komercijalna banka
ad skopje

2015/16
Superbrands
Macedonia's Choice

ANNUAL REPORT

komercijalna banka ad skopje

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FINANCIAL HIGHLIGHTS

	(in 000 MKD)			
	2016 Unconsolidated Fin. Statements	2016 Consolidated Fin. statements	2015 Unconsolidated Fin. statements	2015 Consolidated Fin. statements
Data on the profit realized (for the year)				
Profit before taxes	866,360	879,784	567,884	568,356
Net profit	773,987	786,067	506,611	505,970
Data from the Balance Sheet (as at the end of the year)				
Total assets	100,903,414	100,897,069	97,325,102	97,316,767
Loans to and claims from other customers	45,268,154	45,268,154	47,644,522	47,644,522
Loans to and claims from banks	10,084,209	10,084,209	9,208,426	9,208,426
Investments in securities	7,062,697	7,049,959	7,217,263	7,204,525
Deposits from banks	1,676,302	1,648,463	1,381,823	1,363,581
Deposits from other customers	86,115,337	86,115,337	82,837,690	82,837,690
Capital and reserves	10,694,043	10,715,026	10,208,812	10,217,708
Profitability ratios				
Return on assets (ROA)				
- before taxation	0.9%	0.9%	0.6%	0.6%
- after taxation	0.8%	0.8%	0.5%	0.5%
Return on equity (ROE)				
- before taxation	8.1%	8.2%	5.6%	5.6%
- after taxation	7.2%	7.3%	5.0%	5.0%
Expenses ratio	36.5%	36.5%	37.3%	37.3%
Capital and reserves to total assets	10.6%	10.6%	10.5%	10.5%
Capital adequacy	15.2%	15.2%	13.8%	13.8%

Mid-exchange rate as per the Exchange Rate List of NBRM

	2016	2015
1 EUR	**61.48**	**61.59**
1 USD	**58.33**	**56.37**

REPORT OF THE CHIEF EXECUTIVE OFFICER

Dear shareholders, business partners and clients,

On a global level, 2016 is characterized by the worldwide stagnation of the economic growth, continuation of the geopolitical risks, lowering of the credit rating of countries and more rigorous criteria for their financing. In 2016, the Republic of Macedonia suffered from natural disaster and from the prolonged political crisis which had a strong impact on the economy, despite the premature parliamentary elections held in December.

The highlights show that despite the increased risks connected with factors from domestic and external nature, Macedonian economy managed to keep macroeconomic stability. According to data of the State Statistical Office, the physical volume of the industrial manufacturing noted a growth of 3.4%, the volume of exchange of goods was increased for 6.0%, and consequently, the coverage of import by export was increased and reached 70.8%. Real gross domestic product in the fourth quarter of 2016 was 2.4%. Prices in the Republic of Macedonia were kept in the deflation zone, whereas the inflation rate for the period January-December 2016, compared to the same period in 2015, noted a decrease of 0.2%.

The banking system of Macedonia remained stable and safe, despite the uncertain domestic ambient and the political events in the country that affected the deposit base and the loan market. As a result of the political speculations of individuals and the influence of the social networks and media, in April, there was a significant decrease of the total deposit base. Still, in the second half of 2016, the conditions got stabilized and the deposits marked an annual growth in December of 5.7%. The total loans in December marked an annual growth of 1% which is partly a result of the uncertain conditions and the decreased deposit base, but also a result of the write-off of due outstanding claims, in accordance with the amendments in the Decision on credit risk management from December 2015.

In the course of 2016, NBRM raised the reference interest rate from 3.25% to 4.00% and increased the rate of mandatory reserve for liabilities in local currency with a foreign

currency clause. It also involved the possibility for placement of foreign currency deposits with NBRM at interest rates more favorable than those offered on the international markets. Upon attentive follow-up of situations and once the conditions got stabilized, NBRM again lowered the interest rate on treasury bills for 0.25 percentage points and as at 31 December it is 3.75%. The foreign currency reserves as at December 2016 achieved the amount of EUR 2,613 million and in comparison to December 2015, they are increased for around EUR 351 million.

In the area of banking regulation, several decisions are especially important, such as amendments and supplements to the Banking Law where the most significant change refers to the increase of capital requirements to be fulfil by banks by introducing capital buffers in order to comply with Basel III, as well as amendments to the section concerning the jurisdictions of the Bank's authorities with the purpose to comply with the Law on Trade Companies.

Dear shareholders, business partners and clients,

I am pleased to declare that in 2016, in spite of the challenges it was faced to, the Bank realized net profit after taxation in the amount of MKD 774 million, being an increase of 52.8%, compared to 2015. As a result of the increased financial results the profitability ratios[1] were also improved – the Return on Equity (ROE) and Return on Assets (ROA), which are increased in terms of the previous year and are to the extent of 7.2% and 0.8%, respectively.

In order to additionally strengthen its capital position and to meet the supervisory requirements properly, in 2016, the Bank allocated MKD 240 million from the realized net-profit into reserves. The realized capital adequacy ratio at the end of the reporting year was increased and is 15.2%. It is within the recommendations of NBRM.

In the course of 2016, despite the political crisis and temporary withdrawals, deposits were increased for additional MKD 3.6 billion, compared to 2015, of for 4.2%, which is an indicator for the traditional high trust of clients in the Bank.

Proportionally to the growth of the resources, total assets of Komercijalna Banka AD Skopje noted an increase of 3.7% reaching the amount of MKD 100.9 billion, whereas the growth is mostly a result from the increased monetary assets and increased loans to and claims from banks.

In the course of the previous year, Komercijalna Banka AD Skopje maintained the liquidity on a level which allowed it to perform its financial activities and fulfil the legal obligations. The excess of liquid assets was placed by the Bank with treasury and government bills, deposit available in NBRM, denar deposit in domestic banks and FX deposits in NBRM and lending to other banks.

In addition, the Bank continued to perform its activities in a qualitative manner and to improve its products and services in accordance with the needs and desires of its clients concurrently emphasizing its innovativeness in terms of other banks.

[1] After taxation

In 2016, the Bank noted the following significant events and activities:

- *became one of the 16 most actively traded regional companies comprising the new stock exchange SEE LinX and SEE LinX EWI indexes in the regional SEE Link platform;*
- *introduced 3D Secure technology for safe on-line buying for all cards of the Visa and Mastercard® brands;*
- *apart from contactless cards from the Mastercard® program, the Bank started to issue contactless cards from the Visa program too;*
- *introduced new functionalities in the Internet Bank for individuals and legal entities, as well as in mBanka – a mobile banking application for individuals, thus increasing the number of users of the mobile banking service;*
- *promoted the possibilities offered by e-banking, which resulted in increased total number of realized e-payment orders in the denar payment operations for 8%, in the FX payment operations for 10.5%, while in the retail banking number of payment orders through the Internet Bank was increased for 25.2%;*
- *extended promotion periods for approving cash and housing loans with better terms and lowered interest rates;*
- *opened two new city - branches in Skopje;*
- *commenced financing infrastructural projects as per the established cooperation with the Municipal Infrastructural Development Fund (MIDF) etc.*

During 2016, Komercijalna Banka AD Skopje continued its activities for investment in the community through its Coordinating Authority for social responsibility and realization of activities for social responsibility through projects in sport, culture, volunteering activities, as well as encouraging the internal processes for socially responsible practices and continuous education and involvement of the employees in this type of projects of the Bank. As more significant projects that the Bank undertook through its Coordinating Authority for corporate social responsibility are the following: financial support to people affected by floods, Track-guides for people with damaged vision, realization of the project "Donate an organ - save a life", support for economic strengthening of the women in the rural areas and female victims of family violence and other campaigns in cooperation with Red Cross of the Republic of Macedonia and NGO "HERA".

As a confirmation of the rating and quality of the realized activities of the Bank are the international and domestic awards and recognitions that KB received during 2016 such as: most active participant in EBRD TFP – Trade Facilitation Program – for promotion of the international trade worldwide from the European Bank for Reconstruction and Development for the 12-th time; Best FX Provider for the Republic of Macedonia" (services given in FX operations in Macedonia for 2017) by the international magazine Global Finance, listed joint stock company with the highest turnover and member with the most realized transactions in the past 20 years since the existence of the MSE, as well as "Crystal Bell" for the most transparent listed joint stock company (I place) for 2015 and Plaque for total turnover and transactions realised in 2015 (II place).The Bank was also named a Superbrand for 2015/2016 in the category of financial institutions, which represents a confirmation for the high quality of its services and additional motivation for improved performances in future.

The results achieved in different segments of its operation are a motive for the Bank to undertake all the necessary measures in the forthcoming period in order to readily respond the changes mainly arising from uncertainty in terms of statements of corporate clients.

The results achieved from the operation could not have been achieved without qualitative engagement of the members of the Supervisory Board, management and all employees of the Bank, for which I would like to use this opportunity to express my gratitude on behalf of the Board of Directors.

At the same time, I would like to express my gratitude to you, dear shareholders, for your support provided, and to our business partners and clients, for their professionalism and trust shown in the course of the year.

Yours truly,
Chief Executive Officer,
Hari Kostov

BANK'S PROFILE

Komercijalna Banka AD Skopje is one of the leading banks in the Republic of Macedonia, which, in its 61 years of existence, has created an image of a bank with tradition, confidence, safety, innovation and strong local and international reputation.

The Bank was established in 1955 as Komunalna Banka of the City of Skopje, specialized for citizens' savings, housing loans to citizens and enterprises and financial support to construction of municipalities. Since then, the Bank has gone through several changes, as a result of the changes in the banking sector, and in 1990, it was transformed into a shareholding company under the name of Komercijalna Banka AD Skopje.

Today, it is a universal bank with wide range of banking activities, such as taking deposits, lending to legal entities and individuals, issuing bank cards, providing services in the domestic and international payment operations, e-banking and m-banking, intermediating activities in purchase and sale of foreign currencies, securities, forfeiting, etc.

The Bank has wide network of city-branches and branches, which is permanently extended on the whole territory of the country. Its business network is comprised of 11 branches (Prilep, Ohrid, Veles, Strumica, Kochani, Shtip, Kumanovo, Kavadarci, Gostivar, Bitola and Tetovo) and 57 city-branches, out of which 39 located in the City of Skopje and the others 18 throughout the country. In order to provide fast and efficient services to satisfy the needs of its clients, the Bank has correspondent relations established with 856 banks in 77 countries in the world.

As at 31 December 2016, the shareholders' capital of the Bank is comprised of 2,279,067 ordinary shares with nominal value of MKD 1,000.00. Out of the total number of issued shares 2,276,304 are voting shares.

As at 31 December 2016, Komercijalna Banka AD Skopje has total 5,046 shareholders, compared to 5,106 shareholders as at 31 December 2015. East Capital Explorer Investments AB and European Bank for Reconstruction and Development are shareholders with qualified share in the Bank. As at 31.12.2016, East Capital Explorer Investments AB holds 10.0% of the total number of issued shares and 10.012% of the total number of voting shares, while European Bank for Reconstruction and Development holds 5.245% of the total number of issued shares and 5.251% of the total number of voting shares.

The holders of ordinary shares have the following rights:
1. Right on voting at the Bank's Assembly;
2. Right on part of the profit (dividend), and
3. Right on part of the remaining liquidation or bankruptcy estate.

Each voting share provides right on one vote at the Bank's Assembly.

The shares of Komercijalna Banka AD Skopje are listed on the official market of the Macedonian Stock Exchange and they are included in the calculation of the Macedonian Stock Exchange index, while since 2007, they are also on the super listing. In the course of 2016, the shares of Komercijalna Banka kept the trend as one of the most liquid shares. In the course of the period reported, the average price of the Bank's traded shares was MKD 2,418.00. Total 265,006 shares with nominal value of MKD 1,000.00 were traded in the course of the reported period. Dividend yield per share was 4.34%.

Komercijalna Banka AD Skopje holds 49% of the equity capital of KB Prvo penzisko drustvo AD Skopje. This company was founded together with Prva pokojninska druzba from Ljubljana, in accordance with the reform of the pension system accomplished in the Republic of Macedonia in 2005. At the end of 2016, the pension company managed 53.5% of total assets paid in the second pillar of the pension system. As at 31.12.2016, 51.8% of total number of mandatory and 53.9% of total voluntary pension insures are registered in KB Prvo penzisko drustvo AD Skopje.

Komercijalna Banka AD Skopje holds qualified share of 64.29% in the Investment Fund Management Company – KB Publikum Invest AD Skopje. The company was established together with a group of investors from Slovenia and Italy in 2008 and it has been managing the Open investment fund KB Publikum Balanced since 2009 and with the KB Publikum Cash and KB Publikum Bonds investment funds, since 2011.

Komercijalna Banka AD Skopje is one of the most successful banks in the Republic of Macedonia with strong local and international reputation, which is confirmed both by its leading position at the Macedonian banking market and the numerous international and national banking awards, such as: most active participant in EBRD TFP – Trade Facilitation Program – for promotion of the international trade worldwide from the European Bank for Reconstruction and Development for the 12-th time; listed joint stock company with the highest turnover and member with the most realized transactions in the past 20 years since the existence of the MSE, as well as "Crystal bell" for the most transparent listed joint stock company (I place) for 2015 and Plaque for total turnover and transactions realised in 2015 (II place); Best FX Provider for the Republic of Macedonia" (services given in FX operations in Macedonia for 2017) by the international magazine Global Finance, The Bank was also named a Superbrand for 2015/2016 in the category of financial institutions, which represents a confirmation for the high quality of its services and additional motivation for improved performances in future.

OBJECTIVES OF THE BANK IN 2017

The priority aims and objectives of the Bank are based on the Policy Statement of the Bank, realized results from operation and the level of realization of the Bank's strategic goals.

The priority aims and objectives of the Bank's Business Policy for 2017 are as follows:

- Maintenance of the capital value and its increase through a policy of further allocation of significant part of the net profit into reserves, thus providing capital adequacy rate that would correspond to the planned activities;
- Profit maximization by undertaking acceptable risks;
- Maintenance and eventual increase of the Bank's participation on the banking market of the Republic of Macedonia, in conditions of increased competition;
- Successful compliance with the legal framework on financial reporting and managing the risks from operation;
- Permanent development and improvement of the information technology in all segments;
- Continuous improvement of the work organization of the bank and human resources management providing higher quality of services;
- Utilizing bank marketing in order to properly inform the target groups and in accordance with the Strategy for corporate social responsibility;
- In 2017 the commitment of the Bank remains, that if the Bank's shareholders provide a control package of shares and set proper parameters, the Bank's management shall take proper measures and activities for possible attraction of potential strategic foreign

investor that should fulfil the conditions defined by the consortium of shareholders of the Bank, as follows: to be a bank whose name is a renowned international brand; the offer should reflect the real value of shares of Komercijalna Banka and to submit a strategic plan for future development of the Bank.

In the course of 2017 Komercijalna Banka AD Skopje shall prospect the following additional aims and objectives, taking into consideration the existing risks in the macro economic environment. In that regard, the Bank shall undertake activities for:

- Introducing new or modified banking products and services according to customer demands, development of new non-traditional banking functions, conquering new market segments;
- Further improvement of the e-banking and mobile banking and promoting the possibilities they offer;
- Improvement of the whole process of risk management, improvement of the process of determining the internal capital of the Bank, compliance with the changes in the Banking Law and the Decision on the Methodology for Determining the Capital Adequacy in the part of the capital requirements;
- Undertaking more intense activities for sale of the foreclosed assets etc.

The realization of the priority aims and objectives in 2017 shall be carried out in accordance with the realization of the Strategic priorities and Macroeconomic Policy of the Government of the Republic of Macedonia, the Monetary Policy implemented by the NBRM in the course of 2017, the Strategy for Corporate Social Responsibility of the Bank for the period 2017-2021 and other law regulations and acts of the Bank. The activities shall be realized following the principles of modern banking operation (liquidity, safety and profitability), in compliance with the economic rules and events in the country and abroad, flexible adjustment of the Bank with the needs of its clients and complete adherence to the financial and monetary-credit discipline in the realization of undertaken obligations towards the business partners.

ECONOMIC ENVIRONMENT IN 2016 AND PROJECTIONS FOR 2017

In the course of 2016, the activities of Komercijalna Banka AD Skopje were carried in accordance with the Program of Business Policy Measures and Activities for the respective year and objectives of the Macroeconomic Policy of NBRM for the respective period.

1. **The ambience in the economy in the Republic of Macedonia in the course of 2016** is characterized by the following indicators[2]: annual increase of the physical volume of the industrial production by 3.4%, annual increase of the volume of goods exchange by 6.0% and coverage of the import by the export up to 70.8%, increase of the GDP by 2.4% (in the 4th quarter of 2016) and decrease of the inflation rate by 0.2%.

In the course of August 2016, the Credit Rating Agency Fitch lowered the credit rating of Macedonia from „BB+" to „BB", characterizing it as an unsafe country with increased investment risk. Main factors for downward rating were the political crisis and corruption. Unlike Fitch, the Credit Rating Agency Standard & Poor's confirmed the credit rating of „BB- stable" for Macedonia, as a result of expectations that the unemployment would keep on declining due to intensified cooperation between domestic companies and foreign

[2] Source: State Statistical Office

investors, as well as further development of economy as a result of new foreign investments in the economic zones.

In September, IMF ended its official visit in R. Macedonia, after which, it decreased the projection for the growth of the domestic economy in 2016 to 2.2%. IMF accentuated the introduction of high-quality measures in order to enable the public debt to remain below 50% of the GDP, maintaining the stability of the monetary and financial sector and implementing reforms in the labour market and management.

Throughout 2016, the Republic of Macedonia had continuous progress in the report of the World Bank and, compared to 2017, it moved forward for 84 places, as a result of conducted over 30 system reforms, which facilitated operation of companies; administrative procedures and time needed to proceed certain procedures were drastically shortened. It also noted a high place in terms of the tax payment indicator; it was fourth country in the world easiest to start a business in, while according to the "Doing Business" report it is the country having the best business climate on the Balkans.

During 2016, **the capital market** in the Republic of Macedonia noted positive trend. The total value of the turnover realized at the Macedonian Stock Exchange (MSE) in 2016 was around EUR 97.6 million, which is 13.1% higher compared to last year.

The regional platform for redirecting payment orders (SEE Link) became operational in 2016. It includes the Macedonian stock exchange, Bulgarian stock exchange, Zagreb stock exchange, Belgrade stock exchange and Ljubljana stock exchange. In order to satisfy investor needs, SEE Link published two stock indexes, SEE LinX and SEE LinX EWI. The two indexes are comprised from the same 16 most traded regional companies from Croatia (five), Slovenia (four), Bulgaria (three), Serbia (two) and Macedonia (two). One of the Macedonian companies is Komercijalna Banka AD Skopje, and the other one is Alkaloid AD Skopje. The Bank also obtained consent to receive transfer of orders for purchase and sale of securities for the needs of SEE Link by the Securities Commission.

2. **Monetary policy** in the reporting period was conducted in changing conditions. As a response to the decreased liquidity in the banking system due to the pressures on the FX market and deposit base of banks caused by local factors of non-economic character manifested in April, NBRM, in May, increased the rate of treasury bills from 3.25% to 4.0% and decreased the offer thereof. Upon attentive follow-up of situations and once the conditions got stabilized, NBRM again lowered the interest rate on treasury bills for 0.25 percentage points – from 4% to 3.75% and increased their offer (from MKD 22,000 million to MKD 23,000 million).

NBRM also raised the rate of mandatory reserves for liabilities in local currency with a foreign currency clause from 20% to 50% in order to keep the low inclination of companies for placements in this type of deposits.

As a result from the shock that had destabilized the deposit base of banks and in conditions of increased demand for foreign currency in cash, the NBRM's Council adopted a decision on placement of foreign currency deposits by banks with NBRM at higher interest rates compared to the negative interest rate dominating on the international financial markets. In October, the possibility for placements of foreign currency deposits with NBRM was derogated.

The foreign currency reserves as at December 2016 achieved the amount of EUR 2,613 million and in comparison to December 2015, they are increased for around EUR 351 million.

The banking system of Macedonia remained stable and safe, despite the uncertain domestic ambient and the political events in the country that affected the deposit base and the loans market. As a result of the political speculations of individuals and the influence of the social networks and media, in April there was a significant decrease of the total deposit base. Still, in the second half of 2016 the condition got stabilized and the deposits marked an annual growth in December of 5.7% (2.5% with households and 13.4% with legal entities). The total loans in December marked an annual growth of 1.0% (7% growth with households and 3.7% decrease with legal entities) which is partly a result of the uncertain conditions and the decreased deposit base, but also a result of the write-off of due outstanding claims, in accordance with the amendments in the Decision on credit risk management from December 2015.

In the area of banking regulation, several decisions are especially important, such as amendments and supplements to the Banking Law where the most significant change refers to the increase of capital requirements to be fulfil by banks by introducing capital buffers in order to comply with Basel III, as well as amendments to the section concerning the jurisdictions of the Bank's authorities with the purpose to comply with the Law on Trade Companies.

3. I**n 2017, the macroeconomic conditions in which the Bank will realize its activity** are expected to be more stable and with lower level of uncertainty compared to 2016. The growth of the Macedonian economy, after the slowdown in 2016, is expected to accelerate once again, thus the real growth of GDP is expected to be in range between 3.0% and 3.5%. That means that the Macedonian economy would return back to the growth track on which it already was before 2016. Stabilization of the political situation in the country is expected to lead to smaller restraint for investing by the business entities from the private sector. Additional positive influence will be the continued realization of public capital investments in the infrastructure, especially in the road infrastructure.

The increased investment activity will be accompanied by bigger domestic consumption, as a result of the expected increase of the number of employees, realization of the announced increase of salaries and pensions, as well as growth of the lending support from the bank, with historically low interest rates. The growth of the Macedonian economy in 2017 will be supported by more favourable realization of net export, supported by improved foreign demand with some of the European countries - trading partners of Republic of Macedonia.

For 2017 there is some planned reduction in the budget deficit, which would move between 3% - 3.5% from the GDP. Fiscal consolidation would have to start at least in limited volume in 2017. Otherwise, the risk of worsening the financial conditions will rise and with them, the financing of the budget deficit on the foreign financial markets. Additionally, the perception for long-term sustainability of the permanent movement trends with the public finances in Republic of Macedonia would deteriorate.

NBRM will continue its implementation of the monetary strategy on targeting the FX exchange rate and maintaining the stability of the nominal MKD-Euro FX exchange rate, in order to maintain the price stability. The average annual inflation rate, as measured by the index of costs of living, is expected to move in range between 1% - 1.5% in 2017. In conditions of more stable economic ambience and decreased uncertainty, the lending expansion of the banks is expected to continue. On annual basis, the growth of the loans would move between 6%-7%. As in the past period, the credit expansion would predominantly rely on the deposit base which would continue to rise in line with the high trust in the banking sector in the Republic of Macedonia.

FINANCIAL PERFORMANCES OF THE BANK

INCOME STATEMENT

In 2016, the Bank realized gross positive financial result from its operation in the amount of MKD 866,360 thousand. The realized net profit for 2016 is MKD 773,987 thousand.

The realized *net interest income* noted decline of 3.1% as a result of decreased interest income under loans approved to non-financial entities and banks, which is 88.3% of the total interest income realized. On the other side, the interest under investments in money assets and equivalents, which have smaller participation in the total realized interest income, showed increase of 13.9%, while the interest under investments in securities noted an increase of 53.3%. The net interest margin is 3.64%.

Net income under fees and commissions is decreased by 3.7% in regards to the same period last year, mainly due to the accelerated dynamics of increase of the expenses under fees versus the increase of the income under fees.

The *net income under fx differences* is decreased by 4.4%.

Other income from business activities showed increase of 75.8% in regards to 2015, mainly as a result of increased amount of collected previously written-off claims and increased amount of capital gain from sale of foreclosed assets.

The provisioning on financial assets on net basis is for 0.7% lower, compared to the previous year.

The loss due to impairment of non-financial assets showed decline by 36.0%. Most of the impairment recorded (MKD 241.4 million) refers to the property foreclosed after 01.01.2010, while the rest thereof is recorded impairment for the property foreclosed until 01.01.2010 and loss under impairment on the basis of reappraisals.

BANK'S RESOURCES

As at 31.12.2016, total resources of the Bank reached the amount of MKD 100,903,414 thousand and realized increase of 3.7% or MKD 3,578,312 thousand versus the end of 2015.

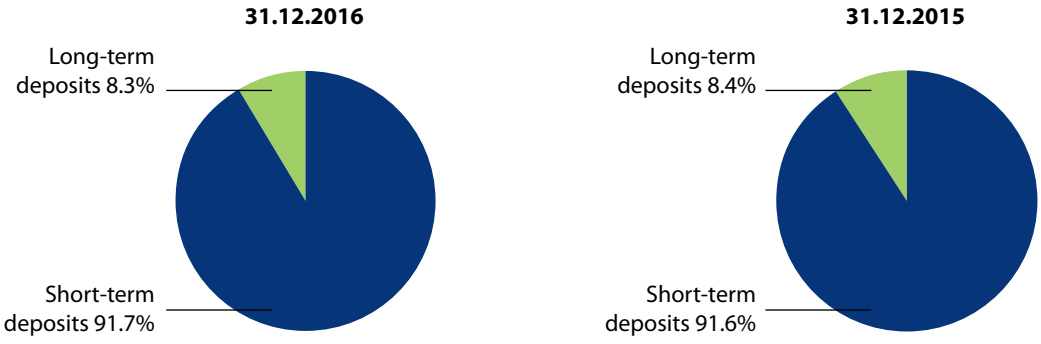
The increase of total resources is due to the growth of the deposits and capital and reserves of the Bank. This growth is especially important, given the fact that during April there was a sudden withdrawal of deposits from the banks in the Republic of Macedonia as a result of speculations in the media regarding the political crisis. The Bank answered to the increased liquidity demand and made payments as required.

Total deposits (deposits of banks and deposits of other clients) have dominant participation of 87% in the total Bank's resources and compared to 2015, they noted an increase of 4.2%.

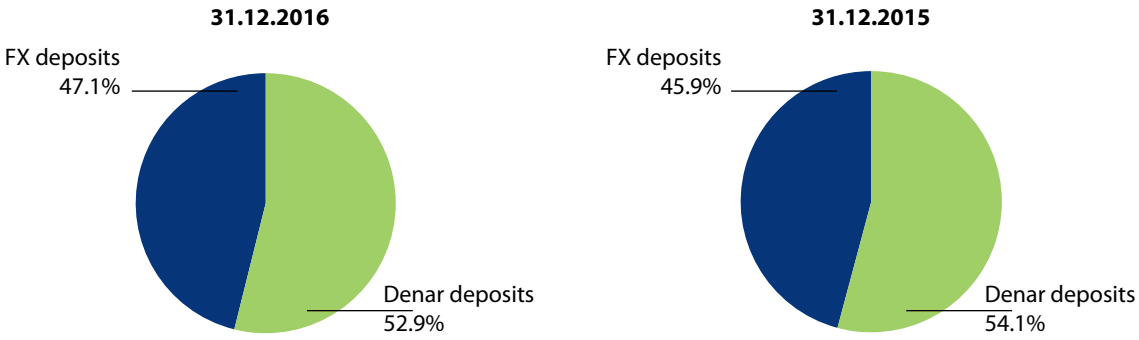
Deposits of other clients, being in the amount of MKD 86,115,337 thousand, noted increase of 4.0%. Within these frames, an increase was realized by the deposits of households by 0.6%, deposits of legal entities by 13.9% and deposits of public sector by 22.0%.

The trend of higher participation of short-term deposits on the account of long-term deposits continued in 2016 as well. Consequently, the short-term deposits, having an increase of 4.1%, represent 91.7% of the total deposits of other clients of the Bank, while the long-term deposits noted participation of 8.3% therein and an increase of 2.0%.

Graph No. 1
Maturity structure of the deposits



Graph No. 2
Currency structure of the deposits



Within the deposits of other clients, the largest participation of 52.3% belongs to the time deposits, followed by current accounts and demand deposits having participation of 45.2% and restricted deposits with participation of 2.5%. These deposits include the amount of accrued interest payable.

The *liabilities under loans* are in the amount of MKD 1,650,522 thousand with a drop of 23.8% noted versus 2015. Within these frames, the liabilities under long-term loans, having the dominant participation therein, showed a decrease of 24.5%, while the liabilities under short-term loans noted a decrease of 21.8%. The decline of the liabilities under long-term loans is mainly due to the repayment of the instalments due under EIB I, II and III credit lines, the Revolving Fund of the Italian Commodities Credit Line, Social Development Fund of the Council of Europe and of the Agriculture Credit Discount Fund administered through MBDP (PSDL 2, IFAD 1, IFAD 2 and EIB). Liabilities under short-term loans note a decrease as a result of the reduced amount of due loan liabilities used from the following credit lines of the Agriculture Credit Discount Fund: IFAD 1, IFAD 2, EIB and PSDL-2.

The position liabilities under loans also include funds from the credit line for joint financing of infrastructural and investment projects in the municipalities according to the cooperation agreement between the Bank and the Municipality Infrastructure Development Fund (MIDF).

As at 31 December 2016, *other reserves* reached the amount of MKD 6,708,773 thousand, showing an increase of 3.7% as a result of allocation of 2015 profit into reserves in the amount of MKD 240,225 thousand.

In 2016, the dynamics of the total resources of the Bank was respectively influenced by the resources of its branches, as follows: the Prilep Branch with participation of 5.8%, Ohrid Branch with 3.7%, Strumica Branch with 4.1%, Kochani Branches with 3.9%, Shtip Branch with 3.5%, Kumanovo Branch with 2.6%, Kavadarci Branch with 2.3%, Veles Branch with 2.2%, Tetovo Branch with 1.7%, Bitola Branch with 1.4% and Gostivar Branch with 0.7% participation in the Bank's total resources.

BANK'S ASSETS

Bank's total assets in 2016 realized volume and dynamics adequate to the resources and reached the total amount of MKD 100,903,414 thousand.

The increase of the total assets is mainly due to the increased balance of the cash and cash equivalents and increased loans and advances to banks.

Cash and cash equivalents, having participation of 33.2% in the total assets, realized increase of 21.2% or MKD 5,874,953 thousand.

The loans to and receivables from banks noted an increase of MKD 875,783 thousand. The increase results from the fx deposits placed with NBRM. This instrument with maturity from 1 to 2[3] years was activated in May 2016 as a response to the shock that destabilized the deposit base of the banks and caused increased demand for foreign currency cash. The banks were enabled to place deposit at more favorable conditions versus the placement of Euro assets abroad.

Investments in securities (available for sale and held to maturity) showed decrease of MKD 154,566 thousand as a result of the decreased statement with the securities available for sale, mainly due to the higher amount of matured than subscribed government bills. On the other side, securities held to maturity noted increase as a result of higher amount of government bills and continuous government bond with Euro clause bought with interest rate of 2.7% and maturity term of two years.

Investments in associate companies increased for 11.1% under the positive net effect from the recorded share in the profit of the associate company KB Prvo penzisko drustvo AD Skopje and dividend paid and recorded according to the method of principal.

Real estate and equipment, participating by 2.9%, noted decline of 3.2% or MKD 96,574 thousand, mostly due to the calculated amortization on the real estate and equipment.

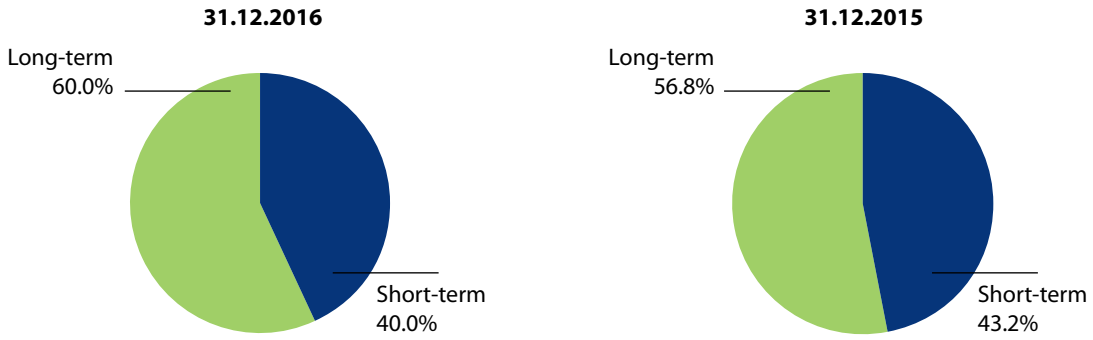
The loans to and receivables from other clients, having participation of 44.9% in the total assets, noted a decline of MKD 2,376,368 thousand, as a result of the decreased statement of the gross loans of non-financial entities (loans to small and medium size enterprises). Gross loans to individuals noted decline due to decreased statement of the loans under credit cards and overdraft facilities on current accounts, while an increase is noted with the long-term loans, especially of the housing loans with currency clause, due to the favorable conditions for their approval.

The write-offs made until 31.12.2016 are in the amount of MKD 6.2 billion[4].

As from the maturity aspect, 40% of the loans are short-term loans, and 60% are long-term loans. Compared to 2015, short-term loans show a decrease of 12% and the long-term loans are increased for 0.4%.

[3] NBRM stopped realizing fx deposits auctions according to the Decision of Operative Monetary Policy Committee of 28.10.2016.
[4] In accordance with the amendments and supplements to the Decision on Credit Risk Management according to which all claims being fully provisioned for more than two years have to be written-off.

Graph No. 3
Maturity structure of loans to and claims from other clients



When considered by type of debtor, 74.7% of the loans are approved to non-financial legal entities, while 25.3% are loans approved to retail clients.

The largest portion of the loans approved to non-financial legal entities or 54.1% are loans approved to large enterprises, 45.9% are loans approved to small and medium size enterprises, while within the exposures approved to retail clients – 83.2% are loans, 8.6% are overdraft facilities on current accounts and 8.2% are utilized credit limits on credit cards.

On consolidated basis, total assets amount in MKD 100,897,069 thousand, total capital and reserves are MKD 10,715,026 thousand and the total consolidated net profit is MKD 786,067 thousand. As at 31.12.2016, the total assets of the subsidiary are less than 1% of the total assets of the Bank. Pursuant to the Decision of the National Bank of the Republic of Macedonia on consolidated supervision (Official Gazette of RM No. 17/2008), when total assets of the subsidiary entity is less than 1% of the assets of the main entity, the subsidiary entity shall not be included in the consolidated financial statements for the needs of the consolidated supervision. According to the aforesaid, capital adequacy is not defined on consolidated basis.

RISK MANAGEMENT

The modern concept of banking, in conditions of market-oriented economy, is based on proper management of risks, as one of the basic preconditions for successful operation of any bank.

Any probability that certain activity or event may have direct adverse impact on the profit and/or own assets, or may cause difficulties in realization of the Bank's objectives, is a risk.

Komercijalna Banka AD Skopje continually manages banking risks by their timely identification, evaluation, monitoring, control and reporting. For that purpose, the Bank had established system for undertaking and managing the risk, which is permanently improved and complied with the amendments and supplements in the law regulations and with the amendments in the international theory and practice, having in mind the Bank's Strategy for undertaking and managing the risks.

The Bank's system for managing the risks is in compliance with the nature, size and complexity of the financial activities performed by the Bank and covers the following types of risks: credit risk (including the country risk), liquidity risk, currency risk, market risk, risk from changes of the interest rates in the portfolio of banking activities, risk from Bank's exposure concentration, operational risk (including the legal risk), reputation risk and the strategic risk. In its system for managing the risks, the Bank also includes other risks it is exposed to in the course of its operation, when it is determined that they have significant impact on the performance of the Bank.

CREDIT RISK

Credit risk is a risk from loss of the Bank, due to the inability of its client to settle its obligations towards the Bank in the agreed amount and within the agreed terms.

Credit risk management is performed by the Bank through established processes of identification, assessment, measuring, monitoring and control.

Organizational units undertaking the credit risk make its identification through established procedures for assessment of the creditability of clients, and the organizational units managing the credit risk make the identification through the process of measuring, monitoring and control of their performances.

As an integral part of the process of assessment of the credit risk, the Bank applies the system of internal ranking of clients, through a developed scoring system for non-financial legal entities and individuals.

The scoring system is a two-dimension ranking model comprised of assessment of the client risk and assessment of the transaction risk (exposure to credit risk).

The process of measuring the credit risk provides quantification of the risk of the clients and their related parties, as well as quantification of the risk of the total portfolio. The result from the scoring model is an important measuring tool.

The purpose of the process of monitoring the credit risk is to check the compliance with the Bank's Strategy and adjustment with the legal and internal limits of the Bank.

The process of control of the credit risk means maintenance of the quantitative and qualitative risk indicators within the risk frame predicted by the Bank and within the frame prescribed by the law regulations. In addition, there is a warning system for cases when the risk indicators exceed the defined limits.

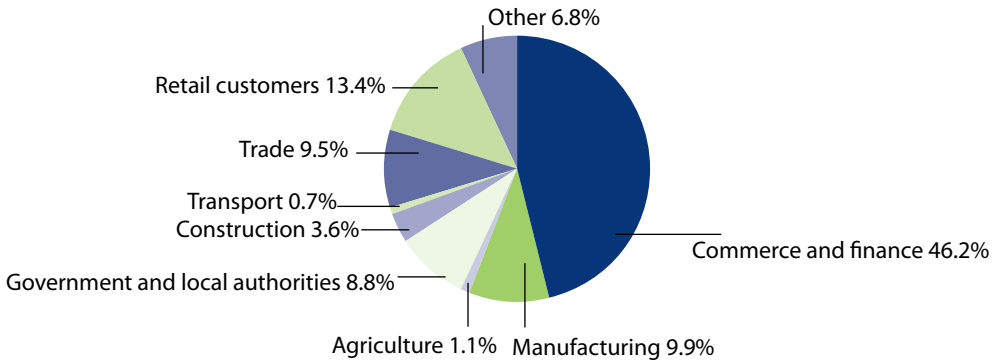
Classification and determination of the provisioning/special reserve for all credit risk exposures are carried out on individual basis. Estimations of the current value of future cash flows are calculated through models based on series of historical data, matrices of migration and experience based assessments of the management.

Table 1 - Quality of the credit portfolio of the Bank[5] (in %)

Risk category	31.12.2016	31.12.2015
A	76.3	69.8
B	6.5	6.0
C	1.7	5.6
D & E	15.5	18.6

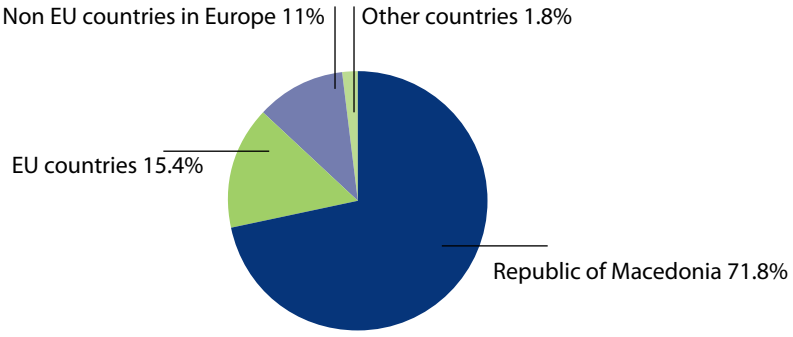
[5] The decrease of the credit exposure in D and E risk category is influenced by the Decision on managing the credit risk, according to which any claim which is fully provisioned more than two years should be written-off.

Graph No. 4
Credit risk concentration by sectors



The Bank does not have high credit risk concentration by sectors because the sectors with more than 15% participation therein have internal dispersed structure. Thus, the retail sector, has an internal dispersed structure, the concentration in the other sectors relates to different areas, while the concentration in finance and insurance business lines refers to exposures towards NBRM and first-class banks.

Graph No. 5
Credit risk concentration by geographic location



CAPITAL ADEQUACY

Within the overall process of the risk management of the Bank, management of the Bank's capital, as well as determination of the capital adequacy is a separate, extensive and important process.

The Bank defines its own assets and capital adequacy in accordance with the Methodology for determining capital adequacy prescribed by the National Bank of the Republic of Macedonia.

Pursuant to the regulation, the assets weighted according to the credit risk and the capital needed to cover the operational risk are calculated by application of a standardized approach.

The Bank has established a process for determining the internal capital needed for covering the acceptable level of risk, appropriate to its risk profile and the size and complexity of the current and future financial activities.

Capital adequacy ratio, set as relation between the Bank's own assets and risk weighted assets, as at 31.12.2016 is 15.23% and is within the legally prescribed limit of 8% and over the minimum of 12% defined in the Risk Management Strategy of Komercijalna Banka AD Skopje.

Table 2 - Capital adequacy ratio

Period	Capital adequacy ratio
31.12.2016	**15.23%**
31.12.2015	**13.81%**

LIQUIDITY RISK

Liquidity risk occurs when the Bank cannot provide sufficient funds to settle its short-term liabilities at their maturity, or when it provides the necessary funds at much higher costs.

Liquidity risk management means management of the assets and liabilities in a manner that provides timely and regular payment of the liabilities, either in normal or extraordinary conditions for operation.

In the course of 2016, the Bank continued to monitor and manage its liquidity. Pursuant to the law and internal regulations, the Bank permanently fulfilled its legal obligation for the obligatory reserve in denars and in foreign currency, maintained stable level of the cash at counters, in function of protection of the unstable segments of the deposit base, subscribed treasury and government bills, monitored the stability and concentration of the deposit base, harmonization of the inflows and outflows on the Bank's account, residual and prospected maturity and currency compliance of the Bank's assets and liabilities, internal liquidity indices as well as the liquidity rates, performed stress-testing, followed the concentration level etc. In the course of 2016, the Bank had stable current liquidity position, maintained the liquidity rates over the prescribed minimum level and was complied with the internal limits.

RISK FROM CHANGES IN THE INTEREST RATES IN THE PORTFOLIO OF THE BANKING ACTIVITIES

The risk from changes in the interest rates in the portfolio of the banking activities is a risk of loss arising from unfavorable change of the interest rates having impact on the items in the portfolio of the banking activities of the Bank.

The purpose of managing the risk from changes in the interest rates is to maximize the stability and profitability by applying optimum structure and optimum interest rates in the portfolio of banking activities.

In the course of 2016, the Bank was making regular analysis of the interest bearing assets and liabilities, the realized interest income and interest expenses, the level of change sensitivity of the interest rates, the average risk weighted loan and deposit interest rate, interest spread and net interest margin (NIM), the ratio of the interest bearing assets and interest bearing liabilities, interest gap, changes in the economic value of the portfolio of banking activities, analysis of the harmonization of the interest rates on the financial assets and liabilities and of the maturity (in)compliance of the interest-sensitive asset and liability positions, risk from the difference in the level of the reference interest rates on instruments with similar characteristics, risk arising from the options incorporated in the interest-sensitive positions, stress-testing, as well as other relevant indicators, as foundation for successful management of the interest rates risk. In the course of 2016, the Bank was complied with the internal and external limits.

Taking into account the principles of safety, profitability and competitiveness, during 2016, the Bank continued implementing the concept of differentiated interest rates in accordance with previously set criteria, as well as introducing new products, in accordance with the needs and capabilities of the existing and potential clients.

CURRENCY RISK

Currency risk is a risk of loss due to change of the exchange rates or change of the denar value in relation to value of other foreign currencies.

Hence, the denar exchange rate and its stability, foreign currency reserves of NBRM and its capacity for intervention, foreign currency reserves of banks, inter-currency relations, the Monetary Policy of NBRM, etc., are the factors that have direct or indirect influence and determine the level and exposure to currency risk of the Bank.

The main principle of managing the currency risk is to realize and maintain harmonization of the receivables in foreign currency with the payables in foreign currency. Furthermore, this relation is managed from the perspective of maturity of the receivables and payables in foreign currency, as well.

The methods for measuring the currency risk include monitoring and analysis of the currency risk by positions and collectively, currency structure of Balance sheet, currency structure of foreign assets, stress testing and other methods.

Management of the currency risk means daily monitoring, quantification and control of the aggregate FX position, as a main indicator of the level of currency risk exposure of the Bank.

In the course of 2016, the Bank continually followed and managed the currency risk, thus maintaining stable level of aggregate FX position within the legal frames of up to 30% of the own assets.

MARKET RISK

Market risk is a risk of loss as a result of changed price of the financial instruments intended for trade.

Management of the market risk means management of the trading portfolio of the Bank, with simultaneous adherence to the basic principles of banking operations, safety, liquidity

and profitability. In the course of 2016, and according to the participation of the trading portfolio in the total activities, which at the end of December 2016 was 0.34% (the highest participation during 2016 was 0.37%), the Bank was not obligated to allocate capital for covering of the market risk.

OPERATIONAL AND REPUTATION RISK

The operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The operational risk includes legal risk, as well the risk of money laundering and terrorist financing, risk of inadequacy of IT systems and other operational risks.

In its daily performance, Komercijalna Banka AD Skopje permanently monitors, records and analyses the loss events and events that represent potential operational risk. On the basis of the information obtained and analyses made, the Bank is undertaking specific measures for recovery of the deteriorations and elimination/limiting and control of the risk in future.

During the period January – December 2016, the Bank has no significant exposure to operational risk.

In the reporting period, the Bank did not have any significant damage from the exposure to legal risk, i.e. it does not have a significant influence on the Bank`s profit and own funds, caused by violation of the law and by-law regulation, agreements, provided practices, ethical standards, or as a consequences, rules, agreements and other legal documents.

Within the activities established in accordance with the law regulation, the Bank controls the risk from money laundering and terrorism financing, though measures and activities which are undertaken in the Bank, and the same is kept on a low level.

Pursuant to the legislation requirements, the Bank determinates capital required for operational risk coverage, using standardized approach.

Reputation risk is current or future risk which may influence the profit or own funds of the Bank due to unfavorable observing by customers, creditors, shareholders, investors and regulatory bodies. Komercijalna Banka AD Skopje monitors the reputational risk and undertakes measures for protections from this risk. During 2016 there are no transactions, activities or events that could cause significant exposure to reputation risk.

STRATEGIC RISK

The strategic risk is current or future risk on the profit or own funds of the Bank arising from changes in the business environment, negative business decisions, improper implementation of decisions or insufficient responsiveness of the Bank to the changes in the business environment.

Strategic risk management includes all the activities connected with adequate preparation of strategic and business plan of the Bank, proper targeting, appropriate allocation of resources, undertaking timely activities depending on the expected influence of the external and internal factors of the environment, compliance with levels of exposure to other risks from operation set out by the respective policies and timely and accurate reporting in terms of realization of the defined objectives and quantifications.

CORPORATE BANKING

Corporate lending, as a core activity of Komercijalna Banka AD Skopje, is being realized in compliance with the Credit Policy and Procedures of the Bank, with strict adherence to the principles of profitability, efficiency and safety of the placements bearing acceptable credit risk.

In the course of 2016, the Bank continued applying the conservative and restrictive approach by making careful analysis on the risks related to the real sector in the Republic of Macedonia that may have negative impact on the quality of the credit portfolio.

Apart from the support to the existing small and large clients, the Bank's focus in the period passed was on placing credit products for micro, small and medium size creditworthy companies having short-term liquidity needs.

Also, Komercijalna Banka continued applying interest rates policy of appropriately positioned interest rates for the clients that settle their obligations on regular basis and were ranked as first-class clients with appropriate collateral provided.

In the domain of lending to non-financial legal entities, the activities of the Bank were directed towards providing short-term loans for supporting clients' current operation and simultaneously approving long-term loans for investments and working capital. The largest portion of the placements in loans was approved from the Bank's own assets, while the rest was approved from the proceeds of the credit lines placed through the Bank. Following the practice from the previous years, in cooperation with the Macedonian Bank for Development Promotion, in 2016 the Bank continued to support and to monitor the clients'

projects through the funds of the credit lines, especially of the credit lines of the European Investment Bank (EIB) for financing small and medium size enterprises and priority projects. During 2016 Komercijalna Banka AD Skopje has started approving loans due to established collaboration with the Municipal Infrastructure Development Fund (MIDF), and also has continued approving loans from the credit line of the commission operation between the Bank and MBDP within the frames of the Program for self-employment by lending and the Project for lending to legal entities (micro and small entities).

In 2016, Komercijalna Banka continued to approve FX loans from own funds and from domestic and foreign credit lines, whereas out of total FX loans approved from own funds 32.5% are short-term, 35.7% are long-term, while 31.8% are revolving loans. Also, the Bank regularly administered its liabilities under already disbursed FX loans from the credit line of the Council of Europe Social Development Fund and the Revolving Fund of the Italian Commodities Credit Line.

In 2016, the structure of the Bank's credit portfolio was in accordance with the proportions set out for the risk diversification by industrial sectors, in accordance with the Credit Policy and Procedures of the Bank.

Table no.3 - Structure of the credit portfolio by sectors as at 31.12.2016	
Sector	**% of participation**
Industry	**29.6**
Trade and finance	**28.4**
Construction	**10.7**
Transport	**2.2**
Agriculture, forestry and fishing	**3.4**
Other	**25.7**

Apart from corporate lending, within the denar operations with legal entities, the Bank has issued payable and performance denar guarantees. In the reporting period, the newly approved denar guarantees noted an increase in value of 12.5%. The Bank successfully continued the issuance of bid bonds in electronic form, whose key benefits are simplified procedure and saving in issuance time and costs.

INTERNATIONAL BANKING

In the course of the period reported, Komercijalna Banka AD Skopje continued performing the activities in the domain of international banking with maximum engagement in keeping the confidence and meeting the needs of its clients.

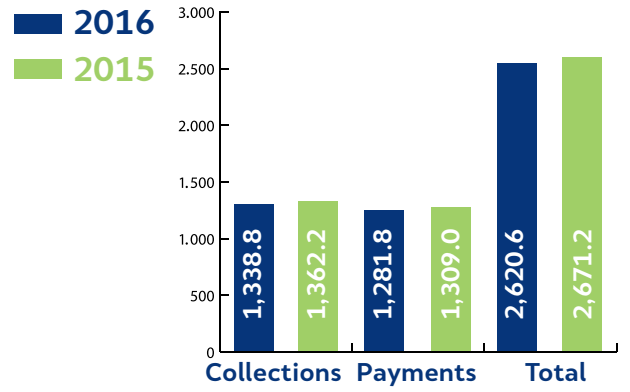
The Bank has established highly professional correspondent relations with 856 banks from 77 countries in the world, which are completely put in the function of the Macedonian companies, enabling them to have easier and more successful access to the global market. The permanent quality offered by the Bank in the segment of international banking is mainly due to the permanent research on improvement and unification of the banking practice in regard to the local and international law regulations.

In 2016, international payment operations and part of the international documentary collections noted decline or stagnation as a result of few factors, such as: deteriorated operation of part of the clients, decline in their trade operations, increased competition and decreased commissions at the market.

INTERNATIONAL PAYMENT OPERATIONS

In 2016 international payment operations show decrease of 1.9% relative to 2015, while the number of realized collections and payments is increased for 2.3%.

Graph no.6
International payment operations realized (in million EUR)

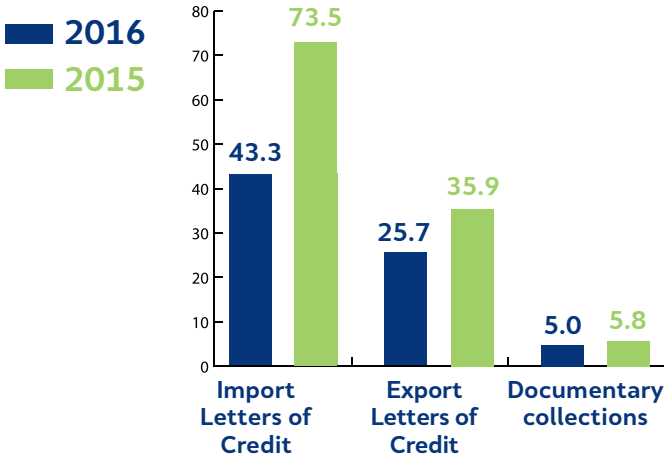


In the course of 2016, the Bank continued its activities on instructing the clients to use E-banking in function of increasing the efficiency, reducing the time needed for realization of payment operations activities and lower clients' costs, which resulted in higher number of new E-banking users for 7.8%, increased number of active users for 22.4%, of the number of new subscriptions to fx market for legal entities for 1.8%, of the number of payment orders realized for 10.5% and of the number of new subscriptions for receiving notifications on realized international payments for 6.7%.

LETTER OF CREDIT AND DOCUMENTARY OPERATIONS

The comparison data on documentary credits operation are in compliance with the international trends in use of this instrument and at the same time they are reflection of the current situation in the economy.

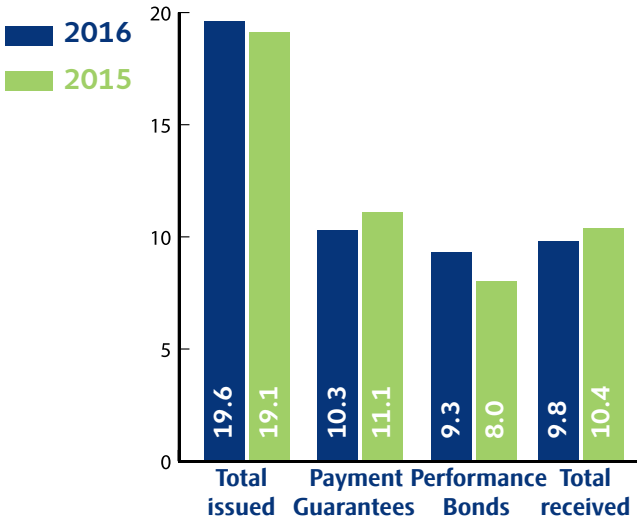
Graph No. 7
Letters of Credit and Documentary collections (in million EUR)



FX LETTERS OF GUARANTEE

In the course of 2016, the Bank was providing guarantee support to the clients' contracts liabilities in the international operations, as well as support for the companies' participation in international bids, thus realizing value increase of 2.6% compared to the previous year.

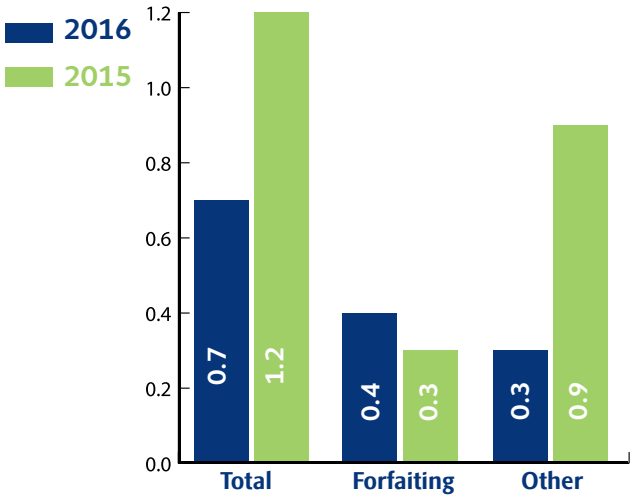
Graph No. 8
FX Letters of Guarantee - new
(in mill. EUR)



EXPORT-TRADE FINANCING

In the period reported, the Bank continued to purchase receivables of domestic exporters under international trade operation instruments (forfaiting) and under export invoices. The Bank is present in this segment since 2003 and its membership in the International Forfaiting Association – IFA since 2012 is the confirmation of its commitment for further improvement and strengthening of its capacity.

Graph No. 9
Export financing – new
(in mill. EUR)



LIQUIDITY MANAGEMENT

In the course of 2016, the Bank achieved optimal level of its denar and foreign currency liquidity, which enabled smooth realization of the financial activities and fulfilment of the legal obligations and obligations toward clients.

TREASURY BILLS

In accordance with the conditions for realization of NBRM's auctions of Treasury Bills and the Bank's Policy for Liquidity Management, in the course of 2016, the Bank bought Treasury Bills on its behalf and for its account in the total amount of MKD 69,793,000 thousand or 7.5% less than in 2015.

The average statement of purchased Treasury Bills in 2016 is in the amount of MKD 5,813,925 thousand.

On 31.12.2016, the statement of the subscribed Treasury Bills in nominal value is in the amount of MKD 5,784,000 thousand.

GOVERNMENT BILLS

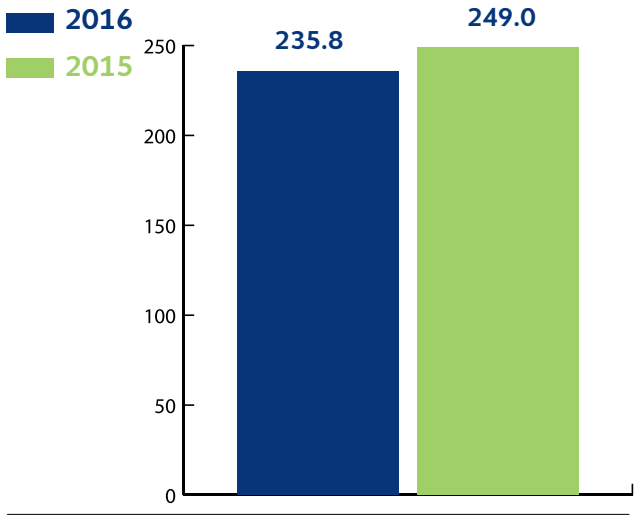
In 2016, the Bank participated in the auctions of Government Bills and on its behalf and for its account bought Government Bills in denars and in denars with FX clause in the amount of MKD 9,511,880 thousand or 24.5% more than in 2015. The average statement of purchased Government Bills in 2016 is in the amount of MKD 6,138,471 thousand.

On 31.12.2016, the statement of the subscribed Government Bills in nominal value is in the amount of MKD 6,055,880 thousand.

PLACEMENTS WITH DOMESTIC AND FOREIGN BANKS

The average amount of the placed foreign currency assets in 2016 was EUR 235.8 million, which is for 5.3% less than the average amount of placed foreign currency assets in 2015 (EUR 249.0 million).

Graph No. 10
Placed FX Deposits
(in mill. EUR)



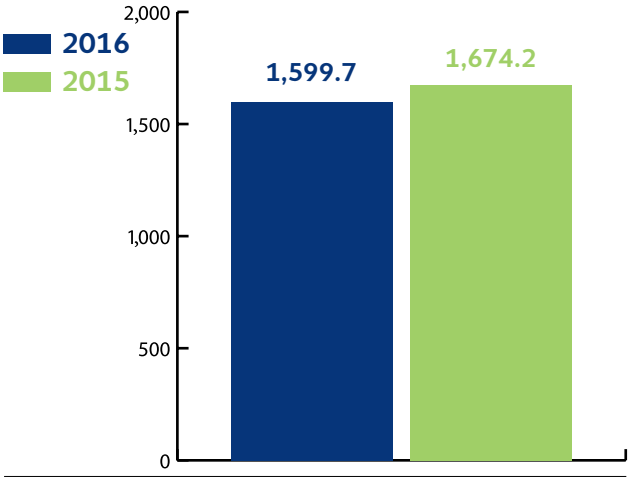
FX MARKET

The total turnover realized in 2016 on the internal FX market of the Bank was EUR 1,599.7 million. Compared to the turnover realized in 2015 (EUR 1,674.2 million), there is a decrease of 4.5%.

In 2016, the Bank concluded total 81,898 FX purchase agreements, and compared to 2015, when total 78,224 FX purchase agreements were concluded, there is an increase for 3,674 purchase agreements or 4.7% more.

The share of Komercijalna Banka AD Skopje in the FX market in the Republic of Macedonia ranged between 18.30% and 24.57%.

Graph No.11
Internal FX market of Komercijalna Banka (in mill. EUR)



PURCHASE/SALE OF FOREIGN CURRENCIES WITH INTERNATIONAL AND DOMESTIC BANKS

The total turnover realized in 2016 under FX transactions is EUR 857.1 million, which is for EUR 24.7 million or 2.8% less, compared to the turnover of EUR 881.8 million realized in 2015.

INVESTMENTS IN SECURITIES

INVESTMENTS HELD FOR TRADING

2016 was characterized by increased bank's investments in ownership and debt securities intended for trade.

As at 31.12.2016, the value of ownership securities held for trading is MKD 384,567 thousand, out of which the investments in shares were in the amount of MKD 68,551 thousand and the investments in stakes of KB Publikum Invest – Open investment fund - Balanced and stakes of KB Publikum Invest – Open investment fund - Cash in the amount of MKD 316,016 thousand.

On 31.12.2016 the value of the structure government bonds under denationalization is MKD 22,880 thousand.

INVESTMENTS AVAILABLE FOR SALE

As at 31.12.2016, the statement of the equity securities available for sale amounted MKD 64,988 thousand comprised of securities issued by domestic and foreign financial companies.

As at 31.12.2016, statement of the long-term debt securities issued by the state, available for sale, is in the amount of MKD 403,440 thousand.

GOVERNMENT BONDS HELD TO MATURITY

As at 31.12.2016, the value of the bonds issued by the Republic of Macedonia and held to maturity is MKD 597,554 thousand and they are comprised of investments in denationalization bonds and continuous government bond with fx clause.

INVESTMENTS IN ASSOCIATES AND SUBSIDIARIES

As at 31.12.2016, the Bank has an investment in the associate company KB Prvo penzisko drustvo AD Skopje in the amount of MKD 210,171 thousand and an investment in the subsidiary Investment Fund Management Company KB Publikum Invest AD Skopje in the amount of MKD 12,738 thousand.

GOVERNMENT SECURITIES FOR CLIENTS

In the course of 2016, at the Government Bonds and Government Bills' auctions, the Bank purchased government securities on its behalf and for the account of its clients in the amount of MKD 2,082,480 thousand, or 4.7% less, compared to 2015 when the purchased government securities amounted in MKD 2,185,500 thousand.

TRADING WITH SECURITIES

In the reporting period the activities at the Macedonian Stock Exchange note an increase of 13.1% in relation to the same period last year, while the Bank's activities in this segment are in the amount of MKD 1,437,314 thousand, and the same are increased for 69.2%. The largest part of the turnover of the Bank (63.1%) is realized through classical trading, while the rest of 36.9% are block-transactions. The Bank's participation on the capital market as at 31.12.2016 amounts 17.9% in the total number of transactions and 24% in the total realized trade.

CUSTODIAN ACTIVITIES

Pursuant to the provisions of the Law on Securities, as at 31.12.2016, the Bank has concluded 22 agreements for carrying out custodian services with 19 non-resident legal entities and 3 non-resident individual clients. Based on these agreements the Bank keeps total 53 portfolios with a market value of MKD 2,674,640 thousand, whose market value, compared to 2015, is for 23% higher.

In the course of the period reported, the Bank also provided services to a voluntary and mandatory pension fund, managed by a single company – client of the Bank, and provided services of a depositary bank for nine investment funds, managed by three companies – clients of the Bank.

RETAIL BANKING

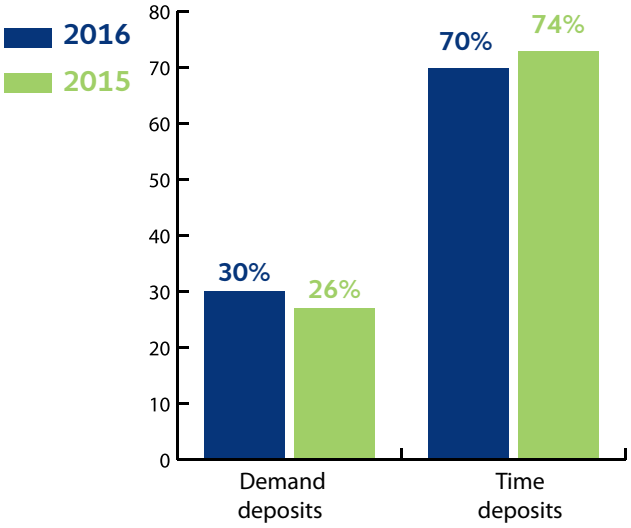
CITIZENS' DEPOSITS

As at 31.12.2016, total citizens' deposits with Komercijalna Banka AD Skopje amount in MKD 62,466,258 thousand and compared to 31.12.2015 when they were in the amount of MKD 62,089,937 thousand, they show an increase of 0.6%. Although the trend of increase continues, it is with slower dynamics as a result of withdrawal of part of citizens' savings deposits in the course of April due to certain uneconomic factors.

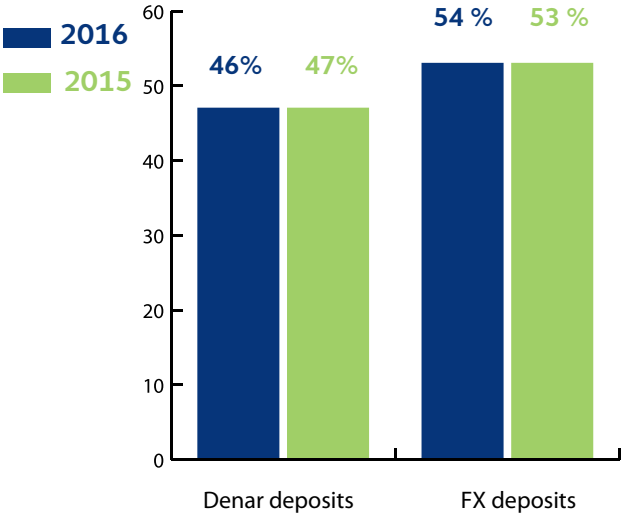
Total citizens' deposits have 72.5% participation in the Bank's client's base, while their participation in the total resources is 61.9% and represents the base for realization of the deposit function of the Bank.

The maturity structure of the citizens' deposits as at 31.12.2016 shows 30% participation of demand deposits and 70% of time deposits.

Graph No.12
Maturity structure of citizens' deposits



Graph No.13
Currency structure of citizens' deposits



LENDING TO CITIZENS

The total credit exposure towards citizens, as at 31.12.2016, amounted in MKD 13,435,664 thousand, and compared to the total credit exposure as at 31.12.2015 when it amounted in MKD 13,501,503 thousand, it shows a decrease of 0.5%.

In 2016, the Bank approved total 10,101 loans in the total amount of MKD 3,816,502 thousand, being a decline of the number of the newly-approved loans for 23% and decline in the value thereof for 29.5%, compared to 2015.

The table below illustrates the lending activities of the Bank in relation to citizens, by volume, amount and type of loans.

Table No. 4 – Loans approved to citizens

Purpose	(in MKD 000)				
	31.12.2016		31.12.2015		Index
	Number	Amount	Number	Amount	2016/2015
Loans with identified purpose for purchasing immovable property and for construction	810	1,783,469	1,255	2,515,887	70.9
Loans for cars	3	4,717	2	2,652	177.9
Scholarship loans	-	-	2	179	-
Loans through merchants	91	2,577	262	6,979	37.0
Tourist loans	-	-	-	-	-
Loans for energy efficiency improvement	-	-	2	235	-
Cash loans with no purpose identified	8,468	1,758,015	10,866	2,530,639	69.5
Loans upon pledge of deposit	704	249,825	655	214,735	116.3
Loans with no purpose identified under mortgage on real estate and draft	25	17,899	58	142,092	12.6
Loans upon 30% or 50% deposit and mortgage	-	-	1	1,230	-
Total	**10,101**	**3,816,502**	**13,103**	**5,414,628**	**70.5**

The Bank continued to apply the sellective approach, taking into consideration the detailed credit analysis, the quality of collateral and the credit history of the clients when approving the loans to its clients in order to minimize and identify the credit risk in due time. When approving the loans, the priority was given to housing loans in order to increase their participation in the total loan portfolio.

TRANSACTION CURRENT ACCOUNTS

In the course of 2016, the Bank opened total 17,314 new transaction accounts and issued total 23,240 debit cards, out of which 4,331 Visa Electron debit cards, 746 Maestro® debit cards, 186 Maestro® cards for non-residents, 15,485 Debit Mastercard® and 2,492 Debit Mastercard® World cards. The increased participation of Debit Mastercard® cards in the total number of debit cards issued resulted from the active promotion of this type of cards as new products in this sphere.

In the course of the period reported, total inflow on transaction current accounts is MKD 91.2 billion. Total number of companies that paid salaries on transaction accounts with the Bank has increased for 1%. The transaction accounts receiving inflows under monthly salaries reached the number of 112,294, while pensions are received on total 66,499 transaction accounts or on 0.6% more accounts compared to the previous year.

As at 31.12.2016, the number of current accounts with positive balances has increased for 1.4%, while the number of current accounts with overdraft facility approved thereon has decreased for 9.4%.

Total placements on transaction accounts under overdraft facility decreased for 1.6%, while the utilization thereof is decreased from 39.4% to 37.9%.

This segment of operation is characterized by more intensive accent of the Bank on development of alternative options for use of the assets on the accounts by the clients. Thus, the Bank is permanently engaged in increasing the volume and type of payments by standing orders and of the functionality of e-banking and SMS-banking services. Thus, in 2016, the number of collected standing orders increased for 17.4%. The number of e-banking registered users increased for 9,595 new subscriptions and reached the number of 95,432 users-individuals, out of which 25,997 users may execute payments though Internet by using a list of codes or digital certificate. Also, as at 31.12.2016, there are 1,379 subscriptions approved for the SMS banking services. In the course of 2016, mobile banking for individuals – mBanka service is used by 11,513 users, out of which 1,729 have realized certain transactions there through, so the total number of order forms realized through the mobile banking service reached 51,572.

CARDS OPERATIONS

In 2016, Bank's performance in this domain was in accordance with its strategy for strengthening the leading position on the banking market in the country. So, the cards operations were focused on further increasing the turnover and number of transactions, expanding the POS terminals network, increasing the number of ATMs and increasing the number of users of all types of debit and credit cards.

CARDS ISSUANCE

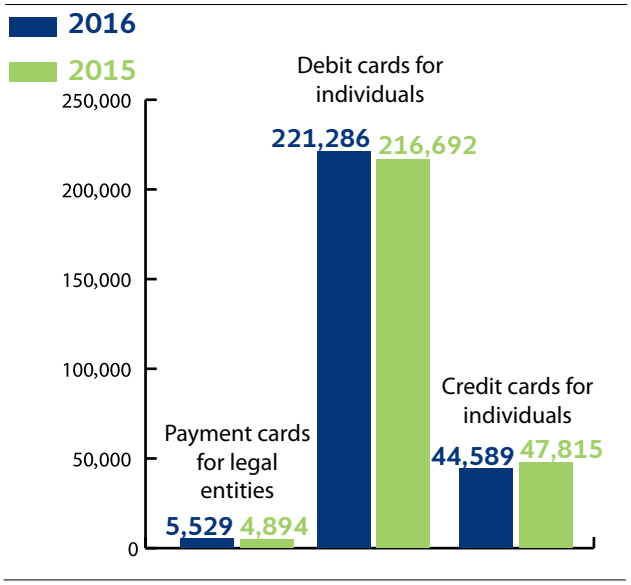
As at 31.12.2016, there are total 271,404 active cards issued by the Bank and their number is for 0.7% higher, relative to 2015, which is a result of the increase of the cards number and at the same time optimization of the cards portfolio by closing or not renewing the cards without any transactions realized there through for a longer period of time.

Apart from issuing contactless Mastercard® cards, the period reported is characterized by the issuance of Visa program contactless cards. Furthermore, the Bank introduced 3D secure technology for safe Internet shopping for all cards of Visa and Mastercard® brands.

In 2016, the Bank realized total 13,384,376 transactions with total value of MKD 29,224.4 million. Compared to the total number of transactions of 11,909,935 in 2015, having total value of MKD 27,495.6 million, there is an increase of 12.4% realized in the number of transactions, while their value is increased for 6.3%.

All indicators point out the successful payment card operations and strengthened leading position of the Bank in this area.

Graph No.14
Payment cards' structure



CARDS ACQUIRING

From the aspect of cards acquiring, there are total 5,193 POS terminals installed until 31.12.2016, while in the course of 2016 the number of new POS terminals installed by the Bank reached 931. Relative to 2015, total number of POS terminals showed decline of 10%, while the number of new POS terminals installed is higher for 48%.

The decreased number of points of sale resulted from the increased efficiency of the Bank's terminals network. Namely, apart from network expansion and increase of the turnover realized through the terminals, it is important to point out that there is proper utilization of the terminals on the ground. Thus, the average number of active points of sale where there had been at least one transaction per month is 3,947, while this number in 2015 was 3,530.

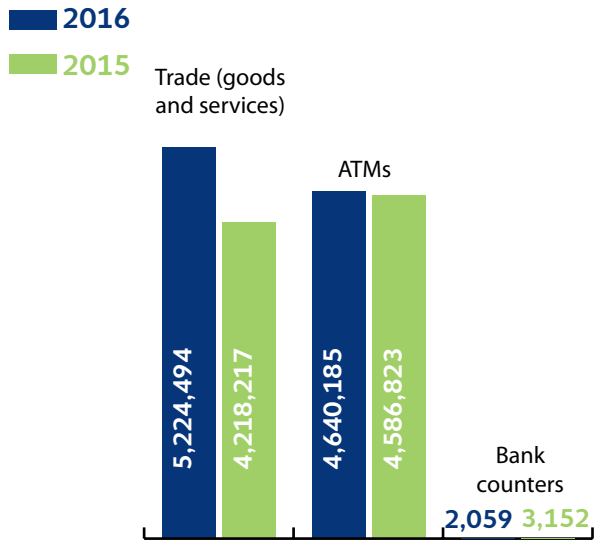
More important activities worth mentioning in this sphere of operation are as follows: the agreement concluded for acceptance of bank cards by the clinics within the Clinical Center in Skopje, increased number of valid agreements concluded with trading companies that accept cards at virtual POS terminals through Komercijalna Banka, continuous replacement of the existing terminals with terminals that offer the option for contactless payments, realized campaigns for promotion of contactless payment cards in cooperation with Mastercard and Cineplexx and Eurofarm pharmacies.

The Bank has a developed network of total 158 ATMs installed.

In the course of 2016 there were total 9,866,738 transactions realized through the Bank's network worth MKD 27,104.2 million, which is an increase of 12% of the number of transactions and 6.3% of their value, compared to the previous year.

It is worth mentioning that there was a research realized by Visa and its member banks showing that in the course of the first two quarters of 2016 the Bank noted higher percentage of authorizations and international payments compared to the overall banking market.

Graph No.15
Number of transactions through the Bank's network



As a result of long-lasting education of the clients and activities undertaken for increased use of the cards for payment purposes, for the first time in the course of 2016 the number of transactions in trade exceeded the number of cash withdrawal transactions, showing that step by step the clients are changing their habits of working with cash.

2016 was characterized by 77,135 e-commerce transactions realized in total value of MKD 90.3 million, being a double increase related to 2015.

DOMESTIC PAYMENT OPERATIONS

In the course of 2016, the Bank continued to perform the activities from the domain of domestic payment operations successfully.

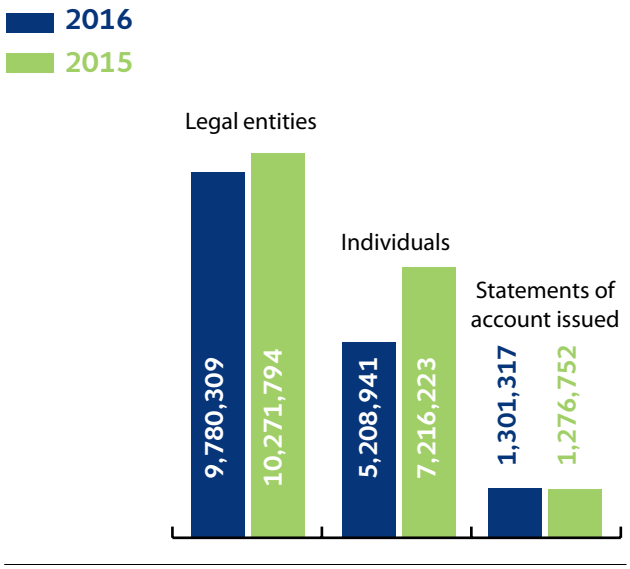
As at 31.12.2016, the Bank's officers processed total 16,290,567 transactions for legal entities and retail clients.

Within the total number of transactions processed, 9,780,309 transactions are initiated by legal entities, out of which 7,191,372 are non-cash and 2,588,937 are cash transactions. Most of the non-cash transactions (65%) are processed through the internal clearing, 33% are processed through KIBS and only 2% are payment orders processed through MIPS. Within the cash transactions, 95% are payment and 5% are disbursement transactions.

In the domain of transactions with individuals, the number of transactions related with *denar savings* noted a decline of 10%, the number of *f/x savings* transactions noted a drop of 3%, the *exchange operations* noted a decrease of 2%, the transactions connected with the *payments towards the Banking cards* declined 2%, the number of transactions under *current accounts* noted a decrease of 8% and the number of transactions connected with payment of public services for 55%. The decline of the transactions connected with payment of public services is a result of the changes in the payment, recording and processing of the invoices for public services. With the change, individuals that don't hold an account with the Bank, but pay at the counters will have to pay commission. This aims to divert payments through

alternative channels. As a result, there is growth in the non-cash transactions through e-banking and mobile banking.

Graph No.16
Total transactions processed



As at 31.12.2016, Komercijalna Banka AD Skopje opened total 38,571 denar accounts to legal entities, which, in terms of 2015, note a decrease of 12.5% mostly due to legal entities being deleted from the Central Register.

Pursuant to the legal obligations, the Bank issued 144,756 certificates for the operations of legal entities for the needs of Public Revenue Office. The authorities competent for proceeding Decisions on forced collection from entity's account had proceeded 78,021 decisions, out of which 26% were collected, while blockades on clients' accounts were initiated for 69% of the decisions proceeded.

Internet Bank service, as fast, safe and more economical way for realization of the transactions in the domestic payment operations, showed permanent increase. Consequently, the number of legal entities users of Internet Bank service increased for 13%, while the number of electronic payment orders of legal entities realized through the Internet Bank is for 8% higher in 2016 relative to 2015.

The Bank continued with performing of the other services for clients: the service fast money transfer through the service Western Union, possibility for issuing insurance policies by the insurance company Eurolink AD, issuing American visas etc.

MARKET SHARE OF KOMERCIJALNA BANKA AD SKOPJE IN THE BANKING MARKET OF THE REPUBLIC OF MACEDONIA[6]

Table No. 5

		31.12.2016	31.12.2015
1	Total assets	22.7%	22.9%
2	Capital and reserves	20.7%	20.7%
3	Total deposits from non-financial sector	26.6%	27.0%
4	Total net-loans to non-financial sector	17.4%	19.4%
5	Total number of issued debit cards	16.7%[7]	16.7%
6	Total number of issued credit cards	14.7%[7]	15.0%
7	Total number of merchants in the country acquiring bank cards issued by KB	43.0%[7]	41.2%
8	Total number of POS and ATMs acquiring cards	21.2%[7]	22.5%
9	Total value of realized domestic payment operations	20.2%[7]	20.6%
10	Total number of accounts opened to legal entities[8]	20.7%[7]	20.8%
11	Total trading realized at the Macedonian Stock Exchange[9]	23.9%	16.0%
12	Total number of transactions realized at the Macedonian Stock Exchange[9]	17.9%	13.2%

[6] NBRM is the source of information; the exceptions are marked in the table. The data refer to the whole year – cumulative, except the data on the market share in card operations and domestic payment operations that are as at 31.03.2016
[7] Due to preparing new methodology for presentation of market share in the domain of card operations and payment operations by the competent institutions, the data presented in this report are as at 31.03.2016.
[8] Source - ERTS
[9] Source - MSE

MARKETING ACTIVITIES

In 2016, marketing activities of the Bank were directed towards improvement of the communication with the target groups and of the distribution channels, permanent monitoring of the market, pointing out the advantages and benefits related to the products and services offered by the Bank and attracting new clients.

Most of the marketing activities are preparation and realization of research projects on issues arising from the daily operations of the Bank. In this sense, more important activities realized in this sphere of operation are the telephone and on-line surveys for the mobile application and measuring the satisfaction of the target groups regarding the products and services offered by the Bank.

In the course of the period reported, the Bank continued with the activities for communication with the target groups aimed towards presentation of the Bank and its products and services. The priority was given to the communication of the promotion conditions under which the Bank was approving the housing loans and consumption loans with Euro clause. The Bank also realized promotion campaigns for the mobile application "mBanka" (under the slogan "A bank within hand's reach"), for the introduction of Mastercard Secure Code secure Internet payment (under the slogan "Buy carelessly"), the promotion campaign for contactless payment by Mastercard® cards at Eurofarm pharmacies, as well as activities for additional promotion of contactless payments by Mastercard® cards and Mastecard® Platinum credit cards.

In order to provide timely and accurate information to the clients, shareholders and the public in general, the Bank was permanently updating the data published through

the electronic media and the printed materials. The Bank's ATMs, as the most important distribution channels, were used for advertising purposes as well, where their displays were used for advertising for the Bank's campaigns.

Traditionally, the Bank supports certain projects in the sphere of culture, arts and sports that have long-term favorable effects on the community and the image of the Bank, and at the same time takes care to maximize the effects from the approved sponsorships versus its investments.

As social responsible company, the Bank financially supported numerous concerts and music projects, culture and sport events. Taking part in the realization of different humanitarian projects, the Bank had provided financial support for many medical treatments of the most vulnerable categories of citizens. In order to help in overcoming the problems the community's citizens were faced with, in the course of 2016, Komercijalna Banka donated financial support at the solidarity gyro account of the Red Cross of the Republic of Macedonia as help for the citizens hit by the natural disaster.

INFORMATION & COMMUNICATION TECHNOLOGY

In the reporting period, more significant activities realized in the domain of information & communication technology are:

- New features have been introduced or improved in the applications mBanka for individuals and Internet Bank;
- On the KB portal, new functionalities for e-mail marketing have been introduced, the mechanism for Popup commercials has been expanded, there is a new mechanism for anonymous survey questionnaires, as well as a new form for complaints, suggestions and praises;
- Changes and additions in the appropriate application solutions and reports have been made, in compliance with the new Decisions and Manuals of NBRM for credit risk management and capital adequacy;
- Amendments and supplements to the software solution to support the operations of the Office for prevention of money laundering and financing terrorism as recommended by NBRM;
- Realization of the first two phases of the project to upgrade the BI system of the Bank;
- Specific actions in support to the area of financial operations, corporate lending, FX operations, FX market operations, domestic payment operations, retail banking (collection and bank cards), branch network, broker operations, as well as employee records and pay calculations through software solutions, reports, automating certain processes, etc.;

- The main production data bases of the Bank and the e-mail structure have been migrated to newer server versions and the solution FortiWeb for corporate e-mail access through the Internet has been implemented;
- Realized solutions for: rerouting GPRS/3G traffic from T-Mobile to the alternative computer center; connecting the BMS (Building Management System of the Bank within the existing LAN and WAN network, as well as configuring a remote access to this system; rerouting the network traffic from LAN POS terminals connected to the Internet through the alternative computer center; automated update of the Active Directory attributes and signatures of the employee emails;
- Implementation of a new MS Share Point Portal system to manage documents and migration of official documents from the existing Meridio system to the new one;
- Upgrades to: the SWIFT platform of WEB Platform, the backup and archiving software to version NetBackup 7.7.3, the infrastructure for virtualization to version 6.5, the IMPERVA system for tracing audit trails from the databanks to version 11.5;
- Realized projects for: a complete Easy Way platform within the Euro Clear system; introducing 3D Secure technology as a card issuer, for safe Internet shopping with Mastercard® and VISA cards of the bank; implementation of the upgraded app for budget payments on POS terminals; implementation of the so called unattended POS terminals, integration of POS terminals with cash registers; monitoring company vehicles through GPS (Global Positioning System); installation of a dealer station Thompson Reuters FXT (with a special keyboard in an isolated VLAN), FX Trade adapter, printing Thompson Reuters transactions and installed DCAP tools for Bloomberg contribution, etc.

HUMAN RESOURCES

As a modern, independent and market oriented company, Komercijalna Banka AD Skopje pays great attention to its human resources, treating them as one of the most important factor in determining the competitiveness of any company. By investing in its human resources and highlighting their role, the Bank has realized positive impact on the financial performances.

The Human Resources Policy of the Bank encompasses planning, selection and employment of new personnel, their introduction to and adjustment to the operative processes, motivation, awarding, assessment of the performances, permanent professional education and training, improvement, allowing personal development and career development, promotion of personnel etc.

As at 31.12.2016, the total number of the Bank's employees is 1,055.

The Bank's personnel qualification structure, as analyzed in the course of the previous years, notes increase of participation of university graduated personnel.

The process of education of the Bank's employees includes permanent monitoring of the needs for appropriate training and their organization. Consequently, there are different internal and external trainings organized, as well as attendance at seminars, conferences, courses at the country and abroad. In 2016, 177 employees attended different professional courses in the country and abroad. According to the needs arising from the current operation, the employees attended internal trainings on different issues, such as: operational performance within the city-branches network, tellers operation, E-banking

for legal entities in the domain of international payment operations, technical support and servicing of ATMs, office operations and archiving, sale of Visa cards for legal entities and individuals, strengthening the team capacities, code of ethics for the employees, analysis of loan applications for legal entities, etc. Furthermore, 15 managers from Skopje attended the management team building event organized by the Bank. There were also regular internal trainings organized on the news in the current operations and other spheres of banking operations. 247 practitioners had their practical education with the Bank, out of which 112 students in Skopje and 135 at the Bank's branches and city-branches throughout the country.

Working in accordance with the law regulations and novelties in operations, new achievements in the business area, economy and banking, all are realized through professional literature, magazines and publications which are provided from the Bank's Library available to all employees.

CORPORATE SOCIAL RESPONSIBILITY

In the course of 2016, and through its Coordinative Corporate Social Responsibility Body, Komercijalna Banka AD Skopje continued its activities for investing in the community and managed to increase the awareness for the corporate social responsibility by realizing actual projects, encouraging the internal processes for social responsibility practices and permanent education and engagement of the employees in voluntary activities of the Bank.

Based on the analysis of the activities undertaken so far, as well as on the assessment for the future needs of the community, the Bank made its Corporate Social Responsibility Strategy for the period 2017-2021.

MONITORING THE MARKET NEEDS

Monitoring of the market needs in 2016 was focused on the needs of the clients and the stakeholders for high-quality services and new products. The accent of the Bank's activities in this sphere was put on the education of the clients for the use of Bank's products, monitoring the clients' satisfaction from the products and services and being open for information.

HUMAN RESOURCES AS TOP PRIORITY

The care for the employees was focused on further education and professional training of the staff in order to achieve high level of expertise and integrity, simultaneously paying attention to the security, adherence to the internal policies and codes by the employees, motivation, etc.

CORPORATE VOLUNTEERING

In the course of the reported period, corporate volunteering was recognized by the sense for the social and economic problems in the community and the contribution in the process of education of the youth. While paying attention to the social and economic circumstances in the community, as well as having in mind the need for social integration of certain groups in the society and the struggle against the poverty, the Bank's management and employees organized different activities, donations and sponsorships at local and national level, in cooperation with the non-government organizations and local institutions. In this context, the Bank realized several projects and donations, such as: Track-guides for people with damaged vision in the city branch "Rasadnik", two new city branches in Skopje, Awarded saving books Open Children Savings "Ververicki" for all children born on 31st of October, Campaign of the Bank and Mastercard®, in order to realize the project (in collaboration with Red Cross) "Donate an organ-give a life", Support of the project "Economic strengthening of the women in the rural areas and female victims of family violence", as well as supporter of the campaign "Go pink" 2016 which is against cancer disease; Continuation of the collaboration with Red Cross of Republic of Macedonia for the project "Better socialization of the children and youth with special needs" and continuation of the collaboration with the NGO "HERA" and the project "Family center for family violence victim" which in 2015 was awarded,

After the floods which caused catastrophic damages in certain Skopje areas, the Bank donated MKD 2,000,000.00 on the solidary transaction account of the Red Cross and distributed 25,000 liters of drinking water, while the employees, in organized action for help, distributed packages of food, water, clothes and hygiene supplies.

ETHICAL MANAGEMENT - EDUCATION

In the course of the year, the ethical management was focused on cooperation with qualitative business partners that share social responsibility practice, as well as on the improvement of the structure and confidence of the clients, which, as part of the objectives of the Coordinative Body for corporate social responsibility, were realized through education and cooperation with the higher education institutions and primary and secondary schools, as well.

The team work and permanent internal training courses intended for raising the awareness and responsibility of the employees for the social problems, both in the process of operation and through the donation actions, contributed to the successful realization of the operative plans and the activities related to the social responsibility. In 2016, the Bank awarded its best tellers. Traditionally, on the occasion of 31 October - World Savings Day, Komercijalna Banka awarded jubilee awards to its employees with 15 and 30 years uninterrupted working experience with the Bank.

ENVIRONMENTAL PROTECTION

The environmental protection is incorporated in the Credit Policy of the Bank, on the basis of which the Bank defines the level of the environmental risk. Komercijalna Banka has cooperation with organizations which, through their activities, take care for the healthy environment and meet the European and world's standards for environmental protection when purchasing products and services.

In the following period, the Bank will continue to undertake activities aimed towards improvement of the quality of life in the society by sharing the values and beliefs in better future with all its clients, employees and all stakeholders, and in compliance with the aims and objectives and priorities defined in the new adopted Corporate Social Responsibility Strategy 2017 – 2021.

As a result of the active and long lasting social responsibility commitment, Komercijalna Banka is a leader in the banking sector of the Republic of Macedonia. It is confirmed by the awards received in the course of the previous years, such as: awards for Integrated approach to the social responsibility for large enterprises from the Centre for Institutional Development - CIRA, for three years in a row (2009, 2010 and 2011), award from the National Coordinative Social Responsibility Body for 2009, in the category - large enterprises, three awards from the Transparency - Zero Corruption, award for the Bank's adapted e-banking solution by means of which blind people are enabled unaided access and simplified use of Bank's services, special acknowledgement for social responsibility – Certificate of Acknowledgement for "The most creative practice" for the Project "For equal rights and possibilities", as well as many certificates of recognition and appreciation from the institutions being sponsored and donated.

FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

KPMG Macedonia DOO Skopje
3 Filip Vtori Makedonski Street
Skopje 1000, Republic of Macedonia
+389 (2) 3135 220
mk-office@kpmg.com
kpmg.com/mk

Independent auditors' report to the shareholders of Komercijalna Banka AD Skopje

We have audited the accompanying separate financial statements of Komercijalna Banka AD Skopje ("the Bank"), which comprise the separate statement of financial position as at 31 December 2016, the separate statements of profit and loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of separate 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 separate financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing adopted and published in the Official Gazette of the Republic of Macedonia no. 79 from 11 June 2010. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the separate 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.

KPMG Macedonia DOO Skopje, a Macedonian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.
Document classification: KPMG Confidential

Registered with the Trade Register of the Republic of Macedonia with EMBS: 5076508

Tax No. MK4030996107650

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 separate 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 separate financial statements give a true and fair view of the separate financial position of the Bank as at 31 December 2016, and of its separate financial performance and its separate cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Macedonia DOO
1 March 2017
Skopje

KPMG Macedonia DOO

AUDITED FINANCIAL STATEMENTS

SEPARATE STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
Interest income		3,636,963	3,894,798
Interest expense		(558,217)	(717,243)
Net interest income	6	3,078,746	3,177,555
Fee and commission income		1,111,945	1,103,140
Fee and commission expense		(247,666)	(205,796)
Net fee and commission income	7	864,279	897,344
Dividend income		6,210	5,582
Foreign exchange gains, net		125,479	131,271
Net gains/(losses) on financial instruments classified as held for trading	8	12,870	7,177
Other operating income	9	484,963	275,799
Personnel expenses	10	(844,457)	(825,830)
Depreciation and amortization	22,23,24	(185,022)	(195,348)
Other operating expenses	11	(657,878)	(670,276)
Net impairment loss on financial assets	12	(1,708,600)	(1,721,300)
Net impairment loss on non-financial assets		(353,855)	(553,118)
Operating profit		**822,735**	**528,856**
Share of profit of associates accounted for using the equity method		43,625	39,028
Profit before tax		**866,360**	**567,884**
Income tax expense	13	(92,373)	(61,273)
Profit for the year		**773,987**	**506,611**
Other comprehensive income for the period, net of income tax			
Items that are or may be reclassified to profit and loss			
Fair value reserve (available for sale financial assets):			
Net change in fair value		(3,256)	10,475
Related tax		(617)	(1,048)
Other comprehensive income, net of tax		(3,873)	**9,427**
Total comprehensive income		**770,114**	**516,038**
Earnings per share	14		
Basic (in Denars)		340	222
Diluted (in Denars)		340	222

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

SEPARATE STATEMENT OF FINANCIAL POSITION
At December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
ASSETS			
Cash and cash equivalents	15	33,538,670	27,663,717
Financial assets at fair value through profit and loss	16	407,732	368,751
Financial assets available-for-sale	17	3,687,968	7,214,747
Financial assets held-to-maturity	18	3,374,729	2,516
Loans and advances to banks	19	10,084,209	9,208,426
Loans and advances to customers	20	45,268,154	47,644,522
Investments in associates	21	210,171	189,147
Property and equipment	22	2,941,057	3,037,631
Investment property	23	26,948	27,785
Intangible assets	24	38,644	41,264
Other assets	25	590,816	530,882
Assets acquired through foreclosure procedures	26	734,316	1,395,714
Total assets		**100,903,414**	**97,325,102**
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions	27	1,676,302	1,381,823
Deposits from other customers	28	86,115,337	82,837,690
Borrowings	29	1,650,522	2,165,476
Current tax liabilities		39,044	50,973
Deferred tax liabilities	13	17,254	18,285
Provisions	32	112,577	149,748
Other liabilities	30	598,335	512,295
Total liabilities		**90,209,371**	**87,116,290**
EQUITY			
Share capital		2,279,067	2,279,067
Share premium		771,527	771,527
Retained earnings		929,122	680,243
Revaluation reserve		5,554	9,427
Reserves		6,708,773	6,468,548
Total equity	31	**10,694,043**	**10,208,812**
Total liabilities and equity		**100,903,414**	**97,325,102**
Commitments and contingent liabilities	32	14,096,767	15,447,095

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

The separate financial statements were authorised by the Supervisory Board of the Bank on 28 February 2017.

Signed on behalf of Komercijalna banka AD Skopje:

Maja Stevkova Sterieva, Phd.
Chief Finance Officer

Ilija Iloski
Chief Operating Officer

Hari Kostov
Chief Executive Officer

SEPARATE STATEMENT OF CHANGES IN EQUITY
Year ended December 31, 2016
(In thousands of Denars)

	Share capital	Share premium	Fair value reserve	Statutory reserve	Other reserves	Retained earnings	Total equity
Balance, January 1, 2015	2,279,067	771,527	-	455,813	5,917,131	269,236	9,692,774
Total comprehensive income							
Profit for the year	-	-	-	-	-	506,611	**506,611**
Other comprehensive income, net of tax							
Fair value reserve (available-for-sale financial assets)							
Net change in fair value			10,475				10,475
Tax on other comprehensive income	-	-	(1,048)	-	-	-	(1,048)
Total other comprehensive income	-	-	9,427	-	-	-	9,427
Total comprehensive income	**-**	**-**	**9,427**	**-**	**-**	**506,611**	**516,038**
Transactions with owners, recognized directly in equity							
Transfer to other reserve	-	-	-	-	95,604	(95,604)	**-**
Total contributions by and distributions to owners	**-**	**-**	**-**	**-**	**95,604**	**(95,604)**	**-**
Balance, December 31, 2015	**2,279,067**	**771,527**	**9,427**	**455,813**	**6,012,735**	**680,243**	**10,208,812**
Balance, January 1, 2016	2,279,067	771,527	9,427	455,813	6,012,735	680,243	10,208,812
Total comprehensive income							
Profit for the year	-	-	-	-	-	773,987	**773,987**
Other comprehensive income, net of tax							
Fair value reserve (available-for-sale financial assets)							
Net change in fair value	-	-	(3,256)	-	-	-	**(3,256)**
Tax on other comprehensive income	-	-	(617)	-	-	-	**(617)**
Total other comprehensive income			(3,873)				**(3,873)**
Total comprehensive income	**-**	**-**	**(3,873)**	**-**	**-**	**773,987**	**770,114**
Transactions with owners, recognized directly in equity							
Transfer to other reserve	-	-	-	-	240,225	(240,225)	**-**
Dividends paid	-	-	-	-	-	(284,883)	**(284,883)**
Total contributions by and distributions to owners	**-**	**-**	**-**	**-**	**240,225**	**(525,108)**	**(284,883)**
Balance, December 31, 2016	**2,279,067**	**771,527**	**5,554**	**455,813**	**6,252,960**	**929,122**	**10,694,043**

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

SEPARATE STATEMENT OF CASH FLOWS
Year ended December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
Profit before tax		866,360	567,884
Adjustments for:			
Depreciation of property and equipment and amortization of intangible assets	22,24	184,185	194,510
Gain on sale of property and equipment	9	(107)	(457)
Gain on sale of assets acquired through foreclosure procedure	9	(101,265)	(26,198)
Loss on sale of assets acquired through foreclosure procedure	11	909	1,046
Impairment losses on assets acquired through foreclosure procedure		353,855	553,118
Depreciation of investment property	23	837	838
Impairment losses	12	1,708,600	1,721,300
Dividend income		(6,210)	(5,582)
Interest income	6	(3,636,963)	(3,894,798)
Interest expense	6	558,217	717,243
Net trading income		(12,870)	(7,177)
Share of profit from associates accounted for using the equity method		(43,625)	(39,028)
Operating loss before changes in operating assets and liabilities:		**(128,077)**	**(217,301)**
Changes in:			
Restricted accounts		(560,558)	(21,534)
Mandatory reserves in foreign currency with NBRM		(171,230)	(154,615)
Financial assets at fair value through profit and loss		(26,111)	(14,535)
Loans and advances to banks		(876,402)	(939,978)
Loans and advances to customers		592,396	(1,595,930)
Collected collateral		407,899	56,264
Other assets		(95,128)	(245,019)
Deposits from banks and other financial institutions		293,253	206,389
Amounts owed to other depositors		3,313,348	4,065,131
Other liabilities		86,040	93,280
		2,835,430	**1,232,152**
Interest received		3,714,880	3,922,588
Interest paid		(593,339)	(806,851)
Income tax paid		(103,071)	(16,716)
Net cash generated from operating activities		**5,853,900**	**4,331,173**
Cash flows from investing activities			
Acquisition of property and equipment		(78,462)	(61,164)
Acquisition of intangible assets		(11,033)	(17,377)
Proceeds from sale of property and equipment		221	635
Acquisition of investments securities		(9,509,277)	(7,625,693)
Proceeds from sale of investment securities		9,658,194	3,744,856
Dividends received		28,811	13,115
Net cash flows generated from/(used in) investing activities		**88,454**	**(3,945,628)**
Cash flows from financing activities			
Proceeds from borrowed funds		1,830,720	2,816,192
Repayments of borrowed funds		(2,345,026)	(3,265,514)
Dividends paid		(284,883)	-
Net cash (used in)/generated from financing activities		**(799,189)**	**(449,322)**

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

SEPARATE STATEMENT OF CASH FLOWS (Continued)
Year ended December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
Net change of cash and cash equivalents			
Cash and cash equivalents at beginning of year		23,422,775	23,486,552
Net increase/(decrease) in cash and cash equivalents		5,143,165	(63,777)
Cash and cash equivalents at the end of the year	15	**28,565,940**	**23,422,775**

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

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
December 31, 2016

1. General Information

Komercijalna Banka AD - Skopje (hereinafter "the Bank"), is a shareholding company having its registered office in the Republic of Macedonia. The head office of the Bank is Orce Nikolov str. No. 3, 1000 Skopje. The Bank operates in the Republic of Macedonia with a network of branch and sub-branches

The Bank is registered as a universal type of commercial bank in accordance with the Macedonian laws. The principal activities of the Bank are as follows:

- Collecting deposits and other recurrent sources of funds;
- Placing loans and advances domestically and abroad, including factoring and financing commercial transactions;
- Issuance and administration of payment instruments (cards, cheques, traveler cheques, bills of exchange);
- Foreign exchange operations;
- Domestic and international payment operations, including purchase/sale of foreign currency funds;
- Fast money transfer;
- Issuing payment guarantees, backing guarantees and other forms of security;
- Providing services of renting safe deposit boxes, depositories and depot;
- Trade in instruments on the money market;
- Trading with foreign currencies;
- Trading with securities;
- Providing services of a bank-custodian of investment and pension funds;
- Keeping of securities for clients;
- Intermediating in selling insurance policies;
- Data collection and analysis of companies' credit rating;
- Sale of shares in investment funds;
- Other financial services defined by law, which are within the scope of activities only by a bank.

The shares of the Bank are listed on the Macedonian Stock Exchange official market in the segment of super- listing of joint stock companies with special reporting requirements, and is one of the ten companies comprising the Macedonian Stock Exchange index MBI-10. The ID quotation code is the following:

Code	ISIN code
KMB (common share)	MKKMBS101019

The financial statements of the Bank for the year ended 31 December 2016 were authorised for issue by the Supervisory Board on 28 February 2017.

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
December 31, 2016

2. Basis of Preparation of Financial Statements

(a) Statement on Compliance

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

(b) Basis of Measurement

The financial statements have been prepared on the historical cost basis except for the following:

- financial instruments at fair value through profit or loss are measured at fair value;
- available-for-sale financial assets are measured at fair value.
- foreclosed assets measured at the lower of cost or fair value less costs to sale.

These financial statements represent separate financial statements of the Bank. As the Bank has investment in a subsidiary, it also prepares consolidated financial statements.

(c) Functional and Presentation Currency

The presented financial statements are expressed in thousands of Denars. The Denar represents the functional and presentation currency of the Bank.

(d) Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of 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 available from other sources. Actual results in subsequent periods 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 3.19 to the financial statements.

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

(e) Changes in accounting policies

The Bank consistently applied the accounting policies as set out in Note 3 to all periods presented in these separate financial statements.

2. Basis of Preparation of Financial Statements (Continued)

(f) Changes in accounting estimates

For the year ended 31 December 2016, there were no changes in accounting estimates.

(g) New Standards and Interpretations not yet adopted

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2017; however, the Bank has not applied the following new or amended standards in preparing these separate financial statements.

New or amended standards	*Summary of the requirements*	*Possible impact on separate financial statements*
IFRS 9 Financial Instruments (2014) (Effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively with some exemptions. The restatement of prior periods is not required, and is permitted only if information is available without the use of hindsight. Early application is permitted.)	This Standard replaces IAS 39, Financial Instruments: Recognition and Measurement, except that the IAS 39 exception for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply, and entities have an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting. Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit and loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different. A financial asset is measured at amortized cost if the following two conditions are met: • the assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and, • its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. In addition, for a non-trading equity instrument, a company may elect to irrevocably present subsequent changes in fair value (including foreign exchange gains and losses) in OCI. These are not reclassified to profit or loss under any circumstances. For debt instruments measured at FVOCI, interest revenue, expected credit losses and foreign exchange	It is expected that the new Standard, when initially applied, will have a significant impact on the financial statements, since the classification and the measurement of the Entity's financial instruments are expected to change. Based on its preliminary assessment, the Entity, as a bank, expects that substantially all of financial assets classified as loans and receivables under IAS 39 will continue to be measured at amortised cost under IFRS 9. At this stage it is still unclear what portion of the Entity's debt securities will be measured at FVTPL, at FVOCI or amortized cost as this determination will depend on the outcome of the business model test. It is expected that a significant portion of debt securities will be reclassified under IFRS 9 either into or out of FVOCI. It is not expected that the equity instruments the Entity holds will be measured at FVTPL, but this determination will depend on an election to be made by the entity at the date of initial application – that is 1 January 2018. The Entity has not yet decided how it will classify these instruments.

	gains and losses are recognised in profit or loss in the same manner as for amortised cost assets. Other gains and losses are recognised in OCI and are reclassified to profit or loss on derecognition. The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that a loss event will no longer need to occur before an impairment allowance is recognised. IFRS 9 includes a new general hedge accounting model, which aligns hedge accounting more closely with risk management. The types of hedging relationships – fair value, cash flow and foreign operation net investment – remain unchanged, but additional judgment will be required. The standard contains new requirements to achieve, continue and discontinue hedge accounting and allows additional exposures to be designated as hedged items. Extensive additional disclosures regarding an entity's risk management and hedging activities are required.	It is expected that deposits from customers will be continued to be measured at amortised cost under IFRS 9. It is expected that the new expected credit loss model under IFRS 9 will accelerate the recognition of impairment losses and lead to higher impairment allowances at the date of initial application.
IFRS 15 Revenue from contracts with customers (Effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.)	The new Standard provides a framework that replaces existing revenue recognition guidance in IFRS. Entities will adopt a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised: • over time, in a manner that depicts the entity's performance; or • at a point in time, when control of the goods or services is transferred to the customer. IFRS 15 also establishes the principles that an entity shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.	The Entity is assessing the potential impact on its separate financial statement resulting from IFRS 15.
IFRS 16 Leases	IFRS 16 supersedes IAS 17 Leases and related interpretations. The	The Entity does not expect that the Standard, when

(Effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15.)	Standard eliminates the current dual accounting model for lessees and instead requires companies to bring most leases on-balance sheet under a single model, eliminating the distinction between operating and finance leases. Under IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For such contracts, the new model requires a lessee to recognise a right-of-use asset and a lease liability. The right-of-use asset is depreciated and the liability accrues interest. This will result in a front-loaded pattern of expense for most leases, even when the lessee pays constant annual rentals. The new Standard introduces a number of limited scope exceptions for lessees which include: • leases with a lease term of 12 months or less and containing no purchase options, and • leases where the underlying asset has a low value ('small-ticket' leases). Lessor accounting shall remain largely unaffected by the introduction of the new Standard and the distinction between operating and finance leases will be retained.	initially applied, will have material impact on the financial statements.
Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively. Early application is permitted.)	The amendments clarify share-based payment accounting on the following areas: • the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; • share-based payment transactions with a net settlement feature for withholding tax obligations; and • a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.	The Entity expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the entity because the Entity does not enter into share-based payment transactions.
Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Effective for annual periods beginning on or after 1 January 2021; to be applied prospectively.)	The amendments address concerns arising from implementing IFRS 9 before implementing the replacement standard that the IASB is developing for IFRS 4. The amendments introduce two optional solutions. One solution is a temporary exemption from IFRS 9, effectively deferring its application for some insurers. The other is an overlay approach to presentation to alleviate the volatility that may arise when	The Entity is not an insurance provider and therefore does not expect any material impact on the financial statements of the Entity.

	applying IFRS 9 before the forthcoming insurance contracts standard.	
Amendments to IFRS 10 and IAS 28 Sale or contribution of assets between an investor and its associate or joint venture (The effective date has not yet been determined by the IASB, however earlier adoption is permitted.)	The Amendments clarify that in a transaction involving an associate or joint venture, the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business, such that: • a full gain or loss is recognised when a transaction between an investor and its associate or joint venture involves the transfer of an asset or assets which constitute a business (whether it is housed in a subsidiary or not), while • a partial gain or loss is recognised when a transaction between an investor and its associate or joint venture involves assets that do not constitute a business, even if these assets are housed in a subsidiary.	The quantitative impact of the adoption of the Amendments can only be assessed in the year of initial application of the Amendments, as this will depend on the transfer of asset or businesses to the associate that take place during that reporting period.
Amendments to IAS 7 (Effective for annual periods beginning on or after 1 January 2017, to be applied prospectively. Early application is permitted.)	The amendments require new disclosures that help users to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes (such as the effect of foreign exchange gains or losses, changes arising for obtaining or losing control of subsidiaries, changes in fair value).	The Entity expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the Entity.
Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses (Effective for annual periods beginning on or after 1 January 2017; to be applied prospectively. Early application is permitted.)	The amendments clarify how and when to account for deferred tax assets in certain situations and clarify how future taxable income should be determined for the purposes of assessing the recognition of deferred tax assets.	The Entity expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the Entity because the Entity already measures future taxable profit in a manner consistent with the Amendments.
Amendments to IAS 40 Transfers of Investment Property (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively.).	The amendments reinforce the principle for transfers into, or out of, investment property in IAS 40 *Investment Property* to specify that such a transfer should only be made when there has been a change in use of the property. Based on the amendments a transfer is made when and only when there is an actual change in use – i.e. an asset meets or ceases to meet the definition of investment property and there is evidence of the change in use. A change in management intention alone does not support a transfer.	The Entity does not expect that the amendments will have a material impact on the financial statements because the Entity transfers a property asset to, or from, investment property only when there an actual change in use.
IFRIC 22 Foreign Currency Transactions and Advance Consideration	The Interpretation clarifies how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial	The Entity does not expect that the Interpretation, when initially applied, will have material impact on

(Effective for annual periods beginning on or after 1 January 2018).	recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. In such circumstances, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.	the financial statements as the Entity uses the exchange rate on the transaction date for the initial recognition of the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

2. Basis of Preparation of Financial Statements (Continued)

(g) New Standards and Interpretations not yet adopted (Continued)

Annual Improvements to IFRSs

The improvements introduce two amendments to two standards and consequential amendments to other standards and interpretations that result in accounting changes for presentation, recognition or measurement purposes. These amendments are applicable to annual periods beginning on or after either 1 January 2017 or 1 January 2018; to be applied retrospectively.

None of these amendments are expected to have a significant impact on the financial statements of the Bank.

3. Summary of Significant Accounting Policies

3.1 Interest Income and Expense

Interest income and expense are recognized in profit or loss for all interest bearing instruments on accrual basis, measured at amortized cost using the effective interest rate method.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and commissions paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3.2 Fee and Commission Income

Fees and commissions, except loan origination fees, are generally recognized on an accrual basis over the period of service rendering. Other fees relating to the acquisition and origination of loans are deferred over the life of the loan and amortized using the effective interest rate method.

3.3 Dividend Income

Dividend income is recognized when the right to receive payment is established for all shareholders who participate in distribution of profit.

3.4 Foreign currency Transactions

Transactions denominated in foreign currencies have been translated into Denars at rates set by the National Bank of the Republic of Macedonia ("NBRM") at the dates of the transactions. Assets and liabilities denominated in foreign currencies are translated into Denars at the end of the reporting period using official rates of exchange ruling on that date. Foreign exchange gains or losses arising upon the translation of transactions, and the translation of assets and liabilities denominated in foreign currencies are recognized in the profit or loss in the period in which they occurred.

Commitments and contingent liabilities denominated in foreign currencies are translated into Denars by applying the official exchange rates at the end of the reporting period.

3. Summary of Significant Accounting Policies (Continued)

3.5 Financial Assets

Financial assets are classified into the following specified categories: financial assets at fair value through profit or loss, held-to-maturity financial assets, available-for-sale financial assets, loans and receivables. The classification depends on the nature and the purposes of the financial assets and is determined at initial recognition. Financial assets are recognized and derecognized on settlement date, which represents the date when the asset is delivered to/from the Bank.

3.5.1 Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and nostro accounts, that represent demand deposits and placements with other banks and financial institutions, account balances with the the National Bank of the Republic of Macedonia ("NBRM") and other financial assets such as treasury and other government bills, as highly liquid assets with maturity up to three months and insignificant changes to fair value.

3.5.2 Financial Assets at Fair Value through Profit or Loss

Financial assets at fair value through profit or loss include held-for-trading financial assets. Held-for-trading financial assets are securities included in a portfolio in which a pattern of short-term profit making exists. Initially, these securities are recognized at cost and subsequently measured at fair value as determined based on their market price.

All the respective realized and unrealized gains and losses are included in profit or loss for the period. Interest, if realized, during the period of ownership of these securities, is recognized as net trading income in the profit or loss for the period. The purchase and disposal of securities held-for-trading is recognized at settlement date, which represents the date when the asset is delivered to/from the Bank. When the settlement date and the trade date are different, then the Bank recognizes the changes in fair value from the trade date to the settlement date through profit and loss.

3.5.3 Available-for-sale Financial Assets

Available-for-sale financial assets 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. This portfolio comprises quoted and unquoted equity investments in shares of banks and other financial institutions and enterprises, where the Bank does not exercise control.

Available-for-sale financial assets are initially recognized at cost, including all transaction costs, and subsequently re-measured at fair value based on quoted prices in active markets or amounts derived from cash flow models for unquoted equity investments. Transaction costs represent the costs that are directly attributable to acquisition of the financial asset.

Unrealized gains and losses arising on changes in the fair value of available-for-sale financial assets are recognized in other comprehensive income, until the financial asset is derecognized or impaired at which time the cumulative gain or loss previously accumulated in the other comprehensive income should be recognized in profit or loss for the period. Interest calculated using the effective interest method and impairment losses are recognized in the profit or loss for the period.

3.5.4 Held-to-maturity Financial Assets

Held-to-maturity financial assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity. If the Bank is to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale and the Bank will not be able to classify financial assets held-to-maturity for the current and next two years. These financial assets are measured at amortized cost using the effective interest rate method.

3.5.5 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

3. Summary of Significant Accounting Policies (Continued)

3.5 Financial Assets (Continued)

3.5.5 Loans and receivables (Continued)

Loans are initially recognized at fair value, including any transaction costs, and are subsequently measured at amortized cost using the effective interest rate method. Interest on loans originated by the Bank is included in interest income. Loans to customers and financial institutions are stated at their net amount reduced by allowance for impairment and un-collectability.

3.5.6 Impairment of Financial Assets

The Bank assesses at end of each reporting period whether there is objective evidence that a financial asset is impaired.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired.

If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in other comprehensive income – is removed from other comprehensive income and recognized in the profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the profit or loss for the period. However any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognized in other comprehensive income.

The amount of the impairment loss for financial assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. Interest on the impaired assets continues to be recognised through the unwinding of the discount.

3.5.7 Impairment Losses on Loans and Receivables

Allowances for impairment and un-collectability are determined if there is objective evidence that the Bank cannot collect all amounts due on a claim according to the original contractual terms. A "claim" means a loan, a commitment such as a letter of credit, guarantee or commitment to extend the credit. A provision for loan impairment is reported as a reduction of the carrying amount of the loan, whereas for off-balance sheet items are presented within the provisions. Additions to provisions are made through impairment losses on financial assets in the profit or loss.

The allowances for impairment and un-collectability are determined on the basis of the degree (size) of the risk of un-collectability or specific country risk on the basis of the following principles:

- Separate loan exposures (risks) are assessed on the basis of the type of loan applicant, his/her/its overall financial position, resources and payment records and recoverable value of collaterals. Allowances for losses on impairment and un-collectability are measured and determined for the difference between the carrying amount of the loan and its estimated recoverable amount, which is, in fact, the present value of expected cash flows;

- All allowances for losses on impairment and un-collectability are reviewed monthly, and any further changes in the amount and timing of expected future cash flows in comparison to previous assessments result in changes in allowances for losses on impairment and un-collectability recorded in profit or loss;

- Any loan, which is considered impossible to be collected, is written off against the relevant allowance for losses on impairment. Further collections are recorded in the profit or loss;

- In case of loans granted to borrowers in countries with increased risk of difficulties for servicing external debt, the political and economic circumstances are assessed and additional allowances for sovereign risk are allocated.

For more details, refer to 4.1. Credit risk.

3. Summary of Significant Accounting Policies (Continued)

3.5 Financial Assets (Continued)

3.5.8 De-recognition of Financial Assets

The Bank derecognizes financial assets when the right to receive cash from the financial asset has expired or has transferred its rights to receive cash flows from the asset and substantially all the risks and rewards of ownership of the assets to another entity.

3.6 Financial Liabilities

Financial liabilities are classified in accordance with the substance of the contractual arrangement. Financial liabilities are classified as deposits from banks, financial institutions and customers, loans payable, other payables and derivative financial instruments.

3.6.1 Deposits from Banks and Other Financial Institutions and Customers

These financial liabilities are initially recognized at fair value, net of transaction costs incurred. Subsequently they are measured at amortized cost.

3.6.2 Borrowings

Borrowings payable are initially recognized at fair value net of transaction costs incurred. Subsequent measurement is at amortized cost and any difference between net proceeds and the redemption value is recognized in profit or loss over the period of the loan using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability.

3.6.3 Other Payables

Other payables are stated at amortised cost.

3.6.4 De-recognition of Financial Liabilities

The Bank derecognizes financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or have expired.

3.7 Fair value measurement

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction. The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price.

Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

3. Summary of Significant Accounting Policies (Continued)

3.7 Fair value measurement (Continued)

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price. The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

3.8 Investments in Associates and Subsidiaries

An associate is an entity, over which the Bank has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. If the Bank holds, directly or indirectly, 20 per cent or more of the voting power of the investee, it is presumed that the Bank has significant influence. A substantial or majority ownership by another investor does not necessarily preclude the Bank from having significant influence.

Investments in an associate are measured using the equity method, by which the investment is initially recognized at cost. Subsequent to the initial measurement, carrying amount is increased or decreased to recognize the Bank's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment.

'Subsidiaries' are investees controlled by the Bank. The Bank 'controls' an investee if it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are recorded in these separate financial statements at cost.

3.9 Property and Equipment

Property and equipment is recorded at cost, less accumulated depreciation and accumulated impairment losses, if any. Expenditure incurred to replace a component of an item of property and equipment that is accounted for separately is capitalized. Other subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditures are recognized in the profit or loss as an expense as incurred.

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 charged at estimated rates so as to write off the cost of assets over their estimated useful lives, using the straight-line method. Land is not depreciated. No depreciation is charged on construction in progress until the constructed assets are put into use.

The useful life of certain categories of property and equipment are as follows:

Buildings	40 years
Furniture and equipment	4-20 years
Leasehold improvements	40 years

The gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the profit and loss. The Bank annually reviews its property and equipment for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

3.10 Intangible Assets

Intangible assets are reported at cost less accumulated amortization and accumulated impairment losses, if any. Intangible assets include computer software and software that was acquired apart from hardware. Software is amortized on a straight-line basis over the estimated useful life, which is five years. The Bank annually reviews its intangible assets and assess whether there is any indication for impairment. If such indications exist, an estimate is performed to assess whether the carrying amount is recoverable. If the carrying amount exceeds the recoverable amount, it is written down to the recoverable amount.

3. Summary of Significant Accounting Policies (Continued)

3.11 Impairment of non-financial assets

The management of the Bank regularly reviews the carrying amounts of the Bank's non-financial assets. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is written down to its recoverable amount. An impairment loss is recognized as an expense of the current period. If the recoverable amount of an asset is increased due to change in the indications and factors of impairment at the moment the last impairment loss is recognized, the carrying amount of the asset is increased to its current recoverable amount. A reversal of an impairment loss is recognized as income immediately.

3.12 Investment property

Investment property includes buildings owned by the Bank with the intention of earning rentals or for capital appreciation or both, and is initially recorded at cost, which includes transaction costs. The classification of the investment property is based on the criteria that the property is mostly held to earn rentals when compared to the property used by the Bank for its own needs.

Subsequent to initial recognition, investment property is measured at cost less accumulated depreciation and any accumulated impairment losses. The depreciation of investment property is calculated on a straight-line basis in a way to write off the cost value of assets over their estimated useful lives, which approximates the useful life of similar assets included in property and equipment.

Investment property is annually reviewed for impairment. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized as an expense of the current period.

3.13 Assets Acquired Through Foreclosure Proceedings

Foreclosed assets include property and equipment acquired through foreclosure proceedings in full or partial recovery of a related loan and is disclosed in assets acquired through foreclosure proceedings. These assets are initially measured at the lower of the appraised value, less estimated cost to sell, charged to the Bank, and the cost of the foreclosed asset. The appraised value is determined by local certified appraiser on the date of foreclosure.

After initial recognition, foreclosed assets are reviewed for impairment at least annually and are measured at the lower of their carrying amount and fair value less estimated costs to sell.

3.14 Managed funds for and on behalf of third parties

The Bank acts as a fiduciary and in other fiduciary matters provides services for and on behalf of third parties such as legal entities, citizens, investment and pension funds and other institutions for which it keeps and manages assets or invests funds received in various financial instruments at the direction of the customer. The Bank receives fee income for providing these services. Managed funds are not assets of the Bank and are not recognized in the financial statements. The Bank is not exposed to any credit risk relating to such placements, as it does not guarantee them.

3.15 Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation.

Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

3. Summary of Significant Accounting Policies (Continued)

3.16 Employment benefits

Health, pension and social insurance contributions from gross wages and salaries are being paid by the Bank during the year to the national organizations at the statutory rates. Such contributions represent defined contribution benefit plans and are recognized as an expense when employees have rendered services entitling them to the contributions. There is no additional liability to these plans.

The Bank is obliged to pay to its employees a termination lump sum upon retirement equal to two monthly average salaries paid in the Republic of Macedonia. The Bank records provisions for retirement to allocate such costs by periods to which they relate. In accordance with IAS 19, these benefits are considered defined pension benefit plans. The carrying amount of the Bank's liabilities arising from employee benefits is calculated at the end of the reporting period. The balance of these liabilities at the end of the reporting period presents the discounted amount of future payments.

The calculations are made under the following parameters and used indicators (bases) valid on 31 December each year:

- Rate of growth of average monthly salary per year in the Republic of Macedonia: 1% for the Year 2015 and 1% for the Year 2016, estimated growth of future salaries in Republic of Macedonia, taking into consideration the rate of inflation;
- Discount rate: 3,8% for the Year 2015 and 3.9% for the Year 2016, derived from long-term risk-free securities;
- Severance pay for retiring to the extent of 2 average net salaries per employee in the Republic of Macedonia, paid out in the previous 3 months: MKD 22.040,00 for the Year 2015 and MKD 22.315,00 for the Year 2016, published by the State Statistical Office of the Republic of Macedonia in December for each year respectively.

3.17 Taxation

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity, through other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date of 10%, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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.

Deferred tax assets are recognized for unused tax losses, unused tax credit and deductible temporary differences to the extent for which is probable that the future taxable profits against which the asset can be utilized. Deferred tax assets are estimated at the end of each reporting period and reduced to the extent that is no longer probable that these tax revenues will be realized. Any such reduction should be reversed to the extent that it is probable that sufficient taxable profit will be available. Unrecognised deferred tax assets are assessed at the end of each reporting period and recognised to the extent it is probable that future taxable income will be sufficient against which the asset can be utilised.

3.18 Leases

Assets leased out under operating lease are included in the statement of financial position as investment property. The Bank leases assets as operating leases. Rental income and expenses is recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

3. Summary of Significant Accounting Policies (Continued)

3.19 Critical Accounting Judgments and Estimates

The most significant areas, for which judgments, estimates and assumptions are required, are:

Fair Value of Financial Instruments

The fair values of the financial instruments that are not quoted in active markets are determined using internal valuation techniques. These include present value methods, models based on observable input parameters. All valuation models are validated before they are used as a basis for financial reporting, and periodically reviewed by qualified personnel independent of the area that created the model. Wherever possible, the Bank compares valuations derived from models with quoted prices of similar instruments, and with actual values when realized, in order to further validate and standardize models. A variety of factors are incorporated into the models, including actual or estimated market prices and rates, such as time value and volatility, and market conditions and liquidity.

The Bank applies its models consistently from one period to the next, ensuring comparability and continuity of valuations over time, but estimating fair value inherently involves a significant degree of judgment.

In the Republic of Macedonia sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables and other financial assets or liabilities, for which published market prices are presently not readily available.

The Management assesses its overall risk exposure and in instances in which it estimates that the value in the books may not be realized, it recognizes a provision. In the opinion of management, the reported carrying amounts for the assets that are not quoted in an active market represent the most valid and useful reporting values under the present market conditions.

Allowance for Impairment of Loans

The Bank reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in the profit and loss, 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 in the Bank, or national or local economic conditions that correlate with defaults on assets in the Bank.

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. For more details, refer to 4.1. Credit risk.

Useful Lives of Tangible and Intangible Assets

The Bank's management determines estimated useful lives and related depreciation and amortization charges for its tangible and intangible assets. The appropriateness of the estimated useful lives is reviewed whenever there is an indication of significant changes in the underlying assumptions, such as anticipated technological developments and changes in the broad economic and industry factors.

Investment property and assets acquired through foreclosure procedures

Information about the assumptions made in measuring fair value are included in the following notes:

- Note 23 – investment property;
- Note 26 – assets acquired through foreclosure procedure.

4. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is a core business activity and the operational risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Bank's financial performance.

The most important types of risks identified, evaluated and mitigated by the Bank's risk management policies are credit risk, liquidity risk, market risk and operational risk.

Risk Management Framework

The Bank has established a Strategy for risk management, adopted by the Supervisory Board of the Bank that is revised regularly. The Strategy defines the main objectives and general directions in undertaking and managing risks, general approach to the risk management, general approach to the internal determining and assessment of the Bank's necessary capital adequacy, general review of the business strategy of the bank, as well as the possible changes in the bank's business strategy and acceptable level of risk the bank can be exposed to during its operations.

The Bank's Shareholders Assembly appoints the members of the Supervisory Board and the Audit Committee. The Supervisory Board has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Supervisory Board has established the Board of Directors, Credit Committee and Risk Management Committee These bodies are responsible for monitoring and developing risk management policies in specific areas. The Bank has established an organizational structure, with clearly defined competences and responsibilities. The Risk Management and Planning Division is responsible for monitoring and reporting of global risk exposure, while the organizational units of the Bank, which create risk exposure are responsible for practical application of risk management. The Internal Audit Department is responsible for review of risk management.

4.1 Credit Risk

The Bank is exposed to credit risk, which represents the risk of financial loss due to customer's default on their contractual obligations. Credit risk is the most important risk for the Bank's operations; therefore, the management carefully manages the Bank's exposure to credit risk. The exposure to this risk arises principally from lending activities and advances, as well as activities related to off-balance sheet financial instruments, such as loan commitments to enterprises and households, guarantees and letters of credit.

Taking into consideration the events arising from the global financial crisis, the Bank applies more restrictive credit policy higher precautions in assessing the creditworthiness of each customer and projects subject to financing.

A Credit Risk Management

The Bank has an established organizational structure, with clearly defined competences and responsibilities of the Supervisory Board and the Board of Directors regarding credit risk management.

The organization of the credit risk management is established on the following levels of hierarchy:
- Strategic level - the risk management function is performed by the members of Supervisory Board and the Board of Directors; Risk Management Committee and Audit Committee;
- Macro level - the risk management function at the level of business unit, or business line is performed by other persons with special rights and responsibilities performing managing function and/or by special organizational unit responsible for monitoring the credit risk management.

Credit risk management at the level of business unit in the Bank includes each Division where the credit risk is undertaken and the persons with special rights and responsibilities that performs the management function in the Division. The duties of these organizational units in the Bank are regulated in the appropriate Policies adopted from the Bank's Supervisory Board. The organizational unit in the Bank responsible for credit risk management is Risk Management and Planning Division – Credit Risk Management Department.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

A Credit Risk Management (Continued)

All credit exposures exceeding 10% of the Bank's own funds up to the legally determined limit of exposure towards a single client (up to 25% of regulatory capital) are subject to approval by the Supervisory Board.

The Credit Committee oversees the overall credit operation of the Bank. Also, the Credit Committee is mainly responsible for approving and proposing to the Risk Management Committee and Board of Directors, all policies, procedures and amendments thereto relating to the extension of credit, to ensure that these policies are applied consistently and complied with throughout the Bank, to approve credit exposure between 3% and 10% from own funds.

Board of directors, Corporate Lending Division Manager and Department Managers of the Bank are authorized for approving credit exposures up to 3% of the Bank's own funds.

B Credit Risk Assessment

(a) Loans and Advances

In assessing credit risk of loans and advances to customers and banks at a counterparty level, the Bank uses three components:

(I) the 'probability of default' by the client or counterparty on its contractual obligation (expected cash flows);
(II) the likely recovery ratio on the defaulted obligations, the 'loss given default';
(III) the amount and quality of the collateral for the exposure.

These credit risk measurements, which reflect expected loss, i.e. the 'expected loss model' and are required by the Basel Committee on Banking Regulations and the Supervisory Practices (the Basel Committee), are embedded in the Bank's daily operational management. The operational measurements can be contrasted with impairment allowances required under IAS 39, which are based on losses that have been incurred at the end of the reporting period (the 'incurred loss model') rather than expected losses (Note 4.1.D).

(i) The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. They have been developed internally and combine statistical analysis with credit officer judgment and are validated, where appropriate, by comparison with externally available data. Clients of the Bank are segmented in four rating classes. The Bank's rating scale, which is shown below, reflects the range of default probabilities defined for each rating class. This means that, in principal, exposures migrate between classes as the assessment of their probability of default changes. The rating tools are kept under review and upgraded as necessary. The Bank regularly validates the performance of the rating and their predictive power with regard to default events.

Bank's internal rating scale

Bank's rating	Description of the grade
A	Pass/acceptable for financing
B	Watch (careful)
C	Sub-standard
D+E	Suspicious (doubtful)+Loss

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4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

B Credit Risk Assessment (Continued)

(a) Loans and Advances (Continued)

Bank's rating grade A (pass/acceptable for financing) includes:

- Amounts owing to the European Central Bank and the central governments and central banks of countries whose claims pursuant to the methodology for determining the capital adequacy have a risk weight of 0%.
- Part of credit exposure that is secured by first-rate collateral instruments, if the instrument is activated within 60 days of the date of maturity of the exposure;
- Financial position and cash flows of the client allows its further operation and opportunity to cover the current and future liabilities to the bank;
- Liabilities based on credit exposure are settled within the maturity period or with a delay of 31 days, or
- In the last twelve months, no credit exposure for that client has been restructured.

Bank's rating grade B (Watch (careful)) includes:

- The client shows financial weaknesses, but its cash flows are sufficient for regular settlement of due liabilities;
- Liabilities based on credit exposure are commonly settled with a delay of 60 days, or 90 days as an exception, if the delay only occasionally ranges from 61 to 90 days, or
- In the last six months, the credit exposure has not been restructured.

Bank's rating grade C (Sub-standard) includes:

- Cash inflows of client are unsuitable for regular settlement of liabilities;
- There is an inadequate maturity structure between the sources of funding of the program/project for which financial support has been requested from the Bank and proceeds generated from the program/project;
- The Bank does not hold the necessary and updated information to assess the creditworthiness of the client;
- The credit exposure is restructured;
- Liabilities based on credit exposure are commonly settled with a delay of up to 120 days, or 180 days as an exception, if the delay only occasionally ranges from 121 to 180 days;
- The client - nonfinancial entity has claims based on financial loan on entity enjoying a credit rating equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's") or an entity enjoying a higher credit rating, but its domicile country's credit rating equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's"), or
- The client - nonfinancial entity has claims based on financial loan is entity for which no credit rating has been established, but its domicile country's credit rating equal to or lower than B- (according to the rating of "Standard & Poor's" or "Fitch") or B3 (according to the rating of "Moody's") or its domicile country's credit rating has not been established yet.

  The Bank may not classify credit exposure to the client under bullet points 6 and 7 in C risk category, if:

- The exposure is based on a customs guarantee or bid guarantee;
- The financial loan does not exceed Denar 31,000,000 (in case of foreign currency financial loan, the Denar equivalent of the loan shall be taken into consideration), or
- The financial loan is equal to or greater than Denar 31,000,000, and the Bank's exposure is greater than the amount of financial loan and the Bank has calculated impairment or allocated special reserve, at least in the amount exceeding 20% of the amount of financial loan, whereby the credit exposure or the client meets the criteria for classification in another risk category.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

B Credit Risk Assessment (Continued)

(a) Loans and Advances (Continued)

Bank's rating grade D (Suspicious (doubtful) loss) includes:

- The client is illiquid;
- The collection of credit exposure depends on the use of collateral instruments;
- The liabilities based on credit exposure are commonly settled with a delay of up to 240 days, or 300 days, as an exception, if the delay only occasionally ranges from 241 to 300 days;
- The client (including governments and central banks) enjoys a credit rating equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's");
- The client's credit rating is higher than the rating referred to in the sentence above, but its domicile country's credit rating is equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's"), or
- The client has not been given any credit rating, but its domicile country's credit rating is equal to or lower than B- (according to the rating of "Standard & Poor's" or "Fitch") or B3 (according to the rating of "Moody's") or its domicile country has not been given any credit rating yet.

Bank's rating grade E (Suspicious (doubtful) loss) includes:

- Liabilities based on credit exposure are commonly settled with a delay of over 241 days
- The client has undergone bankruptcy or liquidation proceedings;
- The client denies the existence of credit exposure (in court or out-of-court proceedings), or
- The Bank expects to collect only an insignificant portion of credit exposure from the client.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

B Credit Risk Assessment (Continued)

(a) Loans and Advances (Continued)

(ii) Loss given default or loss severity represent the Bank's expectations of the extent of loss on a claim should default occur. It is expressed as percentage loss per unit of exposure and typically varies by type of counterparty, type and seniority of claim and availability of collateral or other credit mitigations.

(iii) Amount and quality of the collateral depends on the terms, type (immovable property, movable property, inventories, receivables) and the possibility for its enforcement. The Bank divides the clients in two groups: one where the exposure of the Bank is secured with value of the collateral that is lower than the amount of the exposure and second where the value of the collateral is higher than the amount of the exposure. The collateral is not taken into calculation of the expected cash flows from the financial assets, only as an input into the internal rating of the client.

(b) Debt Securities and Other Bills

The Bank is striving to maintain acceptable level of credit risk exposure regarding debt securities, so investment activities are primarily in government debt securities.

C Risk Limit Control and Mitigation Policies

The Bank manages and controls concentration of credit risk to clients, and to industries and countries.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

Measures for specific control and mitigation of credit risk are prescribed in the Bank's act that regulates credit activities and procedures are obtaining collateral and credit-related contingencies

(a) Collateral

Collateral is considered as a secondary factor in granting a credit facility. Security by itself, with its lack of ability to generate cash flow, is insufficient to justify the granting of credit facilities. The principal collateral types for loans and advances are:

(i) For corporate entities
- Cash
- Property
- Equipment and vehicles
- Inventory
- Receivables
- Guarantees (Bank guarantees, guarantees from legal entities)
- Securities (Debt securities issued by the Government of RM, Securities issued by legal entities).

Loans to corporate entities are generally secured.

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

C Risk Limit Control and Mitigation Policies (Continued)

(a) Collateral (Continued)

(ii) For individuals
- Property
- Cars
- Deposits
- Securities (Debt securities issued by the Government of RM, Securities issued by legal entities)
- In some cases draft or draft with endorsers covering the total receivables.

Loans to individuals are generally secured.

(b) Credit-related contingencies

The primary purpose to these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. The Bank issues collateralized and uncollateralized guarantees and letters of credit. The Bank monitors the term of maturity of these credit commitments, because long-term commitments have greater degree of credit risk than short-term commitments, also as uncollateralized commitments regarding collateralized commitments.

D Impairment and Provisioning Policies

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 are specific loss component that relates to individually significant exposures.

According to the Bank's policy, there are four internal rating grades. The majority of the allowance for impairment comes from the bottom two grades. The table below shows the structure of the Bank's loans and advances portfolio regarding internal rating system and the associated allowance for impairment for each internal rating grade:

	December 31, 2016		December 31, 2015	
	Loans %	Impairment %	Loans %	Impairment %
Pass/acceptable for financing (A)	76.3	1.1	69.9	1.1
Watch (careful) (B)	6.5	6.3	6.0	9.6
Sub-standard (C)	1.7	26.6	5.6	28.4
Suspicious (doubtful)+ Loss (D) +(E)	15.5	84.6	18.5	94.1
Total	**100.00**	**14.8**	**100.00**	**20.4**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

E Maximum Exposure to Credit Risk Before Collateral Held or Other Credit Enhancements

	In thousands of Denars Year ended December 31, 2016	2015
Credit risk exposure relating to balance sheet assets		
Loans and advances to banks	10,084,209	9,208,426
Loans to customers		
Loans to individuals		
- overdrafts (exemption off-balance sheet exposure)	1,085,024	1,146,181
- credit cards (exemption off-balance sheet exposure)	1,033,505	1,052,866
- loans	10,850,672	10,202,735
Loans to corporate entities		
- Large corporate clients	14,943,371	17,056,906
- Small and medium size companies (SMEs)	17,355,582	18,185,834
Financial assets at fair value through profit and loss	407,732	368,751
Financial assets available for sale	3,687,968	7,214,747
Financial assets held to maturity	3,374,729	2,516
Other assets	590,816	530,882
	63,413,608	**64,969,844**
Credit risk exposure relating to off-balance sheet assets/liabilities		
Guarantees	8,771,527	8,685,207
Letters of credit	923,166	2,231,977
Unused overdrafts on current accounts	1,148,506	1,722,585
Unused credit cards limits	1,737,632	1,186,358
Unused credit limits-non-cancellable	1,515,935	1,620,969
	14,096,766	**15,447,096**
Total credit risk exposure	**77,510,374**	**80,416,940**

The above table presents a worst case scenario of credit risk exposure to the Bank as at 31 December 2016 and 2015, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet items, the exposures set out above are based on net carrying amounts as reported in the statement of financial position.

As shown above, 71.4% of the total maximum exposure is derived from loans and advances to banks and customers (2015: 71%); 18.2% represents off-balance-sheet items (2015: 19%).
Management is confident in its ability to continue to control and sustain minimum exposure to credit risk to the Bank resulting from both loans and advances portfolio and off balance sheet items based on the following:

- 82.8% of the loans and advances are categorised in top two grades on the internal rating system (2015: 75.9%);
- Loans and advances to customers are collateralized and loans to banks are mostly in first investment grade-high credit worthiness banks ;
- 60.04% of loans and advances are considered neither past due nor impaired (2015: 63.05%);
- The decrease of off-balance-sheet items generally resultiing in decrease of letters of credit and unused overdrafts on current accounts

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances

Loans and advances are summarised as follows:

	In thousands of Denars			
	Year ended December 31, 2016		Year ended December 31, 2015	
	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks
Neither past due nor impaired	2,176,673	10,081,042	2,089,285	9,201,777
Past due but not impaired	219,886	-	65,842	-
Impaired	50,764,645	4,374	57,725,785	8,533
Gross	**53,161,204**	**10,085,416**	**59,880,912**	**9,210,310**
Less: allowance for impairment	(7,893,050)	(1,207)	(12,236,390)	(1,884)
Net	**45,268,154**	**10,084,209**	**47,644,522**	**9,208,426**

Further information on the impairment allowance for loans and advances is provided in Notes 19 and 20.

(a) Loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Bank's internal rating system.

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Loans and advances to banks	10,081,042	9,201,777
Loans to customers		
Loans to individuals		
- Loans	356,692	352,875
Loans to corporate entities		
- Large corporate clients	1,537,408	1,460,697
- Small and medium size companies (SMEs)	282,573	275,713
Total	**12,257,715**	**11,291,062**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(b) Loans and advances past due but not impaired

The amount of past due but not impaired loans included exposures which are past due up to 30 days, and are mostly cash covered. Gross amount of loans and advances that were past due but not impaired were as follows:

	In thousands of Denars December 31, 2016			
	Up to 30 days	Up to 90 days	Over 90 days	Total
Loans to customers	213,281	6,605	-	219,886
Value of collateral				**275,854**

	In thousands of Denars December 31, 2015			
	Up to 30 days	Up to 90 days	Over 90 days	Total
Loans to customers	64,453	1,389	-	65,842
Value of collateral				**98,095**

(c) Loans and advances individually impaired

i) Loans and advances

The breakdown of individually impaired loans and advances by class and the fair value of related collateral held by the Bank as security are as follows:

	In thousands of Denars December 31, 2016							
	Large corporate clients	Small and medium size companies (SMEs)	Loans and advances to banks	Overdrafts	Credit cards	Retail loans	Total	Allowance for Individually impaired loans
Gross amount	16,683,832	21,031,626	4,374	1,155,863	1,098,589	10,794,735	**50,769,019**	7,894,257
Value of collateral	**23,848,453**	**29,759,291**	**-**	**4,304**	**442**	**12,619,127**	**66,231,617**	

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(c) Loans and advances individually impaired (Continued)

In thousands of Denars
December 31, 2015

	Large corporate clients	Small and medium size companies (SMEs)	Loans and advances to banks	Overdrafts	Credit cards	Retail loans	Total	Allowance for Individually impaired loans
Gross amount	19,092,320	25,498,547	8,533	1,344,399	1,306,025	10,484,494	**57,734,318**	12,238,274
Value of collateral	**22,315,127**	**33,613,193**	**-**	**4,312**	**1,479**	**11,851,312**	**67,785,423**	

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(c) Loans and advances individually impaired (Continued)

The disclosed fair value of collateral is determined by certified appraisals and represents estimated value realizable by the legal owners of the assets. The Bank makes valuations of the market value of residential property or commercial real estate at least once a year. The Bank shall provide an appraisal of the market value of the property in a shorter period as well, in case of a significant decline of market prices of similar properties.

Breakdown of the collateral:

- Most of the Retail loans are covered by the property for private use (flats, houses),
- Loans for corporate clients are covert by: 1) commercial real estate 2) property for private use and pledge over movables.

Value of collateral for mitigating of credit risk

	Loans and advances to customers	
in thousands of denars	**Current year 2016**	**Previous year 2015**
Value of collateral of credit exposure assessed for impairment on an individual basis		
First-class collateral instruments		
cash deposits (in depot and/or restricted in accounts held with the Bank)	1,223,323	1,158,521
government securities	-	-
government unconditional guarantees	-	-
bank guarantees	-	83,356
Guarantees from insurance companies and insurance policies	-	-
Corporate guarantees (besides bank Guarantees and guarantees from insurance companies)	61,133	398,984
Guarantees from individuals	1	-
Mortgage on real estate		-
property for private use (flats, houses)	17,292,667	17,225,271
business facility	34,289,954	33,907,303
Pledge over movables	13,678,522	15,463,763
Other types of collateral	952,928	657,330
Total value of collateral of credit exposure assessed for impairment on an individual basis	**67,498,528**	**68,894,528**

ii) Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 31 December 2016 amounts to Denar 4,374 thousand (2015: 8,533 thousand). Generally, no collateral is held by the Bank for these placements.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(d) Loans and advances renegotiated

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

For the purposes of disclosures in these financial statements, 'loans with renegotiated terms' are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Bank has made concessions by agreeing to terms and conditions that are more favorable for the borrower than the Bank had provided initially and that it would not otherwise consider.

Once the loan is restructured it is classified as substandard in at least C risk grade and remains in the same rating grade at least two quarters independent of satisfactory performance after restructuring. The restructured loans as at 31 December 2016 and 31 December 2015 are as follows:

	In thousands of Denars	
	December 31, 2016 Carrying amount	December 31, 2015 Carrying amount
Restructured loans	**1,677,060**	**3,424,111**

The restructured loans are classified in C and D risk grades, with impairment in the range from 28% to 51%. Out of the total exposure, the amount of 655,863 thousand denars is up to 90 days and the amount of 1,021,197 thousand denars is over 90 days overdue.

G Debt Securities, Treasury Bills and Other Eligible Bills

The table below presents an analysis of debt securities, treasury bills and other eligible bills based on the respective issuer as at 31 December 2016. Issuer of the investment securities is the Central Bank of the Republic of Macedonia and the Republic of Macedonia. Fitch Ratings assigned its BB+ long term default rating and BB+ local currency long term default rating to the Republic of Macedonia.

	In thousands of Denars December 31, 2016			
Issuer	**Cash and cash equivalents**	**Trading securities**	**Investment securities**	**Total**
Central bank of the Republic of Macedonia	5,778,123	-	-	5,778,123
Republic of Macedonia	-	23,165	6,984,971	7,008,136
Total	**5,778,123**	**23,165**	**6,984,971**	**12,786,259**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

G Debt Securities, Treasury Bills and Other Eligible Bills (Continued)

	In thousands of Denars December 31, 2015			
Issuer	**Cash and cash equivalents**	**Trading securities**	**Investment securities**	**Total**
Central bank of the Republic of Macedonia	6,299,613	-	-	6,299,613
Republic of Macedonia	-	14,847	7,139,551	7,154,398
Total	**6,299,613**	**14,847**	**7,139,551**	**13,454,011**

H Repossessed Collateral

As at December 31, 2016 and 2015 the Bank assets obtained through foreclosure procedures amount to:

	In thousands of Denars	
	December 31, 2016 Carrying amount	**December 31, 2015 Carrying amount**
Property and equipment	**734,316**	**1,395,714**

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December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure

a) Geographical sectors

The following table breaks down the Bank's credit exposure at their carrying amount, categorized by geographic region, based on the country of domicile of counterparties:

In thousands of Denars

	Total	Republic of Macedonia	EU Countries	Non-EU Countries in Europe	Other countries
ASSETS					
Cash and cash equivalents	**33,538,670**	16,385,550	11,039,402	4,859,317	1,254,401
Financial assets at fair value through P&L	**407,732**	407,732	-	-	-
Loans and advances to banks	**10,084,209**	18,311	3,792,642	5,810,548	462,708
Loans and advances to customers					
Loans to individuals					
- Term Loans	**10,850,672**	10,850,672	-	-	-
- Overdrafts	**1,085,024**	1,085,024	-	-	-
- Credit cards	**1,033,505**	1,033,505	-	-	-
Loans to corporate entities					
- Large corporate customers	**14,943,371**	14,943,371	-		-
- SMEs	**17,355,582**	17,233,671	121,911	-	-
Financial assets available for sale	**3,687,968**	3,686,034	1,408	526	-
Financial assets held-to-maturity	**3,374,729**	3,374,729	-	-	-
Other assets	**590,816**	590,816	-	-	-
Total assets at 31 December 2016	**96,952,278**	**69,609,415**	**14,955,363**	**10,670,391**	**1,717,109**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure (Continued)

a) Geographical sectors (Continued)

The following table breaks down the Bank's credit exposure at their carrying amount, categorized by geographic region, based on the country of domicile of our counterparties:

In thousands of Denars

	Total	Republic of Macedonia	EU Countries	Non-EU Countries in Europe	Other countries
ASSETS					
Cash and cash equivalents	**27,663,717**	18,315,960	6,914,444	998,421	1,434,892
Financial assets at fair value through P&L	**368,751**	368,751	-	-	-
Loans and advances to banks	**9,208,426**	141,365	6,816,359	2,250,702	-
Loans and advances to customers					
Loans to individuals					
- Term Loans	**10,202,735**	10,202,735	-	-	-
- Overdrafts	**1,146,181**	1,146,181	-	-	-
- Credit cards	**1,052,866**	1,052,866	-	-	-
Loans to corporate entities					
- Large corporate customers	**17,056,906**	17,056,906	-		-
- SMEs	**18,185,834**	18,053,045	126,644	6,145	-
Financial assets available for sale	**7,214,747**	7,212,828	1,411	508	-
Financial assets held-to-maturity	**2,516**	2,516	-	-	-
Other assets	**530,882**	530,882	-	-	-
Total assets at 31 December 2015	**92,633,561**	**74,084,035**	**13,858,858**	**3,255,776**	**1,434,892**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure (Continued)

b) Industry sector

The following table breaks down the Bank's credit exposure at their carrying amount, categorized by industry sector of our counterparties:

In thousands of Denars

	Total	Manufac -turing	Commerce and finance	Retail customers	Agriculture	Government and local authorities	Construc -tion	Transport	Trade	Other
ASSETS										
Cash and cash equivalents	**33,538,670**	-	33,538,670	-	-	-	-	-	-	-
Financial assets at fair value through profit and loss	**407,732**	-	384,567	-	-	23,165	-	-	-	-
Loans and advances to banks	**10,084,209**	-	10,084,209	-	-	-	-	-	-	-
Loans and advances to customers										
Loans to individuals										
- Term Loans	**10,850,672**	-	-	10,850,672	-	-	-	-	-	-
- Overdrafts	**1,085,024**	-	-	1,085,024	-	-	-	-	-	-
- Credit cards	**1,033,505**	-	-	1,033,505	-	-	-	-	-	-
Loans to corporate entities										
- Large corporate customers	**14,943,371**	5,530,685	13,211	-	250,140	1,474,107	857,672	30,167	3,289,514	3,497,875
- SMEs	**17,355,582**	4,053,342	89,949	-	843,512	43,279	2,613,786	692,117	5,923,688	3,095,909
Financial assets available for sale	**3,687,968**	-	77,726	-	-	3,610,242	-	-	-	-
Financial assets held to maturity	**3,374,729**	-	-	-	-	3,374,729	-	-	-	-
Other assets	**590,816**	-	590,816	-	-	-	-	-	-	-
Total assets at 31 December 2016	**96,952,278**	**9,584,027**	**44,779,148**	**12,969,201**	**1,093,652**	**8,525,522**	**3,471,458**	**722,284**	**9,213,202**	**6,593,784**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure (Continued)

b) Industry sector (Continued)

The following table breaks down the Bank's credit exposure at their carrying amount, categorized by industry sector of our counterparties:

In thousands of Denars

	Total	Manufac -turing	Commerce and finance	Retail customers	Agriculture	Government and local authorities	Construc -tion	Transport	Trade	Other
ASSETS										
Cash and cash equivalents	**27,663,717**	-	27,663,717	-	-	-	-	-	-	-
Financial assets at fair value through profit and loss	**368,751**	-	353,904	-	-	14,847	-	-	-	-
Loans and advances to banks	**9,208,426**	-	9,208,426	-	-	-	-	-	-	-
Loans and advances to customers										
Loans to individuals										
- Term Loans	**10,202,735**	-	-	10,202,735	-	-	-	-	-	-
- Overdrafts	**1,146,181**	-	-	1,146,181	-	-	-	-	-	-
- Credit cards	**1,052,866**	-	-	1,052,866	-	-	-	-	-	-
Loans to corporate entities										
- Large corporate customers	**17,056,906**	6,315,463	19,980	-	135,414	1,478,449	959,716	287,913	3,913,771	3,946,200
- SMEs	**18,185,834**	4,475,312	376,743	-	860,192	38,208	2,740,068	1,473,478	5,004,787	3,217,046
Financial assets available for sale	**7,214,747**	-	77,711			7,137,036				
Financial assets held to maturity	**2,516**	-	-	-	-	2,516	-	-	-	-
Other assets	**530,882**	-	530,882	-	-	-	-	-	-	-
Total assets at 31 December 2015	**92,633,561**	**10,790,775**	**38,231,363**	**12,401,782**	**995,606**	**8,671,056**	**3,699,784**	**1,761,391**	**8,918,558**	**7,163,246**

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4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk

The Bank takes on exposure to market risk. Market risk arises from open positions in interest rate, currency, and price risk, all of which are exposed to general and specific market movements. The Bank estimates the market risk of positions held and the maximum losses expected based upon a number of assumptions for various changes in market conditions. The Board of Directors sets limits on the value of risk that may be accepted, which is monitored on a regular basis.

A Market Risk Measurement

Regarding market risk managing and measuring, the Bank's management on a regular basis through adequate analysis and reporting process, is monitoring:

- interest rate changes regarding market movements and internal decisions, and the influence on interest bearing assets and liabilities and the net interest margin;
- changes of foreign currency rates regarding foreign currency assets and liabilities and maintain an adequate structure regarding foreign exchange risk exposure;

The aim of the Bank is maximizing the stability and profitability, by applying the optimum combination of foreign currency and interest rate structure of the assets and liabilities.

B Foreign Currency Risk

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for overnight position, which are monitored daily. The table below summarizes the Bank's exposure to foreign currency exchange rate risk at 31 December 2016 and 2015. Included in the table are the Bank's assets and liabilities at carrying amounts categorized by currency.

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

B Foreign Currency Risk (Continued)

(i) Concentrations of assets and liabilities

The Bank had the following significant currency positions:

	In thousands of Denars December 31, 2016				
	EUR	**USD**	**MKD**	**Other**	**Total**
Assets					
Cash and cash equivalents	10,829,113	4,116,209	16,385,550	2,207,798	33,538,670
Financial assets at fair value through profit and loss	23,165	-	384,567	-	407,732
Financial assets available-for-sale	1,409	526	3,686,033	-	3,687,968
Financial assets held-to-maturity	1,192,901	-	2,181,828	-	3,374,729
Loans and advances to banks	9,722,397	-	18,310	343,502	10,084,209
Loans and advances to customers	14,795,602	718,460	29,754,092	-	45,268,154
Investments in associates	-	-	210,171	-	210,171
Other assets	200,970	109,367	280,363	116	590,816
Total assets	**36,765,557**	**4,944,562**	**52,900,914**	**2,551,416**	**97,162,449**
Liabilities					
Deposits from banks and other financial institutions	356,965	228,007	956,120	135,210	1,676,302
Deposits from other customers	33,534,115	4,625,288	45,580,513	2,375,421	86,115,337
Borrowings	1,525,744	-	124,778	-	1,650,522
Other liabilities	163,722	15,625	407,783	11,205	598,335
Total liabilities	**35,580,546**	**4,868,920**	**47,069,194**	**2,521,836**	**90,040,496**
Net on-balance sheet financial position	**1,185,011**	**75,642**	**5,831,720**	**29,580**	**7,121,953**
Contingencies and commitments	**4,544,190**	**427,189**	**9,125,388**	**-**	**14,096,767**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

B Foreign Currency Risk (Continued)

(i) Concentrations of assets and liabilities (Continued)

In thousands of Denars
December 31, 2015

	EUR	USD	MKD	Other	Total
Total assets	**33,110,666**	**4,739,029**	**52,518,243**	**2,454,770**	**92,822,708**
Total liabilities	**33,680,144**	**4,712,420**	**46,059,293**	**2,445,427**	**86,897,284**
Net on-balance sheet financial position	**(569,478)**	**26,609**	**6,458,950**	**9,343**	**5,925,424**
Contingencies and commitments	**6,162,866**	**400,312**	**8,883,917**	**-**	**15,447,095**

The table below summarizes the sensitivity analysis for foreign currency risk and the effect on the profit or loss:

In thousands of Denars

	Increase 2016	Increase 2015	Effect on profit and loss and equity	
			2016	2015
EUR	0.5%	0.5%	5,925	(2,847)
USD	5.0%	5.0%	3,782	1,330
Other	1.0%	1.0%	296	93

C Interest Rate Risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest- bearing assets and interest-bearing liabilities mature or re-price at different times or in different amounts. In the case of floating rate assets and liabilities, the Bank is also exposed to basis risk, which is the difference in re-pricing characteristics of the various floating rates, such as the savings rates, LIBOR /EURIBOR and different types of interest. Risk management activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Bank's business strategies.

Assets-liability risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. In general, the Bank is asset sensitive because of the majority of the interest-bearing assets; the Bank has the right simultaneously to change the interest rates. In decreasing interest rate environments, margins earned will narrow as liabilities interest rates will decrease with a lower percentage compared to assets interest rate. However the actual effect will depend on various factors, including stability of the economy, environment and level of the inflation.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

C Interest Rate Risk (Continued)

In thousands of Denars	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2016							
Assets							
Cash and cash equivalents	19,254,603	3,152,995	-	-	-	11,131,072	33,538,670
Financial assets at fair value through profit and loss	-	-	-	-	-	407,732	407,732
Financial assets available –for-sale	1,199,131	49,905	2,357,606	-	-	81,326	3,687,968
Financial assets held-to-maturity	99,955	567,577	2,108,873	596,993	-	1,331	3,374,729
Loans and advances to banks	759,076	2,460,839	6,862,930	-	-	1,364	10,084,209
Loans and advances to Customers	2,403,473	2,814,614	30,662,628	3,700,593	4,245,240	1,441,606	45,268,154
Investments in associates	-	-	-	-	-	210,171	210,171
Other assets	-	-	-	-	-	590,816	590,816
Total assets	**23,716,238**	**9,045,930**	**41,992,037**	**4,297,586**	**4,245,240**	**13,865,418**	**97,162,449**
Liabilities							
Deposits from banks and other financial institutions	626,316	372,811	383,537	-	-	293,638	1,676,302
Deposits from other customers	46,726,514	10,070,238	27,628,038	-	-	1,690,547	86,115,337
Borrowings	130,011	3,573	336,760	944,107	108,859	127,212	1,650,522
Other liabilities	-	-	-	-	-	598,335	598,335
Total liabilities	**47,482,841**	**10,446,622**	**28,348,335**	**944,107**	**108,859**	**2,709,732**	**90,040,496**
Total interest repricing gap	**(23,766,603)**	**(1,400,692)**	**13,643,702**	**3,353,479**	**4,136,381**	**11,155,686**	**7,121,953**
As at 31 December 2015							
Total assets	22,874,521	8,247,462	41,292,199	4,309,039	4,079,339	12,020,148	92,822,708
Total liabilities	42,724,854	11,359,328	28,998,574	1,265,957	168,361	2,380,210	86,897,284
Total interest repricing gap	**(19,850,333)**	**(3,111,866)**	**12,293,625**	**3,043,082**	**3,910,978**	**9,639,938**	**5,925,424**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

C Interest Rate Risk (Continued)

The interest rate sensitivity analysis has been determined based on the exposure to interest rate risk at the reporting date. At 31 December 2016, if variable interest rates had been 100 basis points higher/lower (2015: 100 basis points higher/lower) with all other variables held constant, the Bank's profit or loss for the twelve month period ended 31 December 2016 would increase/decrease by approximately Denar 102,415 thousand (2015: increase/decrease by Denar 103,873 thousand). If adjustable interest rates had been 150 basis points (2015: 150 basis points) higher/lower with all other variables held constant, the Bank's profit or loss for the twelve month period ended 31 December 2016 would respectively decrease /increase by approximately Denar 814,744 thousand (2015: Denar 745,622 thousand).

4.3. Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence of liquidity risk may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

A Liquidity Risk Management Process

Liquidity risk management policy of the Bank defines the method of managing the Bank's liquidity.

Perception and monitoring of the Bank's liquidity is an essence of its stability and successful working. Implementation of the liquidity risk management policy is done using defined risk management process which includes planning and managing with cash flows, maintaining adequate structure of assets and liabilities, financial instruments for liquidity risk management, adequate diversification of deposits and other liabilities by maturity and client, procedures for identification and monitoring the deposit's stability, monitoring the maturity of assets and liabilities, monitoring the off-balance sheet items, monitoring liquidity ratios, internal liquidity indicators, liquidity stress testing and continuity plan in irregular conditions reporting to Bank's bodies and adequate management information system and responsibilities of Bank's organizational units in liquidity risk management process. The aim of the Bank is maximizing the profitability, by applying the optimum combination of maturity and foreign currency structure of the assets and liabilities.

However, the Bank strives to use adequate term structure of funds adjusted to term structure of placements, based on contractual and expected maturity of the deposit base. The primary strategy of the Bank is to maintain its liquidity at the highest level.

The table below analyses the undiscounted contractual cash flows of assets and liabilities of the Bank into relevant maturity buckets based on the remaining period at the date of the statement of financial position to the contractual maturity date for assets and liabilities. The presented information represents undiscounted cash flows, which include estimated interest payments.

Although the Bank has a shortage of short-term assets over short-term liabilities maturing within one month, one to three months, the Bank's management considers its deposit base as being stabile and liquidity not jeopardized.. This is based on statistical data and calculations of expected maturity in order to determine the funding and stability of the deposit base.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.3. Liquidity Risk (Continued)

A Liquidity Risk Management Process (Continued)

Maturities of assets and liabilities In thousands of Denars
December 31,2016

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits from banks and other financial institutions	942,848	189,368	400,826	147,446	-	1,680,488
Deposits from other customers	46,485,304	10,335,519	22,187,364	7,471,058	4,765	86,484,010
Borrowings	133,299	3,580	330,998	1,083,346	123,105	1,674,328
Other liabilities	532,710	12,977	3,913	12,961	35,774	598,335
Total liabilities (contractual maturity dates)	**48,094,161**	**10,541,444**	**22,923,101**	**8,714,811**	**163,644**	**90,437,161**
Total assets (contractual maturity dates)	**30,904,134**	**9,083,625**	**23,389,315**	**22,418,501**	**11,156,703**	**96,952,278**

Maturities of assets and liabilities In thousands of Denars
December 31,2015

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits from banks and other financial institutions	759,100	197,524	148,243	281,789	-	1,386,656
Deposits from other customers	42,810,420	11,134,026	21,923,001	7,127,007	674	82,995,128
Borrowings	172,903	12,531	413,072	1,421,320	179,645	2,199,471
Other liabilities	478,583	4,309	5,056	(3,514)	27,861	512,295
Total liabilities (contractual maturity dates)	**44,221,006**	**11,348,390**	**22,489,372**	**8,826,602**	**208,180**	**87,093,550**
Total assets (contractual maturity dates)	**28,134,348**	**8,370,638**	**23,062,672**	**21,904,697**	**11,161,206**	**92,633,561**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.3. Liquidity Risk (Continued)

B Assets Held for Managing Liquidity Risk

The Bank holds a diversified portfolio of cash, highly marketable assets and highly-liquid securities to support payment obligations in stressed market environment. The Bank's assets held for managing liquidity risk comprise:

- Cash and balances with the National Bank of Republic of Macedonia;
- Treasury bills;
- Government bills and Government Bond that are readily acceptable in repurchase agreements with the National Bank of the Republic of Macedonia;
- Short-term Loans and advances to banks.

C Off-balance Sheet Items (Uncollateralized)

(a) Guarantees

The maturity buckets are based on the remaining contractual maturity date of the guarantees i.e. the earliest period in which the guarantees could be called.

(b) Letter of credit

The maturity groupings based on the remaining contractual maturity date of letter of credit are also included in the table below.

(c) Other

This item includes approved undistributed overdrafts on current accounts and cards and loans in Denars. The maturity buckets based on the remaining contractual maturity date are summarized in the table below:

In thousands of Denars
December 31, 2016

	Up to 1 year	1-5 years	Over 5 years	Total
Guarantees	5,399,665	3,312,680	96,239	8,808,584
Letter of credit	835,339	88,735	-	924,074
Other	4,476,686	-	-	4,476,686
Total	**10,711,690**	**3,401,415**	**96,239**	**14,209,344**

In thousands of Denars
December 31, 2015

	Up to 1 year	1-5 years	Over 5 years	Total
Guarantees	4,640,804	4,075,123	6,426	8,722,353
Letter of credit	2,152,544	85,285	-	2,237,829
Other	4,636,660	-	-	4,636,660
Total	**11,430,008**	**4,160,408**	**6,426**	**15,596,842**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.4. Financial instruments

A Fair value

Fair value represents the amount at which an asset could be replaced or a liability settled on regular, market conditions between informed and voluntary parties. Fair value has been based on management assumptions according to the profile of the asset and liability base.

The following table summarizes the carrying amounts and fair values of financial assets and liabilities.

Financial instruments not measured at fair value

	Carrying amount		In thousands of Denars Fair value	
	As at 31 December 2016	As at 31 December 2015	As at 31 December 2016	As at 31 December 2015
Financial assets				
Loans and advances to banks	10,084,209	9,208,426	10,084,209	9,208,426
Loans and advances to customers	45,268,154	47,644,522	45,260,976	47,641,292
- Retail customers(individuals)	12,969,201	12,401,782	12,969,201	12,401,782
- large corporate customers	14,943,371	18,185,834	14,943,371	18,185,701
- SMEs	17,355,582	17,056,906	17,348,404	17,053,809
Financial assets held-to-maturity	3,374,729	2,516	3,378,655	2,483
Financial liabilities				
Deposits from banks and other financial institutions	1,676,302	1,381,823	1,676,302	1,381,823
Deposits from other customers	86,115,337	82,837,690	86,115,337	82,837,690
Borrowings	1,650,522	2,165,476	1,650,522	2,165,476

The fair value of the above presented financial assets and liabilities are determined within level 2 fair value measurement hierarchy.

a) Loans and advances to banks

The fair value of loans and advances to banks is equal to their carrying amounts due to their short-term maturity.

b) Loans and advances to customers

Loans and advances to customers are stated according to amortized cost less impairment. A major part of the loans and advances to customers is with adjustable interest rate. The appraised fair value of loans and advances to customers is determined by the discounted expected future cash flows. Expected future cash flows for determining the fair value are discounted using current market interest rate.

c) Financial assets held-to-maturity

Fair value for assets classified as held-to-maturity is based on published prices on active market or published prices available from stock exchange, dealer and broker. In cases where this information is not available, fair value is estimated by: information for realized prices of recent normal commercial transactions among voluntary parties; analysis of discounted cash flows; other alternative models for price determination.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.4. Financial instruments (Continued)

A Fair value (Continued)

d) Deposits from banks and other financial institutions

Due to their short-term maturity and insignificant risk of changes in value, the fair value of demand and time deposits is equal to their carrying amounts. The fair value of deposits with adjustable interest rate is their carrying amount.

e) Deposits from customers

The fair value of the sight deposits and deposits with adjustable interest rate is their carrying amount. The amount of deposits with fixed interest rates is nil, thus the carrying amount of total deposits of other customers approximates their carrying amount.

f) Borrowings

Fair value of borrowings with variable interest rate does not differ from its carrying value due to interest rate adjustment for specific financial liabilities with market interest rates for similar instruments. The fair value of credit lines regulated with special terms and for which the market does not provide reliable estimates of prices for similar instruments, approximately presents their carrying value.

B Fair value hierarchy

The Bank measures financial assets and liabilities at fair value, using fair value hierarchy which reflects the significance of inputs used in determining fair value. The fair value hierarchy includes the following levels:

a) Level 1 – Fair value is determined directly with reference to quoted market prices of the financial instruments in active markets;
b) Level 2 - Fair value is determined using valuation techniques that include active markets inputs, which can be direct, i.e. prices, or indirect, i.e. derived from prices;
c) Level 3 - Fair value is determined using valuation techniques that include inputs that cannot be directly or indirectly followed on the active markets, or are not observable.

For financial instruments carried at fair value, the level in the fair value hierarchy into which the fair values are categorised are as follows:

			In thousands of Denars December 31,2016	
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets at fair value through profit and loss				
- Debt and other fixed income investments securities	23,165	-	-	**23,165**
- Equity investments	384,567	-	-	**384,567**
Financial assets available-for-sale	-	-	-	
- Government bills	-	3,203,202	-	**3,203,202**
- Government bonds	-	407,040	-	**407,040**
Total assets	**407,732**	**3,610,242**	-	**4,017,974**

			In thousands of Denars December 31,2015	
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets at fair value through profit and loss				
- Debt and other fixed income investments securities	14,847	-	-	**14,847**
- Equity investments	353,904	-	-	**353,904**
Financial assets available-for-sale		-	-	
- Government bills	-	6,186,040	-	**6,186,040**
- Government bonds	-	950,996	-	**950,996**
Total assets	**368,751**	**7,137,036**	-	**7,505,787**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.5. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The operational risk includes legal risk, as well the risk of money laundering and terrorist financing, risk of inadequacy of IT systems and other operational risk.

Legal risk is current or prospective risk to the Bank's profit and own funds, caused by violation or non-adherence to the legal framework, agreements, prescribed practices, ethics standards, or as a result of misinterpretation of the regulations, rules, agreements and other legal documents.

The Bank had established a framework for managing the operational risk that is based on Strategy, Policy and Methodology; appropriate organizational structure and established process for managing this risk. The established framework allows within the various Bank processes to identify risks arising from these processes, their measurement and taking corrective actions in order to avoid the potential adverse effect on the financial results and capital position of the Bank. The adequacy of the established framework for managing operational risk is regularly reviewed.

The Bank is identifying and measuring the operational risk by analyzing the collected data on loss events and key risk indicators, as well as applying the method of self-assessment through a qualitative approach and analysis of external data losses at other banks.

The Bank sets the capital requirement for operational risk, using the standardized approach in accordance with the national legislation.

4.6. Capital management

The Bank's objectives regarding capital management, which is a broader concept than the 'equity' on the face of the statement of financial position are:

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

Capital adequacy and the use of regulatory capital are regularly monitored by the Bank's management, employing techniques prescribed by national regulatory authority, i.e. the National Bank of Republic of Macedonia (NBRM). The required information is submitted to regulatory authority on a quarterly basis.

In addition, the Bank has established a Process of determining the Internal Capital (PIC) in accordance with the Decision on risk management, prescribed by the NBRM. The process of determining the internal capital is based on adopted Policy and Procedures and within the process, the Bank:

• determines the internal capital required to cover the acceptable level of risk, in accordance with its risk profile and the size and complexity of current and future financial activities;
• is aiming to establish a sustainable level of capital in long term, taking into account the impact of all material risks, etc

4. FINANCIAL RISK MANAGEMENT (Continued)

4.6. Capital management (Continued)

The Bank determines its own funds and capital adequacy in accordance with the Methodology for determining capital adequacy and own funds prescribed by the NBRM. In accordance with the regulation, the credit risk weighted assets and the capital required for coverage of operational risks are calculated based on the standardized approach.

The regulatory authority requires that each bank has to maintain capital adequacy ratio above 8%.

The Bank's regulatory capital is divided in two groups:

- Tier 1 that includes: ordinary and non-cumulative non-voting shares and share premium, statutory reserves and retained earnings or loss, items as result of consolidation, less: intangible assets;
- Tier 2 that includes: cumulative non-voting shares and share premium, hybrid capital liabilities and subordinated liabilities.

Investments in other Banks or financial institutions and investments in insurance and re-insurance companies over 10% of capital of such institution are deducted from Tier 1 and Tier 2 capital to arrive at the regulatory capital.

Total risk-weighted asset is a sum of credit risk-weighted assets, currency risk weighted assets, operational risk weighted assets and other risk-weighted assets.

According to national regulations, credit risk-weighted assets (on-balance and off-balance) are distributed by appropriate risk weights according to the level of credit quality (credit rating) of the debtor, taking into consideration credit protection instruments.The capital adequacy ratio is calculated as a ratio between the Bank's regulatory capital and the risk weighted assets.

The table below summarizes the compositions of regulatory capital and the capital adequacy ratio of the Bank for the years ended 31 December 2016 and 2015 in accordance with the requirements of regulatory authority. During these two years, the Bank complied with all of the regulatory imposed capital requirements to which the Bank is subject.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.6. Capital management (Continued)

	In thousands of Denars December 31, 2016
Tier 1 capital	
Ordinary and non-cumulative non-voting shares and share premium	3,050,594
Statutory reserves and retained earnings or loss	6,708,773
Items as result of consolidation	-
Deductions from Tier 1 capital	(420)
Total qualifying Tier 1 capital	**9,758,947**
Tier 2 capital	
Cumulative non-voting shares and share premium	-
Hybrid capital liabilities	-
Subordinated liabilities	-
Revaluation reserves	4,937
Total qualifying Tier 2 capital	**4,937**
Deductions from regulatory capital	(259,256)
Total regulatory capital	**9,504,628**
Credit risk-weighted assets	**53,249,576**
FX risk-weighted assets	**1,454,050**
Operational risk-weighted assets	**7,710,206**
Other risks weighted assets	**-**
Capital adequacy ratio	**15.2%**

	In thousands of Denars December 31, 2015
Tier 1 capital	
Ordinary and non-cumulative non-voting shares and share premium	3,050,594
Statutory reserves and retained earnings or loss	6,468,549
Items as result of consolidation	-
Deductions from Tier 1 capital	(914)
Total qualifying Tier 1 capital	9,518,229
Tier 2 capital	
Cumulative non-voting shares and share premium	-
Hybrid capital liabilities	-
Subordinated liabilities	-
Total qualifying Tier 2 capital	-
Deductions from regulatory capital	(238,231)
Total regulatory capital	**9,279,998**
Credit risk-weighted assets	**59,137,539**
FX risk-weighted assets	**493,000**
Operational risk-weighted assets	**7,544,649**
Other risks weighted assets	**-**
Capital adequacy ratio	**13.8%**

5. SEGMENT REPORTING

Segment reporting is carried out by the Bank's operating segments.

Operating segment is a component of the activities of the Bank for which the following conditions have been fulfilled:

- Performs activities as a result based on which incomes are generated and expenditures arise;
- Is being reviewed by the Bank's Supervisory Board, in order to assess the accomplishments and make decisions for future business activities of the segment; and
- Financial information for the segment is available.

The Bank discloses the information independently for each significant operating segment. A segment is considered significant if:

- The income of the segment participates with more than 10% of the total income of the Bank;
- The amount of the profit or loss represents 10% or more from the total income of all operating segments which have made profit, or from the total loss of all the operating segments which have made loss;
- Total assets of the segment participate with 10% or more of the Bank's total assets;
- Management has assessed that they are significant to follow for the Bank's management needs.

For the purposes of the financial reporting, the Bank groups two or more segments into one operating segment if those operating segments are similar in terms of the variety of the goods and services, the type of the users of the goods and of the services and the methods of distribution and offering of the goods and services. As at December 31, 2016 and 2015 the Bank does not group two or more operating segments into one.

The operating segments of Komercijalna Banka are the same as the business lines (BL) prescribed in the "Decision on the methodology for determining capital adequacy", using the standardized approach for the determination of capital required for coverage of operational risk.

Geographical areas according to which the Bank is reporting are:

- Member countries of the European Union;
- Other European countries, outside the EU;
- Countries outside Europe, members of the Organization for Economic Cooperation and Development (OECD);
- Other countries.

As at December 31, 2016 and 2015 there are no significant clients upon which the Bank realizes 10% or more from its total business income or expenditure.

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
December 31, 2016

5. SEGMENT REPORTING (Continued)

A. Operating segments

December 31, 2016

In thousands of Denars	BL 1: Services related to financing of medium and large sized enterprises	BL 2: Trading and sales	BL 3: Retail banking	BL 4: Corporate banking	BL 5: Payment and settlement	BL 6: Custody services	BL 7: Asset management	BL 8: Retail brokerage	Other insignificant operating segments	Unallocated	Total
Net interest income	-	1,285	477,164	2,600,177	119	1	-	-	-	-	3,078,746
Net fee and commission income	-	1,879	81,553	161,070	593,435	23,596	-	2,752	-	(6)	864,279
Dividend income	-	6,106	-	104	-	-	-	-	-	-	6,210
Net gains/(losses) on financial instruments classified as held for trading	-	12,870	-	-	-	-	-	-	-	-	12,870
Other operating income	-	157,388	(20,855)	432,308	31,966	(8,863)	-	1	-	18,497	610,442
Share of profit of associates accounted for using the equity method	-	-	-	-	-	-	-	-	43,625	-	43,625
Income realized between the segments	-	-	-	-	-	-	-	-	-	-	-
Total income per segment	-	179,528	537,862	3,193,659	625,520	14,734	-	2,753	43,625	18,491	4,616,172
Net impairment losses on financial assets	-	-	(19,480)	(1,689,120)	-	-	-	-	-	-	(1,708,600)
Personnel expenses	-	(8,783)	(194,478)	(123,290)	(314,560)	(8,783)	-	(9,627)	-	(184,936)	(844,457)
Depreciation and amortization	-	(1,924)	(42,611)	(27,013)	(68,921)	(1,924)	-	(2,109)	-	(40,520)	(185,022)
Other operating expenses	-	(10,321)	(387,009)	(401,604)	(119,674)	(1,761)	-	(2,849)	-	(88,515)	(1,011,733)
Investments in property and equipment	-	-	-	-	-	-	-	-	-	-	-
Total expenses per segment	-	(21,028)	(643,578)	(2,241,027)	(503,155)	(12,468)	-	(14,585)	-	(313,971)	(3,749,812)
Financial result per segment	-	158,500	(105,716)	952,632	122,365	2,266	-	(11,832)	43,625	(295,480)	866,360
Income tax expense											(92,373)
Profit for the year											773,987
Total assets per segment	-	441,271	14,210,097	82,518,822	2,708,915	35,476	-	36,526	222,909		100,174,016
Unallocated assets per segment										729,398	729,398
Total assets											100,903,414
Total liabilities per segment	-	-	64,772,708	24,641,382	132,326	513,157	-	-	-		90,059,573
Unallocated liabilities per segment										149,798	149,798
Total liabilities											90,209,371

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
December 31, 2016

5. SEGMENT REPORTING (Continued)

A. Operating segments (Continued)

December 31, 2015

In thousands of Denars	BL 1: Services related to financing of medium and large sized enterprises	BL 2: Trading and sales	BL 3: Retail banking	BL 4: Corporate banking	BL 5: Payment and settlement	BL 6: Custody services	BL 7: Asset management	BL 8: Retail brokerage	Other insignificant operating segments	Unallocated	Total
Net interest income	-	156	306,241	2,871,030	142	(14)	-	-	-	-	3,177,555
Net fee and commission income	-	(2,279)	72,826	175,480	625,678	23,710	-	1,897	-	32	897,344
Dividend income	-	5,515	-	67	-	-	-	-	-	-	5,582
Net gains/(losses) on financial instruments classified as held for trading	-	7,177	-	-	-	-	-	-	-	-	7,177
Other operating income	-	204,237	(478,530)	633,167	12,365	(256)	-	5	-	36,082	407,070
Share of profit of associates accounted for using the equity method	-	-	-	-	-	-	-	-	39,028	-	39,028
Income realized between the segments	-	-	-	-	-	-	-	-	-	-	-
Total income per segment	-	214,806	(99,463)	3,679,744	638,185	23,440	-	1,902	39,028	36,114	4,533,756
Impairment charge for credit losses	-	-	(18,790)	(1,702,510)	-	-	-	-	-	-	(1,721,300)
Personnel expenses	-	(8,423)	(187,381)	(120,820)	(308,117)	(9,166)	-	(9,910)	-	(182,013)	(825,830)
Depreciation and amortization	-	(1,993)	(44,324)	(28,579)	(72,884)	(2,168)	-	(2,344)	-	(43,056)	(195,348)
Other operating expenses	-	(10,386)	(394,724)	(590,209)	(112,967)	(1,672)	-	(2,861)	-	(110,575)	(1,223,394)
Investments in property and equipment	-	-	-	-	-	-	-	-	-	-	-
Total expenses per segment	-	(20,802)	(645,219)	(2,442,118)	(493,968)	(13,006)	-	(15,115)	-	(335,644)	(3,965,872)
Financial result per segment	-	194,004	(744,682)	1,237,626	144,217	10,434	-	(13,213)	39,028	(299,530)	567,884
Income tax expense	-	-	-	-	-	-	-	-	-	-	(61,273)
Profit for the year	-										506,611
Total assets per segment	-	402,656	13,401,192	79,819,273	2,650,551	38,960	-	39,945	201,885		96,554,462
Unallocated assets per segment	-									770,640	770,640
Total assets	-										97,325,102
Total liabilities per segment	-	-	64,498,024	22,012,870	125,404	266,690	-	7	-		86,902,995
Unallocated liabilities per segment	-									213,295	213,295
Total liabilities	-										87,116,290

5. SEGMENT REPORTING (Continued)

B. Geographical areas

In thousands of Denars

December 31, 2016

	Republic of Macedonia	EU member countries	Europe (other)	OECD member countries (without EU members of OECD)	Other (insignificant geographical areas)	Unallocated	Total
Total income	4,566,933	21,763	15,069	12,035	360	12	4,616,172
Non-current assets*	3,740,965	-	-	-	-	-	3,740,965

In thousands of Denars

December 31, 2015

Total income	4,213,023	138,804	147,318	34,999	(2,065)	1,677	4,533,756
Non-current assets*	4,502,394	-	-	-	-	-	4,502,394

*Non-current assets include items of property and equipment, investment property, intangible assets and assets acquired through foreclosure procedure.

6. NET INTEREST INCOME

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Interest and similar income		
Loans and advances:		
- To banks	4,729	12,684
- To customers	3,208,185	3,547,729
Cash and cash equivalents	258,597	226,950
Investment securities	164,744	107,435
Other	708	-
	3,636,963	**3,894,798**
Interest expense and similar charges		
Deposits from banks and other financial institutions	21,969	19,164
Deposits from other customers	518,240	676,356
Other borrowed funds	18,008	21,723
	558,217	**717,243**

Interest income from collected previously written off interest amounts to Denar 264,535 thousand (2015: Denar 377,745 thousand).

As at 31 December 2016 the interest income from financial assets at fair value through profit or loss is Denar 577 thousand (2015: Denar 156 thousand).

7. NET FEE AND COMMISSION INCOME

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Fee and commission income		
Payment operations		
-in the country	377,465	386,559
- abroad	197,686	206,287
Letters of credit and guarantees	171,770	174,818
Credit cards	210,716	187,752
Brokerage fees	4,956	2,824
Fiduciary activities	25,863	23,749
Banking services	71,847	73,319
Other	51,642	47,832
	1,111,945	**1,103,140**
Fee and commission expense		
Loans	153,339	117,510
Payment operations		
-in the country	67,122	65,192
-abroad	13,533	12,661
Brokerage fees	704	717
Fiduciary activities	2,082	1,070
Other	10,886	8,646
	247,666	**205,796**

8. NET GAINS/(LOSSES) ON FINANCIAL INSTRUMENTS CLASSIFIED AS HELD FOR TRADING

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
Gains/(losses) from changes in fair value of equity securities, net (realized/unrealized)	12,870	7,177
Net (losses)/gains on financial instruments classified as held for trading	**12,870**	**7,177**

9. OTHER OPERATING INCOME

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
Membership fee for credit cards	37,781	37,660
Net foreign currency transactions	30,833	62,422
Rental income	9,878	15,858
Collected previously written off receivables	286,624	99,412
Gain on sale of property and equipment	107	457
Gain on sale of assets acquired through foreclosure procedures	101,265	26,198
Other	18,475	33,792
	484,963	**275,799**

The amount of MKD 286,624 thousand in 2016 in the line Collected previously written off receivables is derived from the collection of the receivables that the Bank has written off during the 2016, according the Decision for amending the Decision for managing the credit risk from NBRM (Official Gazette 223/16), i.e. after the fulfilment of the condition two year to be passed from date the Bank was required to fully impair the receivable.

The amount of MKD 101,265 thousand in 2016 in the line “Capital gain from the sale of foreclosed assets” results from sale of several foreclosed assets (production line, catering facility and commercial building), while in 2015 a significant part of the capital gain was from sale of a single industrial facility.

10. PERSONNEL EXPENSES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Wages and salaries	579,564	568,592
Contributions to defined contribution plans	208,486	205,722
Other staff costs	56,407	51,516
	844,457	**825,830**

11. OTHER OPERATING EXPENSES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Insurance premiums for deposits	306,446	306,944
Services	168,119	164,637
Administration and marketing costs	71,738	77,048
Materials	73,055	81,952
Loss on sale of assets acquired through foreclosure procedure	909	1,046
Tax and contributions	2,270	2,235
Court litigation expenses	4,721	8,165
Provisions for pension and other employee benefits, net	2,021	11,510
Loss from sale of securities available-for-sale	362	84
Other	28,237	16,655
	657,878	**670,276**

12. NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Loans and advances to banks (Note 19)	(677)	715
Loans and advances to customers (Note 20)	1,711,191	1,712,291
Other assets (Note 25)	35,187	35,071
Contingencies and commitments (Note 32)	(37,171)	(26,382)
Cash and Cash equivalents (Note 15)	70	(395)
	1,708,600	**1,721,300**

13. INCOME TAX EXPENSE

The major components of income taxes in profit or loss are as follows:

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Current tax expense		
Current year	92,973	63,329
Deferred tax expense		
Origination of temporary differences	(600)	(2,056)
Total income tax expenses	**92,373**	**61,273**

The total charge for the year can be reconciled to the accounting profit as follows:

	In %	December 31, 2016	In %	In thousands of Denars December 31, 2015
Profit before tax		**866,360**		567,884
Tax calculated at a tax rate of 10% (2015: 10%)	10.00	86,636	10.00	56,788
Non-deductible expenses	0.7	6,348	0.9	5,037
Tax-exempt income	(0.1)	(611)	(0.1)	(552)
Income tax expense	**10.6**	**92,373**	**10.8**	**61,273**

Recognised deferred tax liabilities

Deferred tax liabilities are attributable to the following:

In thousands of denars	Assets	Liabilities	Net	Assets	Liabilities	Net
		2016			**2015**	
Assets acquired through foreclosure procedures	-	(16,637)	(16,637)	-	(17,237)	(17,237)
Available-for-sale financial assets	-	(617)	(617)	-	(1,048)	(1,048)
Net tax assets (liabilities)	**-**	**(17,254)**	**(17,254)**	**-**	**(18,285)**	**(18,285)**

13. INCOME TAX EXPENSE (CONTINUED)

Movements in temporary differences during the year

In thousands of denars	Net balance at 1 January	Recognised in profit or loss	Recognised in OCI	Balance at 31 December
2016				
Assets acquired through foreclosure procedures	17,237	(600)	-	16,637
Available-for-sale financial assets	1,048	-	(431)	617
	18,285	**(600)**	**(431)**	**17,254**

14. EARNINGS PER SHARE

The calculation of earnings per share for the year ended 31 December 31 2016 was based on the net profit attributable to ordinary shareholders of Denar 773,987 thousand (2015: Denar 506,611 thousand) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2016 of 2,279,067 shares (2015: 2,279,067 shares). The calculation of the basic and diluted earnings per share is:

	December 31, 2016	December 31, 2015
Net profit attributable to shareholders for basic and diluted earnings per share (in thousands of Denars)	773,987	506,611
Weighted average number of shares for basic and diluted earnings per share	2,279,067	2,279,067
Basic earnings per share (in Denars)	340	222
Diluted earnings per share (in Denars)	340	222

The calculation of the weighted average number of ordinary shares for the years ended December 31, 2016 and 2015 is as follows:

	Number of shares	
	2016	**2015**
Issued ordinary shares at 1 January	2,279,067	2,279,067
At 31 December	**2,279,067**	**2,279,067**

15. CASH AND CASH EQUIVALENTS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Cash on hand	1,542,569	1,365,782
Accounts and deposits with NBRM, except mandatory reserves in foreign currency	5,154,588	3,238,591
Current accounts with local banks	885	8,492
Current accounts with foreign banks	5,977,886	5,453,004
Time deposits held with banks up to 3 months	10,110,239	7,054,341
Treasury bills up to 3 months	5,778,123	6,299,613
Other short term highly liquid investments	1,650	2,952
Included in cash and cash equivalents	**28,565,940**	**23,422,775**
Restricted accounts	769,354	208,796
Mandatory reserves in foreign currency	4,203,376	4,032,146
	33,538,670	**27,663,717**

The level of mandatory reserves in foreign currency held with the Central Bank in the amount of Denar 4,203,376 thousand (2015: Denar 4,032,146 thousand) is determined by the Decision for mandatory reserves prescribed by the Central Bank. Those reserves are calculated based on the average amount of deposits in foreign currencies existing during one calendar month. The Central Bank does not pay any interest on these reserves.

Accounts and deposits with NBRM, except mandatory reserves in foreign currency in the amount of Denar 5,154,588 thousand (2015: Denar 3,238,591 thousand) represent current account in Denars with NBRM. The Central Bank does not pay any interest on these reserves.

Time deposits up to 3 months in the amount of Denar 10,110,239 thousand (2015: Denar 7,054,341 thousand) relate to deposits placed with domestic and foreign banks, with original maturities from 1 day to 3 months, bearing interest at rates in the range from 0,01% to 2,3% per annum (2015 from 0.01% to 2.5% p.a.).

Treasury bills up to 3 months in the amount of Denar 5,778,123 thousand (2015: Denar 6,299,613 thousand) are debt securities issued by the National Bank of Republic of Macedonia with maturity of 28 days, bearing interest at rate of 3.75% per annum (2015: 3.25% p.a.).

Restricted accounts in the Denar 769,354 thousand (2015: Denar 208,796 thousand) represent collateral for Visa International and MasterCard and collateral for custody activities.

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	2016	2015
Balance at 1 January	**66**	**461**
Net charge/(release) to profit or loss (Note 12)	70	(395)
Balance at 31 December	**136**	**66**

16. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

	In thousands of Denars	
Held for trading	December 31, 2016	December 31, 2015
Debt securities		
Government bonds	23,165	14,847
Total debt securities	**23,165**	**14,847**
Equity investments	384,567	353,904
	407,732	**368,751**

Government bonds in the amount of Denar 23,165 thousand (2015: Denar 14,847 thousand) refers to structural government bonds, bearing interest at the rate of 2% per year.

The quoted equity investments held for trading in the amount of Denar 68,551 thousand (2015: Denar 47,244 thousand) relates to investments in shares issued by domestic banks in the amount of Denar 99 thousand (2015: Denar 66 thousand) and investments in shares issued by domestic non-financial entities in the amount of Denar 68,452 thousand (2015: Denar 47,178 thousand).

The other unquoted equity investments in the amount of Denar 316,016 thousand (2015: Denar 306,660 thousand) relate to investments in the open-end investment fund KB Publikum – Balansiran in the amount of Denars 8,348 thousand (2015: Denar 7,241 thousand) and investments in the open-end investment fund KB Publikum - Paricen in the amount of Denar 307,668 thousand (2015: Denar 299,419 thousand).

17. FINANCIAL ASSETS AVAILABLE-FOR-SALE

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Government bills	3,203,202	6,186,040
Government bonds	407,040	950,996
Equity investments	77,726	80,335
	3,687,968	**7,217,371**
Less: Specific allowance for impairment	-	(2,624)
	3,687,968	**7,214,747**

Investments in available-for-sale debt securities includes government bills in the amount of 3,203,202 thousands of denars (2015: 6,186,040 thousands of denars) as well as government bonds in the amount of 407,040 thousands of denars (2015: 950,996 thousands of denars).

The investments in equity instruments available-for-sale in the amount of 77,726 of thousands of denars (2015: 80,335 thousands of denars) includes the amount of 64,988 thousand of denars (2015: 67,597 thousands of denars) related to the investments in securities issued by financial institutions for which there is no active market, as well as a lack of recent transactions that could be applied in determination of the fair value. Accordingly, investments in these available-for-sale securities are stated at their cost, less any impairment.

In addition, other equity instruments available for sale includes investment in a subsidiary in the amount of 12,738 thousands of denars (2015: 12,738 thousands of denars). The significant subsidiary of the Bank is KB Publikum Invest AD Skopje. Its principle place of business is the Republic of Macedonia. The Bank holds 64.29% of ownership interest (2015: 64.29%) which is equal to 64.29% (2015: 64.29%) of the voting rights

The Bank does not plan to sell those investments whose operations are related to the regular operations of the Bank, while the rest of the investments will be sold only when the Bank will estimate that there are favourable conditions at the capital market for their disposal.

17. FINANCIAL ASSETS AVAILABLE-FOR-SALE (Continued)

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	Year ended December 31 2016	Year ended December 31 2015
Balance at 1 January	2,624	2,624
Write off	(2,624)	-
Balance at 31 December	**-**	**2,624**

18. FINANCIAL ASSETS HELD-TO-MATURITY

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Government bonds	598,885	2,516
Government bills	2,775,844	-
	3,374,729	**2,516**

The bonds issued by the Government of the Republic of Macedonia in the amount of 598,885 thousands of denars (2015: 2,516 thousands of denars) include bonds for denationalisation VI emission in the amount of 568 thousand denars (2015: 2,516 thousands of denars) with maturity in 2017 (2015: 2017), which bear interest at an annual rate of 2% (2015: 2% annually) and government bonds in the amount of 598,317 thousands of denars (2015: nil) with maturity up to 2018 which bear interest at an annual rate of 2,7%.

The bills issued by the Government of the Republic of Macedonia in the amount of 2,775,844 thousands of denars (2015: nil) bear interest at an annual rate from 2,2% to 2,6%.

Total current portion of the financial assets held-to-maturity amounts to Denar 2,777,737 thousand (2015: Denar 1,953 thousand).

19. LOANS AND ADVANCES TO BANKS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Placements with foreign banks	10,067,105	9,066,993
Placements with domestic banks	18,311	143,317
	10,085,416	**9,210,310**
Less: Specific allowance for impairment	(1,207)	(1,884)
	10,084,209	**9,208,426**

Total current portion of the loans and advances to banks amounts to Denar 9,129,398 thousand (2015: Denar 8,251,857 thousand).

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	2016	2015
Balance at 1 January	1,884	1,169
Net charge/(release) to profit or loss (Note 12)	(677)	715
Balance at 31 December	**1,207**	**1,884**

20. LOANS AND ADVANCES TO CUSTOMERS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Individuals (retail customers):		
- Overdrafts	1,155,863	1,344,399
- Credit cards	1,099,519	1,307,334
- Term loans	11,180,282	10,849,770
	13,435,664	13,501,503
Corporate entities:		
- Large corporate customers	21,500,996	20,553,029
- SMEs	18,224,544	25,826,380
	39,725,540	46,379,409
	53,161,204	59,880,912
Less: Allowance for impairment	(7,893,050)	(12,236,390)
	45,268,154	**47,644,522**
Current	18,084,655	20,561,201
Non- current	27,183,499	27,083,321

20. LOANS AND ADVANCES TO CUSTOMERS (Continued)

Loans and advances to customers include accrued interest and other receivables of Denar 193,005 thousand (2015: Denar 248,196 thousand).

Out of the total loans and advances to other customers the Bank has pledged a lien with regard to the sub-loans approved from the credit line of the European Investment Bank ("EIB"), and from the Italian credit line (IKL), in favour of MBDP. As at 31 December 2016 the amount of the pledged loans and advances is in the amount of 1,593,485 thousands of denars (2015: 1,980,236 thousands of denars).

Movement of allowance for impairment is as follows:

Retail customers

			In thousands of Denars	
	Overdrafts	**Credit cards**	**Loans**	**Total**
Balance at 1 January 2015	199,909	270,123	629,243	1,099,275
Net charge/(release) to profit or loss (Note 12)	(1,691)	(15,655)	17,792	446
Balance at 1 January 2016	**198,218**	**254,468**	**647,035**	**1,099,721**
Net charge/(release) to profit or loss (Note 12)	19,709	(11,703)	110,028	118,034
Write off	(147,088)	(176,751)	(427,454)	(751,293)
Balance at 31 December 2016	**70,839**	**66,014**	**329,609**	**466,462**

Corporate entities

			In thousands of Denars
	Large corporate customers	**SMEs**	**Total**
Balance at 1 January 2015	**2,799,304**	**6,593,578**	**9,392,882**
Net charge/(release) to profit or loss (Note 12)	696,819	1,015,026	1,711,845
Release upon foreclosure procedures	-	81,266	81,266
Write off	-	(49,324)	(49,324)
Balance at 1 January 2016	**3,496,123**	**7,640,546**	**11,136,669**
Net charge/(release) to profit or loss (Note 12)	(214,950)	1,808,106	1,593,156
Release upon foreclosure procedures	-	(3,914)	(3,914)
Write off	-	(5,299,323)	(5,299,323)
Balance at 31 December 2016	**3,281,173**	**4,145,415**	**7,426,588**

The increase in the amount of write offs is a results of the Decision for amending the decision for managing the credit risk (Official Gazette No. 223/16), according to which the Bank was required to write off the credit exposures after two years when the Bank was required to allocate allowance for impairment of 100%. As a result an amount of Denar 6,050,616 thousand (Note 20) was written off and other receivables in the amount of Denar 157,152 thousand (See note 25) were written off, as well.

21. INVESTMENTS IN ASSOCIATES

The Bank owns 49% of equity interest which is equal to 49% of the voting rights in KB Prvo Penzisko Drustvo AD Skopje. The principle place of business of KB Prvo is Republic of Macedonia.

The shares of KB Prvo Penzisko Drustvo AD Skopje are not publicly listed and consequently do not have published price quotations.

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
KB Prvo Penzisko Drustvo AD Skopje	189,147	157,652
Share of results for the year ended 31 December	43,625	39,028
Dividends received	(22,601)	(7,533)
	210,171	**189,147**

Summary financial information on the associates is presented below:

	In thousands of Denars December 31, 2016					
	Assets	**Liabilities**	**Equity**	**Revenues**	**Profit/Loss**	**Interest held**
KB Prvo Penzisko Drustvo AD Skopje	440,011	17,856	422,155	225,751	89,031	49%
	440,011	**17,856**	**422,155**	**225,751**	**89,031**	

	In thousands of Denars December 31, 2015					
	Assets	**Liabilities**	**Equity**	**Revenues**	**Profit/Loss**	**Interest held**
KB Prvo Penzisko Drustvo AD Skopje	394,212	14,963	379,249	204,442	79,649	49%
	394,212	**14,963**	**379,249**	**204,442**	**79,649**	

There are no significant restrictions on the ability of the associates to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

22. PROPERTY AND EQUIPMENT

In thousands of Denars

	Land and Buildings	Furniture & Equipment	Assets in course of construction	Leasehold improvements	Total
Carrying amount 1 January 2015	2,840,703	268,737	27,739	19,123	3,156,302
Additions	-	-	61,164	-	61,164
Transfers	25,417	45,192	(70,609)	-	-
Disposals and write off				(126)	(126)
Depreciation charge	(77,445)	(94,178)	-	(8,086)	(179,709)
Carrying amount 31 December 2015	**2,788,675**	**219,751**	**18,294**	**10,911**	**3,037,631**
At 31 December 2015					
Cost	3,231,673	1,224,422	18,294	61,560	4,535,949
Accumulated depreciation	(442,998)	(1,004,671)	-	(50,649)	(1,498,318)
Carrying amount for 31 December 2015	**2,788,675**	**219,751**	**18,294**	**10,911**	**3,037,631**
Carrying amount 1 January 2016	2,788,675	219,751	18,294	10,911	3,037,631
Additions	-	-	78,462	-	78,462
Transfers	7,952	60,157	(74,138)	1,639	(4,390)
Disposals and write off	-	-	-	(114)	(114)
Depreciation charge	(78,097)	(86,270)	-	(6,165)	(170,532)
Carrying amount 31 December 2016	**2,718,530**	**193,638**	**22,618**	**6,271**	**2,941,057**
At 31 December 2016					
Cost	3,238,425	1,222,062	22,618	56,001	4,539,106
Accumulated depreciation	(519,895)	(1,028,424)	-	(49,730)	(1,598,049)
Carrying amount 31 December 2016	**2,718,530**	**193,638**	**22,618**	**6,271**	**2,941,057**

The amount of commitments for the purchase of property and equipment in 2016 amounts to Denar 1,250 thousand (2015: Denar 7,503 thousand). As at 31 December 2016 and 31 December 2015 the Bank does not have any property and equipment pledged as collateral.

23. INVESTMENT PROPERTY

	In thousands of Denars	
	2016	2015
At 1 January		
Cost	33,510	33,510
Accumulated depreciation	(5,725)	(4,887)
Carrying amount	**27,785**	**28,623**
Carrying amount 1 January	27,785	28,623
Depreciation charge	(837)	(838)
Carrying amount 31 December	**26,948**	**27,785**
At 31 December		
Cost	33,510	33,510
Accumulated depreciation	(6,562)	(5,725)
Carrying amount	**26,948**	**27,785**

Fair value of investment property amounts to Denar 28,437 thousand as at December 31, 2016 (2015: Denar 29,019 thousand).

Investment property comprises of property leased by Komercijalna Banka AD Skopje. The lease contains an initial non-cancellable period of 90 days. The contract is on indefinite period. The fair value of investment property was determined by property valuation specialist, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued. The valuation specialist provide the fair value of the Bank's investment property portfolio once a year.

Certified property valuators, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued, determined the fair value of the investment property.

The fair value measurement of investment property has been categorised as a Level 3 fair value based on the inputs to the valuation technique used.

Valuation technique and significant unobservable inputs

The following table shows the valuation technique used in measuring the fair value of investment property, as well as the significant unobservable inputs used.

Valuation technique	*Significant unobservable inputs*	*Inter-relationship between key unobservable inputs and fair value measurement*
Discounted cash flows: The valuation model considers the present value of net cash flows to be generated from the property, taking into account expected rental growth rate, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discount rates. Among other factors, the discount rate estimation considers the quality of a building and its location (prime vs secondary) and lease terms.	• Expected market rental growth (2%). • Occupancy rate (100%, based on signed leased contracts with the Bank) • Risk-adjusted discount rates (8%)	The estimated fair value would increase (decrease) if: ••expected market rental growth were higher (lower); ••the occupancy rate were higher (lower); or ••the risk-adjusted discount rate were lower (higher).

24. INTANGIBLE ASSETS

	In thousands of Denars	
	2016	2015
Cost		
Balance at 1 January	280,551	263,174
Additions	11,033	17,377
Disposals and write offs	(4,390)	-
Balance at 31 December	**287,194**	**280,551**
Accumulated amortisation		
Balance at 1 January	239,287	224,486
Charge for the year	13,653	14,801
Disposals and write-offs	(4,390)	-
Balance at 31 December	**248,550**	**239,287**
Carrying amount at 31 December	**38,644**	**41,264**
Carrying amount at 1 January	**41,264**	**38,688**

As at 31 December 2016 the Bank does not have any commitments for the intangible assets (31 December 2015: none).

25. OTHER ASSETS

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
Credit card receivables	296,760	199,872
Other bad and doubtful receivables	60,652	170,744
Trade receivables	199,483	227,243
Receivable from insurance company	7,806	7,821
Inventory of office materials	16,333	18,941
Inventory of numismatic collections	16,842	18,063
Fee and commission receivables	37,401	46,024
Advances for property and equipment	975	-
Other assets	41,337	51,496
	677,589	**740,204**
Less: Allowance for impairment	(86,773)	(209,322)
	590,816	**530,882**

The current portion of other assets amounts to Denar 589,055 thousand (2015: Denar 525,563 thousand).

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	Year ended December 31 2016	**Year ended December 31 2015**
Balance at 1 January	209,322	179,250
Net charge/(release) to profit or loss (Note 12)	35,187	35,071
Release/additional upon foreclosure procedures	(584)	-
Write-off	(157,152)	(4,999)
Balance at 31 December	**86,773**	**209,322**

The increase in the amount of write offs is a results of the Decision for amending the decision for managing the credit risk (Official Gazette No. 223/16), according to which the Bank was required to write off the exposures after two years when the Bank was required to allocate allowance for impairment of 100%. Because of this, an amount of Denar 157,152 thousand of other receivables was written off.

26. ASSETS ACQUIRED THROUGH FORECLOSURE PROCEDURES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Foreclosed collateral		
Land	63,280	100,446
Buildings	576,720	1,131,749
Residential buildings and apartments	47,795	85,833
Other	46,521	77,686
	734,316	**1,395,714**

The fair value of the acquired assets through foreclosure procedure as at 31 December 2016 is in the amount of 1,346,020 thousands of denars (as at 31 December 2015 is in the amount of 2,055,462 thousands of denars).

Certified property valuators, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued, determined the fair value of foreclosed assets.

The fair value measurement for foreclosed assets has been categorised as a Level 3 fair value based on the inputs to the valuation technique used.

Valuation technique and significant unobservable inputs

The following table shows the valuation technique used in measuring the fair value of foreclosed assets, as well as the significant unobservable inputs used.

Valuation technique	*Significant unobservable inputs*	*Inter-relationship between key unobservable inputs and fair value measurement*
Discounted cash flows: The valuation model considers the present value of net cash flows to be generated from the property, taking into account expected rental growth rate, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discount rates. Among other factors, the discount rate estimation considers the quality of a building and its location (prime vs secondary) and lease terms.	• Expected market rental growth (2%). • Occupancy rate (58% - 80% for business facilities and warehouses (2015: 25%-65% depending on the season, for hotels, and 58% - 80% for business facilities and warehouses)) • Risk-adjusted discount rates (8%, 10%,13 depending on the type of real estate which is estimated, 8% for residential, retail and office facilities, 10-13% for logistics and warehouses (2015: 8%, 9,5%,13 depending on the type of real estate which is estimated, 8% for hotels, 9,5% for business facilities, 13% for warehouses))	The estimated fair value would increase (decrease) if: ••expected market rental growth were higher (lower); ••the occupancy rate were higher (lower); or ••the risk-adjusted discount rate were lower (higher).

27. DEPOSITS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Demand deposits		
Banks and other financial institutions	642,600	425,122
Insurance companies	84,367	80,479
Time deposits		
Banks and other financial institutions	564,372	241,735
Insurance companies	378,009	398,274
Restricted deposits		
Banks and other financial institutions	-	232,208
Insurance companies	6,954	4,005
	1,676,302	**1,381,823**
Current	1,533,042	1,104,867
Non-current	143,260	276,956

Deposits from banks and other financial institutions include accrued interest payable of Denar 3,737 thousand (2015: Denar 1,100 thousand).

28. DEPOSITS FROM OTHER CUSTOMERS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Public institutions		
Current / settlement accounts	221,529	243,836
Time deposits	75,888	-
Companies		
Current / settlement accounts	20,178,995	17,080,111
Time deposits	2,313,893	2,584,483
Retail customers		
Current / demand accounts	18,482,170	16,154,091
Time deposits	42,673,163	44,755,766
Restricted deposits		
Citizens	1,310,925	1,180,080
Companies	858,774	839,323
	86,115,337	**82,837,690**

Deposits from other customers include accrued interest payable of Denar 249,216 thousand (2015: Denar 286,325 thousand).

Restricted deposits in the total amount of Denar 2,169,699 thousand (2015: Denar 2,019,403 thousand) relate to Deposits from other customers, placed for payments abroad, letters of credit, deposits placed as collateral for securing repayment of loans and guarantees, and received early repayments of loans.

Current portion of deposits from other customers amounts to Denar 79,008,187 thousand (2015: Denar 75,867,447 thousand).

29. BORROWINGS

	In thousands of Denars			
	December 31, 2016		December 31, 2015	
	Short-term	Long-term	Short-term	Long-term
Domestic borrowings:				
MBDP (Macedonian Bank for Development Promotion)	68	10,606	111	15,405
MBPR- ZKDF (Macedonian Bank for Development Promotion funds granted from Agriculture Credit Discount Fund)	8,148	15,953	19,934	60,376
Agency for Managing Accounts	-	115,970	-	115,970
NBRM- Primary issue	-	8,809	-	8,809
Foreign borrowings administered through domestic financial and government institutions:				
MBDP – IKL (Macedonian Bank for Development Promotion funds granted from Italian Credit Line)	72	11,374	135	21,250
MBDP – EIB (Macedonian Bank for Development Promotion funds granted from EIB)	3,105	1,456,518	3,578	1,904,143
MF - FSR (Ministry of finance funds granted from former lender Council of Europe Social Development Fund)	8	7,859	19	15,746
	11,401	**1,627,089**	**23,777**	**2,141,699**
Foreign borrowings:				
MIDF B.V	13	12,019	-	-
	13	**12,019**	**-**	**-**
Current	467,877	-	598,506	-
Non-current	-	1,182,645	-	1,566,970

Borrowings include accrued interest payable of Denar 3,296 thousand (2015: Denar 3,944 thousand). Current portion of long-term borrowings is Denar 456,463 thousand (2015: Denar 574,729 thousand).

29. BORROWINGS (Continued)

Creditor	Currency	Interest rate	Year of maturity	Type of security
MBDP	MKD/EUR	3.0%	According to the agreements concluded with final users	4 bills of exchange
MBDP – IKL	EUR	3%	According to the agreements concluded with final users	12 bills of exchange * Pledge of receivables under sub-loan agreements with final users in the form of Notary deed
MBDP – ZKDF	MKD/EUR	0.5%	According to the agreements concluded with final users	3 bills of exchange
MF – FSR	EUR	3 months EURIBOR + 1.44%;	30.05.2017	3 bills of exchange
NBRM – Primary issue	MKD	-	2020	1 bill of exchange
MBDP - EIB	EUR	1%	According to the agreements concluded with final users	16 bills of exchange in form of Notary deed * Pledge of receivables under sub-loan agreements with final users in the form of Notary deed
Agency for Managing Accounts	MKD	-	2020	unsecured
MIDF B.V	EUR	6,5% fixed, 5% adjustable	According to the agreements concluded with final users	unsecured

The Bank has pledged a lien in the form of a notary deed in favour of MBDP based on receivables from sub-loan agreements concluded with final users approved from the credit lines with EIB and IKL, both administered through MBDP. As at 31 December 2016 the amount of borrowings for which the Bank has pledged receivables is 1,368,652 thousands of denars (2015: 1,597,845 thousands denars).

30. OTHER LIABILITIES

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
Credit card liabilities	284,998	170,426
Liabilities to Ministry of Finance	9,585	11,885
Suppliers payable	17,364	24,087
Advances received	17,198	2,464
Fee and commission	7,913	8,333
Provision for pension and other employee benefit	53,218	56,094
Liabilities for VAT	2,829	30,755
Undistributed foreign payments from legal companies and citizens	118,827	117,757
Other liabilities	86,403	90,494
	598,335	**512,295**
Current	549,600	487,948
Non-current	48,735	24,347

31. EQUITY

(a) Share capital

	In number of issued shares			
	Ordinary shares		Non-voting shares	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
In number of shares				
At 1 January	2,279,067	2,279,067	-	-
At 31 December	**2,279,067**	**2,279,067**	**-**	**-**

At 31 December 2016 the authorized share capital comprised of 2,279,067 (2015: 2,279,067) ordinary shares. Ordinary shares have a par value of Denar 1,000 (2015: Denar 1,000). All issued shares are fully paid. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at Shareholders' Assembly of the Bank. All shares rank equally with regard to the Bank's residual assets.

According to the Bank's shareholders book as at 31 December 2016, on 102,951 ordinary shares i.e 4.52% from the total shareholder capital of the Bank (as at 31 December 2015, 128,228 ordinary shares i.e. 5.63%) there is limitation of the rights established based on the law and/or Decision or act of the competent body (for example limitation of the vote right according to the Governor decision).

As at 31 December 2016 the Bank does not hold treasury shares. The Open-end Investment Fund KB Publikum – Balansiran managed by the Bank's subsidiary, KB Publikum Invest AD owns 2,109 shares, i.e. 0.0925% of the total share capital of the Bank (as at 31 December 2015 owns 2,109 shares, i.e. 0.0925%).

The below stated shareholders have more than 5% ownership of the Bank's ordinary shares:

	In %	
Shareholder	**December 31, 2016**	**December 31, 2015**
East Capital Explorer Investments AB, Stockholm	10.0	10.0
European Bank for Reconstruction and Development, London	5.25	5.25

(b) Reserves

Statutory reserve

Under local statutory legislation, the Bank is required to set aside 5 percent of its net profit for the year in a statutory reserve until the level of the reserve reaches 1/10 of the court registered capital. Until achieving the minimum required level the statutory reserve could only be used for loss recovery. When the statutory reserve exceeds the minimum required level and when all losses are covered, the statutory reserve can also be used for distribution of dividends, based on a decision of the shareholders' meeting, but only if the amount of the dividends for the current business year has not reached the minimum for distribution as prescribed in the Trade Company Law or by the Bank's Statute. The Bank has reached the regulatory minimum.

Other reserves

The other reserves are formed in addition to statutory reserve, based on decisions by the bodies of the Bank for distribution of profit, and can be used to cover certain losses or for other expenses.

(c) Dividends

The following dividends were recognised as distributions to owners during the year ended 31 December.

	In thousands of Denars	
	December 31, 2016	December 31, 2015
125 Denars per ordinary share	284,883	-

31. EQUITY (continued)

(c) Dividends

Announced dividend after the balance sheet date (the liabilities for dividends are not shown in the Balance sheet).

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Announced dividends after December 31	341,860	284,883

	In Denars	
	December 31, 2016	December 31, 2015
Dividend per ordinary share	150	125

32. CONTIGENCIES AND COMMITMENTS

(a) Off-balance sheet items

The following table indicates the contractual amounts of the Bank's contingencies and commitments by category:

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Guarantees		
in domestic currency	5,902,083	5,343,035
in foreign currency	2,906,502	3,379,319
	8,808,585	**8,722,354**
Letters of credit	924,074	2,237,829
Unused credit card limits	1,177,461	1,247,322
Unused overdrafts on current accounts	1,766,422	1,751,450
Unused credit limits - non cancellable	1,532,802	1,637,888
Total	**14,209,344**	**15,596,843**
Less: provision for off-balance sheet items	(112,577)	(149,748)
	14,096,767	**15,447,095**

The Bank provides banks guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to one year. Expirations are not concentrated in any period.

These commitments and contingent liabilities have off balance-sheet credit risk because only organisation fees and accruals for probable losses are recognised in the statement of financial position until the commitments are fulfilled or expire. Many of the contingent liabilities and commitments will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows.

Movement in provision is as follows:

	In thousands of Denars
	Year ended December 31 2016
Balance at January 1, 2016	149,748
Additional provisions during the year	184,158
(release of provisions during the year)	(221,203)
Exchange rate effect	(126)
As at 31 December 2016	**112,577**

32. CONTIGENCIES AND COMMITMENTS (continued)

(b) Litigations

For part of the contingent liabilities in the amount of 248,724 thousands of denars there is a litigation proceeding upon issued letter of guarantee for Granit AD Skopje. The case was initiated in front of an authorized court in Poland on September 16th 2011 by the State Treasury – General Directorate for National Roads and Motorways from Warsaw (beneficiary of the guarantee) against Komercijalna Banka AD Skopje, which was received in the Bank on July 2nd 2012, requesting a payment upon the issued letter of guarantee in the amount of 17.897.404,09 PLN, equivalent to 248,724 thousands of denars. The letter of guarantee was issued based on a contract for building a motorway concluded on May 5th, 2010 between the plaintiff (State Treasury – General Directorate for State Roads and Motorways) and Granit AD Skopje (requestor of the guarantee).

The guarantee has been activated and a payment is requested as a result of a breach of contract for building a motorway between the State Treasury – General Directorate for National Roads and Motorways of Warsaw and Granit AD Skopje. There is a separate legal dispute related to this contract, which is handled in front of the authorized court in Warsaw, Poland. On 7th of March 2016, the court passed a verbal verdict in which it ruled in favour of the plaintiff and ordered Komercijalna banka AD Skopje to pay the amount under the activated guarantee, interest and court expenses. The verdict was appealed and the procedure is in decision making stage by higher court.

The Bank has not performed a payment upon this issued letter of guarantee as a result of a Decision for temporary suspension issued on the 4th of February 2011 by the Basic Court in Skopje 2, on request of Granit AD Skopje. The temporary suspension prohibits the beneficiary of the guarantee to undertake any activities which would protest or enforce the guarantee, at the same time imposing a restriction on the Bank to make payments upon the issued letter of guarantee. The Bank has an obligation to follow the ruling of the Macedonian court, as long as it is in force. If the Bank is to make a payment upon this issued letter of guarantee, the amount will be transformed into a receivable from Granit AD Skopje, and the Bank's Management does not expect collection problems and adverse financial effects.

33. RELATED PARTY TRANSACTIONS

Persons related to the Bank are the following: persons with special rights and responsibilities and persons related thereto (classified as key management personnel), shareholders with qualified holding in the Bank (direct or indirect ownership of at least 5% of the total number of shares or the issued voting shares in a Bank or which makes it possible to exercise a significant influence in the Bank) and entities related thereto and responsible persons of those shareholders – legal entities (classified as other related parties). In addition, the Bank has investments in associates and a subsidiary.

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and borrowings. The volumes of related party transactions and outstanding balances at the year-end, are as follows:

33. RELATED PARTY TRANSACTIONS (continued)

	Placements as at 1 January 2016	Placements during the year	Withdrawals during the year	Placements as at 31 December 2016
	1	2	3	4=(1+2-3)
1. Assets				
Current accounts				
a) Subsidiaries	-	-	-	-
b) Associates	-	-	-	-
c) Key management personnel of the Bank	-	-	-	-
d) Other related parties	-	-	-	-
Trading assets				
a) Subsidiaries	306,661	9,355	-	316,016
b) Associates	-	-	-	-
c) Key management personnel of the Bank	-	-	-	-
d) Other related parties	-	-	-	-
Mortgage loans				
a) Subsidiaries				
b) Associates	-	-	-	-
c) Key management personnel of the Bank	64,265	19,129	20,444	62,950
d) Other related parties	-	-	-	-
Consumer loans				
a) Subsidiaries				
b) Associates	-	-	-	-
c) Key management personnel of the Bank	28,437	15,892	10,806	33,523
d) Other related parties	-	-	-	-
Other loans and claims				
a) Subsidiaries	-	19	18	1
b) Associates	130	1,742	1,749	123
c) Key management personnel of the Bank	89,940	133,138	76,205	146,873
d) Other related parties	-	-	-	-
Investment in securities				
a) Subsidiaries	12,738	-	-	12,738
b) Associates	189,147	43,625	22,601	210,171
c) Key management personnel of the Bank	-	-	-	-
d) Other related parties	-	-	-	-
2.Liabilities				
Deposits				
a) Subsidiaries	18,214	35,749	26,174	27,789
b) Associates	450	713,682	709,942	4,190
c) Key management personnel of the Bank	544,552	5,825,384	5,725,731	644,205
d) Other related parties	-	-	-	-

33. RELATED PARTY TRANSACTIONS (Continued)

Income and expenditures arising from related party transactions

In thousands of Denars

	Year ended December 31, 2016				Year ended December 31, 2015			
	Subsidiaries	Associates	Key management personnel of the Bank	Total	Subsidiaries	Associates	Key management personnel of the Bank	Total
Income								
Interest Income	-	-	11,480	**11,480**	-	-	9,512	**9,512**
Fee and commission income	31	218	5,363	**5,612**	30	154	4,264	**4,448**
Net gains from trading	9,355	-	-	**9,355**	9,072	-	-	**9,072**
Other income	2	43,701	4,602	**48,305**	2	39,115	8,816	**47,933**
Transfers between entities	-	-	-	**-**	-	-	-	**-**
Total Income	**9,388**	**43,919**	**21,445**	**74,752**	**9,104**	**39,269**	**22,592**	**70,965**
Expenses								
Interest expense	439	1	8,336	**8,776**	253	2	8,322	**8,577**
Expenditures for fees and commissions	-	-	-	**-**	-	-	-	**-**
Net losses from trading	-	-	-	**-**	-	-	-	**-**
Expenditures for procurement of non-current assets	-	-	-	**-**	-	-	-	**-**
Impairment of financial assets, on net basis	-	-	4,135	**4,135**	-	4	444	**448**
Other expenses	-	70	3,741	**3,811**	-	80	8,320	**8,400**
Transfers between entities	-	-	-	**-**	-	-	-	**-**
Total Expenses	**439**	**71**	**16,212**	**16,722**	**253**	**86**	**17,086**	**17,425**

33. RELATED PARTY TRANSACTIONS (Continued)

Key management personnel

	In thousands of Denars	
	Year ended December 31, 2016	Year ended December 31, 2015
Salaries and other short - term benefits	122,072	126,284
	122,072	**126,284**

34. FUNDS MANAGED ON BEHALF OF THIRD PARTIES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Banks and other financial institutions	34,639	28,013
Companies	511,867	236,941
Individuals	49,124	46,503
	595,630	**311,457**

The Bank manages assets on behalf of third parties which are in the form of loans to companies for various investments. The Bank receives fee income for providing these services. Funds managed on behalf of third parties are not assets of the Bank and are not recognized in the statement of financial position. The Bank is not exposed to any credit risk relating to such placements, as it does not guarantee these investments, however, has a fiduciary responsibility to properly handle and invest client funds.

Income and expenses of the Funds managed on behalf of third parties are accrued to the account of the respective third party and the Bank has no liability in connection with these transactions.

35. LEASE COMMITMENTS

At the end of the reporting period, the future minimum lease payments under non-cancellable operating leases are payable as follows

		Maturity period for operating lease payments		
In thousands of Denars	Total	up to 1 year	from 1 to 5 years	over 5 years
Balance at December 31, 2016	48,100	1,868	7,472	38,760
Total	**48,100**	**1,868**	**7,472**	**38,760**
Balance at December 31, 2015	66,733	2,495	9,979	54,259
Total	**66,733**	**2,495**	**9,979**	**54,259**

36. SUBSEQUENT EVENTS

No material events subsequent to the reporting date have occurred which require disclosure in the financial statements.

37. EXCHANGE RATES

Official exchange rates used in the translation of the items denominated in foreign currencies in the statement of financial position were as follows:

	In Denars	
	December 31, 2016	December 31, 2015
1 EUR	61.4812	61.5947
1 USD	58.3258	56.3744

INDEPENDENT AUDITOR'S REPORT

KPMG Macedonia DOO Skopje
3 Filip Vtori Makedonski Street
Skopje 1000, Republic of Macedonia
+389 (2) 3135 220
mk-office@kpmg.com
kpmg.com/mk

Independent auditors' report to the shareholders of Komercijalna Banka AD Skopje

We have audited the accompanying consolidated financial statements of Komercijalna Banka AD Skopje and its subsidiary ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of profit and loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing adopted and published in the Official Gazette of the Republic of Macedonia no. 79 from 11 June 2010. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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.

KPMG Macedonia DOO Skopje, a Macedonian limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.
Document classification: KPMG Confidential

Registered with the Trade Register of the Republic of Macedonia with EMBS: 5078598

Tax No. MK4030996107850

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 consolidated 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 consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Macedonia DOO
1 March 2017
Skopje

KPMG Macedonia DOO

AUDITED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
Interest income		3,636,963	3,894,798
Interest expense		(557,777)	(716,990)
Net interest income	6	**3,079,186**	**3,177,808**
Fee and commission income		1,133,196	1,121,631
Fee and commission expense		(247,720)	(205,856)
Net fee and commission income	7	**885,476**	**915,775**
Dividend income		6,210	5,683
Foreign exchange gains, net		125,477	131,269
Net gains on financial instruments classified as held for trading	8	13,079	7,492
Other operating income	9	483,972	274,806
Personnel expenses	10	(850,137)	(831,140)
Depreciation and amortization	22,23,24	(185,140)	(195,409)
Other operating expenses	11	(659,509)	(671,905)
Net impairment loss on financial assets	12	(1,708,600)	(1,721,300)
Net impairment loss on non-financial assets		(353,855)	(563,751)
Operating profit		**836,159**	**529,328**
Share of profit of associates accounted for using the equity method		43,625	39,028
Profit before tax		**879,784**	**568,356**
Income tax expense	13	(93,717)	(62,386)
Profit for the year		**786,067**	**505,970**
Other comprehensive income for the period, net of income tax			-
Items that are or may be reclassified to profit and loss			
Fair value reserve (available for sale financial assets):			
Net change in fair value		(3,256)	10,475
Related tax		(617)	(1,048)
Other comprehensive income, net of tax		**(3,873)**	**9,427**
Total comprehensive income for the year		**782,194**	**515,397**
Profit attributable to:			
Shareholders' of the Bank		781,751	502,375
Non-controlling interests		4,316	3,595
Profit		**786,067**	**505,970**
Total comprehensive income attributable to:			
Shareholders' of the Bank		777,878	511,802
Non-controlling interests		4,316	3,595
		782,194	**515,397**
Earnings per share	14		
Basic (in Denars)		343	220
Diluted (in Denars)		343	220

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
At December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
ASSETS			
Cash and cash equivalents	15	33,538,674	27,663,719
Financial assets at fair value through profit and loss	16	411,339	371,029
Financial assets available-for-sale	17	3,675,230	7,202,009
Financial assets held-to-maturity	18	3,374,729	2,516
Loans and advances to banks	19	10,084,209	9,208,426
Loans and advances to customers	20	45,268,154	47,644,522
Investments in associates	21	210,171	189,147
Property and equipment	22	2,968,183	3,037,777
Investment property	23	-	27,785
Intangible assets	24	38,907	41,534
Other assets	25	593,157	532,589
Assets acquired through foreclosure procedures	26	734,316	1,395,714
Total assets		**100,897,069**	**97,316,767**
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks and other financial institutions	27	1,648,463	1,363,581
Deposits from customers	28	86,115,337	82,837,690
Borrowings	29	1,650,522	2,165,476
Other tax liabilities		39,347	51,849
Deferred tax liabilities	13	17,254	18,285
Provisions	33	112,577	149,748
Other liabilities	30	598,543	512,430
Total liabilities		**90,182,043**	**87,099,059**
EQUITY			
Share capital		2,279,067	2,279,067
Share premium		771,527	771,527
Retained earnings		938,063	681,413
Revaluation reserve		5,554	9,427
Reserves		6,708,773	6,468,548
Total equity attributable to shareholders' of the Bank	31	**10,702,984**	**10,209,982**
Non-controlling interests		**12,042**	**7,726**
Total equity		**10,715,026**	**10,217,708**
Total liabilities and equity		**100,897,069**	**97,316,767**
Commitments and contingent liabilities	33	**14,096,767**	**15,447,095**

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

The consolidated financial statements were authorised by the Supervisory Board of the Bank on 28 February 2017.

Signed on behalf of Komercijalna banka AD Skopje:

Maja Stevkova Sterieva, PhD
Chief Finance Officer

Ilija Iloski
Chief Operating Officer

Hari Kostov
Chief Executive Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year ended December 31, 2016
(In thousands of Denars)

	Share capital	Share premium	Fair value reserve	Statutory reserve	Other reserves	Retained earnings	Total equity, attributable to the shareholders of the Group	Non-controlling Interest*	Total equity
Balance, January 1, 2015	2,279,067	771,527	-	455,813	5,917,131	274,569	9,698,107	4,131	**9,702,238**
Total comprehensive income									
Profit for the year	-	-	-	-	-	502,375	**502,375**	3,595	**505,970**
Other comprehensive income, net of tax									
Fair value reserve (available-for-sale financial assets)									
Net change in fair value	-	-	10,475	-	-	-	**10,475**	-	**10,475**
Tax on other comprehensive income	-	-	(1,048)	-	-	-	**(1,048)**	-	**(1,048)**
Total other comprehensive income	-	-	9,427	-	-	-	**9,427**	-	**9,427**
Total comprehensive income for the year	**-**	**-**	**9,427**	**-**	**-**	**502,375**	**511,802**	**3,595**	**515,397**
Transactions with owners, recognized directly in equity									
Treasury shares sold	-	-	-	-	-	73	**73**	-	**73**
Transfer to other reserve	-	-	-	-	95,604	(95,604)	-	-	-
Total contributions by and distributions to owners	**-**	**-**	**9,427**	**-**	**95,604**	**(95,531)**	**9,500**	**-**	**9,500**
Balance, December 31, 2015	**2,279,067**	**771,527**	**9,427**	**455,813**	**6,012,735**	**681,413**	**10,209,982**	**7,726**	**10,217,708**
Balance, January 1, 2016	2,279,067	771,527	9,427	455,813	6,012,735	681,413	**10,209,982**	7,726	**10,217,708**
Total comprehensive income									
Profit for the year	-	-	-	-	-	781,751	**781,751**	4,316	**786,067**
Other comprehensive income, net of tax									
Fair value reserve (available-for-sale financial assets)									
Net change in fair value	-	-	(3,256)	-	-	-	**(3,256)**	-	**(3,256)**
Tax on other comprehensive income	-	-	(617)	-	-	-	**(617)**	-	**(617)**
Total other comprehensive income	-	-	(3,873)	-	-	-	**(3,873)**	-	**(3,873)**
Total comprehensive income for the year	-	-	**(3,873)**	-	-	**781,751**	**777,878**	**4,316**	**782,194**
Transactions with owners, recognized directly in equity									
Treasury shares sold	-	-	-	-	-	(43)	**(43)**	-	**(43)**
Transfer to other reserve	-	-	-	-	240,225	(240,225)	-	-	-
Dividends paid	-	-	-	-		(284,833)	**(284,883)**	-	**(284,883)**
Total contributions by and distributions to owners	**-**	**-**	**-**	**-**	**240,225**	**(525,101)**	**(284,876)**	**-**	**(284,876)**
Balance, December 31, 2016	**2,279,067**	**771,527**	**5,554**	**455,813**	**6,252,960**	**936,063**	**10,702,984**	**12,042**	**10,715,026**

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

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
Profit before tax		879,784	568,356
Non – controlling interest, included in consolidated profit and loss		(4,316)	(3,595)
Adjustments for:			
Depreciation of property and equipment and amortization of intangible assets	22,24	184,303	194,571
Gain on sale of property and equipment	9	(107)	(457)
Gain on sale of assets acquired through foreclosure procedure	9	(101,265)	(26,198)
Loss on sale of assets acquired through foreclosure procedure	11	909	1,046
Impairment losses on assets acquired through foreclosure procedure		353,855	563,751
Depreciation of investment property	23	837	838
Impairment losses on financial assets	12	1,708,600	1,721,300
Dividend income		(6,210)	(5,683)
Interest income	6	(3,636,963)	(3,894,798)
Interest expense	6	557,777	716,990
Net trading income		(13,079)	(7,492)
Share of profit from associates accounted for using the equity method		(43,625)	(39,028)
Operating loss before changes in operating assets and liabilities:		**(119,500)**	**(210,399)**
Restricted accounts		(560,558)	(21,534)
Mandatory reserves in foreign currency with NBRM		(171,230)	(154,615)
Financial assets at fair value through profit and loss		(27,231)	(14,145)
Loans and advances to banks		(876,402)	(939,978)
Loans and advances to customers		594,801	(1,582,020)
Collected collateral		407,899	45,631
Other assets		(95,762)	(245,464)
Deposits from banks and other financial institutions		283,656	196,411
Amounts owed to other depositors		3,313,348	4,065,131
Other liabilities		86,113	93,327
		2,835,134	**1,232,345**
Interest received		3,714,880	3,922,588
Interest paid		(592,899)	(806,598)
Income tax paid		(103,071)	(16,716)
Net cash generated from operating activities		**5,854,044**	**4,331,619**
Cash flows from investing activities			
Acquisition of property and equipment		(78,545)	(61,309)
Acquisition of intangible assets		(11,092)	(17,677)
Proceeds from sale of property and equipment		221	635
Acquisition of investments securities		(9,509,277)	(7,625,693)
Proceeds from sale of investments		9,658,194	3,744,856
Dividends received		28,811	13,115
Net cash flows generated from/(used in) investing activities		**88,312**	**(3,946,073)**
Cash flows from financing activities			
Proceeds from borrowed funds		1,830,720	2,816,192
Repayments of borrowed funds		(2,345,026)	(3,265,514)
Dividends paid		(284,883)	-
Net cash (used in)/generated from financing activities		**(799,189)**	**(449,322)**

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

CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)
Year ended December 31, 2016
(In thousands of Denars)

	Notes	2016	2015
Net change of cash and cash equivalents			
Cash and cash equivalents at beginning of year		23,422,777	23,486,553
Net increase/(decrease) in cash and cash equivalents		5,143,167	(63,776)
Cash and cash equivalents at the end of the year	15	**28,565,944**	**23,422,777**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

1. General Information

Komercijalna Banka AD - Skopje (hereinafter "the Bank"), is a shareholding company having its registered office in the Republic of Macedonia. The head office of the Bank is Orce Nikolov str. No. 3, 1000 Skopje. The Bank operates in the Republic of Macedonia with a network of branch and sub-branches. These consolidated financial statements include the Bank and its subsidiary KB Publikum Invest AD Skopje ("KB Publikum") (together referred to as the "Group").

The Bank is registered as a universal type of commercial bank in accordance with the Macedonian laws. The principal activities of the Bank are as follows:

- Collecting deposits and other recurrent sources of funds;
- Placing loans and advances domestically and abroad, including factoring and financing commercial transactions;
- Issuance and administration of payment instruments (cards, cheques, traveler cheques, bills of exchange);
- Foreign exchange operations;
- Domestic and international payment operations, including purchase/sale of foreign currency funds;
- Fast money transfer;
- Issuing payment guarantees, backing guarantees and other forms of security;
- Providing services of renting safe deposit boxes, depositories and depot;
- Trade in instruments on the money market;
- Trading with foreign currencies;
- Trading with securities;
- Providing services of a bank-custodian of investment and pension funds;
- Keeping of securities for clients;
- Intermediating in selling insurance policies;
- Data collection and analysis of companies' credit rating;
- Sale of shares in investment funds;
- Other financial services defined by law, which are within the scope of activities only by a bank.

The shares of the Bank are listed on the Macedonian Stock Exchange official market in the segment of super-listing of joint stock companies with special reporting requirements, and is one of the ten companies comprising the Macedonian Stock Exchange index MBI-10. The ID quotation code is the following:

Code	ISIN code
KMB (common share)	MKKMBS101019

KB Publikum is licensed to set up and manage open and closed ended investment funds as approved by the Securities and Exchange Commission. It manages three open-end investment funds, KB Publikum-Balanced, KB Publikum-Bonds and KB Publikum-Cash. These funds are not legal entities and do not perform specific activities

The consolidated financial statements of the Bank for the year ended 31 December 2016 were authorised for issue by the Supervisory Board on 28 February 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

2. Basis of Preparation of Consolidated Financial Statements

(a) Statement on Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standard Board ("IASB").

(b) Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- financial instruments at fair value through profit or loss are measured at fair value;
- available-for-sale financial assets are measured at fair value.
- foreclosed assets measured at the lower of cost or fair value less costs to sale.

(c) Functional and Presentation Currency

The presented consolidated financial statements are expressed in thousands of Denars. The Denar represents the functional and presentation currency of the Group.

(d) Use of Estimates and Judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of 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 available from other sources. Actual results in subsequent periods 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 consolidated financial statements are described in Note 3.20 to the consolidated financial statements.

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

(e) Changes in accounting policies

The Group consistently applied the accounting policies as set out in Note 3 to all periods presented in these consolidated financial statements.

2. Basis of Preparation of Consolidated Financial Statements (Continued)

(f) Changes in accounting estimates

For the year ended 31 December 2016, there were no changes in accounting estimates.

(g) New Standards and Interpretations not yet adopted

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2017; however, the Group has not applied the following new or amended standards in preparing these consolidated financial statements.

New or amended standards	*Summary of the requirements*	*Possible impact on consolidated financial statements*
IFRS 9 Financial Instruments (2014) (Effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively with some exemptions. The restatement of prior periods is not required, and is permitted only if information is available without the use of hindsight. Early application is permitted.)	This Standard replaces IAS 39, Financial Instruments: Recognition and Measurement, except that the IAS 39 exception for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply, and entities have an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting. Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit and loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different. A financial asset is measured at amortized cost if the following two conditions are met: • the assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and, • its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. In addition, for a non-trading equity instrument, a company may elect to irrevocably present subsequent changes in fair value (including foreign exchange gains and losses) in OCI. These are not reclassified to profit or loss under any circumstances. For debt instruments measured at FVOCI, interest revenue, expected	It is expected that the new Standard, when initially applied, will have a significant impact on the financial statements, since the classification and the measurement of the Group's financial instruments are expected to change. Based on its preliminary assessment, the Group, with predominant banking activities, expects that substantially all of financial assets classified as loans and receivables under IAS 39 will continue to be measured at amortised cost under IFRS 9. At this stage it is still unclear what portion of the Group's debt securities will be measured at FVTPL, at FVOCI or amortized cost as this determination will depend on the outcome of the business model test. It is expected that a significant portion of debt securities will be reclassified under IFRS 9 either into or out of FVOCI. It is not expected that the equity instruments the Group holds will be measured at FVTPL, but this determination will depend on an election to be made by the entity at the date of initial application – that is 1 January 2018. The Group has not yet decided how it will classify these instruments.

	credit losses and foreign exchange gains and losses are recognised in profit or loss in the same manner as for amortised cost assets. Other gains and losses are recognised in OCI and are reclassified to profit or loss on derecognition. The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that a loss event will no longer need to occur before an impairment allowance is recognised. IFRS 9 includes a new general hedge accounting model, which aligns hedge accounting more closely with risk management. The types of hedging relationships – fair value, cash flow and foreign operation net investment – remain unchanged, but additional judgment will be required. The standard contains new requirements to achieve, continue and discontinue hedge accounting and allows additional exposures to be designated as hedged items. Extensive additional disclosures regarding an entity's risk management and hedging activities are required.	It is expected that deposits from customers will be continued to be measured at amortised cost under IFRS 9. It is expected that the new expected credit loss model under IFRS 9 will accelerate the recognition of impairment losses and lead to higher impairment allowances at the date of initial application.
IFRS 15 Revenue from contracts with customers (Effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.)	The new Standard provides a framework that replaces existing revenue recognition guidance in IFRS. Entities will adopt a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised: over time, in a manner that depicts the entity's performance; or at a point in time, when control of the goods or services is transferred to the customer. IFRS 15 also establishes the principles that an entity shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.	The Group is assessing the potential impact on its separate financial statement resulting from IFRS 15.
IFRS 16 Leases (Effective for annual periods	IFRS 16 supersedes IAS 17 Leases and related interpretations. The Standard eliminates the current dual	The Group does not expect that the Standard, when initially applied, will have

beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15.)	accounting model for lessees and instead requires companies to bring most leases on-balance sheet under a single model, eliminating the distinction between operating and finance leases. Under IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For such contracts, the new model requires a lessee to recognise a right-of-use asset and a lease liability. The right-of-use asset is depreciated and the liability accrues interest. This will result in a front-loaded pattern of expense for most leases, even when the lessee pays constant annual rentals. The new Standard introduces a number of limited scope exceptions for lessees which include: • leases with a lease term of 12 months or less and containing no purchase options, and • leases where the underlying asset has a low value ('small-ticket' leases). Lessor accounting shall remain largely unaffected by the introduction of the new Standard and the distinction between operating and finance leases will be retained.	material impact on the financial statements.
Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively. Early application is permitted.)	The amendments clarify share-based payment accounting on the following areas: • the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; • share-based payment transactions with a net settlement feature for withholding tax obligations; and • a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.	The Group expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the entity because the Group does not enter into share-based payment transactions.
Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Effective for annual periods beginning on or after 1 January 2021; to be applied prospectively.)	The amendments address concerns arising from implementing IFRS 9 before implementing the replacement standard that the IASB is developing for IFRS 4. The amendments introduce two optional solutions. One solution is a temporary exemption from IFRS 9, effectively deferring its application for some insurers. The other is an overlay approach to presentation to alleviate the volatility that may arise when	The Group is not an insurance provider and therefore does not expect any material impact on the financial statements of the Group.

	applying IFRS 9 before the forthcoming insurance contracts standard.	
Amendments to IFRS 10 and IAS 28 Sale or contribution of assets between an investor and its associate or joint venture (The effective date has not yet been determined by the IASB, however earlier adoption is permitted.)	The Amendments clarify that in a transaction involving an associate or joint venture, the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business, such that: • a full gain or loss is recognised when a transaction between an investor and its associate or joint venture involves the transfer of an asset or assets which constitute a business (whether it is housed in a subsidiary or not), while • a partial gain or loss is recognised when a transaction between an investor and its associate or joint venture involves assets that do not constitute a business, even if these assets are housed in a subsidiary.	The quantitative impact of the adoption of the Amendments can only be assessed in the year of initial application of the Amendments, as this will depend on the transfer of asset or businesses to the associate that take place during that reporting period.
Amendments to IAS 7 (Effective for annual periods beginning on or after 1 January 2017, to be applied prospectively. Early application is permitted.)	The amendments require new disclosures that help users to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes (such as the effect of foreign exchange gains or losses, changes arising for obtaining or losing control of subsidiaries, changes in fair value).	The Group expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the Group.
Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses (Effective for annual periods beginning on or after 1 January 2017; to be applied prospectively. Early application is permitted.)	The amendments clarify how and when to account for deferred tax assets in certain situations and clarify how future taxable income should be determined for the purposes of assessing the recognition of deferred tax assets.	The Group expects that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the Group because the Group already measures future taxable profit in a manner consistent with the Amendments.
Amendments to IAS 40 Transfers of Investment Property (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively.).	The amendments reinforce the principle for transfers into, or out of, investment property in IAS 40 *Investment Property* to specify that such a transfer should only be made when there has been a change in use of the property. Based on the amendments a transfer is made when and only when there is an actual change in use – i.e. an asset meets or ceases to meet the definition of investment property and there is evidence of the change in use. A change in management intention alone does not support a transfer.	The Group does not expect that the amendments will have a material impact on the financial statements because the Group transfers a property asset to, or from, investment property only when there an actual change in use.
IFRIC 22 Foreign Currency Transactions and Advance Consideration	The Interpretation clarifies how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial	The Group does not expect that the Interpretation, when initially applied, will have material impact on

(Effective for annual periods beginning on or after 1 January 2018).	recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. In such circumstances, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.	the financial statements as the Group uses the exchange rate on the transaction date for the initial recognition of the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

2. Basis of Preparation of Financial Statements (Continued)

(g) New Standards and Interpretations not yet adopted (Continued)

Annual Improvements to IFRSs

The improvements introduce two amendments to two standards and consequential amendments to other standards and interpretations that result in accounting changes for presentation, recognition or measurement purposes. These amendments are applicable to annual periods beginning on or after either 1 January 2017 or 1 January 2018; to be applied retrospectively.

None of these amendments are expected to have a significant impact on the financial statements of the Group.

3. Summary of Significant Accounting Policies

3.1 Basis of consolidation

3.1.1 Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date – i.e. when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if they are related to the issue of debt or equity securities.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

3.1.2 Non-controlling interests ("NCI")

NCI are measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

3.1.3 Subsidiaries

'Subsidiaries' are investees controlled by the Group. The Group 'controls' an investee if it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date when control ceases.

3.1.4 Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related NCI and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

3. Summary of Significant Accounting Policies (continued)

3.1 Basis of consolidation (consolidation)

3.1.5 Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses (except for foreign currency transaction gains or losses) arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3.2 Interest Income and Expense

Interest income and expense are recognized in profit or loss for all interest bearing instruments on accrual basis, measured at amortized cost using the effective interest rate method.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and commissions paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3.3 Fee and Commission Income

Fees and commissions, except loan origination fees, are generally recognized on an accrual basis over the period of service rendering. Other fees relating to the acquisition and origination of loans are deferred over the life of the loan and amortized using the effective interest rate method.

3.4 Dividend Income

Dividend income is recognized when the right to receive payment is established for all shareholders who participate in distribution of profit.

3.5 Foreign currency Transactions

Transactions denominated in foreign currencies have been translated into Denars at rates set by the National Bank of the Republic of Macedonia (“NBRM”) at the dates of the transactions. Assets and liabilities denominated in foreign currencies are translated into Denars at the end of the reporting period using official rates of exchange ruling on that date. Foreign exchange gains or losses arising upon the translation of transactions, and the translation of assets and liabilities denominated in foreign currencies are recognized in the profit or loss in the period in which they occurred.

Commitments and contingent liabilities denominated in foreign currencies are translated into Denars by applying the official exchange rates at the end of the reporting period.

3.6 Financial Assets

Financial assets are classified into the following specified categories: financial assets at fair value through profit or loss, held-to-maturity financial assets, available-for-sale financial assets, loans and receivables. The classification depends on the nature and the purposes of the financial assets and is determined at initial recognition. Financial assets are recognized and derecognized on settlement date, which represents the date when the asset is delivered to the Group.

3.6.1 Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and nostro accounts, that represent demand deposits and placements with other banks and financial institutions, account balances with the National Bank of the Republic of Macedonia (“NBRM”) and other financial assets such as treasury and government bills, as highly liquid assets with maturity up to three months and insignificant changes to fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

3. Summary of Significant Accounting Policies (Continued)

3.6 Financial Assets (Continued)

3.6.2 Financial Assets at Fair Value through Profit or Loss

Financial assets at fair value through profit or loss include held-for-trading financial assets. Held-for-trading financial assets are securities included in a portfolio in which a pattern of short-term profit making exists. Initially, these securities are recognized at cost and subsequently measured at fair value as determined based on their market price.

All the respective realized and unrealized gains and losses are included in profit or loss for the period. Interest, if realized, during the period of ownership of these securities, is recognized as net trading income in the profit or loss for the period. The purchase and disposal of securities held-for-trading is recognized at settlement date, which represents the date when the asset is delivered to/from the Group. When the settlement date and the trade date are different, then the Group recognizes the changes in fair value from the trade date to the settlement date through profit and loss.

3.6.3 Available-for-sale Financial Assets

Available-for-sale financial assets 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. This portfolio comprises quoted and unquoted equity investments in shares of banks and other financial institutions and enterprises, where the Group does not exercise control.

Available-for-sale financial assets are initially recognized at cost, including all transaction costs, and subsequently re-measured at fair value based on quoted prices in active markets or amounts derived from cash flow models for unquoted equity investments. Transaction costs represent the costs that are directly attributable to acquisition of the financial asset.

Unrealized gains and losses arising on changes in the fair value of available-for-sale financial assets are recognized in other comprehensive income, until the financial asset is derecognized or impaired at which time the cumulative gain or loss previously accumulated in the other comprehensive income should be recognized in profit or loss for the period. Interest calculated using the effective interest method and impairment losses are recognized in the profit or loss for the period.

3.6.4 Held-to-maturity Financial Assets

Held-to-maturity financial assets are financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity. If the Group is to sell other than, an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale and the Group will not be able to classify financial assets held-to-maturity for the current and next two years. These financial assets are measured at amortized cost using the effective interest rate method.

3.6.5 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. Loans are initially recognized at fair value, including any transaction costs, and are subsequently measured at amortized cost using the effective interest rate method. Interest on loans originated by the Group is included in interest income.

Loans to customers and financial institutions are stated at their net amount reduced by allowance for impairment and un-collectability.

3.6.6 Impairment of Financial Assets

The Group assesses at end of each reporting period whether there is objective evidence that a financial asset is impaired.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired.

3. Summary of Significant Accounting Policies (Continued)

3.6 Financial Assets (Continued)

3.6.6 Impairment of Financial Assets (Continued)

If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that Financial asset previously recognized in other comprehensive income – is removed from other comprehensive income and recognized in the profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the profit or loss for the period. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognized in other comprehensive income.

The amount of the impairment loss for financial assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. Interest of the impaired assets continues to be recognized through the unwinding of the discount.

3.6.7 Impairment Losses on Loans and Receivables

Allowances for impairment and un-collectability are determined if there is objective evidence that the Group cannot collect all amounts due on a claim according to the original contractual terms. A "claim" means a loan, a commitment such as a letter of credit, guarantee or commitment to extend the credit. A provision for loan impairment is reported as a reduction of the carrying amount of the loan, whereas for off-balance sheet items are presented within the provisions. Additions to provisions are made through impairment losses on financial assets in the profit or loss.

The allowances for impairment and un-collectability are determined on the basis of the degree (size) of the risk of un-collectability or specific country risk on the basis of the following principles:

- Separate loan exposures (risks) are assessed on the basis of the type of loan applicant, his/her/its overall financial position, resources and payment records and recoverable value of collaterals. Allowances for losses on impairment and un-collectability are measured and determined for the difference between the carrying amount of the loan and its estimated recoverable amount, which is, in fact, the present value of expected cash flows;

- All allowances for losses on impairment and un-collectability are reviewed and tested monthly, and any further changes in the amount and timing of expected future cash flows in comparison to previous assessments result in changes in allowances for losses on impairment and un-collectability recorded in profit or loss;

- Any loan which, is considered impossible to be collected, is written off against the relevant allowance for losses on impairment. Further collections are recorded in the profit or loss;

- In case of loans granted to borrowers in countries with increased risk of difficulties for servicing external debt, the political and economic circumstances are assessed and additional allowances for sovereign risk are allocated.

For more details, refer to 4.1. Credit risk.

3.6.8 De-recognition of Financial Assets

The Group derecognizes financial assets when the right to receive cash from the financial asset has expired or has transferred its rights to receive cash flows from the asset and substantially all the risks and rewards of ownership of the assets to another entity.

3. Summary of Significant Accounting Policies (Continued)

3.7 Financial Liabilities

Financial liabilities are classified in accordance with the substance of the contractual arrangement. Financial liabilities are classified as deposits from banks, financial institutions and customers, loans payable, other payables and derivative financial instruments.

3.7.1 Deposits from Banks and Other Financial Institutions and Customers

These financial liabilities are initially recognized at fair value, net of transaction costs incurred. Subsequently they are measured at amortized cost.

3.7.2 Borrowings

Borrowings payable are initially recognized at fair value net of transaction costs incurred. Subsequent measurement is at amortized cost and any difference between net proceeds and the redemption value is recognized in profit or loss over the period of the loan using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability.

3.7.3 Other Payables

Other payables are stated at amortised cost.

3.7.4 De-recognition of Financial Liabilities

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or have expired.

3.8 Fair value measurement

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

3. Summary of Significant Accounting Policies (Continued)

3.8 Fair value measurement (Continued)

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

3.9 Investments in Associates

An associate is an entity, over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. If the Group holds, directly or indirectly, 20 per cent or more of the voting power of the investee, it is presumed that the Group has significant influence. A substantial or majority ownership by another investor does not necessarily preclude the Group from having significant influence.

Investments in associates are measured using the equity method, by which the investment is initially recognized at cost. Subsequent to the initial measurement, carrying amount is increased or decreased to recognize the Group's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment.

3.10 Property and Equipment

Property and equipment is recorded at cost, less accumulated depreciation and accumulated impairment losses, if any. Expenditure incurred to replace a component of an item of property and equipment that is accounted for separately is capitalized. Other subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditures are recognized in the profit or loss as an expense as incurred. 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 charged at estimated rates to write off the cost of assets over their estimated useful lives, using the straight-line method. Land is not depreciated. No depreciation is charged on construction in progress until the constructed assets are put into use.

The useful life of certain categories of property and equipment are as follows:

Buildings	40 years
Furniture and equipment	4-20 years
Leasehold improvements	40 years

The gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognized in the profit and loss. The Group annually reviews its property and equipment for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

3.11 Intangible Assets and goodwill

Goodwill that arises on the acquisition of subsidiaries is presented with intangible assets. Subsequent to initial recognition, goodwill is measured at cost less accumulated impairment losses.

Intangible assets are reported at cost less accumulated amortization and accumulated impairment losses, if any. Intangible assets include computer software and software that was acquired apart from hardware. Software is amortized on a straight-line basis over the estimated useful life, which is five years. The Group annually reviews its intangible assets and assess whether there is any indication for impairment. If such indications exist, an estimate is performed to assess whether the carrying amount is recoverable. If the carrying amount exceeds the recoverable amount, it is written down to the recoverable amount.

3. Summary of Significant Accounting Policies (Continued)

3.12 Impairment of non-financial assets

The management of the Group regularly reviews the carrying amounts of the Group's non-financial assets. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is written down to its recoverable amount. An impairment loss is recognized as an expense of the current period. If the recoverable amount of an asset is increased due to change in the indications and factors of impairment at the moment the last impairment loss is recognized, the carrying amount of the asset is increased to its current recoverable amount. A reversal of an impairment loss is recognized as income immediately.

3.13 Investment property

Investment property includes buildings owned by the Bank with the intention of earning rentals or for capital appreciation or both, and is initially recorded at cost, which includes transaction costs. The classification of the investment property is based on the criteria that the property is mostly held to earn rentals when compared to the property used by the Bank for its own needs.

Subsequent to initial recognition, investment property is measured at cost less accumulated depreciation and any accumulated impairment losses. The depreciation of investment property is calculated on a straight-line basis in a way to write off the cost value of assets over their estimated useful lives, which approximates the useful life of similar assets included in property and equipment.

Investment property is annually reviewed for impairment. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized as an expense of the current period.

3.14 Assets Acquired Through Foreclosure Proceedings

Foreclosed assets include property and equipment acquired through foreclosure proceedings in full or partial recovery of a related loan and is disclosed in assets acquired through foreclosure proceedings. These assets are initially measured at the lower of the appraised value, less estimated cost to sell, charged to the Group, and the cost of the foreclosed asset. The appraised value is determined by local certified appraiser on the date of foreclosure.

After initial recognition, foreclosed assets are reviewed for impairment at least annually and are measured at the lower of their carrying amount and fair value less estimated costs to sell.

3.15 Managed funds for and on behalf of third parties

The Group acts as a fiduciary and in other fiduciary matters provides services for and on behalf of third parties such as legal entities, citizens, investment and pension funds and other institutions for which it keeps and manages assets or invests funds received in various financial instruments at the direction of the customer. The Group receives fee income for providing these services. Managed funds are not assets of the Bank and are not recognized in the financial statements. The Group is not exposed to any credit risk relating to such placements, as it does not guarantee them.

3. Summary of Significant Accounting Policies (Continued)

3.16 Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation.

Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

3.17 Employment benefits

Health, pension and social insurance contributions from gross wages and salaries are being paid by the Group during the year to the national organizations at the statutory rates. Such contributions represent defined contribution plans and are recognized as an expense when employees have rendered services entitling them to the contributions. There is no additional liability to these plans.

The Group is obliged to pay to its employees a termination lump sum upon retirement equal to two monthly average salaries paid in the Republic of Macedonia. The Group records provisions for retirement to allocate such costs by periods to which they relate. In accordance with IAS 19, these benefits are considered defined pension benefit plans. The carrying amount of the Group's liabilities arising from employee benefits is calculated at the end of the reporting period. The balance of these liabilities at the end of the reporting period presents the discounted amount of future payments.
The calculations are made under the following parameters and used indicators (bases) valid on 31 December each year:

- Rate of growth of average monthly salary per year in the Republic of Macedonia: 1% for the Year 2015 and 1% for the Year 2016, estimated growth of future salaries in Republic of Macedonia, taking into consideration the rate of inflation;
- Discount rate: 3.8% for the Year 2015 and 3.9% for the Year 2016, derived from long-term risk-free securities;
- Severance pay for retiring to the extent of 2 average net salaries per employee in the Republic of Macedonia, paid out in the previous 3 months: MKD 22.040,00 for the Year 2015 and MKD 22.315,00 for the Year 2016, published by the State Statistical Office of the Republic of Macedonia in December for each year respectively.

3.18 Taxation

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date of 10%, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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. Deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax assets are recognized for unused tax losses, unused tax credit and deductible temporary differences to the extent for which is probable that the future taxable profits against which the asset can be utilized. Deferred tax assets are estimated at the end of each reporting period and reduced to the extent that is no longer probable that these tax revenues will be realized. Any such reduction should be reversed to the extent that it is probable that sufficient taxable profit will be available. Unrecognised deferred tax assets are assessed at the end of each reporting period and recognised to the extent it is probable that future taxable income will be sufficient against which the asset can be utilised.

3. Summary of Significant Accounting Policies (Continued)

3.19 Leases

Assets leased out under operating lease are included in the statement of financial position as investment property. The Group leases assets as operating leases. Rental income and expenses is 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.

3.20 Critical Accounting Judgments and Estimates

The most significant areas, for which judgments, estimates and assumptions are required, are:

Fair Value of Financial Instruments

The fair values of the financial instruments that are not quoted in active markets are determined using internal valuation techniques. These include present value methods, models based on observable input parameters. All valuation models are validated before they are used as a basis for financial reporting, and periodically reviewed by qualified personnel independent of the area that created the model. Wherever possible, the Group compares valuations derived from models with quoted prices of similar instruments, and with actual values when realized, in order to further validate and standardize models. A variety of factors are incorporated into the models, including actual or estimated market prices and rates, such as time value and volatility, and market conditions and liquidity.

The Group applies its models consistently from one period to the next, ensuring comparability and continuity of valuations over time, but estimating fair value inherently involves a significant degree of judgment.

In the Republic of Macedonia sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables and other financial assets or liabilities, for which published market prices are presently not readily available.

The Management assesses its overall risk exposure and in instances in which it estimates that the value in the books may not be realized, it recognizes a provision. In the opinion of management, the reported carrying amounts for the assets that are not quoted in an active market represent the most valid and useful reporting values under the present market conditions.

Allowance for Impairment of Loans

The Group reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in the profit and loss, the Group 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 in the Group, or national or local economic conditions that correlate with defaults on assets in the Group.

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. For more details, refer to 4.1. Credit risk.

Useful Lives of Tangible and Intangible Assets

The Group's management determines estimated useful lives and related depreciation and amortization charges for its tangible and intangible assets. The appropriateness of the estimated useful lives is reviewed whenever there is an indication of significant changes in the underlying assumptions, such as anticipated technological developments and changes in the broad economic and industry factors.

Investment property and assets acquired through foreclosure procedures

Information about the assumptions made in measuring fair value are included in the following notes:

- Note 23 – investment property;
- Note 26 – assets acquired through foreclosure procedure.

3. Summary of Significant Accounting Policies (Continued)

3.20 Critical Accounting Judgments and Estimates (Continued)

Determination of control over investees

Management applies its judgment to determine whether the control indicators set out in accounting policy 3.1 indicate that the Group has a control over an investee or an investment fund.

Investment funds

The Group acts as fund manager to three investment funds. Determining whether the Group controls such an investment fund usually focuses on the assessment of the aggregate economic interests of the Group in the funds (comprising any carried interests and expected management fees) and the investors' rights. The assets of the investment funds are legally separated from the assets of the Group, In case of bankruptcy of the Group, the assets of the investment funds belong to the holders of stakes in the investment funds. In addition, the Group has week aggregate economic interests in the funds. As a result, the Group has concluded that it acts as agent for the investors in all cases, and therefore has not consolidated these funds.

4. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is a core business activity and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Group's financial performance.

The most important types of risks identified, evaluated and mitigated by the Group's risk management policies are credit risk, liquidity risk, market risk and operational risk.

Risk Management Framework

The Group has established a Strategy for risk management, adopted by the Supervisory Board that is revised regularly. The Strategy defines the main objectives and general directions in undertaking and managing risks, general approach to the risk management, general approach to the internal determining and assessment of the Group's necessary capital adequacy, general review of the business strategy of the Group, as well as the possible changes in the Group's business strategy and acceptable level of risk the Group can be exposed to during its operations.

The Shareholders Assembly appoints the members of the Supervisory Board and the Audit Committee. The Supervisory Board has overall responsibility for the establishment and oversight of the Group's risk management framework. The Supervisory Board has established the Board of Directors, Credit Committee and Risk Management Committee These bodies are responsible for monitoring and developing risk management policies in specific areas. The Group has established an organizational structure, with clearly defined competences and responsibilities. The Risk Management and Planning Division is responsible for monitoring and reporting of global risk exposure, while the organizational units of the Group, which create risk exposure are responsible for practical application of risk management. The Internal Audit Department is responsible for review of risk management.

4.1 Credit Risk

The Group is exposed to credit risk, which represents the risk of financial loss due to customer's default on their contractual obligations. Credit risk is the most important risk for the Group's operations; therefore, the management carefully manages the Group's exposure to credit risk. The exposure to this risk arises principally from lending activities and advances, as well as activities related to off-balance sheet financial instruments, such as loan commitments to enterprises and households, guarantees and letters of credit.

Taking into consideration the latest events arising from the global financial crisis, the Group applies more restrictive credit policy, higher precautions in assessing the creditworthiness of each customer and projects subject to financing.

A Credit Risk Management

The Group has an established organizational structure, with clearly defined competences and responsibilities of the Supervisory Board and the Board of Directors regarding credit risk management.

The organization of the credit risk management is established on the following levels of hierarchy:
- Strategic level - the risk management function is performed by the members of Supervisory Board and the Board of Directors; Risk Management Committee and Audit Committee;
- Macro level - the risk management function at the level of business unit, or business line is performed by other persons with special rights and responsibilities performing managing function and/or by special organizational unit responsible for monitoring the credit risk management.

Credit risk management at the level of business unit in the Group includes each Division where the credit risk is undertaken and the persons with special rights and responsibilities that performs the management function in the Division. The duties of these organizational units in the Group are regulated in the appropriate Policies adopted from the Supervisory Board. The organizational unit in the Group responsible for credit risk management is Risk Management and Planning Division – Credit Risk Management Department.

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

4.1 Credit Risk (Continued)

A Credit Risk Management (Continued)

All credit exposures exceeding 10% of the Group's own funds up to the legally determined limit of exposure towards a single client (up to 25% of regulatory capital) are subject to approval by the Supervisory Board.

The Credit Committee oversees the overall credit operation of the Group. Also, the Credit Committee is mainly responsible for approving and proposing to the Risk Management Committee and Board of Directors, all policies, procedures and amendments thereto relating to the extension of credit, to ensure that these policies are applied consistently and complied with throughout the Group, to approve credit exposure between 3% and 10% from own funds.

Board of directors, Corporate Lending Division Manager and Department Managers are authorized for approving credit exposures up to 3% of the Group's own funds.

B Credit Risk Assessment

(a) Loans and Advances

In assessing credit risk of loans and advances to customers and banks at a counterparty level, the Group uses three components:

(I) the 'probability of default' by the client or counterparty on its contractual obligation (expected cash flows);
(II) the likely recovery ratio on the defaulted obligations, the 'loss given default';
(III) the amount and quality of the collateral for the exposure.

These credit risk measurements, which reflect expected loss, i.e. the 'expected loss model' and are required by the Basel Committee on Banking Regulations and the Supervisory Practices (the Basel Committee), are embedded in the Group's daily operational management. The operational measurements can be contrasted with impairment allowances required under IAS 39, which are based on losses that have been incurred at the end of the reporting period (the 'incurred loss model') rather than expected losses (Note 4.1.D).

(i) The Group assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. They have been developed internally and combine statistical analysis with credit officer judgment and are validated, where appropriate, by comparison with externally available data. Clients of the group are segmented in four rating classes. The Group's rating scale, which is shown below, reflects the range of default probabilities defined for each rating class. This means that, in principal, exposures migrate between classes as the assessment of their probability of default changes. The rating tools are kept under review and upgraded as necessary. The Group regularly validates the performance of the rating and their predictive power with regard to default events.

Group's internal rating scale

Group's rating	Description of the grade
A	Pass/acceptable for financing
B	Watch (careful)
C	Sub-standard
D+E	Suspicious (doubtful)+Loss

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

4.1 Credit Risk (Continued)

B Credit Risk Assessment (Continued)

(a) Loans and Advances (Continued)

Group's rating grade A (pass/acceptable for financing) includes:

- Amounts owing to the European Central Bank and the central governments and central banks of countries whose claims pursuant to the methodology for determining the capital adequacy have a risk weight of 0%
- Part of credit exposure that is secured by first-rate collateral instruments, if the instrument is activated within 60 days of the date of maturity of the exposure;
- Financial position and cash flows of the client allows its further operation and opportunity to cover the current and future liabilities to the group;
- Liabilities based on credit exposure are settled within the maturity period or with a delay of 31 days, or
- In the last twelve months, no credit exposure for that client has been restructured.

Group's rating grade B (Watch (careful)) includes:

- The client shows financial weaknesses, but its cash flows are sufficient for regular settlement of due liabilities;
- Liabilities based on credit exposure are commonly settled with a delay of 60 days, or 90 days as an exception, if the delay only occasionally ranges from 61 to 90 days, or
- In the last six months, the credit exposure has not been restructured.

Group's rating grade C (Sub-standard) includes:

- Cash inflows of client are unsuitable for regular settlement of liabilities;
- There is an inadequate maturity structure between the sources of funding of the program/project for which financial support has been requested from the Group and proceeds generated from the program/project;
- The Group does not hold the necessary and updated information to assess the creditworthiness of the client;
- The credit exposure is restructured;
- Liabilities based on credit exposure are commonly settled with a delay of up to 120 days, or 180 days as an exception, if the delay only occasionally ranges from 121 to 180 days;
- The client - nonfinancial entity has claims based on financial loan on entity enjoying a credit rating equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's") or an entity enjoying a higher credit rating, but its domicile country's credit rating equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's"), or
- The client - nonfinancial entity has claims based on financial loan is entity for which no credit rating has been established, but its domicile country's credit rating equal to or lower than B- (according to the rating of "Standard & Poor's" or "Fitch") or B3 (according to the rating of "Moody's") or its domicile country's credit rating has not been established yet.

The Group may not classify credit exposure to the client under bullet points 6 and 7 in C risk category, if:

- The exposure is based on a customs guarantee or bid guarantee;
- The financial loan does not exceed Denar 31,000,000 (in case of foreign currency financial loan, the Denar equivalent of the loan shall be taken into consideration), or
- The financial loan is equal to or greater than Denar 31,000,000, and the Group's exposure is greater than the amount of financial loan and the Group has calculated impairment or allocated special reserve, at least in the amount exceeding 20% of the amount of financial loan, whereby the credit exposure or the client meets the criteria for classification in another risk category.

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

4.1 Credit Risk (Continued)

B Credit Risk Assessment (Continued)

(a) Loans and Advances (Continued)

Group's rating grade D (Suspicious (doubtful) loss) includes:

- The client is illiquid;
- The collection of credit exposure depends on the use of collateral instruments;
- The liabilities based on credit exposure are commonly settled with a delay of up to 240 days, or 300 days, as an exception, if the delay only occasionally ranges from 241 to 300 days;
- The client (including governments and central banks) enjoys a credit rating equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's");
- The client's credit rating is higher than the rating referred to in the sentence above, but its domicile country's credit rating is equal to or lower than CCC+ (according to the rating of "Standard & Poor's" or "Fitch") or Caa1 (according to the rating of "Moody's"), or
- The client has not been given any credit rating, but its domicile country's credit rating is equal to or lower than B- (according to the rating of "Standard & Poor's" or "Fitch") or B3 (according to the rating of "Moody's") or its domicile country has not been given any credit rating yet.

Group is rating grade E (Suspicious (doubtful) loss) includes:

- Liabilities based on credit exposure are commonly settled with a delay of over 241 days
- The client has undergone bankruptcy or liquidation proceedings;
- The client denies the existence of credit exposure (in court or out-of-court proceedings), or
- The Group expects to collect only an insignificant portion of credit exposure from the client.

(ii) Loss given default or loss severity represent the Group's expectations of the extent of loss on a claim should default occurs. It is expressed as percentage loss per unit of exposure and typically varies by type of counterparty, type and seniority of claim and availability of collateral or other credit mitigations.

(iii) Amount and quality of the collateral depends on the terms, type (immovable property, movable property, inventories, receivables) and the possibility for its enforcement. The Group divides the clients in two groups: one where the exposure of the Group is secured with value of the collateral that is lower than the amount of the exposure and second where the value of the collateral is higher than the amount of the exposure. The collateral is not taken into calculation of the expected cash flows from the financial assets, only as an input into the internal rating of the client.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

B Credit Risk Assessment (Continued)

(b) Debt Securities and Other Bills

The Group is striving to maintain acceptable level of credit risk exposure regarding debt securities, so investment activities are primarily in government debt securities.

C Risk Limit Control and Mitigation Policies

The Group manages and controls concentration of credit risk to clients, and to industries and countries.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate.

Measures for specific control and mitigation of credit risk are prescribed in the act that regulates credit activities and procedures are obtaining collateral and credit-related contingencies

(a) Collateral

Collateral is considered as a secondary factor in granting a credit facility. Security by itself, with its lack of ability to generate cash flow, is insufficient to justify the granting of credit facilities. The principal collateral types for loans and advances are:

(i) For corporate entities
- Cash
- Property
- Equipment and vehicles
- Inventory
- Receivables
- Guarantees (Bank guarantees, guarantees from legal entities)
- Securities (Debt securities issued by the Government of RM, Securities issued by legal entities).

Loans to corporate entities are generally secured.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

C Risk Limit Control and Mitigation Policies (Continued)

(ii) For individuals
- Property
- Cars
- Deposits
- Securities (Debt securities issued by the Government of RM, Securities issued by legal entities)
- In some cases draft or draft with endorsers covering the total receivables.

Loans to individuals are generally secured.

(b) Credit-related contingencies

The primary purpose to these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. The Group issues collateralized and uncollateralized guarantees and letters of credit. The Group monitors the term of maturity of these credit commitments, because long-term commitments have greater degree of credit risk than short-term commitments, also as uncollateralized commitments regarding collateralized commitments.

D Impairment and Provisioning Policies

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are specific loss component that relates to individually significant exposures.

According to the Group's policy, there are four internal rating grades. The majority of the allowance for impairment comes from the bottom two grades. The table below shows the structure of the Group's loans and advances portfolio regarding internal rating system and the associated allowance for impairment for each internal rating grade:

	December 31, 2016		December 31, 2015	
	Loans %	Impairment %	Loans %	Impairment %
Pass/acceptable for financing (A)	76.3	1.1	69.9	1.1
Watch (careful) (B)	6.5	6.3	6.0	9.6
Sub-standard (C)	1.7	26.6	5.6	28.4
Suspicious (doubtful)+ Loss (D) +(E)	15.5	84.6	18.5	94.1
Total	**100.00**	**14.8**	**100.00**	**20.4**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

E Maximum Exposure to Credit Risk Before Collateral Held or Other Credit Enhancements

	In thousands of Denars Year ended December 31, 2016	2015
Credit risk exposure relating to balance sheet assets		
Loans and advances to banks	10,084,209	9,208,426
Loans to customers		
Loans to individuals		
- overdrafts (exemption off-balance sheet exposure)	1,085,024	1,146,181
- credit cards (exemption off-balance sheet exposure)	1,033,505	1,052,866
- loans	10,850,672	10,202,735
Loans to corporate entities		
- Large corporate clients	14,943,371	17,056,906
- Small and medium size companies (SMEs)	17,355,582	18,185,834
Financial assets at fair value through profit and loss	411,339	371,029
Financial assets available for sale	3,675,230	7,202,009
Financial assets held to maturity	3,374,729	2,516
Other assets	593,157	532,589
	63,406,818	**64,961,091**
Credit risk exposure relating to off-balance sheet assets/liabilities		
Guarantees	8,771,527	8,685,206
Letters of credit	923,166	2,231,977
Unused overdrafts on current accounts	1,148,506	1,722,585
Unused credit cards limits	1,737,632	1,186,358
Unused credit limits-noncallable	1,515,935	1,620,969
	14,096,766	**15,447,095**
Total credit risk exposure	**77,503,584**	**80,408,186**

The above table presents a worst case scenario of credit risk exposure to the Group as at 31 December 2016 and 2015, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet items, the exposures set out above are based on net carrying amounts as reported in the statement of financial position.

As shown above, 71.9% of the total maximum exposure is derived from loans and advances to banks and customers (2015: 71%); 18.2% represents off-balance-sheet items (2015: 19%).

Management is confident in its ability to continue to control and sustain minimum exposure to credit risk to the Group resulting from both loans and advances portfolio and off balance sheet items based on the following:

- 82.8% of the loans and advances are categorised in top two grades on the internal rating system (2015: 75.9%);
- Loans and advances to customers are collateralized and loans to banks are mostly in first investment grade-high credit worthiness banks ;
- 60.05% of loans and advances are considered neither past due nor impaired (2015: 63.06%).
- The decrease of off-balance-sheet items generally resultiing in decrease of financial Letters of credit, unused overdrafts on current accounts.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances

Loans and advances are summarized as follows:

	In thousands of Denars			
	Year ended December 31, 2016		Year ended December 31, 2015	
	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks
Neither past due nor impaired	2,176,673	10,081,042	2,089,285	9,201,777
Past due but not impaired	219,886	-	65,842	-
Impaired	50,764,645	4,374	57,725,785	8,533
Gross	**53,161,204**	**10,085,416**	**59,880,912**	**9,210,310**
Less: allowance for impairment	(7,893,050)	(1,207)	(12,236,390)	(1,884)
Net	**45,268,154**	**10,084,209**	**47,644,522**	**9,208,426**

Further information on the impairment allowance for loans and advances is provided in Notes 20 and 21.

(a) Loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the Group's internal rating system.

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Loans and advances to banks	10,081,042	9,201,777
Loans to customers		
Loans to individuals		
- Loans	356,692	352,875
Loans to corporate entities		
- Large corporate clients	1,537,408	1,460,697
- Small and medium size companies (SMEs)	282,573	275,713
Total	**12,257,715**	**11,291,062**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(b) Loans and advances past due but not impaired

The amount of past due but not impaired loans included exposures which are past due up to 30 days, and are mostly cash covered. Gross amount of loans and advances by class of customer that were past due but not impaired were as follows:

	In thousands of Denars December 31, 2016			
	Up to 30 days	**Up to 90 days**	**Over 90 days**	**Total**
Loans to customers	213,281	6,605	-	219,886
Value of collateral				**275,854**

	In thousands of Denars December 31, 2015			
	Up to 30 days	**Up to 90 days**	**Over 90 days**	**Total**
Loans to customers	64,453	1,389	-	65,842
Value of collateral				**98,095**

(c) Loans and advances individually impaired

i) Loans and advances

The breakdown of individually impaired loans and advances by class and the fair value of related collateral held by the Group as security, are as follows:

In thousands of Denars
December 31, 2016

	Large corporate clients	**Small and medium size companies (SMEs)**	**Loans and advances to banks**	**Overdrafts**	**Credit cards**	**Retail loans**	**Total**	**Allowance for Individuall y impaired loans**
Gross amount	16,683,832	21,031,626	4,374	1,155,863	1,098,589	10,794,735	**50,769,019**	7,894,257
Value of collateral	**23,848,453**	**29,759,291**	**-**	**4,304**	**442**	**12,619,127**	**66,231,617**	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(c) Loans and advances individually impaired (Continued)

In thousands of Denars
December 31, 2015

	Large corporate clients	Small and medium size companies (SMEs)	Loans and advances to banks	Overdrafts	Credit cards	Retail loans	Total	Allowance for Individuall y impaired loans
Gross amount	19,092,320	25,498,547	8,533	1,344,399	1,306,025	10,484,494	**57,734,318**	12,238,274
Value of collateral	**22,315,127**	**33,613,193**	**-**	**4,312**	**1,479**	**11,851,312**	**67,785,423**	

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(c) Loans and advances individually impaired (Continued)

The disclosed fair value of collateral is determined by certified appraisals and represents estimated value realizable by the legal owners of the assets. The Group makes valuations of the market value of residential property or commercial real estate at least once a year. The Group shall provide an appraisal of the market value of the property in a shorter period as well, in case of a significant decline of market prices of similar properties.

Breakdown of the collateral:

- Most of the Retail loans are covered by the property for private use (flats, houses),
- Loans for corporate clients are covered by: 1) commercial real estate 2) property for private use and pledge over movables.

Value of collateral for mitigating of credit risk

	Loans and advances to customers	
in thousands of denars	**Current year 2016**	**Previous year 2015**
Value of collateral of credit exposure assessed for impairment on an individual basis		
First-class collateral instruments		
cash deposits (in depot and/or restricted in accounts held with the Bank)	1,223,323	1,158,521
government securities	-	-
government unconditional guarantees	-	-
bank guarantees	-	83,356
Guarantees from insurance companies and insurance policies	-	-
Corporate guarantees (besides bank Guarantees and guarantees from insurance companies)	61,133	398,984
Guarantees from individuals	1	
Mortgage on real estate		-
property for private use (flats, houses)	17,292,667	17,225,271
business facility	34,289,954	33,907,303
Pledge over movables	13,678,522	15,463,763
Other types of collateral	952,928	657,330
Total value of collateral of credit exposure assessed for impairment on an individual basis	**67,498,528**	**68,894,528**

ii) Loans and advances to banks

The total gross amount of individually impaired loans and advances to banks as at 31 December 2016 amounts to Denar 4,374 thousand (2015: Denar 8,553 thousand). Generally, no collateral is held by the Group for these placements.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

F Loans and Advances (Continued)

(d) Loans and advances renegotiated

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

For the purposes of disclosures in these financial statements, 'loans with renegotiated terms' are defined as loans that have been restructured due to a deterioration in the borrower's financial position, for which the Bank has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Bank had provided initially and that it would not otherwise consider.

Once the loan is restructured it is classified as substandard in at least C risk grade and remains in the same rating grade at least two quarters independent of satisfactory performance after restructuring. The restructured loans as at 31 December 2016 and 31 December 2015 are as follows:

	In thousands of Denars	
	December 31, 2016 Carrying amount	December 31, 2015 Carrying amount
Restructured loans	**1,677,060**	**3,424,111**

The restructured loans are classified in C and D risk grades, with impairment in the range from 28% to 51%. Out of the total exposure, the amount of 655,863 thousand denars is up to 90 days and the amount of 1,021,197 thousand denars is over 90 days overdue.

G Debt Securities, Treasury Bills and Other Eligible Bills

The table below presents an analysis of debt securities, treasury bills and other eligible bills based on the respective issuer as at 31 December 2016. Issuer of the investment securities is the Central Bank of the Republic of Macedonia and the Republic of Macedonia. Fitch Ratings assigned its BB+ long term default rating and BB+ local currency long term default rating to the Republic of Macedonia.

	In thousands of Denars December 31, 2016			
Issuer	**Cash and cash equivalents**	**Trading securities**	**Investment securities**	**Total**
Central bank of Republic of Macedonia	5,778,123	-	-	5,778,123
Republic of Macedonia	-	23,165	6,984,971	7,008,136
Total	**5,778,123**	**23,165**	**6,984,971**	**12,786,259**

	In thousands of Denars December 31, 2015			
Issuer	**Cash and cash equivalents**	**Trading securities**	**Investment securities**	**Total**
Central bank of Republic of Macedonia	6,299,613	-	-	6,299,613
Republic of Macedonia	-	14,847	7,139,551	7,154,398
Total	**6,299,613**	**14,847**	**7,139,551**	**13,454,011**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

H Repossessed Collateral

As at December 31, 2016 and 2015 the Group assets obtained through foreclosure procedures amount to:

	In thousands of Denars	
	December 31, 2016 Carrying amount	December 31, 2015 Carrying amount
Property and equipment	**734,316**	**1,395,714**

I Concentration of Risks of Financial Assets with Credit Risk Exposure

a) Geographical sectors

The following table breaks down the Group's credit exposure at their carrying amount, categorized by geographic region, based on the country of domicile of counterparties:

				In thousands of Denars	
	Total	Republic of Macedonia	EU Countries	Non-EU Countries in Europe	Other countries
ASSETS					
Cash and cash equivalents	**33,538,674**	16,385,554	11,039,402	4,859,317	1,254,401
Financial assets at fair value through P&L	**411,339**	411,339	-	-	-
Loans and advances to banks	**10,084,209**	18,310	3,792,643	5,810,548	462,708
Loans and advances to customers					
Loans to individuals					
- Term Loans	**10,850,672**	10,850,672	-	-	-
- Overdrafts	**1,085,024**	1,085,024	-	-	-
- Credit cards	**1,033,505**	1,033,505	-	-	-
Loans to corporate entities					
- Large corporate customers	**14,943,371**	14,943,371	-		-
- SMEs	**17,355,582**	17,233,671	121,911	-	-
Financial assets available for sale	**3,675,230**	3,673,296	1,408	526	
Financial assets held-to-maturity	**3,374,729**	3,374,729	-	-	-
Other assets	**593,157**	593,157	-	-	-
Total assets at 31 December 2016	**96,945,492**	**69,602,628**	**14,955,364**	**10,670,391**	**1,717,109**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure (Continued)

a) Geographical sectors (Continued)

The following table breaks down the Group's credit exposure at their carrying amount, categorized by geographic region, based on the country of domicile of our counterparties:

In thousands of Denars

	Total	Republic of Macedonia	EU Countries	Non-EU Countries in Europe	Other countries
ASSETS					
Cash and cash equivalents	**27,663,719**	18,315,962	6,914,444	998,421	1,434,892
Financial assets at fair value through P&L	**371,029**	371,029	-	-	-
Loans and advances to banks	**9,208,426**	141,365	6,816,359	2,250,702	-
Loans and advances to customers					
Loans to individuals					
- Term Loans	**10,202,735**	10,202,735	-	-	-
- Overdrafts	**1,146,181**	1,146,181	-	-	-
- Credit cards	**1,052,866**	1,052,866	-	-	-
Loans to corporate entities					
- Large corporate customers	**17,056,906**	17,056,906	-		-
- SMEs	**18,185,834**	18,053,045	126,644	6,145	-
Financial assets available for sale	**7,202,009**	7,200,090	1,411	508	
Financial assets held-to-maturity	**2,516**	2,516	-	-	-
Other assets	**532,589**	532,589	-	-	-
Total assets at 31 December 2015	**92,624,810**	**74,075,284**	**13,858,858**	**3,255,776**	**1,434,892**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure (Continued)

b) Industry sector

The following table breaks down the Group's credit exposure at their carrying amount, categorized by industry sector of our counterparties:

In thousands of Denars

	Total	Manufac -turing	Commerce and finance	Retail customers	Agriculture	Government and local authorities	Construc -tion	Transport	Trade	Other
ASSETS										
Cash and cash equivalents	**33,538,674**	-	33,538,674	-	-	-	-	-	-	-
Financial assets at fair value through profit and loss	**411,339**	-	388,174	-	-	23,165	-	-	-	-
Loans and advances to banks	**10,084,209**	-	10,084,209	-	-	-	-	-	-	-
Loans and advances to customers										
Loans to individuals										
- Term Loans	**10,850,672**	-	-	10,850,672	-	-	-	-	-	-
- Overdrafts	**1,085,024**	-	-	1,085,024	-	-	-	-	-	-
- Credit cards	**1,033,505**	-	-	1,033,505	-	-	-	-	-	-
Loans to corporate entities										
- Large corporate customers	**14,943,371**	5,530,685	13,211	-	250,140	1,474107	857,672	30,167	3,289,514	3,497,875
- SMEs	**17,355,582**	4,053,342	89,949	-	843,512	43,279	2,613,786	692,117	5,923,688	3,095,909
Financial assets available for sale	**3,675,230**	-	64,988	-	-	3,610,242	-	-	-	-
Financial assets held to maturity	**3,374,729**	-	-	-	-	3,374,729	-	-	-	-
Other assets	**593,157**	-	593,157	-	-	-	-	-	-	-
Total assets at 31 December 2016	**96,945,492**	**9,584,027**	**44,772,362**	**12,969,201**	**1,093,652**	**8,525,522**	**3,471,458**	**722,284**	**9,213,202**	**6,593,784**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Credit Risk (Continued)

I Concentration of Risks of Financial Assets with Credit Risk Exposure (Continued)

b) Industry sector (Continued)

The following table breaks down the Group's credit exposure at their carrying amount, categorized by industry sector of our counterparties:

In thousands of Denars

	Total	Manufac -turing	Commerce and finance	Retail customers	Agriculture	Government and local authorities	Construc -tion	Transport	Trade	Other
ASSETS										
Cash and cash equivalents	27,663,719	-	27,663,719	-	-	-	-	-	-	-
Financial assets at fair value through profit and loss	371,029	-	356,182	-	-	14,847	-	-	-	-
Loans and advances to banks	9,208,426	-	9,208,426	-	-	-	-	-	-	-
Loans and advances to customers										
Loans to individuals										
- Term Loans	10,202,735	-	-	10,202,735	-	-	-	-	-	-
- Overdrafts	1,146,181	-	-	1,146,181	-	-	-	-	-	-
- Credit cards	1,052,866	-	-	1,052,866	-	-	-	-	-	-
Loans to corporate entities										
- Large corporate customers	17,056,906	6,315,463	19,980	-	135,414	1,478,449	959,716	287,913	3,913,771	3,946,200
- SMEs	18,185,834	4,475,312	376,743	-	860,192	38,208	2,740,068	1,473,478	5,004,787	3,217,046
Financial assets available for sale	7,202,009	-	64,973	-	-	7,137,036	-	-	-	-
Financial assets held to maturity	2,516	-	-	-	-	2,516	-	-	-	-
Other assets	532,589	-	532,589	-	-	-	-	-	-	-
Total assets at 31 December 2015	**92,624,810**	**10,790,775**	**38,222,612**	**12,401,782**	**995,606**	**8,671,056**	**3,699,784**	**1,761,391**	**8,918,558**	**7,163,246**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk

The Group takes on exposure to market risk. Market risk arises from open positions in interest rate, currency, and price risk, all of which are exposed to general and specific market movements. The Group estimates the market risk of positions held and the maximum losses expected based upon a number of assumptions for various changes in market conditions. The Board of Directors sets limits on the value of risk that may be accepted, which is monitored on a regular basis.

A Market Risk Measurement

Regarding market risk managing and measuring, the Group's management on a regular basis through adequate analysis and reporting process, is monitoring:

- interest rate changes regarding market movements and internal decisions, and the influence on interest bearing assets and liabilities and the net interest margin;
- changes of foreign currency rates regarding foreign currency assets and liabilities and maintain of adequate structure regarding foreign exchange risk exposure;

The aim of the Group is maximizing the stability and profitability, by applying the optimum combination of foreign currency and interest rate structure of the assets and liabilities.

B Foreign Currency Risk

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for overnight position, which are monitored daily. The table below summarizes the Group's exposure to foreign currency exchange rate risk at 31 December 2016 and 2015. Included in the table are the Group's assets and liabilities at carrying amounts categorized by currency.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

B Foreign Currency Risk (Continued)

(i) Concentrations of assets and liabilities

The Group had the following significant currency positions:

				In thousands of Denars December 31, 2016	
	EUR	**USD**	**MKD**	**Other**	**Total**
Assets					
Cash and cash equivalents	10,829,113	4,116,209	16,385,554	2,207,798	**33,538,674**
Financial assets at fair value through profit and loss	23,165	-	388,174	-	**411,339**
Financial assets available-for-sale	1,409	526	3,673,295	-	**3,675,230**
Financial assets held-to-maturity	1,192,901	-	2,181,828	-	**3,374,729**
Loans and advances to banks	9,722,397	-	18,310	343,502	**10,084,209**
Loans and advances to customers	14,795,602	718,460	29,754,092	-	**45,268,154**
Investments in associates	-	-	210,171	-	**210,171**
Other assets	200,970	109,367	282,704	116	**593,157**
Total assets	**36,765,557**	**4,944,562**	**52,894,128**	**2,551,416**	**97,155,663**
Liabilities					
Deposits from banks and other financial institutions	356,965	228,007	928,281	135,210	**1,648,463**
Deposits from customers	33,534,115	4,625,288	45,580,513	2,375,421	**86,115,337**
Borrowings	1,525,744	-	124,778	-	**1,650,522**
Other liabilities	163,722	15,625	407,991	11,205	**598,543**
Total liabilities	**35,580,546**	**4,868,920**	**47,041,563**	**2,521,836**	**90,012,865**
Net on-balance sheet financial position	1,185,011	75,642	5,852,565	29,580	7,142,798
Contingencies and commitments	**4,544,190**	**427,189**	**9,125,388**	**-**	**14,096,767**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

B Foreign Currency Risk (Continued)

(i) Concentrations of assets and liabilities

	In thousands of Denars December 31, 2015				
	EUR	USD	MKD	Other	Total
Total assets	**33,110,666**	**4,739,029**	**52,509,492**	**2,454,770**	**92,813,957**
Total liabilities	**33,680,181**	**4,712,420**	**46,041,149**	**2,445,427**	**86,879,178**
Net on-balance sheet financial position	**(569,515)**	**26,609**	**6,468,343**	**9,343**	**5,934,779**
Contingencies and commitments	**6,162,866**	**400,312**	**8,883,917**	**-**	**15,447,095**

The table below summarizes the sensitivity analysis for foreign currency risk and the effect on the profit or loss:

			In thousands of Denars Effect on profit and loss and equity	
	Increase 2016	Increase 2015	2016	2015
EUR	0.5%	0.5%	5,925	(2,847)
USD	5.0%	5.0%	3,782	1,330
Other	1.0%	1.0%	296	93

C Interest Rate Risk

The Group's operations are subject to the risk of interest rate fluctuations to the extent that interest-bearing assets and interest-bearing liabilities mature or re-price at different times or in differing amounts. In the case of floating rate assets and liabilities, the Group is also exposed to basis risk, which is the difference in re-pricing characteristics of the various floating rates, such as the savings rates, LIBOR/EURIBOR and different types of interest. Risk management activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Group's business strategies.

Assets-liability risk management activities are conducted in the context of the Group's sensitivity to interest rate changes. In general, the Group is asset sensitive because of the majority of the interest-bearing assets; the Group has the right simultaneously to change the interest rates. In decreasing interest rate environments, margins earned will narrow as liabilities interest rates will decrease with a lower percentage compared to assets interest rate. However the actual effect will depend on various factors, including stability of the economy, environment and level of the inflation.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

C Interest Rate Risk (Continued)

In thousands of Denars	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2016							
Assets							
Cash and cash equivalents	19,254,603	3,152,995	-	-	-	11,131,076	**33,538,674**
Financial assets at fair value through profit and loss	-	-	-	-	-	411,339	**411,339**
Financial assets available –for-sale	1,199,131	49,905	2,357,606	-	-	68,588	**3,675,230**
Financial assets held-to-maturity	99,955	567,577	2,108,873	596,993	-	1,331	**3,374,729**
Loans and advances to banks	759,076	2,460,839	6,862,930	-	-	1,364	**10,084,209**
Loans and advances to Customers	2,403,473	2,814,614	30,662,628	3,700,593	4,245,240	1,441,606	**45,268,154**
Investments in associates	-	-	-	-	-	210,171	**210,171**
Other assets	-	-	-	-	-	593,157	**593,157**
Total assets	**23,716,238**	**9,045,930**	**41,992,037**	**4,297,586**	**4,245,240**	**13,858,632**	**97,155,663**
Liabilities							
Deposits from banks and other financial institutions	624,631	365,211	365,037	-	-	293,584	**1,648,463**
Deposits from customers	46,726,514	10,070,238	27,628,038	-	-	1,690,547	**86,115,337**
Borrowings	130,011	3,573	336,760	944,107	108,859	127,212	**1,650,522**
Other liabilities	-	-	-	-	-	598,543	**598,543**
Total liabilities	**47,481,156**	**10,439,022**	**28,329,835**	**944,107**	**108,859**	**2,709,886**	**90,012,865**
Total interest repricing gap	**(23,764,918)**	**(1,393,092)**	**13,662,202**	**3,353,479**	**4,136,381**	**11,148,746**	**7,142,798**
As at 31 December 2015							
Total assets	**22,874,521**	**8,247,462**	**41,292,199**	**4,309,039**	**4,079,339**	**12,011,397**	**92,813,957**
Total liabilities	**42,723,849**	**11,358,528**	**28,982,174**	**1,265,957**	**168,361**	**2,380,308**	**86,879,177**
Total interest repricing gap	**(19,849,328)**	**(3,111,066)**	**12,310,025**	**3,043,082**	**3,910,978**	**9,631,089**	**5,934,780**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.2. Market Risk (Continued)

C Interest Rate Risk (Continued)

The interest rate sensitivity analysis has been determined based on the exposure to interest rate risk at the reporting date. At 31 December 2016, if variable interest rates had been 100 basis points higher/lower (2015: 100 basis points higher/lower) with all other variables held constant, the profit or loss for the twelve month period ended 31 December 2016 would increase/decrease by approximately Denar 102,415 thousand (2015: increase/decrease by approximately Denar 103,873 thousand). If adjustable interest rates had been 150 basis points (2015: 150 basis points) higher/lower with all other variables held constant, the profit or loss for the twelve month period ended 31 December 2016 would respectively decrease /increase by approximately Denar 814,744 thousand (2015: Denar 745,622 thousand).

The sensitive analysis refers to the Bank, because of the insignificant participation (under 1%) of total assets of the subsidiary in the assets of the Bank.

4.3. Liquidity Risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence of liquidity risk may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

A Liquidity Risk Management Process

Liquidity risk management policy of the Group defines the method of managing the Group's liquidity.

Perception and monitoring of the Group's liquidity is an essence of its stability and successful working. Implementation of the liquidity risk management policy is done using defined risk management process which includes planning and managing with cash flows, maintaining adequate structure of assets and liabilities, financial instruments for liquidity risk management, adequate diversification of deposits and other liabilities by maturity and client, procedures for identification and monitoring the deposit's stability, monitoring the maturity of assets and liabilities, monitoring the off-balance sheet items, monitoring liquidity ratios, internal liquidity indicators, liquidity stress testing and continuity plan in irregular conditions reporting to Group's bodies and adequate management information system and responsibilities of Group's organizational units in liquidity risk management process. The aim of the Group is maximizing the profitability, by applying the optimum combination of maturity and foreign currency structure of the assets and liabilities.

However, the Group strives to use adequate term structure of funds adjusted to term structure of placements, based on contractual and expected maturity of the deposit base. The primary strategy of the Group is to maintain its liquidity at the highest level.

The table below analyses the undiscounted contractual cash flows of assets and liabilities of the Group into relevant maturity buckets based on the remaining period at the date of the statement of financial position to the contractual maturity date for assets and liabilities. The presented information represents undiscounted cash flows, which include estimated interest payments

Although the Group has a shortage of short-term assets over short-term liabilities maturing within one month, one to three months, the Group's management considers its deposit base as being stabile and liquidity not jeopardized. This is based on statistical data and calculations of expected maturity in order to determine the funding and stability of the deposit base.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.3. Liquidity Risk (Continued)

A Liquidity Risk Management Process (Continued)

Maturities of assets and liabilities

In thousands of Denars
December 31, 2016

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits from banks and other financial institutions	941,109	181,768	396,926	131,396	-	1,651,199
Deposits from customers	46,485,304	10,335,519	22,187,364	7,471,058	4,765	86,484,010
Borrowings	133,299	3,580	330,998	1,083,346	123,105	1,674,328
Other liabilities	532,918	12,977	3,913	12,961	35,774	598,543
Total liabilities (contractual maturity dates)	**48,092,630**	**10,533,844**	**22,919,201**	**8,698,761**	**163,644**	**90,408,080**
Total assets (contractual maturity dates)	**30,896,028**	**9,083,709**	**23,390,551**	**22,418,501**	**11,156,703**	**96,945,492**

In thousands of Denars
December 31, 2015

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits from banks and other financial institutions	758,058	196,724	131,843	281,789	-	1,368,414
Deposits from customers	42,810,420	11,134,026	21,923,001	7,127,007	674	82,995,128
Borrowings	172,903	12,531	413,072	1,421,320	179,645	2,199,471
Other liabilities	478,714	4,309	5,056	(3,510)	27,861	512,430
Total liabilities (contractual maturity dates)	**44,220,095**	**11,347,590**	**22,472,972**	**8,826,606**	**208,180**	**87,075,443**
Total assets (contractual maturity dates)	**28,125,485**	**8,370,660**	**23,062,762**	**21,904,697**	**11,161,206**	**92,624,810**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.3. Liquidity Risk (Continued)

B Assets Held for Managing Liquidity Risk

The Group holds a diversified portfolio of cash, highly marketable assets and highly-liquid securities to support payment obligations in stressed market environment. The Group's assets held for managing liquidity risk comprise:

- Cash and balances with the National Bank of Republic of Macedonia;
- Treasury bills;
- Government bills and Government bonds that are readily acceptable in repurchase agreements with the National Bank of Republic of Macedonia;
- Short-term Loans and advances to banks.

C Off-balance Sheet Items (Uncollateralized)

(a) Guarantees

The maturity buckets are based on the remaining contractual maturity date of the guarantees i.e. the earliest period in which the guarantees could be called.

(b) Letter of credit

The maturity groupings based on the remaining contractual maturity date of letter of credit are also included in the table below.

(c) Other

This item includes approved undistributed overdrafts on current accounts and cards and loans in Denars. The maturity buckets based on the remaining contractual maturity date are summarized in the table below:

	In thousands of Denars December 31, 2016			
	Up to 1 year	1-5 years	Over 5 years	Total
Guarantees	5,399,665	3,312,680	96,239	8,808,584
Letter of credit	835,339	88,735	-	924,074
Other	4,476,686	-	-	4,476,686
Total	**10,711,690**	**3,401,415**	**96,239**	**14,209,344**

	In thousands of Denars December 31, 2015			
	Up to 1 year	1-5 years	Over 5 years	Total
Guarantees	4,640,804	4,075,123	6,426	8,722,353
Letter of credit	2,152,544	85,285	-	2,237,829
Other	4,636,660	-	-	4,636,660
Total	**11,430,008**	**4,160,408**	**6,426**	**15,596,842**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.4. Financial instruments

A Fair value

Fair value represents the amount at which an asset could be replaced or a liability settled on regular, market conditions between informed and voluntary parties. Fair value has been based on management assumptions according to the profile of the asset and liability base.

The following table summarizes the carrying amounts and fair values of financial assets and liabilities.

Financial instruments not measured at fair value

In thousands of Denars

	Carrying amount		Fair value	
	As at 31 December 2016	As at 31 December 2015	As at 31 December 2016	As at 31 December 2015
Financial assets				
Loans and advances to banks	10,084,209	9,208,426	10,084,209	9,208,426
Loans and advances to customers	45,268,154	47,644,522	45,260,976	47,641,292
- Retail customers(individuals)	12,969,201	12,401,782	12,969,201	12,401,782
- large corporate customers	14,943,371	18,185,834	14,943,371	18,185,701
- SMEs	17,355,582	17,056,906	17,348,404	17,053,809
Financial assets held-to-maturity	3,374,729	2,516	3,378,655	2,483
Financial liabilities				
Deposits from banks and other financial institutions	1,648,463	1,363,581	1,648,463	1,363,581
Deposits from customers	86,115,337	82,837,690	86,115,337	82,837,690
Borrowings	1,650,522	2,165,476	1,650,522	2,165,476

The fair value of the above presented financial assets and liabilities are determined within level 2 fair value measurement hierarchy

a) Loans and advances to banks

The fair value of loans and advances to banks is equal to their carrying amounts due to their short-term maturity.

b) Loans and advances to customers

Loans and advances to customers are stated according to amortized cost less impairment. A major part of the loans and advances to customers is with adjustable interest rate. The appraised fair value of loans and advances to customers is determined by the discounted expected future cash flows. Expected future cash flows for determining the fair value are discounted using current market interest rate.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.4. Financial instruments (Continued)

A Fair value (Continued)

c) Financial assets held-to-maturity

Fair value for assets classified as held-to-maturity is based on published prices on active market or published prices available from stock exchange, dealer and broker. In cases where this information is not available, fair value is estimated by: information for realized prices of recent normal commercial transactions among voluntary parties; analysis of discounted cash flows; other alternative models for price determination.

d) Deposits from banks and other financial institutions

Due to their short-term maturity and the insignificant risk of changes in value, the fair value of demand and time deposits is equal to their carrying amounts. The fair value of deposits with adjustable interest rate is their carrying amount.

e) Deposits from customers

The fair value of the sight deposits and the deposits with adjustable interest rate is their carrying amount. The amount of deposits with fixed interest rates is nil, thus the carrying amount of total deposits of other customers approximates their carrying amount.

f) Borrowings

Fair value of borrowings with variable interest rate does not differ from its carrying value due to interest rate adjustment for specific financial liabilities with market interest rates for similar instruments. The fair value of credit lines regulated with special terms and for which the market does not provide reliable estimates of prices for similar instruments, approximately presents their carrying value.

B Fair value hierarchy

The Group classifies all financial assets and liabilities at fair value, using fair value hierarchy which reflects the significance of inputs used in determining fair value. The fair value hierarchy includes the following levels:

a) Level 1 – Fair value is determined directly with reference to quoted market prices of the financial instruments in active markets;

b) Level 2 - Fair value is determined using valuation techniques that include active markets inputs, which can be direct, i.e. prices, or indirect, i.e. derived from prices;

c) Level 3 - Fair value is determined using valuation techniques that include inputs that cannot be directly or indirectly followed on the active markets, or are not observable.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.4. Financial instruments (Continued)

B Fair value hierarchy (Continued)

For financial instruments carried at fair value, the level in the fair value hierarchy into which the fair values are categorised are as follows:

	In thousands of Denars December 31,2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets at fair value through profit and loss				
- Debt and other fixed income investments securities	23,165	-	-	**23,165**
- Equity investments	385,676	2,498		**388,174**
Financial assets available-for-sale				
–Government bills	-	3,203,202	-	**3,203,202**
- Government bonds	-	407,040	-	**407,040**
Total assets	**408,841**	**3,612,740**		**4,021,581**

	In thousands of Denars December 31,2015			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets at fair value through profit and loss				
- Debt and other fixed income investments securities	14,847	-	-	**14,847**
- Equity investments	353,994	2,187	-	**356,181**
Financial assets available-for-sale				
–Government bills	-	6,186,040	-	**6,186,040**
- Government bonds	-	950,996	-	**950,996**
Total assets	**368,841**	**7,139,223**	**-**	**7,508,064**

4. FINANCIAL RISK MANAGEMENT (Continued)

4.5 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The operational risk includes legal risk, as well the risk of money laundering and terrorist financing, risk of inadequacy of IT systems and other operational risk.

Legal risk is current or prospective risk to the Group's profit and own funds, caused by violation or non-adherence to the legal framework, agreements, prescribed practices, ethics standards, or as a result of misinterpretation of the regulations, rules, agreements and other legal documents.
The Group had established a framework for managing the operational risk that is based on Strategy, Policy and Methodology; appropriate organizational structure and established process for managing this risk. The established framework allows within the various Group processes to identify risks arising from these processes, their measurement and taking corrective actions in order to avoid the potential adverse effect on the financial results and capital position of the Group. The adequacy of the established framework for managing operational risk is regularly reviewed.

The Group is identifying and measuring the operational risk by analyzing the collected data on loss events and key risk indicators, as well as applying the method of self-assessment through a qualitative approach and analysis of external data losses at other banks.

The Group sets the capital requirement for operational risk, using the standardized approach in accordance with national legislation.

4.6. Capital management

According to the Decision on consolidated supervision of the Central Bank, if total assets of the subordinated entity represent less than 1% of the assets of the parent entity, subordinated entity will not be included in the consolidated financial statements for purposes of consolidated supervision. Based on the above, capital adequacy is not determined on a consolidated basis.

The Bank's objectives regarding capital management, which is a broader concept than the 'equity' on the face of the statement of financial position, are:

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

Capital adequacy and the use of regulatory capital are regularly monitored by the Bank's management, employing techniques prescribed by national regulatory authority, i.e. the National Bank of Republic of Macedonia (NBRM). The required information is submitted to regulatory authority on a quarterly basis.

In addition, the Bank has established a Process of determining the Internal Capital (PIC) in accordance with the Decision on risk management, prescribed by the NBRM. The process of determining the internal capital is based on adopted Policy and Procedures and within the process, the Bank:

- determines the internal capital required to cover the acceptable level of risk, in accordance with its risk profile and the size and complexity of current and future financial activities;
- is aiming to establish a sustainable level of capital in long term, taking into account the impact of all material risks, etc.

The Bank determines its own funds and capital adequacy in accordance with the Methodology for determining capital adequacy and own funds prescribed by the NBRM. In accordance with the regulation, the credit risk weighted assets and the capital required for coverage of operational risks are calculated based on the standardized approach.

The regulatory authority requires that each bank has to maintain capital adequacy ratio above 8%.

The Bank's regulatory capital is divided in two groups:

4. FINANCIAL RISK MANAGEMENT (Continued)

4.6. Capital management (Continued)

- Tier 1 that includes: ordinary and non-cumulative non-voting shares and share premium, statutory reserves and retained earnings or loss, items as result of consolidation, less: intangible assets;
- Tier 2 that includes: cumulative non-voting shares and share premium, hybrid capital liabilities and subordinated liabilities.

Investments in other Banks or financial institutions and investments in insurance and re-insurance companies over 10% of capital of such institutions are deducted from Tier 1 and Tier 2 capital to arrive at the regulatory capital.

Total risk-weighted asset is a sum of credit risk-weighted assets, currency risk weighted assets, operational risk weighted assets and other risk-weighted assets.

According to national regulations, credit risk-weighted assets (on-balance and off-balance) are distributed by appropriate risk weights according to the level of credit quality (credit rating) of the debtor, taking into consideration credit protection instruments.The capital adequacy ratio is calculated as a ratio between the Bank's regulatory capital and the risk weighted assets.

The table below summarizes the compositions of regulatory capital and the capital adequacy ratio of the Bank for the years ended 31 December 2016 and 2015 in accordance with the requirements of regulatory authority. During these two years, the Bank complied with all of the regulatory imposed capital requirements to which the Bank is subject.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

4. FINANCIAL RISK MANAGEMENT (Continued)

4.6. Capital management (Continued)

	In thousands of Denars
Tier 1 capital	**December 31, 2016**
Ordinary and non-cumulative non-voting shares and share premium	3,050,594
Statutory reserves and retained earnings or loss	6,708,773
Items as result of consolidation	-
Deductions from Tier 1 capital	(420)
Total qualifying Tier 1 capital	**9,758,947**
Tier 2 capital	
Cumulative non-voting shares and share premium	-
Hybrid capital liabilities	-
Subordinated liabilities	-
Revaluation reserves	4,937
Total qualifying Tier 2 capital	**4,937**
Deductions from regulatory capital	(259,256)
Total regulatory capital	**9,504,628**
Credit risk-weighted assets	**53,249,576**
FX risk-weighted assets	**1,454,050**
Operational risk-weighted assets	**7,710,206**
Other risks weighted assets	**-**
Capital adequacy ratio	**15.2%**

Tier 1 capital	**December 31, 2015**
Ordinary and non-cumulative non-voting shares and share premium	3,050,594
Statutory reserves and retained earnings or loss	6,468,549
Items as result of consolidation	-
Deductions from Tier 1 capital	(914)
Total qualifying Tier 1 capital	9,518,229
Tier 2 capital	
Cumulative non-voting shares and share premium	-
Hybrid capital liabilities	-
Subordinated liabilities	-
Total qualifying Tier 2 capital	**-**
Deductions from regulatory capital	(238,231)
Total regulatory capital	**9,279,998**
Credit risk-weighted assets	**59,137,539**
FX risk-weighted assets	**493,000**
Operational risk-weighted assets	**7,544,649**
Other risks weighted assets	-
Capital adequacy ratio	**13.8%**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

5. SEGMENT REPORTING

Segment reporting is carried out by the Group's operating segments.

Operating segment is a component of the activities of the Group for which the following conditions have been fulfilled:

- Performs activities as a result based on which incomes are generated and expenditures arise;
- Is being reviewed by the Group's Supervisory Board, in order to assess the accomplishments and make decisions for future business activities of the segment; and
- Financial information for the segment is available.

The Group discloses the information independently for each significant operating segment. A segment is considered significant if:

- The income of the segment participates with more than 10% of the total income of the Group;
- The amount of the profit or loss represents 10% or more from the total income of all operating segments which have made profit, or from the total loss of all the operating segments which have made loss;
- Total assets of the segment participate with 10% or more of the Group's total assets;
- Management has assessed that they are significant to follow for the Group's management needs.

For the purposes of the financial reporting, the Group groups two or more segments into one operating segment if those operating segments are similar in terms of the variety of the goods and services, the type of the users of the goods and of the services and the methods of distribution and offering of the goods and services. As at December 31, 2016 and 2015 the Group does not group two or more operating segments into one.

The operating segments of Komercijalna banka are the same as the business lines (BL) prescribed in the "Decision on the methodology for determining capital adequacy", using the standardized approach for the determination of capital required for coverage of operational risk.

Geographical areas according to which the Group is reporting are:

- Member countries of the European Union;
- Other European countries, outside the EU;
- Countries outside Europe, members of the Organization for Economic Cooperation and Development (OECD);
- Other countries.

As at December 31, 2016 and 2015 there are no significant clients upon which the Group realizes 10% or more from its total business income or expenditure.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

5. SEGMENT REPORTING (Continued)

A. Operating segments

December 31, 2016

In thousands of Denars	BL 1: Services related to financing of medium and large sized enterprises	BL 2: Trading and sales	BL 3: Retail banking	BL 4: Corporate banking	BL 5: Payment and settlement	BL 6: Custody services	BL 7: Asset management	BL 8: Retail brokerage	Other insignificant operating segments	Unallocated	**Total**
Net interest income	-	1,285	477,164	2,600,617	119	1	-	-	-	-	**3,079,186**
Net fee and commission income	-	1,879	81,553	161,070	593,404	23,596	-	2,752	21,228	(6)	**885,476**
Dividend income	-	6,106	-	104	-	-	-	-	-	-	**6,210**
Net gains/(losses) on financial instruments classified as held for trading	-	12,870	-	-	-	-	-	-	209	-	**13,079**
Other operating income	-	157,386	(20,855)	432,308	31,966	(8,863)	-	1	3	17,503	**609,449**
Share of profit of associates accounted for using the equity method	-	-	-	-	-	-	-	-	43,625	-	**43,625**
Income realized between the segments	-	-	-	-	-	-	-	-	-	-	
Total income per segment	**-**	**179,526**	**537,862**	**3,194,099**	**625,489**	**14,734**	**-**	**2,753**	**65,065**	**17,497**	**4,637,025**
Net impairment losses on financial assets	-		(19,480)	(1,689,120)	-	-	-	-	-	-	**(1,708,600)**
Personnel expenses	-	(8,783)	(194,478)	(123,290)	(314,560)	(8,783)	-	(9,627)	(5,680)	(184,936)	**(850,137)**
Depreciation and amortization	-	(1,924)	(42,611)	(27,013)	(68,921)	(1,924)	-	(2,109)	(118)	(40,520)	**(185,140)**
Other operating expenses	-	(10,321)	(387,009)	(401,604)	(119,674)	(1,761)	-	(2,849)	(1,631)	(88,515)	**(1,013,364)**
Investments in property and equipment	-	-	-	-	-	-	-	-	-	-	
Total expenses per segment	**-**	**(21,028)**	**(643,578)**	**(2,241,027)**	**(503,155)**	**(12,468)**	**-**	**(14,585)**	**(7,429)**	**(313,971)**	**(3,757,241)**
Financial result per segment	-	158,498	(105,716)	953,072	122,334	2,266	-	(11,832)	57,636	(296,474)	**879,784**
Income tax expense											**(93,717)**
Profit for the year											**786,067**
Total assets per segment	-	441,271	14,210,097	82,518,822	2,708,915	35,476	-	36,526	216,564		**100,167,671**
Unallocated assets per segment										729,398	**729,398**
Total assets											**100,897,069**
Total liabilities per segment	-	-	64,772,708	24,613,543	132,326	513,157	-	-	511		**90,032,245**
Unallocated liabilities per segment										149,798	**149,798**
Total liabilities											**90,182,043**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

5. SEGMENT REPORTING (Continued)

A. Operating segments (Continued)

December 31, 2015

In thousands of Denars	BL 1: Services related to financing of medium and large sized enterprises	BL 2: Trading and sales	BL 3: Retail banking	BL 4: Corporate banking	BL 5: Payment and settlement	BL 6: Custody services	BL 7: Asset management	BL 8: Retail brokerage	Other insignificant operating segments	Unallocated	**Total**
Net interest income	-	156	306,241	2,871,283	142	(14)	-	-	-	-	**3,177,808**
Net fee and commission income	-	(2,279)	72,826	175,480	625,648	23,710	-	1,897	18,461	32	**915,775**
Dividend income	-	5,515	-	67	-	-	-	-	101	-	**5,683**
Net gains/(losses) on financial instruments classified as held for trading	-	7,177	-	-	-	-	-	-	315	-	**7,492**
Other operating income	-	204,235	(478,530)	633,165	12,365	(256)	-	5	3	35,088	**406,075**
Share of profit of associates accounted for using the equity method	-	-	-	-	-	-	-	-	39,028	-	**39,028**
Income realized between the segments	-	-	-	-	-	-	-	-	-	-	**-**
Total income per segment	**-**	**214,804**	**(99,463)**	**3,679,995**	**638,155**	**23,440**	**-**	**1,902**	**57,908**	**35,120**	**4,551,861**
Impairment charge for credit losses	-	-	(18,790)	(1,702,510)	-	-	-	-	-	-	**(1,721,300)**
Personnel expenses	-	(8,423)	(187,381)	(120,820)	(308,117)	(9,166)	-	(9,910)	(5,310)	(182,013)	**(831,140)**
Depreciation and amortization	-	(1,993)	(44,324)	(28,579)	(72,884)	(2,168)	-	(2,344)	(61)	(43,056)	**(195,409)**
Other operating expenses	-	(10,386)	(394,724)	(590,209)	(112,967)	(1,672)	-	(2,861)	(12,262)	(110,575)	**(1,235,656)**
Investments in property and equipment											
Total expenses per segment	**-**	**(20,802)**	**(645,219)**	**(2,442,118)**	**(493,968)**	**(13,006)**	**-**	**(15,115)**	**(17,633)**	**(335,644)**	**(3,983,505)**
Financial result per segment	-	194,002	(744,682)	1,237,877	144,187	10,434	-	(13,213)	40,275	(300,524)	**568,356**
Income tax expense											**(62,386)**
Profit for the year											**505,970**
Total assets per segment	-	402,656	13,401,192	79,819.273	2,650,551	38,960	-	39,945	193,550		**96,546,127**
Unallocated assets per segment										770,640	**770,640**
Total assets											**97,316,767**
Total liabilities per segment	-	-	64,498,024	21,994,628	125,404	266,690	-	7	1,012		**86,885,765**
Unallocated liabilities per segment										213,294	**213,294**
Total liabilities											**87.099,059**

5. SEGMENT REPORTING (Continued)

B. Geographical areas

In thousands of Denars

December 31, 2016

	Republic of Macedonia	EU member countries	Europe (other)	OECD member countries (without EU members of OECD)	Other (insignificant geographical areas)	Unallocated	**Total**
Total income	4,587,786	21,763	15,069	12,035	360	12	**4,637,025**
Non-current assets*	3,741,406	-	-	-	-	-	**3,741,406**

In thousands of Denars

December 31, 2015

Total income	4,231,128	138,804	147,318	34,999	(2,065)	1,677	**4,551,861**
Non-current assets*	4,502,810	-	-	-	-	-	**4,502,810**

*Non-current assets include items of property and equipment, investment property, intangible assets and assets acquired through foreclosure procedure.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

6. NET INTEREST INCOME

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
Interest and similar income		
Loans and advances:		
- To banks	4,729	12,684
- To customers	3,208,185	3,547,729
Cash and cash equivalents	258,597	226,950
Investment securities	164,744	107,435
Other	708	-
	3,636,963	**3,894,798**
Interest expense and similar charges		
Deposits from banks and other financial institutions	21,529	19,164
Deposits from customers	518,240	676,103
Other borrowed funds	18,008	21,723
	557,777	**716,990**

Interest income from collected previously written off interest amounts to Denar 264,535 thousand (2015: Denar 377,745 thousand).

As at 31 December 2016 the interest income from financial assets at fair value through profit or loss is Denar 577 thousand (2015: Denar 156 thousand).

7. NET FEE AND COMMISSION INCOME

	In thousands of Denars	
	December 31, 2016	**December 31, 2015**
Fee and commission income		
Payment operations		
-in the country	377,446	386,541
-abroad	197,676	206,276
Letters of credit and guarantees	171,770	174,818
Credit cards	210,716	187,752
Brokerage fees	4,954	2,821
Fiduciary activities	25,863	23,749
Banking services	71,847	-
Other	72,924	139,674
	1,133,196	**1,121,631**
Fee and commission expense		
Loans	153,339	117,510
Payment operations		
-in the country	67,124	65,195
-abroad	13,533	12,661
Brokerage fees	704	717
Fiduciary activities	2,082	1,070
Other	10,938	8,703
	247,720	**205,856**

8. NET GAINS/(LOSSES) ON FINANCIAL INSTRUMENTS CLASSIFIED AS HELD FOR TRADING

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Gains/(losses) from changes in fair value of equity securities, net (realized/unrealized)	13,079	7,492
Net (losses)/gains on financial instruments classified as held for trading	**13,079**	**7,492**

9. OTHER OPERATING INCOME

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Membership fee for credit cards	37,781	37,660
Net foreign currency transactions	30,833	62,422
Rental income	8,884	14,864
Collected previously written off receivables	286,624	99,412
Gain on sale of Property Plant and Equipment	107	457
Gain on sale of assets acquired through foreclosure procedures	101,265	26,198
Other	18,478	33,793
	483,972	**274,806**

The amount of MKD 286,624 thousand in 2016 in the line Collected previously written off receivables is derived from the collection of the receivables that the Bank has written off during the 2016, according the Decision for amending the Decision for managing the credit risk from NBRM (Official Gazette 223/16), i.e. after the fulfilment of the condition two year to be passed from date the Bank was required to fully impair the receivable.

The amount of MKD 101,265 thousand in 2016 in the line “Capital gain from the sale of foreclosed assets” results from sale of several foreclosed assets (production line, catering facility and commercial building), while in 2015 a significant part of the capital gain was from sale of a single industrial facility.

10. PERSONNEL EXPENSES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Wages and salaries	583,672	572,410
Contributions to defined contribution plans	209,991	207,129
Other staff costs	56,474	51,601
	850,137	**831,140**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

11. OTHER OPERATING EXPENSES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Insurance premiums for deposits	306,446	306,944
Services	169,466	165,778
Administration and marketing costs	71,820	77,161
Materials	73,145	82,054
Loss on sale of assets acquired through foreclosure procedure	909	1,046
Tax and contributions	2,287	2,242
Court litigation expenses	4,722	8,172
Provisions for pension and other employee benefits, net	2,021	11,510
Loss from sale of securities available-for-sale	362	84
Other	28,331	16,914
	659,509	**671,905**

12. NET IMPAIRMENT LOSSES ON FINANCIAL ASSETS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Loans and advances to banks (Note 19)	(677)	715
Loans and advances to customers (Note 20)	1,711,191	1,712,291
Other assets (Note 25)	35,187	35,071
Contingencies and commitments (Note 33)	(37,171)	(26,382)
Cash and Cash equivalents (Note 15)	70	(395)
	1,708,600	**1,721,300**

13. INCOME TAX EXPENSE

The major components of income taxes in profit or loss are as follows:

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Current tax expense		
Current year	94,317	64,442
Deferred tax expense		
Origination of temporary differences	(600)	(2,056)
Total income tax expenses	**93,717**	**62,386**

13. INCOME TAX EXPENSE (CONTINUED)

The total charge for the year can be reconciled to the accounting profit as follows:

				In thousands of Denars
	In %	December 31, 2016	In %	December 31, 2015
Profit before tax		879,784		579,063
Tax calculated at a tax rate of 10% (2015: 10%)	10.00	87,978	10.00	57,906
Non-deductible expenses	0.7	6,410	0.9	5,087
Tax-exempt income	(0.1)	(671)	(0.1)	(607)
Income tax expense	**10.6**	**93,717**	**10.8**	**62,386**

Recognized deferred tax liabilities

Deferred tax liabilities are attributable to the following:

In thousands of denars	Assets	Liabilities	Net	Assets	Liabilities	Net
		2016			2015	
Assets acquired through foreclosure procedures	-	(16,637)	(16,637)	-	(17,237)	(17,237)
Available-for-sale financial assets	-	(617)	(617)	-	(1,048)	(1,048)
Net tax assets (liabilities)	**-**	**(17,254)**	**(17,254)**	**-**	**(18,285)**	**(18,285)**

Movements in temporary differences during the year

In thousands of denars	Net balance at 1 January	Recognised in profit or loss	Recognised in OCI	Balance at 31 December
2016				
Assets acquired through foreclosure procedures	17,237	(600)	-	16,637
Available-for-sale financial assets	1,048	-	(431)	617
	18,285	**(600)**	**(431)**	**17,254**

14. EARNINGS PER SHARE

The calculation of earnings per share for the year ended 31 December 2016 was based on the net profit attributable to ordinary shareholders of Denar 781,751 thousand (2015: Denar 502,375 thousand) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2016 of 2,279,067 shares (2015: 2,279,067 shares). The calculation of the basic and diluted earnings per share is:

	December 31, 2016	December 31, 2015
Net profit attributable to shareholders for basic and diluted earnings per share (in thousands of Denars)	781,751	502,375
Weighted average number of shares for basic and diluted earnings per share	2,279,067	2,279,067
Basic earnings per share (in Denars)	343	220
Diluted earnings per share (in Denars)	343	220

The calculation of the weighted average number of ordinary shares for the years ended December 31, 2016 and 2015 is as follows:

	Number of shares	
	2016	2015
Issued ordinary shares at 1 January	2,279,067	2,279,067
At 31 December	**2,279,067**	**2,279,067**

15. CASH AND CASH EQUIVALENTS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Cash on hand	1,542,572	1,365,784
Accounts and deposits with NBRM, except mandatory reserves in foreign currency	5,154,588	3,238,591
Current accounts with local banks	886	8,492
Current accounts with foreign banks	5,977,886	5,453,004
Time deposits held with banks up to 3 months	10,110,239	7,054,341
Treasury bills up to 3 months	5,778,123	6,299,613
Other short term highly liquid investments	1,650	2,952
Included in cash and cash equivalents	**28,565,944**	**23,422,777**
Restricted accounts	769,354	208,796
Mandatory reserves in foreign currency	4,203,376	4,032,146
	33,538,674	**27,663,719**

The level of mandatory reserves in foreign currency held with the Central Bank in the amount of Denar 4,203,376 thousand (2015: Denar 4,032,146 thousand) is determined by the Decision for mandatory reserves prescribed by the Central Bank. Those reserves are calculated based on the average amount of deposits in foreign currencies existing during one calendar month. The Central Bank does not pay any interest on these reserves.

Accounts and deposits with NBRM, except mandatory reserves in foreign currency in the amount of Denar 5,154,588 thousand (2015: Denar 3,238,591 thousand) represent current account in Denars with NBRM. The Central Bank does not pay any interest on these reserves.

Time deposits up to 3 months in the amount of Denar 10,110,239 thousand (2015: Denar 7,054,341 thousand) relate to deposits placed with domestic and foreign banks, with original maturities from 1 day to 3 months, bearing interest at rates in the range from 0,01% to 2,3% per annum (2015 from 0.01% to 2.5% p.a.).

Treasury bills up to 3 months in the amount of Denar 5,778,123 thousand (2015: Denar 6,299,613 thousand) are debt securities issued by the National Bank of Republic of Macedonia with maturity of 28 days, bearing interest at rate of 3.75% per annum (2015: 3.25% p.a.).

Restricted accounts in the Denar 769,354 thousand (2015: Denar 208,796 thousand) represent collateral for Visa International and MasterCard and collateral for custody activities.

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	2016	**2015**
Balance at 1 January	**66**	**461**
Net charge/(release) to profit or loss (Note 12)	70	(395)
Balance at 31 December	**136**	**66**

16. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

	In thousands of Denars	
Held for trading	December 31, 2016	December 31, 2015
Debt securities		
Government bonds	23,165	14,847
Total debt securities	**23,165**	**14,847**
Equity investments	388,174	356,182
	411,339	**371,029**

Government bonds in the amount of Denar 23,165 thousand (2015: Denar 14,847 thousand) refers to structural government bonds, bearing interest at the rate of 2% per year.

The quoted equity investments held for trading in the amount of Denar 69,660 thousand (2015: Denar 47,334 thousand) relates to investments in shares issued by domestic banks in the amount of Denar 99 thousand (2015: Denar 66 thousand) and investments in shares issued by domestic non-financial entities in the amount of Denar 69,561 thousand (2015: Denar 47,268 thousand).

The other unquoted equity investments in the amount of Denar 318,514 thousand (2015: Denar 308,848 thousand) relate to investments in the open-end investment fund KB Publikum – Balansiran in the amount of Denars 8,348 thousand (2015: Denar 7,241 thousand), investments in the open-end investment fund KB Publikum - Paricen in the amount of Denar 307,668 thousand (2015: Denar 299,419 thousand), and investments in KD Funds AD Skopje - KD Cash deposit in the amount of 2,498 thousand of denars (2015: 2,187 thousand of denars).

17. FINANCIAL ASSETS AVAILABLE-FOR-SALE

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Government bills	3,203,202	6,186,040
Government bonds	407,040	950,996
Equity investments	64,988	67,597
	3,675,230	**7,204,633**
Less: Specific allowance for impairment	-	(2,624)
	3,675,230	**7,202,009**

Investments in available-for-sale debt securities includes government bills in the amount of 3,203,202 thousands of denars (2015: 6,186,040 thousands of denars) as well as government bonds in the amount of 407,040 thousands of denars (2015: 950,996 thousands of denars).

The investments in equity instruments available-for-sale in the amount of 64,988 thousands of denars (2015: 67,597 thousands of denars) relate to the investments in securities issued by financial institutions for which there is no active market, as well as a lack of recent transactions that could be applied in determination of the fair value. Accordingly, the investments in available-for-sale securities are stated at their cost, less any impairment.

The Group does not plan to sell those investments whose operations are related to the regular operations of the Group, while the rest of the investments will be sold only when the Group will estimate that there are favourable conditions for their disposal.

17. FINANCIAL ASSETS AVAILABLE-FOR-SALE (Continued)

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	Year ended December 31 2016	Year ended December 31 2015
Balance at 1 January	2,624	2,624
Write off	(2,624)	-
Balance at 31 December	**-**	**2,624**

18. FINANCIAL ASSETS HELD-TO-MATURITY

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Government bonds	598,885	2,516
Government bills	2,775,844	-
	3,374,729	**2,516**

The bonds issued by the Government of the Republic of Macedonia in the amount of 598,885 thousands of denars (2015: Denar 2,516 thousand) include bonds for denationalisation VI emission in the amount of 568 thousand denars (2015: Denar 2,516 thousand) with maturity in 2017 (2015: 2017), which bear interest at an annual rate of 2% (2015: 2% annually) and government bonds in the amount of 598,317 thousands of denars (2015: nil) with maturity up to 2018 which bear interest at an annual rate of 2,7%.

The bills issued by the Government of the Republic of Macedonia in the amount of 2,775,844 thousands of denars (2015: nil) bear interest at an annual rate from 2,2% to 2,6%.

Total current portion of the financial assets held-to-maturity amounts to Denar 2,777,737 thousand (2015: Denar 1,953 thousand).

19. LOANS AND ADVANCES TO BANKS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Placements with foreign banks	10,067,105	9,066,993
Placements with domestic banks	18,311	143,317
	10,085,416	**9,210,310**
Less: Specific allowance for impairment	(1,207)	(1,884)
	10,084,209	**9,208,426**

Total current portion of the loans and advances to banks amounts to Denar 9,129,398 thousand (2015: Denar 8,251,857 thousand).

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	2016	2015
Balance at 1 January	1,884	1,169
Net charge/(release) to profit or loss (Note 12)	(677)	715
Balance at 31 December	**1,207**	**1,884**

20. LOANS AND ADVANCES TO CUSTOMERS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Individuals (retail customers):		
- Overdrafts	1,155,863	1,344,399
- Credit cards	1,099,519	1,307,334
- Term loans	11,180,282	10,849,770
	13,435,664	13,501,503
Corporate entities:		
- Large corporate customers	21,500,996	20,553,029
- SMEs	18,224,544	25,826,380
	39,725,540	46,379,409
	53,161,204	59,880,912
Less: Allowance for impairment	(7,893,050)	(12,236,390)
	45,268,154	**47,644,522**
Current	18,084,655	20,561,201
Non- current	27,183,499	27,083,321

20. LOANS AND ADVANCES TO CUSTOMERS (Continued)

Loans and advances to customers include accrued interest and other receivables of Denar 193,005 thousand (2015: Denar 248,196 thousand).

Out of the total loans and advances to other customers the Bank has pledged a lien with regard to the sub-loans approved from the credit line of the European Investment Bank ("EIB"), and from the Italian credit line (IKL), in favour of MBDP. As at 31 December 2016 the amount of the pledged loans and advances is in the amount of 1,593,485 thousands of denars (2015: 1,980,236 thousands of denars).

Movement of allowance for impairment is as follows:

Retail customers

			In thousands of Denars	
	Overdrafts	**Credit cards**	**Loans**	**Total**
Balance at 1 January 2015	199,909	270,123	629,243	1,099,275
Net charge/(release) to profit or loss (Note 12)	(1,691)	(15,655)	17,792	446
Balance at 1 January 2016	**198,218**	**254,468**	**647,035**	**1,099,721**
Net charge/(release) to profit or loss (Note 12)	19,709	(11,703)	110,028	118,034
Write offs	(147,088)	(176,751)	(427,454)	(751,293)
Balance at 31 December 2016	**70,839**	**66,014**	**329,609**	**466,462**

Corporate entities

			In thousands of Denars
	Large corporate customers	**SMEs**	**Total**
Balance at 1 January 2015	2,799,304	6,593,578	9,392,882
Net charge/(release) to profit or loss (Note 12)	696,819	1,015,026	1,711,845
Release upon foreclosure procedures	-	81,266	81,266
Write offs	-	(49,324)	(49,324)
Balance at 1 January 2016	**3,496,123**	**7,640,546**	**11,136,669**
Net charge/(release) to profit or loss (Note 12)	(214,950)	1,808,106	1,593,156
Release upon foreclosure procedures	-	(3,914)	(3,914)
Write offs	-	(5,299,323)	(5,299,323)
Balance at 31 December 2016	**3,281,173**	**4,145,415**	**7,426,588**

The increase in the amount of write offs is a results of the Decision for amending the decision for managing the credit risk (Official Gazette No. 223/16), according to which the Bank was required to write off the credit exposures after two years when the Bank was required to allocate allowance for impairment of 100%. As a result an amount of Denar 6,050,616 thousand (Note 20) was written off and other receivables in the amount of Denar 157,152 thousand (See note 25) were written off, as well.

21. INVESTMENTS IN ASSOCIATES

The Group owns 49% of equity interest, which is equal to 49% of the voting rights in KB Prvo Penzisko Drustvo AD Skopje. The principle place of business of KB Prvo is Republic of Macedonia.

The shares of KB Prvo Penzisko Drustvo AD Skopje are not publicly listed and consequently do not have published price quotations.

	In thousands of Denars	
	December 31, 2016	December 31, 2015
KB Prvo Penzisko Drustvo AD Skopje	189,147	157,652
Share of results for the year ended 31 December	43,625	39,028
Dividends received	(22,601)	(7,533)
	210,171	**189,147**

Summary financial information on the associates is presented below:

	In thousands of Denars December 31, 2016					
	Assets	Liabilities	Equity	Revenues	Profit/Loss	Interest held
KB Prvo Penzisko Drustvo AD Skopje	440,011	17,856	422,155	225,751	89,031	49%
	440,011	**17,856**	**422,155**	**225,751**	**89,031**	

	In thousands of Denars December 31, 2015					
	Assets	Liabilities	Equity	Revenues	Profit/Loss	Interest held
KB Prvo Penzisko Drustvo AD Skopje	394,212	14,963	379,249	204,442	79,649	49%
	394,212	**14,963**	**379,249**	**204,442**	**79,649**	

There are no significant restrictions on the ability of the associates to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

22. PROPERTY AND EQUIPMENT

In thousands of Denars

	Land and Buildings	Furniture & Equipment	Assets in course of construction	Leasehold improvements	Total
Carrying amount 1 January 2015	2,840,703	268,768	27,739	19,123	**3,156,333**
Additions	-	-	61,309	-	**61,309**
Transfers	25,417	45,337	(70,754)	-	**-**
Disposals and write off	-	-	-	(126)	**(126)**
Depreciation charge	(77,445)	(94,208)	-	(8,086)	**(179,739)**
Carrying amount 31 December 2015	**2,.788,675**	**219,897**	**18,294**	**10,911**	**3,037,777**
At 31 December 2015					
Cost	3,231,673	1,226,663	18,294	62,653	**4,539,283**
Accumulated depreciation	(442,998)	(1,006,766)	-	(51,742)	**(1,501,506)**
Carrying amount for 31 December 2015	**2,788,675**	**219,897**	**18,294**	**10,911**	**3,037,777**
Carrying amount 1 January 2016	**2,788,675**	**219,897**	**18,294**	**10,911**	**3,037,777**
Additions	-	-	105,493	-	**105,493**
Transfers	34,900	60,241	(101,170)	1,639	**(4,390)**
Disposals and write off	-	-	-	(113)	**(113)**
Depreciation charge	(78,099)	(86,321)	-	(6,164)	**(170,584)**
Carrying amount 31 December 2016	**2,745,476**	**193,817**	**22,617**	**6,273**	**2,968,183**
At 31 December 2016					
Cost	3,271,935	1,222,587	22,617	56,202	**4,573,341**
Accumulated depreciation	(526,459)	(1,028,770)	-	(49,929)	**(1,605,158)**
Carrying amount 31 December 2016	**2,745,476**	**193,817**	**22,617**	**6,273**	**2,968,183**

The amount of commitments for the purchase of property and equipment in 2016 amounts to Denar 1,250 thousand (2015: Denar 7,503 thousand). As at 31 December 2016 and 31 December 2015 the Bank does not have any property and equipment pledged as collateral.

23. INVESTMENT PROPERTY

	In thousands of Denars	
	2016	2015
At 1 January		
Cost	33,510	33,510
Accumulated depreciation	(5,725)	(4,887)
Carrying amount	**27,785**	**28,623**
Carrying amount 1 January	27,785	28,623
Depreciation charge	(837)	(838)
Transfer to owner-occupied premises	(26,948)	
Carrying amount 31 December	**-**	**27,785**
At 31 December		
Cost	-	33,510
Accumulated depreciation	-	(5,725)
Carrying amount	**-**	**27,785**

Fair value of investment property amounts to Denar 29,019 thousand as at December 31, 2015.

Investment property comprised of property leased by Komercijalna banka AD Skopje. The lease contained an initial non-cancellable period of 90 days. The contract is on indefinite period. The fair value of investment property was determined by external, independent property valuation specialist, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued. The independent valuation specialist provide the fair value of the Bank's investment property portfolio once a year.

The fair value measurement for investment property of Denar 29,019 thousand in 2015 was categorised as a Level 2 fair value based on the inputs to the valuation technique used (see Note 5.B).

Valuation technique and inputs used were based on the cost method, according to the methodology for valuation of investment property.

The fair value measurement of investment property were categorised as a Level 3 fair value based on the inputs to the valuation technique used.

Valuation technique and significant unobservable inputs

The following table shows the valuation technique used in measuring the fair value of investment property in 2015, as well as the significant unobservable inputs used.

Valuation technique	*Significant unobservable inputs*	*Inter-relationship between key unobservable inputs and fair value measurement*
Discounted cash flows: The valuation model considers the present value of net cash flows to be generated from the property, taking into account expected rental growth rate, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discount rates. Among other factors, the discount rate estimation considers the quality of a building and its location (prime vs secondary) and lease terms.	• Expected market rental growth (2%). • Occupancy rate (100%, based on signed leased contracts with the Bank) • Risk-adjusted discount rates (8%)	The estimated fair value would increase (decrease) if: ••expected market rental growth were higher (lower); ••the occupancy rate were higher (lower); or ••the risk-adjusted discount rate were lower (higher).

24. INTANGIBLE ASSETS

	In thousands of Denars	
	2016	**2015**
Cost		
Balance at 1 January	281,286	274,241
Other additions	11,092	17,678
Disposals and write offs	(4,390)	(10,633)
Balance at 31 December	**287,988**	**281,286**
Accumulated amortisation		
Balance at 1 January	239,752	224,920
Charge for the year	13,719	14,832
Disposals and write-offs	(4,390)	-
Balance at 31 December	**249,081**	**239,752**
Carrying amount at 31 December	**38,907**	**41,534**
Carrying amount at 1 January	**41,534**	**49,321**

As at 31 December 2016 the Group does not have any commitments for the intangible assets (31 December 2015: none).

25. OTHER ASSETS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Credit card receivables	296,760	199,872
Other bad and doubtful receivables	60,652	170,744
Trade receivables	199,483	227,243
Receivable from insurance company	7,806	7,821
Inventory of office materials	16,333	18,941
Inventory of numismatic collections	16,842	18,063
Fee and commission receivables	39,539	47,705
Advances for property and equipment	975	-
Advances for intangible assets	63	-
Other assets	41,477	51,522
	679,930	**741,911**
Less: Allowance for impairment	(86,773)	(209,322)
	593,157	**532,589**

The current portion of other assets amounts to Denar 591,396 thousand (2015: Denar 527,270 thousand).

Movement in specific allowance for impairment is as follows:

	In thousands of Denars	
	Year ended December 31 2016	Year ended December 31 2015
Balance at 1 January	209,322	179,250
Net charge/ (release) to profit or loss (Note 13)	35,187	35,071
Release upon foreclosure procedures	(584)	-
Write-off	(157,152)	(4,999)
Balance at 31 December	**86,773**	**209,322**

The increase in the amount of write offs is a results of the Decision for amending the decision for managing the credit risk (Official Gazette No. 223/16), according to which the Bank was required to write off the exposures after two years when the Bank was required to allocate allowance for impairment of 100%. Because of this, an amount of Denar 157,152 thousand of other receivables was written off.

26. ASSETS ACQUIRED THROUGH FORECLOSURE PROCEDURES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Foreclosed collateral		
Land	63,280	100,446
Buildings	576,720	1,131,749
Residential buildings and apartments	47,795	85,833
Other	46,521	77,686
	734,316	**1,395,714**

The fair value of the acquired assets through foreclosure procedure as at 31 December 2016 is in the amount of 1,346,020 thousands of denars (as at 31 December 2015 is in the amount of 2,055,462 thousands of denars).

Certified property valuators, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued, determined the fair value of foreclosed assets.

The fair value measurement for foreclosed assets has been categorized as a Level 3 fair value based on the inputs to the valuation technique used.

Valuation technique and significant unobservable inputs

The following table shows the valuation technique used in measuring the fair value of foreclosed assets, as well as the significant unobservable inputs used.

Valuation technique	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Discounted cash flows: The valuation model considers the present value of net cash flows to be generated from the property, taking into account expected rental growth rate, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discount rates. Among other factors, the discount rate estimation considers the quality of a building and its location (prime vs secondary) and lease terms.	• Expected market rental growth (2%). • Occupancy rate (58% - 80% for business facilities and warehouses (2015: 25%-65% depending on the season, for hotels, and 58% - 80% for business facilities and warehouses)) • Risk-adjusted discount rates (8%, 10%,13 depending on the type of real estate which is estimated, 8% for residential, retail and office facilities, 10-13% for logistics and warehouses (2015: 8%, 9,5%,13 depending on the type of real estate which is estimated, 8% for hotels, 9,5% for business facilities, 13% for warehouses))	The estimated fair value would increase (decrease) if: ••expected market rental growth were higher (lower); ••the occupancy rate were higher (lower); or ••the risk-adjusted discount rate were lower (higher).

27. DEPOSITS FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Demand deposits		
Banks and other financial institutions	642,600	425,108
Insurance companies	84,367	80,479
Time deposits		
Banks and other financial institutions	564,333	223,507
Insurance companies	350,209	398,274
Restricted deposits		
Banks and other financial institutions	-	232,208
Insurance companies	6,954	4,005
	1,648,463	**1,363,581**
Current	1,519,803	1,086,625
Non-current	128,660	276,956

Deposits from banks and other financial institutions include accrued interest payable of Denar 3,687 thousand (2015: Denar 1,073 thousand).

28. DEPOSITS FROM OTHER CUSTOMERS

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Public institutions		
Current / settlement accounts	221,529	243,836
Time deposits	75,888	-
Companies		
Current / settlement accounts	20,178,995	17,080,111
Time deposits	2,313,893	2,584,483
Retail customers		
Current / demand accounts	18,482,170	16,154,091
Time deposits	42,673,163	44,755,766
Restricted deposits		
Citizens	1,310,925	1,180,080
Companies	858,774	839,323
	86,115,337	**82,837,690**

Deposits from other customers include accrued interest payable of Denar 249,216 thousand (2015: Denar 286,325 thousand).

Restricted deposits in the total amount of Denar 2,169,699 thousand (2015: Denar 2,019,403 thousand) relate to Deposits from other customers, placed for payments abroad, letters of credit, deposits placed as collateral for securing repayment of loans and guarantees, and received early repayments of loans.

Current portion of deposits from other customers amounts to Denar 79,008,187 thousand (2015: Denar 75,867,447 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016

29. BORROWINGS

In thousands of Denars

	December 31, 2016		December 31, 2015	
	Short-term	Long-term	Short-term	Long-term
Domestic borrowings:				
MBDP (Macedonian Bank for Development Promotion)	68	10,606	111	15,405
MBPR- ZKDF (Macedonian Bank for Development Promotion funds granted from Agriculture Credit Discount Fund)	8,148	15,953	19,934	60,376
Agency for Managing Accounts	-	115,970	-	115,970
NBRM- Primary issue	-	8,809	-	8,809
Foreign borrowings administered through domestic financial and government institutions:				
MBDP – IKL (Macedonian Bank for Development Promotion funds granted from Italian Credit Line)	72	11,374	135	21,250
MBDP – EIB (Macedonian Bank for Development Promotion funds granted from EIB)	3,105	1,456,518	3,578	1,904,143
MF - FSR (Ministry of finance funds granted from former lender Council of Europe Social Development Fund)	8	7,859	19	15,746
	11,401	**1,627,089**	**23,777**	**2,141,699**
Foreign borrowings:				
MIDF B.V	13	12,019	-	-
	13	**12,019**	**-**	**-**
Current	467,877	-	598,506	-
Non-current	-	1,182,645	-	1,566,970

Borrowings include accrued interest payable of Denar 3,296 thousand (2015: Denar 3,944 thousand). Current portion of long-term borrowings is Denar 456,463 thousand (2015: Denar 574,729 thousand).

29. BORROWINGS (Continued)

Creditor	Currency	Interest rate	Year of maturity	Type of security
MBDP	MKD/EUR	3.0%	According to the agreements concluded with final users	4 bills of exchange
MBDP – IKL	EUR	3%	According to the agreements concluded with final users	12 bills of exchange * Pledge of receivables under sub-loan agreements with final users in the form of Notary deed
MBDP – ZKDF	MKD/EUR	0.5%	According to the agreements concluded with final users	3 bills of exchange
MF – FSR	EUR	3 months EURIBOR + 1.44%;	30.05.2017	3 bills of exchange
NBRM – Primary issue	MKD	-	2020	1 bill of exchange
MBDP - EIB	EUR	1%	According to the agreements concluded with final users	16 bills of exchange in form of Notary deed * Pledge of receivables under sub-loan agreements with final users in the form of Notary deed
Agency for Managing Accounts	MKD	-	2020	unsecured
MIDF B.V	EUR	6,5% fixed, 5% adjustable	According to the agreements concluded with final users	unsecured

The Group has pledged a lien in the form of a notary deed in favour of MBDP based on receivables from sub-loan agreements concluded with final users approved from the credit lines with EIB and IKL, both administered through MBDP. As at 31 December 2016 the amount of borrowings for which the Group has pledged receivables is 1,368,652 thousands of denars (2015: Denar 1,597,845 thousand).

30. OTHER LIABILITIES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Credit card liabilities	284,998	170,426
Liabilities to Ministry of Finance	9,585	11,885
Suppliers payable	17,445	24,175
Advances received	17,198	2,464
Fee and commission	7,913	8,333
Provision for pension and other employee benefit	53,218	56,094
Liabilities for VAT	2,829	30,755
Undistributed foreign payments from legal companies and citizens	118,827	117,757
Other liabilities	86,530	90,541
	598,543	**512,430**
Current	549,808	488,079
Non-current	48,735	24,351

31. EQUITY

(a) Share capital

In number of issued shares

	Ordinary shares		Non-voting shares	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
In number of shares				
At 1 January	2,279,067	2,279,067	-	-
Issued shares during the year	-	-	-	-
At 31 December	**2,279,067**	**2,279,067**	**-**	**-**

At 31 December 2016 the authorised share capital comprised of 2,279,067 (2015: 2,279,067) ordinary shares. Ordinary shares have a par value of Denar 1,000 (2015: Denar 1,000). All issued shares are fully paid. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at Shareholders' Assembly. All shares rank equally with regard to the Group's residual assets.

According to the shareholders book as at 31 December 2016, on 102,951 ordinary shares i.e 4.52% from the total shareholder capital of the Bank (as at 31 December 2015, 128,228 ordinary shares i.e 5.63%) there is limitation of the rights established based on the law and/or Decision or act of the competent body (for example limitation of the vote right according to the Governor decision).

As at 31 December 2016 the Bank does not hold treasury shares. The Open-end Investment Fund KB Publikum – Balansiran managed by the Bank's subsidiary, KB Publikum Invest AD owns 2,109 shares, i.e. 0,0925% of the total share capital of the Bank (as at 31 December 2015 owns 2,109 shares, i.e. 0,0925%).

The below stated shareholders have more than 5% ownership of the Bank's ordinary shares:

	In %	
Shareholder	**December 31, 2016**	**December 31, 2015**
East Capital Explorer Investments AB, Stockholm	10.0	10.0
European Bank for Reconstruction and Development, London	5.25	5.25

(b) Reserves

Statutory reserve

Under local statutory legislation, the Group is required to set aside 5 percent of its net profit for the year in a statutory reserve until the level of the reserve reaches 1/10 of the court registered capital. Until achieving the minimum required level the statutory reserve could only be used for loss recovery. When the statutory reserve exceeds the minimum required level and when all losses are covered, the statutory reserve can also be used for distribution of dividends, based on a decision of the shareholders' meeting, but only if the amount of the dividends for the current business year has not reached the minimum for distribution as prescribed in the Trade Company Law. The Group has reached the regulatory minimum.

Other reserves

The other reserves are formed in addition to statutory reserve, based on decisions by the bodies of the Group for distribution of profit, and can be used to cover certain losses or for other expenses.

31. EQUITY (Continued)

(c) Dividends

The following dividends were recognised as distributions to owners during the year ended 31 December.

	In thousands of Denars	
	December 31, 2016	December 31, 2015
125 Denars per ordinary share	284,883	-

Announced dividend after the balance sheet date (the liabilities for dividends are not shown in the Balance sheet).

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Announced dividends after December 31	341,860	284,883

	In Denars	
	December 31, 2016	December 31, 2015
Dividend per ordinary share	150	125

32. GROUP SUBSIDIARIES

See accounting policy Note 3.1.

(a) Significant subsidiaries

The significant subsidiary of the Group is KB Publikum. Its principle place of business is the Republic of Macedonia. The Bank holds 64.29% of ownership interest (2015: 64.29%).

(b) Significant restrictions

The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities.

32. GROUP SUBSIDIARIES

(c) NCI in subsidiaries

The following table summarises the information relating to the Group's subsidiary that has material NCI.

KB Publikum

in thousands of denars	**Note**	**31 December 2016**
Assets		
Cash and cash equivalents		43
Held for trading financial assets		3,607
Bank deposits		27,750
Property and equipment	22	178
Intangible assets	24	325
Other assets		2,329
Total assets		**34,232**
Liabilities		
Liabilities to suppliers and other liabilities		511
Total liabilities		**511**
Net assets		**33,721**
Carrying amount of non-controlling participation		**12,042**

	For the period from 01.01.2016 - 31.12.2016
Revenue	22,095
Expenses	(10,008)
Profit	**12,087**
Total comprehensive income	**12,087**
Profit of non-controlling interest	**4,316**

	For the year ended 31 December 2016
Cash flows from operating activities	10,945
Cash flows from investing activities	(10,918)
Cash flows from financing activities, before dividends to non-controlling interest	-
Cash flows from financing activities, dividends to non-controlling interest	-
Net increase of cash and cash equivalents	**27**

32. GROUP SUBSIDIARIES (Continued)

(d) NCI in subsidiaries (Continued)

in thousands of denars	Note	31 December 2015
Assets		
Cash and cash equivalents		16
Held for trading financial assets		2,277
Bank deposits		18,200
Property and equipment	22	146
Intangible assets	24	270
Other assets		1,735
Total assets		**22,644**
Liabilities		
Liabilities to suppliers and other liabilities		1,010
Total liabilities		**1,010**
Net assets		**21,634**
Carrying amount of non-controlling participation		**7,725**

	For the period from 01.01.2015 - 31.12.2015
Revenue	19,168
Expenses	(9,103)
Profit	**10,065**
Total comprehensive income	**10,065**
Profit of non-controlling interest	**3,595**

	For the year ended 31 December 2016
Cash flows from operating activities	10,729
Cash flows from investing activities	(10,759)
Cash flows from financing activities, before dividends to non-controlling interest	-
Cash flows from financing activities, dividends to non-controlling interest	-
Net increase of cash and cash equivalents	**(30)**

33. CONTIGENCIES AND COMMITMENTS

(a) Off-balance sheet items

The following table indicates the contractual amounts of the Group's contingencies and commitments by category:

	In thousands of Denars	
	December 31 2016	December 31, 2015
Guarantees		
in domestic currency	5,902,083	5,343,035
in foreign currency	2,906,502	3,379,319
	8,808,585	**8,722,354**
Letters of credit	924,074	2,237,829
Unused credit card limits	1,177,461	1,247,322
Unused overdrafts on current accounts	1,766,422	1,751,450
Unused credit limits – non cancelable	1,532,802	1,637,888
Total	**14,209,344**	**15,596,843**
Less: provision for off-balance sheet items	(112,577)	(149,748)
	14,096,767	**15,447,095**

The Group provides banks guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to one year. Expirations are not concentrated in any period.

These commitments and contingent liabilities have off balance-sheet credit risk because only organization fees and accruals for probable losses are recognised in the statement of financial position until the commitments are fulfilled or expire. Many of the contingent liabilities and commitments will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows.

Movement in provision is as follows:

	In thousands of Denars
	Year ended December 31 2016
Balance at January 1	149,748
Additional provisions during the year	184,158
(release of provisions during the year)	(221,203)
Exchange rate effect	(126)
As at 31 December	**112,577**

(b) Litigations

For part of the contingent liabilities in the amount of 248,724 thousands of denars there is a litigation proceeding upon issued letter of guarantee for Granit AD Skopje. The case was initiated in front of an authorized court in Poland on September 16th 2011 by the State Treasury – General Directorate for National Roads and Motorways from Warsaw (beneficiary of the guarantee) against Komercijalna Banka AD Skopje, which was received in the Bank on July 2nd 2012, requesting a payment upon the issued letter of guarantee in the amount of 17.897.404,09 PLN, equivalent to 248,724 thousands of denars. The letter of guarantee was issued based on a contract for building a motorway concluded on May 5th, 2010 between the plaintiff (State Treasury – General Directorate for State Roads and Motorways) and Granit AD Skopje (requestor of the guarantee).

33. CONTIGENCIES AND COMMITMENTS (continued)

b) Litigations (continued)

The guarantee has been activated and a payment is requested as a result of a breach of contract for building a motorway between the State Treasury – General Directorate for National Roads and Motorways of Warsaw and Granit AD Skopje. There is a separate legal dispute related to this contract, which is handled in front of the authorized court in Warsaw, Poland. On 7th of March 2016, the court passed a verbal verdict in which it ruled in favour of the plaintiff and ordered Komercijalna banka AD Skopje to pay the amount under the activated guarantee, interest and court expenses. The verdict was appealed and the procedure is in decision making stage by higher court.

The Bank has not performed a payment upon this issued letter of guarantee as a result of a Decision for temporary suspension issued on the 4th of February 2011 by the Basic Court in Skopje 2, on request of Granit AD Skopje. The temporary suspension prohibits the beneficiary of the guarantee to undertake any activities which would protest or enforce the guarantee, at the same time imposing a restriction on the Bank to make payments upon the issued letter of guarantee. The Bank has an obligation to follow the ruling of the Macedonian court, as long as it is in force. If the Bank is to make a payment upon this issued letter of guarantee, the amount will be transformed into a receivable from Granit AD Skopje, and the Bank's Management does not expect collection problems and adverse financial effects.

34. RELATED PARTY TRANSACTIONS

Persons related to the Group are the following: persons with special rights and responsibilities and persons related thereto (classified as key management personnel), shareholders with qualified holding in the Group (direct or indirect ownership of at least 5% of the total number of shares or the issued voting shares in a Group or which makes it possible to exercise a significant influence in the Group) and entities related thereto and responsible persons of those shareholders – legal entities (classified as other related parties). In addition, the Group has investments in associates.

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and borrowings. The volumes of related party transactions and outstanding balances at the year-end, are as follows:

	Placements as at 1 January 2016	Placements during the year	Withdrawals during the year	Placements as at 31 December 2016
	1	2	3	4=(1+2-3)
1. Assets				
Current accounts				
a) Associates	-	-	-	-
b) Key management personnel of the Group	-	-	-	-
c) Other related parties	-	-	-	-
Trading assets				
a) Associates	-	-	-	-
b) Key management personnel of the Group	-	-	-	-
c) Other related parties	-	-	-	-
Mortgage loans				
a) Associates	-	-	-	-
b) Key management personnel of the Group	64,265	19,129	20,444	62,950
c) Other related parties	-	-	-	-

34. RELATED PARTY TRANSACTIONS (Continued)

Balance sheet (Continued)

	Placements as at 1 January 2016	Placements during the year	Withdrawals during the year	Placements as at 31 December 2016
Consumer loans				
a) Associates	-	-	-	-
b) Key management personnel of the Group	28,437	15,892	10,806	33,523
c) Other related parties	-	-	-	-
Other loans and claims				
a) Associates	130	1,742	1,749	123
b) Key management personnel of the Group	89,940	133,138	76,205	146,873
c) Other related parties	-	-	-	-
Investment in securities				
a) Associates	189,147	43,625	22,601	210,171
b) Key management personnel of the Group	-	-	-	-
c) Other related parties	-	-	-	-
2.Liabilities				
Deposits				
a) Associates	450	713,682	709,942	4,190
b) Key management personnel of the Group	544,552	5,825,384	5,725,731	644,205
c) Other related parties	-	-	-	-

34. RELATED PARTY TRANSACTIONS (Continued)

Income and expenses arising from related party transactions

In thousands of Denars

	Year ended December 31, 2016				Year ended December 31, 2015			
	Associates	Key management personnel of the Group	Other related parties	Total	Associates	Key management personnel of the Group	Other related parties	Total
Income								
Interest Income	-	11,480	-	**11,480**	-	9,512	-	**9,512**
Income from fees and commissions	218	5,363	-	**5,581**	154	4,264	-	**4,418**
Net gains from trading	-	-	-	**-**	-	-	-	**-**
Dividend income	-	-	-	**-**	-	-	-	**-**
Capital gains from sale of non-current assets	-	-	-	**-**	-	-	-	**-**
Other income	43,701	4,602	-	**48,303**	39,115	8,816	-	**47,931**
Transfers between entities	-	-	-	-	-	-	-	-
Total Income	**43,919**	**21,445**	**-**	**65.364**	**39,269**	**22,592**	**-**	**61,861**
Expenses								
Interest expense	1	8,336	-	**8,337**	2	8,322	-	**8,324**
Fee and commission expense	-	-	-	**-**	-	-	-	**-**
Net losses from trading	-	-	-	**-**	-	-	-	**-**
Expenditures for procurement of non-current assets	-	-	-	**-**	-	-	-	**-**
Impairment of financial assets, on net basis	-	4,135	-	**4,135**	4	444	-	**448**
Other expenditures	70	3,741	-	**3,811**	80	8,320	-	**8,400**
Total Expenses	**71**	**16,212**	**-**	**16,283**	**86**	**17,086**	**-**	**17,172**

34. RELATED PARTY TRANSACTIONS (Continued)

Key management personnel

	In thousands of Denars	
	Year ended December 31, 2016	Year ended December 31, 2015
Salaries and other short - term benefits	125,996	129,876
	125,996	**129,876**

35. FUNDS MANAGED ON BEHALF OF THIRD PARTIES

	In thousands of Denars	
	December 31, 2016	December 31, 2015
Banks and other financial institutions	34,639	28,013
Companies	511,867	236,941
Individuals	49,124	46,504
	595,630	**311,458**

The Group manages assets on behalf of third parties which are in the form of loans to companies for various investments. The Group receives fee income for providing these services. Funds managed on behalf of third parties are not assets of the Group and are not recognized in the statement of financial position. The Group is not exposed to any credit risk relating to such placements, as it does not guarantee these investments, however, has a fiduciary responsibility to properly handle and invest client funds.

Income and expenses of the Funds managed on behalf of third parties are accrued to the account of the respective third party and the Group has no liability in connection with these transactions.

36. LEASE COMMITMENTS

At the end of the reporting period, the future minimum lease payments under non-cancellable operating leases are payable as follows

		Maturity period for operating lease payments		
In thousands of Denars	Total	up to 1 year	from 1 to 5 years	over 5 years
Balance at December 31, 2016	48,100	1,868	7,472	38,760
Total	**48,100**	**1,868**	**7,472**	**38,760**
Balance at December 31, 2015	66,733	2,495	9,979	54,259
Total	**66,733**	**2,495**	**9,979**	**54,259**

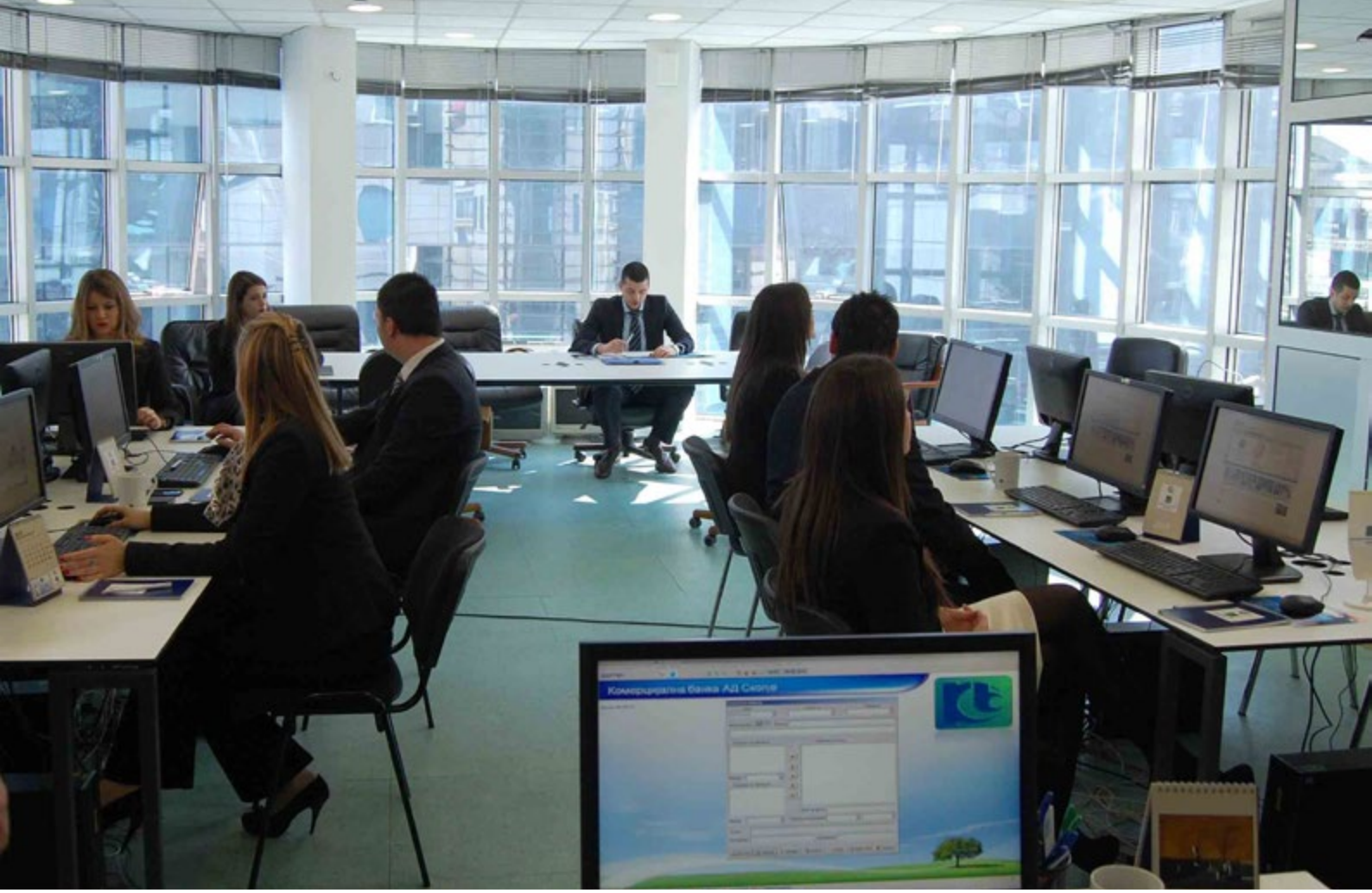
37. SUBSEQUENT EVENTS

No material events subsequent to the reporting date have occurred which require disclosure in the consolidated financial statements.

38. EXCHANGE RATES

Official exchange rates used in the translation of the items denominated in foreign currencies in the statement of financial position were as follows:

	In Denars	
	December 31, 2016	December 31, 2015
1 EUR	61.4812	61.5947
1 USD	58.3258	56.3744



CORPORATE GOVERNANCE

The corporate governance of Komercijalna Banka AD Skopje is based on the rules for managing and management monitoring with the Bank defined by the Code of Corporate Governance passed by the Shareholders Assembly of the Bank on March 25th, 2009. At the Bank's Shareholders Assembly meetings held in March 2010, March 2011, March 2012 and March 2013, Decisions have been made for supplements and amendments to the Code for corporate governance of Komercijalna Banka AD Skopje, while on the Assembly held in March 2014, March 2015 and March 2016 Decisions on appropriateness to the Code of Corporate Governance of Komercijalna Banka AD Skopje were adopted.

According to the Code, corporate management is a combination of mutual relations between the Board of Directors, other persons with special rights and responsibilities performing management functions in the Bank, the Supervisory Board, Bank's shareholders and other stakeholders. In its regular operations the Bank shows strict adherence to the principles of corporate governance, which include guaranteeing the rights and interests of the shareholders, transparency in the ownership structure, division of duties, regular and efficient control and audit, adherence to the laws, ethical standards and practices, independence and objectivity and all other principles defined. The Code is consisted of the obligatory elements defined by the Decision on basic principles of corporate governance of the Bank, passed by the National Bank.

In the course of 2016, Bank's managing bodies performed their activities in accordance with their competences defined by the law regulations and the Statute of the Bank:

- In the course of the reported period, the **Shareholders Assembly** held one regular General Meeting on 23 March 2016. At the General Meeting, the Assembly adopted the Financial reports of the Bank and their consolidated financial reports for 2015, audited by an audit company, adopted the Bank's Annual Statement for 2015, considered and adopted all reports and proposed materials for performance of the Bank in 2015, adopted the Bank's Program for Measures and Activities of Business Policy and financial plan for 2016, passed a Decision on adopting the Report for compliance of the Banks' performance with the Corporate Governance Code for the companies listed on the Macedonian stock exchange and Decision on the adequacy of the Corporate Governance Code of Komercijalna Banka AD Skopje.

- In the course of 2016, the **Supervisory Board** of the Bank had 12 regular meetings where it debated on essential questions from the scope of operation of the Bank, made monthly review of the liquidity and economic and financial situation and performed other current activities under its competence.

In the course of 2016 and pursuant to the Banking Law, the Supervisory Board performed its function as a team comprised of 7 members, as follows:

1. Mrs. Sava Dimitrova –independent member and President of the Supervisory Board;
2. Mr. Taki Fiti Ph.D., - Vice President;
3. Ms. Margot Jacobs – Member;
4. Mr. Zvone Taljat – Member;
5. Mr. Sasho Naumoski – Member (since 26.04.2016);
6. Ms.Aleksandra Maksimovska - Independent Member (since 26.04.2016) and
7. Mr. Goran Antevski - Member (since 26.04.2016).

The members of the Supervisory Board – Zvone Taljat and Margot Jacobs are experts in the sphere of finances, and the members Sava Dimitrova and Aleksandra Maksimovska are independent members of the Supervisory Board. When electing the independent members, the Bank fully adhered to the independency criteria prescribed by the Banking Law.

- During 2016, the **Board of Directors** of the Bank performed its activities in accordance with the Banking Law, Statute of the Bank and other by-laws. The Board of Directors is comprised of three members with a mandate of six years, as follows:

- Mr. Hari Kostov – Chief Executive Officer and President of the Board of Directors;
- Mr. Ilija Iloski – Chief Operative Officer and
- Mrs. Maja Stevkova Shterieva, Ph.D. – Chief Finance Officer.

The Decisions on nomination of members of the Board of Directors were adopted by the Supervisory Board of the Bank on 31.05.2012 and on 28.09.2016. Based on previous documentation for an extension of the mandate, on 19.12.2016 the Governor of NBRM adopted the Decision to obtain previous agreement to name Hari Kostov and Maja Stevkova Shterieva members of the Board of Directors.

- In the course of the period reported, the **Risk Management Committee** of the Bank had 52 meetings where it monitored the overall operation of the Bank. The Committee performed its activities in compliance with the Banking Law, Statute of the Bank and other acts and reported to the Supervisory Board. It is comprised of five members and six alternate members with a mandate of six years, as follows: Mr. Hari Kostov – President, Mrs. Maja Stevkova Shterieva, Ph.D. – Vice President, Mrs. Suzana Moskovska – Member, Mrs. Biljana Maksimovska Popovikj – Member and Mrs. Teodora Gushkova Prodanova – Member. The alternate members of the Risk Management Committee are Mrs. Tatjana Leskaroska Minoska, Mrs. Vesna Kiprijanova, Mrs. Irena Zhivkovikj Zareva, Mrs. Biljana Hadzi-Velkova, Mr. Nikola Dzambazovski and Mrs. Lidija Ilikj.

- In 2016, the **Audit Committee** of the Bank held 4 regular meetings and made decisions and considered respective information and reports that are under its competence. The Audit Committee is comprised of five members, with a mandate of four years, as follows: Mrs. Sava Dimitrova, Mr. Taki Fiti, Ph.D., Aleksandra Maksimovska, Mr. Blazho Nedev, Ph.D. and Mr. Marjan Andonov. Mr. Blazho Nedev Ph.D. and Mr. Marjan Andonov are independent members of the Committee. When electing the independent members of the Audit Committee, the Bank fully adhered to the independency criteria prescribed by the Banking Law.

- In the course of 2016, the **Credit Committee** of the Bank held 52 meetings and considered and approved many information, credit analyses, reviews and reports under its competence. The Credit Committee had also considered and approved the draft-decisions under the competence of the Risk Management Committee and the draft-decisions under the competence of the Supervisory Board of the Bank. It is comprised of five members and five alternate members, with a mandate of four years, as follows: Mr. Ilija Iloski – President, Mrs. Maja Stevkova Shterieva, Ph.D. – Vice President, Mrs. Biljana Maksimovska Popovikj – Member, Mrs. Gabriela Milenkovikj – Member and Mrs. Suzana Moskovska – Member. The alternate members of the Credit Committee of the Bank are: Mrs. Tatjana Leskaroska Minoska, Mrs. Biljana Hadzi-Velkova, Mr. Nikola Dzambazovski, Mrs. Lidija Ilikj and Mrs. Zorica Pejkoska.

- The **Information Technology Committee** is consisted of seven members with mandate of four years. The members of the Committee are: Ilija Iloski – president, Zorica Cherepnalkoska – Vice President, Ph.D. Ana Madevska Bogdanova – member, Igor Bislimoski – member, Gabriela Milenkovich - member, Milica Georgieva – member and Tatjana Leskaroska Minoska - member. The Information Technology Committee of the Bank in 2016 held 2 meetings.

SUPERVISORY BOARD

Sava Dimitrova,
Independent member
and President,
AD Evropa Skopje
General Manager

Margot Jacobs,
Member,
East Capital Private
Equity AB,
Stockholm, Sweden
Senior Advisor

Taki Fiti, Ph.D.,
Vice President,
Faculty of Economics –
Skopje
Professor and President
of MASA (Macedonian
Academy of Science and
Art)

Goran Antevski,
Member,
Rade Konchar TEP
Manager
(member since
26.04.2016)

Zvone Taljat,
Member,
Publikum Holding,
Ljubljana
Manager

Aleksandra
Maksimovska,
Independent member
Faculty of Law
Justinianus Primus St.
Cyril and Methodius
University
Professor
(member since
26.04.2016)

Sasho Naumoski
Member,
Vitaminka AD Prilep
Chief Executive Director
(member since
26.04.2016)

BOARD OF DIRECTORS

Hari Kostov,
President
Komercijalna
Banka AD Skopje,
Chief Executive
Officer

Ilija Iloski,
Member
Komercijalna Banka
AD Skopje,
Chief Operative
Officer

Maja Stevkova Shterieva, Ph.D.,
Member
Komercijalna
Banka AD Skopje,
Chief Finance
Officer

MANAGEMENT

Maja Stevkova Shterieva, Ph.D.
Manager of the Risk Management and Planning Division
tel.: +389 2 3168-802
e-mail: Maja.Stevkova-Sterieva@kb.com.mk

Suzana Moskovska
Manager of the Liquidity and Financial Market Division
tel.: +389 2 3168-301
e-mail: Suzana.Moskovska@kb.com.mk

Biljana Maksimovska Popovikj
Manager of the Corporate Lending Division
tel.: +389 2 3168-501
e-mail: Biljana.Maksimovska.Popovik@kb.com.mk

Vesela Churilova, MA
Manager of the International Division
tel.: +389 2 3168-601
e-mail: Vesela.Curilova@kb.com.mk

Gabriela Milenkovikj
Manager of the Retail Banking Division
tel.: +389 2 3168-101
e-mail: Gabriela.Milenkovic@kb.com.mk

Natasha Brova, MA
Manager of the Human Resources and General Affairs Division
tel.: +389 2 3168-401
e-mail:Natasa.Brova@kb.com.mk

Teodora Gushkova Prodanova
Manager of the Legal Affairs and Problem Loan Workout Division
tel.: +389 2 3168-201
e-mail: Teodora.Guskova.Prodanova@kb.com.mk

Zorica Cherepnalkoska
Manager of the Information Technology Division
tel.: +389 2 3168-808
e-mail: Zorica.Cerepnalkoska@kb.com.mk

Anita Bislimovska
Manager of the Independent Finance Department
tel.: +389 2 3168-758
e-mail: Anita.Bislimovska@kb.com.mk

Biljana Mitevska, MA
Manager of the Independent Domestic Payment Operations Department
tel.: +389 2 3168-901
e-mail: Biljana.Mitevska@kb.com.mk

Aneta Velevska, MA
Manager of the Independent Vault Department
tel.: +389 2 3168-726
e-mail: Aneta.Velevska@kb.com.mk

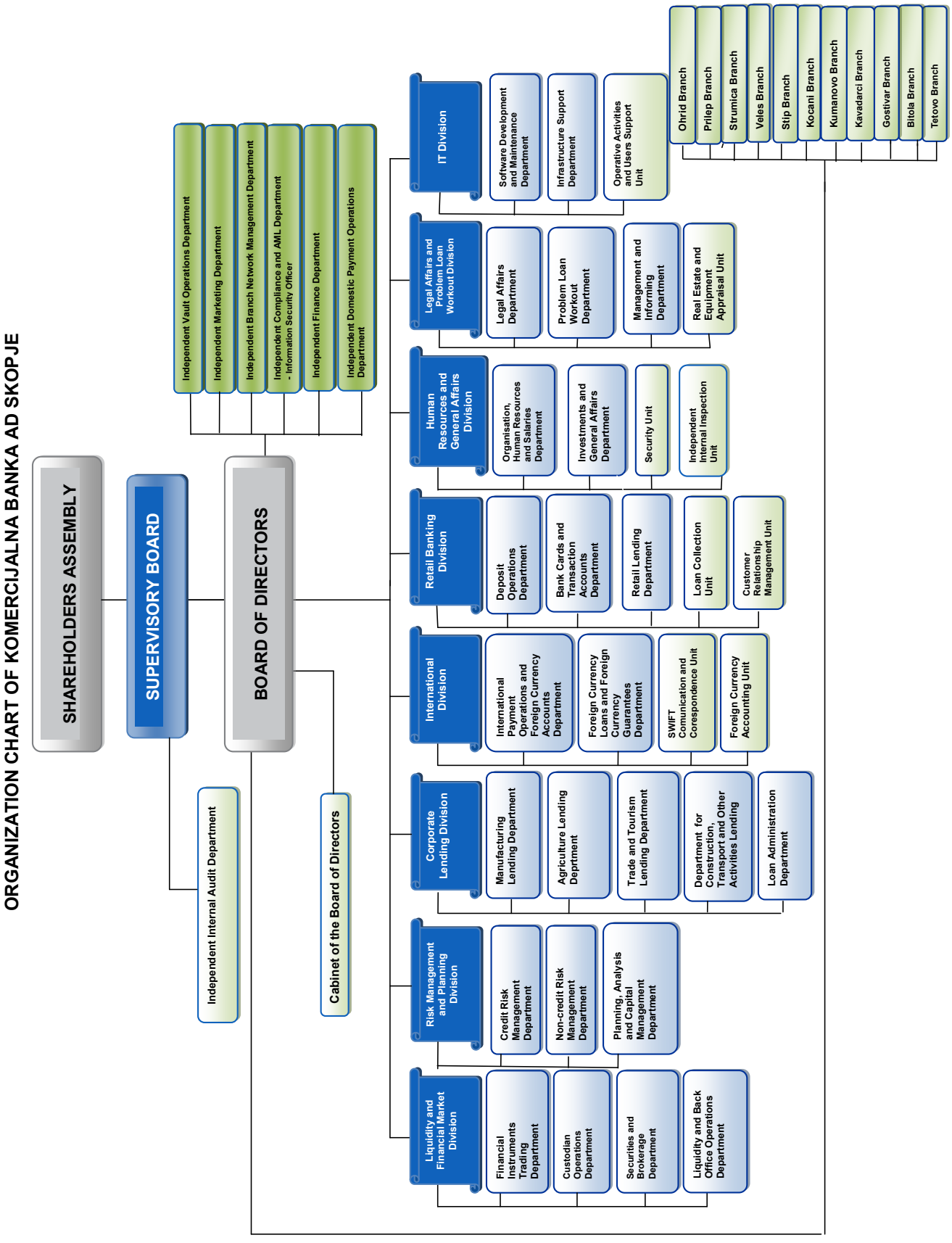
Jasmina Bucevska, Ph.D.
Manager of the Independent Marketing Department
tel.: +389 2 3168-720
e-mail: Jasmina.Bucevska@kb.com.mk

Vesna Maslinko
Manager of the Independent Internal Audit Department
tel.: +389 2 3168-711
e-mail: Vesna.Maslinko@kb.com.mk

Nina Fiti – Nedelkovska, Ph.D.
Manager of the Independent Branch Network Management Department
tel.:+389 2 3168-750
e-mail: Nina.Fiti-Nedelkovska@kb.com.mk

Milica Georgieva
Manager of the Independent Bank's Operation Compliance Control and Money Laundering Prevention Department
tel.: +389 2 3168-701
e-mail: Milica.Georgieva@kb.com.mk

ORGANIZATION CHART

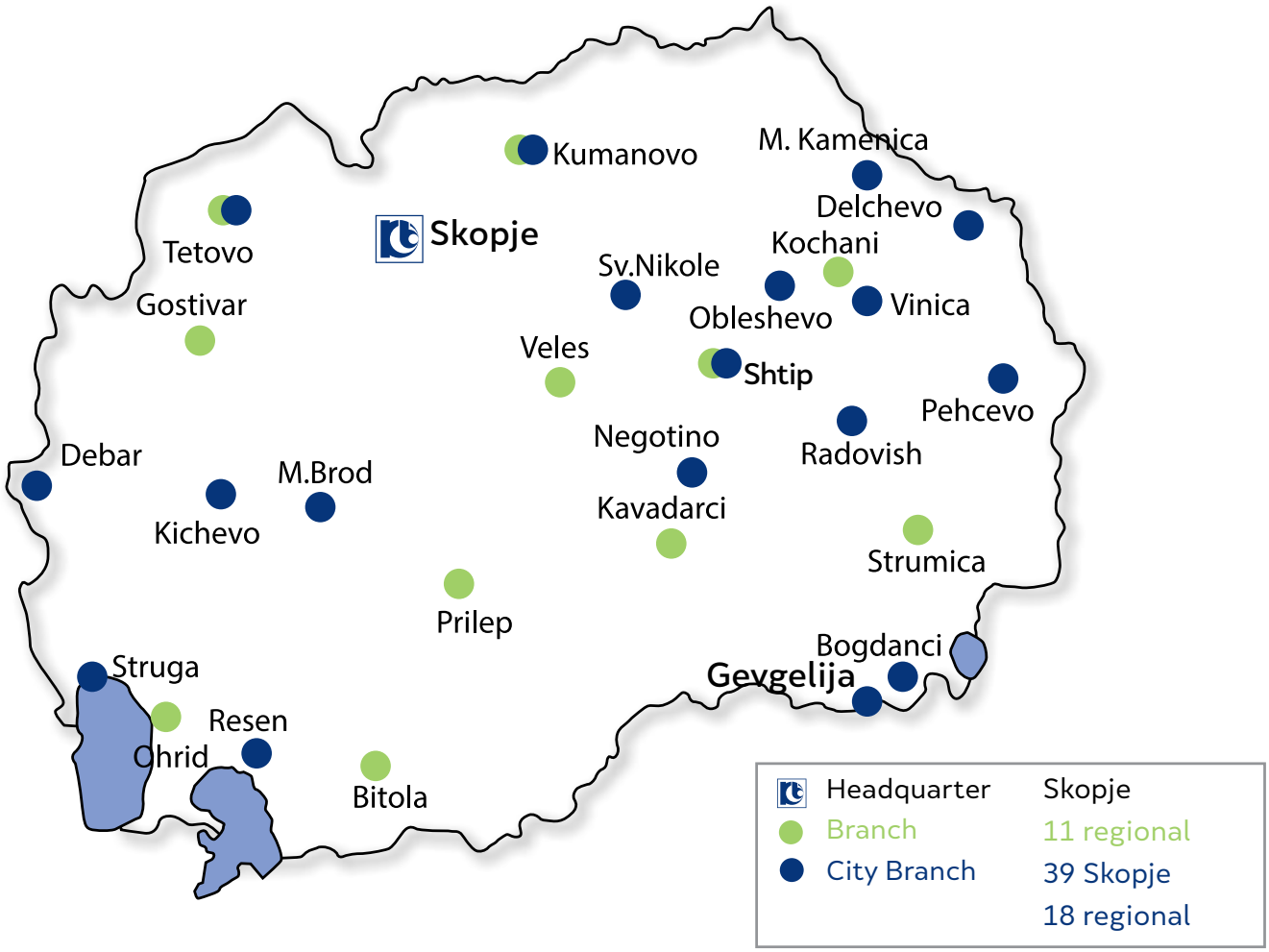


BANK'S NETWORK OF BRANCHES AND CITY-BRANCHES

Komercijalna Banka AD Skopje has developed network of branches and city-branches throughout the Republic of Macedonia.

They are located in the following towns:

- Branches: Ohrid, Prilep, Strumica, Veles, Shtip, Kochani, Kumanovo, Kavadarci, Gostivar, Bitola and Tetovo
- City-branches throughout the Country: Bogdanci, Vinica, Gevgelija, Debar, Delchevo, Kichevo, Makedonski Brod, Makedonska Kamenica, Radovish, Resen, Sveti Nikole, Struga, Ilindenska - Tetovo, Negotino, Obleshevo, Pehchevo, Tush - Shtip and Tush – Kumanovo.
- 39 city-branches in Skopje


Kumanovo
M. Kamenica
Delchevo
Skopje
Tetovo
Kochani
Sv.Nikole
Gostivar
Vinica
Obleshevo
Veles
Shtip
Pehcevo
Negotino
Radovish
Debar
M.Brod
Kavadarci
Kichevo
Strumica
Prilep
Bogdanci
Struga
Gevgelija
Resen
Ohrid
Bitola
Headquarter
Branch
City Branch
Skopje
11 regional
39 Skopje
18 regional

komercijalna banka
ad skopje