

DEPOSIT PROTECTION FUND,
PODGORICA

Financial statements for 2018

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*This is an English translation of the
Auditor's Report originally prepared in
Montenegrin language
(For management purposes only)*

INDEPENDENT AUDITORS' REPORT TO THE MANAGEMENT BOARD OF THE DEPOSIT PROTECTION FUND, PODGORICA

We have audited the accompanying financial statements of Deposit Protection Fund, Podgorica (hereinafter: „the Fund”), which comprise the balance sheet as at 31 December 2018, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Law on Accounting and the accounting regulations of Montenegro, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with the Law on Accounting and with the accounting regulations of Montenegro.



Other matters

The financial statements for the year ended 31 December 2017 were audited by another auditor who expressed unmodified opinion on those statement on 4 April 2018.

Report on other legal and regulatory requirements

We have reviewed the annual management report of the Fund. Management is responsible for the preparation of the annual management report in accordance with the legal requirements of Montenegro. Our responsibility is to assess whether the annual management report is consistent with the annual financial statements for the same financial year. Our work regarding the annual management report has been restricted to assessing whether the accounting information presented in the annual management report is consistent with the annual financial statements and did not include reviewing other information contained in the annual management report originating from non-audited financial or other records. In our opinion, the accounting information presented in the annual management report is consistent, in all material respects, with the financial statements of the Fund for the year ended 31 December 2018.

Podgorica, 29 May 2019

Ernst & Young Montenegro d.o.o.
Podgorica, Montenegro

Danijela Mirković
Partner

Nikola Ribar
Authorized auditor

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2018.

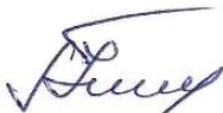
In thousand of EUR

| Position | Note | 2018. | 2017. |
|---|-------------|----------------------|-------------------|
| I. OPERATING INCOME | | 16.594.179 | 14.641.324 |
| Sales | 4 | 16.593.128 | 14.632.655 |
| Other operating income | 5 | 1.051 | 8.669 |
| II. OPERATING EXPENSES | | (112.731.153) | (347.659) |
| Costs of material | 6 | (6.867) | (7.337) |
| Salaries, compensations and other personal expenses | 7 | (220.035) | (227.657) |
| Depreciation, amortization and provision | 8 | (112.416.020) | (15.198) |
| Other operating expenses | 9 | (88.229) | (97.467) |
| A. OPERATING RESULT | | (96.136.974) | 14.293.665 |
| Financial income | 10 | 172.830 | 374.149 |
| Financial expenses | 11 | (326.616) | (326.081) |
| B. FINANCIAL RESULT | | (153.786) | 48.068 |
| I Other income | 12 | 60.000 | - |
| II Other expenses | - | - | - |
| C. RESULT FROM OTHER ACTIVITIES | | 60.000 | - |
| D. PROFIT/(LOSS) BEFORE TAX | | (96.230.760) | 14.341.733 |
| H. TAX EXPENSES OF THE PERIOD | | - | - |
| Tax expense | | - | - |
| Deferred tax expenses | | - | - |
| I. NET PROFIT/ (LOSS) | | (96.230.760) | 14.341.733 |

Notes on the following pages are an integral part of these financial statements.

The accompanying financial statements were adopted for issuance on May 31st, 2019 and signed on behalf of the Fund's management by:

Person responsible for the preparation of the financial statements



 (Slavica Žarić)

Director





 (Predrag Marković)

DEPOSIT PROTECTION FUND, PODGORICA

STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2018

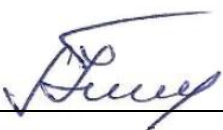
In thousand of EUR

| Position | Note | 2018. | 2017. |
|--|------|--------------------|-------------------|
| ASSETS | | | |
| A. Non-current assets | | 2.428.241 | 2.455.970 |
| Intangible assets | 13 | 166 | 5.771 |
| Property, plant and equipment | 14 | 11.366 | 20.666 |
| Other long-term financial placements | 15 | 2.416.709 | 2.429.533 |
| B. CURRENT ASSETS | | 109.289.223 | 93.096.875 |
| Accounts Receivable | 16 | 23.971 | 98.401 |
| Short-term financial placements | 17 | - | 15.248.441 |
| Cash and cash equivalents | 18 | 109.265.252 | 77.750.063 |
| TOTAL ASSETS | | 111.717.464 | 95.552.875 |
| EQUITY AND LIABILITIES | | | |
| A. EQUITY | | (770.719) | 95.460.041 |
| Share capital | | 95.460.041 | 81.118.308 |
| Retained earnings | | - | 14.341.733 |
| Losses | | (96.230.760) | - |
| D. SHORT-TERM PROVISIONS AND SHORT-TERM LIABILITIES | | 112.488.183 | 92.834 |
| Accounts payable | | 1.628 | 1.040 |
| Other short-term liabilities, accruals and deferred income | 20 | 85.808 | 91.757 |
| Value added tax and other tax liabilities | | - | 37 |
| Short-term provisions | 21 | 112.400.746 | - |
| TOTAL EQUITY AND LIABILITIES | | 111.717.464 | 95.552.875 |

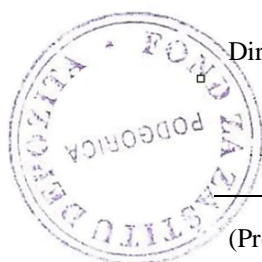
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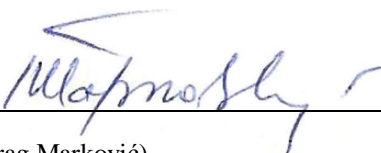
Person responsible for the preparation of the financial statements



 (Slavica Žarić)



Director



 (Predrag Marković)

STATEMENT OF CHANGES IN EQUITY FOR YEAR ENDED DECEMBER 31, 2018

| In thousand of EUR | <u>Share capital</u> | <u>Retained earnings</u> | <u>Losses</u> | <u>Total</u> |
|--|----------------------|--------------------------|---------------------|---------------------|
| Balance as of January 1, 2017 | 66.949.888 | 13.168.420 | - | 81.118.308 |
| Transfer | 13.168.420 | (13.168.420) | - | - |
| Net movements in 2017 | - | 14.341.733 | - | 14.341.733 |
| Balance as of December 31, 2017 | 81.118.308 | 14.341.733 | - | 95.460.041 |
| Transfer | 14.341.733 | (14.341.733) | - | - |
| Net movements in 2018 | - | - | (96.230.760) | (96.230.760) |
| Balance as of December 31, 2018 | 95.460.041 | - | (96.230.760) | (770.719) |

Notes on the following pages are an integral part of these financial statements.

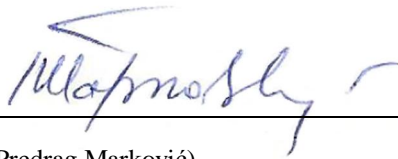
The accompanying financial statements were adopted for issuance on May 31, 2019 and signed on behalf of the Fund's management by:

Person responsible for the preparation of the financial statements

Executive Director


(Slavica Žarić)




(Predrag Marković)

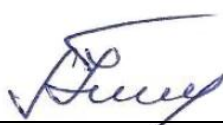
STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2018

| In thousand of EUR | <u>2018.</u> | <u>2017.</u> |
|--|--------------------|--------------------|
| A. CASH FLOW FROM OPERATING ACTIVITIES | | |
| I. Cash inflow from operating activities | 16.654.188 | 14.641.324 |
| Sales and received advances | 16.593.128 | 14.632.655 |
| Received interest from operating activities | 1.060 | 8.669 |
| Other receipts from operating activities | 60.000 | - |
| II. Cash outflows from operating activities | (646.217) | (566.940) |
| Outflows from payments to suppliers and advances paid | (94.000) | 17.438 |
| Salaries, compensations and other personal expenses | (220.035) | (227.657) |
| Interest paid | (332.182) | (326.081) |
| Public revenues paid | - | (30.640) |
| | 16.007.970 | 14.074.384 |
| I. Cash inflows from investment activities | 15.507.677 | 414.827 |
| Cash receipts from investment activities | 246.412 | 414.827 |
| Other financial placements (net inflows) | 15.261.265 | - |
| II. Cash outflows from investment activities | (459) | (2.042.437) |
| Purchase of property, plant, and equipment | (459) | (4.091) |
| Other financial investments (net outflows) | - | (2.038.346) |
| III. Net cash flow from investment activities | 15.507.218 | (1.627.610) |
| I. Cash inflows from financing activities | | |
| II. Cash outflows from financing activities | | |
| III. Net cash flow from financing activities | | |
| IV. Net cash flow for the year | 31.515.189 | 12.446.774 |
| E. Cash at the beginning of the accounting period | 77.750.063 | 65.303.289 |
| F. Cash at the end of the accounting period | 109.265.252 | 77.750.063 |

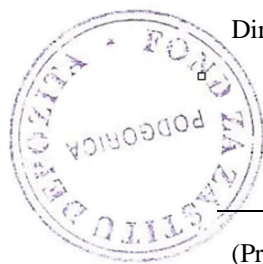
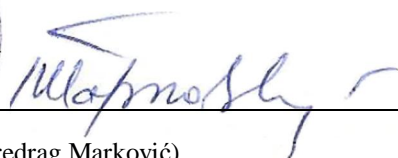
Notes on the following pages are an integral part of these financial statements.

The accompanying financial statements were adopted for issuance on May 31, 2019 and signed on behalf of the Fund's management by:

Person responsible for the preparation of the financial statements



 (Slavica Žarić)

Director



 (Predrag Marković)

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

1. GENERAL INFORMATION

The Deposit Protection Fund, Podgorica (hereinafter referred to as "the Fund") was established in accordance with the Law on Deposit Protection ("Official Gazette of Montenegro" No. 40/2003) and officially started to operate on November 18, 2004 upon the registration in the Statistical Bureau of Montenegro. Through the amendments of the Law on Deposit Protection (Official Gazette of Montenegro 44/10, 40/11), further harmonization with the EU Directive 94/19 EC was carried out (the increase of the level of protection from EUR 5,000 to EUR 50,000, as well as shortening deadlines for payment of guaranteed deposits from 90 to 20 days), as well as the separation of the governing and managerial function of the Fund itself, by separating the Fund governing bodies into the Management Board and the Director of the Fund. The amendments of the Law on Deposit Protection (Official Gazette of Montenegro 44/10, 40/11 and 47/15), the deadline for payment of guaranteed deposit was decreased further, to 15 days.

Commercial banks, licensed by the Central Bank of Montenegro, are obliged, to pay a Premium to the Fund in the name of deposit protection under the conditions and in the manner prescribed by the Law on Deposit Protection.

The main activity of the Fund is to secure deposit protection in banks and it is obligated to pay guaranteed deposits when required in accordance with the Law on Deposit Protection (occurrence of the "protected case"). Deposit protection relates to deposits placed with the bank before or on the day of the occurrence of the protected case. The protected case arises as of the date on which a decision to initiate bankruptcy proceedings in a bank is adopted. Starting from January 1, 2013, the Fund is obligated to make a payment of up to EUR 50,000 per depositor, regardless of the number and amount that the depositor owns with the bank in which bankruptcy proceedings have initiated. In the transitional period from January 1 to December 31, 2011, this amount was EUR 20,000, and from January 1 to December 31, 2012, EUR 35,000.

The Fund's headquarters are located in Podgorica, Miljana Vukova bb street.

On the day of December 31, 2018, the Fund has seven employees (seven employees on December 31, 2017).

Members of the Fund's Management Board

The Central Bank of Montenegro (hereinafter: CBoM) appoints the Management Board ("Board") comprising of three members. One member of the Board is chosen on the proposal of the Ministry of Finance, and one based on the proposal of the Association of Banks and Financial Institutions. On the day of the publication of these financial statements, the Fund's Board of Directors is comprised of members whose names are shown below:

| <u>Name and last name</u> | <u>Position</u> |
|---------------------------|--|
| Vujačić Dejan | Director of the Sector for Control of Banks in the CBoM, Chairman of the Board of Directors. (until September 9, 2018, Chairman of the Board was Darko Bulatović, Director of the Sector for Control of Banks in the CBoM), |
| Jovović Jelena | Head of department within the Ministry of Finance (member of the Board from 10.09.2018). Until September 9, 2018, Radulović Ivan – Head of department within the Ministry of Finance – member of the Board. Until June 5, 2018, Dr. Bojana Bošković, Director of the Directorate for Financial System and Business Environment Improvement, Member of the Board. |
| Đoković Nebojša | Advisor for Economic Affairs at the Association of Banks of Montenegro, Member of the Board from September 10, 2018. (Until September 9, 2018, Prof Dr. Marko Backović - Member of the Board, professor at the Faculty of Economics in Belgrade.) |

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.1. Basis for the preparation and presentation of financial statements

Fund has an obligation to maintain its accounting records and prepare financial statements in accordance with the requirements of the Law on Accounting ("Official Gazette of Montenegro", No. 52/16) and the Rulebook on the content and form of financial statements for business organisations and other legal entities ("Official Gazette of Montenegro", No. 5/2011, "Official Gazette of Montenegro", No. 52/2016).

In accordance with the Law on Accounting of Montenegro, the International Accounting Standards ("IAS") and International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board, have to be translated by the appropriate competent authority of Montenegro that owns the right of translation and publishing thereof, approved by the International Federation of Accountants ("IFAC"). Therefore, only IFRS and IAS officially adopted and published by the respective competent authority of Montenegro may be applicable. In 2009 were last officially translated IAS and IFRS (except for IFRS 7), and newly adopted IFRS 10, 11, 12 and 13, which are applicable from 2013. Bearing in mind the effects that differences of accounting regulations of Montenegro from IFRS and IAS may have on the presentation of the Fund's financial statements, the accompanying financial statements in that section are different and depart from IFRS and IAS and cannot be treated as financial statements prepared in accordance with IFRS and IAS.

The financial statements have been prepared under the historical cost basis, except otherwise stated in accounting policies.

In the preparation of the accompanying financial statements, the Fund has adhered to the accounting policies described in Note 3, which are based on the accounting and tax regulations of Montenegro.

2.2. Functional currency

The financial statements are presented in euros (EUR) – the official currency in Montenegro and the reporting currency of the Fund, and all numerical values are displayed in thousands (EUR 000), unless stated otherwise.

2.3. Use of estimates

The preparation of the financial statements requires the Fund's management to use the best possible estimates and reasonable assumptions that affect the reported amounts of assets and liabilities, and disclosures of potential receivables and liabilities as of the balance sheet date, as well as income and expenses of the reporting period. These estimates and assumptions are based on the information at disposal as of the balance sheet date. However, the actual results can deviate from these estimates. These estimates mostly refer to the estimation of the useful life of the equipment in use, the estimation of impairment of receivables from operating activities, provisions in accordance with the requirements of MRS 37 and other estimates.

2.4. Going concern

The enclosed financial statements for 2018 are prepared in accordance with the going concern concept and do not contain any corrections that would possibly be needed if the Fund stops being able to operate in accordance with the principle of going concern.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic accounting policies used for the preparation of these financial statements are outlined in the text below. These policies were consistently used for all displayed years unless stated otherwise.

3.1 Revenue recognition

3.1.1. Revenues from deposit protection premiums

Deposit protection premiums represent funds that commercial banks in Montenegro are obligated to pay to the Fund in accordance with the Law on Deposit Protection ("Official Gazette of Montenegro", No. 44/10, 40/11 and 47/15) and the Decision on the ordinary premium rate and methodology for calculation of the premium ("Official Gazette of Montenegro" No. 76/17).

Deposit protection premiums from the Fund relate to:

- initial premiums;
- regular premiums.

The bank to which the Central Bank of Montenegro has issued a license for work shall be obliged to pay an initial premium of EUR 50,000 to the account of the Fund prior to commencing its activities.

Banks are obliged to pay the annual premiums for the protection of deposits to the Fund in quarterly installments, ie through regular premiums. The beginning of the quarter is the first day of January, April, July and October of the current year. The basis for the calculation of the regular premium is the average of the total deposits of the bank on the last day of each month in the previous quarter. The rate for calculating the regular premium can not be higher than 0.5%. With the amendments to the Law on Deposit Protection from July 2015, this rate can not be higher than 0.8%. The Decision on the ordinary premium rate and methodology for calculation of the premium is adopted by the Board at the end of November of the current year for the next year. Banks are obliged to pay the regular premium at the beginning of the quarter for the current quarter, at the latest within eight days from the day of receiving the invoice of the Fund.

During 2018, the Fund calculated the annual premium. The annual premium rate is determined for each financial year and is published in the Official Gazette of Montenegro.

In the Decision on the ordinary premium rate and methodology for calculation of the premium, the Board may determine different premiums according to the rating and degree of operating risk of certain banks (differentiated premiums).

When the Fund's assets reach the level of 10% of the guaranteed deposits, the Board may decide to reduce the regular premium rate, or temporarily suspend the payment of the regular premium.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.2 Employee benefits

3.2.1. Employee Contributions for Social Security

In accordance with the regulations effective in Montenegro, the Fund has an obligation to pay contributions to state funds that provide social security to employees.

These liabilities include the payment of contributions on behalf of the employer in an amount calculated based on the rates prescribed by relevant laws. The Fund is also obliged to suspend contributions from the gross salary of employees, and on to pay them on behalf of employees. The contributions on behalf of the employee and contributions on behalf of the employer represent the expense of the period to which they relate.

3.2.1. Retirement benefits

The present value of other future obligations under the General Collective Agreement, such as retirement benefits after fulfilling the conditions, according to the estimation of the Fund's management, does not materially affect the financial statements observed as a whole, and therefore, in these financial statements, no provision is made on the basis of employee benefits.

3.3 Foreign exchange gains or losses

Assets and liabilities denominated in foreign currencies are converted in Euros by applying the official exchange rates, as determined by the Central Bank of Montenegro, effective on balance sheet date.

Foreign currency transactions during the year are converted to Euros by applying the official foreign exchange rates effective on the day of the transaction.

Net foreign exchange gains or losses arising from transactions in foreign currencies and from translation of balance sheet items denominated in foreign currencies are credited or charged to the Statement of comprehensive income for the period.

3.4 Taxation

Prior to the Amendment of the Law on Deposit Protection of July 2015, the Fund was exempted from paying taxes, duties and contributions in performing deposit protection activities. By amending the Law on Deposit Protection from July 2015, the Fund is a taxpayer in accordance with the Law. The Fund is obliged to pay taxes and contributions to earnings of employees in accordance with the regulations that apply in Montenegro. In accordance with Article 6 of the Law on Corporate Income Tax ("Official Gazette of Montenegro", No. 65/01 of 31.12.2001, 12/02 of 15.03.2002, 80/04 of 29.12.2004, Official Gazette CG ", No. 40/08 of 27.06.2008, 86/09 of 25.12.2009, 40/11 of 08.08.2011, 14/12 of 07.03.2012, 61/13 of 30.12.2013), which is Lex specialis, public funds are exempt from paying taxes on profit.

3.5 Intangible assets

Intangible assets are carried at cost and relate to purchased software. The cost of intangible assets is recorded based on the invoice of the supplier, and is increased for all expenditures of bringing these assets into the state of functional usability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment loss. Cost includes expenditure that is directly attributable to the acquisition of the fixed asset of bringing them into the state of functional usability.

Subsequent costs: costs of replacement of equipment parts (installation of new spare parts), are recognized as an increase in the present value of equipment, only when it is probable that future economic benefits associated with the item will flow to the Fund and the cost of the item can be measured reliably.

Current maintenance and repairs costs are charged to expenses during the financial period in which they are incurred. Gains and losses on disposals or sale of equipment are recorded in the income statement as part of other income or other expenses.

3.7 Depreciation

Depreciation of intangible assets and equipment is calculated on the cost basis using a proportional method of depreciation over their useful lives.

The following are annual depreciation rates that are applied:

| <u>Groups of assets</u> | <u>Rate (%)</u> |
|---------------------------------|------------------------|
| Software licenses | 20.00% |
| Computer and computer equipment | 20.00 – 33.33% |
| Technical equipment | 12.50 – 20.00% |
| Office furniture | 10.00 – 12.50% |

3.8 Financial instruments

Financial assets relate to the following: Long-term placements, Short-term financial placements held to maturity, receivables and cash and cash equivalents. The classification of financial assets depends on the nature and purpose of the financial asset and it was established at the time of initial recognition.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.8 Financial instruments (Continued)

3.8.1. *Effective interest rate method*

The effective interest rate method is the method of calculating the amortized cost of the financial asset and the allocation of interest income to the appropriate time periods. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (the calculation includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts) through the expected life of the financial instrument or, when appropriate, a shorter period.

3.8.1. *Long-term placements*

Long-term financial placements consist of bonds held-to-maturity and loans granted to employees.

Bonds relate to bonds issued by state of Montenegro on November 2016, maturing on November 16, 2020 and interest-bearing coupons maturing annually. The bonds were purchased at nominal value (interest rate of 4%), and are accounted for as securities held to maturity. The Fund may sell bonds in the event of a lack of liquid assets for the payment of a guaranteed deposit in case of bankruptcy of one or more commercial banks in Montenegro. On 16.11.2016, the first interest coupon was collected, on 16.11.2017, the second, and on 16.11.2018 the third interest coupon each in the amount of EUR 88.000

Loans are initially recognized at fair value. Subsequently, they are measured at amortized cost using the effective interest method. The difference between fair value at the date of recognition and allocated funds is recognized as prepaid employee benefits within long-term receivables from employees. Prepaid employee benefits are amortized over the period of receipt of benefits. The period of receipt is equal to the employee's expected working life, however it cannot be longer than the period for which the loan is granted.

3.8.3. *Short-term financial investments held to maturity*

Short-term financial assets held-to-maturity are non-derivative financial assets with fixed and determinable payments and fixed maturity, and for which Fund's management has a positive intention and ability to hold to maturity. Investments held-to-maturity relate to Treasury bills issued by the Ministry of Finance of Montenegro.

These investments are stated at amortized cost using the effective interest rate method less impairment based on a management estimate of their probable collectability.

3.8.4. *Receivables from operating activities*

Receivables for premiums and other receivables from business operations with fixed or determinable payments that are not quoted in a trading market are measured at amortized cost using the effective interest rate method less impairment based on the management's estimate of their probable collectability.

3.8.5. *Cash and cash equivalents*

In the statement of cash flows, cash and cash equivalents include cash and cash equivalents in the CBoM and cash funds deposited through the Asset Manager - the CBoM, for a period up to three months, which can be quickly converted into known amounts of cash with an insignificant risk of a change in value.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.8 Financial instruments (Continued)

3.8.6. Impairment of financial assets

Financial assets are evaluated for the purpose of identifying impairment indicators at the date of preparation of financial statements.

Financial assets are considered to be impaired when it is proved that, as a result of one or more events that occurred after the initial recognition of financial assets, the estimated future cash flows of the investment have been changed.

Objective evidence of impairment of financial assets may include:

- significant financial difficulty of a legal entity - parties under contract; or
- delay or failure to pay interest or premium; or
- when it becomes probable that the debtor will go bankrupt or will undergo financial restructuring.

The impairment of the carrying amount of receivables for premiums is accounted for on the related impairment account. When the receivable is uncollectible, it is written off through this account. Subsequent collection of previously written off amounts is recorded as a reduction of impairment. Changes in the carrying amount of the impairment account are recognized in the income statement.

If, in the subsequent period, the amount of impairment loss decreases, and the decrease objectively relates to an event that occurred after the recognition of impairment, the previously recognized impairment loss is reversed through the income statement to an extent that will not result in the increase of the carrying amount higher than it would be based on amortized cost as if the recognition of impairment has not been initially recognized.

3.8.7. Derecognition of financial assets

The Fund derecognizes financial assets only when the contractual rights to cash flows from financial assets expire; or if it transfers financial assets, and with that all risk and rewards from ownership to another entity. If the Fund does not transfer or retain substantially all risks and returns from ownership and maintains control over financial assets, the Fund continues to recognize financial assets.

3.8.8. Other financial liability

Other financial liabilities, including loan liabilities, are initially recognized at fair value less transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the cost of depreciation of a financial liability and determining the cost of interest for the relevant period. The effective interest rate is the rate that accurately discounts the estimated future cash payments through the expected duration of the financial liability, or, where possible, in a shorter period.

3.8.9. Derecognition of financial liabilities

The Fund derecognizes the financial liability when, and only when, the Fund's liabilities are released, canceled or expired.

3.9 Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, its is probable that the outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the obligation.

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

4. SALES

Sales revenue in 2018 amounts to EUR 16,593,128 (in 2017: EUR 14,632,655) and relates to income from deposit protection premiums. Deposit insurance premiums represent assets that commercial banks in Montenegro are obligated to pay to the Fund in accordance with the Deposit Protection Act ("Official Gazette of Montenegro", No. 44/10, 40/11 and 47/15) and Decisions on the amount of the rate for the calculation of the regular premium and the method of calculating the regular premium for 2018 that banks pay to the Fund ("Official Gazette of Montenegro" No. 76/17).

5. OTHER OPERATING INCOME

Income from refunds in 2018 amounted to EUR 1,051 (in 2017: EUR 8,669) refers to sick pay refund for one employee.

6. COSTS OF MATERIAL

| In EUR | 2018. | 2017. |
|-----------------------|--------------|--------------|
| Fuel and energy costs | 5.094 | 6.058 |
| Other material costs | 1.773 | 1.279 |
| Total | 6.867 | 7.337 |

7. SALARIES, COMPENSATIONS AND OTHER PERSONAL EXPENSES

| In EUR | 2018. | 2017. |
|---|----------------|----------------|
| Gross salaries and wages | 144.961 | 151.868 |
| Social security contributions - on behalf of the employer | 19.459 | 18.602 |
| Management Board compensation | 35.307 | 31.542 |
| Travel expenses | 16.930 | 20.388 |
| Other personal expenses | 3.378 | 5.257 |
| Total | 220.035 | 227.657 |

8. DEPRECIATION, AMORTIZATION AND PROVISION

| In EUR | 2018. | 2017. |
|---|--------------------|---------------|
| Amortization of intangible assets (Note 13) | 5.605 | 5.605 |
| Depreciation of property, plant and equipment (Note 14) | 9.669 | 9.593 |
| Provisions for guaranteed deposit payments (Note 21) | 112.400.746 | - |
| Total | 112.416.020 | 15.198 |

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

9. OTHER OPERATING EXPENSES

| In EUR | 2018. | 2017. |
|------------------------------------|---------------|---------------|
| Advertising and marketing costs | 10.236 | 15.613 |
| Fee charges - records | 14.132 | 28.648 |
| Membership fees | 17.482 | 16.964 |
| Training costs - education | 13.074 | 3.831 |
| Post, internet and telephone costs | 2.785 | 2.763 |
| Maintenance costs | 11.665 | 6.857 |
| Other expenses | 18.855 | 22.791 |
| Total | 88.229 | 97.467 |

10. FINANCIAL REVENUE

| In EUR | 2018. | 2017. |
|-------------------------------------|----------------|----------------|
| Interest revenue – treasury bills | 84.830 | 286.149 |
| Interest revenue – government bonds | 88.000 | 88.000 |
| Total | 172.830 | 374.149 |

11. FINANCIAL EXPENSE

| In EUR | 2018. | 2017. |
|----------------------------------|----------------|----------------|
| Interest expense – EBRD | 152.083 | 152.115 |
| Interest expense – term deposits | 174.533 | 173.966 |
| Total | 326.616 | 326.081 |

On November 8, 2010, the Fund signed a Stand-By Arrangement with the EBRD - a credit line in the amount of EUR 30,000,000. These funds are available to the Fund in case that the Fund's assets are not sufficient to cover the guaranteed deposit in case of bankruptcy of one or more banks in the system. The loan is granted on 15 years, with the possibility to use it in the next 7 years. Interest rate of 0.50% is calculated and paid in the period until the funds are withdrawn, and 1.00% in the period after the withdrawal.

In order to preserve financial stability and to prevent possible events that could cause the confidence of depositors to fall into the banking system, the Fund, with the approval of the Ministry of Finance, signed the Annex in November 2017, which extended this contract for one year. In November 2018, the Agreement was renewed for the second time (Annex II) for one year under the same conditions as the original agreement, with the withdrawal period of one year and the repayment period of 6 (six) years.

12. OTHER INCOME

Other income in the amount of EUR 60,000 as of December 31, 2018 is entirely related to revenues collected from fines and penalties.

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

13. INTANGIBLE ASSETS

| In EUR | <u>Intangible assets</u> |
|----------------------------------|------------------------------|
| Carrying value | |
| Balance, 01 January 2017 | 42.884 |
| Additions | - |
| Balance, 31 December 2017 | 42.884 |
| Additions | - |
| Balance, 31 December 2018 | 42.884 |
| Accumulated depreciation | |
| Balance, 01 January 2017 | 31.508 |
| Amortization (Note 8) | 5.605 |
| Balance, 31 December 2017 | 37.113 |
| Amortization (Note 8) | 5.605 |
| Balance, 31 December 2017 | 42.718 |
| Net book value | |
| Balance, 31 December 2017 | 5.711 |
| Balance, 31 December 2018 | 166 |

14. EQUIPMENT

| In EUR | <u>Equipment</u> |
|----------------------------------|------------------|
| Carrying value | |
| Balance, 01 January 2017 | 94.473 |
| Additions | 4.092 |
| Disposals | - |
| Balance, 31 December 2017 | 98.565 |
| Additions | 369 |
| Disposals | - |
| Balance, 31 December 2018 | 98.934 |
| Accumulated depreciation | |
| Balance, 01 January 2017 | 68.306 |
| Depreciation (Note 8) | 9.593 |
| Sale | - |
| Balance, 31 December 2017 | 77.899 |
| Depreciation (Note 8) | 9.669 |
| Disposals | - |
| Balance, 31 December 2017 | 87.568 |
| Net book value | |
| Balance, 31 December 2017 | 20.666 |
| Balance, 31 December 2018 | 11.366 |

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

15. OTHER LONG-TERM FINANCIAL PLACEMENTS

| In EUR | 31.12.2018. | 31.12.2017. |
|------------------------------------|--------------------|--------------------|
| Investments in government bonds | 2.200.000 | 2.200.000 |
| Loans to employees - Housing Loans | 216.709 | 229.533 |
| Total | 2.416.709 | 2.429.533 |

Investments in government bonds relate to investments in bonds of Montenegro in the amount of EUR 2,200,000 maturing in 2020 and annual interest-bearing coupons of EUR 88,000 (4% annual interest rate).

Loans to employees relate to housing loans granted in 2015. Loans were initially approved with a maturity of 15 or 30 years. They are repaid in equal monthly instalments. During 2018, EUR 12,824 was repaid (2017: EUR 12,824).

The maturity of long-term loans to employees on 31 December 2018 and 2017 is presented in the following table (maturity of undiscounted future cash flows).

| Due to payment | 31.12.2018. | 31.12.2017. |
|----------------------------------|--------------------|--------------------|
| Up to 1 year | 12.824 | 12.824 |
| 1 to 3 years | 25.648 | 25.648 |
| 3 to 5 years | 25.648 | 25.648 |
| Over 5 years | 165.413 | 178.237 |
| Total loans | 229.533 | 242.357 |
| Minus: short-term part (Note 16) | (12.824) | (12.824) |
| Total | 216.709 | 229.533 |

16. ACCOUNTS RECEIVABLE

| In EUR | 31.12.2018. | 31.12.2017. |
|---|--------------------|--------------------|
| Interest receivables – treasury bills | - | 73.591 |
| Interest receivables - government bonds | 11.090 | 11.090 |
| Housing loans given to employees | 12.824 | 12.824 |
| Other receivables | 57 | 896 |
| | 23.971 | 98.401 |

17. SHORT-TERM FINANCIAL PLACEMENTS

Short-term financial placements - treasury bills, which amount to EUR 15,248,441 as of December 31, 2017, represent debt securities issued by the CBoM on behalf of the Ministry of Finance of Montenegro. The total amount of treasury - bills was due and collected during 2018, with a return of EUR 73,591.

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

18. CASH AND CASH EQUIVALENTS

| In EUR | 31.12.2018. | 31.12.2017. |
|------------------------------------|--------------------|-------------------|
| Cash on a giro account of the CBoM | 59.317.248 | 27.622.034 |
| Interest-bearing deposits | 49.947.924 | 50.127.990 |
| Petty cash | 80 | 39 |
| | <u>109.265.252</u> | <u>77.750.063</u> |

In accordance with the Asset Management Agreement which came into force on 7 May 2012, the Fund's Management Board has engaged and authorized the CBoM to manage the Fund's assets as an Asset Manager. In accordance with the above, the CBoM issues orders for investing in deposits and purchasing and selling portfolio investments in the name and for the account of the Fund at a bank or a dealer it chooses and which, according to information available to the Central Bank, offers security, liquidity and the most favorable return for the Fund at a given moment.

The primary goal of all investment decisions is security, in order to protect the capital of the Fund. The Fund invests in debt instruments, which are rated by one of the internationally recognized rating agencies, with a minimum rating of: Standard & Poor's A / 1, Moody's A2 / P-1, Fitch A / F1. Investments in shares and investments with higher risk are excluded:

- debt securities in EUR issued by a bank, a financial institution or countries with a credit rating determined by internationally recognized rating agencies, which is not lower than the rating "A" or "P1";
- deposits in EUR deposited in banks of EU Member States or OECD with a credit rating determined by an internationally recognized rating agency, which is not lower than the rating "P1".

In addition, the Fund may invest in debt securities in EUR issued and guaranteed by the state of Montenegro in the amount of 20% of the total investment portfolio, as well as deposits in EUR with the CBoM.

The CBoM will manage the Fund's assets independently, without special instructions, in accordance with the acts of the CBoM for managing the international reserves, while respecting the principles of the Fund's Investment Policy.

In accordance with the terms and conditions of the Asset Management Agreement, interest is calculated on the available assets of the Fund and accrued to the deposit amount, except in the case when the Fund directs otherwise. As at 31 December 2018, the short-term deposits of the Fund in the amount of EUR 49,947,924 bear negative interest rates from 0.35% to 0.38%.

DEPOSIT PROTECTION FUND, PODGORICA**NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018****19. EQUITY**

| In EUR | 31.12.2018. | 31.12.2017. |
|-------------------|--------------------|--------------------|
| Share capital | 95.460.041 | 81.118.308 |
| Retained earnings | - | 14.341.733 |
| Accumulated loss | (96.230.760) | - |
| Total | (770.719) | 95.460.041 |

The Deposit Protection Fund was established in 2003, in accordance with the Law on Deposit Protection (Official Gazette of the Republic of Montenegro No. 40/2003). Since the Fund was established by law, the initial capital was not paid in. Instead, total equity represents accumulated profit for the period from the establishment until December 31, 2018.

20. OTHER SHORT-TERM LIABILITIES, ACCRUALS AND DEFERRED INCOME

| In EUR | 31.12.2018. | 31.12.2017. |
|---|--------------------|--------------------|
| Interest payable EBRD | 60.833 | 60.866 |
| Interest payable – interest-bearing deposits | 24.975 | 30.506 |
| Salaries, and other employee benefits payable | - | 385 |
| Total | 85.808 | 91.757 |

21. SHORT-TERM PROVISIONS

Short-term provisions as of December 31st, 2018 entirely relate to the payment of guaranteed deposits in accordance with the obligations of the Fund under the Law on Deposit Protection due to the creation of a "protected case" or the initiation of bankruptcy proceedings in Invest Banka Montenegro a.d .. Podgorica and Atlas Banci a.d. Podgorica (Note 24).

22. FINANCIAL INSTRUMENTS**22.1 Category of financial instruments**

| In EUR | 31.12.2018. | 31.12.2017. |
|---|--------------------|--------------------|
| Financial assets | | |
| Cash and cash equivalents | 109.265.252 | 77.750.063 |
| Short-term financial placements | - | 15.248.441 |
| Other long-term financial placements | 2.416.709 | 2.429.533 |
| Accounts receivable | 23.971 | 98.401 |
| Total | 111.750.932 | 95.526.438 |
| Financial liabilities | | |
| Trade payables, other short-term liabilities and deferred income | 87.437 | 92.834 |

22. FINANCIAL INSTRUMENTS (Continued)

22.2 Finacial risk management

In its regular course of business, the Fund is exposed to a variety of financial risks:

22.2.1 Market risk

22.2.2 Liquidity risk and

22.2.3 Credit risk

The Fund's risk management is focused towards minimizing the potential negative impacts on the financial state and operating activities of the Fund due to uncertainties on the financial markets. The Fund does not use derivative financial instruments in any form in order to mitigate risk losses. A formal framework for financial risk management has been established in the Fund and it is within the jurisdiction of the Fund's Management Board.

22.2.1 Market risk

Foreign currency risk

The fund is not exposed to the risk of foreign currency fluctuations because it performs its business in the functional currency. The only currency risk that the Fund may face relates to the occurrence of a "protected case" when all the deposits held in foreign currency at the account of the bank in which the bankruptcy proceedings are initiated are paid in Euros.

Interest rate risk

The Fund is exposed to various risks which, through the effects of changes in the level of market interest rates, affect its financial position and cash flows. The Fund's business is exposed to the risk of interest rate changes to the extent that interest-bearing assets and interest-bearing liabilities are due for payment at different times or in different amounts.

Price risk

The risk of change in other prices includes changes in the cost of capital, change in price of goods, early payment risk and residual value risk. The fund is not significantly exposed to these types of risks.

22.2.2 Liquidity risk

Liquidity risk is the risk that the Fund will not be able to finance its assets with appropriate sources of funding in respect of related maturities and interest rates, the risk of being unable to liquidate an asset at a reasonable price and in an appropriate timeframe, as well as the risk of being unable to pay off its obligations within maturity

The Management Board of the Fund is responsible for monitoring the level of short-term funding and adjust the needs of short-term and long-term funding in accordance with defined investment policies.

22.2.3 Credit risk

Credit risk is the risk of financial losses of the Fund as a result of delays of the client or other counterparty in the settlement of contractual obligations. Credit risk is primarily linked to the Fund's exposure to cash and cash equivalents, short-term and long-term financial placements.

DEPOSIT PROTECTION FUND, PODGORICA

NOTES TO FINANCIAL STATEMENTS FOR YEAR ENDED ON DECEMBER 31, 2018

22. FINANCIAL INSTRUMENTS (Continued)

22.3 Fair value of financial instruments

The business policy of the Fund is to disclose information on the fair value of assets and liabilities for which there is official market information and when fair value varies significantly from its carrying amount. There is not enough market experience in Montenegro, nor stability nor liquidity in the purchase and sale of receivables and other financial assets and liabilities, as official market information is not always available. Therefore, the fair value cannot be reliably determined with the absence of an active market.

The management of the Fund assesses risks, and in cases where it is estimated that the value at which property is kept in the accounting records will not be realized, accounts for impairment.

The management of the Fund considers that the amounts in the accompanying financial statements reflect the value that in the given circumstances is the most credible and useful for the use of reporting under the given circumstances.

In EUR

| Financial assets | 31.12.2018. | | 31.12.2017 | |
|--|--------------------|--------------------|-------------------|-------------------|
| | Carrying value | Fair value | Carrying value | Fair Value |
| Cash and cash equivalents | 109.265.252 | 109.265.252 | 77.750.063 | 77.750.063 |
| Short-term financial investments | - | - | 15.248.441 | 15.248.441 |
| Other long-term financial investments | 2.416.709 | 2.416.709 | 2.429.533 | 2.429.533 |
| Receivables | 23.971 | 23.971 | 98.401 | 98.401 |
| Total | <u>111.750.932</u> | <u>111.750.932</u> | <u>95.526.438</u> | <u>95.526.438</u> |
| Financial liabilities | | | | |
| Trade payables, other short-term liabilities and deferred income | <u>87.437</u> | <u>87.437</u> | <u>92.834</u> | <u>92.834</u> |

23. LITIGATIONS

As of December 31, 2018, there is no legal dispute against the Fund.

24. SUBSEQUENT EVENT

On December 7, 2018, the CBoM established a compulsory administration in Invest Banka Montenegro a.d. Podgorica and Atlas banka a.d. Podgorica.

On January 4, 2019 the CBoM's Council adopted the decision no. 0101-10202-3/2018 according to which the bankruptcy proceedings in Invest Banka Montenegro a.d. (IBM) were initiated.

Immediately upon receipt of the aforementioned resolution, the Fund informed the depositors of the occurrence of a "protected case" through a press release and by notifying depositors of IBM bank, which was published on January 5 in 3 printed media releases which are distributed on Montenegro's territory.

Based on the previously conducted selection procedure of the payee bank, the Fund has selected three banks that will disburse the guaranteed deposits of IBM bank in bankruptcy.

After receiving information from the Bankruptcy Trustee, the Fund informed the depositors of the IBM Bank about the chosen banks to the depositors, the place and the time at which depositors can collect their guaranteed deposit, all in accordance with the Decision on the manner and procedure for payment of guaranteed deposits (Official Gazette of Montenegro No. 76 / 17 and 17/19).

24. SUBSEQUENT EVENT (Continued)

On January 28, 2019, the Fund started to make payments of guaranteed deposits for 2,677 IBM depositors in bankruptcy. The total liability related to guaranteed deposits amounted to EUR 22,333,240. Up to the date of these financial statements, 77% of the total liabilities of the Fund were paid to IBM depositors.

On April 5, according to the decision of the CBoM no. 0101-3292-4 / 2019 bankruptcy proceedings were initiated in Atlas bank ad. Podgorica.

In this case, the Fund has conducted the same procedure for informing the public and the depositors as in the IBM bankruptcy, in the deadlines and in the manner prescribed by the law. The Fund started to pay guaranteed deposits to depositors of Atlas Bank on April 24, 2019. The total number of depositors who have a guaranteed deposit at Atlas banka ad in bankruptcy was 90.063. The total amount of liability arising from guaranteed deposits amounts to EUR 90,067,506. Up to the day of these financial statements, 55% of the total liabilities of the Fund was paid.

The fund is in the third row of priorities for payment from the bankruptcy assets. The Bankruptcy Trustee of IBM executed the payments and provisions for the first two priority orders, and then, on April 3 2019, made a payment form the bankruptcy assets of IBM to the Fund in the amount of EUR 10,000,000. We expect that around EUR 2,000,000 will be additionally paid out from the IBM's bankruptcy assets until the end of May.

All funds that were in foreign banks' accounts, and which were managed by the Central Bank of Montenegro under the Asset Management Agreement, were transferred to the account of the Fund on April 25, 2019.

Bearing in mind the total amount of Atlas bank's ad. Podgorica assets' value during the bankruptcy, and the amount of assets requiret to be paid to the first and second row of priority debtors from the bankruptcy assets, we are of the opinion that the return of the assets paid for guaranteed deposits will be recovered 100%.

Until April 30, 2019, the first and second installments of the regular premium in the amount of EUR 8,343,383 were calculated and collected.

As of April 30, 2019, the Fund's assets available for the payment of guaranteed deposits amounted to EUR 81,029,243 (EUR 49,334,752 on the account with the CBoM; EUR 30,121,342 of advances for paid relating to depositors of Atlas banka ad and EUR 1,573,149 of advances paid relting to depositors of IBM ad), while liabilities arising from unpaid guaranteed deposits amounted to EUR 60,773,643. In addition to the aforementioned assets, the Fund also has at its disposal the Stand-By arrangement with EBRD in the amount of EUR 30,000,000 as disclosed in Note 11.

The draft of the ammended Law on Deposit Protection was sent to the Ministry of Finance on April 25, 2019, in order to obtain an opinion from the European Commission (together with other laws proposed by the CBoM), which, according to the new work plan of the Government and the Parliament, were proposed for adoption in the third quarter of 2019.

Based on the announced call for application for the appointment of the new Fund's Director, the Management Board has reappointed Predrag Markovic, a bachelor of Economics, on the meeting on February 11, 2019, to serve as the Fund's director for another 4 years.