Erste Bank AD Podgorica

Annual report 2015.

Erste Bank

General information

Erste Bank AD Podgorica
Identification number: 02351242
Giro account: 907-54001-10
SWIFT: OPPO ME PG
Internet: www.erstebank.me
E-mail: info@erstebank.me
Telephone: +382 (0)20 440 440

HEAD OFFICE OF ERSTE BANK AD PODGORICA
Studentska bb, 81000 Podgorica, Montenegro
Phone: +382 (0)20 440 440
Fax: +382 (0)20 440 432

Contents

4 - Introductory Statement of the President of the Board of Directors

5 - Board of Directors

6 - Introductory Statement of the Chief Executive Officer

7 - Executive Directors

8 - Ownership Structure - Information on the Work of the Board of Directors

10 - Macroeconomic Environment

10 - Retail

12 - Corporate

14 - Direct Channels

16 - Payment System

18 - Treasury

19 - Risk Management

20 - Human Resources

21 - Organizational scheme

Statement of the President of the Board of Directors

In 2015, Erste Bank continued the trend of good business in a relatively stable macroeconomic environment. Performing business in the line of strategic guidelines, we have achieved the most important planned commercial objectives and maintained a very high credit quality.

During 2015, the Bank has maintained a significant market share in all segments, having turned to the clients and industry branches the business perspective of which is unquestionable. We recorded a growth in loans, deposits and realized profit.

Market share in total loans at the end of the year remained stable at 12.4%, while the share in total assets reduced to 10.6%. Market share growth in loans was driven primarily by the growth in the segment of approving loans to legal entities. In the prior year, we have continued activities to optimize resources and harmonize the interest rates on deposits. Market share was in line with the expectations, i.e. decreased to 10.4%.

The orientation towards the client will mark the business of Erste Bank in 2016 as well, whereas the focus will be on creating the permanent relationships with clients, to whom Erste shall be a reliable partner in realization of their financial needs and business plans. Opening new opportunities for private and corporate sector, the expansion of the availability of credit products and application of modern innovative solutions brought by the trend of digitalization, will be at the center of our activities in the forthcoming period as well.

The community in which we operate is our very important partner. We have kept the traditional partnerships of a general sponsorship of the First Montenegrin basketball league - Erste league and Montenegrin Symphony Orchestra, along with the implementation of numerous projects at national and local level.

On behalf of the Board of Directors, I would like to express my gratitude to all the employees and the management team for their commitment and dedication, and to congratulate on successfully implemented goals. In this year also, we will continue in the same direction, with the aim of creating added value and contribution to a development of the economy as a whole.

Reinhard Ortner
President of the Board of Directors

Board of Directors

REINHARD ORTNER
President of the Board of Directors

CHRISTOPH SCHOEFBOECK
Deputy President of the Board of Directors

SLAĐANA JAGAR
Member of the Board of Directors

BORISLAV CENTNER
Member of the Board of Directors

SAVA IVANOV DALBOKOV
Member of the Board of Directors

Statement of the Chief Executive Officer

We have behind us another successful year in which we managed to achieve excellent financial results. We reaffirmed the strong market position of Erste Bank, which is nowadays a significant support to all categories of clients. Although we are predominantly focused on a retail business, last year we also significantly strengthened the partnership support of the Montenegrin economy.

Our business is characterized by a high quality and stability, which are presented through a few key parameters. Last year we achieved a profit of EUR 6.53 million, which is 9.3% higher than in the previous year. The return on equity was around 13.3%, while return on assets was 1.8%.

At the end of 2015, net loans to customers amounted to EUR 235.84 million and those were 1.9% higher than for the prior year. Over the past year, it was continued the support in the retail segment, through stable activities of the loan placements. At the end of 2015, market share amounted to 15.34%.

As for the corporate segment, a significant growth in the volume of loans granting has been achieved, while the number of new clients with exposure was almost doubled. Market share at the end of 2015 rose to 9.98%.

When the quality of the assets is concerned, we have maintained our NPL at a very low level, especially considering the average on the market. At the end of the prior year, Erste Bank's exposure to non-performing loans amounted to 6.4%.

The level of deposits is at a stable level, although, during the last year as well, we worked on optimizing the deposit interest rates. Clients deposits at the end of the year amounted to EUR 273.91 million and were on a stable level when compared to the end of 2014.

The Bank's liquidity has been consistently strong, and all liquidity ratios well above the legal minimum. The Bank ended 2015 as a well-capitalized bank with a solvency ratio of 20.53%* (excluding the profit for the current year), which is well above the legal minimum of 10%.

I express my gratitude to the employees, business partners and the clients for the excellent cooperation. I believe that, through the long-term partnerships, understanding of the needs and transparent communication, we will continue to realize our joint business success.

Chief Executive Officer
Aleksa Lukić

*local reporting standards

Executive directors

ALEKSA LUKIĆ, Chief Executive Officer

- In charge for the Retail Division, Corporate Division, Treasury Division, Human Resources Department, Marketing Department and Communication Department

DARKO KEKOVIĆ, Executive Director

- In charge for Information Technology and Organization Division, Processing Division, Property Management Division, Division of Direct Channels

ALEKSANDRA RADIĆ, Executive Director

- In charge for Finance and Accounting Division, Risk Management Division, Department of Legal Affairs

Ownership structure

Erste Bank AD Podgorica is 100% owned by Erste&Steiermärkische Bank d.d. Rijeka, Croatia.

Information on the work of the Board of Directors

In accordance with the Law on Banks of Montenegro ("Off. Gazette of Montenegro", No. 17/08, 44/10 and 40/11), in 2015, 17 sessions of the Board of Directors were held – out of which 12 regular (in accordance with the legal obligation) and five extraordinary sessions.

The work of the Board of Directors was focused on the fulfilment of obligations defined by legal regulations and by-laws, as well as the Articles of Incorporation and other general acts of the Bank.

The Board of Directors regularly discussed all issues of importance for the Bank's work, including monthly reports on the financial results, credit and market risk, liquidity risk and operational risk, the functioning of the internal control system, reports on information security and business continuity, and issued decisions within its scope of work.

The Board of Directors also considered the findings resulted from the supervision of the Central Bank, and in accordance with its responsibilities, monitored the implementation of recommendations and implementation of the measures imposed by the supervision.

In June 2015, the Board of Directors adopted a decision on the opening of seasonal Bank counter in Sutomore in order to improve competitiveness and provide better service to the existing clients, but also for the purpose of acquisition of new ones, having taken into account the popularity of the resort and itsgreat attendance, which was recorded in the summer months.

At its session held in July 2015, based on the analysis of market developments, the Board of Directors brought a decision that enabled the intensification of partnership with the Investment - Development Fund of Montenegro.

In September, the Board of Directors adopted a decision on the introduction of a new product - letters of credit - in the Bank's offer. At the session of the Board of Directors held in November, it was adopted a Decision on opening of a branch of the Bank in Kolašin. Through the implementation of this Decision, the Bank becomes present in another local community and the number of the branch offices in Montenegro increased to 17. In addition to the Decision on opening of a branch, at this session the Board also adopted the Decision on the principled consent to the introduction of brokerage, dealer activities and the activities of investment management company, the implementation of which will enable a complement to the Bank's offer in the area of investment banking and create new opportunities for future contribution to the financial result.

In December 2015, it was adopted the Whistle blowing Procedure for the purpose of compliance with the requirements of the regulator and Erste Group and compliance with the best practices in respect of provision of mechanisms for reporting the irregularities that may result in a harm to the clients and the Bank.

The Board of Directors has timely considered the reports and work plans of independent functions of the Bank, in accordance with its competences. In addition to the plans and reports, the Board of Directors has, at the suggestion of independent functions, discussed and adopted the changes / additions to internal documents from the scope of action of those independent functions.

The Board of Directors was regularly informed about the findings of the internal audit and the implementation of the imposed measures/given recommendations.

In addition, the Board of Directors periodically reviewed and adopted the summary report on the functioning of internal control system with recommendations for improvement given by the Audit Committee.

The subject of decision making were the changes in the organizational structure of the Bank and the appointment of heads of second-line management and all other issues in accordance with current legislation and internal documents of the Bank.

Macroeconomic environment*

Macroeconomic environment in Montenegro in 2015 was relatively stable. According to preliminary Monstat data, real GDP increased by about 3.2%. The growth was driven by the investments, both public and private, and especially in the second half. According to the latest forecasts published by the Ministry of Finance, the average real GDP growth should reach 3.8% for the period 2015-2018.

The unemployment rate in the last quarter of 2015 was 17.9%, mildly lower than in the same period last year. The average annual inflation rate was 1.5%. Net FDI inflow in 2015 amounted to 619.3 million EUR, which is about 75% more than in 2014. The total FDI inflow reached EUR 757.4 million, or 52.1% more than in the previous year. The growth trend of FDI continued significant increase in the inflow of equity investments (investments in domestic companies and banks), as well as reducing the outflow of FDI. The total outflow was EUR 138.2 million, which is 4.2% less than in the previous year.

After the consolidation measures taken in 2014, the budget deficit was reduced to 3.1% of GDP, an increase in capital expenditures related to the highway and a non-achievement of revenues in 2015, the budget deficit was returned to 7.9% and the public debt has risen to 68% of GDP. The banking system is stable in terms of liquidity.

In the banking sector, in 2015, it was recorded a growth in total assets of 10.9% compared to December 2014. Total deposits were 13.7% higher than at the end of 2014, while total loans recorded a modest annual growth of 0.8 %.

*sources: the Ministry of Finance, MONSTAT, Central Bank of Montenegro

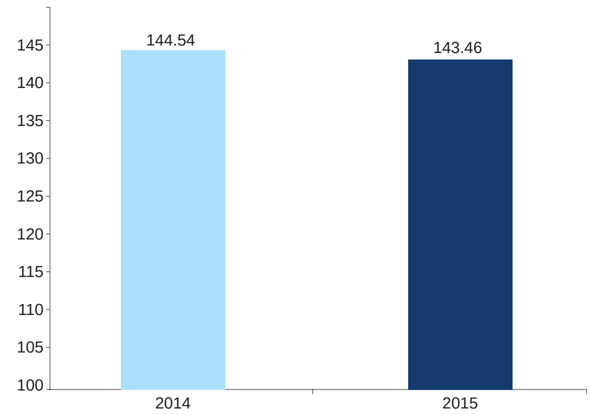
Retail

In the retail department in 2015, it was continued a trend of continuous growth in the number of the clients, and their number has reached about 77,000, which is almost 4% higher than for the prior year. Our goal is to continue this trend, so as to remain firmly positioned among the leading banks in the retail department. We consider the improving of services quality and operating with the innovative offers and servicesthe path to this goal.

As for the segment of small businesses, we achieved remarkable results, especially when it comes to the efficiency of the approval process.

Permanently listening to customers' needs, in the forthcoming period, we will promote the special products in the field of mobile and electronic banking. We expect a positive response of the market, according to the benefits that these solutions shall bring to customers - lower cost and availability of services without the time and space barriers.

Retail loans in EUR million



Retail loans

Last year, the activities of loan placements remained at a stable level. The average participation rate in total placements of the banking sector amounted to 15.68%, and the market share in the retail segment was 15.34% at the end of 2015.

The structure of loans of the retail department is dominated by cash loans with a 55.21% share, and the value of approved cash loans increased by 4.61%. It was increased a placement of long-term loans, housing and mortgage ones, and the quality of the portfolio was further improved. Housing loans increased by 3.2%. The outstanding performance was achieved in loans to small businesses, which recorded a growth of 8.39% of the portfolio.

There has been achieved a growth in loans through an overdraft by the transaction accounts of the clients by 3.59%, and the clients shown a great interest for the all-purpose loan for refinancing.

In the past year also, a great attention was paid to the activities of collection, in order to maintain the high quality of the loan portfolio and retention of NPL below the market average.

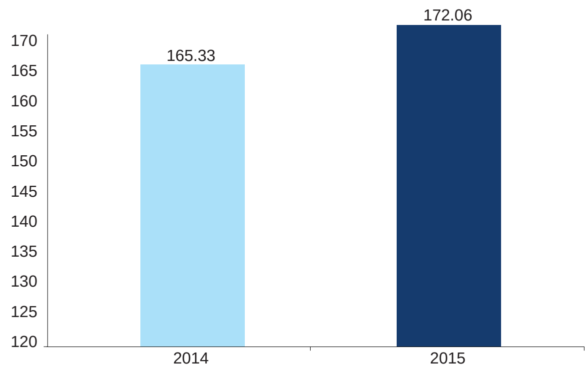
Retail deposits

During 2015, according to the strategy of the Bank, it was continued an optimization of deposit rates, which did not affect the dynamics of the inflow of new deposits and retention of the existing ones. Thanks to the trust of clients, even with the reducing in the average interest rate by 0.97%, there occurred an increase in the deposit portfolio of the retail segment by 4.1%, or EUR 6.73 million, with a decrease in the total interest cost of EUR 0.78 million.

At the year end, the market share in the retail department deposits amounted to 11.58%.

In the structure of deposit portfolio, the term deposits accounted for 52.62%, demand deposits accounted for 46.42% and the interest rate of about 1%.

Retail deposits in EUR million



Corporate

In 2015, the corporate department recorded a growth of the loan portfolio by 3.8%. The achieved result is in line with the strategic guidelines, and, therefore, through an invasive strategy in a key market segment, i.e. private companies, it was compensated the overall decline in the portfolio for the previous comparative period and the total market share of the department returned to the zone of systemic banks. Deposits of the corporate department recorded a decrease, primarily as a result of a decrease in deposits of the public sector.

In 2015, it was recorded a slight growth of the economy, which affected the growth of the market portfolio of economy in Montenegro by 0.9%. The market of corporate deposits recorded a significant increase of even 21.2%, due to the accumulation of funds intended for investment activities of primarily foreign companies in Montenegro. This primarily applies to multinational companies in the energy sector.

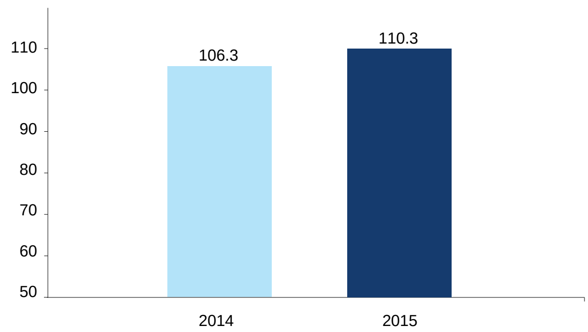
The depth of the market determined the strategy of growth in the direction of refinancing of the existing SME exposures with other banks. This resulted in a reduction in interest rates, while the portfolio quality further improved, and the exposure of non performing loans at the end of 2015 stood at 7.69%.

Income from commissions in payment transactions and fees from documentary business recorded a growth that will be especially in focus in the next period as well.

Corporate loans

The total loan portfolio of the corporate department increased by EUR 4 million, primarily as a result of the growth of portfolio of private companies by even 14.3%. In the banking market in general, the private companies portfolio grew by only 2.1% in relation to the comparative year. The number of new clients with exposure was nearly doubled when compared to 2014. Special attention was devoted to in-depth approach to clients and it was further developed an advisory role of employees in the Department. Such an approach to the market has led to the handover of a significant number of major clients from other banks. In the related period, the market share of the Corporate Department has increased from 9.67% to 9.98%.

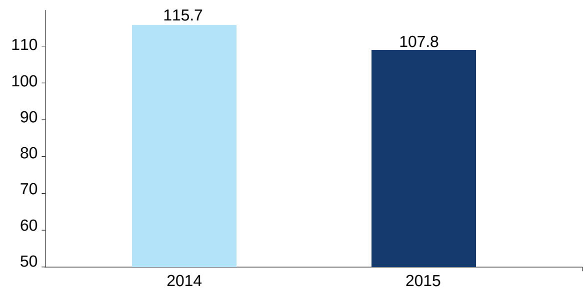
Corporate loans in EUR million



Corporate deposits

Deposit portfolio was, as planned, decreased by 5.2% with a continued reduction in the average rates on time deposits by 0.88% as a result of matching the offer with the market conditions and the Bank's policy in the field of reducing the cost of liquidity. Despite the reduction in interest rates, the corporate department has achieved a growth in deposits of private companies by 2.1% as a result of trust that the Bank exercises in the market. On the other hand, the planned withdrawal of government deposits contributed to a decrease in the aggregate result.

Corporate deposits in EUR million

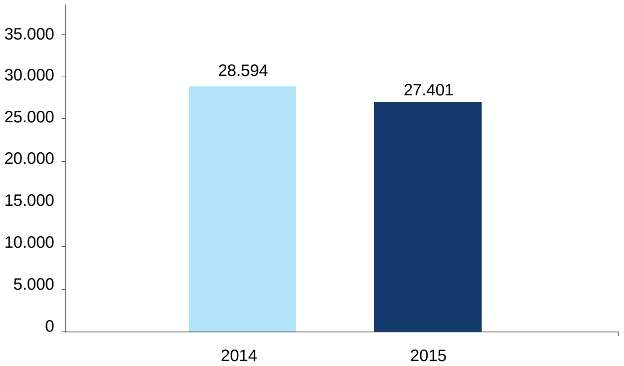


Direct channels

Card Business

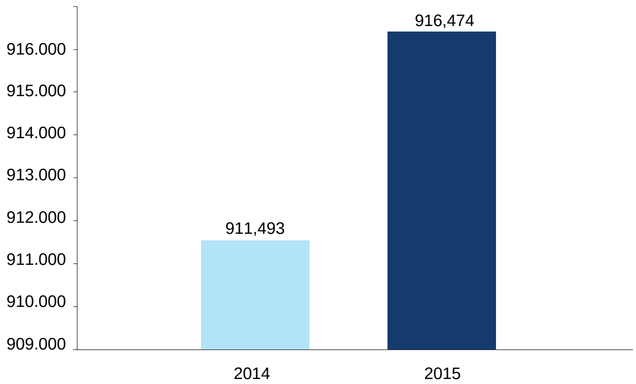
In 2015, Erste Bank recorded a decrease from 4.14% in the number of active cards, and those were in the number of 27,401.

The total number of cards



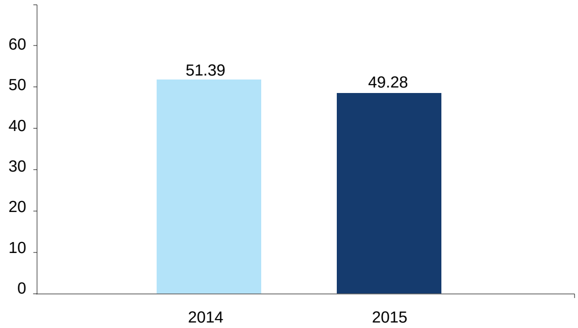
The total number of transactions with payment cards in 2015 increased by 0.55% to 916,474. Out of the total number of transactions, debit card payments realized 92.2%, and the rest were the transactions realized with the credit cards.

The total number of transactions with payment cards



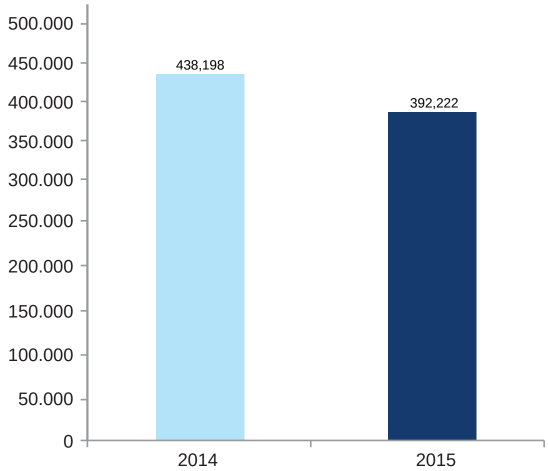
The total turnover realized with the payment cards of the Bank in 2015, when compared to 2014, was lower by 4.12% and amounted to 49.28 million EUR.

Total turnover with the payment cards in EUR million



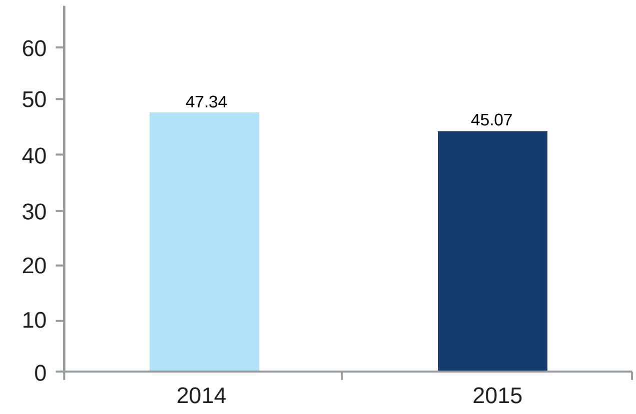
In 2015, the ATM network was expanded by 12.12%. The total number of ATM transactions in 2015 decreased by 10.49% to 392,222.

The total number of transactions with payment cards at ATMs



Total turnover with payment cards at ATMs of Erste Bank in 2015 amounted to 45.07 million, i.e. 4.79% less than in 2014.

Total turnover of payment cards in EUR million

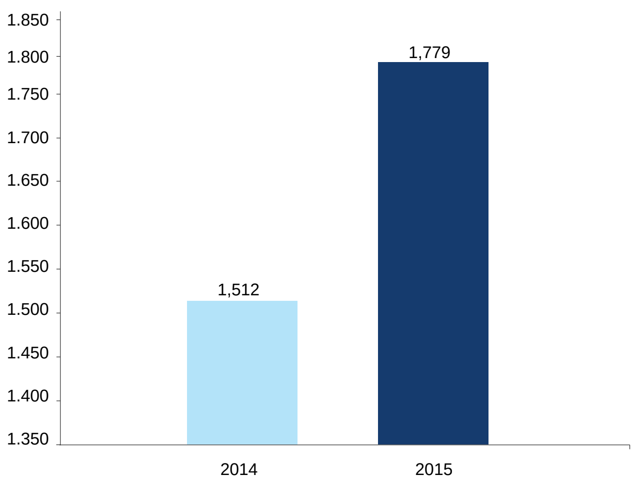


The share of cards that have the functionality of contactless payment reached 79.31% of the total number of debit cards, while in 2014, such a share was 30.2%. The number of contactless payments in 2015 was 21.43% in relation to the total number of debit cards payments. The average amount of a contactless transaction amounted to EUR 14.76.

Digital Banking

The number of e-banking users in 2015 increased by 17.66% compared to 2014.

Number of users of electronic banking



The total number of orders executed via electronic banking out of the total payment transactions of the Bank was 111,922, which represents an increase of 43.63%. Out of the total number of the realized orders generated by the electronic banking, the corporate subjects are the leading in the payment system with their share of 87.54%.

Out of the overall structure of the number of orders generated by electronic banking in relation to the total number of payment orders realized in payment transactions, the physical entities comprise 5.1% at the end of 2015, while legal entities in the same structure comprise 28.2%.

Info service - SMS alert

The number of users of SMS info service on the current account in 2015 increased by 31.5% and reached 11,400. The number of users of SMS services for payment cards was the 578.

Innovations in products and services

In 2015, it was launched a new, improved e-banking service for physical entities and corporate units - NetBanking.

Along with the NetBanking as a new service, the Bank also introduced a new display card as a new mean of authentication for the related service. Display Card is the first card of its kind on the market of Montenegro.

Payment system

Projects of application of the Law on Payment System, by-laws and regulatory requirements of other state institutions marked the year of 2015 in the field of payments. During the aforementioned activities, the Bank successfully and in due time carried out the legal framework analysis, system adjustment and alignment of processes and documents, with the timely notification and communication with the clients.

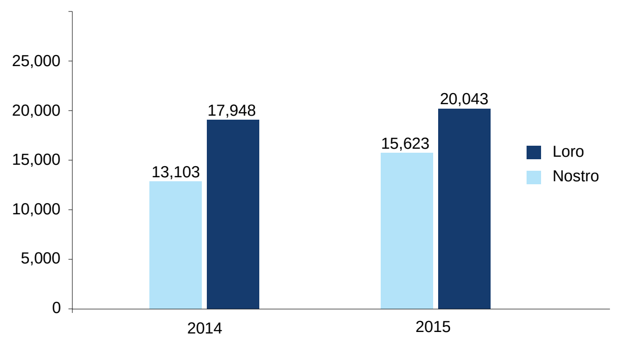
Along with the foregoing, the activities were carried out so as to improve the effectiveness and efficiency of services through the adoption of new operational guidelines, revision of the existing documents, as well as a clearer synchronization of the business processes with the requirements of the saledepartments. The improvement of the quality and speed of support to internal and external clients has resulted in an increase in the volume of activity.

Foreign payments

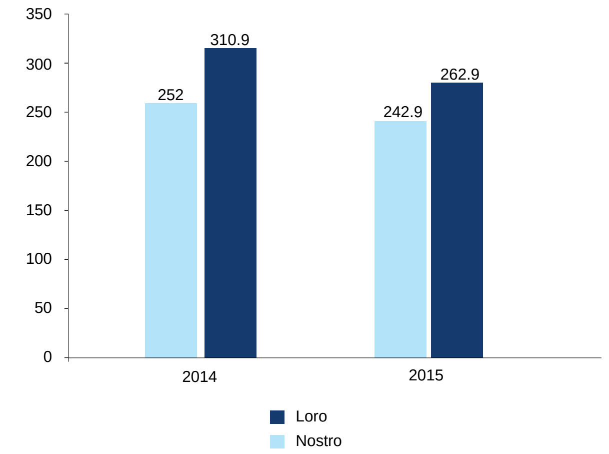
Dedication to the clients' satisfaction was the main focus in the processing of the international payment system orders, which contributed to increasing the payments made to foreign countries for about 19.23%. The Bank realized 15,623 nostro remittances, totaling around EUR 263 million. In 2015, it was realized 20.043 loro remittances totalingEUR 242.9 million, which represents an increase in the number of loro transactions by 11.67%.

The restrictive policy of closing the accounts of major banks of the European Union countries in the region was continued, and thus the Bank had the task to manage and optimize costs, in addition to maintaining the quality correspondent relationships.

Number of Loro / Nostro remittances



Value of Loro / Nostro remittances in millions of EUR

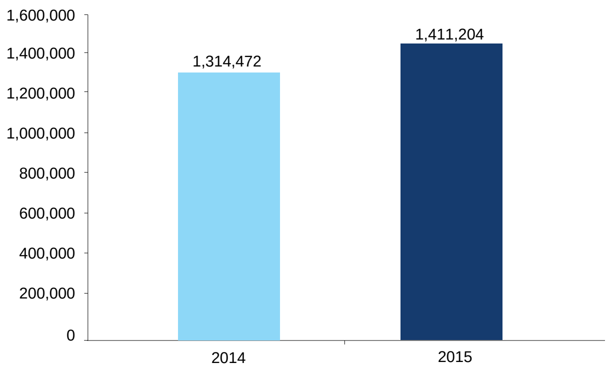


During 2015, 559 checks of physical entities were realized to cash.

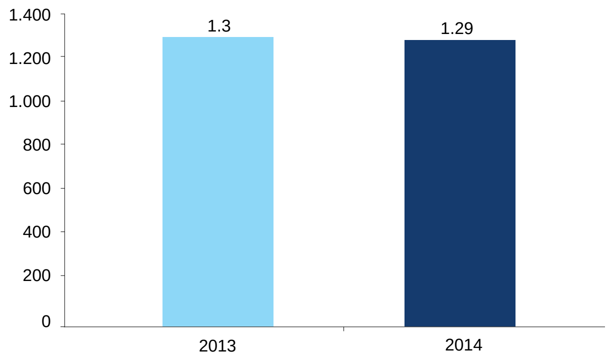
Domestic payments

In 2015, domestic payments significantly increased when compared to the previous year, due to growth in the number of clients. The number of 1,411,204 transactions were realized with the reference to the non-cash and cash transactions of physical and legal entities, which represented an increase of 7.36%. The total value of realized payment transactions amounted to about EUR 1.29 million.

The volume of transactions in the domestic payment system



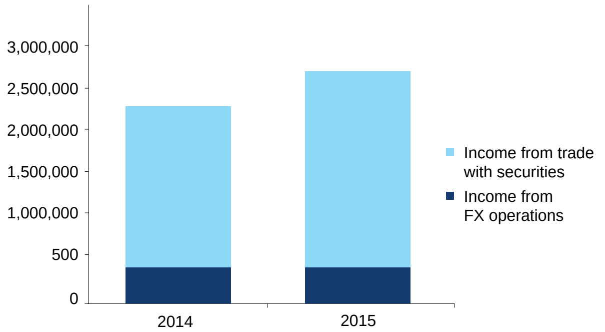
The value of domestic payments in millions of EUR



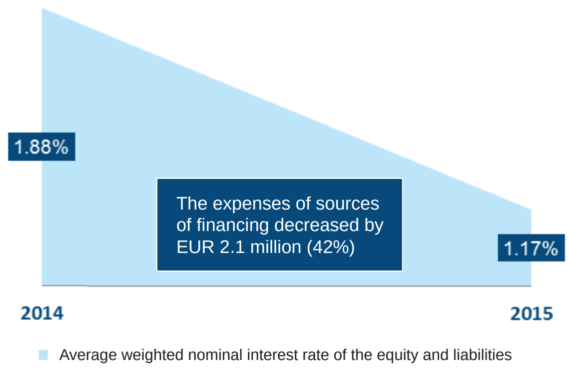
Treasury

Management of the asset and equity and liability and trading

Income from FX operations in 2015 amounted to EUR 327 thousand. Portion of the excess in the liquidity, which resulted from an increase in the level of clients deposits, was placed in securities, so that the income from these operations accounted for more than EUR 2.5 million, which is slightly above the budgeted revenue for 2015.

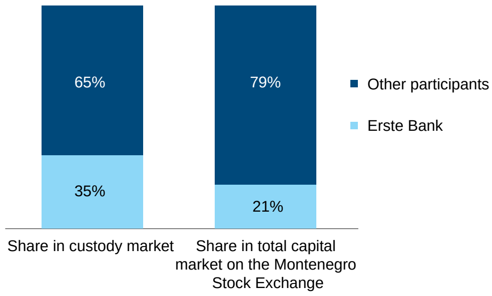


In terms of liquidity, maturity compliance of sources and placement of funds, the assets and the equity and liabilitieswere managed by the ALCO Committee in accordance with the prescribed internal decisions and legal provisions prescribed by the regulator. Liquidity was carefully monitored, planned and designed at the optimum level so that the available liquidity, except for the investments in clients' loans and securities, was also used for the early repayment of EUR 11.5 million of previously withdrawn credit lines from the Erste Holding. With this operation charged as an item of the equity and liability, the total indebtedness of the Bank upon the total liabilities from borrowings was reduced by 85% when compared to the end of 2014. Thus the Bank strongly influenced the structure of financing source in such a manner that the clients' deposits became apredominant source, the share of which was higher than 90% of total sources. Along with the foregoing, a special attention was paid to the control of the costs of equity and liabilities. With an active influence on the pricing policy of depositing, the average weighted nominal interest rate of total liabilities decreased by 0.71% when compared to 2014, whereas the average cost of time deposits decreased by 0.96%. In total, the costs of funding sources in 2015 (bank loans + client deposits) decreased by EUR 2.1 million, i.e. less by 42% when compared to 2014. This significantly neutralized the negative impact on net margin achieved by the Bank, which was reflected in the decline of the average weighted interest rate on loans for slightly more than 1% when compared to 2014.



Custody and depositary operations

Although the performance of these operations began in early 2015, the Bank has managed to position itself highly in the market. Participation in the custody market accounted for 35%, while the share of the total market capital on the Montenegro Stock Exchange amounted to over 21%. Total collected commissions on these transactions amounted to EUR 184 thousand, with a realized net profit from bonds trading, in the amount of EUR 199 thousand, the Department of custody and depository operations have generated a net result amounting to EUR 336 thousand.



In mid-2015, a client of the Depository Department has become the greatest privatization fund in Montenegro, whose total assets, within the open and closed portion is over EUR 40 million.

It is important to mention that, in the context of the fourth issuance of international bonds of the state of Montenegro, Erste Group was re-elected by the Ministry of Finance for Join Lead Manager and Bookrunner edition.

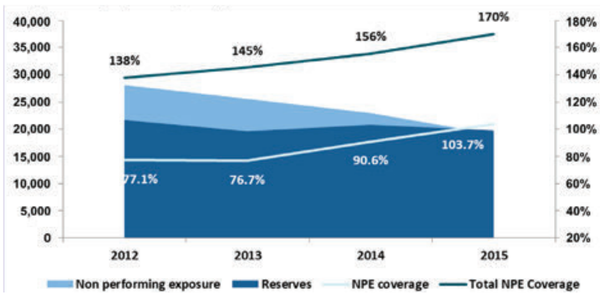
Risk management

During 2015, the Macroeconomic environment in Montenegro was relatively stable. According to preliminary data, real GDP showed an increase of 3.2%. Growth was boosted by the investments, both public and private. After the consolidation measures in 2014, the budget deficit was reduced to 3.1% of GDP, an increase in capital expenditures related to the highway and a non-achievement of revenues in 2015, decreased the budget deficit to 7.9% and public debt increased to 68% of GDP. The banking system is stable in terms of liquidity. During 2015, the amount of system NPL has decreased by about 4%, however, it continued to be a burden on the balance sheets of the banks. There is a significant lack of liquidity of the economy, about 20% of the total legal entities and entrepreneurs has their accounts blocked due to failure in settlement of their liabilities.

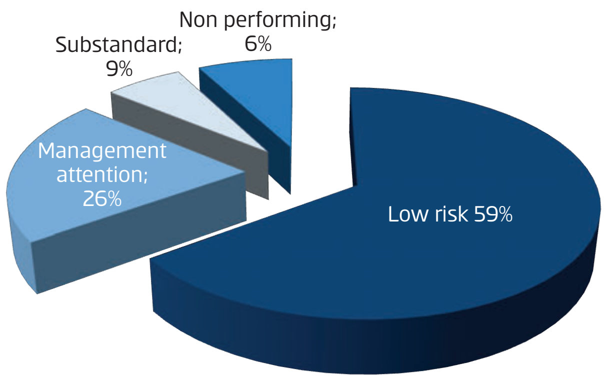
The risk profile of Erste Bank in 2015 was significantly better than the profile of the banking market taken as a whole. This is reflected in significantly better indicators of asset quality and lower credit risk than the industry average. There are significant lower percentages of days of delay and NPL in relation to system values. Delays over 90 days were reduced during 2015. In the corporate segment, DPD> 90 decreased from 11.1% to 8.9%, and in the retail segment from 6.7% to 5.8%.

The cost of reservations had a positive value of EUR 1.5 million in 2015. In percentage of the loans, the cost, or income was -0.64% when compared to 0.3% of the cost in 2014. The coverage NPEreserves was high and amounted to 103.7% at the end of 2015 without the inclusion of the value of collaterals.

Non-performing exposure (NPE) to the reserve coverage



Exposure by risk categories in Erste Bank



Non performing exposure (NPE) was decreasing in 2015, and, at the end of the year, it was 6.4%. The share of exposure in the best rating category "Low risk" decreased from 65% as of December 31, 2014 to 59% as of December 31, 2015. This was not the result of deterioration of the portfolio, but the introduction of the new credit rating for clients.

The Bank's liquidity was consistently strong - all liquidity ratios were well above the legally prescribed minimum. During 2015, the exposure to market risk remained at a low level.

The Bank ended the year of 2015 as a well-capitalized bank with a solvency ratio of 19.28% (excluding the profit for the current year), which was well above the legally prescribed minimum of 10%.

During 2015, the Bank maintained a significant market share in all areas, while extremely taking into account the very quality of placements and turning towards clients and industries that were not or were minimally affected by the crisis and the business perspective of whichwas unquestionable. Exposure of the Bank to the industries that were more significantly affected by the crisis, for example construction, remained at a minimal level, and those branches have not been the focus of interest.

Human resources

From a strategic point of view, the Human Resources are the most important potential of the company, while the managing of those requires a systematic recruitment, monitoring, evaluation, investment in education and training, all with the aim of achieving the plans of the organization.

Keeping in mind today's market operations, a step forward, in comparison to the competition and winning in the market, is characterized by the human relationship itself, orientation towards the client and building upon his needs and expectations. In this regard, the Bank will continue its orientation and commitment in this direction.

In 2015, we continued to enrich the relations in the collective, to develop and improve the competencies (skills and knowledge), we create the preconditions for growth and development, as well as for maintenance of the essence of success and recognition of Erste Bank - satisfaction, expertise and motivation of the team spirit.

We closed the year with 266 employees. Out of the total number of employees, 48% are women, while the average age is 39 years.

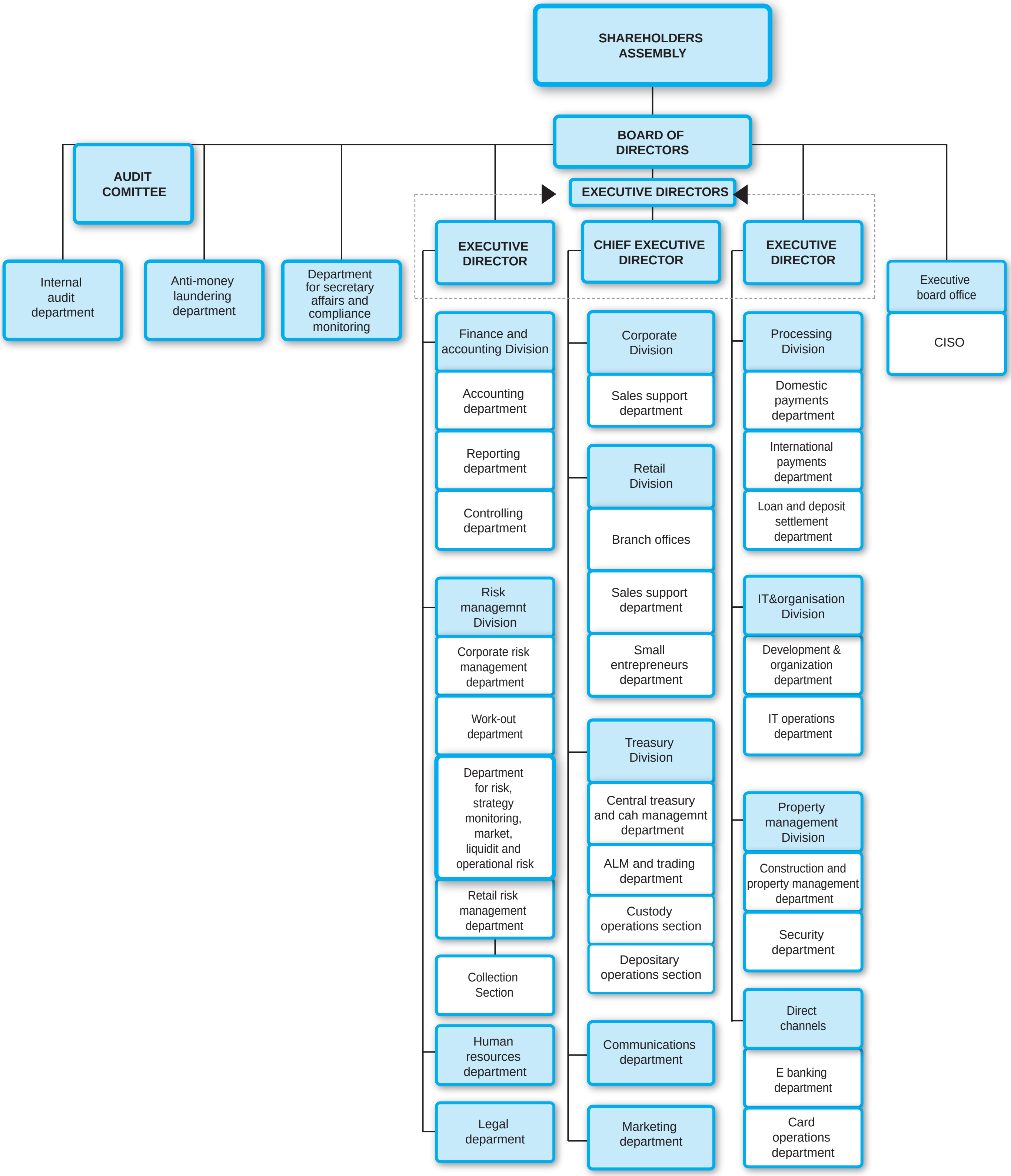
As in the previous years, in 2015 we participated in the government program 'Vocational training of the graduate students' and received 50 graduate students for an internship, out of whom 30% continued to work at the bank.

Within the System of employees performance management, this year brough the use of this very important tool for growth and development, in a different and better way. There were conducted the trainings for employees in terms of more precise and clear definition of objectives, improvement in communication with superiors and more realistic process of evaluation and self-assessment. Through an innovation in the application - development plan, we defined the space for the improvement of skills and knowledge of employees, which created conditions to mark the year ahead with the realization of education according to the development plans.

In the field of education in 2015, the focus was mainly placed on specialized and expertise knowledge through the acquisition of certificates, licenses, attending the workshops within the Erste Group, as well as the training conducted by external contractors. In 2015, the average of 5.13 days per employee was spent on trainings.

The performance of the Bank's business is organized into nine departments and seven services equipped and trained to specialized performance of groups of related tasks from the business scope of the Bank.

Organizational scheme:



ERSTE BANK A.D., PODGORICA

FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2015 AND INDEPENDENT AUDITORS' REPORT

	Page
Responsibility for the financial statements	3
Independent Auditors' Report	4
Statement of comprehensive income for the year ended 31 December 2015	5
Statement of financial position as at 31 December 2015	6
Statement of cash flows for the year ended 31 December 2015	7
Statement of changes in equity for the year ended 31 December 2015	8
Notes to the financial statements	9 - 74

Building a better
working world

Ernst & Young Montenegro d.o.o.
Serdara Jola Piletića
PC Palada (II sprat) lokal 2A
81000 Podgorica, Crna Gora

Tel: +382 20 238 477
Fax: +382 20 238 476
ey.com

INDEPENDENT AUDITOR'S REPORT

TO THE OWNERS OF ERSTE BANK A.D., PODGORICA

We have audited the accompanying financial statements of Erste bank A.D., Podgorica (hereinafter: the Bank), which comprise the balance sheet as at 31 December 2015, and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2015, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Registarski broj: 5-0537154 kod Centralnog registra privrednih subjekata u Podgorici
Upisan i unijet osnovni kapital: EUR 5.000,00; PIB: 02759080; PDV: 30/31-08878-9
Poslovni račun: 520-13125-82 kod Hipotekarne banke A.D., Podgorica

Building a better working world

Other matters

The financial statements of the Bank for the year ended 31 December 2014 were audited by another auditor whose report dated 27 February 2015 expressed an unqualified opinion.

Podgorica, 25 March 2016

Ernst & Young Montenegro doo

Ernst & Young Montenegro d.o.o.

ERSTE BANK A.D., PODGORICA

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2015

In thousands of EUR	Notes	2015	2014 reclassified
Interest income		24,069	26,474
Interest expense		(5,524)	(7,765)
Net interest income	5	**18,545**	**18,709**
Fee and commission income		4,127	3,835
Fee and commission expense		(898)	(732)
Net fee and commission income	6	**3,229**	**3,103**
Net trading income		327	367
Net gains from investment in securities		293	688
Dividend income		2	1
Gains on derecognition of non-financial assets		2	24
Impairment gain/loss on assets	7	255	(1,382)
Provisions	8	(534)	(276)
General administrative expenses	9	(14,630)	(14,330)
Other operating result	10	(312)	(385)
INCOME BEFORE TAX		**7,177**	**6,519**
Income tax	11	(645)	(551)
INCOME FOR THE YEAR		**6,532**	**5,968**
Other comprehensive income			
(Losses)/ Gains on available for sale financial assets		(797)	695
Income tax effect		72	(58)
Actuarial gains on long-term employee benefits	22	(5)	(29)
Income tax effect		1	3
Revaluation of property		-	(472)
Income tax effect		-	43
Total other comprehensive income for the year, net of tax		(729)	182
Total comprehensive income for the year, net of tax		5,803	**6,150**
Earnings per share	31		
Basic Earnings per share (in EUR)		1.223	1.118
Diluted earnings per share (in EUR)		1.223	1.118

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

Podgorica, February 29, 2016

Approved by and signed on behalf of Erste Bank A.D., Podgorica

Aleksa Lukić	Aleksandra Radić	Kristina Bukilić
Chief Executive Director	Executive Director	Director of Finance and Accounting

ERSTE BANK AD PODGORICA ERSTE Bank 3

ERSTE BANK A.D., PODGORICA

STATEMENT OF FINANCIAL POSITION AS AT DECEMBER 31, 2015

In thousands of EUR	Note	2015	2014
ASSETS			
Cash and balances with banks and Central Bank	12	48,380	56,615
Loans and advances to banks, net	13	11,605	32,313
Loans and advances to customers, net	14	235,842	231,451
Financial assets available for sale	15	14,824	40,130
Financial assets held to maturity	16	51,265	7,917
Investment property		257	135
Property and equipment	17	3,400	3,590
Intangible assets	18	1,693	2,051
Other assets, net	19	1,973	2,682
Total assets		**369,239**	**376,884**
LIABILITIES AND EQUITY			
Liabilities			
Deposits from banks		415	162
Deposits from customers	20	273,916	273,906
Deposits from custody business		140	398
Other borrowed funds	21	21,663	36,743
Debt securities	22	15,029	15,025
Current tax liability		691	621
Deferred tax liabilities	11	162	244
Provisions	23	2,242	1,598
Other liabilities	24	3,031	2,209
Total liabilities		**317,289**	**330,906**
Shareholders' equity			
Share capital		6,910	6,910
Other reserves		2,638	3,545
Retained earnings		42,402	35,523
Total shareholders' equity	25	**51,950**	**45,978**
Total liabilities and shareholders' equity		**369,239**	**376,884**

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

Podgorica, February 29, 2016

Approved by and signed on behalf of Erste Bank A.D., Podgorica

Aleksa Lukić	Aleksandra Radić	Kristina Bukilić
Chief Executive Director	Executive Director	Director of Finance and Accounting

ERSTE BANK AD PODGORICA
ERSTE Bank
3

ERSTE BANK A.D., PODGORICA

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2015

In thousands of EUR	**2015**	**2014**
Operating activities		
Net income	6,532	5,968
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and amortization	1,228	1,322
Net losses on fixed assets	12	18
Foreign currency translation gains	(327)	(368)
Interest on securities	(2,537)	(2,031)
Provision for loan losses	255	826
Income tax expense	645	551
Change in operating assets and liabilities:		
Increase in mandatory reserves with the Central Bank of Montenegro	1,520	(2,215)
Increase in loans and advances to customers	(2,930)	27,968
Increase in accrued interest and other assets	(697)	1,926
Increase in securities available for sale	25,306	(21,461)
Increase in securities held to maturity	(43,347)	(1,743)
Increase in deposits from banks and customers	1,386	54,540
Increase in other liabilities	1,897	(584)
Paid income tax	(583)	(564)
Net cash used in operating activities	(11,640)	64,153
Investing activities		
Net additions to fixed and intangible assets	(793)	(860)
Net cash used in investing activities	(793)	(860)
Financing activities:		
Repayments of borrowings	(15,035)	(34,839)
Net cash used in financing activities	(15,035)	(34,839)
Net (decrease)/ increase in cash and cash equivalents	(27,468)	28,454
Cash and cash equivalents at beginning of year	71,367	42,913
Cash and cash equivalents at end of year (Notes 30)	**43,899**	**71,367**

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

Podgorica, February 29, 2016

Approved by and signed on behalf of Erste Bank A.D., Podgorica

Aleksa Lukić	Aleksandra Radić	Kristina Bukilić
Chief Executive Director	Executive Director	Director of Finance and Accounting

ERSTE BANK AD PODGORICA ERSTE Bank 3

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31, 2015

In thousands of EUR	**Share capital**	**Share premium**	**Other reserves**	**General risk reserves**	**Special regulatory reserves**	**Revaluation reserves - Property valuation**	**Fair value reserves**	**Retained earnings**	**Total**
Balance as at January 1, 2014	5,339	1,571	300	182	1,467	430	958	29,568	39,815
Total comprehensive income	-	-	-	-	-	(430)	638	5,942	6,150
Change of revaluation model	-	-	-	-	-	-	-	13	13
Balance as at December 31, 2014	**5,339**	**1,571**	**300**	**182**	**1,467**	**-**	**1,596**	**35,523**	**45,978**
Adjustment on correction of error (note 2.7 and note 25)	-	-	-	(182)	-	-	-	182	-
Adjustment on correction of error (note 2.7 and note 23)								169	169
Total comprehensive income	-	-	-	-	-	-	(725)	6,528	5,803
Balance as at December 31, 2015	**5,339**	**1,571**	**300**	**-**	**1,467**	**-**	**871**	**42,402**	**51,950**

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

Podgorica, February 29, 2016

Approved by and signed on behalf of Erste Bank A.D., Podgorica

Aleksa Lukić	Aleksandra Radić	Kristina Bukilić
Chief Executive Director	Executive Director	Director of Finance and Accounting

ERSTE BANK AD PODGORICA ERSTE Bank 3

1. ACTIVITY

Erste Bank A.D., Podgorica ("the Bank") was registered in April 2002, based on the Decision of the Monetary Council of the Central Bank of Montenegro as Opportunity Bank A.D. Podgorica. The Bank changed its name in July 2009 to Erste Bank AD, Podgorica. The Bank has received a license to perform payments and deposit activities domestically and abroad.

The Bank is a joint stock company incorporated and domiciled in Montenegro. Its registered office is at Studentska bb, Podgorica, Montenegro.

In accordance with the Law on Banks, Articles of Association, Statute and Decision of the Central Bank of Montenegro, the Bank performs the following operations:

- accepting deposits and other funds of private individuals and legal entities and the use of these funds, either partially or wholly, for granting loans or investing on the Bank's own behalf;
- · issuing guarantees and accepting other obligations;
- purchase and collection of claims;
- issuing, processing and recording payment instruments (including credit cards, travel and bank checks);
- foreign payment operations;
- financial leasing;
- trading on its own behalf and for its own account or for the account of clients with foreign currencies, including exchange operations,
- currency and interest rate instruments;
- collecting, analyzing and giving information and advice on credit worthiness of companies and entrepreneurs and other issues regarding operations;
- deposit operations;
- safe-keeping services;
- activities directly related to the operations of the Bank and other activities, which are of an ancillary nature in relation to the Bank operations.

The Bank conducts its operations through its Head Office and sixteen branches located in the cities of Podgorica, Berane, Nikšić, Bijelo Polje, Pljevlja, Bar, Kotor, Ulcinj, Budva, Herceg Novi, Rožaje, Cetinje and Tivat.

Erste & Steiermarkische Bank d.d., Rijeka, Croatia owns 100% shares of the Bank from February 27, 2009. The ultimate parent of the Group is Erste Group Bank AG, Vienna, Austria.

As at December 31, 2015, the Bank had 266 employees (2014: 268 employees).

Members of the Board of Directors

As of the issuance date of the accompanying financial statements, i.e. on 29 February 2016, the members of the Board of Directors were as presented below:

Position held	First name and surname
President	Reinhard Ortner
Member	Borislav Centner
Member	Sava Ivanov Dalbokov
Member	Christoph Schofbock
Member	Slađana Jagar

Position held	First name and surname
Chief Executive Director	Aleksa Lukić
Executive director	Aleksandra Radić
Executive director	Darko Keković

2. BASIS OF PREPARATION

2.1. Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in accordance with Montenegrin banking regulation and related instructions. These financial statements are based on the Bank's statutory books and records, as adjusted and reclassified in order to comply with IFRS.

2. 2 Basis of measurement

The financial statements have been prepared on the historical cost basis, except for the financial instruments at fair value through profit or loss, financial instruments available for sale. which are measured at fair value.

2.3 Functional and presentation currency

The financial statements are presented in thousands of Euro (EUR) which is the Bank's functional and presentation currency.

2.4 Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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

Information about significant areas of estimation uncertainty and critical estimates in applying accounting policies that have the most significant effect on the amount recognized in the financial statements are described in Note 4.

A summary of the principal accounting policies applied in preparing the IFRS financial statements are set out within Note 3 to the financial statements.

2.5 Consolidation

The Bank does not have control over any other entity.

2.6 Going concern

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

2.7 Correction of an error

The opening balance adjustment of retained earnings as at January 1, 2015 of EUR 351 thousand is related to the effects of reversal of reserves for operational risk the Bank was recognizing from FY 2009 in accordance with the Decision of the Central Bank of Montenegro on minimum standards for operational risk management in banks ("Official Gazette of Montenegro" no. 24/2009) which become ineffective from FY 2013.

Accordingly, based on the Management Decision on December 30, 2015, the Bank adjusted opening balance of retained earnings as at January 1, 2015 of EUR 351 thousand which were previously presented under General risk reserves of EUR 182 thousand and Other liabilities of EUR 169 thousand.

2. BASIS OF PREPARATION (continued)

2.8 Reclassification of comparative figures on previously adopted and issued Statement of Comprehensive Income for the year ended 2014

In order to adapt presentation of Statement of Comprehensive Income with Erste Group accounting policies, the Bank has reclassified comparative figures in the Statement of Comprehensive Income for the year ended 2014 and appropriate note disclosure of these restatements have also been included in the current year's financial statements.

The comparative amounts have been reclassified to reflect the below matters:

The comparative amounts have been reclassified to reflect the below matters:

In thousands of EUR	Interest expense	Gains on derecognition of non-financial assets	Impairment gain/loss on assets	Provisions	General administrative expenses	Other operating result	Total
Impairment on non-financial assets – foreclosed assets			866			(866)	-
Impairment on Loans and advances to banks			(2)			2	-
Provision for Commitments and guarantees given			(308)	308			-
Personnel expenses	9				(9)		-
Deposit insurance fund commission					1,191	(1,191)	-
Provision for litigation				(32)		32	-
Net losses from fixed and acquired assets		(24)				24	-
Total	**9**	**(24)**	**556**	**276**	**1,182**	**(1,999)**	**-**

2. BASIS OF PREPARATION (continued)

2.8 Reclassification of comparative figures on previously adopted and issued Statement of Comprehensive Income for the year ended 2014 (continued)

In thousands of EUR	Previously Adopted and Issued Statement of Comprehe-nsive Income 2014	Effects of Reclassifi-cation	Reclassified Statement of Comprehe-nsive Income 2014
Interest income	26,475	(1)	26,474
Interest expense	(7,756)	(9)	(7,765)
Net interest income	18,719	(10)	18,709
Fee and commission income	3,835		3,835
Fee and commission expense	(732)		(732)
Net fee and commission income	3,103		3,103
Net trading income	367		367
Net gains from investment in securities	688		688
Dividend income	-	1	1
Gains on derecognition of non-financial assets	-	24	24
Impairment gain/loss on assets	(826)	(556)	(1,382)
Provisions	-	276	(276)
General administrative expenses	(13,148)	(1,182)	(14,330)
Other operating result	(2,384)	1,999	(385)
INCOME BEFORE TAX	6,519	-	6,519
Income tax	(551)	-	(551)
INCOME FOR THE YEAR	5,968	-	5,968
Other comprehensive income			
(Losses)/ Gains on available for sale financial assets	695	-	695
Income tax effect	(58)	-	(58)
Actuarial gains on long-term employee benefits	(29)	-	(29)
Income tax effect	3	-	3
Revaluation of property	(472)	-	(472)
Income tax effect	43	-	43
Total other comprehensive income for the year, net of tax	182	-	182
Total comprehensive income for the year, net of tax	6,150	-	6,150

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1 Application of amended and new IFRS/IAS

The accounting policies adopted are consistent with those used in the previous financial year except for standards and interpretations that became effective for financial years beginning on or after 1 January 2015. As regards new standards and interpretations and their amendments, only those that are relevant for the business of the Bank are listed below.

3.1.1 Effective standards and interpretations

The following standards and their amendments have been mandatory since 1 January 2015:
- IFRIC 21 Levies
- Annual Improvements to IFRSs 2011-2013 Cycle

IFRIC 21 Levies

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. These criteria are among others applied for recovery & resolution fund which is presented in other operating income. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. Retrospective application is required for IFRIC 21. This interpretation has no impact on the Bank as it has applied the recognition principles under IAS 37 Provisions, Contingent Liabilities and Contingent Assets consistent with the requirements of IFRIC 21 in prior years. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014, but in EU for annual periods beginning on or after 17 June 2014.

Annual Improvements to IFRSs 2011 2013 Cycle

In December 2013, the IASB issued a set of amendments to various standards. The amendments are effective for annual periods beginning on or after 1 July 2014, but in EU for annual periods beginning on or after 1 January 2015. Application of these amendments did not have a significant impact on financial statements of the Bank.

3.1.2 Standards and interpretations not yet effective

The standards and interpretations shown below were issued by the IASB but are not yet effective.

Following standards, amendments and interpretations are not yet endorsed by the EU:
- IFRS 9: Financial Instruments
- IFRS 14 Regulatory Deferral Accounts: The European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard
- IFRS 15: Revenue from Contracts with Customers including amendments to IFRS 15: Effective date of IFRS 15
- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture
- Amendments to IFRS 10, IFRS 12 and IAS 28: Investment Entities: Applying the Consolidation Exception
- IFRS 16: Leases
- Amendments to IAS 12: Recognition of deferred tax assets for unrealised losses

Following standards, amendments and interpretations are already endorsed by the EU:
- Amendments to IAS 19 – Defined Benefit Plans: Employee Contributions
- Annual Improvements to IFRSs 2010-2012 Cycle
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
- Amendments to IFRS 11: Accounting for Acquisitions of Interest in Joint Operations
- Amendments to IAS 1: Disclosure Initiative
- Annual Improvements to IFRSs 2012-2014 Cycle

The adoption of standards and interpretation is described below:

IFRS 9: Financial Instruments (IASB Effective Date: 1 January 2018)

IFRS 9 was issued in July 2014 and is effective for annual periods beginning on or after 1 January 2018. IFRS 9 addresses three main areas of accounting for financial instruments: classification and measurement, impairment and hedge accounting.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Application of amended and new IFRS/IAS (continued)

3.1.2 Standards and interpretations not yet effective (continued)

IFRS 9 introduces two classification criteria for financial assets: 1) an entity's business model for managing the financial assets, and 2) the contractual cash flow characteristics of the financial assets. As a result, a financial asset is measured at amortised cost only if both the following conditions are met: a) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding and b) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows. Measurement of a fair value through other comprehensive income is applicable to financial assets that meet condition a) but the business model applied to them is focused both on holding the assets to collect contractual cash flows and selling the assets. All other financial assets are measured at fair value with changes recognised in profit or loss. For investments in equity instruments that are not held for trading, an entity may make an irrevocable election at initial recognition to measure them at fair value with changes recognised in other comprehensive income.

IFRS 9 does not change classification and measurement principles for financial liabilities compared to IAS 39. The only change is related to financial liabilities designated at fair value through profit or loss (fair value option). The fair value changes related to the credit risk of such liabilities will be presented in other comprehensive income.

The standard provides a uniform impairment model applied to both financial assets and off-balance sheet credit risk bearing exposures (loan commitments and financial guarantees). At initial recognition of financial instruments loss allowance to reflect credit loss is recognised in the form of 12-month expected losses. Lifetime expected losses are to be recognised for all instrument whose credit risk increases subsequently after initial recognition. Furthermore the standard brings new rules for accounting for losses resulting from modification of contractual conditions of financial assets.

During the year 2015, the Erste Group proceeded with the development of master business concepts and business requirements documentation addressing the changes in policies, procedures, processes and systems, assessed as necessary in preparation for transition to IFRS 9 on 1 January 2018. As part of this effort, iterative financial impact studies (notably with regards to classification/measurement and impairment of financial assets) were started across the Erste Group and are planned to continue throughout 2016, along with gradually moving from the concept phase to the implementation phase of the documented business requirements.

IFRS 14 Regulatory Deferral Accounts (IASB Effective Date: 1 January 2016)

IFRS 14 Regulatory Deferral Accounts permits an entity which is a first-time adopter of International Financial Reporting Standards to continue to account, with some limited changes, for regulatory deferral account balances in accordance with its previous GAAP, both on initial adoption of IFRS and in subsequent financial statements. The bank does not expect any significant impact from application of IFRS 14.

IFRS 15 Revenue from Contracts with Customers (IASB Effective Date: 1 January 2018)

IFRS 15 was issued in May 2014 and is effective for annual periods beginning on or after 1 January 2018. IFRS 15 specifies how and when an entity recognises revenue from contracts with customers. It also requires such entities to provide users of financial statements with more informative and more relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. Also in the areas of variable considerations and capitalisation of cost IFRS 15 provides modified regulations. The standard is not focused on recognition of revenues from financial services. The Bank does not expect any significant impact from application of IFRS 15

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (IASB Effective Date: 1 January 2016)

Amendments to IFRS 10 and IAS 28 were issued in September 2014 and are effective for annual periods beginning on or after 1 January 2016.These amendments deal with the sale or contribution of assets or subsidiaries in a transaction between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognised only when the assets or the subsidiaries constitute a business, as defined in IFRS 3. Application of these amendments is not expected to have a significant impact on the Bank's financial statements.

Amendments to IFRS 10, IFRS 12 and IAS 28: Investment Entities: Applying the Consolidation Exception (IASB Effective Date: 1 January 2016)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Application of amended and new IFRS/IAS (continued)

3.1.2 Standards and interpretations not yet effective (continued)

The amendments confirm that the exemption from preparing consolidated financial statements for an intermediate parent entity is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all of its subsidiaries at fair value. Also, they clarify that when applying the equity method to an associate or a joint venture, a non-investment entity investor in an investment entity may retain the fair value measurement applied by the associate or joint venture to its interests in subsidiaries. Application of these amendments is not expected to have a significant impact on the Bank's financial statements.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation (IASB Effective Date: 1 January 2016)

Amendments to IAS 16 and IAS 38 were issued in May 2014 and are effective for annual periods beginning on or after 1 January 2016. The amendments prohibit the use of revenue-based depreciation for property, plant and equipment and significantly limiting the use of revenue-based amortisation for intangible assets. Application of these amendments is not expected to have a significant impact on the Bank's financial statements.

Amendments to IFRS 11: Accounting for Acquisitions of Interests in Joint Operations (IASB Effective Date: 1 January 2016)

Amendments to IFRS 11 were issued in May 2014 and are effective for annual periods beginning on or after 1 January 2016. The amendments specify that the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3, is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11. Application of these amendments is not expected to have a significant impact on the Bank's financial statements.

Amendments to IAS 1: Disclosure Initiative (IASB effective date: 1 January 2016)
Disclosure Initiative (Amendments to IAS 1) makes the following changes:

Materiality
The amendments clarify that (1) information should not be obscured by aggregating or by providing immaterial information, (2) materiality considerations apply to the all parts of the financial statements, and (3) even when a standard requires a specific disclosure, materiality considerations do apply.

Statement of financial position and statement of profit or loss and other comprehensive income
The amendments (1) introduce a clarification that the list of line items to be presented in these statements can be disaggregated and aggregated as relevant and additional guidance on subtotals in these statements and (2) clarify that an entity's share of OCI of equity-accounted associates and joint ventures should be presented in aggregate as single line items based on whether or not it will subsequently be reclassified to profit or loss.

Notes
The amendments add additional examples of possible ways of ordering the notes to clarify that understand ability and comparability should be considered when determining the order of the notes and to demonstrate that the notes need not be presented in the order so far listed in paragraph 114 of IAS 1. The IASB also removed guidance and examples with regard to the identification of significant accounting policies that were perceived as being potentially unhelpful.

These changes and clarifications are not expected to trigger significant changes in the presentation of the Bank's financial statements.

Annual Improvements to IFRSs 2012-2014 Cycle (IASB effective date: 1 January 2016)

In September 2014, the IASB issued a set of amendments to various standards. The amendments are effective for annual periods beginning on or after 1 January 2016. Application of these amendments is not expected to have a significant impact on the Bank's financial statements.

IFRS 16 Leases (IASB Effective Date: 1 January 2019)

In January 2016, the IASB issued IFRS 16 being effective for annual periods beginning on or after 1 January 2019. IFRS 16 specifies the depiction of lease arrangements in the financial statements. Compared to the previous standard IAS 17, there is a fundamental alteration in respect of the recognition of operating leasing arrangements for the lessee. As defined in IFRS 16, the standard requires the lessee to recognize a right of use asset on the debit side of the statement of financial position as well as a corresponding lease liability on the credit side of the statement of financial position except for immateriality in cases of short term leasing arrange

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1 Application of amended and new IFRS/IAS (continued)

3.1.2 Standards and interpretations not yet effective (continued)

ments and small ticket leasing arrangements for low-value assets. By contrast, accounting changes for the lessor are only minor compared to IAS 17. Compared to IAS 17 the notes will be much more comprehensive under IFRS 16.
The Bank does not expect any significant impact from application of IFRS 16.

Amendments to IAS 12 – Recognition of deferred tax assets for unrealised losses (IASB effective date: 1 January 2017)

Amendments to IAS 12 were issued in January 2016 and are effective for annual periods beginning on or after 1 January 2017. The amendments clarify that unrealised losses on debt instruments measured at fair value in the financial statements but at cost for tax purposes can lead to deductible temporary differences. The amendments also clarify that not the carrying amount but the tax base of an asset is the relevant base for the estimate of future taxable profits and that the carrying amount is not the ceiling to be used for the calculation. When comparing deductible temporary differences with future taxable profits, the future taxable profits exclude tax deductions resulting from the reversal of those deductible temporary differences.
Application of these amendments is not expected to have a significant impact on the Bank's financial statements.

3.2 Recognition of income and expenses

3.2.1 Interest

Interest income and expense are recognized in the statement of comprehensive income using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability.

The calculation of the effective interest rate includes all fees and points paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

3.2.2 Fees and commissions

Fees and commissions income/expenses arising upon financial services provided by/to the Bank include transfer payments and other banking services.

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are deferred and recognized as a part of the effective interest rate.

When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognized in the statement of comprehensive income on an accrual basis.

Other fees and commission expense relate mainly to transaction and service fees, which are recognized in the statement of comprehensive income as the services are provided or received.

3.2.3 Net trading income

Net trading income include foreign currency exchange gains (realized and unrealized) and losses, fair value adjustments and gains/losses on sale of financial assets at fair value through profit or loss and financial assets available for sale.

3.2.4 Operating lease expenses

The Bank is involved in operating lease arrangements as the lessee. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

3.2.5 Income and other taxes

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the statement of comprehensive income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

3.2.6 Current income tax

Current tax represents an amount calculated and payable under the Montenegrin Corporate Income Tax Law. The income tax rate is 9% (2014: 9%) and is payable on taxable profit.

Taxable profit includes the profit shown in the statutory statement of comprehensive income, adjusted for differences, as defined by the Montenegrin Corporate Income Tax Law.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2 Recognition of income and expenses (continued)

3.2.6 Current income tax (continued)

Montenegrin Tax Law does not allow tax losses of the current period to be used to recover tax paid within a specific carry back period. However, current year tax losses may be used to decrease taxable profits for future periods up to a maximum of five years.

3.2.7 Deferred tax

Deferred tax is provided using the statement of financial position method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently, enacted tax rates are used in the determination of deferred income tax. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3.3 Financial assets and liabilities

Classification

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, available-for-sale financial assets and loans and advances. The Bank classifies its financial liabilities into the following categories: financial liabilities at fair value through profit or loss and other financial liabilities.

Financial assets or liabilities at fair value through profit or loss are financial instruments that are classified as held for trading or upon initial recognition are designated by the Bank as at fair value through profit or loss. Financial assets or liabilities at fair value through profit or loss are those that the Bank acquired or incurred principally for the purpose of selling or repurchasing it in the near term, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking or derivatives.

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and the ability to hold them to maturity.

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to a debtor with no intention of trading the receivable. Loans and receivables comprise loans and advances to banks and customers.

Available for sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Equity investments are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or changes in equity prices.

Recognition

Financial assets or liabilities at fair value through profit or loss, held to maturity investments and financial assets available for sale are initially recognized on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes "regular way trades": purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. All other financial assets and liabilities are recognized on the settlement date, i.e., the date that an asset is delivered to or by Bank.

Initial measurement

A financial asset or financial liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Financial assets and liabilities (continued)

Derecognition

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognized as a separate asset or liability.

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank writes off certain loans when they are determined to be uncollectible (see Note 28).

Amortized cost measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

Fair value measurement

The fair values stated for financial instruments are the amounts for which the asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair values of certain financial instruments are approximately equivalent to their carrying amounts. These include cash as well as receivables and liabilities without a defined maturity or fixed interest rate. For other receivables and liabilities, future anticipated cash flows are discounted to their present value using current interest rates.

Subsequent measurement

Financial assets or financial liabilities held-for-trading

Financial assets or financial liabilities held-for-trading are recorded in the statement of financial position at fair value. Changes in fair value are recognized in 'Net trading income'. Interest and dividend income or expense is recorded in 'Net trading income' according to the terms of the contract, or when the right to the payment has been established.

Loans and advances

Loans and advances are subsequently measured at amortized cost using the effective interest rate method less allowances for impairment. Amortized cost is calculated by taking into account any issuance costs and any discount or premium on settlement. The losses arising from impairment are recognized in the statement of comprehensive income .

When the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is classified as a finance lease and a receivable equal to the net investment in the lease is recognized and presented within loans and advances.

If a lessor transfers substantially all the risks and rewards incident to the ownership of an asset to the lessee, lease contracts are classified as finance leases. The Bank, as a lessor, recognizes assets held under a finance lease in its statement of financial position and presents them as finance lease receivables at an amount equal to the net investment in the lease. The sum of future minimum lease payments and initial origination fees equate to the gross investment in the lease (since finance lease contracts include a purchase clause at the end of the lease period there is no unguaranteed residual value). The difference between the gross and net investment in the lease represents unearned finance income, which is recognized as interest income over the lease term at a constant periodic rate of return on the net investment in the lease.

Financial assets available for sale

Financial assets available-for-sale are subsequently measured at fair value. Unrealized gains and losses are recognized directly in equity in the fair value reserve. When the investment is disposed of, the cumulative gain or loss previously recognized in equity is recognized in the statement of comprehensive income. Where the Bank holds more than one investment in the same security they are deemed to be disposed of on a first-in first-out basis. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the effective interest rate. Dividends earned whilst holding financial asset available for sale are recognized in the statement of comprehensive income when the right of the payment has been established. The losses arising from impairment of such investments are recognized in the statement of comprehensive income and removed from the fair value reserve.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Financial assets and liabilities (continued)

Subsequent measurement (continued)

Financial assets held to maturity

Financial assets held-to-maturity are non-derivative financial assets quoted in an active market with fixed or determinable payments and fixed maturities, which the Bank has the intention and ability to hold to maturity. After initial measurement, financial assets held-to-maturity are subsequently measured at amortized cost using the effective interest rate, less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in interest income. The losses arising from impairment of such investments are recognized in the statement of comprehensive income .

Other financial liabilities

Other financial liabilities are subsequently measured at amortized cost using the effective interest rate method.

Identification and measurement of impairment

At each statement of financial position date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed individually for impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortized cost) with similar risk characteristics.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Identification and measurement of impairment

In assessing collective impairment the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognized in statement of comprehensive income and reflected in an allowance account against loans and advances. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through statement of comprehensive income .

Impairment losses on financial assets available for sale are recognized by transferring the difference between the amortized acquisition cost and current fair value out of equity to statement of comprehensive income. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through statement of comprehensive income . However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognized directly in equity.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, current accounts with the Central Bank of Montenegro and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Financial assets and liabilities (continued)

Cash and cash equivalents **(continued)**

changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortized cost in the statement of financial position.

3.4 Property, plant and equipment

Property, plant and equipment are stated in the statement of financial position at historical cost. In previous year the buildings were stated at fair value model , and Bank changed it's accounting policy during 2015 to historical cost model.

Cost includes expenditure that is directly attributable to the acquisition of the asset.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Depreciation rates in use are as follows:

Description	%
Building	2.5
Computers and related equipment	14.29 – 25
Furniture and other equipment	10 – 33.33

Maintenance and repairs are charged to profit and loss account when incurred. Improvements are capitalized.

3.5 Intangible assets

Intangible assets are stated at cost decreased for accumulated amortization and impairment. Intangible assets represent computer software, Swift license, Master Card license and other intangible assets. Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives. Amortization rates used range from 10% to 40%.

3.6 Acquired assets held for sale

The Bank acquired properties through the enforcement of security over loans and advances. Acquired properties are measured at the lower of its carrying amount and fair value less cost to sell.

3.7 Employment benefits

Pursuant to the Collective Bargaining Agreement, the Bank is obliged to pay retirement benefits in an amount equal to six average monthly salaries in the Bank. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and/or the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

Provision for retirement benefits is calculated by independent actuary. The liability recognized in the statement of financial position is the present value of the obligation, determined by discounting estimated future outflows using the projected unit credit method. Actuarial gains and losses are recognized in the period in which they arise in other comprehensive income.

3.8 Financial guarantees

In ordinary course of business, the Bank gives financial guarantees, consisting of guarantees, performance bonds and acceptances. Financial guarantees are initially recognized in the financial statements at fair value, being the premium received. Subsequent to initial recognition the Bank's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to the financial guarantees is taken to the statement of comprehensive income. The premium received is recognized in the statement of comprehensive income on a straight line basis over the life of the guarantee.

3.9 Foreign currency translation

Transactions in foreign currency are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rate ruling at the statement of financial position date. Foreign exchange differences arising on translation are recognized in the statement of comprehensive income using .

Non-monetary assets denominated in foreign currency are translated at the rate ruling at the historic date.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3 Financial assets and liabilities (continued)

3.9 Foreign currency translation (continued)

Official exchange rates for major currencies used in the translation of assets and liabilities denominated in foreign currencies at December 31, 2015 and 2014 are as follows:

In EUR	2015	2014
USD	0.9152	0.8224
CHF	0.9247	0.8314
GBP	1.3550	1.2783

4. USE OF ESTIMATES AND JUDGMENTS

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities within 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 under circumstances.

These disclosures supplement the commentary on financial risk management (see Note 27).

The most significant uses of judgment and estimates are as follows:

4.1 Impairment losses on loans

The Bank reviews its loan portfolios to assess impairment at least on a monthly basis. In determining whether an impairment loss should be recorded in the statement of comprehensive income , the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, local economic conditions that correlate with defaults on assets.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

4.2 Fair value of financial instruments

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

4.3 Long-term employee benefits

The cost of the long-term employee benefits is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases and personnel turnover rate. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

4.4 Useful lives of intangible assets, property, plant and equipment

The Bank reviews useful lives of intangible assets, property, plant and equipment as of each annual reporting period.

5. NET INTEREST INCOME

In thousands of EUR	2015	2014 reclassified
Interest income		
Time deposits with banks	1	2
foreign banks	1	1
Central bank	-	1
Loans	21,531	24,441
corporate customers	4,382	5,274
retail customers	14,843	15,192
public institutions	2,304	3,968
other	2	7
Securities	2,537	2,031
held to maturity	1,269	184
available for sale	1,268	1,847
Total interest income	**24,069**	**26,474**
Interest expense		
Deposits and borrowed funds from banks	(1,120)	(2,147)
Deposits and borrowed funds from customers	(4,005)	(5,082)
corporate customers	(1,201)	(1,334)
retail customers	(2,708)	(3,518)
public institutions	(96)	(230)
Debt securities	(388)	(429)
Subordinated loans	-	(98)
Other liabilities	(12)	(9)
Total interest expense	**(5,524)**	**(7,765)**
Net interest income	**18,545**	**18,709**

6. NET FEE AND COMMISSION INCOME AND EXPENSE

In thousands of EUR	**2015**	**2014**
Fee and commission income		
Lending business	650	723
Card transactions	854	851
Payment transfers	2,227	1,909
Other fee and commission income	396	352
Total fee and commission income	**4,127**	**3,835**
Fee and commission expense		
Card transactions	(487)	(475)
Payment transfers	(334)	(214)
Custodial fees	(48)	(25)
Other fee and commission expenses	(29)	(18)
Total fee and commission expense	**(898)**	**(732)**
Net fee and commission income	**3,229**	**3,103**

7. IMPAIRMENT GAIN/LOSS ON ASSETS

In thousands of EUR	**2015**	**2014 reclassified**
Impairment / reversal of impairment on financial assets		
Loans and advances to customers (note 14)	1,036	3,611
Recoveries on written off loans	(2,640)	(3,094)
Impairment on non-financial assets - repossessed assets (note 19)	1,349	865
Total	**(255)**	**1,382**

8. PROVISIONS

In thousands of EUR	2015	2014 reclassified
Commitments and guarantees given	121	308
Provision for litigation	413	(32)
Total	**534**	**276**

9. GENERAL ADMINISTRATIVE EXPENSES

In thousands of EUR	2015	2014 reclassified
Personnel expenses	7,459	6,971
Other administrative expenses	5,942	6,037
Depreciation of property and equipment (note 17)	630	649
Amortization of intangible assets (note 18)	599	673
Total	**14,630**	**14,330**

Personal expenses relate to following:

In thousands of EUR	2015	2014 reclassified
Wages and salaries - net	4,306	4,083
Tax on salaries	582	739
Employee contributions	1,252	1,389
Legal social security contribution	729	715
Other personnel expenses	311	7
Provision for long-term employee benefits (note 23)	24	38
Provisions for unused vacation	255	-
Total	**7,459**	**6,971**

Other administrative expenses relate to following:

In thousands of EUR	2015	2014 reclassified
Expenses dependent upon personnel	165	149
Expenses for office space	1,316	1,282
Office operating expenses	553	456
IT expenses	1,076	1,137
Advertising / marketing	566	602
Legal and consulting costs	916	1,205
Payment into deposit insurance fund	1,343	1,191
Sundry administrative expenses	7	15
Total	**5,942**	**6,037**

10. OTHER OPERATING RESULTS

In thousands of EUR	**2015**	**2014 reclassified**
Other operating income	57	59
Net losses from fixed and acquired assets	(49)	(108)
Provisions for other assets (note 19)	(217)	(274)
Other miscellaneous expense	(103)	(62)
Total	**(312)**	**(385)**

Provisions for other assets in the amount of EUR 217 thousand (2014: EUR 274 thousand) mostly relate to provisions for fees and commissions.

11. INCOME TAX

The components of income tax for the years ended December 31, 2015 and December 31, 2014 are:

In thousands EUR	**2015**	**2014**
Current tax – current income tax	654	585
Deferred tax – relating to origination and reversal of temporary differences	(9)	(34)
	645	551

Reconciliation between the tax expense and the accounting result multiplied by the Montenegrin tax rate for the year ended December 31, 2015 and 2014 is as follows:

In thousands EUR	**2015**	**2014**
Accounting profit before tax	7,177	6,519
At Montenegrin statutory tax rate of 9%	646	587
Other	(1)	(36)
	645	551
Effective interest rate	**8.99%**	**8.45%**

11. INCOME TAX (continued)

Deferred tax related to items charged or credited directly to equity during the year is as follows:

In thousands EUR	**2015**	**2014**
Losses on financial assets available for sale	(72)	58
Revaluation of property	-	(42)
Actuarial gains on long-term employee benefits recognized in equity	(1)	(3)
	(73)	**13**

Deferred tax assets and liabilities recognized in statement of financial position relate to the following:

	2015			**2014**		
In thousands of EUR	**Assets**	**Liabilities**	**Net**	**Assets**	**Liabilities**	**Net**
Actuarial gains on long-term employee benefits recognized in equity	-	(8)	(8)	-	(8)	(8)
Gains on financial assets available for sale	-	(85)	(85)	-	(158)	(158)
Temporary differences between intangible assets, property and equipment for tax purposes and their carrying amounts		(69)	(69)	-	(78)	(78)
Net tax assets/(liabilities)	**-**	**(162)**	**(162)**	**-**	**(244)**	**(244)**

12. CASH AND CASH EQUIVALENTS

In thousands EUR	2015	2014
Cash on hand (note 30)	12,293	10,649
Current accounts with the Central Bank of Montenegro (note 30)	20,394	28,753
Deposits with the Central Bank of Montenegro	15,693	17,213
Balance as at December 31,	**48,380**	**56,615**

The Bank's obligatory reserves on December 31, 2015 were set aside in accordance with the Decision of Central Bank of Montenegro on obligatory reserve of the banks to be held with the Central Bank of Montenegro (Official Gazette of Montenegro No. 35/11,22/12, 61/12, 57/13, 52/14 and 7/15) which prescribes that banks allocate the obligatory reserve by applying rate of: 9,5% on deposits base which is consisted of demand deposits and deposits with agreed maturity up to one year, or up to 365 days and 8.5% on deposit base which is consisted of deposits with agreed maturity over one year, or over 365 days. On deposits with agreed maturity over one year, or 365 days, and clause on possibility of termination of the deposit within less than one year, the rate applied is 9.5%.

The Bank's obligatory reserves represent the minimum deposits set aside onto domestic accounts of obligatory reserves and/or onto the accounts of the Central Bank of Montenegro held abroad. In accordance with the Decision and to December 31, 2015 on 15% of obligatory reserve held on obligatory reserve accounts, the Central Bank is paying a monthly fee that is calculated at a rate equal to EONIA (Euro OverNight Index Average) minus 10 basis points per annum, with a note that this rate cannot be less than zero, until 8th of the current month for previous month. The Bank may hold part of obligatory reserve in government treasury bills issued by Montenegro, as follows: up to 25% in the form of bills with any type of maturity, after what the Bank may hold additional 10% in the form of bills with maturity up to 182 days.. The obligatory reserve is held in EUR.

13. LOANS AND ADVANCES TO BANKS, NET

In thousands of EUR	**2015**	**2014**
Current accounts with foreign banks (note 30)	11,212	31,965
Time accounts with foreign banks	-	-
Deposit for Master Card business	396	356
Allowance for impairment	(3)	(8)
Balance as at December 31,	**11,605**	**32,313**

14. LOANS AND ADVANCES TO CUSTOMERS, NET

In thousands of EUR	2015 Gross Amount	2015 Impairment	2015 Carrying amount	2014 Gross Amount	2014 Impairment	2014 Carrying amount
Retail customers						
Personal loans	79,702	(2,325)	77,377	90,159	(7,176)	82,983
Credit cards	3,192	(444)	2,748	4,870	(733)	4,137
Finance lease	30	(26)	4	142	(133)	9
Housing loans	33,032	(1,003)	32,029	37,480	(2,008)	35,472
Mortgage loans	7,303	(1,211)	6,092	8,297	(963)	7,334
Other lending	19,736	(4,166)	15,570	3,301	(127)	3,174
Corporate customers						
Credit cards	74	(4)	70	59	(2)	57
Finance lease	244	(60)	184	492	(203)	289
Factoring	-	-	-	25	-	25
Revolving loans	10,162	(320)	9,842	665	(86)	579
Investment loans	-	-	-	30,532	(3,031)	27,501
Other lending	61,343	(8,108)	53,235	29,968	(4,677)	25,291
Public customers						
Factoring	1,798	(74)	1,724	3,680	(6)	3,674
Investment loans	-	-	-	13,057	(97)	12,960
Other lending	36,639	(224)	36,415	27,855	(160)	27,695
Other customers						
Investment loans	582	(30)	552	292	(19)	273
Other lending	-	-	-	(2)	-	(2)
Balance as at December 31,	**253,837**	**(17,995)**	**235,842**	**250,872**	**(19,421)**	**231,451**

A reconciliation of allowance for impairment of loans and advances to customers is as follows:

In thousands of EUR	2015	2014
Balance as at January 1,	19,421	18,807
Charge for the year (note 7)	1,036	3,611
Unwinding	(769)	(811)
Write off	(1,693)	(2,186)
Balance as at December 31,	**17,995**	**19,421**

14. LOANS AND ADVANCES TO CUSTOMERS, NET (continued)

Analysis of loans and advances to customers by sector is as follows:

In thousands of EUR	**2015**	**2014**
Agriculture	3,095	2,439
Building construction	6,407	7,779
Trade	35,939	33,333
Tourism	3,839	4,907
Production	7,296	5,483
Transportation	4,352	2,572
Administration and other public services	40,202	41,801
Retail	142,995	144,249
Other	9,712	8,309
	253,837	250,872
Less: Allowance for impairment	(17,995)	(19,421)
Balance as at December 31,	**235,842**	**231,451**

Analysis of loans and advances to customers by maturity is as follows:

In thousands of EUR	**Due**	**Short term**	**Long term**	**Impairment**	**Carrying amount**
Retail customers	2,772	1,875	138,348	(9,175)	133,820
Corporate customers	4,461	21,021	46,341	(8,492)	63,331
Public customers	-	-	38,437	(298)	38,139
Other customers	-	268	314	(30)	552
Balance as at December 31, 2015	**7,233**	**23,164**	**223,440**	**(17,995)**	**235,842**

In thousands of EUR	**Due**	**Short term**	**Long term**	**Impairment**	**Carrying amount**
Retail customers	4,146	24,509	115,594	(11,140)	133,109
Corporate customers	2,797	26,714	32,230	(7,999)	53,742
Public customers	1	16,857	27,734	(263)	44,329
Other customers	-	99	191	(19)	271
Balance as at December 31, 2014	**6,944**	**68,179**	**175,749**	**(19,421)**	**231,451**

14. LOANS AND ADVANCES TO CUSTOMERS, NET (continued)

Accrued interest ad deferred loan fees that are included in gross loans in above table:

In thousands of EUR	Due Interest	Accrued Interest	Impairment	Carrying amount of Interest	Deferred income
Retail customers	257	770	(137)	890	282
Corporate customers	154	174	(50)	278	105
Public customers	-	89	(1)	88	14
Other customers	-	6	-	6	2
Balance as at December 31, 2015	**411**	**1,039**	**(188)**	**1,262**	**403**

In thousands of EUR	Due Interest	Accrued Interest	Impairment	Carrying amount of Interest	Deferred income
Retail customers	300	710	(160)	850	371
Corporate customers	193	161	(34)	320	101
Public customers	1	111	(1)	111	20
Other customers	-	2	(1)	1	2
Balance as at December 31, 2014	**494**	**984**	**(196)**	**1,282**	**494**

The Bank manages its exposure to credit risk by applying a range of control measures including: regular assessments using agreed credit criteria and diversification of sector risk to avoid undue concentration in any particular type of business or geographic location. The Bank obtains security in the form of mortgages, guarantees and pledges in order to reduce the level of credit risk.

For loans granted to individuals weighted average interest rate was 10.28% (FY 2014: 11.01%) p.a. (FY 2014: 11.01%) and for loans granted to companies weighted average interest rate was 6.32% p.a. (FY 2014: 7.82%).

As disclosed in Note 21, the Bank assigned to the EFSE Luxemburg as collateral for loans granted from the EFSE loan fund of EUR 894 thousand (31 December 2014: EUR 1,897 thousand) relating to all present and future payment claims and all other rights which relate to any Sub-Loan refinanced under Framework Agreement between the Bank and EFSE Luxembourg and any rights and claims arising from any collateral or guarantee granted either by the Sub-Borrower or any other obligor as a security for such Sub-Loan.

Finance lease receivables

Loans and advances to customers include the following finance lease receivables:

In thousands of EUR	2015	2014
More than five years	30	36
Between one and five years	97	193
Less than one year	168	438
Gross investment in finance leases, receivable	295	667
Unearned future income on finance leases	(21)	(33)
Net investment in finance leases	**274**	**634**

14. LOANS AND ADVANCES TO CUSTOMERS, NET (continued)

Future minimum lease payments receivable, unearned future income and the net investment in finance lease by maturity as at December 31, 2015 and 2014 are as follows:

			2015
In thousands of EUR	**Gross investment**	**Unearned income**	**Investment in the lease**
Less than one year	168	(5)	163
Between one and five years	97	(10)	87
More than five years	30	(6)	24
Investment in finance leases at end of year 2015	**295**	**(21)**	**274**

			2014
In thousands of EUR	**Gross investment**	**Unearned income**	**Investment in the lease**
Less than one year	438	(7)	431
Between one and five years	193	(15)	178
More than five years	36	(11)	25
Investment in finance leases at end of year 2014	**667**	**(33)**	**634**

15. FINANCIAL ASSETS AVAILABLE FOR SALE

In thousands EUR	**2015**	**2014**
Debt instruments – Eurobonds of the Ministry of Finance of the Government of Montenegro	12,059	37,514
Debt instruments – Bonds of the Ministry of Finance of the Government of Serbia	2,052	2,057
	14,111	39,571
Equity instruments	713	559
Balance as at December 31,	**14,824**	**40,130**

The following table presents debt instruments for Eurobonds of the Ministry of Finance of the Government of Montenegro and Bonds of the Ministry of Finance of the Government of Serbia:

In thousands of EUR	**Outstanding amount**	**Maturity date**
Eurobonds of the Ministry of Finance of the Government of Montenegro	107	April 8, 2016
Bonds of the Ministry of Finance of the Government of Serbia	2,052	June 13, 2016
Eurobonds of the Ministry of Finance of the Government of Montenegro	3,397	March 18, 2020
Eurobonds of the Ministry of Finance of the Government of Montenegro	8,555	May 20, 2019
Financial assets available for sale as of December 31, 2015	**14,111**	

15. FINANCIAL ASSETS AVAILABLE FOR SALE (continued)

In thousands of EUR	Outstanding amount	Maturity date
Eurobonds of the Ministry of Finance of the Government of Montenegro	110	April 8, 2016
Bonds of the Ministry of Finance of the Government of Serbia	2,057	June 13, 2016
Eurobonds of the Ministry of Finance of the Government of Montenegro	7,738	March 3, 2016
Eurobonds of the Ministry of Finance of the Government of Montenegro	29,666	May 20, 2019
Financial assets available for sale as of December 31, 2014	**39,571**	

16. FINANCIAL ASSETS HELD TO MATURITY

In thousands of EUR	**2015**	**2014**
Debt instruments – Eurobonds of the Ministry of Finance of the Government of Montenegro	50,637	6,988
Bonds of Work Fund Podgorica	628	929
Balance as at December 31,	**51,265**	**7,917**

The following table presents debt instruments held to maturity for Eurobonds of the Ministry of Finance of the Government of Montenegro and Bonds of Work Fund Podgorica:

In thousands of EUR	**Outstanding amount**	**Maturity date**
Eurobonds of the Ministry of Finance of the Government of Montenegro	500	March 2, 2016
Eurobonds of the Ministry of Finance of the Government of Montenegro	4,000	January 13, 2016
Eurobonds of the Ministry of Finance of the Government of Montenegro	4,699	February 23, 2020
Eurobonds of the Ministry of Finance of the Government of Montenegro (reclassified from financial asset available for sale, note 15)	25,000	May 20, 2019
Eurobonds of the Ministry of Finance of the Government of Montenegro (reclassified from financial asset available for sale, note 15)	16,438	March 18, 2020
Bonds of Work Fund Podgorica	628	July 25, 2017
Financial assets held to maturity as of December 31, 2015	**51,265**	

According to the Bank's ALCO Committee's Decision from 29 May 2015, the Bank reclassified EUR 40,000 thousand of Eurobonds issued by the Ministry of Finance initially recognized as Available for sale to Held for maturity financial instruments.

As the Bank has ability to hold abovementioned debt instruments to maturity, with this Decision, the Bank has also reduced the risk of the possible negative impact of the change in market value of these securities on the Bank's capital adequacy.

16. FINANCIAL ASSETS HELD TO MATURITY (continued)

In thousands of EUR	Outstanding amount	Maturity date
Eurobonds of the Ministry of Finance of the Government of Montenegro	6,988	February 24, 2015
Bonds of Work Fund Podgorica	929	July 25, 2017
Financial assets held to maturity as of December 31, 2014	**7,917**	

17. PROPERTY AND EQUIPMENT

Property, plant and equipment are stated in the statement of financial position at cost.

In thousands EUR	**Buildings**	**IT equipment**	**Other assets**	**Total**
Cost				
Balance, January 1, 2014	2,803	1,786	3,469	8,058
Additions	-	171	130	301
Sale and disposals	-	-	(89)	(89)
Write-off	-	(138)	(278)	(416)
Reclassification	(673)	(120)	120	(673)
Balance, December 31, 2014	**2,130**	**1,699**	**3,352**	**7,181**
Additions	-	226	232	458
Sale and disposals	-	(51)	(2)	(53)
Write-off	-	(44)	(56)	(100)
Balance, December 31, 2015	**2,130**	**1,830**	**3,526**	**7,486**
Accumulated depreciation				
Balance, January 1, 2014	559	1,321	1,754	3,634
Depreciation (note 9)	54	181	414	649
Sale and disposals	-	-	(79)	(79)
Write-off	-	(134)	(265)	(399)
Reclassification	(214)	(119)	119	(214)
Balance, December 31, 2014	**399**	**1,249**	**1,943**	**3,591**
Depreciation (note 9)	53	176	401	630
Sale and disposals	-	(47)	(2)	(49)
Write-off	-	(41)	(45)	(86)
Balance, December 31, 2015	**452**	**1,337**	**2,297**	**4,086**
Net book value:				
- December 31, 2014	**1,731**	**450**	**1,409**	**3,590**
- December 31, 2015	**1,678**	**493**	**1,229**	**3,400**

18. INTANGIBLE ASSETS

The movements in intangible assets for the year ended as at December 31, 2015 and 2014 were as follows:

In thousands of EUR	Computer Software	Purchased Licenses	Other intangible assets	Total
Cost				
As at January 1, 2014	2,864	8	1,560	4,432
Additions	79	-	346	425
Write-off	-	-	(396)	(396)
As at December 31, 2014	**2,943**	**8**	**1,510**	**4,461**
Additions	197	8	36	241
Reclassification	81	-	(81)	-
As at December 31, 2015	**3,221**	**16**	**1,465**	**4,702**
Accumulated amortization				
As at January 1, 2014	1,276	3	854	2,133
Charge for the year (note 9)	293	1	379	673
Write-off	-	-	(396)	(396)
As at December 31, 2014	**1,569**	**4**	**837**	**2,410**
Charge for the year (note 9)	317	3	279	599
As at December 31, 2015	**1,886**	**7**	**1,116**	**3,009**
Net book value:				
- December 31, 2014	**1,374**	**4**	**673**	**2,051**
- December 31, 2015	**1,335**	**9**	**349**	**1,693**

19. OTHER ASSETS, NET

In thousands EUR	**2015**	**2014**
Accrued commissions	641	377
Prepaid expenses	115	75
Repossessed assets	3,626	3,310
Other receivables	604	367
	4,986	4,129
Less: Allowance for impairment	(3,013)	(1,447)
Balance as at December 31,	**1,973**	**2,682**

Accrued commissions relates to the receivables based on commission or fees from the mandatory activities, commission or fees for payment operations services, card business activities and other commission or fees.

Other receivables in the amount of EUR 604 thousand (2014: EUR 367 thousand) relates to: receivable from health fund for maternity leave and sick leaves in the amount of EUR 238 thousand (2014: EUR 211 thousand), receivables from credit card transactions in the amount of EUR 93 thousand (2014: EUR 55 thousand), and other receivables in the amount of EUR 273 thousand (2014: EUR 101 thousand).

Movements in allowances are presented as follows:

In thousands EUR	**2015**	**2014**
Balance as at January 1,	1,447	308
Charge/release for the year:		
Impairment on repossessed assets (note 7)	1,349	865
Provisions for other assets (note 10)	217	274
Balance as at December 31,	**3,013**	**1,447**

20. DEPOSITS FROM CUSTOMERS

In thousands of EUR	**2015**	**2014**
Demand deposits	119,077	107,576
Retail customers	77,906	62,468
Corporate customers	34,912	33,434
Public	4,253	9,232
Other	2,006	2,442
Term deposits	152,741	162,851
Retail customers	89,984	97,981
Corporate customers	58,334	59,991
Public	3,860	4,416
Other	563	463
Interest accrued	2,098	3,479
Balance as at December 31,	**273,916**	**273,906**

Demand deposits includes current account balances of corporate, retail, public and other customers that may be withdrawn at any time by the customer.

Term deposits includes account balances of corporate, retail, public and other customers that pays a fixed rate of interest until a contractual maturity date.

Average interest rate for demand deposits was 0.01% for retail and corporate customers.

Average interest rate for term deposits was 2.03 % for retail and 2.33% for corporate customers.

21. OTHER BORROWED FUNDS

In thousands of EUR	2015	2014
Current (due within one year)	2,327	4,034
Non-current (due after one year)	19,264	32,600
Accrued interest	89	154
Deferred origination fees	(17)	(45)
Balance as at December 31,	**21,663**	**36,743**

The following table presents structure of other borrowed funds:

Name of Financial institution / Bank	Initial amount	Interest rate	Balance at December 2015	Balance at December 2014
EFSE, Luxembourg	2,500	7.25%	894	1,897
EIB	6,000	2.95%-3.51%	6,027	6,025
Erste Group bank AG	5,015	2.89%	5,032	11,843
Steiermaerkische bank und Sparkasse	3,485	2.89%	3,497	8,231
Investment development fund, Republic of Montenegro	3,785	2.89%	2,798	2,992
KFW	13,000	6.60%	1,171	3,511
Ministry of Finance, Republic of Montenegro	2,231	0.98%	2,244	2,244
Balance as at December 31,			**21,663**	**36,743**

Other borrowed funds in the amount of EUR 21,663 thousand decreased comparing with previous year (2014: EUR 36,743 thousand) as a result of increased liquidity from customer deposits.

Other borrowed funds include loans from EFSE Luxembourg in the amount of EUR 894 thousand (2014: EUR 1,897 thousand), The Bank assigned to the EFSE Luxemburg as collateral for these loans all present and future payment claims and all other rights which relate to any Sub-Loan refinanced under Framework Agreement between the Bank and EFSE Luxembourg and any rights and claims arising from any collateral or guarantee granted either by the Sub-Borrower or any other obligor as a security for such Sub-Loan.

There is no other collaterals granted from the Bank to other borrowers.

Borrowings from EFSE and KFW are subject of financial covenants. As of December 31, 2015, the Bank is not breaching these covenants.

OTHER BORROWED FUNDS (continued)

In thousands of EUR Name of Financial institution / Bank	2015 Current (due within one year)	2014 Current (due within one year)
EFSE	361	985
Investment development fund, Republic of Montenegro	785	685
KFW	1,181	2,364
Balance as at December 31,	**2,327**	**4,034**

22. DEBT SECURITIES

Debt securities issued as of December 31, 2015 in the amount of EUR 15,029 thousand (2014: EUR 15,025 thousand) relate to 15,000 bonds of nominal value of EUR 1,000 issued on March 10, 2011. These bonds mature on March 10, 2016 and were fully purchased by Erste & Steiermarkische Bank D.D. - Croatia.

Interest rate on issued bonds is 6M EURIBOR + 2.44%. Interest rate is 2.77% (2014: 2.77%) and total payment of interest on bonds issued in 2015 was EUR 388 thousand (2014: EUR 420 thousand).

23. PROVISIONS

In thousands of EUR	**2015**	**2014**
Provision for long term employee benefits (note 9)	287	263
Provision for contingent liabilities	1,213	1,092
Provision for legal claims	487	75
Provision for unused holidays	255	-
Provision for operating risk	-	168
Balance as at December 31,	**2,242**	**1,598**

Provision for long-term employee benefits in the amount of EUR 287 thousand (2014: EUR 263 thousand) relates to upon retirement benefits payable in an amount equal to six average monthly salaries in the Bank and for jubilee provisions.

Provision for retirement benefits is calculated by independent actuary. The liability recognized in the statement of financial position is the present value of the obligation, determined by discounting estimated future outflows using the projected unit credit method. The actuary used discount rate of 5.12% (2014: 4.16 %) and expected increase in salaries of 1% (2014:1%) and personnel turnover rate of 4.58% (2014: 5.86%).

A reconciliation of provision for long term employee benefits is as follows:

In thousands of EUR	**2015**	**2014**
Balance as at January 1,	263	191
Additions:		
Service costs	19	31
Interest costs	12	9
Actuarial gains on jubilee provisions	2	7
Use	(14)	(4)
Actuarial gains on upon retirement benefits	5	29
Balance as at December 31,	**287**	**263**

23. PROVISIONS (continued)

Provision for contingent liabilities relates to the following:

In thousands of EUR	**2015**	**2014**
Issued guarantees	905	693
Credit commitments:		
- overdrafts	177	184
- credit cards	47	159
- revolving loans	50	5
- risk participation	34	51
Balance as at 31 December	**1,213**	**1,092**

A reconciliation of provision for contingent liabilities is as follows:

In thousands of EUR	**2015**	**2014**
Balance as at 1 January	1,092	783
Reversals/(additions)	121	309
Balance as at 31 December	**1,213**	**1,092**

Legal claims

On the statement of financial position date, the Bank was involved in 117 court cases as defendant. The Bank made a provision for the value of possible compensation on legal claims estimated at EUR 487 thousand (2014: EUR 75 thousand).

24. OTHER LIABILITIES

In thousands of EUR	**2015**	**2014**
Accrued expenses	536	640
Accrued employee benefits	773	195
Items in course of collection and other liabilities	1,722	1,374
Balance as at December 31,	**3,031**	**2,209**

Accrued expenses in the amount of EUR 536 thousand (2014: EUR 640 thousand) relates to accrued liabilities to Fund for deposit insurance and other administrative expenses as IT expenses, expenses for office space and legal and consulting costs.

25. EQUITY

In thousands of EUR	**2015**	**2014**
Share capital	5,339	5,339
Share premium	1,571	1,571
General risk reserves	-	182
Other capital reserves	300	300
Fair value reserves	871	1,596
Regulatory reserves for credit losses	1,467	1,467
Retained earnings	42,402	35,523
Balance as at 31 December	**51,950**	**45,978**

Share capital

As at December 31, 2015, the Bank's share capital comprised of 5,339 ordinary shares of individual par value of EUR 1,000 each.

Share premium

Share premium represents the amount by which the issue price of the shares exceeded their accounting par value.

General risk reserves

General risk reserves relate to part of reserves for operational risks.

Other capital reserves

Other capital reserves represent amounts allocated from retained earnings based on decision of the Bank's General Assembly.

Fair value reserves

This reserve comprises changes in fair value of financial assets available for sale.

Regulatory reserves for credit losses

Regulatory reserves for credit losses relate to the difference between the provisions for impairment of financial assets and provision for contingent liabilities recorded in the Bank's statutory accounts as of December 31, 2012 and the amount of the relating provisions assessed in accordance with the new regulation of the Central Bank of Montenegro applicable from 1 January 2013. These reserves are not distributable.

25. Equity (continued)

Retained earnings

Retained earnings represent accumulated net profits, as well as income and expenses recognized in other comprehensive income brought forward.

Dividends

The Board of Directors of the Bank did not declare dividends for the year 2015 (2014: nill).

26. CONTINGENT LIABILITIES AND COMMITMENTS

The Bank provides guarantees, overdraft loans, finance lease and limits on credit cards. These agreements have fixed limits and generally extend for a period up to one year. The contractual amounts of contingent liabilities are set out in the following table by category. The amounts reflected in the table for guarantee, overdraft loans and credit card limits represent the maximum accounting loss that would be recognized at the statement of financial position date if counterparties failed completely to perform as contracted.

In thousands of EUR	**2015**	**2014**
Guarantees	26,493	26,110
Unused overdraft limit on loans	8,668	8,640
Revolving loans	1,794	760
Risk participation	6,000	9,000
Credit cards	1,755	2,916
Provisions for contingent liabilities	(1,213)	(1,092)
Balance as at December 31	**43,497**	**46,334**

Guarantees commitments in the amount of EUR 26,493 thousand (2014: EUR 26,110 thousand) consists of the guarantees given to retail customers in the amount of EUR 19 thousand (2014: EUR 216 thousand), to corporate customers in amount of EUR 22,811 thousand (2014: EUR 25,894 thousand), to financial institutions in amount of EUR 3,661 thousand (2014: EUR 0 thousand) and to Ministry of Finance of the Government of Montenegro in amount of EUR 2 thousand (2014: EUR 0 thousand).

Revolving loans were granted in 2015 and total amount as of December 31, 2015 was EUR 1,794 thousand (2014: 760 thousand).

Risk participation is contingent liability of the Bank where Bank does not participate in the financing of loans, but in the case that the debtor is in default, Bank is obliged to pay the funds in the amount of 50% of claims of main creditor.

Any unused portion of the approved credit limit for overdrafts and credit cards are located within the contingent liabilities as credit card in the amount of EUR 1,755 thousand (2014: EUR 2,916 thousand).

Provision for contingent liabilities consist of following:

In thousands of EUR	**2015**	**2014**
Guarantees	905	693
Credit cards	177	159
Revolving loans	47	5
Used overdraft limit on loans	50	184
Risk participation	34	51
Project financing	-	-
Balance as at December 31	**1,213**	**1,092**

27. RELATED PARTY TRANSACTIONS

As disclosed in Note 1, the Bank is owned by Erste & Steiermarkische Bank DD, Croatia and ultimately owned by Erste Group Bank AG, Vienna, Austria.

In the course of its business, the Bank has entered into various transactions with related parties. The Bank's related parties are: immediate parent company, ultimate parent company and other Erste group entities, and key members of management.

A summary of the Bank's transactions with the Erste Group Bank entities were as follows:

In thousands of EUR	**2015**	**2014**
Assets		
Current accounts with foreign banks	6,244	13,531
Other assets	-	57
	6,244	**13,588**
Liabilities		
Demand deposits	289	271
Borrowings	23,502	35,099
Accrued interest	60	35
Other liabilities	-	84
	23,851	**35,489**
Fee and commission income	**385**	**425**
Expenses		
Interest and similar expenses	1,085	1,823
Other administrative expenses	623	189
	1,708	**2,012**

27. RELATED PARTY TRANSACTIONS (continued)

The above stated amounts include following amounts relating to Erste & Steiermarkische Bank DD, Croatia:

In thousands of EUR	**2015**	**2014**
Assets		
Current accounts with foreign banks	3,133	5,696
Other assets	-	56
	3,133	**5,752**
Liabilities		
Demand deposits	60	60
Borrowings/Debt securities	14,998	15,025
Accrued interest	31	35
Other liabilities	-	84
	15,089	**15,204**
Expenses		
Interest and similar expenses	379	420
Other administrative expenses	11	174
	390	**594**

Compensation to and other transactions with key management personnel of the Bank

In 2015 the Bank paid to top management personnel gross salaries and other compensations in the amount of EUR 413 thousand (2014: EUR 593 thousand) .

The year end balances of loans to and deposits from members of the Board of Directors were null (2014: nil)

The Bank did not grant new loans to the members of the Board of Directors during 2015 (2014: nil).

The Bank granted new loans to the local management personnel who are not members of the Board of Directors, in 2015 amounted to EUR 25 thousand (2014: 210 thousand).

The outstanding balance as at December 31, 2015 for granted loans amounted to EUR 119 thousand (2014: EUR 215 thousand). Interest income on granted loans to management personnel in 2015 amounted to EUR 0 thousand (2014: 6).

Outstanding balances due from related parties at the year-end are secured with cash collateral amounted EUR 105 thousands. There have been no guarantees provided or received for any related party receivables or payables. For the year ended December 31, 2015, the Bank has not made any provisions for doubtful debts relating to amounts owned by related parties (2014: nil).

28. FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES

The table below sets out the Bank's classification of financial assets and liabilities, and their fair values:

In thousands of EUR	Total carrying value	Stated at fair value	Stated at amortized cost	Fair value
As at 31 December 2014				
Cash and balances with banks and Central bank	56,615	-	56,615	56,615
Loans and advances to Banks, net	32,313	-	32,313	32,324
Loans and advances to customers, net	231,451	-	231,451	215,374
Financial assets available for sale	40,130	40,130	-	40,130
Financial assets held to maturity	7,917	-	7,917	7,917
	368,426	**40,130**	**328,296**	**352,360**
Deposits from banks	162	-	162	162
Deposits from customers	273,906	-	273,906	266,341
Other borrowed funds	36,743	-	36,743	35,106
	310,811	**-**	**310,811**	**301,609**
As at 31 December 2015				
Cash and balances with banks and Central bank	48,380	-	48,379	48,379
Loans and advances to Banks, net	11,605	-	11,605	11,612
Loans and advances to customers, net	235,842	-	235,842	214,484
Financial assets available for sale	14,824	14,824	-	14,824
Financial assets held to maturity	51,265	-	51,265	51,265
	361,916	**14,824**	**347,091**	**340,564**
Deposits from banks	415	-	415	434
Deposits from customers	273,916	-	273,916	266,241
Debt securities	15,029	-	15,029	15,659
Other borrowed funds	21,663	-	21,663	20,384
	311,023	**-**	**311,023**	**302,718**

28. FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES (continued)

Assets recorded at fair value

Financial assets available for sale as at December 31, 2015 in the amount of EUR 14,111 thousand (2014: EUR 39,571 thousand) are stated at fair value determined using valuation techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly (Level 2 of the fair value hierarchy) and in the amount of EUR 713 thousand (2014: EUR 559 thousand) at fair value determined using techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data (Level 3 of the fair value hierarchy).

Assets not recorded at fair value

Management on the Bank considers that the fair values of financial assets and liabilities not recorded at fair value do not depart significantly from their fair values, which is based on the following assumptions used to determine fair values which correspond to Level 3 of the fair value hierarchy.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than one year) it is assumed that the carrying amount approximates their fair value. This assumption is also applied to demand deposits, saving accounts without a specific maturity and variable rate financial instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortized cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments to the extent that such rates are observable. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity.

December 31, 2014	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets available for sale	-	39,571	559	40,130
Total assets	**-**	**39,571**	**559**	**40,130**

December 31, 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Available for sale securities	-	14,111	713	14,824
Total assets	**-**	**14,111**	**713**	**14,824**

29. FINANCIAL RISK MANAGEMENT

Introduction and overview

The main objectives of Bank's risk management framework are the following:

• Contribute to development of various business lines optimizing their overall risk adjusted profitability;
• The Bank should be very competitive entity at the Montenegrin market, including part of foreign clients, without neglecting the quality of loan portfolio and efficient risk control;
• Guaranteeing the Bank's sustainability through the implementation of qualitative risk management infrastructure.

The Bank's risk management model depends on:

- strong management influence, from Board of Directors to local operational teams;
- strong internal procedures and guidelines framework;
- continuous supervision by independent bodies.

Traditionally, the Bank is mainly exposed to credit risk and consequently the largest focus is given to the management and continuous development and improvement of credit risk management, but not neglecting in any instance of other risks the Bank is exposed to in its activities such as liquidity risk, operational risk, market risks, legal risk, reputation risk and the like.

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Asset and Liability Committee (ALCO), Credit Committees and Audit Committee which are responsible for developing and monitoring the Bank`s risk management policies in their specified areas. The Board of Directors consists of shareholders representatives and other members.

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

Board of Directors adopted following policies:

- Credit policy
- Policies and procedures for management of the credit risk;
- Policies and procedures for management of the liquidity risk;
- Policies and procedures for management of the market risks;
- Policies and procedures for management of the country risk;
- Policies and procedures for management of the operational risks;
- Risk provisioning policy;
- Policies and procedures for managing bad placements;
- Collection procedures

29. FINANCIAL RISK MANAGEMENT (continued)

Introduction and overview (continued)

Risk policies cover all aspects of the respective type of risk and requirements, quantitative limitations with regard to risk management, risk control as well as, if applicable, performance control, accounting and also regulatory requirements.

The Bank's Internal Audit Department monitors compliance with the Bank's risks management policies and procedures and undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

According to the Law on Banks, the Bank complied with all requirements relating to election of the members of the Board of Directors, election of executive directors and formation of audit committee.

The Bank's Audit Committee is responsible for analyzing the Bank's financial reports, analyzing and monitoring the system of internal controls, activities undertaken by executive directors in order to inform Board of Directors, compliance with law, regulations and the Bank's acts. Audit Committee is assisted in these functions by Internal Audit..

Credit risk

Credit risk is the risk of financial loss occurring as a result of counterparty's default regarding its contractual obligations to the Bank.

To manage the level of credit risk, the Bank:

- reviews the creditworthiness of customers applying for loans, guarantees and other credit products,
- establishes credit limits on the basis of the risk assessment,
- deals with counterparties of good credit standing and takes appropriate collateral.

Customers are monitored continually and risk limits are adjusted if necessary. Risk limits also take into account various collateral types.

The Bank's primary exposure to credit risk arises through its loans granted to small and medium sized companies and individuals. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the statement of financial position.

Basic principles of loan portfolio are:

- Diversification of loans by industries;
- Diversification within the industry and region;
- Diversification by exposure (limit, individual and group);
- Diversification by maturity;
- Diversification by products.

In accordance with the Central Bank of Montenegro regulations, the total amount of loans and receivables including off statement of financial position liabilities, that relate to one client or the group of related clients cannot exceed 25% of bank's own funds. Exceptions, among others, are exposures to the Government of Montenegro or exposures secured with first class collateral, i.e. those which fulfilling Central Bank of Montenegro conditions.

According to regulation exposure to one client or the group of related clients that exceeds 10% of bank's own funds is considered as large exposure.

Loans to individuals and loans to companies are granted through 7 credit committees depending on level of exposure and level of non-secured exposure.

29. FINANCIAL RISK MANAGEMENT (continued)

Credit risk (continued)

The Risk Management Department continuously monitors and measures the level of credit risk and prepares monthly reports on the level of credit risk and reports it to the management and the Board of Directors.

The credit quality of financial assets is managed by the bank using internal credit ratings. The table below shows the credit quality by class of asset for all financial assets exposed to credit risk, based on the bank's internal credit rating system. The amounts presented are gross of impairment allowances.

	Neither past due nor impaired					
	Low Risk 2015	Management Attention 2015	Substandard 2015	Past due but not impaired 2015	Individually impaired 2015	Total 2015
Loans and advances to banks, gross	1,513	-	-	10,095	-	11,608
Loan and advances to customers, gross	133,538	64,050	12,109	25,695	18,445	253,837
public sector	21,083	17,172	-	182	-	38,437
commercial customers	38,612	16,802	1,472	6,845	8,092	71,823
other financial institutions	110	-	-	-	-	110
private customers	73,609	30,076	10,483	18,474	10,353	142,995
other	124	-	154	194	-	472
Investment securities AfS and HtM	64,036	2,052	-	-	-	66,088
Financial assets available for sale	12,772	2,052	-	-	-	14,824
Financial assets held to maturity	51,264	-	-	-	-	51,264

	Neither past due nor impaired					
	Low Risk 2014	Management Attention 2014	Substandard 2014	Past due but not impaired 2014	Individually impaired 2014	Total 2014
Loans and advances to banks, gross	**6,953**	**-**	**-**	**25,368**	**-**	**32,321**
Loan and advances to customers, gross	151,132	40,409	8,862	28,141	22,328	250,872
public sector	40,111	4,196	-	285	-	44,592
commercial customers	28,205	16,591	2,075	6,690	8,178	61,739
other financial institutions	-	-	-		-	-
private customers	82,816	19,622	6,495	21,166	14,150	144,249
other	-	-	292		-	292
Investment securities AfS and HtM	45,431	2,199	417	-	-	48,047
Financial assets available for sale	37,514	2,199	417	-	-	40,130
Financial assets held to maturity	7,917	-	-	-	-	7,917

29. FINANCIAL RISK MANAGEMENT (continued)

Credit risk (continued)

Past due loans and advances but not impaired include those that are only past due by a few days. An analysis of past due but not impaired loans by age is provided in the following tables.

31 December 2015	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 day	Total
Loans and advances to banks, gross	10,095	-	-	-	10,095
Loan and advances to customers, gross	20,050	5,082	461	102	25,695
public sector	182	-	-	-	182
commercial customers	4,515	2,156	172	2	6,845
other financial institutions	-	-	-	-	-
private customers	15,159	2,926	289	100	18,474
other	194	-	-	-	194
Investment securities AfS and HtM	-	-	-	-	-
Financial assets available for sale	-	-	-	-	-
Financial assets held to maturity	-	-	-	-	-

31 December 2014	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 day	Total
Loans and advances to banks, gross	17,771	7,597	-	-	25,368
Loan and advances to customers, gross	21,653	5,468	940	80	28,141
public sector	285	-	-	-	285
commercial customers	3,536	2,752	402	-	6,690
other financial institutions	-	-	-	-	-
private customers	17,832	2,716	538	80	21,166
other	-	-	-	-	-
Investment securities AfS and HtM	-	-	-	-	-
Financial assets available for sale	-	-	-	-	-
Financial assets held to maturity	-	-	-	-	-

See Note 14 for more detailed information on the allowance for impairment losses on loans and advances to customers.

Impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance is a specific loss component that relates to individually significant exposures and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

The Bank grades credit risk exposures to individuals and companies into various categories. The Bank estimates recoverable amounts by discounting future cash flows on individual level for all individually significant exposures classified in the non performing categories. Collective provisions for performing categories are based on estimations of probabilities of default and losses given default for corporate and retail exposures using its own historical data.

29. FINANCIAL RISK MANAGEMENT (continued)

Credit risk (continued)

Individually impaired loans and securities

Individually impaired loans and securities are loans and securities for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan and securities agreement.

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Bank.

Loans with renegotiated terms

Loans with renegotiated terms amounted to EUR 5,642 thousand as at December 31, 2015 (2014: EUR 5,148 thousand).

Write-off policy

The Bank writes off a loan balance when determines that the loans are uncollectable. This determination is reached after considering information such as the occurrence of significant changes in the borrower financial position such that the borrower can no longer pay the obligation and there is no perspective that will pay in the future and there is no adequate collateral. For smaller balance standardized loans, secured mainly with guarantors and there is no payment from guarantors, charge off decisions generally are based on a product specific past due status. These loans are graded R4 in the Bank's internal credit risk grading system.

Unrecoverable borrowings R4 are those where it is considered that the total receivables will not be recovered by primary or secondary cash flow. Concerning unrecoverable placements R4, by default the present value of these receivables equals zero, except when there is a very good collateralization of approved loan.

Written off loans that are considered irrecoverable and which are registered in the off statement of financial position records of the Bank amount to EUR 13,091 thousand as of December 31, 2015 (2014: EUR 15,212 thousand).

Collateral

The amount and type of collateral depend on an assessment of the credit risk of the counterparty.

The Bank holds collaterals against loans and advances to customers in the form of mortgage interests over property, pledge, guarantors and bill of exchange. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and reassessment according local regulation. Collateral generally is not held over loans and advances to banks. Collateral usually is not held against investment securities and no such collateral was held at December 31, 2015 or 2014.

29. FINANCIAL RISK MANAGEMENT (continued)

Credit risk (continued)

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

In thousands of EUR	Loan and advances to customers 2015	2014
Against individually impaired - property	13,949	18,678
Against collectively impaired:		
Property	129,711	151,599
Other pledges	8,864	10,862
Montenegro Government guarantees	12,653	4,075
Guarantee of banks with rating A or more	2,862	1,638
Against past due but not impaired – cash deposits	3	356
Against neither past due nor impaired – cash deposits	2,881	3,350
Total	**170,923**	**190,558**

Collateral values above do not include co-guarantors that the Bank may use as security for loans and advances.

It is the Bank's policy to dispose of repossessed assets. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

During the year the Bank took possession of collateral with a carrying value of EUR 309 thousand (2014: EUR 1,406 thousand) at the statement of financial position date, which the Bank is in process of selling.

Credit risk concentrations

The Bank monitors concentrations of credit risk by industry sector to mitigate its risk and diversify its portfolio. An analysis of concentrations of credit risk at the reporting date is shown below:

In thousands of EUR	Loan and advances to customers 2015	Loan and advances to customers 2014	Debt securities (HTM and AFS) 2015	2014
Retail customers	133,820	133,109	-	-
Corporate customers	63,331	53,742	-	-
Other financial institution	-	(2)	-	-
Government	38,139	44,329	65,375	47,488
Other	552	273	713	559
	235,842	**231,451**	**66,088**	**48,047**

Industrial risk concentrations are presented in Note 14.

The maximum credit exposure to any customer of related group of customers (apart from the Government or the Government guaranteed and other banks) as at December 31, 2015 was EUR 9,686 thousand (2014: EUR 8,228 thousand).

29. FINANCIAL RISK MANAGEMENT (continued)

Country risk

Country risk is the probability of incurring losses to the Bank due to the inability of persons or companies outside of Montenegro to repay obligations due to political, social and economic environment of the country of the debtor. Risks include:

· Political-economic risk, where loss is probably due to political restrictions created by the acts of the country, state bodies or other bodies in the country of the debtor, and/or because of the general economic condition in the country;
· Transfer risk, where probability of loss due to currency restrictions created by the acts of the country, state bodies or other bodies in the country of the debtor, and/or because of the general economic condition in the country.

Risk Management Department monitors risk on an ongoing basis and recommends any needed changes in order to keep the policy and procedures in line with the Bank's strategy and goals.

Risk Management Department submits to the Board monthly reports about country risk exposure.

The Board of Directors reviews the adequacy of the system used to manage country risk and approve any policy changes if needed.

Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its liquidity position. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised using:

· deposits with wide ranges of maturity;
· long term borrowings;
· share capital.

The Bank's general policy aim is to manage liquidity risk in order to meet its obligations associated with its financial liabilities and to increase its liquidity level. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required meeting business goals and targets set in terms of the overall Bank's strategy.

The daily liquidity position is monitored by the Risk Department and the Treasury Department which have formal procedures. Control of liquidity level is necessary in order to maintain liquidity risk on acceptable level. The Bank follows its internal and legal limits prescribed by the Central Bank of Montenegro.

The table below presents undiscounted assets and liabilities by earliest remaining contractual maturities.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

29. FINANCIAL RISK MANAGEMENT (continued)

Liquidity risk (continued)

In thousands of EUR	Up to 3 months	3 months to 1 year	1 to 5 years	More than 5 years	Total undiscounted financial assets/ liabilities
Non derivative assets					
Cash and cash equivalents	40,533	-	7,847	-	48,380
Loans and advanced to Banks	11,212	-	396	-	11,608
Loans and advances to customers	27,098	66,908	148,472	81,444	323,922
Financial assets available for sale	2,240	531	14,162	-	16,933
Financial assets held to maturity	-	365	40,300	-	40,665
Total as at December 31, 2015	**81,083**	**67,804**	**211,177**	**81,444**	**441,508**
Non derivative liabilities					
Deposits from banks	415	-	-	-	415
Deposits from customers	36,912	48,741	190,707	48	276,408
Other borrowed funds	8,875	2,338	11,474	118	22,805
Debt securities	15,136	-	-	-	15,136
Total as at December 31, 2015	**61,338**	**51,079**	**202,181**	**166**	**314,764**

The table below shows an analysis of the Bank's financial assets and liabilities analyzed according to when they are expected to be recovered or settled.

In thousands of EUR	Up to 1 year	More than 1 year	Total
Assets			
Cash and cash equivalents	40,533	7,847	48,380
Loans and advanced to Banks	11,212	396	11,608
Loans and advances to customers	63,008	190,829	253,837
Financial assets available for sale	14,111	713	14,824
Financial assets held to maturity	10,796	40,468	51,264
Total as at December 31, 2015	**139,660**	**240,253**	**379,913**
Liabilities			
Deposits from banks	415	-	415
Deposits from customers	84,414	189,502	273,916
Deposits from custody business	140	-	140
Other borrowed funds	2,403	19,260	21,663
Debt securities	15,029	-	15,029
Total as at December 31, 2015	**102,401**	**208,762**	**311,163**

29. FINANCIAL RISK MANAGEMENT (continued)

Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices and foreign exchange rates will affect the Bank's income or value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return of risk.

Management of market risk

Management of market risk is one of the main Bank's aims in order to limit potential losses caused by adverse changes in interest rates, currency risks, prices index and other market factors that could influence the value of financial instruments, impacting profitability and the capital adequacy of the Bank.

Market risk is monitored by the Risk Management Department. The Bank's system for managing the market risk consists of:

- Identification of current market risk and possible risks from new business activities;
- Measure of market risks through established mechanism and procedures for correct and updated market risk estimate;
- Monitoring market risk through analyzing of its status, changes and trends;
- Control of market risk by managing risk at level acceptable for risk profile of the Bank.

The Bank manages all market risks to which it is exposed, especially:

- Interest rate risk;
- Currency risk and
- Placement risk.

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature at different times or in differing amounts.

Risk management activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Bank's business strategies.

In managing interest rate structure, senior management considers among others:

- macro and micro economic forecasts;
- forecasts in liquidity conditions and
- the anticipated trends in interest rates.

The Bank takes on exposure to the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes or may reduce creating losses in the event that unexpected movements by reprising periods arise. The Board of Directors sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored daily. The table below summarizes the Bank's exposure to interest rate movements.

29. FINANCIAL RISK MANAGEMENT (continued)

Management of market risk (continued)

Interest rate risk (continued)

Exposure to interest rate movements this analysis has been provided on basis of interest reset period or maturity date whichever is earlier.

In thousands of EUR	**Carrying amount**	**Up to 3 months**	**3 months to 1 year**	**1-5 years**	**More than 5 years**	**Non interest sensitive**	**Impairment**
As at 31 December 2015							
Assets							
Cash and balances with banks	48,379	3,621	-	-	-	44,758	-
Loans and advanced to Banks	11,605	-	-	-	-	11,608	(3)
Loans and advances to customers	235,842	76,032	41,860	85,442	50,463	40	(17,995)
Financial assets available for sale	14,824	2,206	299	12,319	-	-	-
Financial assets held to maturity	51,264	9,679	1,117	40,468	-	-	-
	361,914	**91,538**	**43,276**	**138,229**	**50,463**	**56,406**	**(17,998)**
Liabilities							
Deposits from banks	415	-	-	-	-	415	-
Deposits from customers	273,916	56,587	97,789	103,685	167	15,688	-
Other borrowed funds	21,663	8,869	2,033	10,761	-	-	-
Debt securities	15,029	15,029	-	-	-	-	-
	311,023	**80,485**	**99,822**	**114,446**	**167**	**16,103**	**-**
Interest rate gap	**50,891**	**11,053**	**(56,546)**	**23,783**	**50,296**	**40,303**	**(17,998)**
As at 31 December 2014							
Assets							
Cash and balances with banks	56,615	3,632	-	-	-	52,983	-
Loans and advanced to Banks	32,313	-	-	-	-	32,321	(8)
Loans and advances to customers	231,451	87,489	28,733	84,035	50,573	42	(19,421)
Financial assets available for sale							
	40,130	1,087	1,983	37,060	-	-	-
Financial assets held to maturity	7,917	6,988	328	601	-	-	-
	368,426	**99,196**	**31,044**	**121,696**	**50,573**	**85,346**	**(19,429)**
Liabilities							
Deposits from banks	162	-	-	-	-	162	-
Deposits from customers	273,906	70,875	117,904	65,207	196	19,724	-
Other borrowed funds	36,743	21,065	3,094	10,493	2,091	-	-
Debt securities	15,025	-	15,025	-	-	-	-
	325,836	91,940	136,023	75,700	2,287	19,886	-
Interest rate gap	**42,590**	**7,256**	**(104,979)**	**45,996**	**48,286**	**65,460**	**(19,429)**

29. FINANCIAL RISK MANAGEMENT (continued)

Management of market risk (continued)

Interest rate risk (continued)

The Bank prepares reports in accordance with regulations of the Central Bank of Montenegro for measuring interest rate risk for all positions of assets, liabilities and off-balance items, as well as for all other compensations or expenditures that are exposed to interest rate risk. Reports prepared in accordance with regulations of the Central Bank of Montenegro are used to measure risk to Net Interest Income (NII) arising from the re-pricing of assets and liabilities over time. The risk is measured upon the size and duration of potential movements in interest rates. The Bank is aware that maintaining a balanced position for all time periods in a gap reports does not ensure immunity from Interest Rate Risk (IRR). The Bank is aware of the following gap reporting limitations:

· Risk may be hidden in the re-pricing frames;
· Interest rates on assets and liabilities do not always move together;
· Exposure arising from new business.

To avoid such limitations the Bank use simulations (assumptions) with intend of projecting the future composition of the statement of financial position and applying different interest rate scenarios. Impact of loan prepayments and early withdrawing of deposits is also taken into account.

Additionally, the Bank is focused on interest rate spreads. Bank is aware that volatility of IRR spread is potential interest rate risk indicator. This spread is managed by loan pricing, deposit pricing, and investing. The Bank strives to have neither the lowest nor the highest loan or deposit rates in the market. Loans are priced in order to achieve a fair return on shareholder investment. Deposits are priced to provide fair treatment for the Bank's customers and to be reasonably competitive without increasing the Bank's cost of funds.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the net interest income sensitivity of the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a monthly basis to a reasonable possible change in interest rates of 100 basis point (bp) parallel fall or rise in all yield curves in Montenegro. Analysis of the Bank's statement of comprehensive income using sensitivity to an increase or decrease in market interest rates is as follows:

In thousands of EUR	**100 bp parallel increase**	**100 bp parallel decrease**
Average for the period	(276)	276
Maximum for the period	(407)	407
Minimum for the period	(147)	147
As at December 31, 2015	**(147)**	**147**
Average for the period	(329)	329
Maximum for the period	(515)	515
Minimum for the period	(170)	170
As at December 31, 2014	**(220)**	**220**

The sensitivity of equity calculated by revaluing fixed rate available–for–sale financial assets at December 31, 2015, for the effects of the assumed changes in interest rates of 100 bp increase/decrease is EUR 147 thousand decrease/increase. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve.

29. FINANCIAL RISK MANAGEMENT (continued)

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currencies, which are monitored on daily basis.

Since the open positions in GBP, CHF and USD amounted to EUR -18 thousand, EUR 130 thousand and EUR 94 thousand, respectively, the management of the Bank considers that the Bank is currently not significantly exposed to the currency risk.

Placement risk

When determining limits of exposure to the placement risk, the Bank establishes limits of placements, not just as Bank's equity expressed as percentage but, as fixed limits also, which are at acceptable levels and which are not affected by changes in the Bank's equity.

Operational risk

Operational risk means the probability of incurring losses in the Bank's operations, as a result of inadequate internal processes, controls and systems, weaknesses and errors in performance, illegal actions and external events that may expose the Bank to loss. This includes errors, omissions, systems breakdown, natural disasters, terrorist attack and fraudulent activity, causing an impact in terms of unavailability of services, financial loss, increased costs and loss of reputation or failure to make anticipated income or profit.

The goal of operational risk management is to balance cost and risk within the constraints of the risk appetite of the Bank, but to be consistent with the prudent management required of a financial organization.

Risk Management priorities are identified through a combination of:

- experience and observation;
- internal audit assessment and knowledge;
- internal controls;
- detailed risk assessment work;
- change management procedures;
- common sense;
- incident reports.

The Bank has established a system for management of operational risks that includes:

- Policies and procedures for managing operational risks which provides identification, measurement, tracking and controlling risks;
- Responsibility for implementation and effectiveness of Operational Risk rests with the Risk Management Department, as well as monitoring and tracking the risk;
- Responsibility for identifying and managing Operational Risk lies with line management;
- Internal Audit is responsible for the completion of an agreed audit program covering all departments and branches, identifying risk and non-adherence to procedures, completing special investigations and reporting to the CEO and supervisory board.

29. FINANCIAL RISK MANAGEMENT (continued)

Capital management

The Bank's regulator, the Central Bank of Montenegro, sets and monitors capital requirements for the Bank. In implementing current capital requirements the Central Bank of Montenegro requires the Bank to maintain a prescribed capital adequacy ratio of 10%.

The regulatory capital (bank own funds) of the Bank consists of:

- Basic capital and
- Supplementary capital

Basic capital consists of:

- The paid up share capital excluding cumulative preferential shares;
- Premiums realized on issuance (share premium account);
- Reserve allocated from profit after taxes (legal, statutory and other reserves);
- Undistributed retained profit from previous years for which shareholders assembly decided to be included in basic capital, less profit tax and other expected expenses;
- Current profit if following conditions are fulfilled:
- Shareholders assembly or Board of directors with power of attorney given by shareholders assembly made decision to include it in increase of share capital or reserves or undivided profit.
- Existence of profit was confirmed by external auditor
- Central bank approved inclusion of profit in basic capital

Deductible items on basic capital are: losses from current and accumulated losses from prior years, intangible assets, the outstanding balances of purchased own shares excluding cumulative preferable shares, and additional losses assessed in controls of the Central Bank.

Supplementary capital consists of:

- The nominal amount of cumulative preferential shares;
- Realized issuance premiums based on cumulative preferred shares
- General reserves for losses on assets up to 1.25% of risk weighted assets of the bank;
- Subordinated debt according to the Central Bank regulation;
- Hybrid instruments according to the Central Bank regulation;
- Revaluation reserves.

Deductible items on supplementary capital I consist of: outstanding balance of purchased own cumulative preferential shares and liabilities and contingent liabilities secured by hybrid instruments or subordinated debt included in Supplementary capital.

The Bank is obliged to follow the following limitations when calculating regulatory capital:

- Total sum of supplementary capital must not be higher than basic capital;
- Total sum of subordinated debt and cumulative preferred shares cannot exceed 50% of own capital;

The Bank is required to maintain the solvency ratio at the level of at least 10%. The Policy of the Bank is to maintain strong base of capital in order to maintain confidence of market, investors and creditors and for future development. During the year, the Bank complied with the minimal solvency ratio requirement of the Central Bank of Montenegro.

29. FINANCIAL RISK MANAGEMENT (continued)

Capital management (continued)

The Bank's regulatory capital and capital adequacy is calculated as follows:

In thousands of EUR	**2015**	**2014**
Basic Capital		
Share capital	5,339	5,339
Share premium	1,571	1,571
Retained earnings from the previous year	35,793	29,474
Reserves allocated from retained earnings	300	300
Deductible items on basic capital	(1,693)	(2,051)
Total regulatory capital	**41,310**	**34,633**
Risk weighted assets:		
- balance sheet	143,771	142,080
- off balance sheet	11,611	12,257
Capital charge for:		
- operational risk	4,438	4,244
- country risk	610	837
- other risks	845	909
Total capital requirements	**161,275**	**160,327**
Capital Adequacy	**20.53%**	**17.00%**

The Bank calculates regulatory capital and capital adequacy based on financial statements prepared in accordance with regulations of the Central Bank of Montenegro.

In accordance with the requirements of the Central Bank of Montenegro, the Bank is under obligation to maintain a minimum capital adequacy ratio of 10%. As of December 31, 2015 the capital adequacy ratio calculated by the Bank was 20.53% (2014: 17.00%). The Bank is required to maintain certain minimum or maximum ratios with respect to its activities and composition of risk assets in compliance with the Law on Banks of Montenegro and the Central Bank of Montenegro regulations. As of December 31, 2015 the Bank complied with all requirements prescribed by the Central Bank of Montenegro.

30. ADDITIONAL CASH FLOW INFORMATION

CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three month maturity from the date of acquisition including: cash on hand, non-restricted balances with the Central Bank of Montenegro and other banks.

In thousands of EUR	December 31, 2015	December 31, 2014
Cash on hands (Note 12)	12,293	10,649
Current accounts with Central Bank of Montenegro (Note 12)	20,394	28,753
Loans and advances to banks (Note 13)	11,212	31,965
	43,899	**71,367**

31. EARNINGS PER SHARE

Basic and diluted earnings per share are calculated by dividing net profit attributable to the ordinary shareholders by the weighted average number of ordinary shares for the period.

	2015	2014
Income for the year (In thousand EUR)	6,532	5,968
Weighted average number of ordinary shares	5,339	5,339
Basic Earnings per share in EUR	**1,223**	**1,118**
Diluted earnings per share in EUR	**1,223**	**1,118**

The Bank does not hold any potentially diluting ordinary shares such as convertible debt and stock options as at balance sheet date.

32. SUBSEQUENT EVENTS

There were no adjusting and non-adjusting events after the reporting date.