

Report on the Consolidated Project Financial
Statements of the

**BANKING SECTOR STRENGTHENING
PROJECT**

of the Ministry of Finance and Treasury of Bosnia and Herzegovina

Financed by:
- IBRD 8741- BA

For the period 1 January to 31 October 2021

**BANKING SECTOR STRENGTHENING PROJECT
of the Ministry of Finance and Treasury of Bosnia and Herzegovina**

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BANKING SECTOR STRENGTHENING PROJECT of the Ministry of Finance and Treasury of Bosnia and Herzegovina

1. Introduction

The World Bank - International Bank for Reconstruction and Development (IBRD) will provide a credit to the Bosnia and Herzegovina Banking Sector Strengthening (BSSP). The Credit proceeds will be passed into Federation of Bosnia and Herzegovina (FB&H) and Republic Srpska (RS) under Subsidiary Credit Agreements, with terms and conditions satisfactory to IBRD.

1.1 Objectives of the Project

The objective of the Project is to improve the soundness of the banking sector by enhancing bank regulation, supervision and resolution capacity and by enhancing the development finance framework for COVID-19 affected enterprises.

1.2 Components and activities of the Project

Project components shall be the following:

1. Strengthening, regulation and supervision aligned with the Basel III regime, tailored to the level of development of the banking sector (hereinafter referred to as: *Component 1* of the Project),
2. Addressing weaknesses in the banking sector (hereinafter referred to as: *Component 2* of the Project),
3. Operationalizing the new bank resolution framework (hereinafter referred to as: *Component 3* of the Project),
4. Improving governance and business model of entity development banks (hereinafter referred to as: *Component 4* of the Project), and
5. Provision of additional technical assistance in the achievement of the objective of the Project (hereinafter referred to as: *Component 5* of the Project).

Component 1 of the Project has as its objective the provision of support to the FBA and BARS in the following:

- 1) Further strengthening of capital and liquidity requirements to enhance banks' ability to withstand solvency and liquidity shocks,
- 2) Introduction of a risk appetite framework and internal capital adequacy assessment process (hereinafter referred to as: ICAAP), through the implementation of Pillar 2 of Basel III, which aims to enhance the link between an institution's risk profile, its risk management and its capital planning,
- 3) Develop new revised supervisory risk-based methodologies for supervisory risk review and evaluation process (hereinafter referred to as: SREP methodology) aligned with the European Union standards, aimed at enhancing transparency and harmonization of supervisory review processes.

Component 2 of the Project has as its objective the provision of support to the FBA and BARS in the following:

- 1) Improvement and performance of asset reviews in banks (hereinafter referred to as: AQR) and the launch of the 2017 AQRs of in the remaining banks in FB&H and RS, and
- 2) Adoption of adequate programmes for resolving problems in banks, on the basis of results of asset quality reviews, either by mandatory time bound corrective action programs or resolution/liquidation programs for all under-capitalized banks.

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1.2 Components and activities of the Project (continued)

Component 3 of the Project has as its objective the provision of support to the FBA and BARS in the implementation of the legal framework that regulates bank resolution, specifically in the following:

- 1) Preparation and adoption of a key set of bylaws and decisions that regulate bank recovery and resolution,
- 2) Establishment and operationalization of the Bank Resolution Unit within the FBA and BARS and
- 3) Adoption of an internal assessment methodology for recovery plans and subsequent assessment of recovery plans to be submitted by all banks to the FBA and BARS.

Component 4 of the Project has as its objective the provision of support to the FBiHDB and IRBRS in the following:

- 1) Definition and adoption of the FB&H Government's statement on future development of the FBiHDB,
- 2) Adoption of the FB&HDB business plan,
- 3) Alignment of the FB&HDB's risk management organization, reporting lines, and policies and procedures with those required for FBA-regulated banks,
- 4) the RS definition and approval of the strategic vision for IRBRS,
- 5) the transfer of identified Funds' assets aligned with IRBRS' strategy to IRBRS,
- 6) IRBRS' full compliance with BARS bylaw governing the application of banking regulations to IRBRS.

Component 5 of the Project is provision of additional technical assistance in the achievement of the objective of the Project.

In accordance with Amendment No. 2 to the Loan Agreement Project components are replaced in its entirety and are as follows:

1. Strengthen banking regulation and supervision in line with Basel II/III principles,
2. Address weaknesses in the banking sector,
3. Improve FBA's ability to undertake bank recovery and resolution functions,
4. Promote access to financing for COVID-19 affected enterprises through regulatory measures and liquidity measures, while maintaining financial stability, as well as improving the governance and business model of the FBiH Development Bank.

1.3 Financing of the Project

The State of Bosnia and Herzegovina ("B&H") is the borrower of the International Bank for Reconstruction and Development Loan No. 8741-BA amounting to the equivalent of EUR 56,600,000. Under the terms of a subsidiary finance agreements between State of Bosnia and Herzegovina and the Federation of Bosnia and Herzegovina ("FB&H") and Republic Srpska ("RS"), funds of the equivalent of EUR 28,300,000 have been lent to FB&H and funds of the equivalent of EUR 28,300,000 have been lent to RS. Categories of cost items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each category and the percentage of expenditure for cost items so to be financed in each category are as follows:

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1.3 Financing of the Project (continued)

Item	Amount of the Credit allocated (in EUR)	% of expenditures to be financed (inclusive of taxes)
(1) FBiH and RS Eligible Expenditure Program Goods, non-consulting services, consultants'	54,558,500	100%
(2) services, Training, and Incremental Operating Costs for Part A.5 and Part B.5 of the Project	1,900,000	100%
(3) Front-end Fee	141,500	-
Subtotal		56,600,000

In accordance with Amendment No.1 to the Loan Agreement signed on 2 July 2020, categories of cost items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each category and the percentage of expenditure for cost items so to be financed in each category can be presented as follows:

Item	Amount of the Credit allocated (in EUR)	% of expenditures to be financed (inclusive of taxes)
(1) FBiH and RS Eligible Expenditure Program Goods, non-consulting services, consultants'	55,508,500	100%
(2) services, Training, and Incremental Operating Costs for Part A.5 and Part B.5 of the Project	950,000	100%
(3) Front-end Fee	141,500	-
Subtotal		56,600,000

Also, toward Amendment No. 1 the closing date of the Project is 30 June 2021.

In accordance with Amendment No. 2 to the Loan Agreement categories of cost items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each category and the percentage of expenditure for cost items so to be financed in each category can be presented as follows:

Item	Amount of the Credit allocated (in EUR)	% of expenditures to be financed (inclusive of taxes)
(1) FBiH and RS Eligible Expenditure Program Goods, non-consulting services, consultants'	56,388,500	100%
(2) services, Training, and Incremental Operating Costs for Part A.5 and Part B.5 of the Project	70,000	100%
(3) Front-end Fee	141,500	-
Subtotal		56,600,000

Planned closing date of the Project was 30 June 2021.

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Independent Auditor's Report

To the State of Bosnia and Herzegovina,
Ministry of Finance and Treasury
Attn. of Minister of Finance and Treasury H.E. Mr. Vjekoslav Bevanda

Report on the Consolidated Project Financial Statements

Opinion

We have audited the accompanying consolidated project financial statements of the Banking Sector Strengthening Project (the "Project"), which comprise of Summary of sources and uses of funds, Balance sheet, Designated account statement, Statements of loan withdrawals as of and for the period ended 31 October 2021, and a summary of significant accounting policies and other explanatory notes for the year then ended, financed under IBRD Credit 8741-BA.

In our opinion, the accompanying consolidated project financial statements present fairly, in all material aspects, the financial position of the Project as of 31 October 2021, and of the funds received and disbursed during the year then ended, in accordance with the cash basis of accounting based on International Public Sector Accounting Standard ("IPSAS"), as described in Note 4.1.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). In conducting audit, we were also guided by the Bank's financial reporting and auditing requirements, Disbursement Guidelines for Investment Project Financing, the Loan Handbook for World Bank Borrowers and the World Bank's Procurement Framework. 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 Ministry of Finance and Treasury 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 ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

The management of project implementation unit in FBiH and project coordination unit in RS are responsible for the preparation of separate project financial statements in accordance with the cash basis of accounting based on IPSAS, as described in Note 4.1., Guidelines: Annual Financial Reporting and Auditing for World Bank-Financed Activities, and for such internal control as management determines is necessary to enable the preparation of project financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate financial statements, management is responsible for assessing the Project's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Project or to cease operations or has no realistic alternative but to do so. Those charged with governance are responsible for overseeing the financial reporting process. These consolidated financial statements are sum of separate project financial statements.

Responsibilities for the Audit of Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated project 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 consolidated financial statements. As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated project 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 Project'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 Project'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 consolidated 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 Project to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated project financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We 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.

Report on other requirements

In addition, with respect to the Statement of Expenditure, adequate documentation supporting Disbursement Linked Indicators or Performance Based Conditions and underlying expenditures has been maintained to support claims for reimbursements of expenditures occurred and such expenditure were eligible and incurred for the purpose intended under IBRD Credit 8741-BA. Also, respective reports issued during the period were in agreement with the underlying books of account.

Signed on behalf of Baker Tilly Re Opinion d.o.o. Sarajevo

Nihad Fejzić, Director and Certified Auditor

Sarajevo, 17 December 2021



Ezita Imamović, Certified Auditor

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Consolidated project financial statements for the period ended 31 October 2021

(all amounts in EUR, unless otherwise stated)

3. Consolidated project financial statements for the period ended 31 October 2021

3.1 Summary of Sources and Uses of Funds under the IBRD 8741-BA

	Actual Ref. 31/10/2021	Cumulative 31/10/2021	Cumulative 2020	Cumulative budget	Cumulative variance
FINANCING					
IBRD 8741-BA	8,490,000	56,529,250	48,039,250	56,529,250	-
Front-end fee (from direct payments)	-	70,750	70,750	70,750	-
Refund	(668)	(668)	(668)	(668)	(668)
TOTAL FINANCING	3.1	8,489,332	56,599,332	48,110,000	56,600,000
					668

PROJECT EXPENDITURE

By Category

1. Eligible Expenditure Program	8,490,000	56,388,500	47,898,500	56,388,500	-
2. Goods, non-consulting services, consultants' services, Training, and Incremental Operating Costs for Part A.5 and Part B.5 of the Project	29,848	69,332	39,484	70,000	668
3. Front End Fee	-	141,500	141,500	141,500	-
TOTAL EXPENDITURE	3.2.	8,519,848	56,599,332	48,079,484	56,600,000
					668

PROJECT EXPENDITURE

By Component

1. Support to the FBA (component 1-3) DLI FBA	7,960,000	28,159,250	20,199,250	28,159,250	-
DLR 1.1 (RS)	-	1,319,250	1,319,250	1,319,250	-
DLR 1.2 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 1.3 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 1.4 (RS)	-	2,500,000	2,500,000	2,500,000	-
DLR 2.1 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 2.2 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 2.3 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 3.1 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 3.2 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 3.3 (RS)	-	2,360,000	2,360,000	2,360,000	-
DLR 4.1 (RS)	-	2,000,000	2,000,000	2,000,000	-
DLR 4.2 (RS)	-	3,000,000	3,000,000	3,000,000	-
DLR 4.3 (RS)	530,000	530,000	-	530,000	-
2. Consultants services and operating costs	29,848	69,332	39,484	70,000	668
3. Front and Fee	-	141,500	141,500	141,500	-
TOTAL EXPENDITURE	3.2.	8,519,848	56,599,332	48,079,484	56,600,000
					668

Unused funds in FBiH were refunded on 27 August 2021.

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Consolidated project financial statements for the period ended 31 October 2021

(all amounts in EUR, unless otherwise stated)

**3. Consolidated project financial statements for the period ended 31 October 2021
(continued)**

3.2 Balance sheet as of 31 October 2021 showing accumulated funds of the Project and bank balances concerning IBRD financing

	Ref.	31 October 2021	31 December 2020
ASSETS			
Project Expenditures 8741-BA	3.1.	56,599,332	48,079,484
		56,599,332	48,079,484
Designated Account Statement – IBRD 8741-BA (FB&H)	A.1	-	30,516
Designated Sub-account Statement – IBRD 8741-BA (FB&H)	A.2	-	-
		-	30,516
Total assets		56,599,332	48,110,000
LIABILITIES			
IBRD 8741-BA	3.1.	56,599,332	48,110,100
Total liabilities		56,599,332	48,110,000

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4. Notes to the consolidated project financial statements

4.1 Basis of preparation and accounting records

These consolidated project financial statements have been prepared on the cash basis of accounting based on International Public Sector Accounting Standards issued by the Public Sector Committee of the International Federation of Accountants, and incorporate the accounting policies below, which have been consistently followed in all material respects and comply with the "Guidelines: Annual Financial Reporting and Auditing for World Bank – Financed Activities", issued by the Financial Management Sector Board.

4.2 Accounting policies

The Project's fiscal period is 1 January to 31 October for the recording of all transactions.

Cash basis of accounting

All receipts and expenses under IBRD Loan are recorded on actual receipt and payment basis of accounting as per approved categories.

Project expenditure is stated at original cost on the Balance sheet.

Direct payments

Direct payments concern the amounts paid directly from the IBRD Loan account.

Statement of Expenditure (SoE)

Statements of Expenditure are used to state the expenditure under IBRD Loan during a certain period. These statements are sent to the IBRD disbursement specialist who authorizes the payment of the expenditure through the Designated account.

Currency conversions

The reporting currency is Euro (EUR). Sources and use of funds in currencies other than EUR have been converted to EUR using the currency rate at the moment of the transaction.

Bank balances, recorded on the Balance sheet at year-end, have been converted at year-end rate.

Designated account

This is the total amount of the withdrawals from the IBRD Loan account for the Project. IBRD Loan account is in EUR.

Interest on Designated accounts

Interest earned on the Designated accounts belongs to the Borrower.

Interest on Credit account

Interest earned on the Credit account belongs to the Borrower.

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APPENDIX A.1

DESIGNATED ACCOUNT STATEMENT (FB&H)

Account owned by: Ministry of Finance and Treasury of Bosnia and Herzegovina

Account No.: BA391611000003777917

Depository Bank: Raiffeisen Bank BiH d.d. Sarajevo

Address: Zmaja od Bosne bb

Related Credit: IBRD 8741-BA

Currency: EUR

	Ref.	EUR
Opening balance 1 January 2021	3.2	<u>30,516</u>
Add:		
IBRD Replenishments	3.1.1.	-
		-
Deduct:		
Payments of expenditures during the period		963
Refund of unspent funds to WB		668
Transfer to Designated sub-account IBRD 8741-BA	A.2	28,885
		<u>30,516</u>
Ending balance 31 October 2021	3.2	-

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APPENDIX A.2

DESIGNATED SUB-ACCOUNT STATEMENT (FB&H)

Account owned by: Ministry of Finance and Treasury of Bosnia and Herzegovina

Account No.: BA391611000003777917

Depository Bank: Raiffeisen Bank BiH d.d. Sarajevo

Address: Zmaja od Bosne bb

Related Credit: IBRD 8741-BA

Currency: BAM

	Ref.	BAM	EUR
Opening balance 1 January 2021	3.2	-	-
Add:			
Transfer from Designated account IBRD 8741-BA	A.1	56,494	28,885
		56,494	28,885
Deduct:			
Payments of expenditures during the period		56,494	28,885
		56,494	28,885
Ending balance 31 October 2021	3.2	-	-

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APPENDIX B SoE Withdrawal Schedule of IBRD 8741-BA for the period ended 31 October 2021

	Initial deposit	for Part A.5 of the Project	Goods, CW, CS and operating costs for Part B.5 of the Project	Eligible expenditure program (RS)	Front – end fee	Total application	Total replenished
Previous years	30,516	20,238,734	-	27,699,250	141,500	48,079,484	48,110,000
Application No. 5 (FB&H)	-	5,000,000	-	-	-	5,000,000	5,000,000
Application No. 7 (FB&H)	-	2,960,000	-	-	-	2,960,000	2,960,000
Total Reimbursements 2021	-	7,960,000	-	-	-	7,960,000	7,960,000
Application No. 7 (RS)	-	-	530,000	-	530,000	530,000	530,000
Application No. 6* (FB&H)	(12,925)	12,925	-	-	-	12,925	-
Application No. 8** (FB&H)	(16,923)	16,923	-	-	-	16,923	-
Total SoE application 2021	(29,848)	29,848	-	530,000	-	559,848	530,000
Less: Refund to World Bank	(668)	-	-	-	-	-	(668)
Cumulative 2021	-	7,989,848	-	28,229,250	141,500	8,519,848	8,489,332
Cumulative 31 October 2021	-	28,228,582	-	28,229,250	141,500	56,599,332	56,599,332

* Application No. 6 amounts to 19,955 EUR while expenses in amount of 7,030 EUR were made in year 2020 and are presented in audit report as of 31 December 2020.

** Applications No. 6 and No. 8 were replenished from initial deposit.

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(all amounts in EUR, unless otherwise stated)

**APPENDIX C Reconciliation between World Bank's disbursement statements in EUR
and Loan account in EUR according to the balance sheet; SoE
Withdrawal Schedule of Loan No. 8741-BA**

	Changes in IBRD Loan (in EUR)
Original amount	56,600,000
Disbursed in previous period	48,110,000
Withdrawal 7 (RS)	530,000
Withdrawal 5 (FB&H)	5,000,000
Withdrawal 7 (FB&H)	2,960,000
Total disbursed in 2021	8,490,000
Less: refund to WB	(668)
Cumulative disbursements	56,599,332
Calculated undisbursed balance as of 31 October 2021	668
Undisbursed balance as per World Bank Summary for October 2021	668

Unused funds in FB&H were refunded on 27 August 2021.