptions for expected credit losses is subjective because of the significant level of professional judgment exercised by the Management.</p> <p>The most significant judgements refer to:</p> <ul style="list-style-type: none"> • Assumptions used in models of expected credit loss to estimate the credit risk associated with exposure and the client's expected future cash flows. • Timely identification of exposures with a significant increase in credit risk exposure and credit impairment. • Measurement of collateral and assumptions of future cash flows on individually estimated credit exposures. <p>The Management disclosed additional information on costs of loan impairment and provisions for guarantees in the Notes 3.5, 4.3, 6, 14 and 22 to the financial statements.</p>	<p>Based on our risk assessment and industry knowledge, we have examined the costs of loan impairment and provisions, and assessed the methodology applied, as well as the assumptions used, in accordance with the description of the key audit matter.</p> <p>Our procedures included the following elements:</p> <ul style="list-style-type: none"> • Assessment of key controls over assumptions used in expected credit loss models to estimate credit risk associated with exposure and the client's expected future cash flows. • Detailed testing on the sample basis of evidences that support the assumptions used in the expected credit loss models applied in allocating the stages, assumptions applied to obtain the twelve-month and lifelong probability of default and the methods used to obtain the probability of losses arising from the inability to collect a receivable. • Assessment of key controls and testing their effectiveness over the timely identification of exposures with a significant increase in credit risk and the timely identification of loan impairment exposures. • Detailed testing on the sample basis of evidences of timely identification of exposures with a significant increase in credit risk and timely identification of exposures based on loan impairment. • Detailed testing on the sample basis of evidences that support the appropriate identification of assumptions for loan impairment expenses and provisions for guarantees, including the valuation of collateral and assumptions of future cash flows for individually assessed loan impairment exposures. • Assessment of key changes in high-risk portfolios from prior period in relation to industry standards and historical data. • Assessment of adequacy of the various identified management decisions compared to certain macro forecasts applied in models of expected credit loss. • Evaluation of applied methodologies made with use of our industry knowledge and experience. • We have engaged our IT and Credit Risk Specialists in areas that required specific expertise.

(Continued)

INDEPENDENT AUDITOR'S REPORT (Continued)

Board of Directors and Shareholders of Ziraat bank Montenegro AD, Podgorica (Continued)

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Law on Accounting of Montenegro and regulations of the Central Bank of Montenegro governing 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.

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

As part of an audit in accordance with International Standards on Auditing, Law on Auditing of Montenegro and Law on Accounting of Montenegro, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to this risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omission, misrepresentation or the override of internal controls.
- Obtain an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of the Management's use of going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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INDEPENDENT AUDITOR'S REPORT (Continued)

Board of Directors and Shareholders of Ziraat bank Montenegro AD, Podgorica (Continued)

Auditor's Responsibilities for the Audit of the Financial Statements (Continued)

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

Report on Other Legal and Regulatory Requirements

The management of the Bank is responsible for preparation of the annual Management Report in accordance with the requirements of the Law on Accounting applicable in Montenegro, which report is not an integral part of the accompanying financial statements. In accordance with the Law on Auditing applicable in Montenegro, our responsibility is to express an opinion on the compliance of the presented annual Management Report with the financial statements for the same year. In our opinion, the financial information disclosed in the annual Management Report for 2019 is consistent with the audited financial statements for the year ended December 31, 2019, and the annual Management Report for 2019 contains all the elements defined by the provisions of the Law on Accounting.

The engagement partner on the audit resulting in this independent auditor's report is Katarina Bulatović.

Deloitte d.o.o. Podgorica
March 30, 2020

Katarina Bulatović, Certified Auditor
(License No. 067 issued on March 31, 2015)

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INCOME STATEMENT
Year Ended December 31, 2019
(In thousands of EUR)

ITEM	Note	2019	2018
Interest income and similar income	3.1, 5.1	3,337	2,118
Interest expenses and similar expenses	3.1, 5.2	<u>(827)</u>	<u>(512)</u>
NET INTEREST INCOME		2,510	1,606
Fee and commission income	3.5, 7.1	653	224
Fee and commission expense	3.5, 7.2	<u>(252)</u>	<u>(228)</u>
NET FEE AND COMMISSION INCOME		401	(4)
Net Foreign exchange gains and losses		14	8
Other income	10,1	6	19
Staff costs	8	(1,196)	(991)
Depreciation expenses	16,17	(391)	(421)
General and administration expenses	9	(811)	(692)
Net income/(expense) of impairment of financial instruments not measured at fair value through profit and loss	3.5, 6.1	(177)	(146)
Provision expenses	3.5, 6.2	(9)	-
Other expenses	10,2	<u>(69)</u>	<u>(42)</u>
PROFIT/LOSS BEFORE TAXATION		278	(663)
Income tax	3.3, 11.1	<u>16</u>	<u>(15)</u>
NET PROFIT/(LOSS)		294	(648)

Notes on the following pages 9 to 71
form an integral part of these financial statements.

In Podgorica, March 26, 2020

Signed on behalf of Ziraat Bank Montenegro AD by:

Mustafa Šenman
Chief Executive Officer

Goran Bakić
Executive Director

Jelena Božović
Head of Accounting, Reporting and
Budgeting Department

BALANCE SHEET
As at December 31, 2019
(In thousands of EUR)

	<u>Note</u>	<u>2019</u>	<u>2018</u>
ASSETS			
Cash and deposits held with central banks	12	7,189	6,091
Financial assets at amortized cost		73,840	58,323
Loans and receivables due from banks	13,1	4,649	739
Loans and receivables due from customers	14	65,835	54,251
Securities	15,1	3,340	3,322
Other financial assets	13,2	16	11
Financial assets at fair value through other comprehensive income	15,2	1,109	1,112
Properties, plant and equipment	16	347	404
Intangible assets	17	113	318
Differed tax assets	3.3, 11.3	13	-
Other assets	18	440	24
TOTAL ASSETS		83,051	66,272
LIABILITIES			
Financial liabilities carried at amortized cost	3.8,19,20,21	66,054	52,077
Deposit of banks and central banks	19	2	21
Deposits of customers	20	28,636	23,150
Loans of banks and central banks	21	37,416	28,906
Reserves	22	93	134
Deferred tax liabilities	3.3, 11.3	-	4
Other liabilities	23	2,695	137
TOTAL LIABILITIES		68,842	52,352
EQUITY			
Share capital	3,1	18,000	18,000
Retained earnings		(4,150)	(3,502)
Current year loss		294	(648)
Other reserves		65	70
TOTAL EQUITY	24	14,209	13,920
TOTAL EQUITY AND LIABILITIES		83,051	66,272
OFF-BALANCE SHEET ITEMS	25	145,518	115,529

Notes on the following pages 9 to 71
form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2019
(In thousands of EUR)

	Share capital	Other reserves	Accumulated losses	Total
Balance as at January 1, 2018	10,000	150	(3,087)	7,063
Effects of IFRS 9 implementation	-	7	(415)	(408)
Balance as at January 1, 2018	10,000	157	(3,502)	6,655
Issuance of shares	8,000	-	-	8,000
Net decrease in fair value of financial assets at fair value through other comprehensive income	-	(80)	-	(80)
Loss for the current year	-	-	(648)	(648)
Other changes	-	(7)	-	(7)
Balance as at December 31, 2018	18,000	70	(4,150)	13,920
Balance as at January 1, 2019	18,000	70	(4,150)	13,920
Net decrease in fair value of financial assets at fair value through other comprehensive income	-	(5)	-	(5)
Profit for the current year	-	-	294	294
Balance as at December 31, 2019	18,000	65	(3,856)	14,209

Notes on the following pages 9 to 71
form an integral part of these financial statements.

CASH FLOW STATEMENT
Year Ended December 31, 2019
(In thousands of EUR)

	<u>Note</u>	<u>2019</u>	<u>2018</u>
Cash flows from operating activities			
Interest income received and similar income		3,249	2,004
Interest charges paid and similar expenses		(793)	(566)
Fees and commissions received		768	209
Fees and commissions paid		(252)	(228)
Outflows due to cash payments to employees and suppliers		(2,225)	(1,634)
Net increase in loans and other assets		(12,057)	(10,515)
(Outflows)/Inflows from deposits		5,441	(2,161)
Other (outflows)/inflows		2,500	(1)
Net cash generated by/(used in) operating activities		(3,369)	(12,892)
Cash flows from investing activities			
Cash used for purchase of equipment		(99)	(241)
Cash used for purchase of intangible assets		(31)	(1)
Treasury bills and other securities		-	(2,262)
Net cash used in investing activities		(130)	(2,504)
Cash flows from financing activities			
Net increase / (decrease) in borrowed funds		8,500	8,900
Issuance of ordinary shares	24	-	8,000
Net cash (used in)/generated in financing activities		8,500	16,900
Effect of foreign exchange gains and losses on cash and cash equivalents		14	8
Net increase/(decrease) in cash and cash equivalents		5,015	1,513
Cash and cash equivalents at the beginning of period		6,835	5,323
Cash and cash equivalents at end of the period	27	<u>11,850</u>	<u>6,835</u>

Notes on the following pages 9 to 71 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

1. ESTABLISHMENT AND OPERATIONS OF THE BANK

Ziraat Bank Montenegro AD (hereinafter: the "Bank") was established in 2015, and as at May 20, 2015 it was registered as the shareholding company with the Central Registry of Business Entities in Podgorica – registration number 4-0009452.

The Bank was registered with the Commission for Securities in the Register of Securities Issuers under registration number 02/10e-5/2-15 as at May 8, 2015 (Decision number 02/10e-5/2-15).

The Bank performs its financial operations via the transaction account number 907-000000057501-83 with the Central Bank of Montenegro - Payment Transactions.

In accordance with the Law on Banks, the Founding Contract, the Statute and the Decision of the Central Bank of Montenegro, the Bank performs the following activities:

- 1) Issuing guarantees and undertaking other off-balance sheet obligations;
- 2) Purchasing, selling and collecting receivables (factoring, forfaiting and other);
- 3) Issuing, processing and recording payment instruments;
- 4) Performing domestic and foreign payment transactions;
- 5) Performing finance lease operations;
- 6) Performing securities operations;
- 7) Trading in its own name and for its own account or for the account of its customer:
 - a. In foreign payment instruments, including money exchange
 - b. Financial derivative transactions
- 8) Providing depot services;
- 9) Performing analysis and providing information and advices on the creditworthiness of companies, entrepreneurs and other issues relating to business operations;
- 10) Renting of safes

The Bank is headquartered in Podgorica at St. Slobode No. 84 and performs its activities through its branch office in Bulevar Ivana Crnojevića No. 101, branches in Bar at the address Bulevar revolucije B-11 and branches in Budva at the address Ulica Mediteranska bb.

As at December 31, 2019, the Bank had 40 employees (December 31, 2018: 38 employees).

The Bank is managed by the shareholder, in accordance with the law and Statute of the Bank. The governing bodies of the Bank are the Shareholders Assembly consisting of the shareholder of the Bank and the Board of Directors that is appointed by the Shareholders Assembly. The Board of Directors of the Bank has 5 members.

As at December 31, 2019, the members of the Board of Directors of the Bank were the following:

<u>Name and Surname</u>	<u>Function</u>
Ms Burcu TURKER	Chairman
Mr Ertan YILMAZ	Member
Ms Yasin OZTURK	Member
Mr Ertan AYDIN	Member
Ms Berrin MAHMUTOGLU	Member

The Management of the Bank consists of the Chief Executive Officer and the Executive Director (Management members). The Chief Executive Officer represents the Bank and is in charge of coordinating and monitoring of the execution of operations of the Bank and the work of employees of the Bank on a daily basis.

As at December 31, 2019, the executive directors of the Bank were as follows:

<u>Name and surname</u>	<u>Key area</u>
Mr Mustafa ŞENMAN	Chief Executive Officer
Mr Goran BAKIĆ	Executive Director

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

1. ESTABLISHMENT AND OPERATIONS OF THE BANK (Continued)

As at December 31, 2019, the members of the Audit Committee of the Bank:

<u>Name and surname</u>	<u>Position</u>
Mr Sinan SAHIN, PhD	Chairman
Mr Erhan GÜLER	Member
Mr Cüneyt SAĞLIK	Member

As at December 31, 2019, the Compliance Manager was Ms Milena Lakić.

As at December 31, 2019, the Internal Auditor of the Bank was Mr Vladimir Zloković.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.1. Basis of Preparation and Presentation of the Financial Statements

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

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

In preparation of these financial statements the Bank has applied the policies that are in accordance with the regulations of the Central Bank of Montenegro, which, in the recording of receivables for which the conditions were met for exclusion from the balance sheet of the Bank and the format of presentation of financial statements, differ from the requirements of the International Accounting Standards ("IAS") and International Financial Reporting Standards ("IFRS") applicable as at December 31, 2019. In addition, the application of IFRS 16 - Leasing was postponed for January 1, 2020, in accordance with the letter of the Central Bank of Montenegro No. 54/2019 dated January 9, 2019. This standard introduces new accounting treatment for leases.

In accordance with the Accounting Law of Montenegro, the IAS and IFRS published by the International Accounting Standards Board must be translated by the relevant competent authority of Montenegro, which has the right for translation and publication thereof, approved by the International Federation of Accountants (IFAC). Therefore, only IAS and IFRSs officially translated, approved and published by the Institute of Certified Accountants of Montenegro may be applied. The latest official translations have been published for the part of the IASs that have been in effect since January 1, 2009, or part of IFRS in application since January 1, 2013, which includes only the basic text of the standards and interpretations and does not include the basis for concluding, examples, instructions for use, comments, opinions and other material of the explanation. In addition, the translation does not contain a translation basis for the preparation and presentation of financial statements. Also, changes and improvements to the IAS after January 1, 2009, i.e. IFRS after January 1, 2013, have neither been translated nor published.

Bearing in mind the effects that differences of accounting regulations of Montenegro from IFRS and IAS may have on the presentation of the Bank's financial statements, the accompanying financial statements in that section are different and depart from IFRS and IAS and cannot be treated as financial statements prepared in accordance with IFRS and IAS.

The financial statements have been prepared under the historical cost basis, except otherwise stated in accounting policies. In preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 2 to the financial statements.

Official currency in Montenegro and functional and reporting currency of the Bank is the euro (EUR).

2.2. Use of estimates

Presentation of financial statements requires of management of the Bank to make best estimates and reasonable assumptions that affect the presented amounts of assets and liabilities, disclosures of contingent receivables and liabilities as at the date of financial statement preparation, and of income and expenses during the reporting period (Note 3.1).

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

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

2.2. Use of estimates (Continued)

Such estimates and assumptions are based on available information on the date of financial statements preparation and mainly related to: estimate of the amount of impairment for loans and interest, impairment for deposits with other banks, the impairment for permanent placements and off-balance sheet items.

Actual amounts of assets and liabilities may differ from thus estimated amounts in this way.

2.3. Going concern

Financial statements are prepared in accordance with the going concern principle, which implies that the Bank will continue to operate during an unlimited period in the foreseeable future.

2.4. Comparative Data

The comparative data in these standalone financial statements represent data from the Bank's financial statements for 2018.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest and fee income and expense

Interest income and expense are recognized in the income statement for all interest bearing debt instruments, using the effective interest method, on an accrual basis, in accordance with the terms of the contractual relationship defined by the contract between the Bank and the client.

Effective interest method is the method of calculation of costs of repayment of financial assets or liabilities and deferral of interest income or interest expense during relevant period.

The effective interest rate is the rate that discounts future cash inflows or outflows, during expected life period of financial instrument or when it is applicable, shorter period, to the carrying value of financial asset or liability.

The calculation includes all paid and received fees between contractual parties, which are integral part of the effective interest rate, transaction costs and all other premiums and discounts.

Income and expenses from fees were generated by providing or using banking services, and in the income statement are recognized at the time of delivery, or use of services.

These revenues and expenses are also recognized at the sectoral affiliation of clients whose assets the bank uses.

Fees for approved and received loans are considered as an integral part of an ongoing involvement with the resultant financial instrument and are recognized as an adjustment to the effective yield over the life of the loan, using the effective interest rate.

Income and expenses from fees include fees for guarantees issued by the Bank for the benefit of clients, fees for payment transactions in the country and abroad, fees for brokerage and other services provided by the Bank. Expenses from fees are also expenses from fees based on the deposit insurance.

3.2. Foreign Exchange 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).

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2. Foreign Exchange Translation (continued)

a) *Functional and Presentation Currency (continued)*

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

b) *Transactions and Balances*

Transactions made in foreign currencies are translated into euros using the exchange rates prevailing at the date of the business transaction.

Monetary assets and liabilities denominated in foreign currency at the balance sheet date are translated into euros at the exchange rate prevailing at that day.

Non-monetary items measured at historical cost in a foreign currency are translated into euros at the current exchange rate at the transaction date.

Foreign exchange gains and losses arising from the translation of business transactions in foreign currency and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

3.3. Income Tax

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

3.3.1. Current Income Tax

Income taxes are calculated and paid in accordance with the Corporate Income Tax Law ("Official Gazette of the Republic of Montenegro", No. 65/01, 12/02, 80/04, "Official Gazette of Montenegro", No. 40/08, 86/09, 14/12, 61/13 and 55/16), applying the prescribed rate on the taxable profit reported for tax balance.

The amount of taxable profit is determined by harmonizing profit reported in the income statement, for the income and expenses amounts, as defined by tax regulations.

The corporate income tax is calculated using the proportional rate of 9% on the total reported income for tax balance.

Law on Income Tax stipulates that losses from the tax balance sheet in the current year can not be carried back. However, losses per tax balance for the year can reduce taxable income of the future period (except if the loss arises from capital losses or gains), but for a period not exceeding five years.

3.3.2. Deferred Taxes

Deferred taxes are calculated on temporary differences arising between the tax bases of assets and liabilities and their carrying value reported in the financial statements of the Bank.

Deferred tax liabilities are recognized for all taxable temporary differences between the tax bases of assets and liabilities on the balance sheet date and their carrying amounts for financial reporting purposes, which will result in taxable amounts in future periods.

Deferred tax assets are recognized for all deductible temporary differences, unused tax assets and unused tax losses, to the extent that it is probable that future taxable profits will be sufficient to enable realization (utilization) of deductible temporary differences, unused tax assets and unused tax losses.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the use of all or part of the deferred tax assets. The Bank calculates deferred taxes based on:

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Income Tax (Continued)

3.3.2. Deferred Taxes (Continued)

- Differences between the carrying value of fixed assets and intangible assets, which are recorded in the financial statements and their tax values. The difference is a result of the application of different methods of calculation and the rate of depreciation for financial reporting purposes and for tax purposes;
- Changes in the fair value of financial instruments available for sale.

Deferred taxes related to the subsequent measurement of fair value of securities available for sale are charged directly against or in favor of equity and are transferred to the income statement at the same time with the profit / loss from the subsequent measurement of fair value.

Deferred taxes are calculated by applying the 9% rate.

3.3.3. Indirect taxes and contributions

Indirect taxes and contributions which do not depend on Bank's operations include property, value added atx, contributions on salaries paid by the employer, as well as other taxes, fees and contributions paid in accordance with various state and local tax regulations.

3.4. Cash and cash equivalents

As presented in the Statement of Cash Flows, cash and cash equivalents comprise cash and coins in the cash in hand and ATMs, balances with the Central Bank of Montenegro, balances at the accounts held with commercial banks and other highly liquid financial assets with maturity up to three months.

3.5. Financial instruments

The Bank's financial assets are classified in accordance with the Bank's intention regarding those assets at the time of their acquisition and its investment strategy.

The Bank's financial assets may be classified according to the business models as defined under IFRS as follows:

- Financial assets held within the business model whose objective is to collect the contractual cash flows – financial assets at amortized cost (AC);
- Financial assets held within the business model whose objective is to collect the contractual cash flows or sell the assets – financial assets at fair value through other comprehensive income (FVTOCI); and
- Financial assets held for trading - financial assets at fair value through profit or loss (FVTPL)

Classification and measurement of the financial instruments are based on the following two criteria:

- elected business model for which a financial asset has been initially acquired; and
- characteristics of the contractual cash flows of an asset.

A financial asset is measured at amortized cost of fair value through other comprehensive income only if the object of the entity's business model is to hold the financial asset and the contractual cash flows are solely payments of principal and interest on the principal outstanding ("SPPI criteria"). This is assessed for each individual instrument.

Failure to meet the above said criteria may result in classification of a financial instrument to the category of instruments measured at fair value through profit or loss (FVTPL).

In order to pass the SPPI criterion, the contractual cash flows must be generated solely from:

- collection of principal; and
- collection of the interest on the principal outstanding.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial instruments (Continued)

Unless either of the above specified criteria is met, the financial instrument must be measured at FVTPL.

Cash flows generated from collection of interest on the principal outstanding must reflect:

- the time value of money;
- credit risk;
- other basic risks and costs.

Generally, the expected future cash flows of the financial instruments meet the SPPI test criteria if:

- there are no embedded derivatives;
- the interest rate applied is within the market limits;
- one-off loan origination fees and fees charged for unused credit funds approved are within limits stipulated by the relevant decision;
- early loan repayment fees represent a reasonable compensation and has no "penalty" character;
- the interest rates applied, whether fixed or floating, meet the SPPI test criteria.

IFRS 9 generally permits certain departures from the SPPI principle, as described below:

A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a *de minimis* effect on the contractual cash flows of the financial asset.

If a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than *de minimis*, but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset.

A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.

Some options that change the time value of money as a component of the interest may pass the SPPI test depending on the benchmark test results.

3.5.1. Financial assets held with the objective of collecting the contractual cash flows - "held to collect" (held to maturity under IAS 39)

Financial assets held with the objective of collecting the contractual cash flows include:

- Funds held with the Central Bank of Montenegro and other financial assets held with foreign banks;
- Loan receivables (principal, interest, loan fees);
- Receivables arising from activation of bank guarantees issued;
- Receivables per fees and commissions other than those relating to loan receivables;
- Treasury bills of Montenegro;
- Other financial assets.

This category may also include debt securities with fixed or determinable payments and fixed maturities where the Bank has a definite intention and ability to hold them to maturity.

Premiums and discounts, including the initial transaction costs, are included in the carrying value of such a security instrument and are amortized.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial instruments (Continued)

3.5.1. Financial assets held with the objective of collecting the contractual cash flows – “held to collect” (held to maturity under IAS 39)

Loans and receivables include non-derivative financial assets with fixed or determinable future cash flows that are not quoted in an active market.

The Bank's loans and receivables are financial assets originated by the Bank by extending cash funds to its clients.

This category does not include financial assets that initially intended for sale in the near term.

Loans and receivables are initially recognized at fair value increased by transaction costs. They are subsequently stated at amortized cost, using the effective interest method, less impairment allowance.

Impairment allowance charge, i.e., impairment losses on loans and receivables are recognized within expenses in the profit or loss statement (income statement).

The Bank charges default interest on loans and receivables (or portion thereof) outstanding after their due dates.

Interest income on loans is calculated using the effective interest method, with the effective interest rate applied to the gross carrying value of the financial assets.

3.5.2. Financial assets held with the objective of collecting the contractual cash flows and sale – “at fair value through other comprehensive income (FVTOCI)”

Financial assets held with the objective of generating income from collection of the contractual cash flows or sales are debt securities – Government bonds.

There are various objectives that may be consistent with this type of business model. For example, the objective of the business model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding.

Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and value of sales. However, there is no threshold for the frequency or value of sales that must occur in this business model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective.

As they are retained for a certain time in order to collect the contractual cash flows and subsequently sold, financial assets classified in this category must pass the SPPI test.

Such assets are initially and subsequently measured at fair value and the changes in their fair value are recognized within other comprehensive income (equity).

Unrealized gains and losses on securities held to collect the contractual cash flows or for sale are recorded under revaluation reserves within equity until the securities are sold, collected or otherwise realized or permanently impaired.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial instruments (Continued)

3.5.2. Financial assets held with the objective of collecting the contractual cash flows and sale – “at fair value through other comprehensive income (FVTOCI)”

When "held to collect the contractual cash flows or for sale", securities are amortized or impaired and cumulative impairment allowance is reclassified to the profit or loss (income) statement.

Interest income is recognized using the effective interest method in the income statement. Impairment allowance is made in accordance with the impairment methodology and recorded within the income statement and other comprehensive income (equity).

3.5.3. Financial assets held for trading – “at fair value through profit or loss (FVTPL)”

The category of financial assets measured at FVTPL includes equity instruments and financial assets held for trading.

This means that they are held within the business model characterized by constant purchase and sale of instruments for the purpose of generating cash inflows in the amount of the fair value of the financial assets sold.

In addition to the financial assets acquired for short-term sales, this category is comprised of the loan assets that do not meet the SPPI test criteria.

Such financial assets are initially recorded at fair value that represents their cost. Transactions costs are recorded within expenses in the current period's income statement.

All realized and unrealized gains and losses arising from the sale or change in the market value of these securities are presented within the income statement.

3.5.4. Expected Credit Loss (ECL) Calculation

The Central Bank of Montenegro enacted Decision on the Minimum Standards for Credit Risk Management by Banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17 and 82/17) effective as from January 1, 2013. Implementation of the said Decision entails application of the International Financial Reporting Standards (IFRS) in measurement and presentation of the bank balance sheet assets and off-balance sheet items.

In accordance with the aforesaid Decision, the Bank has set up a methodology for assessment of the impairment of the balance sheet assets and estimated losses per off-balance sheet items.

The Bank consistently implements this methodology, reviews at least annually and, based on the review results, adjusts the assumptions underlying the methodology as appropriate.

The new IFRS 9 in effect as from January 1, 2018 is based on the expected credit loss (ECL) model, which has replaced the previous model of incurred losses under IAS 39

The following Bank's exposures are subject to impairment under IFRS 9:

1. On-balance sheet exposures:
 - all types of loans, activated guarantees and syndicated loans;
 - factoring and forfeiting receivables;
 - matured interest, fee and commission receivables and other on-balance sheet receivables;
 - deposits held with other banks and other financial institutions;
 - securities within the portfolio measured at amortized cost (AC); and
 - other receivables.
2. Off-balance sheet exposures:
 - guarantees issued;
 - lines of credit approved (overdraft facilities);
 - letters of credit; and
 - other items.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.4. Expected Credit Loss (ECL) Calculation (Continued)

The impairment for individually or collectively assessed financial assets must be estimated for all of the above exposures in accordance with IFRS 9. When applying the ECL model, the Bank recognizes the expected loss on each reporting date to reflect changes in the credit risk of the given financial asset and takes into account and information about future events.

Expected loss is defined as the difference between the cash flows that the Bank is entitled to under the contractual terms of the financial instrument and the cash flows that the Bank expects to receive (taking into account the likelihood of non-settlement status and expected payment on that basis).

The Bank's general approach to calculating the expected losses for the entire period of the financial instrument makes the difference between:

- Expected losses of 12 months ("Stage 1") applied to financial assets (from initial recognition) until there is a significant deterioration in credit risk;
- Expected Losses in the Full Life Period of the Financial Asset ("Stage 2" and "Stage 3") applied when there has been a significant increase in credit default, i.e. non-performing.

Stages 2 and 3 differ in the manner of recognition of interest income. In Stage 2 interest income is accounted for gross book value. In Stage 3, interest income is accounted for as net book value.

At each reporting date, an assessment is made as to whether there was a significant increase in the credit risk from initial recognition or performance of non-performing status to assess the amount of default (ECL for 12 months or for the entire life of the asset) and the amount of the basis for recognition of interest income (gross book value or net book value).

According to the methodology, the Bank performs the segmentation of financial instruments in three ways:

1. Portfolio - Depending on the type of client, product type and bucket group ("bucket");
2. Stage - Classification into one of three "Stages";
3. Method of assessment - Allowance for impairment is assessed on an individual or collective basis.

Segmentation of financial instruments that show common credit risk characteristics is carried out according to the following criteria:

- Client type (legal entity, natural person, state and bank)
- The type of product (given the fact that the Bank does not have a long enough business history, segmentation by product type is not performed when estimating the amount of waiver)
- Bucket (time category that classifies receivables in 8 categories on the basis of a days of delay).

Segmentation of financial instruments is a subject of regular periodic consideration and may be subject to updating especially in the long run as the existing portfolio by product types increases and the Bank introduces new types of products.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.4. Expected Credit Loss (ECL) Calculation (Continued)

As defined in the methodology, when determining the cash flows that the Bank expects to receive, marginal losses are used, whereby the total expected loss is calculated as a sum of marginal losses occurring at certain time points during the life of the financial asset.

Estimated Default Probability ("PD") is an estimate obtained on the basis of statistical models that observe historical transition of placements and clients from "performing" to "non-performing" status. By conducting projections from historical data and adapting them to anticipated macroeconomic impacts at certain times of the time (Forward looking (FL)), the Bank assesses the default probability (PD) for financial resources.

The Bank is not currently able to estimate its own PD factors due to the lack of historical data. Therefore, for the purpose of calculating the PD factor, it uses the available monthly cross-currency data between the Montenegrin banking classification categories as defined in the Decision on Minimum Standards for Credit Risk Management in Banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17, 82/17 and 86/18) where A, B1 and B2 are "performing" ratings, while C1, C2, C3, C4, D and E are "non performing".

EAD (exposure at default) is an estimate of the exposure including repayments of principal and interest and expected drawdowns on committed facilities. EAD is specified as the gross carrying amount at time while using the effective interest rate to discount cash flows to a present value at the reporting date for unexpired exposures. For exposures that are provided, the net amount of EAD is calculated, which represents a reduction for the expected collection from the provisioning assets discounted to the present value on the reporting date using the effective interest rate. During the estimation of off-balance sheet exposure, the Bank uses the Credit Conversion Factor (CCF) in accordance with the Decision on Capital Adequacy in Central Bank of Montenegro (CBM).

Loss Given Default ("LGD") is an estimate of economic loss under non-fulfillment of liabilities. Namely, in its estimate of credit losses measured in accordance with the methodology, the Bank estimates the expected cash flows after the non-performance of the obligation based on experience, not taking into account the expected collection from collateral. The Bank is not currently able to estimate its own LGDs due to lack of historical data and applies a 45% LGD rate for exposures up to 180 days (60% for delayed exposures up to 270 days, 80% for delayed exposures up to 360 DPDs, or 100% for exposures over a delay of 360 days).

At the reporting date, an estimate of whether there has been a significant increase in credit risk with respect to the date of initial recognition or whether it has defaulted ("default") to determine the applicable provisioning (ECL for 12 months or for the entire lifetime of the asset).

Financial assets are classified in Stage 1, provided the conditions for Stage 2 or Stage 3 are not met.

A Significant Increase in Credit Risk (SICR) involves the determination of quantitative (over 30 days) and qualitative criteria to determine whether the credit risk of the financial asset is significantly increased in relation to initial recognition, which would Classify it in "stage 2". Non-performing is a deterioration to the point when credit losses arise, i.e. if the client is not expected to fulfil the contractual obligations without taking into account the payment from the security or guarantee and/or the client is in a default for more than 90 days.

Forward Looking (FL) is involved by the Bank while adjusting the PD for certain macroeconomic variables through the calculated corrective factor (c) that is determined by placing the ratio of projected amount of non-performing loans (NPL) over the next three years and the historic amounts of NPL loans to the Montenegrin banking sector.

The provision for credit losses is calculated on a quarterly basis.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.5. Provisions and Allowance for Impairment

In addition to valuation of items of assets and off-balance sheet items in accordance with International Accounting Standards, the Bank is obliged to classify items of assets in one of the following classification groups depending on the likelihood of a loss:

- Group A - "quality assets" Classification group "A" classifies a loan and other receivables where there is firmly documented evidence that they will be collected in accordance with the agreed terms and conditions in full amount;
- Group B - "assets with special note" - with subgroups B1 and B2; here the Bank classifies the loan for which it is unlikely that the loss would incur, and such a loan requires special attention due to the fact that potential risk, unless adequately monitored, could lower the probability of collection;
- Group C "substandard assets" - with subgroups C1, C2; here the Bank classifies loans for which there is a high probability of incurring loss, due to clearly identified weaknesses, jeopardizing collection of those assets;
- Group D - "doubtful assets"; here the Bank classifies the loan for which the collection, taking into consideration the debtor's creditworthiness, value and marketability of collaterals, is highly unlikely;
- Group E - "loss"; here the Bank classifies the loans which will not be collected at all or will be collected in the insignificant amount.

The amount of provision for potential losses is not envisaged for placements of the Bank classified in the group A. The estimated amount of the provision for potential losses is calculated using the percentages of 2% and 7% for asset classified in group B, from 20% to 40% for asset classified in group C, 70% for asset classified in group D and 100% for asset classified in group E.

The Bank is obliged to develop a comprehensive strategy for dealing with non-performing loans for a period of three years and determine the annual goals related to reduction of the level of non-performing loans (operating goals).

According to the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17, 82/17 and 86/18), the Bank is obliged to determine the difference between the amount of provisions for potential losses, calculated in accordance with the Decision and the sum of the amounts of allowance for impairment for items of balance sheet assets and provisions for off-balance sheet items, calculated in accordance with the provisions of the Decision which prescribes the method of valuing items of assets using the International Accounting Standards.

The positive difference between the amount of calculated provisions for potential losses and the collection of the amount of the correction for items of balance sheet assets and provisions for off-balance sheet items is a deductible item from the bank's own funds.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Property and Equipment

As at December 31, 2019, property and equipment are stated at cost less accumulated depreciation and impairment.

Cost represents the prices billed by suppliers, plus the associated costs for the purchase and the cost of bringing the asset into use.

Depreciation is calculated using the straight-line method to the purchase price, using the following annual rates in order to entirely write off the business premises and other fixed assets over their useful lives, and there was no change in depreciation rates in 2019 compared to 2018.

The estimated useful life of property and equipment is the following:

	<u>Year</u>
Construction facilities	40
Computers and computer equipment	4
Furniture	10
Equipment	5
Vehicles	4

3.7. Intangible assets

3.7.1. Licenses

Acquired licenses are recorded at historical cost. Licenses have a time-limited useful life and are stated at cost, less accumulated amortization. Depreciation is calculated using the proportion method, in order to distribute the cost of licenses over their estimated useful lives up to 4 years.

3.7.2. Computer software

Computer software costs are capitalized on the basis of the costs incurred to acquire and bring to use. These costs are amortized over their estimated useful lives of 4 years.

3.8. Loan Liabilities

Loan liabilities are initially recognized at fair value, without the incurred expenses. Loan liabilities are subsequently stated at amortized cost, any difference between the inflow of funds, reduced for transaction costs and repayment amounts is recognized in the income statement in the period of the loan use, by applying the effective interest rate method.

Loan liabilities 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.

3.9. Liabilities to employees

Short-term benefits to employees include salaries and all related contributions, as well as social security contributions. Short-term employee benefits are recognized as expense in the period in which those incurred.

The Bank and its employees are legally obliged to make payments in accordance with defined plans of contributions to the Pension Fund of Montenegro. The Bank has no obligation to pay further contributions which are an obligation of the Fund. Taxes and contributions relating to defined plans of the benefits upon salaries, are recognized as expenses in period to which they relate.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.10. Share capital

Paid-up share capital of the Bank is the amount of cash paid by the shareholder for all ordinary shares.

Bank's share capital consists of common shares and is recorded as a separate item in the balance sheet.

Dividends on shares are recorded as a liability in the period in which a decision was made about their payment.

Dividends for the year after the balance sheet date are disclosed in the subsequent events note.

3.11. Off-setting of financial instruments

Financial assets and liabilities are set-off and the difference between their amount reported in the balance sheet when there is a legally enforceable right to set-off the recognized amounts and there is an intention to settle on a net basis, or to simultaneously sell the asset and settle the liability.

3.12. Provisions

Provisions are liabilities with an uncertain maturity or amount and are recognized when the following conditions are met:

- The Bank has an applicable legal or contractual liability as a result of past events;
- There is a likelihood that the settlement of the liability will require an outflow of funds, which generate economic benefits;
- When the amount of the liability can be reliably estimated.

Provisions are measured at the present value of the expected expenditure required to settle the liabilities, using a discount rate that reflects current market assessments of the time value of money. Provisions are reviewed on each balance sheet date and are 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 given liability, provisions should be reversed through the income statement.

In accordance with the Decision on minimum standards for operational risk management in banks ("Official Gazette of Montenegro", No. 24/09), the Bank performs provisions for operational risk and potential losses from litigations.

3.13. Commitments and contingent liabilities on off-balance sheet items

As part of the ordinary operations, the Bank assumes the contractual and contingent liabilities on off-balance sheet items such as guarantees, commitments for loans and letters of credit and transactions with financial instruments.

These financial instruments are recorded in the balance sheet if and when they become payable.

Provision for possible losses on commitments and contingent liabilities are formed on the basis of estimates of possible losses, in accordance with the criteria established in the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17 and 82/17).

3.14. Transactions with the Bank's related parties

The Bank's related parties are parties that represent:

- members of the bank bodies, shareholders, bank employees, as well as their immediate family members (spouse and children);
- legal entity with which entity that holds qualified interest in a Bank, also has a qualified interest;

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.14. Transactions with the Bank's related parties (Continued)

- legal entity in which one of the entities from paragraphs 1 and 2, of this section holds a significant influence or entity from paragraph 1 of this section is a director or another relevant body of that legal entity;
- an entity holding at least 50% of shares or voting rights of legal entity that has a qualified interest in the bank.

When observing each possible transaction with the related party the attention is paid to the substance of the relationship, and not only to the legal form.

3.15. Critical accounting estimates and judgments

The Bank makes estimates and assumptions on effects that the amounts of assets and liabilities included in the financial statements will have in the next financial year.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the given circumstances.

Impairment losses due to decrease in value of balance and off-balance sheet placements

The Bank reviews its loan portfolios at least once a quarter, in order to assess the impairment of credit receivables. The Bank estimates whether there are reliable evidence to show that there will be a reduction in future cash flows from the loan portfolio, which can be identified with an individual loan, and which may affect the income statement.

The methodology and assumptions used for estimating impairment provision in accordance with the policies are disclosed in Note 3.5).

3.15.1. Fair value of financial instruments

Fair value is the amount for which an asset can be exchanged, or a liability settled, in an arm's length transaction between notified and willing parties.

The fair value of financial instruments traded on active markets are determined based on published market prices at the balance sheet date, or the price that represents the best demand for financial resources, or the best deal for financial liabilities.

3.15.2. Depreciation and Amortization

The rate of depreciation is prescribed by the Bank with its accounting policy. The useful life of an asset is estimated and the rates are derived from the estimated useful life by the formula: Annual depreciation rate=100/useful life in years.

The review of useful lives is done at the end of each financial year, and if the resulted expectations significantly differ from the original ones, an adjustment of the calculation of costs for the current and future period is performed. The review shall determine whether the previously established useful life of the fixed asset is correct and whether it is necessary to correct it. Thus, an adjustment of the depreciation rate is made, which affects the overstated or understated costs. If the carrying amount of a fix asset is higher than its estimated recoverable amount, the asset shall be written off to the recoverable amount. Impairment losses are recognized in the period in which they are determined and reported in operating expenses. After recognition of the impairment loss of a fixed asset, the depreciation charge is adjusted in future periods, so that the reassessment of the carrying amount of the assets less any possible residual value is systemically allocated during the remaining useful life of the asset.

3.15.3. Litigations

The Bank's management assesses the amount of provisions for outflows arising from legal disputes based on estimates of probability whether future cash outflows will happen based on contractual or legal obligation from past periods.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.16. Fair Value

International Financial Reporting Standard 13 "Financial instruments: Fair Value Measurement" assumes disclosure of fair value of financial assets and liabilities in the Notes to the financial statements.

For these purposes fair value is defined as the value to be paid for the sale of assets or payments to settle the obligation in a regular transaction between the market participants on the day of measurement in the given triennial circumstances.

Bank's obligation is to disclose all information relating to fair value of receivables and liabilities for which available market information exist and for which materially significant difference between carrying amount and fair value is identified.

In Montenegro, there is not sufficient market experience, stability and liquidity for purchase and sale of financial assets and liabilities, and other financial instruments, and official market information are not available in every moment. Therefore, fair value cannot be reliably determined in the lack of active market, as required by IAS and IFRS. According to Management, amounts disclosed in financial statements reflect real value, which is most accurate in the circumstances and most useful for reporting purposes. For the amount of the identified estimated risks that the carrying amount will not be realized, the amount is impaired based on the decision of the management of the Bank.

4. RISK MANAGEMENT

4.1. Introduction

In its business operations, the Bank is exposed to various risks, the most important of which are:

- Credit risk;
- Market risk;
- Operational risk;
- Interest rate risk;
- Liquidity risk.

The risk management acts of strategy, policy, procedures are designed with a view to identify and analyze risks, to define the adequate limits and controls required for risk management, as well as to keep track of the Bank's exposure to each individual risk.

The risk management acts are subject to regular control ensuring the adequate response to the changes in the market products and services.

4.2. Risk Management Framework

The Board of Directors is responsible for establishing a system of managing all the risks that the Bank is exposed to in its operations, and determining policies and procedures for managing all risks.

The Board of Directors was established by the Audit Committee, the Assets and Liabilities Management Committee (ALCO), the Credit Committee.

The responsibility of the Board of Directors is to establish, through the adoption of the strategy, policies, procedures and other documents from the domain of risk management, an adequate ratio of yield and risks that will enable the effective realization of the objectives of the Bank's shareholder.

The Board of Directors monitors the efficiency and adequacy of the risk management system in the context of legal obligations, but also the interests of shareholder.

**NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019**

4. RISK MANAGEMENT (Continued)

4.2. Risk Management Framework (Continued)

The Audit Committee prepares opinions proposal and standpoints from the scope of work for the decision of the Board of Directors on these issues. The Audit Committee analyzes and monitors the functioning of the risk management system that the Bank is exposed to in its operations and makes suggestions for the improvement of strategies, policies and procedures for risk management.

At least once a year, the Audit Committee submits to the Board of Directors information and data on the functioning of the risk management system through its annual work report, points to weaknesses and makes suggestions for improvement and upgrading of this system.

The Assets and Liabilities Management Committee (ALCO) reviews the monthly risk reports of the Risk Management Department, which examines the current risk profile of the Bank and sets it in the context of the relationship between assets and liabilities necessary for achieving the strategic objectives of the Bank.

The ALCO has competencies and responsibilities for managing the liquidity risk and other risks that the Bank is exposed to in its operations, managing the Bank's capital.

4.3. Credit Risk

The management of price policy and the regulation of the value of internal indicators as well as the limits of allowed deviations from the indicators on the basis of which the structure of the balance sheet of the Bank is monitored.

The Credit Committee is in charge of defining the Bank's exposure policy and for evaluating, but also for rejecting all credit exposures that are not in line with that policy. The Credit Committee makes a decision on the approval of the placements to the level when the individual placement represents 10% of the Bank's own funds (large exposures).

The decision to approve large exposures can be made exclusively by the Board of Directors of the Bank.

Risk Management Department is responsible for monitoring the Bank's exposure to individual risks, which is reported monthly to the Assets and Liabilities Management Committee and the Board of Directors.

Exposure to credit risk is a risk of financial loss, which may occur as a consequence of a counterparty being unable to fulfil its contractual obligations towards the Bank.

The Bank manages the credit risk it undertakes by placing limits in relation to large loans, single borrowers and related parties.

Such risks are monitored on a continuous basis and subject to at least annual reviews. Credit risk is managed both at the level of individual loan placement as well as at the level of the entire portfolio.

The exposure to any borrower including banks and financial institutions is further restricted by sub-limits covering statement of financial position and off-balance sheet exposures.

Actual exposures against limits are monitored regularly.

In order to provide the necessary preconditions for the proper management of credit risk exposure analysis is carried out on two grounds - at the level of individual loans when determining credit worthiness and the upper limit of indebtedness of the client or group of connected clients and at the level of the entire portfolio in the following basis:

- structure of the portfolio in each category (corporate loans, loans to government, retail loans, off-balance sheet exposures);
- structure of the portfolio by credit rating groups (movements between individual creditworthy categories, the transitional matrix, the percentage of cover reserves, coverage ratio);
- portfolio structure by timeliness of settlement of liabilities;
- portfolio structure by industries;
- concentration in clients with of so-called large exposures (clients or group of related clients in which the exposure is higher than 10% of own capital);
- concentration of loans by certain geographic regions, etc.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

Credit risk provisions are allocated in accordance with the valid regulations of the Central Bank of Montenegro.

The amount of provisions for potential losses on items of assets is calculated using the carrying amount of receivables multiplied by the established percentage of reserves, while the Bank may reduce the previous book value of an item of assets for which the reserve is calculated by the amount of first class collateral defined by the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17, 82/17 and 86/18).

In its operations, the Bank seeks to operate with good creditworthiness clients in order to minimize the credit risk exposure as much as possible, which poses a risk that debtors will not be able to settle the debts to the Bank in full and in due time.

When making a decision on loan, it takes into account the changes in the economy, i.e. the state of individual branches that form part of the Bank's loan portfolio, which can lead to losses that differ from the losses on the basis of which the provision was made on the balance sheet date. In order to efficiently manage credit risk, the bank creates stressful credit risk scenarios, while considering the impact of the credit portfolio's weakening on the liquidity, profitability and capital adequacy of the bank.

The Bank's previous practice in making decisions about granting placements paid attention to respect the maximum permissible exposure to a single entity or group of related entities. All placements approved so far are in accordance with the defined internal limits as well as with limits defined by current legislation.

In addition to loans, the Bank approved to the clients the guarantees and the letters of credit, which represent off-balance exposures.

Rating of the creditworthiness was the basis for the approval of each placement, the defined maximum amount of debt (limit).

The Bank was assessing the creditworthiness of the client using primarily tools such as quantitative (financial) and qualitative analysis and evaluation of the quality of collateral, without neglecting the principle of evaluation of risks taken by the classification of placements and potential liabilities of the Bank.

Before approving loans and other placements, the Bank assesses the borrower's creditworthiness taking into account the criteria determined by the internal act, as well as the legal validity and estimated value of the collateral.

Credit risk mitigation involves maintaining the risk at an acceptable level of the Bank, i.e. maintaining an acceptable loan portfolio.

Credit risk mitigation is carried out through the negotiation of adequate collaterals for receivables.

The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral. Types of collateral are as follows:

- Deposits;
- Pledges placed against industrial machines, securities, inventories and vehicles;
- Mortgages against property;
- Bills of exchange (corporate and personal);
- Authorizations for payments from the account;
- Administrative injunctions;
- Guarantors (for retail loans);
- Insurance policies;
- Bank guarantees.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

After the assessment of the financial condition and creditworthiness of the borrower, as well as after a review of the value and legal security of credit security and other relevant factors, Loans Management Department determines the classification of the debtor as a measure of the expected credit risk, verifies internal rating, and gives his opinion on the justification of taking the identified risk.

4.3.1. Loans commitments and contingent liabilities

Commitments are instruments that provide funds to customers when required.

Guarantees and letters of credit, which represent irrevocable written assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

In the case of credit risk in respect of commitments under approved unused loans, the Bank is exposed to a potential loss in the amount of the approved unused loan. However, the probable amount of loss under credit risk is lower than total unused loan, because most of the commitments under approved loans are conditioned by the fulfilment of certain standards by the clients.

The Bank monitors the maturity of loan liabilities since a longer period of validity simultaneously carries a higher credit risk.

4.3.2. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items

	(In thousands of EUR)	
	December 31, 2019	December 31, 2018
Assets		
Monetary funds and deposit accounts held with central banks	7,189	6,091
Loans and receivables due from banks	4,649	739
Loans and receivables due from customers	65,835	54,251
Securities available for sale	3,340	3,322
Financial assets at fair value through other comprehensive income	1,109	1,112
Other financial receivables	16	6
	82,139	65,521
Off-balance sheet items		
Payable guarantees to corporate customers	3,949	7,127
Performance bonds to corporate customers	192	662
Irrevocable liabilities for loans approval	4,648	3,435
	8,789	11,224
Total credit risk exposure	90,928	76,745

The exposure to credit risk is partially controlled by obtaining collaterals and guarantees issued by legal entities and individuals.

Before approving loans and other placements, the Bank assesses the debtor's creditworthiness taking into account the criteria established by the internal regulation, and the legal validity and the estimated value of collateral.

The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3 Credit Risk (Continued)

4.3.2. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

Loans and advances are presented in the following tables:

Description	Not matured not collectively impaired	Matured but not collectively impaired	Individually assessed	Total, (Gross)	Individual Allowance for Impairment	In thousands of EUR December 31, 2019		
						Collective Allowance for Impairment	Total Allowance for Impairment	Total, net
Loans and receivables due from customers	503	-	15,589	16,092	78	7	85	16,007
Loans to Government	-	-	15,589	15,589	78	-	78	15,511
Units of local self- government – long-term	503	-	-	503	-	7	7	496
Retail loans	1,863	25	-	1,888	-	15	15	1,873
Cash loans	972	25	-	997	-	14	14	983
Housing loans	882	-	-	882	-	1	1	881
Overdrafts on bank accounts	9	-	-	9	-	-	-	9
Corporate loans	6,190	396	42,021	48,607	443	101	544	48,063
For permanent working capital	575	-	16,012	16,587	253	-	253	16,334
Overdraft	2,181	-	-	2,181	-	28	28	2,153
Revolving	2,607	-	8,750	11,357	88	63	151	11,206
Investment loan	462	-	1,425	1,887	8	-	8	1,879
Special purpose loan	365	396	15,834	16,595	94	10	104	16,491
Loans and receivables due from customers (gross)	8,556	421	57,610	66,587	521	123	644	65,943
Interest receivables	-	-	-	434	5	-	5	429
Accruals	-	-	-	(537)	-	-	-	(537)
Total loans and receivables due from customers	8,556	421	57,610	66,484	526	123	649	65,835
Loans and receivables due from banks	-	-	4,655	4,655	-	6	6	4,649

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.2. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

Description	Not matured not collectively impaired	Matured but not collectively impaired	Individually assessed	Total, (Gross)	Individual Allowance for Impairment	Collective Allowance for Impairment	In thousands of EUR December 31, 2018	
							Total Allowance for Impairment	Total, net
Loans and receivables due from customers	675	-	21,991	22,666	119	14	133	22,533
Loans to Government	-	-	21,991	21,991	119	-	119	21,872
Units of local self-government – long-term	675	-	-	675	-	14	14	661
Retail loans	1,020	33	-	1,053	-	8	8	1,046
Cash loans	431	33	-	464	-	7	7	457
Housing loans	586	-	-	586	-	1	1	585
Overdrafts on bank accounts	3	-	-	3	-	-	-	3
Corporate loans	4,083	208	26,519	30,810	196	92	288	30,522
For permanent working capital	325	-	18,402	18,727	144	-	144	18,583
Overdraft	2,194	-	-	2,194	-	41	41	2,153
Revolving	1,440	-	3,938	5,378	27	48	75	5,303
Investment loan	30	-	1,679	1,709	11	-	11	1,698
Special purpose loan	94	208	2,500	2,802	14	3	17	2,785
Loans and receivables due from customers (gross)	5,778	241	48,510	54,530	315	114	429	54,101
Interest receivables	-	-	-	11	-	-	-	11
Accruals	-	-	-	139	-	-	-	139
Total loans and receivables due from customers	5,778	241	48,510	54,680	315	114	429	54,251
Loans and receivables due from banks	-	-	740	740	1	-	1	739
	5,778	241	49,250	55,420	316	114	430	54,990

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NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.3. Matured, collectively not impaired loans and placements

December 31, 2019	Up to 30 days	From 31 to 60 days	From 91 to 180 days	Total
Cash loans	13	-	12	25
Investment loan		-		-
Special purpose loan	279	117	-	396
Total	292	117	12	421

December 31, 2018	Up to 30 days	From 31 to 60 days	Total
For permanent working capital	33	-	33
Investment loan		-	-
Special purpose loan	208	-	208
Total	241	-	241

4.3.4. The fair value of collaterals up to the level of placements secured by those collaterals

	December 31, 2019	In thousands of EUR December 31, 2018
Mortgages	8,512	4,844
Pledge/other	3,156	208
Pledge deposit	171	51
Bank guarantee	27,018	13,170
Contract on Cession	496	661
Total	39,353	18,934

The Bank defined both collateral factors and the timing of realization in accordance with the estimated quality of each type of collateral. The collaterals with a short timing of realization comprise, as a principle, bills of exchange, cash deposits, guarantees of legal entities and individuals, collection through a cession, corporate guarantee, guarantee whose principal is the state or other bank, life insurance policy assigned for the benefit of the Bank.

4.3.5. Restructured Loans and Placements

The bank restructured a borrower's loan if due to the borrower's creditworthiness deterioration occurred the following:

- a) Extended the principal and interest maturity;
- b) Decreased the interest rate on the loan approved;
- c) Reduced the amount of debt, principal or interest;
- d) Assumed debt;
- e) Performed capitalization of interest;
- f) Replaced the existing loan with a new loan;
- g) Made other conveniences that place the borrower in a better financial position.

When restructuring the loan, the Bank performs a financial analysis of the borrower and estimates the borrower's ability to repay the loan after the loan restructuring to realize cash flows that will be sufficient to repay the principal and interest on the loan.

At the end of 2019, the Bank had no restructured loans.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.6. Classification and valuation of financial assets and liabilities

Compliant with IFRS 9 classification and valuation of financial assets depends on two basic criteria:

- a business model on the basis of which the Bank manages the financial asset
- the characteristic of contracted cash flows (the so-called SPPI criterion).

The business model reflects the way in which the Bank manages its financial assets for the purpose of collecting cash flows.

The Bank conducted a detailed analysis of its business models, taking into account the past experience of selling financial assets as well as future expectations in this respect.

Other relevant and objective information such as: the risks effecting the success of a business model and how these risks are managed, the manner of assessing the success of a business model, the manner of assessing the financial assets within the framework of this model and evaluating the Bank's management and other shall be taken into account.

The analysis is based on reasonably anticipated scenarios without taking into account the worst scenarios or stress scenarios, accordingly the Bank has defined the following business models:

- held to collect the cash flows.
- held to collect the cash flows and for sale and
- other business models (eg. held for sale).

If there is a change in the business model on which the financial asset is managed, a reclassification of the financial asset shall be performed.

Reclassification is performed prospectively or from the first day of the next reporting period.

The Bank expects no frequent changes in business models. The Bank shall re-evaluate the business model at least once a year.

If a business model of „holding to collect the cash flow“ or „holding to collect the cash flows and for sale“, an estimate is made whether the cash flows represent only the payment of principal and interest (the so-called „SPPI test“).

In accordance with the basic credit arrangement, interest includes the compensation for the time value of the money, the accepted credit risk level of the borrower and other basic lending risks including the appropriate margin.

If agreed terms include exposure to risks that are not in accordance with the core credit arrangement, the financial asset is classified and measured at fair value through profit or loss, independent of the business model.

Based on conducted analysis of business models and features of contracted cash flows, the Bank, starting from January 1, 2018, classifies all financial assets in the following asset classes:

- Financial assets at amortized cost.
- Financial assets at fair value through other comprehensive income and
- Financial assets at fair value through profit and loss.

The Bank has no changes in the manner of classification and valuation of financial liabilities in accordance with IFRS 9 in relation to IAS 39.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9

Expected credit losses are recalculated at each reporting date in order to reflect the change in credit risk from initial recognition of a financial instrument.

This approach results in earlier recognition of credit losses by requiring that twelve months of expected credit losses be recalculated for all credit exposures.

Calculation of expected credit losses for the entire life expectancy is necessary for all credit exposures where there is a significant deterioration in credit risk relative to the moment of recognition of the asset.

The Bank uses future information and macroeconomic factors in calculating the expected credit losses, i.e. the Bank does not only consider historical information adapted to reflect the effects of current conditions and information that provide objective evidence that financial assets are reduced by losses, but understandable and supportive information include projections of future economic conditions in calculating expected credit losses both on an individual and on a group basis.

The level of loss provisioning will grow as the projected economic conditions deteriorate, i.e. the projected economic conditions become more favourable.

The basic principles and rules of the Bank in accounting for provisions under IFRS 9 are the following:

The Bank calculates a 12-month expected credit loss or expected credit loss for the entire life of the financial instrument, depending on the significance of the change in the credit risk of the financial instrument since its initial recognition. For these purposes, the Bank applies the following three levels of impairment:

- Stage 1 covers all new financial assets at the time of initial recognition and instruments that do not have a significant deterioration in credit quality from the time of initial recognition, or these instruments are in the category of low credit risk;
- Stage 2 covers financial instruments that have a significant deterioration in credit quality since the initial recognition date, but there is no objective evidence of impairment on the basis of loan losses;
- Stage 3 covers financial assets with objective impairment indicators at the reporting date.

Stage 1 and Stage 2 include only unproblematic financial assets. Stage 3 includes only non-performing financial assets.

For financial instruments in Stage 1, the estimated 12-month loan losses are calculated.

For financial Instruments in Stage 2, the expected loan losses for the entire lifetime of the instrument shall be calculated.

For financial instruments in Stage 3, expected loan losses shall be calculated for the entire lifetime of the instrument and interest income shall be calculated on net exposure.

In accordance with its accounting policies, the Bank recognizes the interest income on Instruments in Stage 3 at the time of collection.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

The gross exposure according to IFRS 9 is shown in the following table:

Description	In thousands of EUR December 31, 2019						
	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Loans and receivables due from customers	16,092	-	-	16,092	15,589	503	16,092
Loans to Government	15,589	-	-	15,589	15,589	-	15,589
Units of local self government	503	-	-	503	-	503	503
Retail loans	1,830	46	12	1,888	-	1,888	1,888
Cash loans	939	46	12	997	-	997	997
Housing loans	882	-	-	882	-	882	882
Overdrafts on bank accounts	9	-	-	9	-	9	9
Corporate loans	40,620	4,987	3,000	48,607	42,021	6,586	48,607
For permanent working capital	13,587	-	3,000	16,587	16,012	575	16,587
Overdraft	2,181	-	-	2,181	-	2,181	2,181
Revolving	7,912	3,445	-	11,357	8,750	2,607	11,357
Investment loan	462	1,425	-	1,887	1,425	462	1,887
Special purpose loans	16,478	117	-	16,595	15,834	761	16,595
Loans and receivables due from customers	58,542	5,033	3,012	66,587	57,610	8,977	66,587
Cash and deposits accounts held with central banks	7,195	-	-	7,195	7,195	-	7,195
Loans and receivables due from banks	4,655	-	-	4,655	4,655	-	4,655
Securities	4,467	-	-	4,467	4,467	-	4,467
TOTAL:	74,859	5,033	3,012	82,904	73,927	8,977	82,904
Total guarantees	2,372	-	-	4,141	2,033	2,108	4,141
Payable guarantees to corporate customers	2,193	-	-	3,949	2,033	1,916	3,949
Performance bonds to corporate customers	179	-	-	192	-	192	192
Unused liabilities for loans issuance	4,643	-	-	4,648	3,200	1,448	4,648
Unused documentary letters of credit	-	-	-	-	-	-	-
TOTAL:	7,015	-	-	8,789	5,233	3,556	8,789

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NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

Description	In thousands of EUR December 31, 2018						
	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Loans and receivables due from customers	22,666	-	-	22,666	21,991	675	22,666
Loans to Government	21,991	-	-	21,991	21,991	-	21,991
Units of local self government	675	-	-	675	-	675	675
Retail loans	1,039	14	-	1,053	-	1,053	1,053
Cash loans	450	14	-	464	-	464	464
Housing loans	586	-	-	586	-	586	586
Overdrafts on bank accounts	3	-	-	3	-	3	3
Corporate loans	29,322	1,489	-	30,811	26,520	4,291	30,811
For permanent working capital	18,729	-	-	18,729	18,402	326	18,729
Overdraft	2,194	-	-	2,194	-	2,194	2,194
Revolving	4,178	1,200	-	5,378	3,938	1,440	5,378
Investment loan	1,628	81	-	1,709	1,680	29	1,709
Special purpose loan	2,593	208	-	2,801	2,500	303	2,801
Loans and receivables due from customers	53,027	1,503	-	54,530	48,511	6,019	54,530
Cash and deposits accounts held with central banks	6,095	-	-	6,095	6,095	-	6,095
Loans and receivables due from banks	740	-	-	740	740	-	740
Securities	4,453	-	-	4,453	4,453	-	4,453
TOTAL:	64,315	1,503	-	65,818	59,795	6,019	65,818
Total guarantees	5,348	2,440	-	7,789	5,277	2,511	7,789
Payable guarantees to corporate customers	4,686	2,440	-	7,127	5,277	1,849	7,127
Performance bonds to corporate customers	662	-	-	662	-	662	662
Unused liabilities for loans issuance	3,435	-	-	3,435	1,500	1,935	3,435
Unused documentary letters of credit	-	-	-	-	-	-	-
TOTAL:	8,783	2,440	-	11,223	6,777	4,446	11,223

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NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

The allowance for impairment of the values in accordance with IFRS 9 is shown in the following table:

In thousands of EUR
December 31, 2019

Description	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Loans and receivables due from customers	85	-	-	85	78	7	85
Loans to Government	78	-	-	78	78	-	78
Units of local self government	7	-	-	7	-	7	7
Retail loans	10	1	4	15	-	15	15
Cash loans	9	1	4	14	-	14	14
Housing loans	1	-	-	1	-	1	1
Overdrafts on bank accounts	-	-	-	-	-	-	-
Corporate loans	324	41	179	544	443	101	544
For permanent working capital	74	-	179	253	253	-	253
Overdraft	28	-	-	28	-	28	28
Revolving	118	33	-	151	88	63	151
Investment loan	-	8	-	8	8	-	8
Special purpose loan	104	-	-	104	94	10	104
Loans and receivables due from customers	419	42	183	644	521	123	644
Cash and deposits accounts held with central banks	6	-	-	6	6	-	6
Loans and receivables due from banks	6	-	-	6	6	-	6
Securities	18	-	-	18	18	-	18
TOTAL:	449	42	183	674	551	10	674
Total guarantees	24	10	-	34	24	10	34
Payable guarantees to corporate customers	14	10	-	24	14	10	24
Performance bonds to corporate customers	10	-	-	10	10	-	10
Unused liabilities for loans issuance	44	-	-	44	18	26	44
Unused documentary letters of credit	-	-	-	-	-	-	-
TOTAL:	68	10	-	78	42	36	78

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NOTES TO THE FINANCIAL STATEMENTS
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4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

In thousands of EUR
December 31, 2018

Description	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Loans and receivables due from customers	133	-	-	133	119	14	133
Loans to Government	119	-	-	119	119	-	119
Units of local self government	14	-	-	14	-	14	14
Retail loans	8	-	-	8	-	8	8
Cash loans	7	-	-	7	-	7	7
Housing loans	1	-	-	1	-	1	1
Overdrafts on bank accounts	0	-	-	-	-	-	-
Corporate loans	280	9	-	289	196	92	288
For permanent working capital	144	-	-	144	144	-	114
Overdraft	41	-	-	41	-	41	41
Revolving	69	7	-	76	27	48	76
Investment loan	9	2	-	12	11	-	11
Special purpose loan	17	-	-	17	14	3	17
Loans and receivables due from customers	421	9	-	431	315	114	429
Cash and deposits accounts held with central banks	4	-	-	4	4	-	4
Loans and receivables due from banks	1	-	-	1	1	-	1
Securities	24	-	-	19	24	-	24
TOTAL:	450	9	-	455	344	114	458
Total guarantees	50	14	-	64	46	18	64
Payable guarantees to corporate customers	43	14	-	57	46	11	57
Performance bonds to corporate customers	7	-	-	7	-	7	7
Unused liabilities for loans issuance	64	-	-	64	21	43	64
Unused documentary letters of credit	-	-	-	-	-	-	-
TOTAL:	114	14	-	128	67	61	128

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NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

Geographic concentration of the Bank's exposure to the credit risk is shown in the table below:

	In thousands of EUR				
	<u>Montenegro</u>	<u>European Union</u>	<u>Turkey</u>	<u>Other</u>	<u>Total</u>
Loans and receivables due from banks	-	-	4,649	-	4,649
Loans and receivables due from clients	35,262	-	26,287	4,286	65,835
Securities	1,109	-	3,340	-	4,449
December 31, 2019	<u>36,371</u>	<u>9</u>	<u>34,276</u>	<u>4,286</u>	<u>74,933</u>
December 31, 2018	<u>34,066</u>	<u>9</u>	<u>20,591</u>	<u>4,759</u>	<u>59,424</u>

With the aim of identifying, measuring, assessing and monitoring country risk, the Bank uses Country risk management policy as well as the Decision on the methodology for country risk measurement in banks issued by the Central Bank of Montenegro.

The Bank measures the exposure to country risk for all countries in which the head office or residence of the Bank's debtors is located.

The Bank's exposure to country risk is measured based on individual placement, defined in a document, which implies the control of the debtor's country rating, taking into account the political, economic and social conditions in the country of the debtor.

When allocating a rating to a particular country, the rating of an agency is based on a greater number of indicators, out of which the key ones are as follows: per capita income, gross domestic product growth, inflation, external debt, level of economic development and earlier regularity of debt settlement.

Based on the recommendation of the Central Bank, the Bank uses the long-term rating of the borrower's country, determined by the internationally recognized rating agencies (Standard & Poors, Moody's, Fitch) for all specific exposures in asset classification and country risk allocation.

The Bank ranks all debtors' countries in the following risk categories:

- risk-free countries;
- low-risk countries;
- medium-risk countries;
- high-risk countries.

Ranking of debtors' countries serves the Bank for determining the required capital for country risk and for limiting the bank's exposure to certain debtors' countries, groups of countries or regions.

The required capital for the country risk is calculated using weights ranging from 0% to 300%.

As at December 31, 2019, the Bank allocated the amount of capital to cover the exposure to country risk, since it granted loans to certain legal entities and individuals from the Republic of Turkey, B&H and Kosovo and it had securities in its portfolio issued by the Ministry of Finance of the Republic of Turkey.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.8. Industry Concentration

Industry concentration of the Bank's exposure to the credit risk is as follows

	Loans and receivables due from customers	Loans and receivables due from banks	Securities	Total
Manufacturing	3,444	-	-	3,444
Construction	2,234	-	-	2,234
Wholesale and retail trade and repair of motor vehicles and motorcycles	4,468	-	-	4,468
Accommodation and meals services	2,579	-	-	2,579
Financial and insurance activities	-	-	-	-
Professional, scientific and technical activities	19	-	-	19
Public administration, defence and mandatory social insurance	16,006	-	1,109	17,115
Other services	4,785	-	-	4,785
Individuals – residents	1,725	-	-	1,725
Non-residents	30,683	4,649	3,340	38,672
TOTAL	65,943	4,649	4,449	75,041
Interest receivables and impairment of interest receivables	3	-	-	3
Accruals of interest and fees and impairment	111	-	-	111
December 31, 2019	65,835	4,649	4,449	74,933
December 31, 2018	54,251	739	4,434	59,425

4.3.9. Off-balance sheet items

The maturity of off-balance sheet items under which the Bank is exposed to credit risk is as follows:

	December 31, 2019 In thousands of EUR			
	Irrevocable liabilities for loans approval	Guarantees	Uncovered letters of credit	Total
Up to 1 year	3,948	3,965	-	7,913
From 1 to 5 years	700	176	-	876
	<u>4,648</u>	<u>4,141</u>	<u>-</u>	<u>8,789</u>
	December 31, 2018 In thousands of EUR			
	Irrevocable liabilities for loans approval	Guarantees	Uncovered letters of credit	Total
Up to 1 year	3,435	7,706	-	11,141
From 1 to 5 years	-	83	-	83
	<u>3,435</u>	<u>7,789</u>	<u>-</u>	<u>11,224</u>

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.4. Credit Risk (Continued)

The Bank is exposed to market risks. Market risk is a potential loss caused by unfavorable changes in the market: interest rates, foreign exchange positions, prices, indexes and/or other factors that affect the value of financial instruments.

Most often, the main sources of market risk are foreign currency positions and interest rate risk.

The limits for exposure to market risks are internally prescribed and adjusted to the limits prescribed by the Central Bank of Montenegro.

4.4.1 Foreign Currency Risk

The risk of changes in foreign exchange rates is the risk of change of assets and liabilities value due to changes in foreign currency rates.

Bank measures foreign exchange risk and limits it daily, on an aggregate basis and individually by currencies.

The net open foreign exchange position of the Bank at the end of the day, for individual currency which is on the reference exchange rate of the European Central Bank on a daily basis, may not exceed 15% of the core capital of the Bank.

The sum of the net open foreign currency position at the end of the day for all the currencies at the reference exchange rate of the European Central Bank on a daily basis, may not exceed 20% of the share capital of the Bank.

The net open positions at the end of the day for other currencies cannot exceed:

- 5% of core capital of the Bank, individually by currency;
- 10% of core capital, in total for all other currencies of the Bank.

The financial position and cash flows of the Bank are exposed to the effects of currency exchange changes.

The exposure to foreign exchange risk is regularly monitored by harmonizing with the limits prescribed by the Central Bank of Montenegro.

The Bank is exposed to effects of changes in the exchange rates of the most important currencies, which affect its financial position and cash flows.

The management establishes limits on the level of exposure by currencies that are regularly monitored.

The exposure to foreign currency risk as at December 31, 2019 is presented in the following table:

	In thousands of EUR		
	USD	Other currencies	Total foreign currencies
ASSETS			
Cash and deposits held with central banks	950	-	950
Total assets	950	-	950
LIABILITIES			
Deposits due to customers	978	-	978
Borrowings due to banks			
Total liabilities	978	-	978
Net exposure to foreign currency:			
- December 31, 2019	(28)	-	(28)
- December 31, 2018	(31)	1	(30)

**NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019**

4. RISK MANAGEMENT (Continued)

4.4. Market risk (Continued)

4.4.1 Foreign currency risk (Continued)

The Bank is exposed to foreign exchange risk to a small extent, given the fact that, as at December 31, 2019, it had foreign currency funds in USD in the amount of 950 thousand and liabilities in the same currency in the amount of 978 thousand, resulting in a net short position of 28 thousand.

On the basis of the aforementioned, the Bank was not obliged to allocate capital based on the coverage of foreign exchange risk exposure, since the net foreign exchange position is less than 2% of its own funds (as at December 31, 2019 it amounted to 1% of own funds).

All other positions of financial assets and liabilities as at December 31, 2019 were stated in EUR.

4.4.2. Operational risk

Operational risk represents the risk of losses due to the lack or inadequacy of internal processes, people and systems, or due to external events.

Also, operational risk can be the result of engagement of persons outside the Bank, unlawful actions, weaknesses and omissions in the performance of business, and alike.

In order to adequately manage operational risk, the Bank has developed a Policy for identifying, measuring and controlling this type of risk.

The policy sets out the basic principles for managing operational risk in order to achieve the optimum acceptable level of risk.

A phenomenon that is a source of operational risk can be classified into one of the 7 categories of events as follow:

- internal frauds;
- external frauds;
- failures in relation to employees and in the workplace safety system;
- problems in customer relationships, product placements and business practice of the Bank;
- damages on the physical assets of the bank;
- interruptions in operations and errors in the bank's systems;
- execution of transactions, deliveries and management of processes in the bank.

The operational risk associated with credit risk refers to an event arising from credit risk, and includes some of the elements of operational risk (eg. error in the execution of a process, internal/external fraud, commercial dispute).

The qualification of operational risk associated with credit risk requires the two of the following conditions met:

- Loan overdue and delayed by the loan holder - Credit Risk;
- Operational risk case, internal defect (execution error, internal/external fraud) or an external event (external fraud, commercial dispute) that partially or completely contributes to credit loss.

Exposure to operational risk is regularly monitored by aligning with the limits prescribed by the Central Bank of Montenegro.

The objective of operational risk management is to ensure that the level of exposure to operational risk is in line with the Bank's Risk Management and Policy Strategy, i.e. minimizing losses under operational risk.

The Bank uses a simple method for calculating the required capital for operational risk and as at December 31, 2019 it amounted EUR 350 thousand.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.4. Market risk (Continued)

4.4.3 Risk of changes in interest rates

The risk of changes in interest rates on cash flows is the risk that the future cash flows of a financial instrument will be subject to fluctuations due to variable interest rates in the market.

Interest rate risk is the risk that the value of a financial instrument will be subject to fluctuations due to variable interest rates in the market.

The Bank is exposed to the effects of changes in current interest rates in the market, based on the risk of changes in interest rates on cash flows.

The management of interest rate risk is considered to be the risk management of non-compliance of updating interest rates periods (Repricing Risk), sources of funds and placements.

As a consequence of such changes, there may be an increase in interest margins, however, those may reduce profits or lead to loss in case of unexpected movements.

Interest rates are based on market rates so that the Bank regularly re-measure the prices.

Sensitivity of assets, liabilities and off-balance sheet items to a change in the interest rate affects two categories - the amount of net interest income and the market value of certain financial instruments (interest-sensitive sources and placements), which consequently affects the market value of the Bank's capital.

The causes of interest rate risk are:

- Unsatisfactory interest spread ("spread")
- Mismatch of interest-sensitive assets and liabilities of banks ("gap")
- Changes in customer preferences

The following table shows the interest bearing and non-interest bearing assets and liabilities of the Bank as at December 31, 2019:

	In thousands of EUR		
	Interest bearing	Non-interest bearing	Total
ASSETS			
Cash and deposits held with central banks	1,091	6,099	7,189
Loans and receivables due from banks	-	4,649	4,649
Loans and receivables due from customers	65,835	-	65,835
Securities at amortized cost	4,449	-	4,449
Other financial receivables	16	-	16
Total assets	71,391	10,748	82,139
LIABILITIES			
Deposit due to customers	28,551	85	28,636
Loans to banks and central banks	37,416	-	37,416
Other financial liabilities	2,695	-	2,695
Total liabilities	68,661	85	68,746
Exposure to interest rates changes:			
- December 31, 2019	2,730	10,663	13,493
- December 31, 2018	7,267	6,067	13,334

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.5. Liquidity Risk

Liquidity management is one of the key tasks of the Bank. Liquidity risk is defined as a risk of the Bank's inability to provide sufficient funding for settling liabilities as they become due or a risk that the Bank will have to obtain such funding from other sources at a reasonable price and in due time.

4.5.1. Liquidity Risk Management

Liquidity risk presents the risk that the bank will not be able to provide sufficient volume (financial) resources to cover all the liabilities (balance sheet and off-balance sheet) as they mature.

Liquidity risk is identified on the basis of daily, ten-day, monthly, quarterly projections of liquidity, i.e. based on the gaps incurred due to mismatch of assets and resources.

Adequate liquidity risk management is a basic requirement for the safe and efficient operation of the bank.

The quality of liquidity risk management depends on the balance sheet structure of the Bank, i.e. matching between inflows and outflows.

The required liquidity is achieved by rational management of assets and liabilities in order to maintain an appropriate ratio between liquid assets and volatile liabilities.

Aiming to create a secondary liquidity reserves the Bank was investing in debt securities in the amount of EUR 4,449 thousand.

As at December 31, 2019, most of the portfolio of debt securities relates to securities issued by the Ministry of Finance of the Republic of Turkey in the amount of EUR 3,340 thousand, which are classified as available for sale.

Also, the Bank in its portfolio has EUR 1,109 thousand of securities issued by the Ministry of Finance of Montenegro, which are also measured at fair value through other comprehensive result.

Based on the monitoring and measurement of the basic liquidity indicators (daily and decade liquidity coefficients), determined coefficients show that, during 2019, the Bank did not have liquidity problems and the liquidity coefficients were above the limit of values prescribed by the Central Bank.

As at December 31, 2019, the daily liquidity ratio amounted to 2.88 (December 31, 2018: 2.99), while the minimum value of this coefficient defined by the Central Bank's decision was 0.9.

The Bank's liquidity is strongly supported by the parent bank, which provides loans or overnight deposits in case of need for liquid assets. In addition, the Bank has defined and adopted the Liquidity Management Plan in cases of jeopardized liquidity or unforeseen circumstances, which clearly define the duties, tasks and bearers of the tasks to be performed in the event of a jeopardized liquidity of the Bank.

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

The contractual maturities of assets and liabilities are determined based on the remaining period at the balance sheet date in relation to the contractual maturity date.

Considering the fact that the Bank started its operations in the second half of 2015, the methodology for determining the stable level of demand deposits is still not prepared. This requires a series of data for a minimum of several years, so at this point the Bank classifies all demand deposits in the column from 1 to 7 days.

Time deposits are classified by maturity scales in relation to the agreed maturity dates.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)
4.5. Liquidity Risk (Continued)
4.5.1 Liquidity Risk Management (Continued)

	In thousands of EUR								
	From 1 to 7 days	8-15 days	16-30 days	31-90 days	91-180 days	180-365 days	1-5 years	More than 5 years	Tota
December 31, 2019									
ASSETS									
Cash and deposits held with central banks	6,099	-	-	-	-	-	1,090	-	7,189
Cash and cash equivalents	5,011	-	-	-	-	-	-	-	5,011
Allocated mandatory reserve funds	1,088	-	-	-	-	-	1,090	-	2,178
Funds held with banks	4,649	-	-	-	-	-	-	-	4,649
Loans and receivables due from customers	15	518	106	5,273	4,261	27,054	25,425	3,184	65,835
Securities available for sale at amortized cost	-	-	-	43	89	-	1,531	1,677	3,340
Financial assets at fair value through other comprehensive income	-	-	-	58	-	-	1,051	-	1,109
Other receivables	50	-	-	68	-	68	270	-	456
Total assets	10,813	518	106	5,442	4,350	27,122	29,367	4,861	82,578
LIABILITIES									
Total deposits, funds on esc. account and liabilities for interests and accruals	10,962	326	281	789	835	5,372	10,071	-	28,636
Demand deposits	10,865	-	-	-	-	-	-	-	10,865
Time deposits	10	326	281	789	835	5,372	10,071	-	17,684
Liabilities for interests and accruals	87	-	-	-	-	-	-	-	87
Total borrowings	2,695	3	9	-	32,401	5,003	(13)	-	40,098
Borrowings from other credit and financial institutions	-	-	-	-	32,400	5,000	-	-	37,400
Liabilities for interests and accruals	-	3	9	-	1	3	-	-	16
Other due liabilities	2,695	-	-	-	-	-	(13)	-	2,682
Total liabilities	13,657	329	290	789	33,236	10,375	10,058	-	68,734
Maturity gap as at 12/31/2019									
Maturity gap	(2,844)	189	(184)	4,653	(28,886)	16,747	19,309	4,861	13,844
Cumulative gap	(2,844)	(2,655)	(2,839)	1,813	(27,072)	(10,325)	8,983	13,844	(21,095)
% of total funds sources	(4.1)%	(3.9)%	(4.1)%	2.6%	(39.4)%	(15.0)%	13.1%	20.1%	
Maturity gap as at 12/31/2018									
Maturity gap	493	(982)	(4,353)	1,137	10,763	(19,143)	17,083	1,161	6,159
Cumulative gap	(17,603)	17	(7,964)	1,061	15,573	12,138	6,909	3,274	13,405
% of total funds sources	(17,603)	(17,586)	(25,550)	(24,489)	(8,916)	3,222	10,131	13,406	(67,385)
% of total funds sources	-33.8%	-33.7%	-49.0%	-47.0%	-17.1%	6.2%	19.4%	25.7%	

This Report is translation of the Auditors' Report issued in the language officially used in Montenegro. In the case of any discrepancy between the version in language officially used in Montenegro and English version, the version in the language officially used in Montenegro shall prevail.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.5. Liquidity Risk (Continued)

4.5.1 Liquidity Risk Management (Continued)

The liquidity of the Bank as its ability to fulfil its due liabilities within the deadline, depends on one side of the balance sheet structure, and on the other side, the compliance of inflows and outflows of funds.

The structure of financial assets and liabilities as at December 31, 2019 indicates the existence of a maturity mismatch between the remaining maturity of assets and liabilities from 1 to 180 days.

During 2019, the Bank did not have problems with maintaining its liquidity. The daily liquidity ratio as at December 31, 2019 was 2.88% (December 31, 2018: 2.99%), while the decade liquidity ratio as at December 31, 2019 was 2.72% (December 31, 2018: 3.65%).

As a member of the Ziraat Group, the Bank has access to the intergroup money market, and in a very short period of time it can provide liquid cash in a form of a loan from the parent bank or another member bank of the Ziraat Group.

This fact significantly influences the liquid position of the Bank and the reduction of liquidity risk exposure.

4.6. Fair Value of Financial Assets and Liabilities

	Carrying value		In thousands of EUR	
	2019	2018	2019	Fair value 2018
Financial assets				
Loans and receivables due from banks	4,649	739	4,649	739
Loans and receivables due from customers	65,835	54,251	65,835	54,251
Securities at amortized cost	4,449	4,434	4,449	4,434
Other financial receivables	16	11	16	11
Financial liabilities				
Deposits due to clients	28,636	23,150	28,636	23,150
Loans to banks and central banks	37,416	28,906	37,416	28,906
Other liabilities	2,695	137	2,695	137

Fair value of financial instruments is the price that would be received to sell an asset or paid to settle a liability, between notified willing participants during the independent transaction. However, no readily available market prices exist for a certain portion of the Bank's financial instruments.

In this circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing models as appropriate.

Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affects the estimates. Therefore, the calculated fair market estimates cannot be realized in a current sale of the financial instrument.

When estimating the fair value of financial instruments for which such a value can be determined, the following methods and assumptions have been applied:

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.6. Fair Value of Financial Assets and Liabilities (Continued)

4.6.1. Loans and placement to banks

Loans and receivables due from banks include inter-bank placements and line items in the course of collection.

The fair value of floating rate placements and overnight deposits approximates their carrying amount at the balance sheet date.

4.6.2. Loans and receivables due from customers

In order to determine the fair value of loans to clients with fixed interest rates measured at amortized cost, a comparison of interest rates was made according to which loans were granted to clients with available information on the prevailing market interest rates in the banking sector of Montenegro, i.e. the average weighted interest rates by activities.

The Bank's management believes that the Bank's interest rates do not deviate significantly from the prevailing market interest rates in the Montenegrin banking sector and accordingly fair value of loans to customers calculated as the present value of future cash flows discounted by applying the applicable market rates or average weighted interest rates for the banking sector does not significantly change of the stated carrying amount of the loan at the balance sheet date.

In management's opinion, the financial statements reflect the real value that is most credible and useful in the given circumstances for financial reporting purposes.

4.6.3. Financial assets available for sale

The fair value of financial assets available for sale is based on market prices.

4.6.4. Deposits and loan liabilities

For demand deposits, as well as deposits with a residual maturity of less than one year, it is assumed that the estimated fair value does not deviate significantly from the carrying amount.

The estimated fair value of fixed interest bearing deposits with remaining contractual maturities over one year, without a quoted market price, is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

According to the management, Bank's interest rates are harmonized with the current market rates and the amounts stated in the financial statements represent the values that are believed under the circumstances, to approximate the fair value of these financial instruments.

For the fair value of loan liabilities with fluctuating interest rate, it is assumed that it approximates the carrying amount of these liabilities at the reporting date.

4.6.5. Fair Value of Financial Instruments Measured at Fair value

a) Fair value hierarchy for financial instruments measured at fair value

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.6. Fair Value of Financial Assets and Liabilities (Continued)

4.6.5. Fair Value of Financial Instruments Measured at Fair value

a) Fair Value of Financial Instruments Measured at Fair value (Continued)

Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 - Quoted prices (unadjusted) on active markets for identical assets or liabilities. This level includes listed equity investments.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for an asset or a liability, either directly (that is, as prices/values) or indirectly (that is, as derived from prices/values).
- Level 3 - inputs for assets or a liability that are not based on observable market data. This Level includes equity investments with Bank's market assumption (no observable data available). The Bank does not have financial instruments measured at fair value included within Level 3.
- This hierarchy requires the use of observable market data when available. The Bank considers available market prices where possible. As at December 31, 2019 the market price of securities valued at fair value in the Bank's portfolio were available.

December 31, 2019	Level 1	Level 2	Level 3	Total
Securities at fair value through other comprehensive income	1,109			1,109
Total assets	1,109			1,109
December 31, 2018	Level 1	Level 2	Level 3	Total
Securities at fair value through other comprehensive income	1,112	-	-	1,112
Total liabilities	1,112	-	-	1,112

b) Valuation techniques and inputs to valuation techniques for financial instruments measured at fair value

The fair value for financial assets available for sale is based on market prices. If market price information is not readily available, the market prices of quoted securities with similar characteristics are used. As at December 31, 2019, for securities measured at fair value in Bank's portfolio, market prices were available.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.6. Fair Value of Financial Assets and Liabilities (Continued)

4.6.5. Fair Value of Financial Instruments Measured at Fair value (Continued)

c) Fair value hierarchy for financial instruments not measured at fair value

Estimated fair value of financial instruments, based on fair value hierarchy is given as follows:

	Level 1	Level 2	Level 3	Total	Carrying value
December 31, 2019					
Cash and deposits held with central banks	-	7,189	-	7,189	7,189
Loans and receivables due from banks	-	4,649	-	4,649	4,649
Loans and receivables due from customers	-	-	65,835	65,835	65,835
Other financial receivables	-	-	16	16	16
Total assets	-	11,838	65,851	77,689	77,689
Deposits due to customers	-	-	28,636	28,636	28,636
Borrowings due to banks	-	-	37,416	37,416	37,416
Total liabilities	-	-	66,052	66,052	66,052
December 31, 2018					
Cash and deposits held with central banks	-	6,091	-	6,091	6,091
Loans and receivables due from banks	-	739	-	739	739
Loans and receivables due from customers	-	-	54,251	54,251	54,251
Other financial receivables	-	-	11	11	11
Total assets	-	61,830	54,262	61,092	61,092
Deposits due to customers	-	-	23,150	23,150	23,150
Borrowings due to banks	-	-	28,906	28,906	28,906
Total liabilities	-	-	52,056	52,056	52,056

d) Valuation techniques and assumptions used for valuation techniques for financial instruments not measured at fair value

The fair value of financial instruments that are not valued at fair value is calculated only for the purposes of disclosing without effects to the balance sheet position or profit or loss statement.

In addition, since the instruments are not traded in the market, there are significant management judgments required to determine their fair values.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique.

However, no readily available market prices exist for a certain portion of the Bank's financial instruments, and those were accordingly classified into Level 2 based on fair value hierarchy.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.6. Fair Value of Financial Assets and Liabilities (Continued)

4.6.5. Fair Value of Financial Instruments Measured at Fair value (Continued)

d) Valuation techniques and assumptions used for valuation techniques for financial instruments not measured at fair value (Continued)

Under these circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing models as appropriate.

Changes in underlying assumptions including discount rates and estimated future cash flows, significantly affect the estimates.

4.7. Capital Management

The Bank's capital management objectives are:

- To comply with the capital requirements set by the regulator;
- To safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns to shareholders and
- To maintain a strong capital base to support the development of the Bank's further business.

Own assets of the Bank comprise the following:

- Core capital (paid-in share capital, retained earnings from prior years, profit for the year decreased for current year losses);
- Supplementary capital (reserves from profit after taxation: statutory and other reserves, subordinated loans);
- Both decreased for intangible assets, missing reserves and direct or indirect investments in another bank or another credit or financial institution in the amount exceeding 10% of capital of those institutions.

Risk-weighted assets are comprised of items of assets and loan equivalents of off-balance sheet items exposed to risk.

The loan equivalents of off-balance sheet assets are computed by multiplying the book value of off-balance sheet items with the prescribed conversion factors.

Total risk-weighted assets are comprised of assets and loan equivalents of off-balance sheet items exposed to risk (the Bank's risk weighted assets) classified in certain categories and multiplied by adequate prescribed risk weights.

accordance with the requirements of the Central Bank of Montenegro, the Bank is under obligation to maintain a minimum capital adequacy ratio of 10%.

The Bank is obliged to align its business scope with the prescribed indicators, i.e. to align the scope and structure of its risk placements with the Banking Law and the Central Bank of Montenegro regulations.

On December 31, 2019, capital adequacy ratio calculated by the Bank for financial statements was 19.85%.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.8. Risk Exposure Analysis

4.8.1. Risk Exposure Analysis (Foreign Currency Risk)

Foreign currency risk exposure management, in addition to analyzing the Bank's receivables and liabilities denominated in foreign currency, includes sensitivity analysis on foreign currency exchange rate fluctuations. The following table shows the scenario of exchange rate changes ranging from + 10% to -10% compared to EUR.

	<u>Total</u>	<u>Amount in foreign currency</u>	In thousands of EUR	
			<u>10%</u>	<u>(10%)</u>
			Change in exchange rate	
ASSETS				
Cash and deposits held with central banks	7,189	14	1	(1)
Loans and receivables due from banks	4,649	936	9	(9)
Total assets	11,838	950	10	(10)
LIABILITIES				
Deposits due to customers	28,636	978	10	(10)
Other liabilities	2,695	-	-	-
Total liabilities	31,331	978	10	(10)
Net exposure to foreign currency risk:				
- December 31, 2019			1	(1)
- December 31, 2018			1	(1)

As at December 31, 2019, assuming all other parameters were unchanged, the change in the EUR exchange rate against other currencies by + 10% and -10% would increase or decrease the Bank's profit by EUR 1 thousand (December 31, 2018: profit would increase or decrease by EUR 1 thousand).

The cause to the Bank's low exposure to the exchange rate change is the fact that the greatest portion of the Bank's receivables and liabilities is expressed in EUR.

4.8.2. Risk Exposure Analysis (Interest Rate Risk)

During the process of risk management from the change in interest rates, the Bank performs the sensitivity analysis of changes in receivables and liabilities with variable interest rates.

The following table shows the effect of fluctuations in interest rates on the Bank's receivables and liabilities denominated in EUR and foreign currency in the range from +0.4 b.p. to - 0.4 b.p. respectively.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

4. RISK MANAGEMENT (Continued)

4.8. Risk Exposure Analysis (Continued)

4.8.2. Risk Exposure Analysis - Interest Rate Risk (Continued)

		In thousands of EUR	
		Net effect of movements in interest rates	
		+0.4 b.p. EUR/FX KS	-0.4 b.p. EUR/FX KS
ASSETS			
Cash and balances held with central banks	7,189	29	(29)
Loans and receivables due from banks	4,649	19	(19)
Loans and receivables due from customers	65,835	263	(263)
Securities available for sale	4,449	18	(18)
Other financial receivables	16	-	-
	82,138	329	(329)
LIABILITIES			
Deposits due to customers	28,636	115	(115)
Borrowings due to banks	37,416	150	(150)
	66,052	264	(264)
Net exposure to interest rate risk			
		65	(65)
		29	(29)

Under the assumption that all other parameters remain the same, the increase, or decrease in variable interest rates applied to assets and liabilities denominated in EUR and in foreign currency, by 0.4 percentage points, the Bank's profit would increase, or decrease, respectively by EUR 65 thousand (December 31, 2018: the respective decrease would amount to EUR 29 thousand).

The reason why the Bank's exposure to interest rate is small is based on the fact that the major portion of the Bank's assets and liabilities are contracted with a fixed interest rate.

5. INTEREST INCOME AND EXPENSES

5.1. Interest income and similar income

	In thousands of EUR	
	Year ended December 31, 2019	2018
Loan interest income:		
- state organization	667	869
- Corporate customers	2,375	1,022
- Retail customers	76	44
- Other	23	34
	3,141	1,969
Securities available for sale	196	149
	3,337	2,118

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

5. INTEREST INCOME AND EXPENSES (Continued)

5.2. Interest expenses and similar expenses

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Interest expense from deposits due to:		
- Corporate customers	66	117
- Retail customers	162	33
- Other	74	58
	302	208
Liabilities on loans and other borrowings:		
- Financial institutions	525	304
	525	304
	827	512

6. ALLOWANCE FOR IMPAIRMENT AND PROVISION EXPENSES

6.1. Net income/expense from impairment of financial instruments that are not measured at fair value through profit or loss

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Loan impairment expenses	216	68
Expenses of impairment of off-balance items/(cancellation)	(50)	60
Expenses of impairment of AT securities/(cancellation)	(5)	11
Impairment of securities measured at fair value through other comprehensive income (Note 24)	5	6
Interests impairment expenses	2	1
Deposits held with banks impairment expenses	8	-
Other assets impairment expenses	1	-
	177	146

6.2. Provision expenses

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Provisions for severance payments and jubilee awards	9	-
	9	-

7. FEES INCOME AND EXPENSES

7.1. Fee and Commission income

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Fees from operations with loans	324	56
Fees from off-balance items	117	58
Bank charges	160	88
Fees for cards and e-banking	37	12
Other fees and commissions	15	10
	653	224

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

7. FEES INCOME AND EXPENSES (Continued)

7.2. Fee and Commission Expenses

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Fees to Central Bank of Montenegro	47	29
Bank charges	4	2
Deposit insurance premium fees	130	125
Fees for cards and ATM operations	55	34
Other fees and commissions	16	38
	252	228

8. STAFF COSTS

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Net salaries	572	520
Taxes and contributions related to salaries	526	368
Fees to members of Board of Directors	76	80
Taxes and contributions related to fees to members of Board of Directors	9	10
Business trips expenses	10	12
Employees trainings	3	1
	1,196	991

9. GENERAL AND ADMINISTRATIVE EXPENSES

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Rental expenses	176	141
Security	52	38
Property maintenance	206	171
Insurance services	7	5
Cleaning services	25	15
Audit expenses	146	131
Sponsorship and donations	5	3
Advertising	7	5
Electricity and fuel	24	19
Entertainment	17	16
Telecommunication and postal costs	61	57
Office material	9	5
Professional services	38	25
Public utilities services	5	4
Expenses related to capital increase	7	34
Court expenses	0	1
Money transport expenses	5	0
Other expenses	21	22
	811	692

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

10. OTHER INCOME AND EXPENSES

10.1. Other income

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Other income	6	19
	<u>6</u>	<u>19</u>

10.2. Other expenses

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Tax and other duties of local self-government units	69	42
	<u>69</u>	<u>42</u>

11. INCOME TAX

11.1. Income tax components

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Deferred tax income/expense	16	(15)
	<u>16</u>	<u>(15)</u>

11.2. Reconciliation of income tax from Income Statement and results before taxation and prescribed tax rate

	In thousands of EUR	
	Year ended December 31,	
	2019	2018
Gain/Loss before taxation	278	(663)
Income tax at the prescribed rate of (9%)	(25)	(58)
Tax effects of expenses not recognized for tax purposes	1	1
Difference between the present value of fixed assets and intangible assets recognized in the financial statements and their value for tax purposes	16	15
Tax effects of current year tax losses carried forward	44	41
Other	(20)	(14)
Income tax stated in income statement	<u>16</u>	<u>(15)</u>

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

11. INCOME TAX (Continued)

11.3. Deferred tax assets and liabilities

Deferred tax assets and liabilities in the balance sheet refer to the following:

	Year ended December 31, 2019			In thousands of EUR Year ended December 31, 2018		
	Assets	Liability	Net amount	Assets	Liability	Net amount
Amortization of fixed assets	40	(21)	19	24	(21)	3
Change in fair value of securities carried at fair value through other comprehensive income	6	(12)	(6)	4	(11)	(7)
Deferred tax assets/ (liabilities)	46	(33)	13	28	(32)	(4)

Changes in fair value of securities carried at fair value through other comprehensive income (FVOCI) have an effect on calculated revaluated reserve as well as on tax liabilities considered as equity items. Calculated deferred tax liability has an impact for the same amount (EUR 6,000) on equity as well as on liabilities in the balance sheet.

In 2019, the effect of impact of deferred tax asset on balance sheet was EUR 19 thousand, while on profit and loss statement it was recorded as deferred tax income in current period and amounted to EUR 16 thousand.

11.4. Unused operating tax losses that can be carried forward

Year of Inception	Year of Expiry	In thousands of EUR
2015	2020	777
2016	2021	1,165
2017	2022	752
2018	2023	458
		3,644

In accordance with the Law on Corporate Income Tax ("Official Gazette of Montenegro", No. 55/16), losses arising from business relations, except those from which capital gains and losses arise, may be carried forward to the profit account for future accounting periods, but not longer than five years.

As at December 31, 2019, the Bank did not recognize deferred tax assets arising from the capital losses incurred in previous years, due to the uncertainty that existed at the time of the loss that future taxable profits against which the deferred tax assets can be utilized will be available.

As at December 31, 2019, the Bank did not have capital tax losses carried forward, and therefore there were no grounds for capital losses carrying forward to the account of capital gains in the next five years.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

12. CASH AND DEPOSITS HELD WITH CENTRAL BANKS

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Cash in hand in EUR	832	1,196
Cash in hand in foreign currencies	14	24
Cash in ATMs	75	69
Gyro account balance	4,093	3,355
Obligatory reserve held with the Central Bank of Montenegro	2,181	1,451
<i>Less: Allowance for impairment of cash and deposits held with central banks</i>	(6)	(4)
	7,189	6,091

The Bank's obligatory reserve as at December 31, 2019 represents the minimum deposits set aside in accordance with the Central Bank of Montenegro Regulation with respect to "Decision on Bank Reserve Requirements to be held with the Central Bank of Montenegro" ("Official Gazette of Montenegro", No. 35/11, 22/12, 61/12, 57/13, 52/14, 07/15, 33/16 and 15/17). In accordance with the said Decision, the reserve is calculated based on demand deposits and time deposits.

The required reserves are calculated by applying the rate of:

- 7.5 % - to a part of principal made of demand deposits and deposits with agreed maturity of up to one year, i.e. up to 365 days;
- 6.5% - to a part of principal made of deposits with agreed maturity of over one year, i.e. over 365 days; and
- 7.5 % - to deposits with agreed maturity of over 365 days, with an option of early withdrawal (within less than one year, or within less than 365 days).

A Bank may use up to 50% of its allocated reserve to maintain its daily liquidity. The Bank shall not be charged any fee for the use of its reserve.

The Bank shall pay monthly fee for the amount of reserve not returned the same day, at the rate established under a separate Central Bank of Montenegro regulation.

On 50% of funds allocated in accordance with the Decision, the Central Bank pays a monthly fee to the banks until the eight day of the month for the previous month, calculated at the rate of EONIA decreased by 10 basis points annually, whereby this rate may not be lower than zero.

13. LOANS AND RECEIVABLES FROM BANKS AND OTHER FINANCIAL ASSETS

13.1. Loans and receivables due from banks

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Correspondent accounts held with foreign banks	4,655	740
	4,655	740
<i>Less: Allowance for impairment of receivables with foreign banks</i>	(6)	(1)
Total loans and receivables from banks	4,649	739

13.2. Other financial assets

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Settlement account - Master Card	16	11
Other financial assets total	16	11

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

	December 31, 2019	In thousands of EUR December 31, 2018
Loans:		
Privately owned corporate customers	48,607	30,811
Government of Montenegro	15,589	21,991
Retail customers	1,888	1,053
Local self-government units	503	675
Out of which:		
Short-term loans:	3,581	3,929
Privately owned corporate customers	3,546	3,886
Retail customers	35	43
Long-term loans:	63,006	50,601
Privately owned corporate customers	45,061	26,925
Government of Montenegro	15,589	21,991
Retail customers	1,853	1,010
Local self-government units	503	675
Total	66,587	54,530
Interest receivables:	4	11
Loans	4	11
Accruals	(111)	141
Loan interest	430	354
Loan fees	(537)	(213)
Others	(4)	-
TOTAL GROSS LOANS AND RECEIVABLES	66,479	54,682
<i>Less: Allowance for impairment on loans</i>	(644)	(429)
<i>Less: Allowance for impairment on interests</i>	-	(2)
TOTAL LOANS AND RECEIVABLES	65,835	54,251

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

Concentration of total (gross) loans by industry is as given in the following table:

	December 31, 2019	In thousands of EUR December 31, 2018
Manufacturing	3,467	2,426
Construction of residential and non-residential units	2,277	1,776
Wholesale and retail trade	4,540	2,450
Accommodation and meal services	2,594	2,738
Information and communication	2,254	
Engineering activities and technical advisory	-	-
Public administration	16,091	22,666
Other services	1,664	14
Individuals – residents	1,739	1,001
Non-residents	31,024	21,459
	66,587	54,530

Loans to legal entities were approved at the following interest rates:

- Short-term loans with fixed interest rate: 2.99% - 7.50%
- Long-term loans with a fixed interest rate: 2.99% - 7.00%

The active interest rates applied to approved loans to legal entities during 2019 were as follows:

Type of loan	Interest rate
For permanent working capital	3.90% - 6.90%
Overdraft	3.30% - 7.50%
Revolving	2.99% - 6.90%
Investment loan	5.50% - 6.20%
Special purpose loan	3.90% - 7.50%

The active interest rates applied to approved loans to individuals during 2018 were as follows:

Type of loan	Interest rate
Cash loans	2.50% - 8.50%
Housing loans	3.99% - 6.00%
Overdrafts at bank accounts	9.00% - 12.00%

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

14.1. Changes on the accounts related to the impairment of uncollectible receivables and provisions

2019

In thousands of EUR	Loans (Note 14)	Interests (Note 14)	Cash and deposits held with central banks (Note 12 and 13)	Debt securities (Note 15)	Other assets items (Note 18)	Off-balance sheet provisions (Note 22)	Total
Balance, as at January 1, 2019	429	2	5	19	1	134	590
Impairment during the year-NET	216	2	8	(5)	1	(50)	172
Other changes	(1)	(4)	(1)	4	-	-	(2)
Balance, as at December 31, 2019	644	-	12	18	2	84	760

2018

In thousands of EUR	Loans (Note 14)	Interests (Note 14)	Cash and deposits held with central banks (Note 12 and 13)	Debt securities (Note 15.1)	Other assets items (Note 18)	Off-balance sheet provisions (Note 22)	Total
Balance, as at January 1, 2018	27	-	-	2	1	10	40
Adjusted initial balance: effect of the first application of IFRS9	334	2	5	3	-	64	408
Adjusted initial balance	361	2	5	5	1	74	448
Impairment during the year-NET	68	1	-	11	-	60	140
Other changes	-	(1)	-	3	-	-	2
Balance, as at December 31, 2018	429	2	5	19	1	134	590

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

15. INVESTMENT SECURITIES

15.1. Financial assets at amortized cost

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Financial assets at amortized cost		
Securities	3,358	3,341
<i>Less: Impairment of securities</i>	<i>(18)</i>	<i>(19)</i>
	3,340	3,322

- As at December 31, 2019, the Bank has in its portfolio the state bonds of:
- The Republic of Turkey ISIN XS1057340009 in the amount of EUR 1,027 thousand traded as at October 5, 2015 with the maturity date of April 11, 2023.
- The Republic of Turkey ISIN XS1629918415 in the amount of EUR 487 thousand traded as at May 24, 2018 with the maturity date of June 14, 2025.
- The Republic of Turkey ISIN XS1629918415 in the amount of EUR 1,834 thousand traded as at June 25, 2018 with the maturity date of June 14, 2025.

15.2. Financial assets at fair value through other comprehensive income

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Financial assets at fair value through other comprehensive income		
Securities	1,109	1,112
	1,109	1,112

As at December 31, 2019, the Bank has in its portfolio the state bonds of Montenegro ISIN XS1377508996 in the amount of EUR 1,109 thousand (December 31, 2018 in the amount of EUR 1,112 thousand), traded as at March 29, 2016 with the maturity date of March 10, 2021.

16. PROPERTY AND EQUIPMENT

	In thousands of EUR
	Equipment and facilities adaptation
Cost	
Balance as at January 1, 2018	604
Additions during the year	242
Balance as at December 31, 2018	846
Additions during the year	99
Balance as at December 31, 2019	945
Accumulated amortization	
Balance as at January 1, 2018	304
Charge for the year	138
Balance as at December 31, 2018	442
Charge for the year	156
Balance as at December 31, 2019	598
Carrying value as at:	
- December 31, 2019	347
- December 31, 2018	404

As at December 31, 2019, the Bank has no assets under pledge as a collateral for repayment of loans or settlement of other liabilities.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

17. INTANGIBLE ASSETS

Changes in intangible assets during 2019 are shown in the following table:

	In thousands of EUR Software and Licenses
Cost	
Balance as at January 1, 2018	1,133
Additions	1
Balance as at December 31, 2018	1,134
Additions	30
Balance as at December 31, 2019	1,164
Accumulated amortization	
Balance as at January 1, 2018	533
Charge for the year	283
Balance as at December 31, 2018	816
Charge for the year	235
Balance as at December 31, 2019	1,051
Carrying value as at:	
- Balance as at December 31, 2019	113
- Balance as at December 31, 2018	318

18. OTHER ASSETS

	December 31, 2019	In thousands of EUR December 31, 2018
Other receivables for fees and commissions	413	6
Given advances	8	6
Prepaid expenses	21	13
	442	25
<i>Less: Allowance for Impairment</i>	(2)	(1)
	440	24

19. DEPOSITS OF BANKS AND CENTRAL BANKS

	December 31, 2019	In thousands of EUR December 31, 2018
Demand deposits		
Privately owned banks	2	21
	2	21

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

20. DEPOSITS DUE TO CUSTOMERS

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Demand deposits		
Corporate customers	7,225	4,138
Entrepreneurs	37	5
State funds	38	40
NGOs and other non-profit organizations	134	127
Individuals	3,431	1,374
	10,865	5,684
Short-term deposits		
State owned and privately owned funds	874	550
Corporate customers	3	-
NGOs and other non-profit organizations	1,012	-
Individuals	3,630	824
	5,519	1,374
Long-term deposits		
State owned and privately owned funds	5,000	3,000
Corporate customers	3,038	6,165
Individuals	4,127	6,864
	12,165	16,029
Interest payables	-	-
Accruals	87	63
	28,636	23,150

The passive interest rates applied to received deposits of companies during 2019 were as follows:

Type of deposit	Interest rate
Short-term deposits	0.30%-1.10%
Long-term deposits	0.70%-2.60%

The passive interest rates applied to received deposits of individuals during 2019 were as follows:

Type of deposit	Interest rate
Demand deposits	0.01%

Time deposits in EUR:

- three months	
- six months	0.30%-1.10 %
- 12 months	1.80% - 2.30%
- 24 months	1.50% - 2.30%
- 36 months	2.20% - 2.60%

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

21. LOANS OF BANKS AND CENTRAL BANKS

	Currency	In thousands of EUR	
		December 31, 2019	December 31, 2018
<i>Liabilities for taken loans:</i>			
TURKIYE CUMHURIYETI ZIRAAT BANKASI A,S,	EUR	-	15,900
T,C, ZIRAAT BANKASI LONDON	EUR	23,000	8,000
T,C, ZIRAAT BANKASI - BOSNIA	EUR	9,400	-
Hipotekarna banka AD	EUR	5,000	5,000
		37,400	28,900
<i>Liabilities for calculated investment and fees:</i>			
TURKIYE CUMHURIYETI ZIRAAT BANKASI A,S,	EUR	-	3
ZIRAAT BANK BOSNIA	EUR	2	-
T,C, ZIRAAT BANKASI LONDON	EUR	11	1
Hipotekarna banka AD	EUR	3	2
		16	6
		37,416	28,906

The maturity overview of liabilities based on loans is given in the following table:

	Currency	Currency date	Maturity date	In thousands of EUR
				December 31, 2019
ZIRAAT BANK BOSNIA	EUR	30.12.2019.	31.1.2020.	1,400
ZIRAAT BANK BOSNIA	EUR	30.12.2019.	31.1.2020.	2,500
ZIRAAT BANK BOSNIA	EUR	27.12.2019.	26.6.2020.	4,000
ZIRAAT BANK BOSNIA	EUR	27.12.2019.	26.6.2020.	1,500
T.C.ZIRAAT BANKASI LONDON	EUR	18.12.2019.	17.1.2020.	12,500
T.C.ZIRAAT BANKASI LONDON	EUR	13.12.2019.	10.1.2020.	4,000
T.C.ZIRAAT BANKASI LONDON	EUR	20.12.2019.	17.1.2020.	6,000
T.C.ZIRAAT BANKASI LONDON	EUR	29.10.2019.	29.1.2020.	500
Hipotekarna banka AD	EUR	20.12.2019.	20.12.2020.	5,000
				37,400

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

22. PROVISIONS

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Balance as at January 1	134	10
Effects of IFRS 9 application	-	64
Balance as at January 1	134	74
Provision for potential losses on off-balance items	(50)	60
Provision for severance payments and jubilee awards	9	-
	93	134

23. OTHER LIABILITIES

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Temporary account	2,621	-
Other tax liabilities	-	4
Liabilities to suppliers	26	31
Card operations liabilities	4	3
Accrued liabilities	44	99
	2,695	137

The temporary account holds the funds of the capital paid but not subscribed at the amount of EUR 2,5 million. The process of capital increase started in December 2019 by the majority owner Turkiye Cumhuriyeti Ziraat Bankasi AS.

Accrued liabilities mostly referred to costs of: software and hardware maintenance, external audit and other expenses.

24. EQUITY

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Share capital	18,000	18,000
Retained loss from previous years	(4,150)	(3,502)
Gain/loss of the current period	294	(648)
Other reserves	65	70
Revaluation reserves for securities – fair value through other comprehensive income	66	71
Impairment of securities - fair value through other comprehensive income(Note 6.1)	5	6
Deferred tax liability	(6)	(7)
TOTAL EQUITY	14,209	13,920

As at December 31, 2019, the Bank's share capital comprised 18,000 ordinary shares (December 31, 2018: 18,000 ordinary shares) with nominal value of 1 thousand EUR each. All issued shares have been fully paid.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

24. EQUITY (continued)

Total subscribed capital as at December 31, 2019 amounted to EUR 18,000 thousand.

As at December 31, 2019, the 100% shareholder of the Bank was TURKIYE CUMHURİYETİ "ZIRAAT BANKASI ANONİM ŞİRKETİ".

In accordance with the regulations of the Central Bank of Montenegro, as at December 31, 2019, the Bank was obliged to maintain a minimum capital solvency ratio of 10%.

December 31, 2019, the Bank's solvency ratio was 19.85%.

The Bank continuously manages its capital, which is a broader concept than the capital position in the balance sheet, in order to:

- Ensure compliance with the requirements for capital, which are defined by the Central Bank of Montenegro;
- Provide adequate level of capital to continue operations on the "going concern" and ";
- Maintain capital at a level that will allow for future business development.

24.1. Own funds

Capital adequacy and the use of the Bank's capital is monitored monthly by the Bank Management. The Central Bank of Montenegro has defined the following capital limits:

- the minimum amount of capital of EUR 5 million and
- Capital adequacy ratio of 10%.

Total capital or own funds of the Bank consist of core capital, supplementary capital and deduction items.

Core capital consists of: paid-in share capital at nominal value, excluding cumulative preferential shares; collected share issuance premiums; reserves that are formed at the expense of profit after taxation (statutory and other reserves); retained earnings from previous years; profit for the year for which the Shareholders Assembly decided to be included in the core capital; capital gains made from the purchase and sale of own shares.

Deduction items from core capital are: loss from previous years; loss of the current year; capital losses arising from the acquisition and sale of own shares; intangible assets such as goodwill, licenses, patents, trademarks and concessions; nominal value of acquired own shares, excluding cumulative preferential shares; less accrued provisions for potential losses, determined in the process of control.

Supplementary capital comprises: a nominal value of preferential cumulative shares; general reserves, up to 1.25% of total risk weighted assets; subordinated debt hybrid instruments, for which the conditions of the Decision on banks' capital adequacy for inclusion in Tier I have been met.

Deductions from Tier I capital are: acquired own preferential cumulative shares and claims and contingent liabilities secured by hybrid instruments or by subordinated debt of the Bank to the extent in which these instruments are included in Tier I.

Needs for capital are determined separately for different types of risks - credit, operational, market and other risks in accordance with applicable regulations in this area.

Most of the needs for capital refer to the capital required to cover credit risk.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

24. EQUITY (Continued)

24.1. Own funds (Continued)

In this sense, credit risk-weighted assets are calculated using the weights range from 0% to 100% depending on the type of exposure and the amount of credit risk that each individual exposure carries.

The required capital for the country risk is calculated using weights ranging from 0% to 300%.

As at December 31, 2019, the Bank allocated the amount of capital to cover the exposure to country risk, since it granted loans to certain legal entities and individuals from the Republic of Turkey, and it had securities in its portfolio issued by the Ministry of Finance of this country.

The required capital for covering the exposure to operational risk is calculated using the simple method, in accordance with the Decision on the capital adequacy of banks.

The basis for calculating the required capital for operational risk is an average of net interest bearing and net non-interest bearing income for the three previous consecutive business years.

The required capital for operational risk is calculated by multiplying the base for calculating the required capital for operational risk with a coefficient of 0.15 and increasing of the result by 25%.

In accordance with the regulations of the Central Bank of Montenegro, the Bank is obliged to maintain a minimum level of capital adequacy, expressed as a solvency ratio of a minimum of 10%. As at December 31, 2019, the solvency ratio of the Bank was 19.85% and it exceeded the limit of 10% determined by the Law on Banks.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

24. EQUITY (Continued)

24.1. Own funds (Continued)

The own funds of the Banks as at December 31, 2019 comprise the following:

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Basic elements of own funds		
Paid-up share capital at nominal value, excluding cumulative preferential shares	18,000	18,000
Reserves that are formed at the expense of profit after taxation (statutory and other reserves)	149	149
Retained earnings from previous years for which the Shareholders' Assembly has made a decision is included in the core capital, decreased for the income tax and other expected expenses	(415)	(415)
Amount to mitigate the negative effects on the Bank's own assets as a result of transition to measurement of assets items under IFRS 9, determined in accordance with paragraphs 5 and 6 of Article 4 of the Capital Adequacy Decision of Banks	353	394
	18,087	18,128
Deduction items in the calculation of core capital		
Losses carried forward	3,735	3,087
Losses from current years		648
Intangible assets	113	318
Unrealized loss on the basis of value adjustments of financial assets available for sale at fair value	84	80
The positive difference between the amount of accrued provisions for potential losses and the sum of value adjustments for balance sheet assets and provisions for off-balance sheet items	863	534
	4,765	4,665
Core capital	13,292	13,463
OWN FUNDS	13,292	13,463

24.2. Bank's solvency ratio

Pursuant to the provisions of the Decision on the capital adequacy of banks ("Official Gazette of Montenegro", No. 38/11 and 55/12) the Bank calculated capital required for the risks it is exposed to in the course of its operations, as well as its solvency ratio.

Solvency ratio must not be lower than 10%.

The solvency ratio represents the percentage ratio of the Bank's own funds and the sum:

- total amount of risk weighted assets for credit risk;
- amount of risk weighted assets for market risks;
- amount of risk weighted assets for operational risk;
- amount of risk weighted assets for other risks.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

24. EQUITY (Continued)

24.2. Bank's solvency ratio (Continued)

As at December 31, 2019, according to the Bank's calculations, the solvency ratio equalled as follows:

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Core capital	13,292	13,463
Weighted balance assets	54,640	34,953
Weighted off-balance sheet items	2,180	5,698
Amount to mitigate the negative effects on the Bank's own assets as a result of transition to measurement of assets items under IFRS 9, determined in accordance with paragraphs 5 and 6 of Article 4 of the Capital Adequacy Decision of Banks (Article 14 of Capital Adequacy Decision)	353	394
Total weighted balance assets	41,045	41,045
Capital required for operational risk	350	217
Capital required for country risk	6,304	4,734
Solvency ratio of the Bank	19.85%	28.08%

25. OFF- BALANCE SHEET ITEMS

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Guarantees:		
Payable guarantees to corporate customers	3,949	7,127
Performance bonds to corporate customers	192	662
	4,141	7,789
Collaterals:		
- cash deposit	578	40
- agreement on cession	1,200	1,200
- insurance policy	6,339	6,691
- other	448	201
- bills of exchange and administrative bans	79,344	61,866
- mortgages	17,650	16,922
- pledge/other	4,512	1,140
- pledge deposit	-	113
- bank guarantee	26,658	16,132
	136,729	104,305
Other off-balance items:	4,648	3,435
- irrevocable liabilities from loans approval	4,648	3,435
Total	145,518	115,529

26. RELATED PARTY TRANSACTIONS

Numerous transactions with related parties arise in the regular course of business. Related parties are: parent bank, other legal entities that are members of ZIRAAT Group, as well as the key management of the Bank.

Transactions include placements, deposits, foreign currency transactions and personal income of members of the Management Board and individuals with concluded individual contracts with the Bank.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

26. RELATED PARTY TRANSACTIONS (Continued)

The overview of receivables and liabilities to related parties as at December 31, 2019 is given in the following table:

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Cash		
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	4,646	731
ZIRAAT BANK INTERNATIONAL AG	8	1
	4,655	732
Loans:		
- to employees	400	295
- overdrafts on bank accounts of employees	2	1
TOTAL RECEIVABLES	5,057	1,028
Borrowings		
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	-	15,902
T.C.ZIRAAT BANKASI LONDON	23,012	8,001
T.C. ZIRAAT BANKASI - BOSNIA	9,402	-
	32,414	23,903
Deposits		
- due to employees	209	114
TOTAL LIABILITIES	32,623	24,017
NET LIABILITIES	(27,566)	(22,989)
Off-balance sheet items		
Received guarantees:		
- TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	26,659	16,131
- Overdrafts on bank accounts of employees	3	3
Total off-balance items	26,662	16,134

Short and long-term loans to Bank's employees were granted for periods from one to twenty years. Short-term loans (cash loans) were granted at annual nominal interest rates ranging from 6.50 % to 6.90%.

Long-term loans to employees include loans for the purchase of housing units with a nominal interest rate of 3.99% to 5%.

Exposure to parties related to the Bank as at December 31, 2019 amounted to EUR 1,922 thousand and did not exceed the limit of 200% of the Bank's own funds.

Income and expenses from transactions with related parties during 2019 and 2018 were as follows:

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Interest income (from employees):	15	15
Total income	15	15
Interest expenses		
ZIRAAT BANK BAHRAIN BRANCH	-	19
T.C. ZIRAAT ATHENS BRANCH	12	-
T.C.ZIRAAT BANKASI LONDON	211	98
T.C. ZIRAAT BANKASI - SOFIA BRANCH	41	27
UT-BANK JS	-	61
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	48	80
ZIRAAT BANK BH	130	25
ZIRAAT INT.KAZAKHSTAN BANK	3	-
Total expenses	445	310
Net expenses	(430)	(295)

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

26. RELATED PARTY TRANSACTIONS (Continued)

In 2019, the calculated personal income for related individuals, by type of income, amounted as follows:

	Management of the Bank	Key Management	Members of the Board	Total
Salaries	159	355		514
Fees for membership in the boards			85	89
Total	159	355	85	599

In 2018, the calculated personal income for related individuals, by type of income, amounted as follows:

	Management of the Bank	Key Management	Members of the Board	Total
Salaries	152	234	-	386
Fees for membership in the boards	-	-	90	90
Total	152	234	90	476

27. CASH AND CASH EQUIVALENTS (for the needs of Statement of Cash Flows preparation)

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Cash in hand and ATMs (Note 12)	921	1,289
Bank account (Note 12)	2,181	1,451
Mandatory reserve with the Central Bank of Montenegro (Note 12)	4,093	3,355
Correspondent accounts with foreign banks (Note 13)	4,655	740
Settlement account - Master Card	-	-
	11,850	6,835

28. LITIGATIONS

As at December 31, 2019, there were neither litigations against the Bank nor the Bank was in the process of litigation against third parties.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

29. COMPLIANCE WITH INDICATORS OF THE CENTRAL BANK OF MONTENEGRO

The Bank is required to conduct its operations in accordance with the provisions of the Law on Banks and by-laws adopted on the basis of this Law.

Compliance with the performance indicators prescribed by the Central Bank of Montenegro as at December 31, 2019 is presented as follows:

	Prescribed limit of CBM	as at December 31, 2019	Achieved performance indicators as at December 31, 2018
Bank solvency coefficient	min 10%	19.85%	28.08%
Bank Exposure to one party or group of related party	max 25%	24.99%	24.85%
Summary of great exposures	max 800%	323.86%	263.79%
Total exposure to parties related to the Bank	max 200%	14.46%	14.17%
Total exposure to persons employed with the Bank	max 1%	0.49%	0.49%
Bank liquidity coefficient	min 1%	2.88%	2.99%

30. TAX RISKS

Montenegrin tax legislation is subject of varying interpretations, and legislative changes occur frequently. The interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Bank may not coincide with the views of the Bank's management.

Consequently, transactions may be challenged by the relevant tax authorities and the Bank could be imposed additional taxes, penalties and interest.

The period of obsolescence of the tax liability is five years. This practically means that the tax authorities are entitled to determine unpaid obligations in the period of five years from origination of the liability.

31. FOREIGN EXCHANGE RATES

The official exchange rates used in the translation of foreign currency balance sheet items in EUR as at December 31, 2019 and 2018 were as follows:

	December 31, 2019	December 31, 2018
USD	1,1189	1,1454
TRY	6,6567	6,0400

32. GENERAL INFORMATION OF THE BANK

In accordance with the Decision on the contents, deadlines and manner of compiling and submitting bank's financial statements ("Official Gazette of Montenegro", No. 15/12 and 18/13), general information of the Bank are presented as follows:

Name of Bank: ZIRAAT BANK MONTENEGRO AD
Address: Ul. Slobode br. 84, 81 000, Podgorica
Corporate ID: 03048136
Phone/Fax: 020/442-200
Number of entry in the register: 4-0009452
Date of Establishment: May 20, 2015
Description of the structure of ownership: one shareholder with 100% ownership

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

32. GENERAL INFORMATION OF THE BANK (Continued)

Description of activity: Other monetary intermediation
 Activity Code: 6419
 Web page address: <http://www.ziraatbank.me/>
 E-mail address: info@ziraatbank.me
 The Bank has its headquarters in Podgorica St. Slobode No. 84
 Number of employees as at December 31, 2019 was 40
 Account number: 575-1-22
 Information about the chairman and members of the Board of Directors:

Title	Name and surname
Chairman	Burcu TURKER
member	Ertan YILMAZ
member	Yasin OZTURK
member	Ertan AYDIN
member	Berrin MAHMUTOGLU
Chief Executive Officer	Mustafa ŞENMAN
Executive Director	Goran BAKIĆ

Share issuance and issuance label:

Issuance label	Nominal value of the shares	Number of shares
MEZIBMRA1PG6	EUR 1,000	18,000

International identification number of ordinary shares (ISIN): MEZIBMRA1PG6.

During 2019, there were no trading in the Bank's shares.

33. SUBSEQUENT EVENTS

On January 21, 2020, the Bank increased the capital by registering 2,500 ordinary shares with CDA of the nominal value of EUR 1 thousand each. Thus, the Bank's share capital increased by EUR 2,500,000.

The rapid spread of COVID-19 virus and its social and economic impact in Montenegro and globally may result in assumptions and estimates that will require modifications and this may result in material adjustments of the book value of assets and liabilities in the forthcoming financial year. At this stage, the management is not able to reliably estimate the impact as the new events are emerging on a daily basis.

In addition to mentioned, the Central Bank of Montenegro on the Council meeting held on March, 17, 2020 adopted the Decision on temporary measures for the mitigation of negative impact of new Corona virus on the financial system ("Official Gazette of Montenegro", No. 019/20, March, 19, 2020), ("Decision") which prescribes that beneficiaries (legal entities, fiscal entities, entrepreneurs and other clients) of the loans approved by Bank have the right on the moratorium on repayment for the period of 90 days. The Management of the Bank is not in the position to evaluate possible effects of the mentioned decision on the financial statements.

The moratorium is prescribed for all debtors that are interested (corporate customers, individuals, entrepreneurs and other clients).

The Management of the Bank is not in the position to evaluate possible effects of the mentioned decision on the financial statements for the current year.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2019

33. SUBSEQUENT EVENTS (continued)

In the long-run term, the consequences could have an impact on the volume of placements, cash-flows and profitability. Beside mentioned, on the reporting date of this financial statement Ziraat Bank Montenegro continues to meet its obligations within the due date and therefore continues to apply going concern principle as the accounting basis for the preparation of financial statements.

The long-term forecasts show that the consequences may affect the trade volume, cash flows and profitability. Notwithstanding the above, as at the date of issuance of these financial statements, Ziraat Bank Montenegro continues to settle its liabilities in due time, and, therefore, continues to apply the going concern principle as the accounting basis of financial statements preparation.

Except for the above mentioned, there were no other subsequent events that could have an impact on adjustments and/or disclosures in the financial statements for 2019.

In Podgorica, March 26, 2020

Signed on behalf of Ziraat Bank Montenegro AD by:

Mustafa Šenman
Chief Executive Officer

Goran Bakić
Executive Director

Jelena Božović
Head of Accounting, Reporting and
Budgeting Department



ANNUAL MANAGEMENT REPORT FOR 2019

Podgorica, March 2020

This Report is translation of the Annual Management Report issued in the language officially used in Montenegro. In the case of any discrepancy between the version in language officially used in Montenegro and English version, the version in the language officially used in Montenegro shall prevail.

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1. BRIEF DESCRIPTION OF BUSINESS ACTIVITIES AND ORGANIZATIONAL STRUCTURE

1.1. General information

Ziraat Bank Montenegro AD, Podgorica (hereinafter: the "Bank") was granted the authorization to conduct banking activities in Montenegro, issued by the Central Bank of Montenegro, in accordance with the provisions of the Law on Banks, as at April 6, 2015.

The Bank is officially registered in the Central Registry of Business Entities in a legal form of the company - a shareholding company, all in accordance with the provisions of the Companies Law, as at May 20, 2015.

The provisions of the Law on Banks, *lex specialis*, are applied to the Bank's operations, jointly with the relevant by-laws, as well as the Companies Law, *lex generalis*, where the Bank is legally recognized as a shareholding company.

The material assumptions for start of operations of the Bank were fulfilled on July 1, 2015, when the employees of the Bank started using the business premises of the Bank's administrative building. On the same date, all necessary equipment of the Bank was installed and put into operation.

The Bank has opened its first branch office of a universal type that provides services to clients, both individuals and legal entities. The branch was formally registered in the Central Registry of Business Entities as at July 20, 2015. The address of the branch is Bulevar Ivana Crnojevića No. 101, 81000 Podgorica. In December 2018, the Bank opened two universal-type branch offices, one in Bar, at: Bulevar Revolucije B-11 and the other in Budva, at: Ulica mediteranska bb. The branch offices were registered with the Central Registry of Business Enterprises on December 24, 2018.

In the process of developing internal rules and procedures, the Bank has prepared a catalogue of products intended for corporate and retail clients.

The Bank started with loan activities in September 2015.

1.2. Vision

The Bank's vision is to offer products and services in accordance with universal standards, create a difference, add value and cover Montenegro as a whole, be a prestigious and reliable financial institution with high market value, offer quality that will make it more than a bank in every section of the banking and clients' business operations.

1.3. Mission

The mission of the Bank is to be a financial institution that offers optimal solutions from the most adequate sources, which are the result of a better understanding of the needs and expectations of its clients, in order to perform a complete offer of products and services for clients in the fastest and most efficient way through its affiliates and alternative distribution channels at the level of the world standards of sustainable profitability and productivity by emphasizing the ethical principles, treating customer satisfaction as a primary objective, as a respectable member of the Ziraat financial group and the Montenegrin banking sector, contributing to the strengthening of bilateral, economic and trade relations between the two countries and to be a pioneer of mutual investments.

1.4. Business strategy

The Bank's business strategy is to be part of a broad international network, to extend the services of the Ziraat financial group throughout Europe, convey the multi-year know-how of the parent bank in the economy and the banking sector in Montenegro, contribute to economic and financial cooperation between Montenegro and the Republic of Turkey through building stable and long-term business relations with local institutions and businessmen, to support trade and investment opportunities between the two countries and contribute to development of the banking sector in Montenegro, as well as of the synergies in the Ziraat financial group.

1.5. Bank's Values

- Create added value for our clients;
- Be fair and reliable;
- Respect cultural and social values;
- Work as a team with joint values;
- Be open and participative, as well as to
- Have an ambition for success.

1.6. Information on the registration, the areas of business operations to which the business license obtained from the CBM relates

The Bank was established in 2015, and as at May 20, 2015, it was registered as a shareholding company with the Central Registry of Business Entities in Podgorica - registration number 4-0009452.

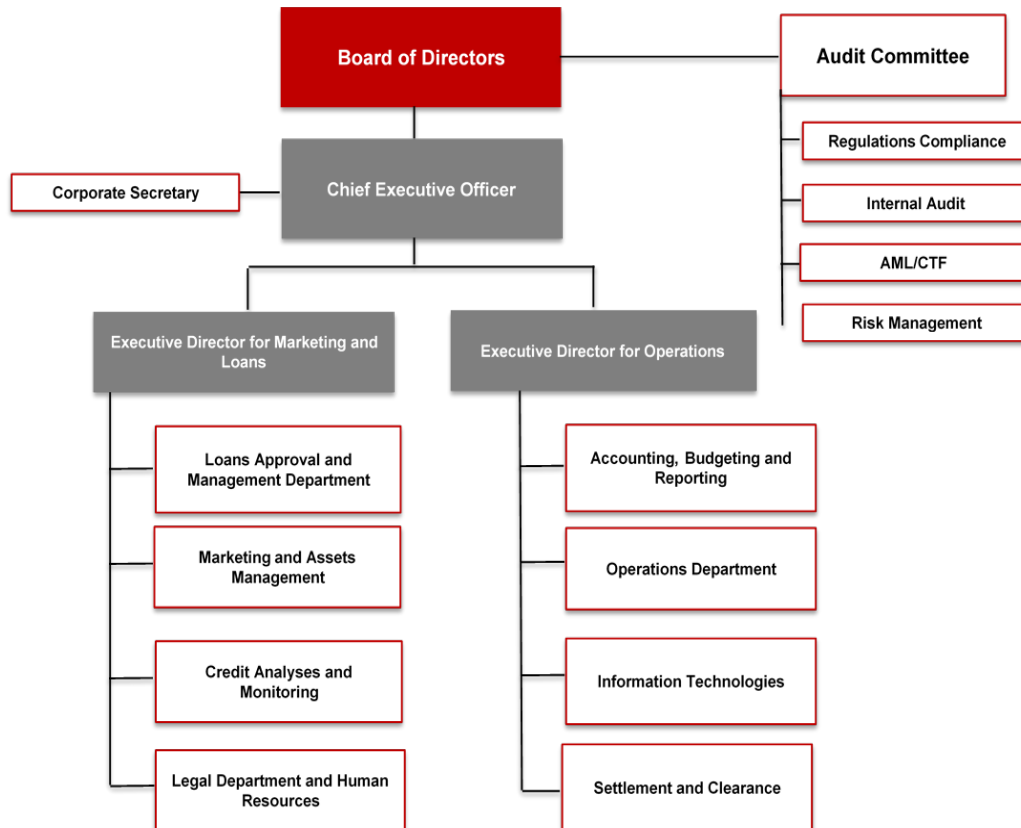
The Bank is registered with the Securities Commission in the Register of Securities Issues under the number 02/10e-5/2-15 as at May 8, 2015 (Decision No. 02/10e-5/2-15).

The Bank performs its financial operations through the transaction account number 907-0000000057501-83 held with the Central Bank of Montenegro - Payment Transactions.

1.7. Organizational structure

As at December 31, 2019, the Bank had 40 employees, out of which 36 employees worked on the basis of a labour contract with an indefinite period of time agreed, while 4 employees had a labour contract with an definite period of time agreed on.

The organizational structure of the bank is presented in the following scheme:



1.8. Activity

In accordance with the Law on Banks, the Founding Contract, the Statute and the Decision of the Central Bank of Montenegro, the Bank was register to perform the following activities:

- 1) Issuing guarantees and undertaking other off-balance sheet obligations;
- 2) Purchasing, selling and collecting receivables (factoring, forfaiting and other);
- 3) Issuing, processing and recording payment instruments;
- 4) Performing domestic and foreign payment transactions;
- 5) Performing finance lease operations;
- 6) Performing securities operations;
- 7) Trading in its own name and for its own account or for the account of its customer:
 - In foreign payment instruments, including money exchange
 - Financial derivative transactions;
- 8) Providing depot services;
- 9) Performing analysis and providing information and advices on the creditworthiness of companies, entrepreneurs and other issues relating to business operations and
- 10) Renting of safes.

The Bank is headquartered in Podgorica at St. Slobode No. 84 and performs its activities through its branch offices in Bulevar Ivana Crnojevića No. 101, Podgorica, in Bulevar revolucije B-11 in Bar and in Ulica Mediteranska bb in Budva.

1.9. Ownership and capital structure

As at December 31, 2019, the Bank's share capital comprised 18,000 ordinary shares (December 31, 2018: 18,000 ordinary shares) with a nominal value of EUR 1,000 each. All issued shares are fully paid.

As at December 31, 2019, the total inscribed capital amounted to 18,000,000 EUR.

As at December 31, 2019, the 100% shareholder of the Bank was TURKIYE CUMHURIYETI "ZIRAAT BANKASI ANONIM SIRKETI".

On January 21, 2020, the Bank increased the capital by registering 2,500 ordinary shares with CDA at the nominal value of EUR 1 thousand each. Thus, the Bank's share capital increased by EUR 2,500,000.

1.10. Workforce Capacities

As at December 31, 2019, the Bank had 40 employees, out of which 36 employees worked on the basis of a labour contract with an indefinite period of time agreed, while 4 employees had a labour contract with a definite period of time agreed on.

Out of 40 employees, 35 employees have university degrees of education, while 5 employees have secondary education degree.

Out of the total number of employees in the Bank, 22 employees i.e. 55% are men while 18 employees i.e. 45% are women.

The Branch Office in Podgorica has 6 employees, Branch Office in Bar has 3 employees, Branch Office in Budva has 3 employees while 28 employees are employed in the headquarters.

2. ANALYSIS OF FINANCIAL POSITION AND RESULTS FROM OPERATIONS
BALANCE SHEET
In thousand of EUR

ASSETS	2018	2019
Cash and deposits held with central banks	6,091	7,189
Financial assets at amortized cost	58,323	73,840
Loans and receivables due from banks	739	4,649
Loans and receivables due from customers	54,251	65,835
Securities	3,322	3,340
Other financial assets	11	16
Financial assets at fair value through other comprehensive income	1,112	1,109
Properties, plant and equipment	404	347
Intangible assets	318	113
Other assets	24	440
Deferred tax assets	-	13
TOTAL ASSETS	66,272	83,051
LIABILITIES	2018	2019
Financial assets at amortized cost	52,077	66,054
Deposits of banks and central banks	21	2
Deposits of clients	23,150	28,636
Loans of banks and central banks	28,906	37,416
Reserves	134	93
Deferred tax payables	4	-
Other liabilities	137	2,695
TOTAL LIABILITIES	52,352	68,842
EQUITY		
Share capital	18,000	18,000
Accumulated Losses	(3,502)	(4,150)
Gain/Loss of the current year	(648)	294
Other reserves	70	65
TOTAL EQUITY	13,920	14,209
TOTAL LIABILITIES AND EQUITY	66,272	83,051
OFF-BALANCE SHEET ITEMS		
	115,529	145,518

INCOME STATEMENT
In thousand of EUR

ITEM	2018	2019
Interest income and similar income	2,118	3,337
Interest expenses and similar expenses	(512)	(827)
Net interest income	1,606	2,510
Fee and commission income	224	653
Fee and commission expense	(228)	(252)
Net fee and commission income	(4)	401
Net gains on foreign currency exchange	8	14
Other income	19	6
Staff costs	(991)	(1,196)
Depreciation expenses	(421)	(391)
General and administration expenses	(692)	(811)
Net income/(expense) of impairment of financial instruments not measured at fair value through profit and loss	(146)	177
Provision expenses	0	(9)
Other expenses	(42)	(69)
LOSS BEFORE TAXATION	(663)	278
Income tax	(15)	(16)
LOSS	(648)	294

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2.1. Ratio Indicators

Ratio analysis is the basic instrument for estimating the financial position and potential of the Bank. Linking the logically associated wholes of the financial statements (Balance Sheet and Income Statement) results in the established relations aiming at assessing the position and activities of the Bank.

Return indicators

In thousand of EUR

ROE (Return on Equity)	2018	2019
Net gain/loss after taxation	(648)	294
Share capital	18,000	18,000
Net loss after taxation / Share capital	(3.60)%	1.63%

ROA (Return on assets)	2018	2019
Net gain/loss after taxation	(648)	294
Total assets	66,272	83,051
Net loss after taxation / Total assets	(0.98)%	0.35%

Interest margin	2018	2019
Interest income	2,118	3,337
Interest expenses	512	827
Total assets	66,272	83,051
(Interest income – Interest expenses) / Total assets	2.42%	3.02%

Financial position indicators

In thousand of EUR

S1	2018	2019
Share capital	18,000	18,000
Total assets	66,272	83,051
Share capital / Total assets	27.16%	21.67%

S2	2018	2019
Total liabilities	52,352	68,842
Total assets	66,272	83,051
Total liabilities / Total assets	79.00%	82.89%

S3	2018	2019
Profit from operations (interest +fee)	2,342	3,990
Loss from operations (interest +fee)	740	1,079
Profit from operations / Loss from operations	316.49%	369.79%

2.1. Ratio Indicators (Continued)

The most important financial indicators of the Bank's operations for the last 2 years are presented in the following table.

In thousand of EUR

Description	12/31/2018	12/31/2019	Banking sector as at 12/31/2019
Liquid assets (LA)	6,091	7,189	
Total loans	54,251	65,835	
Total assets (TA)	66,272	83,051	
Total equity and liabilities (TEL)	66,272	83,051	
Total deposits	23,150	28,636	
Demand deposits	5,705	10,867	
Total borrowings	28,906	37,416	
Total deposits + borrowings	52,056	66,052	
Total liabilities	52,352	68,842	
Fixed assets	722	460	
Total equity	13,920	14,209	

Liquidity indicators			
Liquid assets/deposits	26.31%	25.10%	
Liquid assets /total liabilities	11.63%	10.44%	
Loans/deposits	234.35%	229.90%	
Loans/deposits + borrowings	104.22%	99.67%	
Structure of assets and equity and liabilities:			
Liquid assets / total assets	9.19%	8.66%	
Loans/ total assets	81.86%	79.27%	
Fixed assets/ total assets	1.09%	0.55%	
Equity/ total assets	21.00%	17.11%	
Structure of equity and liabilities:			
Deposits/total equity and liabilities	34.93%	34.48%	
Borrowings/ total equity and liabilities	43.62%	45.05%	
Deposits+ borrowings/ total equity and liabilities	78.55%	79.53%	

At the end of 2019, the loans/deposits ratio amounted to 229.90%, which represents a decrease by 4.45% when compared to 2018. The reason for such a decrease is the increase in deposit activity.

The liquid assets/total assets ratio as at December 31, 2019 was 8.66%. This ratio registered a decrease by 0.56% when compared to 2018.

Share capital/total assets ratio as at December 31, 2019 registered a decrease by od 3.89 % when compared to December 31, 2018.

The Bank is well capitalized and the Bank's solvency ratio is 19.85% and is higher than 10%, that is the minimum prescribed by the Law on Banks.

2.2 Data on corporate governance bodies

Rules of appointment and dismissal of members of the Management

Appointment of the members of the Board of Directors

The Board of Directors members are appointed and dismissed by the Shareholders Assembly in accordance with the provisions of the Companies Law and the Law on Banks.

It is particularly important to point out that a requirement for appointing members of the Board of Directors is a necessary prior approval from the Central Bank of Montenegro. Such an approval by the Central Bank is a condition for the registration of members of the Board of Directors in the CRBE.

Before a member of the Board of Directors is appointed, the Central Bank checks the fulfilment of negative/eliminary criteria. In that sense, a member of the Board of Directors can not be a person:

1. who is controlling or is a member of the board of directors or the executive director of another bank or financial institution, of a legal entity controlled by another bank or financial institution or financial holding;
2. who is related to a legal entity:
 - a. in which another bank has a qualified stake,
 - b. which is a subordinate member of the banking group to which such a bank belongs;
 - c. which worked for the Central Bank in the past 12 months in the affairs in which it had access to information about the operations of banks that are considered classified, the knowledge of which could lead to a competitive advantage over other banks;
3. who has been, in the last 12 months, a director or member of the Management Board of the Deposit Protection Fund;
4. whose property has undergone bankruptcy, i.e. enforcement carried out on a significant scale;
5. who has been engaged on managerial activities in a bank or other legal entity at the time when the bankruptcy proceeding or liquidation proceedings were initialized against that legal entity, unless the Central Bank assesses that there is no liability of that person for bankruptcy or liquidation thereof;
6. who has been a member of the board of directors or a manager of a bank at a time when a temporary administration was introduced in that bank;
7. to whom, pursuant to a decision of the competent court, was pronounced a protective measure of prohibition of performing a title, activity or duty;
8. who has been convicted of an offense that makes him unworthy of exercising the function of a member of the Board of Directors;
9. to whom the bank has a total exposure of more than 2% of the amount of own funds, or it is the owner, member of the board of directors or executive director of a company to which the bank has great exposure.

The Central Bank shall revoke the authorization if it is issued on the basis of untrue data or if there are the obstacles to a selection in the sense of the aforementioned restrictions prescribed by the Law on Banks.

The approval of the Central Bank of Montenegro shall cease to be valid:

1. if the person the approval for appointment of whom has been issued has not been appointed or does not begin to perform his duties within six months from the issuance date of approval;
2. on the day of termination of the member of the Board of Directors function.

The approval of the Central Bank shall not cease to apply in case of reappointment of a member of the Board of Directors for the duration of the mandate.

Appointment of members of the Audit Committee

Regarding the members of the Audit Committee, they are appointed and dismissed by the Board of Directors of the Bank. For the appointment of members of the Audit Committee, the Law on Banks does not prescribe necessary prior approval by the Central Bank of Montenegro, as is the case with the appointment of the members of the Board of Directors.

In accordance with Article 33 of the Law on Banks, the Executive Directors of the Bank are appointed by the Board of Directors. Candidates for Executive Directors must first obtain approval from the Central Bank of Montenegro, which is a necessary condition for their appointment.

In terms of the provisions of the Law on Banks, the Bank must have at least two executive directors, one of which is the chief executive officer.

Only the person with a university education, recognized personal reputation and adequate professional qualifications, professional ability and experience in managerial affairs in the bank or in the financial sector may be appointed for a position of the executive director of the Bank, if for his appointment there are no obstacles referred to in Article 31 of the Law on Banks.

2.2. Data on corporate governance bodies (Continued)

Appointment of Executive Directors

Executive directors may be foreign nationals, with at least one executive director having to know the language that is in official use in Montenegro.

Executive directors are full-time employees at the bank.

When deciding on the issuance of an approval for the executive director, the Central Bank may request from the candidate for the executive director position a presentation on the conduct of the Bank's affairs.

The approval of the Central Bank for appointment of the Executive Director is a condition for registration in the CBM.

The Central Bank shall dismiss the approval if it is issued on the basis of untrue data or if the executive director ceases to fulfil the conditions on the basis of which the approval was issued.

Approval ceases to be valid:

1. if the person for the appointment of whom the approval has been issued is not appointed or does not begin to perform duties within 30 days from the issuance date of the approval;
2. on the day of termination of the executive director title;
3. on the expiration date of the labour contract with the bank.

Appointment of members of other bodies

In addition to the Audit Committee, the Board of Directors has appointed, in accordance with the Law on Banks and the other bodies such as: the ALCO, the Senior Credit Committee and the Credit Committee.

The members of these bodies are appointed and dismissed by the Board of Directors at regular sessions. The appointment or dismissal of the members of the ALCO, the Senior Credit Committee and the Credit Committee does not require the prior approval of the Central Bank of Montenegro in terms of the provisions of the Law on Banks.

Scope of work and competences of the Board of Directors

In accordance with the provisions of the Law on Banks, the Statute of the Bank and the Corporate Governance Code, the Board of Directors is responsible for the following scope of works:

1. Establishes and maintains a risk management system that the bank is exposed to in its business operations;
2. Determines the goals and strategies of the bank and ensures their implementation;
3. Establishes policies and procedures for managing all the risks that the bank is exposed to in its operations;
4. Determines the annual plan of the bank, including the financial plan;
5. Approves the annual report on business operations of the bank with the report of external auditor and reports on the bank's operations during the year;
6. Approves transactions that significantly affect the structure of the balance sheet and the riskiness of the bank's operations, in accordance with the policies and procedures for risk management;
7. Periodically reviews and evaluates the exceptions made in relation to the established policies and procedures;
8. Adopts the annual internal audit plan and the internal audit reports;
9. Establishes the basis for the internal control system functioning, adequate to the size of the bank, the complexity of the operations and the level of risk assumed;
10. Reviews the reports of the Central Bank prepared upon the performed control;
11. Appoints executive directors and other persons responsible for conducting business within certain areas of the bank's business and determines their earnings;
12. Appoints an external auditor of a bank;
13. Appoints members of the Audit Committee;
14. Reviews the annual report on the work of the audit committee;
15. Determines the proposals for decisions made by the General Shareholders Assembly and takes care of the implementation of decisions of the General Shareholders Assembly;
16. Adopts general acts of the bank, except for the acts adopted by the Shareholders Assembly;
17. Adopts ethical standards of conduct of employees in the bank;
18. Approves the introduction of new products and services into the bank's operations;
19. Calls for the General Shareholders Assembly;
20. Performs other activities determined by the law and the Statute of the Bank.

2.2. Data on corporate governance bodies (Continued)

In terms of the provisions of the Law on banks, the responsibility of the Board of Directors is specifically defined for:

1. Establishing the system of managing all the risks that the bank is exposed to in its operations;
2. Provision of bank operations in accordance with the law, regulations of the Central Bank and acts of the bank, as well as for the implementation of the imposed measures of the Central Bank;
3. Business safety and financial stability of the bank;
4. Accuracy of all reports on the operations of banks that are published or submitted to the General Shareholders Assembly, the Central Bank and the competent authorities.

Scope of work and responsibilities of the Audit Committee

The Audit Committee consists of at least three members, most of which are not related to the bank, but have experience in financial affairs.

The executive directors of the bank can not be appointed for a member of the audit committee.

The Audit Committee is responsible to:

- 1) analyze and monitor the functioning of the risk management system that the bank is exposed to in its business operations and provide suggestions for the improvement of strategies, policies and procedures for risk management;
- 2) analyze and monitor the functioning of the internal control system;
- 3) consider the program and reports of internal audit and give an opinion on the findings of the internal audit;
- 4) monitor the implementation of internal audit recommendations;
- 5) analyze the financial statements of the bank prior to their submission to the Board of Directors;
- 6) evaluate the quality of reports and information prior to their submission to the Board of Directors, and in particular:
 - application of accounting policies and procedures,
 - decisions requiring a high degree of assessment
 - effect of unusual transactions on the financial statements,
 - quality of data integration policies,
 - changes arising as a result of performed audits ,
 - assumptions about the sustainability of operations ,
 - compliance with International Financial Reporting Standards and Regulations;
- 7) give opinion on the appointment of the external auditor of the bank and proposes the amount of the fee for conducting the audit.

The Audit Committee prepares proposals, opinions and standpoints from the scope of work for the decision of the Board of Directors on these issues.

The Audit Committee submits annual reports on its work to the Board of Directors.

2.2. Data on corporate governance bodies (Continued)

Scope of work and competences of Credit Committees

The Board of Directors, pursuant to its legal competencies, has appointed the Senior Credit Committee and the Credit Committee responsible for making decisions on the approval of loans to legal entities and individuals, all in accordance with the Decision on approval limits adopted by the Board of Directors at a regular meeting held on September 11, 2015, under serial number 65.

Members of the Senior Credit Committee and the Credit Committee shall be appointed and dismissed by the Board of Directors.

The data on the Chairman and members of the Board of Directors, the Audit Committee, the Credit Committee and the Senior Credit Committee of the Bank are as follows:

Board of Directors	Name and Surname
Chairman	Ms Burcu TURKER
member	Mr Ertan YILMAZ
member	Ms Yasin OZTURK
member	Mr Ertan AYDIN
member	Ms Berrin MAHMUTOGLU

Audit Committee	Name and Surname
Chairman	Mr Sinan SAHIN, PhD
member	Mr Erhan GÜLER
member	Mr Cüneyt SAĞLIK

Management	Name and Surname
Chief Executive Officer	Mr Mustafa ŞENMAN
Executive Director	Mr Goran BAKIĆ

Credit Committee	Name and Surname
Chairman	Mr Mustafa ŞENMAN
member	Mr Goran BAKIĆ
member	Ms Sevgi KÜÇÜK

Senior Credit Committee	Name and Surname
Chairman	Ms Burcu TURKER
member	Mr Mustafa ŞENMAN
member	Mr Goran BAKIĆ
member	Ms Sevgi KÜÇÜK

3. MEASURES OF ENVIRONMENTAL PROTECTION

All activities of the Bank can be considered as environment friendly. The Bank complies with all the rules, procedures and best practices of the local community in the mentioned context.

Waste Management

In its business operations, the Bank uses mostly paper as a consumable. Annual consumption is estimated at 540 packs of paper of A4/80g/m² format, which is about 270,000 sheets. The greatest part is archived or delivered to clients, while the estimated annual amount of paper waste is up to 7% or 18,900 sheets of paper. Given that the stated amount is significantly below 20t of waste, the Bank is not obliged to prepare a Waste Management Plan.

By introducing the Document Management System (DMS) in later years of business operations, paper consumption will be significantly additionally reduced.

Water Management

The bank is considered a modest consumer of water that amounts to less than 1,200 cubic meters per annum.

Energy Management

In its business operations, the Bank mostly uses electricity that is considered as an ecological energy source. There is also a constant effort to optimize electricity to meet basic needs.

In accordance with the criteria defined by Law, the Bank is not recognized as a pollutant and, on that basis, does not pay any fines or penalties. Also, in the foreseeable future, it does not plan any project that could have a negative impact on the environment.

In accordance with the Law on Environmental Impact Assessment, if we consider that a particular project or business activity that we plan can or will have an impact on the environment, we will seek the approval of the competent authority on the impact assessment study or a decision that an environment impact assessment is not required.

4. PLANNED FUTURE DEVELOPMENT

In 2020 and the forthcoming period, the Bank will continue to increase the credit and deposit bases as well as through further optimization and diversification, while maintaining a high level of liquidity and solvency as well as improved key business indicators.

One of the main intentions of the bank is to efficiently use newly opened branches in Bar and Budva with the aim of increasing its portfolio with the clients from neighboring towns and municipalities.

The Bank will analyze the market conditions in order to further expand its business network and increase the clients base.

Ziraat Bank Montenegro operates as a part of the Ziraat Finance Group and the Bank's strategy in 2019 will be further strengthening the synergy achieved through close cooperation with the parent bank and other members of the Ziraat Finance Group in the field of asset and liability management, coordination in the field of liquidity improvement, new technologies.

The Bank's orientation is to continue with the introduction of new products and services based on state-of-the-art technologies, in line with the latest market trends and customer needs.

The Bank has already established and will continue to maintain a comprehensive and stable risk management system that is integrated in all the Bank's business activities.

5. DATA ON RESEARCH AND DEVELOPMENT ACTIVITIES

5.1. Research and Development

Introduction and efficient use of new technologies

At the stage of its establishment in 2015, the Bank introduced carefully designed state-of-the-art technologies that are applied in banking operations. First of all, that refers to hardware, software, and communication technologies.

Equipment modernization

Although it is a continuous process, at the time of preparation of this report, the Bank has adequate modern equipment that does not require further significant investment placements.

Automation of business performance

Automation of business performance is a development process that is continuously taking place in the bank considering the dynamic development of ICT, market demands, and the effect of competition.

Scientific-research, development and technological studies

The Bank did not have any activities in the given context so far.

5.2. Investing in Staff Improvement

The Bank takes into account the professional improvement of employees. In the organizational structure of the Bank, there is one Authorized Accountant and one Certified Accountant holding the External Auditor License issued by the Ministry of Finance of Montenegro. The internal auditor is holding the certificate of the Authorized Internal Auditor Specialist for banking and corporate sector.

The employees with these certificates regularly acquire continuous education organized by the Institute of Certified Accountants and the Institute of Internal Auditors.

Continuous education is carried out by monitoring professional literature, seminars, counselling and symposia.

As at December 31, 2019, the Bank allocated EUR 2,518 for the education of its employees in the country.

In the prior year, in cooperation with the Parent Bank, trainings and education for employees were organized in order to improve the business processes in the Bank.

6. INFORMATION ON REDEMPTION OF OWN SHARES, I.E. STAKES

As at December 31, 2019, the 100% shareholder of the Bank was TURKIYE CUMHURİYETİ ZIRAAT BANKASI ANONİM ŞİRKETİ. The share capital of the Bank comprises 18,000 ordinary shares with nominal value of EUR 1,000 each. All issued shares have been fully paid.

As at December 31, 2019, the Bank did not redeem its shares/stakes in 2019.

7. BUSINESS UNITS

Immediately after the start of its operations in 2015, the Bank opened its first branch of universal type that provides services to clients, individuals and legal entities. The branch was formally registered in the Central Registry of Business Entities, as at July 20, 2015. The address of the branch is Bulevar Ivana Crnojevića No. 101, 81 000 Podgorica. During December 2018, the Bank opened two additional universal type branches in Bar at Bulevar revolucije B-11, and in Budva at Ulica mediteranska bb. Branches were registered with the Central Register of Business Entities on December 24, 2018.

Currently there are 12 employees in the branches, including Branch Managers.

8. DATA ON FINANCIAL INSTRUMENTS OF IMPORTANCE FOR THE ASSESSMENT OF FINANCIAL POSITION AND OPERATIONS PERFORMANCE

As at December 31, 2019, the Bank obtained a gain in the amount of EUR 294 thousand. As at December 31, 2019, the total own funds amounted to EUR 13,292 thousand, which represented a decrease by 1,29% in relation to own funds as at December 31, 2018 when those amounted to EUR 13,463 thousand.

This decrease is mostly a result of the Bank's capital increase that occurred in 2019.

Compared to December 31, 2018, as a result of increased loan activity, total loans increased by 21.35%. As at December 31, 2019, total loans amounted to EUR 65,835 thousand, while as at December 31, 2018, total loans amounted to EUR 54,251 thousand.

As at December 31, 2019, total assets amounted to EUR 83,038 thousand, which is an increase of 25.30% compared to 2018, when it amounted to EUR 66,272 thousand. This is a consequence of the increased credit activity in 2019.

As at December 31, 2019, the total liabilities of the Bank amounted to EUR 68,829 thousand, which is an increase of 31.47% compared to December 31, 2018 when those amounted to EUR 52,352 thousand.

As at December 31, 2019, the total amount of clients' deposits amounted to EUR 28,636 thousand, which is an increase by 23.70% if compared to December 31, 2018, when those amounted to EUR 23,150 thousand.

The total deposits of clients make 34.49% of the total assets of the Bank.

As at December 31, 2019, the borrowings due to banks amounted to EUR 37,416, which represented an increase by 29.44% if compared to December 31, 2018, when it amounted to EUR 28,906 thousand.

Borrowed funds by the members of the Ziraat Group amounted to EUR 32,400 thousand and made 86.63% of the total borrowed funds, while 13.37% of the borrowed funds represent a loan received by Hipotekarna banka in the amount of EUR 5,000 thousand.

All funds borrowed made 45.06% of the Bank's total assets.

As a member of the Ziraat Group, the Bank has access to the interbank (intergroup) money market, in which in a very short period of time it can provide liquid cash in the form of a loan from a parent bank or another member bank of the Ziraat Group.

On the basis of the above positions, we can conclude that the Bank has provided the necessary diversification of the sources of financing.

9. OBJECTIVES AND METHODS FOR FINANCIAL RISK MANAGEMENT

9.1. Strategies and policies for managing all types of risks

The risk management system implies an appropriate Risk Management Strategy, as a general act that represents the starting point for the implementation of policies and procedures for managing individual types of risks. The risk management system is established in a way that corresponds to the size of the Bank, the complexity of products and services in the business as well as the level of risk assumed.

The risk management strategy is adopted, according to the legal provisions, for a time period not shorter than three years. The Bank periodically, and at least once a year, reassesses the adequacy of the risk management strategy.

The Bank, in accordance with the law, regulations of the Central Bank and good practices for risk management in banks, continuously manages all the risks to which it is exposed in its operations. In this regard, the Bank has prepared a Risk Management Strategy.

In accordance with the regulations, the Bank seeks to establish a risk management system, which provides:

- identification of risks arising from existing ones, as well as risks that may arise from new business products or activities;
- measuring risk by establishing mechanisms and procedures for accurate and timely risk assessment;
- monitoring and analyzing risks and
- controlling risk by limiting and minimizing risks.

9.1. Strategies and policies for managing all types of risks (Continued)

In accordance with the Risk Management Strategy, the Bank has adopted several internal acts: policies, procedures, decisions, instructions, etc. (see chapter 9.4).

The Board of Directors of the Bank, which through the Executive Directors of the Bank seeks to manage all types of risks with emphasis on credit, operational and market risks, is responsible for reporting and monitoring of risks.

9.2. Structure and organization of risk management functions

In accordance with the Law, **the Board of Directors** is responsible for establishing a system of managing all the risks that the Bank is exposed to in its operations and defining policies and procedures for managing all risks. For that purpose, the Board of Directors has established permanent working bodies for monitoring of risk management in certain areas of the Bank's operations. The responsibility of the Board of Directors is to establish, through the adoption of the strategy, policies, procedures and other documents from the domain of risk management, an adequate ratio of yield and risks that will enable the effective realization of the objectives of the Bank's shareholder. The Board of Directors monitors the efficiency and adequacy of the risk management system in the context of legal obligations, but also the interests of shareholder.

The Audit Committee prepares proposals, opinions and standpoints from the scope of work for the decision of the Board of Directors on these issues. The basic duties and responsibilities of the Audit Committee are to analyze the financial statements of the Bank, to review the programs and reports of internal audit and to give opinions on the findings of the internal audit, to monitor and analyze the compliance of the Bank's operations with the law and regulations, to give an opinion on the selection of the external auditor of the Bank and to propose the amount of fee for auditing, etc. The Audit Committee analyzes and monitors the functioning of the risk management system that the Bank is exposed to in its operations and proposes improvements to strategies, policies and procedures for risk management.

At least once a year, the Audit Committee submits to the Board of Directors information and data on the functioning of the risk management system through its annual work report, points to weaknesses and makes suggestions for improvement and upgrading of this system.

The Assets and Liabilities Management Committee (ALCO) reviews the monthly risk reports of the Risk Management Department, upon which examines the current risk profile of the Bank and sets it in the context of the relationship between assets and liabilities necessary for achieving the strategic objectives of the Bank. The ALCO has competencies and responsibilities for managing the market risk, liquidity risk and other risks that the Bank is exposed to in its operations, managing the Bank's capital, managing the price policy and prescribing the value of internal indicators, as well as the limits of allowed deviations from the indicators on the basis of which the balance sheet structure of the Bank is monitored.

The Credit Committee is in charge of defining the Bank's exposure policy and for evaluating, but also for rejecting all credit exposures that are not in line with that policy. The Credit Committee makes a decision on the approval of the placements to the level when the individual placement represents 10% of the Bank's own funds (large exposures). The decision to approve large exposures can be made exclusively by the Board of Directors of the Bank.

In its organizational structure, the Bank has an independent organizational unit that is fully committed to identifying, measuring and monitoring of all risks the Bank is exposed to - the Risk Management Department. This approach provides for the separation of the management function, i.e. the monitoring of the risk of a business function in the bank, which is necessary due to the achievement of the necessary objectivity in making decisions.

The Risk Management Department is responsible for regular monitoring and analyzing of the quality of the entire loan portfolio and, accordingly, proposes the formation of an appropriate amount of value adjustments and provisions for potential loan losses.

In terms of market and liquidity risk and securities portfolio risk monitoring, the Risk Management Department, in accordance with the adopted policies and in cooperation with the business part, sets the limits for certain types of risk, adopted by the Board of Directors. The Risk Management Department monitors exposure to a particular type of risk and determines whether this exposure is within the defined limits and reports it to the ALCO Committee and the Board of Directors.

The organizational part of the risk management is also responsible for the reporting system, both to external users (Central Bank of Montenegro, external auditor, creditors) and to internal users (ALCO, Executive Management, Audit Committee, Board of Directors).

9.3. The scope and nature of the risk reporting system and the risk measurement system

The Risk Management Department analyzes and assesses the underlying risk categories:

- Credit risk;
- Market risk;
- Liquidity risk;
- Country risk;
- Operational risk and
- other risks (reputation, compliance risk etc.).

In the case of credit risk, the Risk Management Department and the Credit Management Department:

- carry out a control analysis of loan proposals, determine the quality of the arrangement, classify individual placement/client and determine the level of provisions;
- continuously analyze the structure and quality of the entire loan portfolio, which includes risk concentration analysis, assessment of future trends in the structure and quality of the loan portfolio, stress testing of credit risk, etc.;
- within the scope of their responsibilities that involve the provision of a stable portfolio of risky placements, determine, propose and/or revise the limits, that is, the maximum level of exposure in relation to individual clients, activities and geographical areas, etc.;
- monitor the exposure concentration, keep a record of exposure to individuals, groups of related parties and persons associated with the Bank, certain industrial and economic sectors, geographical regions, as well as other groups of loans and other exposures that have similar risk characteristics and control whether the Bank operates in accordance with established exposure limits;
- take special care of placements classified into substandard, non-performing assets and/or loss and report monthly to ALCO and the Board of Directors;
- submit to the ALCO and the Board of Directors at the monthly level a comprehensive risk report to which the Bank is exposed in order to provide recommendations for risk management of the Bank, in which the Bank's credit risk is elaborated;
- prepare individual reports within the competence of the Sector prescribed by CBM decisions that are submitted to CBM at the monthly and quarterly level and
- perform other activities related to monitoring, managing and reporting on credit risk.

The Risk Management Department monitors market risks by controlling the interest rate risk, exchange rate risk, liquidity risk, and other, as well as the liquidity and risk of the country, by conducting the following:

- identification of existing market risks and market risks that may arise from the affirmation of new products or activities;
- measuring market risks through establishing mechanisms for assessing market risks;
- monitoring market risks through analysis of the situation, changes and trends;
- setting limits;
- control of market risks, risk management adequate to the risk profile of the Bank, through defining the limits and monitoring the compliance of the Bank's operations with set limits;
- measuring exposure to interest rate risk once a month using the gap analysis and standardized interest rate shock;
- in order to minimize the exposure to the risk of placements, the Bank performs the categorization of domestic and foreign banks or financial institutions based on the rating of foreign banks established by the recognized international rating agencies Standard & Poors, Fitch and Moody's and the financial position of domestic banks on the basis of data from the last financial statements of domestic banks on balance sheet result and equity;
- manage the liquidity risk by monitoring the maturity of funds and sources of funds and, in this regard, prepare appropriate Gap analysis, monitor the concentration of deposits by individual clients and by maturity, monitor the variability of deposits and report on compliance with established limits of manual compliance of funds and sources of funding, etc.;
- measuring the country risk exposure for all countries in which the head office is located, i.e. the place of residence of the debtor of the Bank. The Bank ranks all debtor countries into one of the following risk categories: risk-free countries; low-risk countries; medium-risk countries and of high-risk countries, at least twice during the calendar year, if necessary and more often.

9.4. Risk Policy, Risk Mitigation and Strategies and Processes for Continuous Monitoring of the Effectiveness of Risk Protection and Risk Mitigation

The Bank defined the following policies, procedures and other internal Risk Mitigation acts of the Bank:

1. Risk Management Strategy;
2. Capital Management strategy;
3. Annual Equity Plan for 2019;
4. Strategic Equity Plan and Amendments to the Strategic Equity Plan;
5. Liquidity Risk Management Strategy and Policy;
6. Liquidity Management Plan in cases of liquidity jeopardized;
7. Operational Risk Management Policy;
8. Market Risk Management Policy;
9. Country Risk Management Policy;
10. Credit Policy for Corporate Sector;
11. Credit Policy for Retail Sector;
12. Internal methodology for assessing impairment according to IFRS 9 standard;
13. Methodology for determining the required capital for residual risk;
14. Procedure for stress testing of credit risk exposure;
15. Procedure for asset management and financial statements;
16. Procedure for stress testing of liquidity risk;
17. Methodology for determining the required capital for concentration risk and
18. Procedure for detailed categorization of high-risk exposures.

9.5. Internal control system

The system of reporting on conducted internal controls is based on individual reports of responsible persons in the Bank, which are in charge of organizing and managing individual organizational units, on special reports of authorized persons: internal auditor, compliance manager and authorized person for prevention of money laundering and financing of terrorism, as well as on the recommendations of the Audit Committee.

Thus, the Board of Directors is fully informed about the quality of the internal control system in the Bank and about the measures that need to be taken in order to improve the system.

Management control is also carried out by the management through:

- Implementation of strategies, policies, procedures and acts;
- Delegation of duties in accordance with the Rulebook on organization and job classification;
- Monitoring the deadlines for carrying out delegated tasks and the realization of business plans;
- Monitoring procedures and records related to decision making on business transactions, at all levels of the organizational structure;
- Monitoring the process of recording business transactions and preparation of financial statements.

By establishing the described internal control system, the Bank controls the level of operational risk as well as the risk in relation to the financial reporting process.

9.6. Information System

The Bank is based on a technologically rounded Information System based on the primary location in Podgorica and a backup location in Bijelo Polje fully capable of supporting the business, growth and development of the Bank in business and IT.

The production site in Podgorica was implemented on the hardware platform of reliable and well-known brands that fully meet industry and technology standards.

Key services are hosted on a virtual platform composed of physical hosts and the associated storage system. Backup of the data is stored on a separate hardware platform consisting of a physical server and a tape system, and the creation of backup data is done several times a day.

Network Infrastructure is composed of a core and access segment based on switches, while communication with DR location and partners takes place and is secured with the latest-generation firewalls. Communication services for communication with the regulator and partners use the MPLS network of providers with which the Bank is connected with two different physical links, terminated on redundant devices. In the same way, the Bank is also connected to a global Internet network.

9.6. Information System (Continued)

The backup location is implemented so that it completely maps the primary location, with a somewhat lesser capacity in terms of hardware, while in functional terms it is completely equal to the production location. The procedures of the IT sector clearly define the technical process of switching from primary to backup location.

For the Core Banking System, the software product PUB2000 of Asseco SEE was selected, which supports corporate and retail business, card operations, regulatory reporting, electronic banking services, etc. Regular updating of software versions ensures functionality and reliability. Apart from Core Banking System, the Bank also implemented additional software packages to complete the business processes required for the undisturbed growth and development of the Bank.

The Bank independently hosts and maintains services such as active directory, monitoring and IT security systems except corporate e-mail that is migrated to Ziraat Bankasi Istanbul, official web page of the Bank and E-banking service. All instances of the Information System are protected by security mechanisms: IPS/IDS, end-point-protection, anti-spam and anti-malware.

The complete hardware platform is implemented and is based on redundant devices, and their updating is carried out in a way that follows all technological aspects and ensures the stable operation of the Information System.

9.7. The Process of Internal Capital Adequacy Assessment

The Bank has reliable, effective and comprehensive strategies and processes for the continuous assessment and maintenance of the amount, type and distribution of internal capital, which implies capital that the Bank considers adequate in relation to the types and levels of risk it is exposed to or could be exposed to in its business operations. Strategies and processes are subject to regular internal review, which ensures their comprehensiveness and proportionality to the nature, scope and complexity of the Bank's business activities.

The Bank conducts an internal capital adequacy assessment once a year and submit it to the Central Bank of Montenegro no later than April 30 for the previous year, in accordance with Article 250 of the Decision on Capital Adequacy.

The ICAAP Report is prepared in accordance with the principle of proportionality, taking into account the size of the Bank and its percentage of participation in the market. The level of the loan portfolio, and the nature, scope and complexity of the operations that the Bank performs and is based on the use of simple methods based on the ICAAP principle.

9.8. Implementation of New International Standards

For the purpose of financial reporting for the year 2019 the Ziraat Group has implemented the new standard IFRS 16 that defines lease treatment

The Central Bank of Montenegro has decided that the implementation of IFRS 16 won't be applied during 2019 but will be postponed for the beginning of the year 2020. Considering this, the Bank for the purpose of statutory reporting for the year 2019 did not implement IFRS 16.

During 2019 the Bank organized trainings for employees and prepared its internal policies and procedures in order to readily welcome the implementation of IFRS 16 from the year 2020.

10. INFORMATION ON EXPOSURE TO PRICE RISKS, CREDIT RISKS, LIQUIDITY RISKS

The Bank recognizes the following material risks to which it is exposed or may be exposed in its business operations:

Credit Risk is the likelihood of losses in the bank's operations due to the debtor's non-settlement of liabilities towards the bank.

Concentration Risk - part of the credit risk associated with large (associated) individual exposures and significant exposures to groups of counterparties, whose common probability of defaults is determined by common basic factors (sector, economy, geographical area, etc.). Risk of concentration - for other risks, defines exposure or a set of exposures that are linked by common risk factors, which can lead to losses that could jeopardize the Bank's operations.

Residual Risk - a sub-category of credit risk and presents the risk that recognized risk measurement and mitigation techniques are used by the Bank less effective than expected.

Market Risk is the likelihood of incurring a loss in financial instruments in the balance sheet and off-balance sheet of the bank, caused by changes in interest rates, foreign exchange rates, prices, indices and/or other market factors affecting the value of financial instruments, as well as the risks associated with the trading of financial instruments in the market.

Position Risk is the risk of loss arising from a change in the cost of a financial instrument in the case of a derivative financial instrument from a change in price i.e. a variable. The position risk is divided into:

- a. General Position Risk;
- b. Specific Position Risk.

a. The General Position Risk is the risk of loss arising from a change in the cost of a financial instrument due to a change in the level of interest rates or changes in the capital market regardless of any specific characteristics of that financial instrument.

b. The Specific Position Risk is the risk of loss arising from a change in the cost of a financial instrument due to facts relating to its issuer, or in the case of a derivative financial instrument in relation to the issuer of the underlying financial instrument.

Exchange Rate Risk is the likelihood of losses on balance sheet and off-balance sheet items due to changes in exchange rates and/or mismatches in the level of assets, equity and liabilities and off-balance sheet items in the same currency.

Operational Risk is the likelihood of incurring a loss in the bank's operations due to inadequate internal systems, processes and controls, weaknesses and omissions in the performance of unlawful activities and external events that may expose the bank to a loss.

Interest Rate Risk on the Banking Book (interest rate risk that does not arise from the bank's trading activities) is the risk of loss in the bank's operations due to changes in interest rates of balance sheet and off-balance sheet items that are not held for trading.

Liquidity Risk is the probability that the bank will not be able to provide sufficient funds to settle its liabilities at the time of their maturity, or the probability that the bank will have to acquire cash with significant costs to settle its due liabilities.

Country Risk is the probability of a loss for the bank due to the inability to collect receivables from a party outside Montenegro for reasons related to the political, social and economic environment of the country in which the head office is located, i.e the place of residence, of the debtor, and includes the political, economic and transfer risks.

Strategy Risk is an existing or potential risk in relation to income and capital arising from changes in the business environment and from unfavorable business decisions, inadequate implementation of decisions, and the lack of adequate response to changes in the business environment.

11. OBJECTIVES AND POLICIES IN MANAGING FINANCIAL RISKS AND UNCERTAINTIES IN BUSINESS OPERATIONS

In its business operations, the Bank is exposed to various risks, the most important of which are:

- Credit risk;
- Market risk;
- Operational risk;
- Interest rate risk and
- Liquidity risk.

11.1. Credit Risk

Exposure to credit risk is a risk of financial loss, which may occur as a consequence of a counterparty being unable to fulfil its obligations towards the Bank. The Bank manages the credit risk it undertakes by placing limits in relation to large loans, single borrowers and related persons. Such risks are monitored on a continuous basis and are subject to at least annual reviews. Credit risk is managed both at the level of individual loan placement as well as at the level of the entire portfolio. The exposure to any borrower including other banks and financial institutions is further restricted by sub-limits covering statement of financial position and off-balance sheet exposures. Actual exposures against limits are monitored regularly.

In order to provide the necessary preconditions for the proper management of credit risk exposure analysis is carried out on two grounds - at the level of individual loans when determining credit worthiness and the upper limit of indebtedness of the client or group of connected clients and at the level of the entire portfolio in the following basis:

- structure of the portfolio in each category (corporate loans, loans to government, retail loans, off-balance sheet exposures);
 - structure of the portfolio by credit rating groups (movements between individual credit categories, the transitional matrix, the percentage of cover reserves, coverage ratio);
 - portfolio structure by regularity of settlement of liabilities;
 - portfolio structure by industries;
 - concentration in clients with so called large exposures (client or group of connected clients in which the exposure is greater than 10% of risk capital);
 - concentration of loans by certain geographic regions etc.

Credit risk provisions are allocated in accordance with the valid regulations of the Central Bank of Montenegro. The amount of provisions for potential losses on items of assets is calculated using the carrying amount of receivables multiplied by the determined percentage of provisions, while the bank may reduce the previous carrying value of an item of assets for which the provision is calculated by:

- the amount of collateral in a form of a cash deposit;
- the amount of the receivable covered by the irrevocable guarantee;
- countries or central banks of OECD countries;
- parent bank or banks belonging to a banking group to which the Bank belongs;
- banks with a rating higher than BBB+ / A+, determined by the external agency Standard&Poor's, or the equivalent rating of other internationally recognized rating agencies;
- legal entities whose business is controlled by the Central Bank of Montenegro.

In its operations, the Bank seeks to operate with good creditworthiness clients in order to minimize the credit risk exposure as much as possible, which poses a risk that debtors will not be able to settle the debts to the Bank in full and in due time. When making a decision on loan, it takes into account the changes in the economy, i.e. the state of individual branches that form part of the Bank's loan portfolio, which can lead to losses that differ from the losses on the basis of which the provision was made on the balance sheet date. In order to efficiently manage credit risk, the bank creates stressful credit risk scenarios, while considering the impact of the credit portfolio's weakening on the liquidity, profitability and capital adequacy of the Bank.

The Bank's previous practice in making decisions about granting placements paid attention to respect the maximum permissible exposure to a single entity or group of related entities. All placements approved so far are in accordance with the defined internal limits as well as with limits defined by current legislation.

11.1. Credit Risk (Continued)

Compliance with the performance indicators prescribed by the Central Bank of Montenegro as at December 31, 2019 is presented as follows:

Performance indicators prescribed by CBM	Prescribed limit	Achieved performance indicators as at December 31,	
		2019	2018
	CBM		
Solvency ratio of the bank	min 10%	19.85%	28.08%
The Bank's exposure to a single entity or group of related entities	max 25%	24.99%	24.85%
Sum of large exposures	max 800%	323.86%	263.79%
Total exposure to persons related to the Bank	max 200%	14.46%	14.17%
Total exposure to Bank's employees	max 1%	0.49%	0.49%
Liquidity ratio of the Bank	min 1%	2.88%	2.99%

In addition to loans, the Bank approved to the clients the guarantees and the letters of credit, which represent off-balance exposures.

Rating of the creditworthiness was the basis for the approval of each placement, the defined maximum amount of debt (limit). The Bank was assessing the creditworthiness of the client using primarily tools such as quantitative (financial) and qualitative analysis and evaluation of the quality of collateral, without neglecting the principle of evaluation of risks assumed through the classification of placements and potential liabilities of the Bank. Before approving loans and other placements, the Bank assesses the borrower's creditworthiness taking into account the criteria determined by the internal act, as well as the legal validity and estimated value of the collateral.

Credit risk mitigation involves maintaining the risk at an acceptable level of the Bank, i.e. maintaining an acceptable loan portfolio. Credit risk mitigation is carried out through the negotiation of adequate collaterals for receivables. The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral. Types of collateral are as follows:

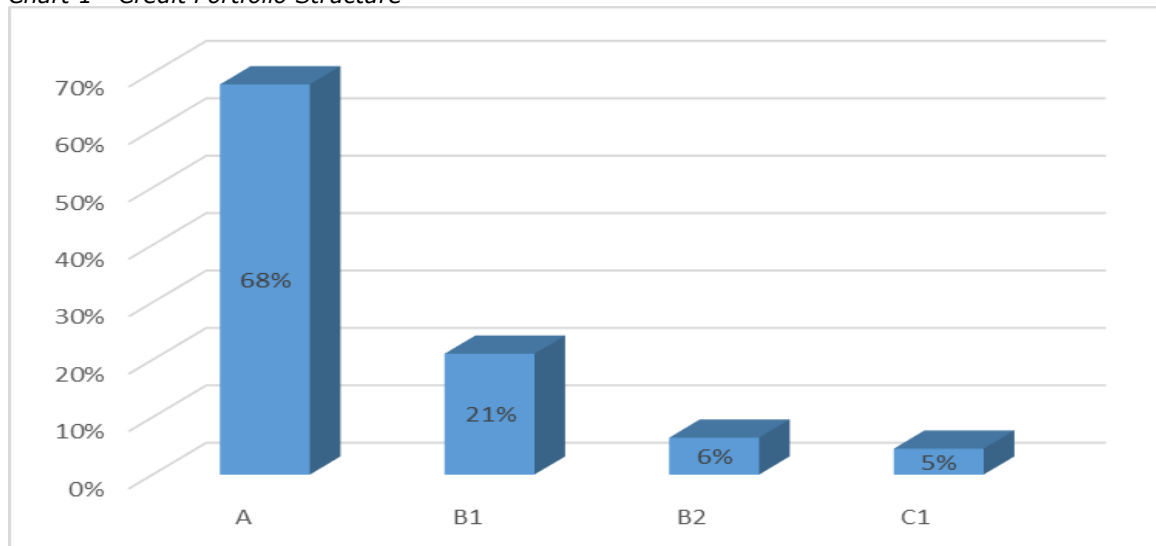
- Deposits;
- Pledges placed against industrial machines, securities, inventories and vehicles;
- Mortgages against property;
- Bills of exchange (corporate and personal);
- Authorizations for payments from the account;
- Administrative injunctions;
- Guarantors (for retail loans);
- Insurance policies and
- Bank guarantees.

After the assessment of the financial condition and creditworthiness of the borrower, as well as after a review of the value and legal security of credit security and other relevant factors, Loans Management Department determines the classification of the debtor as a measure of the expected credit risk, verifies internal rating, and gives his opinion on the justification of taking the identified risk.

11.1. Credit Risk (Continued)

The credit portfolio structure is shown in the following chart:

Chart 1 - Credit Portfolio Structure



In 2018, the Bank started applying the International Financial Reporting Standard IFRS 9, which entered into force on January 1, 2018, which is based on the model of expected credit losses and which replaced the model of losses incurred in accordance with IAS 39.

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 provision expenses depends on the volume of credit impairment from initial recognition. There are two basis for calculation:

- Expected losses of 12 months ("Stage 1") applied to all financial assets (from initial recognition) until there is a significant deterioration in credit risk;
- Expected Losses in the Full Life Period of a Loan ("Stage 2" and "Stage 3") applied when there has been a significant increase in credit default, i.e. non-performing, on individual or collective basis.

Stages 2 and 3 differ in the manner of recognition of interest income. In Stage 2 interest income is accounted for gross book value. In Stage 3, interest income is accounted for as net book value.

At each reporting date, an assessment is made as to whether there was a significant increase in the credit risk from initial recognition or performance of non-performing status to assess the amount of default (ECL for 12 months or for the entire life of the asset) and the amount of the basis for recognition of interest income (gross book value or net book value).

Segmentation of financial instruments can change over time, especially over a long period of time, as new information on individual and collective financial instruments becomes available or the Bank's portfolio changes (for example, the introduction of a new type of loan product or the client's industry becomes more important in view of the risk characteristic, etc.). As a result, segmentation is subject to periodic re-consideration.

The parameters used in calculating the provision for credit losses (PD and LGD) are separately estimated by segment depending on the type of client and the time category (bucket).

At present, the Bank is unable to estimate the PD of life-time due to the lack of historical data.

Therefore, until the available amount of data allow the development of a collective assessment model, the Bank will use the data at the level of the Montenegrin banking system published by the CBM.

11.1. Credit Risk (Continued)

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 granted in Stage 1, if the conditions for Stage 2 or Stage 3 are not met.

The following table presents the process of calculating the impairment.

Portfolio segmentation	Creditworthiness assessment (classification groups)	Staging	Assessment method	
Corporate customers: Loans to corporate customers Retail customers: Loans to retail customers * In the future, depending on the development of the Bank's portfolio, additional segmentation is possible (which will take into account the credit risk characteristics)	Time categories (buckets): 1 (no default) 2 (1 to 30 days of default) 3 (31 to 60 days of default) 4 (61 to 90 days of default) 5 (91 to 120 days of default) 6 (121 to 180 days of default) 7 (181 to 360 days of default)	Stage 3 - Days of default > 90 - loan is impaired Stage 2 - Days of default > 30 - Rating deterioration - Expert opinion Stage 1 - All receivables not classified either in Stage 2 or Stage 3	Exposure of the client >= EUR 50 thousand Exposures that are not subject to individual assessment	Individual assessment Collective assessment

Stage	Total exposure
1	65,557,958
2	6,805,984
3	3,011,721
TOTAL:	75,375,663

Manner of Impairment	Total exposure
Individually	62,842,671
Collectively	12,532,992
TOTAL:	75,375,663

11.2. Market Risk

The Bank is exposed to market risks. Market risk is the risk of the possibility of adverse effects on the financial result and the Bank's capital based on losses in the balance sheet and off-balance sheet items due to market price fluctuations. Market risk primarily refers to changes in interest rates, exchange rates and shares prices, so the most significant risks arising from market risk are as follows:

- Foreign currency risk;
- Position risk (price and interest rate risk);
- Market risks associated with credit risk (counterparty risk and settlement risk).

The Market Risk Management Policy defines the method of identification, measurement, monitoring and management of interest rate risk, currency risk, price risk and other risks associated with trading activities. The Market Risk Management Policy will be adapted to the scope of the Bank's operations.

11.2.1. Foreign Currency Risk

The risk of changes in foreign exchange rates is the risk of change of assets and liabilities value due to changes in foreign currency rates.

Bank measures foreign exchange risk and limits it daily, on an aggregate basis and individually by currencies.

The net open foreign exchange position of the Bank at the end of the day, for individual currency which is on the reference exchange rate of the European Central Bank on a daily basis, may not exceed 15% of the share capital of the Bank.

The sum of the net open foreign currency position at the end of the day for all the currencies at the reference exchange rate of the European Central Bank on a daily basis, may not exceed 20% of the share capital of the Bank.

The net open positions at the end of the day for other currencies cannot exceed:

- 5% of share capital, individually by currency;
- 10% of the share capital, in total for all other currencies of the Bank.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The exposure to currency risk is regularly monitored by harmonizing them with the limits prescribed by the Central Bank of Montenegro.

The Bank is exposed to foreign exchange risk to a small extent, given the fact that, as at December 31, 2019, it had foreign currency funds in USD in the amount of 950 thousand and liabilities in the same currency in the amount of EUR 978 thousand, resulting in a net short position of EUR 28 thousand.

On the basis of the above, the Bank was not obliged to allocate capital based on the coverage of foreign exchange risk exposure, since the net foreign exchange position was less than 2% of its own funds (as at December 31, 2019 it amounted to 2% of own funds).

As at December 31, 2019, all other positions in financial assets and liabilities were in EUR currency (December 31, 2018: USD 11 thousand).

11.3. Operational risk

Operational risk represents the risk of losses due to the lack or inadequacy of internal processes, people and systems, or due to external events. Also, operational risk can be the result of engagement of persons outside the Bank, unlawful actions, weaknesses and omissions in the performance of business, and the like.

In order to adequately manage operational risk, the Bank has developed a Policy for identifying, measuring and controlling this type of risk. The policy sets out the basic principles for managing operational risk in order to achieve the optimum acceptable level of risk.

A phenomenon that is a source of operational risk can be classified into one of the 7 categories of events as follow:

- internal frauds;
- external frauds;
- failures in relation to employees and in the workplace safety system;
- problems in customer relationships, product placements and business practice of the Bank;
- damages on the physical assets of the bank;
- interruptions in operations and errors in the bank's systems and
- execution of transactions, deliveries and management of processes in the bank.

The operational risk associated with credit risk refers to an event arising from credit risk, and includes some of the elements of operational risk (eg. error in the execution of a process, internal/external fraud, commercial dispute).

The qualification of operational risk associated with credit risk requires the two of the following conditions met:

- Loan overdue and delayed by the loan holder - Credit Risk;
- Operational risk case, internal defect (execution error, internal/external fraud) or an external event (external fraud, commercial dispute) that partially or completely contributes to credit loss.

Exposure to operational risk is regularly monitored by aligning with the limits prescribed by the Central Bank of Montenegro.

The objective of operational risk management is to ensure that the level of exposure to operational risk is in line with the Bank's Risk Management and Policy Strategy, i.e. minimizing losses under operational risk.

11.3. Operational risk (Continued)

The Bank uses a simple method for calculating the required capital for Operational risk and it amounted to EUR 350 thousand as at December 31, 2019.

11.4. Liquidity Risk

Liquidity risk presents the risk that the bank will not be able to provide sufficient volume (financial) resources to cover all the liabilities (balance sheet and off-balance sheet) as they mature.

Liquidity risk is identified on the basis of daily, ten-day, monthly and quarterly projections of liquidity, i.e. based on the gaps incurred due to mismatch of assets and resources.

Adequate liquidity risk management is a basic requirement for the safe and efficient operation of the bank. The quality of liquidity risk management depends on the balance sheet structure of the Bank, i.e. matching between inflows and outflows. The required liquidity is achieved by rational management of assets and liabilities in order to maintain an appropriate ratio between liquid assets and volatile liabilities.

Aiming to create a secondary liquidity reserves the Bank was investing in debt securities in the amount of EUR 4,449 thousand. As at December 31, 2019, most of the portfolio of debt securities relates to securities issued by the Ministry of Finance of Montenegro in the amount of EUR 1,109 thousand, which are classified as available for sale.

Also, the Bank in its portfolio has EUR 3,340 thousand of securities issued by the Ministry of Finance of the Republic of Turkey, which are also classified as securities held to maturity.

Based on the monitoring and measurement of the basic liquidity indicators (daily and decade liquidity coefficients), determined coefficients show that, during 2019, the Bank did not have liquidity problems and the liquidity coefficients were above the limit of values prescribed by the Central Bank. As at December 31, 2019, the daily liquidity ratio amounted to 2.88 (December 31, 2018: 2.99), while the minimum value of this coefficient defined by the Central Bank's decision was 0.9.

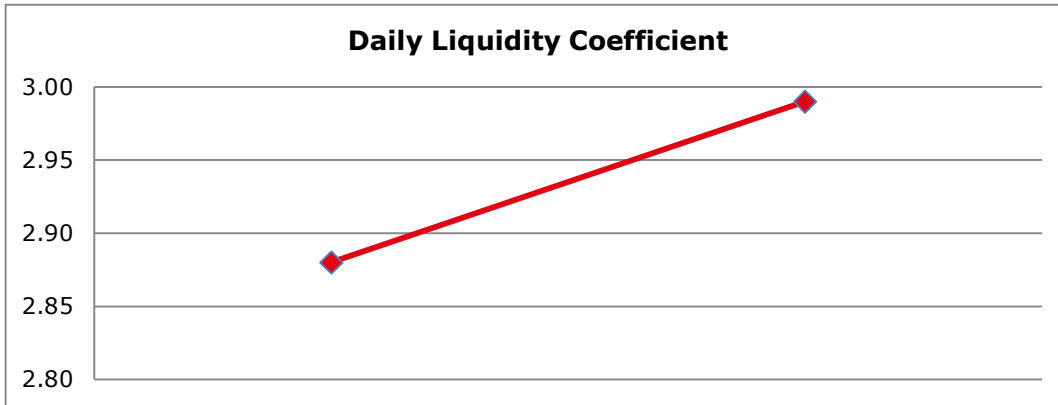
The Bank is obliged to maintain the liquidity level so that the liquidity ratio amounts at least:

- 1) 0.9 - when calculated for one business day;
- 2) 1.0 - when calculated as the average of the liquidity ratios for all business days in a single decade.

11.4. Liquidity Risk (Continued)

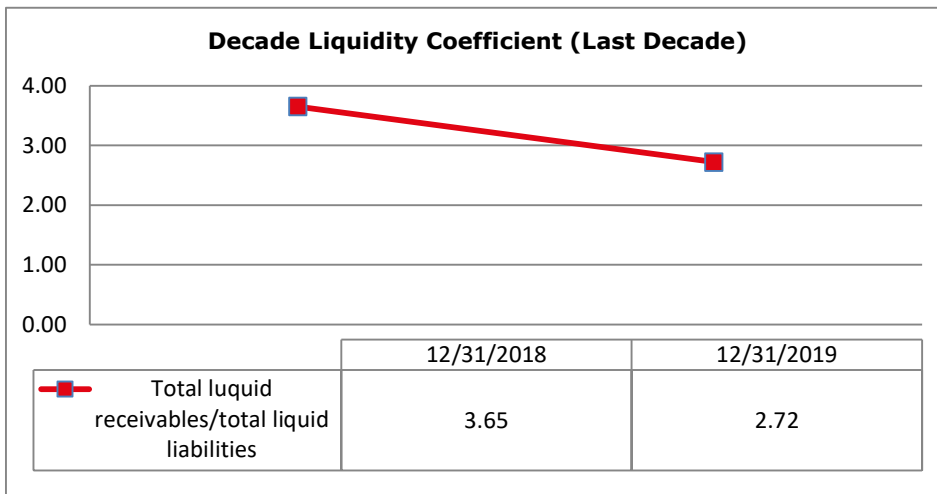
Daily liquidity coefficient for 2018 and 2019 is shown in the following chart:

Chart 2 - Daily liquidity coefficient



The decade liquidity coefficient (last decade) is shown in the following chart:

Chart 3- - Decade liquidity coefficient



The Bank's liquidity is strongly supported by the parent bank, which provides loans or overnight deposits in case of need for liquid assets. In addition, the Bank has defined and adopted the Liquidity Management Plan in cases of jeopardized liquidity or unforeseen circumstances, which clearly define the duties, tasks and bearers of the tasks to be performed in the event of a jeopardized liquidity of the Bank.

12. STATEMENT ON APPLICATION OF CORPORATE GOVERNANCE CODE

In accordance with the Law on Banks ("Official Gazette of Montenegro", No. 17/08, 44/10 and 40/11), the Bank acquired a status of a legal entity on the date of its registration as a shareholding company. As the shareholding company, the Bank regulate the mutual relations of all concerned parties in accordance with its Founding Contract and the Statute.

The Bank's bodies are the Shareholders Assembly, the Board of Directors, the Audit Committee and the Executive Directors. The roles of the bodies of the company are defined by the Statute and the Corporate Governance Code.

The Corporate Governance Code has become an indispensable element of business reports in the annual management report based on the provision of Article 14 of the Law on Accounting ("Official Gazette of Montenegro", No. 52/16).

In its content, this Code represents a set of rules and principles for improving corporate governance practices.

In its management activities, the Bank applies the best international corporate governance practices.

In the first place, the Corporate Governance Code defines the relations between the Shareholders Assembly, the Board of Directors, the Audit Committee and the Executive Directors.

Corporate governance is established in the following manners:

- To ensure that the legal framework of Montenegro and good business practices are complied with all segments of corporate governance;
- to set principles in this framework that are flexible and allow the Board of Directors to manage and govern the Bank in the best possible way and achieve the set goals;
- To ensure that all the mutual relations of stakeholders in the functioning of the Bank are clearly segregated, that there are no overlaps or gaps in responsibilities and competencies, and that a balance of responsibilities and obligations, i.e. rights and competencies is established among all stakeholders;
- The relationship between all interested parties is set up so that in each of those the common interest or interest of the Bank in relation to their individual interests prevail;
- To fully, efficiently and effectively perform all the functions of management and government of the Bank, i.e., to manage the Bank in a manner that leads to achievement of the set goals and tasks.

The application of corporate governance rules comprises all these acts implemented, as well as other internal acts of the Bank, and there are no deviations in the application thereof.

In Podgorica, February 26, 2020

Signed on behalf of Ziraat Bank Montenegro AD by:

Mustafa Šenman
Chief Executive Officer

Goran Bakić
Executive Director

Jelena Božović
Head of Accounting, Reporting and
Budgeting Department