Türkiye İş Bankası A.Ş. – DEGA NË KOSOVË

FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH RULES AND REGULATIONS OF THE CENTRAL BANK OF KOSOVO AS AT AND FOR THE YEAR ENDED 31 DECEMBER 2019 WITH INDEPENDENT AUDITORS' REPORT THEREON

MAZARS

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MAZARS

INDEPENDENT AUDITOR'S REPORT

To management and Shareholders of Türkiye İş Bankası A.Ş. – DEGA NË KOSOVË

Opinion

We have audited the financial statements of **Türkiye İş Bankası A.Ş. – DEGA NË KOSOVË** ("the Bank"), which comprise the statement of financial position as at December 31, 2019, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2019, and its financial performance and its cash flows for the year then ended in accordance with the Rules and Regulation of the Central Bank of the Republic of Kosovo("CBK").

Basis for Opinion

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

Emphasis of matter – Basis of accounting and restriction on use

We draw attention to Note 2 to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Bank in complying with the financial reporting requirements of the "Rules and regulations" referred to above. As a result, the financial statements may not be suitable for another purpose.
Our auditor's report is intended solely for the information and use of the Bank and Central Bank of the Republic of Kosovo and should not be used by parties other than the Central Bank of the Republic of Kosovo. Our opinion is not modified in respect of this matter.

Other matters

The bank prepares a separate set of financial statements for the year ended 31 December 2019 in accordance with the International Financial Reporting Standards, which are its general purpose financial statements, which will be issued after the date of this report.

The financial statements of **Türkiye İş Bankası A.Ş. – DEGA NË KOSOVË** for the year ended December 31, 2018 were audited by another auditor which has expressed an unmodified opinion over the financial statements on March 5th, 2019.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Rules and Regulations of the CBK and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern

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basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

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

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March 9th, 2020

Teit Gjini
Legal Auditor

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Statement of financial position as at 31 December 2019
(Amounts in EUR)

Assets	Notes	31 December 2019	31 December 2018
Cash on hand and at banks and balances with Central Bank	7	22,883,074	23,200,928
Placements with banks	8	4,001,389	6,000,000
Investments in securities	9	5,177,446	2,118,926
Loans and advances to costumers	10	67,839,663	83,809,282
Property and equipment	11	768,136	923,537
Intangible assets	12	88,464	95,311
Right of use of asset	13	2,014,959	-
Prepaid income tax		9,486	12,840
Repossessed collaterals	14	165,333	165,333
Other assets	15	38,559	242,125
Total assets		**102,986,509**	**116,568,282**
Liabilities			
Due to customers	16	75,659,528	58,022,291
Due to Banks	17	11,612,859	13,006,432
Due to Head Office and other affiliates	18	2,970,181	34,435,130
Other taxes and contribution payable	19	33,907	68,281
Deferred revenues	20	1,840	10,137
Other liabilities	21	137,043	92,717
Provisions	22	97,795	-
Lease liability	23	1,984,407	-
Total liabilities		**92,497,560**	**105,634,988**
Shareholders' equity			
Share capital	24	10,000,000	10,000,000
Accumulated profit		488,949	933,294
Total shareholders' equity		**10,488,949**	**10,933,294**
Total liabilities and shareholders' equity		**102,986,509**	**116,568,282**

These Financial Statements were prepared by Deloitte Kosova sh.p.k. and approved on behalf of the Bank on March 5, 2020, by:

Oğuzhan Ceylan
Country Manager
Türkiye Is Bankasi A.S. – Branch in Kosovo

Afrore Rudi
Tax Partner, Certified Accountant Deloitte Kosova sh.p.k

The accompanying notes on pages from 7 to 49 form an integral part of these Financial Statements.

Statement of profit or loss and other comprehensive income for the year ended 31 December 2019
(Amounts in EUR)

	Notes	Year ended 31 December 2019	Year ended 31 December 2018
Interest income		4,696,567	5,084,412
Interest expense		(2,156,339)	(2,077,528)
Net interest income	25	**2,540,228**	**3,006,884**
Fee and commission income		268,435	321,155
Fee and commission expense		(9,101)	(9,118)
Net fee and commission income	26	**259,334**	**312,037**
Net foreign exchange income	27	24,511	(45,494)
Other income	28	34,245	26,150
Total operating income		**58,756**	**(19,344)**
Expenses			
Loan loss provisions	10	87,179	909,720
Provisions for guarantees issued to customers	21	(11,816)	5,054
Provisioning for assets held for sale	14	-	(41,333)
Other operating expenses	29	(968,207)	(992,662)
Employee benefits	30	(878,153)	(788,650)
Depreciation and amortization	11,12, 13	(456,172)	(307,286)
Total expenses		**(2,227,169)**	**(1,215,157)**
Profit before tax		**631,149**	**2,084,420**
Income tax expense	31	(142,200)	(224,252)
Net profit for the year		**488,949**	**1,860,168**
Other comprehensive income		-	-
Total comprehensive profit for the year		**488,949**	**1,860,168**

The accompanying notes on pages from 7 to 49 form an integral part of these Financial Statement

Statement of changes in equity for the year ended 31 December 2019
(Amounts in EUR)

	Share capital	Retained earnings	Total shareholders' equity
Balance at 1 January 2018	10,000,000	(926,874)	9,073,126
Total comprehensive income for the year			
Profit for the year	-	1,860,168	1,860,168
Other comprehensive income	-	-	-
Total comprehensive income for the year		**1,860,168**	**1,860,168**
Contributions by and distributions to owners	-	-	-
Balance at 31 December 2018	10,000,000	933,294	10,933,294
Balance at 1 January 2019	10,000,000	933,294	10,933,294
Total comprehensive profit for the year			
Profit for the year	-	488,949	488,949
Other comprehensive income	-	-	-
Total comprehensive income for the year		**488,949**	**488,949**
Contributions by and distributions to owners	-	(933,294)	**(933,294)**
Balance at 31 December 2019	10,000,000	488,949	10,488,949

The accompanying notes on pages from 7 to 49 form an integral part of these Financial Statements.

Statement of cash flows for the year ended 31 December 2019
(Amounts in EUR)

	Notes	Year ended 31 December 2019	Year ended 31 December 2018
I. Cash flows from operating activities			
Profit before tax		631,149	2,084,420
Adjustments for non-cash items:			
Depreciation and Amortization	11,12,13	456,172	307,286
Loan loss reserve	10,21	(75,362)	(914,775)
Provision for legal cases	29	97,795	-
Interest income	25	(4,696,567)	(5,084,412)
Interest expense	25	2,156,339	2,077,528
Changes in operating assets and liabilities:			
Movement in mandatory reserve with CBK	7	1,080,138	1,487,818
Decrease/(Increase) in placements with banks	8	2,000,000	(6,000,000)
Loans and advances to customers	10	15,820,315	(3,419,102)
Due to customers	16	17,296,240	15,019,417
Tax payables and other liabilities	19,21	(1,864)	11,016
Deferred revenues	20	(8,297)	(13,679)
Other assets	13	(32,845)	(236,356)
Repossession of collaterals	14	-	(165,333)
Income tax paid	15	(131,562)	(121,500)
Interest paid for right of use	13	(144,497)	-
Interest paid		(2,012,550)	(1,706,192)
Interest received		4,905,228	4,885,171
Net cash from operating activities (I)		**37,339,831**	**8,211,308**
II. Cash flows used in investing activities			
Increase in investment in securities	9	(3,032,087)	(1,497,628)
Acquisition of property and equipment	11	(31,070)	(583,363)
Acquisition of intangible assets	12	(4,722)	-
Net cash used in investing activities (II)		**(3,067,880)**	**(2,080,991)**
III. Cash flows from financing activities			
Decrease in borrowings with the Head Office	18	(31,116,818)	(7,948,392)
Repayment of/Proceeds from borrowings	17	(1,400,000)	7,500,000
Dividends paid		(933,294)	-
Lease liability	23	(59,555)	-
Net cash used in financing activities (III)		**(33,509,667)**	**(448,392)**
IV. Net increase in cash and equivalents (I+II+III)		762,284	5,681,926
V. Cash and equivalents at the beginning of the year	7	12,514,746	6,832,820
VI. Cash and equivalents at the end of the year (IV + V)	7	**13,277,031**	**12,514,746**

The accompanying notes on pages from 7 to 49 form an integral part of these Financial Statements.

1. REPORTING ENTITY

Türkiye İş Bankası A.Ş.– Dega në Kosovë ("the Bank" or "the Branch") is a branch of Türkiye İş Bankası A.Ş., a Turkish entity. The Bank operates as a commercial and savings bank to all categories of customers within Kosovo.

The Bank operates under a banking licence numbered 011 issued by the Central Bank of the Republic of Kosovo, registered at the Ministry of Trade and Industry on 19 November 2012 with business number 70899345 and fiscal number 600886131. The Bank operates with two branches. One office is located at street Ukshin Hoti number 100, in Pristina and the other one at Zahir Pajaziti Street, in Prizren.

The Bank had 29 employees as at December 31, 2019 (28 employees as at December 31, 2018).

2. BASIS OF PREPARATION

(a) Statement of compliance

The Bank maintains the accounting records and prepares the financial statements as foreseen by the law in accordance with the principle of historic cost and according to the guidelines and rules of Central Bank of Kosovo ("CBK Guidelines") which are applicable for the bank. CBK guidelines are based upon relevant legal decision that defines the mandatory application of International Financial Reporting Standards ("IFRS") in Kosovo, and other specific requirements, especially about the provisioning of loss from loans and financial assets. These specific requirements are not in accordance with those of IFRS in this aspect, and the financial statement should not be read as prepared in accordance with IFRS. In addition, CBK Guidelines have not adopted principles of the new and amended IFRS standards effective for the reporting periods beginning on January 1, 2018, most significantly IFRS 9: Financial Instruments, consequently the format of the presentation and classification of these financial statements in based on IFRSs effective as of December 31, 2017.

(b) Basis of measurement

The Financial Statements have been prepared on the historical cost basis. Presently the Bank does not have financial investment classified as Available for Sale or other items measured at fair value.

(c) Going concern

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

(d) Functional and presentation currency

The Financial Statements are presented in EUR, which is also the Bank's functional currency.

(e) Use of estimates and judgments

The preparation of financial statements in accordance with CBK guidelines and principles of IFRS requires from the management to make appraisals and assumptions that affect the reported figures of assets and liabilities, disclosures of assets and liabilities in-group on the date of financial statements, and the figures of reported income and expenses during the reporting period. Although these appraisals are based on the best knowledge of events and actual actions, the results may be different from those appraisals. .

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

a) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at the reporting date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate when the fair value was determined. Foreign currency differences arising on translation are recognized in profit or loss.

b) Interest income and expense

Interest income and expense are recognized in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

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

Interest income and expense presented in the statement of profit or loss and other comprehensive income includes interest on financial assets and liabilities measured at amortized cost calculated on an effective interest rate basis.

The Bank does not recognize in its financial statements interest incomes for non - performing clients, as requested by the Central Bank of Republic of Kosovo rules and regulations.

c) Fees and commissions

Fees and commission income and expenses that are integral to the effective interest rate of a financial asset or financial liability are included in the measurement of the effective interest rate.

Other fees and commission income – including account servicing fees, sales commission, placement fees– are recognized as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fees are recognized on a straight-line basis over the commitment period.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

d) Income tax expense

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the profit or loss except to the extent that it relates to items recognized directly in equity or in Other Comprehensive Income.

Current tax

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. It is measured using tax rates enacted or substantively enacted at the reporting date.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d) Income tax expense (continued)

Deferred tax

Deferred tax is recognized 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.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilized. Deferred tax liabilities are recognized for all taxable temporary differences.

Deferred tax assets and deferred tax liabilities are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit and tax obligation, respectively will be realized. Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend is recognized.

For the year ended December 31, 2019 and 2018, there are no temporary differences that would require the recognition of a deferred tax asset or liability in the financial statements.

e) Leases

Policy applicable from January 1, 2019

The Bank assesses whether a contract is or contains a lease, at inception of the contract. The Bank recognizes a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (such as tablets and personal computers, small items of office furniture, vehicles and telephones). For these leases, the Bank recognizes the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the Bank uses its incremental borrowing rate.

Lease payments included in the measurement of the lease liability comprise:

- Fixed lease payments (including in-substance fixed payments), less any lease incentives receivable;
- Variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- The amount expected to be payable by the lessee under residual value guarantees;
- The exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- Payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the statement of financial position. The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The Bank re-measures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e) Leases (continued)

The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.

The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using an unchanged discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).

A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.
The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Whenever the Bank incurs an obligation for costs to dismantle and remove a leased asset, restore the site on which it is located or restore the underlying asset to the condition required by the terms and conditions of the lease, a provision is recognized and measured under IAS 37. To the extent that the costs relate to a right-of-use asset, the costs are included in the related right-of-use asset, unless those costs are incurred to produce inventories.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the Bank expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented as a separate line in the statement of financial position.

The Bank applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the 'Property, Plant and Equipment' policy.

Variable rents that do not depend on an index or rate are not included in the measurement the lease liability and the right-of-use asset. The related payments are recognized as an expense in the period in which the event or condition that triggers those payments occurs and are included in the line "Other expenses" in profit or loss.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The Bank has not used this practical expedient. For contracts that contain a lease component and one or more additional lease or non-lease components, the Bank allocates the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

The Bank has chosen to use the Modified Retrospective Approach in applying IFRS 16. Under the modified retrospective approach, a lessee will not have to recast comparative financial information. Therefore, the date of initial application is the first day of the annual reporting period in which a lessee first applies the requirements of the new lease standard. At the date of the initial application of the new lease standard, lessees will recognize the cumulative effect of the initial application as an adjustment to the opening balance of retained earnings as of 1st January 2019. Prior periods are left as is under the recognition requirements of IAS 17.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e) Leases (continued)

The initial recognition involves calculating the present value of all remaining lease payments using the lessee's incremental borrowing rate at the date of initial application and stating the lease liability at the calculated amount on the balance sheet.

In order to calculate the present values of the remaining lease payments the Bank used an interest rate assigned from the Treasury Department of the Head Office. The interest rate used represents the borrowing rate that the Group usually charges in the interbank borrowings. The Bank has used an interest rate of 7.57% to discount lease payments for the branch of Prishtina and Head Office, and has used an interest rate of 6.71% to discount lease payments for the branch of Prizren.

There are two options for measuring the right-of-use asset on transition. It is important to note that this is done on a lease-by-lease basis:

i) The first approach is to measure the asset as if IFRS 16 had been applied since the commencement date of a lease using a discount rate based on the lessee's incremental borrowing rate at the date of initial application.

ii) The second approach is to measure the asset at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments recognized immediately before the date of initial application.

The Bank has chosen to apply the second method above and measuring the lease liability equal to right of use asset adjusted by any prepayment. The application of IFRS 16 to leases previously classified as operating leases under IAS 17 resulted in the recognition of right-of-use assets of EUR 2,273,091(including prepaid leases) and lease liabilities of EUR 2,043,962.

Policy applicable up to January 1, 2019

Payments made under operating leases are charged to expenses on a straight-line basis over the term of the lease.

f) Financial instruments

Financial assets and financial liabilities are recognized in the Bank's statement of financial position when the Bank becomes a party to the contractual provisions of the instrument.

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

g) Financial assets

All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

All recognized financial assets are measured subsequently in their entirety at either amortized cost or fair value, depending on the classification of the financial assets.

The Bank recognized in its financial statements only financial assets that are held at amortized cost.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g) Financial assets (continued)

Classification of financial assets

Debt instruments that meet the following conditions are measured subsequently at amortized cost:

a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt instruments that meet the following conditions are measured subsequently at fair value through other comprehensive income (FVTOCI):

a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets; and
b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

By default, all other financial assets are measured subsequently at fair value through profit or loss (FVTPL). Despite the foregoing, the Bank may make the following irrevocable election/designation at initial recognition of a financial asset:

a) the Bank may irrevocably elect to present subsequent changes in fair value of an equity investment in other comprehensive income if certain criteria are met (see below); and
b) the Bank may irrevocably designate a debt investment that meets the amortized cost or FVTOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch (see below).

i) Amortized cost and effective interest method

The effective interest method is a method of calculating the amortized cost of a debt instrument and of allocating interest income over the relevant period.

For financial assets other than purchased or originated credit-impaired financial assets (i.e. assets that are credit-impaired on initial recognition), the effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) excluding expected credit losses, through the expected life of the debt instrument, or, where appropriate, a shorter period, to the gross carrying amount of the debt instrument on initial recognition. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated by discounting the estimated future cash flows, including expected credit losses, to the amortized cost of the debt instrument on initial recognition.

The amortized cost of a financial asset is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, adjusted for any loss allowance. The gross carrying amount of a financial asset is the amortized cost of a financial asset before adjusting for any loss allowance.

Interest income is recognized using the effective interest method for debt instruments measured subsequently at amortized cost and at FVTOCI. For financial assets other than purchased or originated credit-impaired financial assets, interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for financial assets that have subsequently become credit-impaired (see below). For financial assets that have subsequently become credit-impaired, interest income is recognized by applying the effective interest rate to the amortized cost of the financial asset.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g) Financial assets (continued)

If, in subsequent reporting periods, the credit risk on the credit-impaired financial instrument improves so that the financial asset is no longer credit-impaired, interest income is recognized by applying the effective interest rate to the gross carrying amount of the financial asset.

For purchased or originated credit-impaired financial assets, the Bank recognizes interest income by applying the credit-adjusted effective interest rate to the amortized cost of the financial asset from initial recognition. The calculation does not revert to the gross basis even if the credit risk of the financial asset subsequently improves so that the financial asset is no longer credit-impaired.

Interest income is recognized in profit or loss and is included in the 'finance income – interest income' line item (note 25).

(ii) Debt instruments classified as at FVTOCI

The corporate bonds held by the Bank are classified as at FVTOCI. The corporate bonds are initially measured at fair value plus transaction costs. Subsequently, changes in the carrying amount of these corporate bonds as a result of foreign exchange gains and losses (see below), impairment gains or losses (see below), and interest income calculated using the effective interest method (see (i) above) are recognised in profit or loss. The amounts that are recognised in profit or loss are the same as the amounts that would have been recognised in profit or loss if these corporate bonds had been measured at amortized cost. All other changes in the carrying amount of these corporate bonds are recognised in other comprehensive income and accumulated under the heading of investments revaluation reserve. When these corporate bonds are de-recognised, the cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss.

iii) Financial assets at FVTPL

Financial assets that do not meet the criteria for being measured at amortized cost or FVTOCI (see above) are measured at FVTPL. Specifically:

a) Investments in equity instruments are classified as at FVTPL, unless the Bank designates an equity investment that is neither held for trading nor a contingent consideration arising from a business combination as at FVTOCI on initial recognition.

b) Debt instruments that do not meet the amortized cost criteria or the FVTOCI criteria are classified as at FVTPL. In addition, debt instruments that meet either the amortized cost criteria or the FVTOCI criteria may be designated as at FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency (so called 'accounting mismatch') that would arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases. The Bank has not designated any debt instruments as at FVTPL.

c) Financial assets at FVTPL are measured at fair value at the end of each reporting period, with any fair value gains or losses recognized in profit or loss to the extent they are not part of a designated hedging relationship. The net gain or loss recognized in profit or loss includes any dividend or interest earned on the financial asset and is included in the 'other gains and losses' line item.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g) Financial assets (continued)

Foreign exchange gains and losses

a) The carrying amount of financial assets that are denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of each reporting period. Specifically, for financial assets measured at amortized cost that are not part of a designated hedging relationship, exchange differences are recognized in profit or loss in the 'other gains and losses' line item ;

b) b) for debt instruments measured at FVTOCI that are not part of a designated hedging relationship, exchange differences on the amortized cost of the debt instrument are recognized in profit or loss in the 'other gains and losses' line item. Other exchange differences are recognized in other comprehensive income in the investments revaluation reserve;

c) c) for financial assets measured at FVTPL that are not part of a designated hedging relationship, exchange differences are recognized in profit or loss in the 'other gains and losses' line item; and

d) d) for equity instruments measured at FVTOCI, exchange differences are recognized in other comprehensive income in the investments revaluation reserve.

Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay.
On derecognition of a financial asset measured at amortised cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognised in profit or loss. In addition, on
derecognition of an investment in a debt instrument classified as at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

Write of policy

The Bank writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Bank's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full. The Group may write-off financial assets that are still subject to enforcement activity.

h) Financial liabilities

Classification as debt or equity

Debt and equity instruments are classified either as financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

All financial liabilities are measured subsequently at amortized cost using the effective interest method or at FVTPL.

However, financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies, and financial guarantee contracts issued by the Bank, are measured in accordance with the specific accounting policies set out below.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial liabilities (continued)

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL when the financial liability is (i) contingent consideration of an acquirer in a business combination, (ii) held for trading or (iii) designated as at FVTPL.

A financial liability is classified as held for trading if:

a) it has been acquired principally for the purpose of repurchasing it in the near term; or
b) on initial recognition it is part of a portfolio of identified financial instruments that the Bank manages together and has a recent actual pattern of short-term profit-taking; or
c) it is a derivative, except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument.

A financial liability other than a financial liability held for trading or contingent consideration of an acquirer in a business combination may be designated as at FVTPL upon initial recognition if:

a) such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
b) the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
c) it forms part of a contract containing one or more embedded derivatives.

Financial liabilities at FVTPL are measured at fair value, with any gains or losses arising on changes in fair value recognized in profit or loss to the extent that they are not part of a designated hedging relationship The net gain or loss recognized in profit or loss incorporates any interest paid on the financial liability and is included in the 'other gains and losses' line in profit or loss.

However, for financial liabilities that are designated as at FVTPL, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognized in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. The remaining amount of change in the fair value of liability is recognized in profit or loss. Changes in fair value attributable to a financial liability's credit risk that are recognized in other comprehensive income are not subsequently reclassified to profit or loss; instead, they are transferred to retained earnings upon de-recognition of the financial liability.

Gains or losses on financial guarantee contracts issued by the Bank that are designated by the Bank as at FVTPL are recognized in profit or loss.

Financial liabilities measured subsequently at amortized cost

Financial liabilities that are not (i) contingent consideration of an acquirer in a business combination, (ii) held for trading, or (iii) designated as at FVTPL, are measured subsequently at amortized cost using the effective interest method.
The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the amortized cost of a financial liability.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h) Financial liabilities (continued)

Financial guarantee contract liabilities

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contract liabilities are measured initially at their fair values and, if not designated as at FVTPL and do not arise from a transfer of an asset, are measured subsequently at the higher of:

- the amount of the loss allowance determined in accordance with IFRS 9 (see financial assets above); and
- the amount recognized initially less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies set out above.

Foreign exchange gains and losses

For financial liabilities that are denominated in a foreign currency and are measured at amortized cost at the end of each reporting period, the foreign exchange gains and losses are determined based on the amortized cost of the instruments. These foreign exchange gains and losses are recognized in the 'other gains and losses' line item in profit or loss for financial liabilities that are not part of a designated hedging relationship. For those which are designated as a hedging instrument for a hedge of foreign currency risk, foreign exchange gains and losses are recognized in other comprehensive income and accumulated in a separate component of equity.

The fair value of financial liabilities denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period. For financial liabilities that are measured as at FVTPL, the foreign exchange component forms part of the fair value gains or losses and is recognized in profit or loss for financial liabilities that are not part of a designated hedging relationship.

De-recognition of financial liabilities

The Bank de-recognizes financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or have expired. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

When the Bank exchanges with the existing lender one debt instrument into another one with the substantially different terms, such exchange is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, the Bank accounts for substantial modification of terms of an existing liability or part of it as an extinguishment of the original financial liability and the recognition of a new liability. It is assumed that the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective rate is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If the modification is not substantial, the difference between:

(1) the carrying amount of the liability before the modification; and

(2) the present value of the cash flows after modification is recognized in profit or loss as the modification gain or loss within other gains and losses.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

i) Impairment of loans and advances

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

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

The basic method used for collective impairment calculation of loans is modelling of clients' previous behavior (in aggregated volumes). This model is based on so called roll-rate coefficients from which historical average coefficients are calculated.

The Branch calculates actual annual default rates for current loans over the past 12 months and applies those default rates against the net risk (by deducting eligible cash collateral) of current loans on monthly basis. The Bank conducts roll-rate analysis separately for Cash Loans and Non-Cash Loans.

The historical average method is a simplified approach that is used to supplement the Roll Rate model. The historical average method provides an estimate of annual averages based on past performance. The time period chosen is twelve months which is long enough to smooth out any impact from significant growth factors, changes in underwriting or lending practices, deteriorating trends in the volume of past due credits, and changes in current local and national economic conditions.

The final historical average coefficient for Standard and Watch classifications is limited up to the ratio of substandard classification.

Provisions created for possible losses on loans and advances classified as standard and watch are classified as general provisions. Off-Balance sheet exposures like guarantees and letters of credit are classified in the same manner. For each risk category, the following minimum rates of specific provision are applied:

Risk Strategy	Loss provision (CBK regulation)	Loss provision applied by the Bank
Standard	No minimum	Roll rate model
Watch	No minimum	Roll rate model
Sub-Standard	Minimum 20%	20%
Doubtful	Minimum 50%	50%
Loss	100%	100%

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

i) Impairment of loans and advances (continued)

Collective impairment rates of loans and advances for Standard and Watch classifications are presented in the table below:

Class.	Category	Delay Buckets (X=Days Past Due)	2019 Provisioning %	2018 Provisioning %
A	Standard - Cash Covered Loans	X ≥ 0	0.00%	0.00%
A0	Standard - On Balance	X=0	0.38%	0.09%
A1	Standard - On Balance	0 < X ≤ 30	5.17%	10.23%
A0	Standard - Off Balance	X=0	0.00%	0.00%
A1	Standard - Off Balance	0 < X ≤ 30	0.00%	0.04%
Standard	Weighted average rate	0 < X ≤ 30	-	0.61%
B	Watch - On Balance	30 ≤ X ≤ 60	20.00%	20.00%
B	Watch - Off Balance	30 ≤ X ≤ 60	0.06%	0.16%
Watch	Weighted average rate	30 ≤ X ≤ 60	-	18.21%
-	Unused Commitments (Overdrafts) - Off Balance	X ≥ 0	0.20%	0.20%

The Bank considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. Those found not to be specifically impaired are collectively assessed for any impairment that has been incurred but not yet identified.

(j) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

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

(k) Deposits and borrowings

Deposits and borrowings are the Bank's main sources of debt funding.

Deposits and borrowings are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method.

(l) Provisions

A provision is recognized if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

(m) Employee benefits

(i) Mandatory social security contributions

The Bank makes only mandatory social security contributions that provide pension benefits for employees upon retirement. The Government of Kosovo is responsible for providing the legally set minimum threshold for pensions in Kosovo under a defined contribution pension plan. The Bank's contributions to the pension plan are charged to profit or loss as incurred.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n) Property and equipment

(i) Recognition and measurement

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset.

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

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from continued use of the asset. Any gain or loss arising on the disposal of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and recognized in profit or loss.

(ii) Subsequent costs

The cost of replacing part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(iii) Depreciation

Depreciation is recognized in profit or loss on a straight line basis over the estimated useful lives of the assets. Depreciation methods, useful lives and residual values (if not insignificant) are reassessed at the reporting date.

The estimated useful lives for the current and comparative years were as follows:

- Furniture, fixtures and equipment 5 years
- Other fixed assets 5 years
- Vehicles 5 years

Leasehold improvements are depreciated over 10 years which is the shorter of the lease term and their useful lives.

(o) Intangible assets

Intangible assets with finite useful life that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

The estimated useful life of the software is five years.

Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

(p) Financial guarantees and loan commitments

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. Such financial commitments are recorded in the statement of financial position if and when they become payable.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(q) Repossessed Collaterals

Collateral held under loan agreement can only be possessed by the Bank in case of borrower's default and conduct of legal procedures in accordance with legislation of Kosovo which enable the Bank to take full legal title and ownership. Only after the completion of these procedures, the Bank can sell or transfer the collateral. Repossessed assets are initially recognized at the amount stipulated by the court order and are subsequently measured at the lower of cost and net realizable value and any gain or loss from the sale of these assets is recognized in the profit or loss. From the initial recognition, the Bank classifies the repossessed property at a minimum of substandard classification and set aside provisioning according to classification. In addition, the Bank recognizes repossessed collateral as an asset only when it has full legal title of the collateral and the fair value of collateral can be determined reliably. The Bank cannot sell, transfer or re-pledge the collateral if legal procedures for transfer of ownership as a result of default have not been completed. The Bank holds the possession of properties acquired through enforcement in the form of a mortgage, for a maximal period of five years. If, within five years, the asset has not been sold by the Bank, it is written down to zero value.

(r) Grants

Grants are not recognized until there is reasonable assurance that the Bank will comply with the conditions attaching to them and that the grants will be received.

Grants are recognized in profit or loss on a systematic basis over the periods in which the Bank recognizes as expenses the related costs for which the grants are intended to compensate. Specifically, grants are recognized as deferred revenue in the consolidated statement of financial position and transferred to profit or loss on a systematic and rational basis over the useful lives of the related assets.

(s) Taxation

Current income tax is calculated based on the income tax regulations applicable in Kosovo, using tax rates enacted at the balance sheet date. The tax rate on corporate income is set at 10% in accordance with Kosovo tax regulations currently in force, Law no. 06/L-105 "On Corporate Income Tax", published on June 27, 2019.
The income tax charge in the profit and loss for the year comprises current tax and changes in deferred tax. Current tax is calculated on the basis of the expected taxable profit for the year using the tax rates enforced or substantially enacted at the balance sheet date.

Taxable profit differs from profit as reported in the profit and loss because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. Taxes other than income taxes are recorded within operating expenses.

Deferred income tax is accounted for using the balance sheet liability method for temporary differences arising between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled based on tax rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are offset when there is legally enforceable right to set off current tax assets against tax liabilities and when they relate to income taxes levied by the same taxation authority.

For the year ended December 31, 2019 and 2018, there are no temporary differences that would require the recognition of a deferred tax asset or liability in the financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

i) Initial application of new amendments to the existing standards effective for the current reporting period

- **IFRS 16 "Leases"** – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2019). Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

- **Amendments to IFRS 9 "Financial Instruments"** - Prepayment Features with Negative Compensation – adopted by the EU on 22 March 2018 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IAS 19 "Employee Benefits"** - Plan Amendment, Curtailment or Settlement – adopted by the EU on 13 March 2019 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IAS 28 "Investments in Associates and Joint Ventures"** - Long-term Interests in Associates and Joint Ventures – adopted by the EU on 8 February 2019 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to various standards due to "Improvements to IFRSs (cycle 2015 -2017)"** resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 14 March 2019 (effective for annual periods beginning on or after 1 January 2019),

- **IFRIC 23 "Uncertainty over Income Tax Treatments"** – adopted by the EU on 23 October 2018 (effective for annual periods beginning on or after 1 January 2019).

The adoption of these new standards, amendments to the existing standards and interpretation has not led to any material changes in the Bank's financial statements, except for IFRS 16 which lead to a material change in the Bank's financial statements. Initial impact of the application of the standard is disclosed under Note 3, (e) Leases

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ii) Standards and amendments to the existing standards issued by IASB and adopted by the EU but not yet effective

At the date of authorization of these financial statements, the following amendments to the existing standards were issued by IASB and adopted by the EU and which are not yet effective

- **Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors"** - Definition of Material - adopted by the EU on 29 November 2019 (effective for annual periods beginning on or after 1 January 2020),

- **Amendments to IFRS 9 "Financial Instruments", IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures"** - Interest Rate Benchmark Reform - adopted by the EU on 15 January 2020 (effective for annual periods beginning on or after 1 January 2020),
- **Amendments to References to the Conceptual Framework in IFRS Standards** adopted by the EU on 29 November 2019 (effective for annual periods beginning on or after 1 January 2020).
- **IFRS 14 "Regulatory Deferral Accounts"** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,

- **IFRS 17 "Insurance Contracts"** (effective for annual periods beginning on or after 1 January 2021),

- **Amendments to IFRS 3 "Business Combinations"** - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period),

- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded).

The Bank anticipates that the adoption of these new standards and amendments to the existing standards will have no material impact on the financial statements of the Bank in the period of initial application.

The Central Bank of the Republic of Kosovo, has issued the regulation "Regulation on application of International Financial Reporting Standard 9", which implies the Banks to calculate and recognize expected credit losses beginning from January 1, 2020 based on the requirements of IFRS 9.

4. FINANCIAL RISK MANAGEMENT

Risk management process and the functions involved in the process are some of the primary responsibilities of the Board of Directors of the Parent Company (Head Office). The Risk Management Department, which operates under the Board of Directors, has been organized as Asset-Liability Management Risk Unit, Credit Risk and Economic Capital Unit, Operational Risk and Model Verification and Subsidiary Risk Unit.

The Bank's risk management process is carried out within the framework of risk policies which are set by the Risk Management Department and issued by the Board of the Directors and written standards which contains risk policies.

These policies which are in line with international practices are general standards which contain: organization and scope of the risk management function, risk measurement policies, duties and responsibilities of the risk management group, procedures for determining risk limits, ways to eliminate limit violations and approval and confirmation to be given in a variety of events and situations. The scope and content of the Bank's risk management system is given by the main risk types.

The Bank has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk
- operational risks

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

(a) Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's Loans to customers and other banks and investments.
Credit risk is defined as the risk of the failure to comply with the requirements or failing to fulfill its obligations partially or totally of the counter side of the transaction contract with the Bank. The methodology and responsibilities of the credit risk management, controlling and monitoring and the framework of credit risk limitations are specified with the credit risk policy. The Bank defines, measures and manages credit risk of all products and activities. The Board of Directors reviews the Bank's credit risk policies and credit risk strategy on an annual basis as a minimum. Management is responsible for the implementation of credit risk policies which are approved by the Board of Directors.
As a result of loan and credit risks analysis all findings are reported to the Board of Directors and Management on a regular basis. In addition to credit risk assessment process, monitoring of credit risk also comprises monitoring and managing the credit by sector, security, geography, currency, credit type and credit rating.
As part of the Bank's credit risk management, as well as limits required by legal regulations, the Bank utilizes the risk limits to undertake the maximum credit risk within risk groups or sectors that the Board of Directors determines.
These limits are determined in such a way that minimize risk concentration within particular sectors. Excess risk limits up to legal requirements and boundary limits are considered as an exception. The Board of Directors has the authority to approve exceptions. The results of the control of risk limits and the evaluations of these limits are presented by Internal Audit and Risk Management Bank to Management and the Board of Directors.

The Bank uses credit decision support systems which are created for the purpose of credit risk management, lending decisions, controlling the credit process and credit provisioning. The consistency of the credit decision support systems with the structure of the Bank's activities, size and complexity is examined continuously. Credit decision support systems include the Risk Committee assessment and approval of Board of Directors.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit Risk (continued)

Maximum Credit exposure

Maximum exposures to credit risk before collateral and other credit enhancements as at 31 December 2019 and 31 December 2018 are as follows:

	31 December 2019	31 December 2018
Balances with Central Bank of Kosovo (see Note 7)	19,307,459	14,421,855
Cash at banks (see Note 7)	3,429,725	8,544,260
Loans and advances to costumers, net	67,839,663	83,809,282
Investments in securities	5,177,446	2,118,926
Guarantees in favor of customers and credit commitments	32,663,621	11,504,823
Maximum exposure to credit risk	**128,417,914**	**120,399,146**

Credit quality by class of financial assets:

31 December 2019	Neither past due nor impaired	Past due but not impaired	Past due and impaired	Total
Balances with Central Bank of Kosovo (Note 7)	19,307,459	-	-	19,307,459
Cash at banks (Note 7)	3,429,725	-	-	3,429,725
Loans and advances to costumers, net	66,871,562	-	968,101	67,839,663
Investments in securities	5,177,446	-	-	5,177,446
Guarantees in favor of customers and credit commitments	32,663,621	-	-	32,663,621
Maximum exposure to credit risk	**127,449,813**	**-**	**968,101**	**128,417,914**

31 December 2018	Neither past due nor impaired	Past due but not impaired	Past due and impaired	Total
Balances with Central Bank of Kosovo (Note 7)	14,421,855	-	-	14,421,855
Cash at banks (Note 7)	8,544,260	-	-	8,544,260
Loans and advances to costumers, net	75,886,836	7,135,787	786,660	83,809,282
Investments in securities	2,118,926	-	-	2,118,926
Guarantees in favor of customers and credit commitments	11,504,823	-	-	11,504,823
Maximum exposure to credit risk	**112,476,700**	**7,135,787**	**786,660**	**120,399,146**

Loans and advances to customer's bears fixed and floating interest rates.

Impaired loans and securities

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

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit Risk (continued)

Past due but not impaired loans

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

Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio.

Loans and advances to customers, net	31 December 2019	31 December 2018
Neither past due nor impaired	66,871,562	75,886,836
Past due and impaired	-	786,660
Past due but not impaired	968,101	7,135,786
Total	**67,839,663**	**83,809,282**

The aging analysis of credit risk exposure is as follows:

Category (Aging)	31 December 2019	31 December 2018
Standard (0 days)	67,107,466	75,809,433
Standard (1-30 days)	-	7,981,738
Watch (31-60 days)	188,751	209,001
Substandard (61-90 days)	988,543	746,908
Doubtful (91-180 days)	49,476	25,178
Loss (more than 180 days)	1,325,532	732,140
Accrued interest	201,971	438,454
Less: Deferred disbursement fee	(69,412)	(93,727)
Total Loans at amortized cost, gross	**69,792,327**	**85,849,125**
Less: Allowance for impairment	(1,952,664)	(2,039,843)
Loans and advances to customers, net	**67,839,663**	**83,809,282**

Set out below is an analysis of collateral obtained as coverage in respect of loans and advances to customers:

Loans and advances to customers	Maximum exposure to credit risk	Real Estate	Total collateral	Surplus collateral	Net Exposure
31 December 2019	67,839,663	295,816,586	73,835,635	227,976,923	-
31 December 2018	83,809,282	307,439,429	77,809,282	217,630,147	6,000,000

The Bank is not permitted to sell or re-pledge collateral held under loan contracts in absence of default by the owner of collateral.

The net exposure consist of a loan to a group client approved centrally, for which the collateral is not held locally but at parent level.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Concentrations

IS Bank has a credit strategy which determines the types of investments (concentrations) based primarily on economic segments such as industry, trade, construction, etc. Due to the small size of the Republic of Kosovo, geographical concentrations within Kosovo are not significant; this strategy is reviewed and updated on an annual basis by the management board or the bank.

The following table breaks down the Bank's main credit exposure at their net amounts, as categorized by the industry sectors of our counterparties.

As of December 31, 2019 and 2018, an analysis of loans to customers and banks by industry sectors was as follows:

	31 December 2019	31 December 2018
Wholesale and retail trade	47,829,150	55,404,066
Electricity, gas, steam and air conditioning supply	6,231,805	12,290,036
Construction	3,251,781	3,793,366
Manufacturing	7,940,420	9,097,834
Accommodation and food service activities	864,690	1,210,173
Water, supply, sewerage and waste management and services	501,138	736,813
Individual	1,079,143	850,756
Mining and quarrying	484,093	455,160
Other services	387,969	645,506
Transportation and storage	506,551	530,594
Administrative and support service activities	4,744	4,853
Professional, scientific and technical activities	578,282	478,675
Information and communication	-	6,564
Accrued interest	201,971	438,454
Deferred revenue on disbursement fee	(69,412)	(93,727)
Total Loans at amortized cost, gross	**69,792,327**	**85,849,123**
Less: Allowance for impairment	(1,952,664)	(2,039,843)
Loans and advances to customers, net	**67,839,663**	**83,809,280**

The top 10 exposures of the Bank make up a total of 60,039 thousand Euro or 69% of the total loan portfolio (2018: Eur 62,282 thousand, 74%). The individual client exposures range up to Euro 216 thousand.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk may raise as a result of funding long-term assets with short-term resources. Care is taken to maintain the consistency between the maturities of assets and liabilities and strategies are used to acquire funds over longer terms.

Based on cash flow projections, prices are differentiated for different maturities and thereby measures are taken to meet liquidity requirements; moreover, liquidity that may be required for extraordinary circumstances is estimated and alternative liquidity sources are determined for possible utilization.

The purpose of Liquidity Risk Management is to ensure, as far as possible, that the Bank will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to its reputation. Liquidity Risk Management is handled in collaboration and close supervision of Treasury Group Department in Head Office. As at 31 December 2019 and 2018, the Bank's financial assets and liabilities have remaining contractual maturities as follows:

31 December 2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Unspecified	Total
Assets							
Cash at banks and balances with Central Bank	13,320,053	-	-	-	-	9,563,020	22,883,074
Placements with banks	4,001,389	-	-	-	-	-	4,001,389
Investments in securities	-	1,756,857	2,173,750	1,246,839	-	-	5,177,446
Loans and advances to customers	6,212,503	3,467,679	24,423,379	29,509,048	4,227,054	-	67,839,663
Total	**23,533,946**	**5,224,536**	**26,597,129**	**30,755,887**	**4,227,054**	**9,563,020**	**99,901,572**
Liabilities							
Due to customers	12,695,708	6,822,669	31,835,351	24,305,800	-	-	75,659,528
Short-term borrowings	7,001,991	2,601,618	2,009,250		-	-	11,612,859
Due to Head Office	1,950,410	295,951	224,585	499,235			2,970,181
Other liabilities	125,314	20,815	205,870	1,189,709	670,813	-	2,212,521
Total	**21,773,423**	**9,741,053**	**34,275,056**	**25,994,744**	**670,813**	**-**	**92,455,089**
Net Position	**1,760,523**	**(4,516,517)**	**(7,677,927)**	**4,761,143**	**3,556,241**	**9,563,020**	**7,446,483**
Cumulative net position	**1,760,523**	**(2,755,994)**	**(10,433,921)**	**(5,672,778)**	**(2,116,537)**	**7,446,483**	**-**

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk

31 December 2018	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Unspecified	Total
Assets							
Cash at banks and balances with Central Bank	18,197,928	-	-	-	-	5,003,000	23,200,928
Placements with banks	6,000,000	-	-	-	-	-	6,000,000
Investments in securities	-	-	1,998,088	120,838	-	-	2,118,926
Loans and advances to customers	13,061,888	9,098,220	29,819,424	26,873,882	4,955,868	-	83,809,282
Total	**37,259,816**	**9,098,220**	**31,817,512**	**26,994,720**	**4,955,868**	**5,003,000**	**115,129,136**
Liabilities							
Due to customers	11,922,203	4,349,770	26,566,627	14,969,691	214,000	-	58,022,291
Short-term borrowings	13,006,432	-	-	-	-	-	13,006,432
Due to Head Office	3,240,074	17,189,203	13,292,662	713,191	-	-	34,435,130
Other liabilities	94,213	37,969	-	-	-	-	132,182
Total	**28,262,922**	**21,576,942**	**39,859,289**	**15,682,882**	**214,000**	**-**	**105,596,035**
Net Position	**8,996,894**	**(12,478,722)**	**(8,041,777)**	**11,311,838**	**4,741,868**	**5,003,000**	**9,533,101**
Cumulative net position	**8,996,894**	**(3,481,828)**	**(11,523,605)**	**(211,767)**	**4,530,101**	**9,533,101**	**-**

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(d) Market Risk

i. Foreign currency risk

Foreign currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Bank manages this risk by establishing and monitoring limits on open positions and also ensuring that these positions remain in compliance with the Central Bank of Republic of Kosovo guidelines and the Bank's internal operational covenants. The Bank has in place procedures for the independent checking of open foreign currency positions. The Head Office manages the foreign currency positions and balances the currency spread of the Bank on an ongoing basis. The foreign currencies the Bank deals with are predominantly United States Dollars (USD), Turkish Lira (TRY), Swiss Franc (CHF) and Great Britain Pound (GBP). However these transactions are limited and assets and liabilities denominated in foreign currency are insignificant on the balance sheet date. As a result the bank is not sensitive to changes in foreign currency rates.

The exchange rates used for conversion of foreign currency values at 31 December 2019 and 2018 are as follows:

Compared to EUR	31 December 2019	31 December 2018
1 USD	0.8902	0.8733
1 TRY	0.1496	0.1650
1 GBP	1.1754	1.1271
1 CHF	0.9213	0.8873

The following tables present the equivalent amount of financial assets and liabilities by currency as at 31 December 2019 and 2018 as translated into EUR:

2019	EUR	TRY	USD	GBP	CHF	Total
Assets						
Cash and balances with Central Bank	22,184,708	36,441	661,656	269	-	22,883,074
Placements with banks	4,001,389	-	-	-	-	4,001,389
Investment securities	5,177,446	-	-	-	-	5,177,446
Loans and advances to customers	67,800,025	-	39,638	-	-	67,839,663
Total	**99,163,568**	**36,441**	**701,294**	**269**	**-**	**99,901,572**
Liabilities						
Due to customers	75,181,455	-	478,063	10	-	75,659,528
Short term borrowings	11,612,859	-	-	-	-	11,612,859
Due to Head Office	2,725,619	-	244,562	-	-	2,970,181
Other liabilities	2,212,200	-	320	-	-	2,212,520
Total	**91,732,132**	**-**	**722,945**	**10**	**-**	**92,455,088**
Net position	**7,431,437**	**36,441**	**(21,651)**	**258**	**-**	**7,446,486**
Cumulative net position	**7,431,437**	**7,467,878**	**7,446,227**	**7,446,486**	**7,446,486**	**-**

4. FINANCIAL RISK MANAGEMENT (CONTINUED)
(d) Market Risk (continued)

i. Foreign currency risk (continued)

2018	EUR	TRY	USD	GBP	CHF	Total
Assets						
Cash and balances with Central Bank	22,712,255	22,219	359,918	73,988	32,548	23,200,928
Placements with banks	6,000,000	-	-	-	-	6,000,000
Investment securities	2,118,926	-	-	-	-	2,118,926
Loans and advances to customers	83,698,126	-	111,156	-	-	83,809,282
Total	**114,529,307**	**22,219**	**471,074**	**73,988**	**32,548**	**115,129,136**
Liabilities						
Due to customers	57,257,652	-	474,917	256,749	32,973	58,022,291
Short term borrowings	13,006,432	-	-	-	-	13,006,432
Due to Head Office	34,378,049	-	57,081	-	-	34,435,130
Other liabilities	132,182	-	-	-	-	132,182
Total	**104,774,315**	**-**	**531,998**	**256,749**	**32,973**	**105,596,035**
Net position	**9,754,992**	**22,219**	**(60,924)**	**(182,761)**	**(425)**	**9,533,101**
Cumulative net position	**9,754,992**	**9,777,211**	**9,716,287**	**9,533,526**	**9,533,101**	**-**

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(d) Market Risk (continued)

ii. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates and the risk that the maturities of interest bearing assets differ from the maturities of the interest bearing liabilities used to fund those assets (re-pricing risk). The length of time for which the rate of interest is fixed on a financial instrument therefore indicates to what extent it is exposed to interest rate risk. The assets and customer term deposits of the bank carry fixed and variable interest rates while borrowings are at variable interest rate. The interest rates applicable to financial assets and liabilities are disclosed in relevant to these financial statements. Interest rate risk management policy of the bank defines the method of identification, measurement, following up and controlling the risk in the event of interest rate modification. The Bank is exposed to various risks associated with the effects of fluctuations of market interest rates on its financial position and cash flows. The tables below summarize the Bank's exposure to interest rate risks.

2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with Central Bank	-	-	-	-	-	22,883,074	**22,883,074**
Placements with banks	4,001,389	-	-	-	-	-	**4,001,389**
Investments in securities	28,704	1,738,667	2,163,233	1,246,842	-	-	**5,177,446**
Loans and advances to customers – fixed rate	6,104,802	3,275,076	24,470,977	29,550,800	3,675,458	-	**67,077,113**
Loans and advances to customers – floating rate	120,502	184,412	295,881	161,755	-	-	**762,550**
Total	**10,255,397**	**5,198,155**	**26,930,091**	**30,959,397**	**3,675,458**	**22,883,074**	**99,901,572**
Liabilities							
Due to customers	4,663,164	6,684,179	31,456,707	24,070,582	-	8,784,896	**75,659,528**
Short term borrowings	7,012,859	2,600,000	2,000,000	-	-	-	**11,612,859**
Dues to Head Office – fixed rate	116,663	240,475	465,121	197,512	-	1,950,410	**2,970,181**
Dues to Head Office – floating rate	-	-	-	-	-	-	-
Other liabilities	5,633	10,177	108,073	1,189,711	670,812	228,115	**2,212,521**
Total	**11,798,319**	**9,534,831**	**34,029,901**	**25,457,805**	**670,812**	**10,963,421**	**90,455,089**
Net Position	(1,542,922)	(4,336,676)	(7,099,810)	5,501,592	3,004,646	11,919,653	7,446,483

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(d) Market Risk (continued)

ii. Interest rate risk (continued)

2018	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and balances with Central Bank	-	-	-	-	-	23,200,928	23,200,928
Placements with banks	6,000,000	-	-	-	-	-	6,000,000
Investments in securities	-	-	1,998,088	120,838	-	-	2,118,926
Loans and advances to customers – fixed rate	12,888,514	8,916,535	29,035,729	26,244,738	4,955,868	-	82,041,384
Loans and advances to customers – floating rate	173,374	181,686	783,695	629,143	-	-	1,767,899
Total	**19,061,888**	**9,098,221**	**31,817,512**	**26,994,719**	**4,955,868**	**23,200,928**	**115,129,136**
Liabilities							
Due to customers	1,251,928	4,318,770	28,469,060	13,242,564	214,000	10,525,969	58,022,291
Short term borrowings	13,006,432	-	-	-	-	-	13,006,432
Dues to Head Office – fixed rate	2,548,511	17,000,000	12,400,369	60,937	-	532,176	32,541,993
Dues to Head Office – floating rate	159,387	189,203	892,294	652,253	-	-	1,893,137
Other liabilities	-	-	-	-	-	132,182	132,182
Total	**16,966,258**	**21,507,973**	**41,761,723**	**13,955,754**	**214,000**	**11,190,327**	**105,596,035**
Net Position	**2,095,630**	**(12,409,752)**	**(9,944,211)**	**13,038,965**	**4,741,868**	**12,010,601**	**9,533,101**

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(d) Market Risk (continued)

ii. *Interest rate risk (continued)*

The average effective yields of significant categories of financial assets and liabilities of the Bank as at 31 December 2019 and 2018 are as follows:

	2019		2018	
	USD	EUR	USD	EUR
Assets				
Cash and balances with Central Bank			N/a	
Loans and advances to customers	4.00%	5.95%	5.65%	6.08%
Investment securities (HTM)	N/a	1.14%	N/a	0.61%
Liabilities				
Customer deposits	1.81%	2.40%	1.86%	2.27%
Short term borrowings	N/a	0.92%	N/a	0.91%
Dues to parent company	N/a	2.75%	N/a	3.74%

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

	2019		2018	
	Increase 1%	Decrease 1%	Increase 1%	Decrease 1%
Estimated Profit (loss) effect	74,464	(74,464)	95,331	(95,331)

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Banks's operations.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and innovation. The implementation of controls to address operational risk is supported by the development of overall standards for the management of operational risk and carried out with collaboration with Head Office.

All risks except financial risks are considered within the scope of operational risk. Studies are un5dertaken by execution of identification, definition, measurement, analysis, monitoring of operational risk, providing and reporting the necessary control related to monitoring the progress of the country and world, the development of techniques and methods, necessary legal reporting, notification and conduct of follow-up transactions. Studies on the subject are conducted by the Department of Risk Management.

Qualitative and quantitative methods are used in a combination for measurement and evaluation of the operational risks. In this process, information used is obtained from "Impact-Probability Analysis", "Missing Event Data Analysis", "Risk Indicators" methods. Methods prescribed by legal regulations are applied as minimum in determining the capital requirement level for the operating risk.

All risks are assessed in the context of operational risk, loss events and the risk indicators, together with operational risks are monitored on a regular basis by the Department of Risk Management and reported periodically to the Risk Committee and the Board of Directors.

(f) Capital management

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholder's return is also recognized and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

Regulatory Capital

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to shareholders through the optimization of the debt and equity. The Bank's overall strategy remains unchanged from previous year. In accordance with the regulations of the Central Bank of Republic of Kosovo, the Bank should maintain a capital equivalency deposit of not less than EUR 7,000,000. The Bank monitors the adequacy of its capital using, among other measures, the rules and ratios established by the Central Bank of Kosovo ("CBK"). The Bank has met the regulatory requirements as at 31 December 2019 and 2018.

5. CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

2019	1-Jan-19	Cash flows	Accruals of Interest	Recognition of Dividends	31-Dec-19
Due to head office	34,435,130	(31,116,818)	(348,131)	-	2,970,181
Short-term borrowings	13,006,432	(1,400,000)	6,428	-	11,612,859
Total liabilities from financing activities	**47,441,562**	**(32,516,818)**	**(341,704)**	**-**	**14,583,040**

6. USE OF ESTIMATES AND JUDGMENTS

(a) Impairment

In determining, whether the loans to customers are impaired on individual basis requires the estimation of the present value of expected cash flows from loans to customers including amounts recoverable from guarantees. Actual results may differ significantly. Key assumptions used in the evaluation of client's credit worthiness are based on the financial positions, profitability, market share, and the value of collateral. Similarly circumstances prevailing in the region of the client are taken in to consideration, such as the court efficiency etc.

The main differences between the CBK and IFRS methodology for provisioning calculation is that CBK methodology is mainly based on days past due and does not take into account expected cash flow from repayments of loan and execution of collateral on the provisioning calculation" and as a result, assumptions used in determining provisions require less management judgement.

An assessment as to whether an investment in sovereign debt is impaired may be complex. In making such an assessment, the Branch considers the market's assessment of creditworthiness as reflected in the bond yields, the rating agencies' assessments of the creditworthiness, the ability of the country to access the capital markets for new debt issuance, the probability of debt being restructured resulting in holders suffering losses through voluntary or mandatory debt forgiveness and the international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country as well as the intention, reflected in public statements, about governments' and agencies' willingness to use those mechanisms. This includes an assessment as to the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

(b) Fair value of financial instruments

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist, and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premium used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Cash and cash equivalents and mandatory reserve

Cash and cash equivalents include balances that are short term. Their fair value is considered to equate to their carrying amount.

6. USE OF ESTIMATES AND JUDGMENTS (CONTINUED)

(b) Fair value of financial instruments

Investment in securities

The treasury bills have an estimated fair value approximately equal to their carrying amount, because of their short-term nature and underlying yield rates except one bond with maturity till 2022 (note 9), which approximate market rates.

Due to Head Office and Short term borrowings

Short term borrowings due to Parent Company (Head Office) have an estimated fair value approximately equal to their carrying amount, because of their short-term nature.

	2019		2018	
	Carrying value	Fair value Level 2	Carrying value	Fair value Level 2
Loans and advances to customers	67,839,663	66,935,883	83,809,282	83,920,753
Due to customers	66,874,632	66,517,872	47,457,628	47,256,178

Fair value measurements (FVM) has been calculated for loans and advances to customers and deposits due to customers. FVM has been calculated as present value of loans and advances to customers and due to customers taken into account as discounting factor open market rates for loans and deposits applicable on the sector.

The portfolio of loans and advances to customers has been homogenized based on original maturity, remaining maturity, type of loan, and industry. The portfolio of dues to customers has been homogenized based on amount, original maturity date and industry.

The open market interest rate has been used from CBK time series data reports that represent the characteristics of Is Bankasi portfolio of loans and advances to customers and portfolio of due to customers.

7. CASH ON HAND AND AT BANKS AND BALANCES WITH CENTRAL BANK

	31 December 2019	31 December 2018
Cash on hand		
Cash on hand	145,890	234,812
Cash at banks		
Current account with Bank for Business	1,621,452	1,503,989
Current account with Raiffeisen Bank Kosovo	952,613	207,909
Current account with IS Bank AG, Germany	243,205	5,670,744
Current account with BKT	328,669	1,111,909
Current account Ziraat Bank	247,346	-
Current account with Head Office	36,440	49,710
Cash and cash equivalents	**3,575,615**	**8,779,073**
Restricted balances with Central Bank		
Current account	16,289,355	9,418,855
Capital Equivalent Deposit	3,018,104	5,003,000
Total	**22,883,074**	**23,200,928**

7. CASH ON HAND AND AT BANKS AND BALANCES WITH CENTRAL BANK(CONTINUED)

In accordance with the CBK rules, the Bank should meet the minimum average liquidity requirement. Balances with Central Bank of Kosovo include a mandatory liquidity reserve balance with CBK of EUR 6,588 thousand (31 December 2018: EUR 5,304 thousand). The liquidity requirement is calculated on a weekly basis as 10% of the deposit base, defined as the average total deposit liabilities to the non-banking public in EUR and other currencies, over the business days of the maintenance period. The assets with which the Bank may satisfy the liquidity requirements are the deposits in EUR with the CBK and 50% of the EUR equivalent of cash denominated in readily convertible currencies. Deposits with the CBK must not be less than 5% of the applicable deposit base. Investments in securities (see Note 9) are also used as capital equivalency deposits required for a branch of a foreign bank.

8. PLACEMENTS WITH BANKS

	31 December 2019	31 December 2018
Fixed Term Placements to Banks		
Placements to Ziraat Bank	4,000,000	-
Placements to Banka per Biznes	-	2,000,000
Placements to Banka Kombetare Tregtare	-	4,000,000
Accrued interest	1,389	
Total	**4,001,389**	**6,000,000**

9. INVESTMENTS IN SECURITIES

	31 December 2019	31 December 2018
Nominal Value – Bonds	5,170,000	2,120,000
Bonds (price)	5,145,224	2,113,137
Accrued interest	28,703	4,025
Amortization of discount	3,519	1,764
Amortization of premium	-	-
Carrying amount at amortized cost	**5,177,446**	**2,118,926**
Total at amortized cost	**5,177,446**	**2,118,926**

Investments in securities represent investments in Government Treasury Bills and Bonds classified as held to collect and issued by the Government of the Republic of Kosovo.

10. LOANS AND ADVANCES TO CUSTOMERS

	31 December 2019	31 December 2018
Commercial Loans	46,395,000	54,761,411
Individual Loans	1,017,922	807,678
Staff Loans	61,221	43,078
Overdrafts	22,185,624	29,892,231
Accrued interest	201,972	438,454
Deferred disbursement fee	(69,412)	(93,727)
Total Loans at amortized cost, gross	**69,792,327**	**85,849,125**
Less: Allowance for impairment	(1,952,664)	(2,039,843)
Loans and advances to customers, net	**67,839,663**	**83,809,282**

Movements in the impairment allowance in 2019 and 2018 are composed as follows:

	2019	2018
Allowance as at 1 January	**2,039,843**	**2,949,563**
Charge for the year	(87,179)	(909,720)
Allowance as at 31 December	**1,952,664**	**2,039,843**

11. PROPERTY AND EQUIPMENT

	Leasehold improvements	IT Equipment	Furniture, fixtures and equipment	Other Assets	Vehicles	Total
Cost						
Balance at 1 January 2018	765,910	188,510	173,140	55,655	49,450	1,232,665
Additions	400,192	25,030	62,062	37,439	-	524,723
Disposals	(303,420)	-	-	-	-	(303,420)
Balance at December 31, 2018	**862,682**	**213,540**	**235,202**	**93,094**	**49,450**	**1,453,968**
Additions	5,937	2,234	21,500	1,399	-	31,070
Disposals	-	-	-	-	-	-
Balance at December 31, 2019	**868,619**	**215,774**	**256,702**	**94,493**	**49,450**	**1,485,038**
Accumulated depreciation						
Balance at 1 January 2018	310,272	53,411	110,101	40,256	30,173	544,213
Charge for the year	206,185	38,327	35,900	6,536	9,890	296,838
Eliminated on disposals	(303,442)	-	(6,637)	(541)	-	(310,620)
Balance at 31 December 2018	**213,015**	**91,738**	**139,364**	**46,251**	**40,063**	**530,431**
Charge for the year	90,478	43,449	34,740	12,166	5,638	186,471
Eliminated on disposals	-	-	-	-	-	-
Balance at 31 December 2019	303,493	**135,187**	**174,104**	**58,417**	**45,701**	**716,902**
Net Balance at 31 December 2018	**649,667**	**121,802**	**95,838**	**46,843**	**9,387**	**923,537**
Net Balance at 31 December 2019	**565,126**	**80,587**	**82,598**	**36,076**	**3,749**	**768,136**

The value of EUR 16,391 and EUR 52,003 categorized into the furniture, fixtures and equipment category represent assets received as donations from Head Office during the fiscal years of 2015 and 2014.

12. INTANGIBLE ASSETS

	Software	Total
Cost		
Balance at 1 January 2018	80,428	80,428
Additions	58,641	58,641
Disposals		-
Balance at December 31, 2018	**139,069**	**139,069**
Additions	4,722	4,722
Disposals	-	-
Balance at December 31, 2019	**143,791**	**143,791**
Accumulated Amortization		
Balance at 1 January 2018	33,415	33,415
Charge for the year	10,343	10,343
Eliminated on disposals	-	-
Balance at 31 December 2018	**43,758**	**43,758**
Charge for the year	11,569	11,569
Eliminated on disposals	-	-
Balance at 31 December 2019	**55,327**	**55,327**
Net Balance at 31 December 2018	**95,311**	**95,311**
Net Balance at 31 December 2019	**88,464**	**88,464**

13. RIGHT OF USE ASSET

	Buildings	Total
Cost		
At 1 January 2019	2,273,091	2,273,091
Charge for the year	-	-
At 31 December 2019	**2,273,091**	**2,273,091**
Accumulated depreciation	-	-
At 1 January 2019	-	-
Charge for the year	(258,132)	(258,132)
At 31 December 2019	**(258,132)**	**(258,132)**
Carrying amount		
At 31 December 2019	**2,014,959**	**2,014,959**

Amounts recognized in profit and loss	**31 December 2019**
Depreciation expense on right-of-use assets	258,132
Interest expense on lease liabilities	144,497
Expense relating to short-term leases	-
Expense relating to leases of low value assets	4,100
Expense relating to variable lease payments not included in the measurement of the lease liability	-

	31 December 2019
Fixed payments (including amortization of prepayment)	348,765
Variable payments	-
Total payments	**348,765**

14. REPOSSESSED COLLATERALS

	31 December 2019	31 December 2018
Repossessed assets	206,666	206,666
Provisioning for impairment	(41,333)	(41,333)
Total	**165,333**	**165,333**

Repossessed assets consist of a residential building repossessed during 2018. Provision for impairment of 20% is created in accordance with CBK guidelines. There was no change in the provisions for repossessed collaterals.

15. OTHER ASSETS

	31 December 2019	31 December 2018
Prepayments	28,807	12,999
Other receivables	9,752	-
Rent prepayments	-	229,126
Total	**38,559**	**242,125**

16. DUE TO CUSTOMERS

	31 December 2019	31 December 2018
Current Accounts		
Individuals	3,354,258	3,038,987
Corporations	4,835,702	5,130,682
State owed entities	3,654	2,063,605
Correspondent banks	80,282	38,694
Non-profit organizations	511,000	292,695
Total current accounts	**8,784,896**	**10,564,663**
Term Deposits		
Individuals	32,680,672	21,657,185
Corporations	26,221,411	22,618,890
State owed entities	5,650,000	800,000
Non-profit organizations	1,500,000	1,900,000
Interest payable	822,549	481,553
Total term deposits	**66,874,632**	**47,457,628**
Total deposits	**75,659,528**	**58,022,291**

Term deposits bear fixed interest rates ranging from 0.1% - 3.4% as of 31 December 2019 (2018: 0.36% - 2.56%).

17. DUE TO BANKS

	31 December 2019	31 December 2018
TEB sh.a	6,000,000	10,000,000
Banka per Biznes - BPB	3,000,000	3,000,000
Banka Ekonomike	2,600,000	-
Accrued interest payable	12,859	6,432
Total	**11,612,859**	**13,006,432**

The short-term borrowing with commercial banks bear interest rates ranging from 0.80% up to 1.5% p.a. (2018: 0.85% p.a.).

18. DUE TO HEAD OFFICE AND OTHER AFFILIATIES

	31 December 2019	31 December 2018
Current accounts with Head Office	1,950,410	493,481
Long-term borrowing	1,012,139	1,885,885
Interest payable	7,632	355,763
Short-term borrowings	-	31,700,000
Total	**2,970,181**	**34,435,130**

The long-term borrowings bear interest rates ranging from 1.75% p.a. to 3.85% p.a. (2018: 1.25% p.a. to 2.45% p.a.) and have remaining weighted average maturity of 3 years. The short-term borrowings from the Head Office bear interest rates ranging from 0.85% p.a. to 5.35% p.a. for year 2018.

Depending on needs for additional disbursements, the Branch has the right at its discretion, to renew or obtain additional funds at short notice from Head Office, as well as return to Head Office any extra liquidity.

19. OTHER TAXES AND CONTRIBUTIONS PAYABLE

	31 December 2019	31 December 2018
Tax payable TTD	10,736	-
Withholding tax on salary	6,027	5,203
Pension contributions payable	4,868	4,091
Withholding tax on rent and interest	1,638	21,018
Corporate tax payable	10,638	37,969
Total	**33,907**	**68,281**

20. DEFERRED REVENUE

	31 December 2019	31 December 2018
Deferred revenue	1,840	10,137
Total	**1,840**	**10,137**

Deferred revenue is related to a donation of office furniture and equipment from Head Office to the Bank. Other income of EUR 1,840 (2018: EUR 10,137) for the year ended 31 December 2019 represent the value of deferred revenue recognized as income from asset donations.

21. OTHER LIABILITIES

	31 December 2019	31 December 2018
Accrued expenses	96,411	63,901
Provision for off-balance sheet items	40,632	28,816
Total	**137,042**	**92,717**

Movement in provision for off balance sheet items during 2019 was EUR 11,816 (2018: Euro (5,054)).

22. PROVISIONS

For the year ended December 31, 2019, the Bank has recognized a provision for an outstanding legal claim in the amount of EUR 97,795 (2018: EUR nil).

23. LEASE LIABILITIES

	31 December 2019	31 December 2018
Maturity analysis:		
Year 1	123,884	-
Year 2	222,486	-
Year 3	238,905	-
Year 4	256,538	-
Year 5	239,851	-
Onwards	902,743	-
Total	**1,984,407**	-
Analysed as:		
Non-current	1,860,523	-
Current	123,884	-

24. SHARE CAPITAL

As at December 31, 2019, the share capital amounted to EUR 10,000 thousand (2018: EUR 10,000 thousand).

25. NET INTEREST INCOME

	Year ended 31 December 2019	Year ended 31 December 2018
Interest income from loans and advances to customers	4,630,252	5,071,789
Interest income from securities	60,959	12,112
Interest income from deposits in local banks	5,356	510
Total interest income	**4,696,567**	**5,084,412**
Interest expenses		
Interest expenses for deposits	(1,319,687)	(813,773)
Interest expenses for borrowings	(692,155)	(1,263,755)
Interest expense for lease liability	(144,497)	-
Total interest expenses	**(2,156,339)**	**(2,077,528)**
Net interest income	**2,540,228**	**3,006,884**

26. NET FEE AND COMMISSION INCOME

	Year ended 31 December 2019	Year ended 31 December 2018
Fees for letter of guarantees	147,089	141,420
Other fee and commission income	113,443	152,162
Fees for early termination of contracts	7,903	27,573
Total fee and commission income	**268,435**	**321,155**
Fee and commission expense	(9,101)	(9,118)
Net fee and commission income	**259,334**	**312,037**

27. NET FOREIGN EXCHANGE LOSS

	Year ended 31 December 2019	Year ended 31 December 2018
Foreign exchange gain	114,844	50,589
Foreign exchange loss	(90,333)	(96,083)
Net foreign exchange gain\(loss)	**24,511**	**(45,494)**

28. OTHER INCOME

	Year ended 31 December 2019	Year ended 31 December 2018
Income from asset donation	8,385	11,270
Other income	25,860	14,880
Total	**34,245**	**26,150**

29. OTHER OPERATING EXPENSES

	Year ended 31 December 2019	Year ended 31 December 2018
Other tax and fee expenses	146,642	145,253
Fees paid to CBK	137,668	150,908
Royalty fee	105,920	-
Provisions for legal cases	97,795	-
Consultancy and auditing	94,518	117,085
Payments system expenses	87,281	84,169
Communication expenses	77,259	65,338
Representation expenses	57,062	63,967
Utilities and Fuel	34,140	30,936
Maintenance and repair	32,497	22,888
Deposit insurance expenses	22,934	15,646
Memberships	13,669	13,508
Security expenses	16,665	12,975
Operating lease expenses for vehicle	4,100	1,000
Other expenses	40,057	36,306
Rent	-	232,681
Total other operating expenses	**968,207**	**992,662**

30. EMPLOYEE BENEFITS

	Year ended 31 December 2019	Year ended 31 December 2018
Salaries	749,126	704,368
Welfare and pension contribution expenses	67,439	63,236
Health insurance	9,936	9,203
Other employee compensations	51,652	11,843
Total employee benefits	**878,153**	**788,650**

31. INCOME TAX

Tax expense for the year is composed of the following:

	Year ended 31 December 2019	Year ended 31 December 2018
Current tax expense	142,200	224,252
Total income tax	**142,200**	**224,252**

Reconciliation of prepaid tax/tax payables

	Year ended 31 December 2019	Year ended 31 December 2018
Current year tax payments	131,562	121,500
Current tax expense	(142,200)	(224,252)
Utilization of carried forward losses	-	64,782
Tax (Payable)/ prepayment	**(10,638)**	**(37,969)**

31. INCOME TAX (CONTINUED)

Tax returns are filed annually but the profits or losses declared for tax purposes remain provisional until the tax authorities examine the returns and the records of the taxpayer and a final assessment is issued. Kosovo tax laws and regulations are subject to interpretations by the tax authorities. Deferred tax is calculated based on the enacted tax rate of 10%. The carry forward period for any tax losses in accordance with the laws in Kosovo is four years. The table below represents the calculation of corporate income tax for the year ended 31 December 2019 and 31 December 2018:

	Year ended 31 December 2019	Year ended 31 December 2018
Profit before tax	**631,149**	**2,084,420**
Investments in Kosovo Governments securities	(6,096)	(1,211)
Tax effect of non-deductible expenses	13,430	2,051
Tax effect of exchange loss	770	4,549
Tax effect of the accrued interest on term deposits	57,175	6,286
Adjustment for off balance sheet provisions	236	-
Adjustment for Loan Loss Provisions	(1,744)	-
Adjustment for depreciation of right of use asset	25,813	-
Rent payments	(34,876)	-
Adjustment for legal provisions	9,780	-
Adjustment for interest expenses lease liability	14,450	-
Other income	147	-
Impairment of repossessed asset	-	4,133
Total corporate income tax expenses	**(142,200)**	**(224,252)**
Utilizing of deferred tax asset	-	**64,782**
Taxes paid in advance	**131,562**	**121,500**
Total payable at the end of the year	**(10,638)**	**(37,969)**

32. RELATED PARTY TRANSACTIONS

Türkiye İş Bankası A.Ş.– Dega në Kosovë is a branch of Türkiye İş Bankası A.Ş. The major shareholders of Türkiye İş Bankası A.Ş and their participations in share capital as at 31 December 2019 are as follows:

- Isbank Pension Fund, acting on behalf of both active and retired Bank employees: 40.47%;
- Free Float: 31.44% (about 60% of the free float is held by foreign investors);
- Ataturk's Shares: 28.09%. The Republican People's Party (CHP) is the testamentary heir to the shares initially held by Ataturk (founder of Isbank).

Related party balances and transactions as at 31 December 2019 and 31 December 2018 are composed as follows:

	31 December 2019	31 December 2018
Due from Head Office		
Current accounts with Head Office	36,441	49,710
Due to Head Office		
Current accounts with Head Office	1,950,410	493,481
Short term borrowings	-	27,700,000
Long term borrowings	1,012,139	1,885,885
Other payables to Head office	-	-
Interest payable related to short and long-term borrowing	7,632	355,763
Deferred revenue from donated assets	1,840	10,137
Due from other related parties (subsidiaries of HO)		
Current accounts with Is Bank AG, Germany	243,205	5,670,744
Due to other related parties		
Due to Is Bank London, UK	-	4,000,000

	Year ended 31 December 2019	Year ended 31 December 2018
Income generated from Head Office		
Other income from donated assets	8,385	11,270
Expense incurred with related parties		-
Management remuneration	190,018	189.906
Interest expense for short-term borrowings	561,440	1,186,400

33. CONTINGENCIES AND COMMITMENTS

Guarantees and credit commitments	31 December 2019	31 December 2018
Guarantees in favor of customers	11,272,645	8,823,241
Loans approved but not yet disbursed	15,450,000	72,250
Undrawn credit commitments	5,940,976	2,609,332
Total	**32,663,621**	**11,504,823**

Non-cancelable lease commitments	31 December 2019	31 December 2018
Less than one year	51,012	46,919
Total	**51,012**	**46,919**

Legal

In 2019, the Bank has recognized a provision of 97 thousand for an outstanding claim. Other outstanding legal claims and litigations are in the normal activity of the Bank.

34. SUBSEQUENT EVENTS

There are no significant events after the reporting date that may require adjustment or disclosure in the financial statements.

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