

**UNION BANK SH.A.**  
**Independent Auditor's Report**  
**and Consolidated Financial Statements**  
**as at and for the year ended 31 December 2017**

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## **INDEPENDENT AUDITOR'S REPORT**

**To the Management and Shareholders of Union Bank sh.a:**

### **Opinion**

We have audited the consolidated financial statements of Union Bank sh.a. (the "Bank"), which comprise the consolidated statement of financial position as at December 31, 2017, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

### **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 consolidated 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") and ethical requirements that are relevant to our audit of the financial statements in Albania, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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 Financial Statements**

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

In preparing the consolidated 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 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**

Our objectives are to obtain reasonable assurance about whether the consolidated 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.

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## Auditor's Responsibilities for the Audit of the Financial Statements (continued)

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

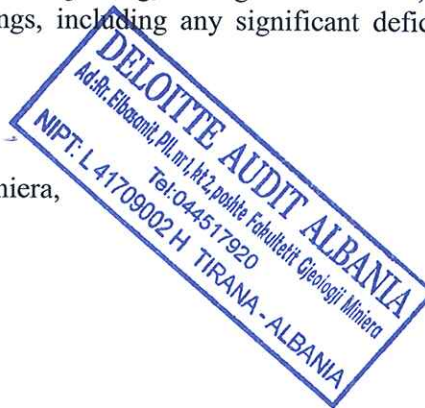
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of 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 Bank'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 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 Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated 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.

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Identification number (NUIS): L41709002H

Engagement Partner  
Statutory Auditor  
Enida Cara

Tirana, Albania  
March 30, 2018



**Union Bank sh.a**
**Consolidated Statement of Financial Position as at 31 December 2017**
*(Amounts in LEK'000)*

	Notes	As at December 31, 2017	As at December 31, 2016
<b>Assets</b>			
Cash and balances with Central Bank	6	5,300,462	4,625,417
Placements and balances with banks	7	3,960,261	2,926,633
Treasury Bills held-to-maturity	8	1,051,668	1,539,380
Bonds held-to-maturity	9	15,732,455	14,032,927
Loans and advances to financial institutions	10	246,969	245,068
Loans and advances to customers	11	18,948,934	16,608,651
Intangible assets	12	98,418	104,869
Property and equipment	13	230,279	214,418
Investment property	14	358,977	372,790
Other assets	15	590,411	918,816
Income tax receivable	29	-	16,437
Deferred tax asset	29	19,794	9,700
<b>Total assets</b>		<b>46,538,628</b>	<b>41,615,106</b>
<b>Liabilities</b>			
Due to Central Bank	16	2,374,465	2,168,572
Due to banks and financial institutions	17	1,559,210	1,390,257
Due to customers	18	38,236,823	34,093,972
Other liabilities	19	308,653	268,972
Income tax payable	28	14,066	-
<b>Total liabilities</b>		<b>42,493,217</b>	<b>37,921,773</b>
<b>Shareholders' equity</b>			
Share capital	20	2,717,813	2,717,813
Share premium		175,600	175,600
Legal Reserve	20	280,405	280,405
Retained earnings		871,593	519,515
<b>Total shareholders' equity</b>		<b>4,045,411</b>	<b>3,693,333</b>
<b>Total liabilities and shareholders' equity</b>		<b>46,538,628</b>	<b>41,615,106</b>

The consolidated statement of financial position is to be read in conjunction with the notes set out on pages 5 to 56 integral part of the consolidated financial statements.

These consolidated financial statements have been approved by Executive Management on 29 March 2018 and signed on its behalf by:

  
Gazmend Kadriu  
Chief Executive Officer



  
Arten Zikaj  
Chief Financial Officer

**Union Bank sh.a**
**Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2017**
*(Amounts in LEK'000)*

	Notes	For the year ended December 31, 2017	For the year ended December 31, 2016
Interest income	21	2,155,638	2,051,151
Interest expense	22	(345,222)	(406,593)
<b>Net interest income</b>		<b>1,810,416</b>	<b>1,644,558</b>
Net impairment loss on loans and advances	10,11	(277,098)	(428,157)
<b>Net interest income after loan impairment</b>		<b>1,533,318</b>	<b>1,216,401</b>
Fee and commission income	23	254,229	223,476
Fee and commission expenses	24	(46,915)	(32,784)
<b>Net fee and commission income</b>		<b>207,314</b>	<b>190,692</b>
Net foreign exchange gain	25	14,008	13,192
Change in fair value of investment property	14	(22,095)	(22,632)
Impairment of assets held for sale	15	(1,681)	1,334
Income from leased investment property	14	5,213	3,168
Write-down on net realizable value of repossessed collaterals	15	(52,497)	(12,686)
Other expense/income, net		(4,077)	15,947
Other charges for provisions		(1,308)	(20,347)
Amortization of intangible assets	12	(24,488)	(26,324)
Depreciation of property and equipment	13	(41,598)	(41,441)
Personnel costs	26	(479,205)	(443,692)
Other operating expenses	27	(682,154)	(628,182)
<b>Profit before tax</b>		<b>450,750</b>	<b>245,430</b>
Income tax expense	28	(73,584)	(41,413)
<b>Profit for the year</b>		<b>377,166</b>	<b>204,017</b>
<b>Other comprehensive income, net of income tax</b>		<b>-</b>	<b>-</b>
<b>Total comprehensive income for the year</b>		<b>377,166</b>	<b>204,017</b>

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes set out on pages 5 to 56 integral part of the consolidated financial statements.

**Union Bank sh.a**
**Consolidated Statement of Changes in Equity for the year ended 31 December 2017**
*(Amounts in LEK'000)*

	Notes	Share capital	Share premium	Legal reserve	Retained earnings	Total
<b>Balance at 1 January 2016</b>		<b>2,717,813</b>	<b>175,600</b>	<b>126,232</b>	<b>469,671</b>	<b>3,489,316</b>
<b>Transactions with owners recorded directly in equity</b>						
Contributions by and distributions to owners						
Increase in share capital		-	-	-	-	-
Legal Reserve	20	-	-	154,173	(154,173)	-
<b>Total contributions by and distributions to owners</b>		<b>-</b>	<b>-</b>	<b>154,173</b>	<b>(154,173)</b>	<b>-</b>
<b>Total comprehensive income for the year</b>						
Profit for the year		-	-	-	204,017	<b>204,017</b>
Other comprehensive income, net of income tax		-	-	-	-	-
<b>Total comprehensive income for the year</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>204,017</b>	<b>204,017</b>
<b>Balance at 31 December 2016</b>		<b>2,717,813</b>	<b>175,600</b>	<b>280,405</b>	<b>519,515</b>	<b>3,693,333</b>
<b>Transactions with owners recorded directly in equity</b>						
Contributions by and distributions to owners						
Increase in share capital		-	-	-	-	-
Legal Reserve		-	-	-	-	-
Dividends distributed	20	-	-	-	(25,088)	<b>(25,088)</b>
<b>Total contributions by and distributions to owners</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>(25,088)</b>	<b>(25,088)</b>
<b>Total comprehensive income for the year</b>						
Profit for the year		-	-	-	377,166	<b>377,166</b>
Other comprehensive income, net of income tax		-	-	-	-	-
<b>Total comprehensive income for the year</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>377,166</b>	<b>377,166</b>
<b>Balance at 31 December 2017</b>		<b>2,717,813</b>	<b>175,600</b>	<b>280,405</b>	<b>871,593</b>	<b>4,045,411</b>

The consolidated statement of changes in equity is to be read in conjunction with the notes set out on pages 5 to 56 integral part of the consolidated financial statements.

**Union Bank sh.a**
**Consolidated Statement of Cash Flows for the year ended 31 December 2017**
*(Amounts in LEK'000)*

	Notes	For the year ended December 31, 2017	For the year ended December 31, 2016
<b>Cash flows from operating activities</b>			
Profit before tax		450,750	245,430
<b>Adjustments for non-cash items:</b>			
Interest income	21	(2,155,638)	(2,051,151)
Interest expense	22	345,222	406,593
Depreciation of property and equipment	13	41,598	41,441
Amortization of intangible assets	12	24,488	26,324
Impairment loss	10,11	277,098	428,157
Write-down on NRV of repossessed collaterals	15	52,497	12,686
Impairment of assets held for sale	15	1,681	(1,334)
Change in fair value of investment property	14	22,095	22,632
Revaluation effect of cash and cash equivalents		121,053	56,628
Other revaluation effects		28,163	17,278
Written of property and equipment		59	1,383
Effect of sale of property and equipment		(5)	(85)
Other charges for provisions		9,839	20,347
Net gain from sale of repossessed collaterals		(42,724)	(8,081)
		<b>(823,824)</b>	<b>(781,752)</b>
Changes in:			
Placements and balances with banks		(327,138)	64,607
Loans and advances to financial institutions		(76)	(254,036)
Loans and advances to customers		(2,661,041)	(1,248,432)
Other assets		272,009	(122,826)
Due to banks and financial institutions		169,420	77,312
Due to customers		4,242,189	2,578,072
Due to Central Bank		205,114	851,327
Other liabilities		31,181	(111,936)
Interest received		2,125,159	2,049,711
Interest paid		(444,248)	(510,298)
Income tax paid	28	(53,175)	(108,545)
<b>Net cash generated from operating activities</b>		<b>2,735,570</b>	<b>2,483,204</b>
<b>Cash flows from investing activities</b>			
Purchases of intangible assets	12	(18,037)	(10,755)
Purchases of property and equipment	13	(59,102)	(60,641)
Proceeds from sale of property and equipment		1,589	1,440
Proceeds from sale of repossessed collaterals		56,881	20,114
Sales of treasury bills held to maturity		487,712	171,489
Purchases of bonds held to maturity		(1,676,992)	(2,064,532)
<b>Net cash used in investing activities</b>		<b>(1,207,949)</b>	<b>(1,942,885)</b>
<b>Cash flows from financing activities</b>			
Dividends distributed		(25,088)	-
<b>Net cash generated from financing activities</b>		<b>(25,088)</b>	<b>-</b>
<b>Net increase in cash and cash equivalents during the year</b>		<b>1,502,533</b>	<b>540,319</b>
Revaluation effect of cash and cash equivalents		(121,053)	(56,628)
<b>Cash and cash equivalents at the beginning of the year</b>		<b>5,272,744</b>	<b>4,789,053</b>
<b>Cash and cash equivalents at the end of the year</b>	29	<b>6,654,224</b>	<b>5,272,744</b>

The consolidated statement of cash flows is to be read in conjunction with the notes set out on pages 5 to 56 integral part of the consolidated financial statements.



## **1. INTRODUCTION**

Union Bank Sh.a. (the “Bank”) is a financial institution registered as a commercial bank on 9 January 2006 based on Decision no. 101, dated 28 December 2005, of the Supervisory Board of the Bank of Albania (“BoA”). The Bank’s activity is subject to Law no. 8269 “On the Bank of Albania” dated 23 December 1997, Law No. 9662 “On Banks in the Republic of Albania” dated 18 December 2006 and all rules and regulations approved by the Supervisory Board of the BoA.

The Bank is a commercial bank, which provides banking services to individuals and enterprises in the Republic of Albania. The Bank is registered as a joint stock company, with the registration number 33563, dated 26 May 2005, on which date the Bank started its commercial activities. The Bank obtained its license for banking activities on 9 January 2006.

Based on the Sale and Purchase Agreement signed in September 2014, on 22 December 2014, the Bank acquired 100% of the shares in Landeslease Sh.a (the “Subsidiary” or “Landeslease”), and is the only shareholder of this financial institution. The Subsidiary is an Albanian leasing company that was registered as a joint stock company and started to operate on 5 April 2005.

The immediate parent of the Group is Union Financiar Tirane sh.a. and the ultimate controlling parents are Mr. Edmond Leka and Mr. Niko Leka

These consolidated financial statements comprise the Bank and its Subsidiary (collectively the ‘Group’).

The Headquarters of the Bank are located in Tirana, Albania.

### **Directors as at 31 December 2017**

#### *Board of Directors of the Bank (Supervisory Board)*

Edmond Leka	Chairman
Niko Leka	Vice-Chairman
Varuzhan Piranjani	Member
Melis Ekmen Tabojer	Member
Gazmend Kadriu	Member
Sokol Marishta	Member
Flutura Veipi	Member

Mrs. Melis Ekmen Tabojer joined the Board on 7 December 2017, replacing Mr. Paul Nabavi.

#### *Board of Directors of the Subsidiary*

Niko Leka	Chairman
Arten Zikaj	Vice-Chairman
Majlinda Hakani	Member
Varuzhan Piranjani	Member
Rezart Ferzaj	Member

## **2. BASIS OF PREPARATION**

### **2.1 Statement of compliance**

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

Group consolidated financial statements are prepared by the parent Company.

### **2.2 Basis of measurement**

The consolidated financial statements have been prepared on the historical cost basis, except for investment property, which is measured at fair value.

### **2.3 Functional and presentation currency**

These consolidated financial statements are presented in Albanian Lek (“LEK”), which is the Group’s functional currency. All financial information presented in LEK has been rounded to the nearest thousands, except when otherwise indicated.

### **2.4 Use of estimates and judgments**

The preparation of consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

**2. BASIS OF PREPARATION (CONTINUED)****2.4 Use of estimates and judgments (continued)**

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and that the consolidated financial statements therefore present the financial position and results fairly. In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the consolidated financial statements are described in note 4.

**3. SIGNIFICANT ACCOUNTING POLICIES****3.1 Basis of consolidation****3.1.1 Business combination**

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any gain on a bargain purchase is recognized in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

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

**3.1.2 Subsidiary**

'Subsidiaries' are entities controlled by the Bank. Control is achieved when the Bank

- has the power over the investee;
- is exposed, or has rights, to variable return from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Bank reassesses whether it has control if there are changes to one or more elements of control. This includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Bank having power over the investee. The financial statements of the Subsidiary are included in the consolidated financial statements from the date on which control commences until the date in which control ceases.

**3.1.3 Loss of control**

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

**3.1.4 Transactions eliminated on consolidation**

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

**3.2 Foreign currency transactions**

Transactions in foreign currencies are translated into the respective functional currency entities at the spot exchange rates at the date of the transactions. Monetary assets and denominated in foreign currencies at the reporting date are retranslated to the functional at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year.

Non-monetary assets and liabilities that are measured at fair value in a foreign currency translated to the functional currency at the spot exchange rate at the date that the fair value determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.2 Foreign currency transactions (continued)**

Foreign currency differences arising on retranslation are generally recognised in profit or loss. Net foreign exchange gains or losses include all foreign exchange differences related to spot transactions with settlement dates two business days after the trade date, although such transactions are recognised on the settlement date.

**3.3 Interest**

Interest income and expense are recognised 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 Group 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 or issue of a financial asset or liability.

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

**3.4 Fees and commissions**

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

Other fee and commission income, including account servicing fees, investment management fees, sales commission and placement fees are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognised 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.

**3.5 Leases****3.5.1 Lease payments**

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

**3.5.2 Leased assets – lessor**

If the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, then the arrangement is classified as finance lease and a receivable equal to the net investment in the lease is recognised and presented within loans and advances (see Note 3.9)

**3.6 Tax expense**

Tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or in other comprehensive income.

**3.6.1 Current tax**

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

### **3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **3.6 Tax expense (continued)**

##### **3.6.2 Deferred tax**

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting, nor taxable profit or loss.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority.

Additional taxes that arise from the distribution of dividends by the Group are recognised at the same time as the liability to pay the related dividend is recognised.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which it can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

##### **3.6.3 Tax exposures**

In determining the amount of current and deferred tax, the Group takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the Group to change its judgement regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

#### **3.7 Financial assets and financial liabilities**

##### **3.7.1 Recognition**

The Group initially recognises loans and advances, deposits, and subordinated liabilities on the date that they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities are recognised initially on the trade date, which is the date that the Group becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus transaction costs that are directly attributable to its acquisition or issue.

##### **3.7.2 Classification**

###### ***Financial assets***

The Group classifies its financial assets in one of the following categories:

- loans and receivables
- held to maturity.

See notes 3.8, 3.9 and 3.10.

###### ***Financial liabilities***

The Group classifies its financial liabilities as measured at amortised cost. See note 3.17.



**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.7 Financial assets and financial liabilities (continued)****3.7.3 Derecognition*****Financial assets***

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in such transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Group enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions.

In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

***Financial liabilities***

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire. Where there has been an exchange between an existing borrower and the lender of debt instruments with substantially different term, or has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for an extinguishment of the original financial liability and the recognition of a new financial liability. Terms are substantially different if the present value of the net cash flows under the new terms discounted using the original effective interest rate is at least 10 per cent different from the present value of the remaining cash flows under the original financial liability. A gain or loss from extinguishment of the original financial liability is recognised in profit or loss.

**3.7.3 Offsetting**

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

**3.7.4 Amortised cost measurement**

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

**3.7.5 Fair value measurement**

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

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### 3.7 Financial assets and financial liabilities (continued)

##### 3.7.5 Fair value measurements (continued)

When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price.

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

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

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

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

##### 3.7.6 Identification and measurement of impairment

At each reporting date the Group 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 by the Group on terms that the Group 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 Group considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (type and amount of the loan). Based on historical data for each of these groups a loss factor is calculated. These expected loss factors are adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends, and then they are applied to estimate impairment loss on each group. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.7 Financial assets and financial liabilities (continued)****3.7.6 Identification and measurement of impairment (continued)**

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower then an assessment is made whether the financial asset should be derecognised. If the cash flows of the renegotiated asset are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case the original financial asset is derecognised and the new financial asset is recognised at fair value. The impairment loss is measured as follows:

If the expected restructuring does not result in derecognition of the existing asset, the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset.

If the expected restructuring results in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition.

This amount is discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances or held-to-maturity investment securities. When an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

The Group writes off certain loans and advances and investment securities when they are determined to be uncollectible (see Note 32). Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

**3.8 Cash and cash equivalents**

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with Central Bank of Albania 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 Group in the management of its short-term commitments.

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

**3.9 Loans and advances**

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. Loans and advances to banks and to customers are classified as loans and receivables. Loans and advances to customers include:

- those classified as loans and receivable; and
- finance lease receivable

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Loans and advances also include finance lease receivable in which the Group is the lessor (see Note 3.5.2).

When the Group purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the Group's consolidated financial statements.

### **3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **3.10 Investment securities held-to-maturity**

Investment securities are initially measured at fair value plus incremental direct transaction costs, and subsequently accounted for as held to maturity.

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as available for sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method, less any impairment losses (see Note 3.7.6). A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available for sale, and would prevent the Group from classifying investment securities as held to maturity for the current and the following two financial years.

However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- sales or reclassifications after the Group has collected substantially all of the asset's original principal; and
- sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.

#### **3.11 Property and equipment**

##### **3.11.1 Recognition and measurement**

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

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, and when the Group has an obligation to remove the asset or restore the site, an estimate of the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

Any gain or loss on disposal of an item of property and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised within other income in profit or loss.

##### **3.11.2 Subsequent costs**

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

##### **3.11.3 Depreciation**

Items of property and equipment are depreciated from the date they are available for use or, in respect of self-constructed assets, from the date that the assets are completed and ready for use. Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values over their estimated useful lives. Depreciation is recognised in profit or loss.



**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.11 Property plant and equipment (continued)****3.11.3 Depreciation (continued)**

Depreciation is calculated using the reducing balance method at the following annual rates:

	<b>Rate per annum</b>
Computers	25%
Office furniture	20%
Electronic equipment	20%
Fixtures and fittings	20%
Vehicles	25%

Leasehold improvements are depreciated using the straight-line basis over the shorter of the lease term and their useful lives. The estimated useful lives of the leasehold improvements range from 3 to 15 years. Work in progress is not depreciated. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

**3.12 Intangible assets**

Software acquired by the Group is measured at cost less accumulated amortisation and any accumulated impairment losses. Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in profit or loss over the estimated useful life of the asset, from the date that it is available for use. Work in progress is not amortised.

Software is amortised using the reducing balance method with an annual amortization rate of 25%, while other intangible assets, including licenses and fees paid for access to electronic systems and services used by the Group, are amortized using the straight line method with an annual rate of 15%.

Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

**3.13 Non-current assets held for sale**

Non-current assets are classified as held for sale as their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the non-current asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. If an extension of the sale period occurs it does not preclude an asset from being classified as held for sale if the delay is caused by events or circumstances beyond the Group's control and there is sufficient evidence that the Group remains committed to its plan to sell the asset.

Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale and subsequent gains and losses on re-measurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

When a non-current asset ceases to be classified as held for sale, it is measured at the lower of (a) its carrying amount before the asset was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset not been classified as held for sale; and (b) its recoverable amount at the date of the subsequent decision not to sell.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.14 Investment property**

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for use in the production or supply of goods or services or for administrative purposes. The Group holds investment property as a consequence of acquisition through the enforcement of security over loans and advances. Investment property is initially measured at cost and subsequently at fair value, with any change therein recognised in profit or loss within other income.

Any gain or loss on disposal of an investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in profit or loss. When the use of a property changes such that it is reclassified as property and equipment or non-current assets held for sale, its fair value at the date of reclassification becomes its cost or carrying amount for subsequent accounting.

**3.15 Inventories**

Inventories are initially measured at cost, and subsequently at the lower of cost and net realisable value (NRV). Cost comprises all cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Any write-down to NRV is recognised as an expense in the period in which write-down occurs. Any reversal is recognised in profit and loss statement in the period in which reversal occurs.

The Group holds inventories in the form of consumption inventories and as repossessed collaterals. Consumption inventories are materials bought in order to be consumed in the rendering of services. Repossessed collaterals are properties acquired through enforcement of security over loans and advances to customers. For a transfer from investment property carried at fair value to inventories, the property's deemed cost for subsequent accounting shall be its fair value at the date of change in use.

**3.16 Impairment of non-financial assets**

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses are recognised in profit or loss. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

**3.17 Deposits, repurchase agreements and borrowings**

Deposits, repurchase agreements and borrowings are the Group's sources of debt funding.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date (repo), the arrangement is accounted for as a financial liability, and the underlying asset continues to be recognised in the Group's consolidated financial statements.

**3.18 Provisions**

A provision is recognised if, as a result of a past event, the Group 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, where appropriate, the risks specific to the liability. The unwinding of the discount is recognised as finance cost.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.19 Employee benefits*****Defined contribution plans***

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss when they are due. The Group makes compulsory social security contributions that provide pension benefits for employees upon retirement. The local authorities are responsible for providing the legally set minimum threshold for pensions in Albania under a defined contribution pension plan.

***Short-term benefits***

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

**3.20 Adoption of new or revised standards and interpretations**

The following standards, amendments to the existing standards and interpretations issued by the International Accounting Standards Board are effective for the current period:

- **Amendments to IAS 7 “Statement of Cash Flows”** - Disclosure Initiative (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IAS 12 “Income Taxes”** - Recognition of Deferred Tax Assets for Unrealised Losses (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IFRS 12 due to “Improvements to IFRSs (cycle 2014-2016)”** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017).

The adoption of these amendments to the existing standards and interpretations has not led to any changes in the Group’s accounting policies.

**3.21 New accounting pronouncements**

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after January 01, 2018 or later, and which the Bank has not early adopted.

- **IFRS 9 “Financial Instruments”** (effective for annual periods beginning on or after 1 January 2018),
- **IFRS 15 “Revenue from Contracts with Customers”** and further amendments (effective for annual periods beginning on or after 1 January 2018),
- **IFRS 16 “Leases”** (effective for annual periods beginning on or after 1 January 2019),
- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 2 “Share-based Payment”** - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- **Amendments to IFRS 4 “Insurance Contracts”** - Applying IFRS 9 “Financial Instruments” with IFRS 4 “Insurance Contracts” (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 “Financial Instruments” is applied first time),
- **Amendments to IFRS 9 “Financial Instruments”** - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),
- **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),
- **Amendments to IAS 28 “Investments in Associates and Joint Ventures”** - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****3.21 New accounting pronouncements (continued)**

- **Amendments to IAS 40 “Investment Property”** - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- **Amendments to IFRS 1 and IAS 28 due to “Improvements to IFRSs (cycle 2014-2016)”** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),
- **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 (effective for annual periods beginning on or after 1 January 2019),
- **IFRIC 22 “Foreign Currency Transactions and Advance Consideration”** (effective for annual periods beginning on or after 1 January 2018),
- **IFRIC 23 “Uncertainty over Income Tax Treatments”** (effective for annual periods beginning on or after 1 January 2019).

The Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. Except for the impact of IFRS 9, the Group anticipates that the adoption of the other standards, revisions and interpretations will have no material impact on the consolidated financial statements of the Group in the period of initial application.

**3.22 Impact of standards issued but not yet effective**

The following standards are expected to have material impact on the Group’s financial statements in the period of initial application.

IFRS 9 “Financial Instruments”, which is to supersede IAS 39 Financial Instruments: Recognition and Measurement. The final wording includes requirements for the classification and measurement of financial assets and financial liabilities.

In 2017, as part of the IFRS 9 project, the Group completed most activities relating to the first application of IFRS 9, focusing on the biggest challenges. The final analysis of the identification of any differences that exist between the currently applied procedures under IAS 39 and new requirements under IFRS 9 – for classification and measurement, provisions for possible losses and hedge accounting were ongoing at the time of preparation of these financial statements.

**Classification and Measurement**

Compared to IAS 39, IFRS 9 establishes new financial reporting principles for most financial assets and financial liabilities, which provide users of financial statements with relevant and useful information to assess the amount, timing and uncertainty of a reporting entity’s future cash flows.

IFRS 9 introduces three categories for the classification of financial instruments depending on whether they are subsequently measured at amortised cost (AC), at fair value with gains and losses recognised in other comprehensive income (fair value through other comprehensive income – FVOCI), or at fair value with gains and losses recognised in profit or loss (fair value through profit or loss – FVTPL).

A financial asset is measured at amortised cost if the following two conditions are met:

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



### **3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **3.22 Impact on standards issued but not yet effective (continued)**

A financial asset is measured at fair value through other comprehensive income if the following two conditions are met:

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

A financial asset is measured at fair value through profit or loss if it is not measured at amortised cost or fair value through other comprehensive income. However, a reporting entity may make an irrevocable election at initial recognition to present subsequent fair value changes of certain equity investments, which would otherwise be measured at fair value through profit and loss, in other comprehensive income.

A reporting entity should only reclassify relevant financial assets if its business model for the management of financial assets changes.

A reporting entity is required to classify its financial assets based on its contractual cash flow characteristics if the financial asset is held within a business model whose objective is to hold assets to collect contractual cash flows, where:

- a) The principal is the fair value of the financial asset at initial recognition; and
- b) The interest consists of consideration for the time value of money, credit risk associated with the outstanding principal amount during the relevant period, other basic risks and expenses of borrowing and the profit margin.

The classification of financial instruments under IFRS 9 is based on the business model used by the Group to manage its financial assets and on whether the contractual cash flows represent solely payments of principal and interest (SPPI). The business model expresses how the Bank manages its financial assets to generate cash flows and create value. Therefore, the business model determines whether cash flows will flow from the collection of contractual cash flows, from the sale of financial assets, or from both.

If a financial instrument is held to collect contractual cash flows, it may be classified in the AC category if it also meets the SPPI requirement. Financial instruments that meet the SPPI requirement, which are held in the Group's portfolio of financial assets to collect cash flows and sell financial assets, may be classified as FVOCI. Financial assets that do not generate cash flows meeting the SPPI must be measured at FVTPL (eg financial derivatives).

The Group's basic business model for investing in financial assets is:

- Ensuring a primary return on invested funds by collecting contractual cash flows;
- Investing in instruments and counterparties that may be used for refinancing transactions if necessary; and
- Stabilising interest income.

For all credit products, the intent of the Group's transaction with a client is to collect contractual cash flows and realise a margin. A credit transaction involves an agreed repayment schedule consisting of repayments of principal, interest and fees, if applicable. The loan price, ie the interest rate, is calculated from the loan principal and takes into account the transaction's/client's credit risk, financing costs (or time value of money), other costs associated with the loan provision and the Group's business margin. The Group does not intend to sell its receivable from the client in any of its credit products. The Group does not purchase impaired receivables from banks or other third parties. Receivables are only sold in the event of a significant increase in credit risk and/or impairment of a receivable and based on approved recovery strategies.

### **3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **3.22 Impact on standards issued but not yet effective (continued)**

The Group analysed the requirements under IFRS 9 and classified financial instruments pursuant to the requirements under IFRS 9 and concluded that the standard will affect the classification and measurement of financial assets held as at 1 January 2018 as follows:

- Loans and advances to banks and to customers that are classified as loans and receivables and measured at amortised cost under IAS 39, will in general also be measured at amortised cost under IFRS 9.
- Held to maturity investment securities measured at amortised cost under IAS 39 will in general also be measured at amortised cost under IFRS 9

The Group has estimated that on the adoption of IFRS 9 at 1 January 2018, these changes will have no impact on the Group's equity.

#### **Provisions for Possible Losses**

IFRS 9 introduces a three-step model that reflects changes in the credit quality since the initial recognition. Impairment-related requirements are based on an expected credit loss model ("ECL") which replaces the incurred-loss model under IAS 39.

The first level (Stage 1) includes financial instruments with no significant increase in credit risk since initial recognition. For these assets, the Bank records a 12-month ECL, and interest income is recognised based on the gross book value of assets.

The second level (Stage 2) includes financial instruments with a significant increase in credit risk since the initial recognition, but no objective proof of impairment exists. For these assets, the Bank records an ECL for the whole life cycle, and interest income is recognised based on the gross book value of assets.

The third level (Stage 3) includes financial instruments with a significant increase in credit risk since initial recognition, and objective proof of their impairment exists. For these assets, the Bank records an ECL for the whole life cycle, and interest income is recognised based on the net book value of assets.

The Group identifies a credit risk increase using predefined criteria at the level of individual transactions and portfolio-level estimates. The ECL estimation should represent a probability-weighted result and the effect of the time-value of money should be based on adequate and documentable information which is available without unreasonable costs or excessive effort.

As part of the IFRS 9 Project, the Group has developed and set up processes, definitions and analytical methods for risk management. Models have been developed to identify significant increases in credit risk and ECL calculation using the relevant parameters in accordance with IFRS 9.

Based on the analysis of the required methodological changes, the main principles of IFRS 9 have been developed and subsequently implemented. The required information, data and models are currently being implemented and tested.

The impact of the transition to IFRS 9 has been calculated as at the reporting date. It represents the current best estimate of Group's management and probably cannot be considered as final. Methodological rules and procedures for the classification, measurement and provisions for possible losses have been finalised in detail.

#### **4. USE OF ESTIMATES AND JUDGEMENTS**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Management discusses with the Audit Committee the development, selection and disclosure of the Group's critical accounting policies and their application, and assumptions made relating to major estimation uncertainties. Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year and about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is disclosed below.

These disclosures supplement the commentary on financial risk management (see Note 32).

##### **4.1 Impairment**

Assets accounted for at amortised cost are evaluated for impairment on a basis described in Note 3.7.6.

The specific component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collective allowance for groups of assets that are not considered individually significant and those that are individually significant but that were not found to be individually impaired cover credit losses inherent in portfolios of loans and advances, and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances, and held-to-maturity investment securities, but the individual impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on the estimates of future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective allowances. A collective component of the total allowance is established for groups of homogeneous loans that are not individually impaired.

Impairment losses for individually significant loans are based on estimates of discounted future cash flows, taking into account repayments and realisation of any assets held as collateral against loans. A 10% increase or decrease in the actual loss experience compared to the estimated future discounted cash flows from individually significant loans, which could arise from differences in amounts and timing of future cash flows, would result in increase in loan impairment losses of LEK 107,182 thousand (2016: LEK 116,630 thousand) or a decrease in loan impairment losses of LEK 108,565 thousand (2016: LEK 129,738 thousand), respectively.

An assessment as to whether an investment in sovereign debt is impaired may be complex. In making such an assessment, the Group 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.

##### **4.2 Fair value**

The determination of fair value for financial assets and financial liabilities for which there is no observable market price requires the use of valuation techniques as described in Note 3.7.5. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

**4. USE OF ESTIMATES AND JUDGEMENTS (CONTINUED)****4.2 Fair value (continued)**

The Group measures fair values using the following hierarchy of methods:

- Level 1: Quoted market price in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The estimation of the fair value is disclosed in note 33.

**4.3 Going concern**

Management prepared these separate financial statements on a going concern basis. In making this judgement management considered the Bank's financial position, current intentions, profitability of operations and access to financial resources, and analysed the impact of the recent financial crisis on future operations of the Bank.

**5. CONSOLIDATION**

The table below shows Bank's and Subsidiary's main figures before consolidation:

	<b>As at 31 December 2017</b>		<b>As at 31 December 2016</b>	
	<b>Bank</b>	<b>Subsidiary</b>	<b>Bank</b>	<b>Subsidiary</b>
Total assets	46,581,287	1,214,189	41,555,815	1,061,122
Total liabilities	42,612,723	882,105	37,902,898	765,469
Shareholder's equity	3,968,564	332,084	3,652,917	295,653
Total banking income	1,939,828	94,959	1,764,722	77,540
Profit before tax	406,752	43,998	210,062	35,368

**6. CASH AND BALANCES WITH CENTRAL BANK**

Cash and balances with the Central Bank are detailed as following:

	<b>As at 31 December 2017</b>	<b>As at 31 December 2016</b>
Cash on hand	1,102,623	957,043
<i>Central Bank:</i>		
Current account	1,614,870	1,412,198
Compulsory reserves	2,582,817	2,256,057
Accrued interest	152	119
<b>Total</b>	<b>5,300,462</b>	<b>4,625,417</b>

In accordance with the Bank of Albania's requirement relating to the deposit reserve, the Bank should maintain a minimum of 10% of customer deposits in Albania with initial maturity up to 24 months with the Bank of Albania as a compulsory reserve account. This reserve is not available for use in the Bank's day to day operations, however according to the applicable regulations the Bank can make use of up to 40% of the compulsory reserve in LEK, provided that the monthly average balance of accounts with the Central Bank (current account plus compulsory reserve) does not fall below the compulsory reserve level.



**7. PLACEMENTS AND BALANCES WITH BANKS**

Placements and balances with banks are detailed as follows:

	As at 31 December 2017	As at 31 December 2016
<b>Current accounts:</b>		
Resident	25,310	27,258
Non-resident	3,391,996	2,573,400
	<b>3,417,306</b>	<b>2,600,658</b>
<b>Deposits:</b>		
Resident	519,425	302,845
	<b>519,425</b>	<b>302,845</b>
Other accounts	23,449	23,071
Accrued interest	81	59
<b>Total</b>	<b>3,960,261</b>	<b>2,926,633</b>

Deposits with resident banks mature in the range of 3 to 80 days (2016: 4 to 20 days) and bear interest in the range of 0.2%p.a. to 1.28%p.a. (2016: 0.2%p.a. to 1.3%p.a.).

**8. TREASURY BILLS HELD-TO-MATURITY**

Treasury Bills held-to-maturity ("T-Bills") are issued by the Albanian Government.

T-Bills by original maturity are presented as follows:

	31 December 2017			31 December 2016		
	Nominal value	Remaining discount	Book Value	Nominal value	Remaining discount	Book Value
12 months	1,059,880	(8,212)	1,051,668	1,548,550	(9,170)	1,539,380
<b>Total</b>	<b>1,059,880</b>	<b>(8,212)</b>	<b>1,051,668</b>	<b>1,548,550</b>	<b>(9,170)</b>	<b>1,539,380</b>

**9. BONDS HELD-TO-MATURITY**

Bonds held-to-maturity ("Bonds") are shown below according to their issuing bodies. The interest is paid semi-annually.

	31 December 2017			
	Nominal value	Remaining discount	Accrued interest	Book Value
Albanian Government	14,827,718	(16,032)	206,598	15,018,284
Foreign Governments	333,300	10,130	3,392	346,822
Foreign Corporate Bonds	354,965	7,499	4,885	367,349
<b>Total</b>	<b>15,515,983</b>	<b>1,597</b>	<b>214,875</b>	<b>15,732,455</b>

	31 December 2016			
	Nominal value	Remaining discount	Accrued interest	Book Value
Albanian Government	13,047,440	(13,414)	182,139	13,216,165
Foreign Governments	590,885	19,025	8,825	618,735
Foreign Corporate Bonds	195,785	867	1,375	198,027
<b>Total</b>	<b>13,834,110</b>	<b>6,478</b>	<b>192,339</b>	<b>14,032,927</b>

(Amounts in LEK '000 unless otherwise stated)

**9. BONDS HELD TO MATURITY (CONTINUED)**

Bonds held to maturity are rated as follows:

<i>Moody's Ratings or equivalents</i>	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
Albanian Government		
Rated B+	888,223	902,507
Not rated	14,130,061	12,313,658
Foreign Governments		
Rated Aaa	112,988	131,487
Rated Aa2	60,094	136,508
Rated Aa3	59,641	-
Rated A1	56,198	65,094
Rated A3	-	202,572
Rated Baa1	57,901	-
Corporate Bonds		
Rated Aa2	77,998	-
Rated A1	67,483	138,640
Rated A2	138,548	142,461
Rated A3	83,320	-
<b>Total</b>	<b>15,732,455</b>	<b>14,032,927</b>

**10. LOANS AND ADVANCES TO FINANCIAL INSTITUTIONS**

Loans and advances to financial institutions are detailed as follows:

	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
Loans	255,578	255,309
Accrued interest	726	858
Allowances for losses on loans and advances	(7,669)	(9,626)
Deferred income	(1,666)	(1,473)
<b>Total</b>	<b>246,969</b>	<b>245,068</b>

The Bank has granted loans to resident financial institutions. These loans mature in the range of 1 to 4 years and bear interest rates ranging from 5.2% p.a. to 5.4% p.a.

**11. LOANS AND ADVANCES TO CUSTOMERS**

Loans and advances to customers are detailed as follows:

	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
Loans and advances at amortized cost	19,605,208	17,224,573
Finance Lease	1,010,700	959,566
Allowance for Impairment	(1,666,974)	(1,575,488)
<b>Total loans and advances to customers, net</b>	<b>18,948,934</b>	<b>16,608,651</b>

Loans and advances to customers at amortized cost:

	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
Loans	16,422,056	14,562,949
Overdrafts	2,968,773	2,519,268
Other advances to customers	205,480	128,935
	<b>19,596,309</b>	<b>17,211,152</b>
Accrued interest	97,364	89,344
Allowances for losses on loans and advances	(1,624,637)	(1,538,265)
Deferred income	(88,465)	(75,923)
<b>Total</b>	<b>17,980,571</b>	<b>15,686,308</b>

**11. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)**

Loans and advances to customers earn interest as follows:

<b>Currency</b>	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
LEK	2.10% - 20.0% p.a.	2.10% - 20.0% p.a.
EUR	1.16% - 15.0% p.a.	1.17% - 15.0% p.a.
USD	1.70% - 15.0% p.a.	1.70% - 15.0% p.a.

The Group has granted few loans with interest rates at the minimum limit shown above, which are lower than the rates that are generally offered by the Group, and are covered by cash collaterals or are granted to personnel under special conditions.

Interest rates of the finance lease portfolio vary from 7.68% p.a. to 9% p.a.(2016: 7% p.a. to 10% p.a.)

Expected cash flows to be reimbursed for finance lease receivables for leases of equipment where the Group is the lessor are as follows:

	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
Less than one year	143,915	128,188
Between one and five years	1,012,265	976,163
Unearned future finance income	(145,480)	(144,785)
<b>Net investment in finance lease</b>	<b>1,010,700</b>	<b>959,566</b>
Less impairment allowance	(42,337)	(37,223)
<b>Total</b>	<b>968,363</b>	<b>922,343</b>

Movements in the allowance for impairment on loans are as follows:

	<b>As at December 31, 2017</b>	<b>As at December 31, 2016</b>
As at 1 January	1,575,488	1,191,778
Net impairment charge for the year	278,892	418,531
Loans written-off during the period	(157,948)	(16,359)
Translation differences	(29,458)	(18,462)
<b>Balance at the end of the year</b>	<b>1,666,974</b>	<b>1,575,488</b>

*(Amounts in LEK '000 unless otherwise stated)***12. INTANGIBLE ASSETS**

Intangible assets are detailed as follows:

	<b>Software</b>	<b>Other intangible assets</b>	<b>Intangible assets in progress</b>	<b>Total</b>
<b>At 1 January 2016</b>				
Cost	251,283	62,719	5,731	319,733
Accumulated amortization	(170,007)	(29,288)	-	(199,295)
<b>Net book amount</b>	<b>81,276</b>	<b>33,431</b>	<b>5,731</b>	<b>120,438</b>
<b>Year ended December 2016</b>				
Additions	6,293	-	4,462	10,755
Amortization charge	(20,454)	(5,870)	-	(26,324)
<b>Closing net book amount</b>	<b>67,115</b>	<b>27,561</b>	<b>10,193</b>	<b>104,869</b>
<b>At 31 December 2016</b>				
Cost	257,576	62,719	10,193	330,488
Accumulated amortization	(190,461)	(35,158)	-	(225,619)
<b>Net book amount</b>	<b>67,115</b>	<b>27,561</b>	<b>10,193</b>	<b>104,869</b>
<b>Year ended December 2017</b>				
Additions	10,235	4,365	3,437	18,037
Adjustments	(264)	-	264	-
Amortization charge	(18,400)	(6,088)	-	(24,488)
<b>Closing net book amount</b>	<b>58,686</b>	<b>25,838</b>	<b>13,894</b>	<b>98,418</b>
<b>At 31 December 2017</b>				
Cost	267,547	67,084	13,894	348,525
Accumulated amortization	(208,861)	(41,246)	-	(250,107)
<b>Net book amount</b>	<b>58,686</b>	<b>25,838</b>	<b>13,894</b>	<b>98,418</b>

Other intangible assets include payments for developing the ATM network supporting systems and the installation, customization, certification and on-line links between Bank's ATM host system and the Bank's system, as well as payments made for SWIFT interface and access fees.

**13. PROPERTY AND EQUIPMENT**

	Computers	Electronic equipment	Office Furniture	Other	Fixed assets in progress	Leasehold improvements	Total
<b>At 1 January 2016</b>							
Cost	206,069	122,932	57,073	3,331	12,724	190,023	592,152
Accumulated depreciation	(158,138)	(77,776)	(37,895)	(1,975)	-	(116,565)	(392,349)
<b>Net book amount</b>	<b>47,931</b>	<b>45,156</b>	<b>19,178</b>	<b>1,356</b>	<b>12,724</b>	<b>73,458</b>	<b>199,803</b>
<b>Year ended December 2016</b>							
Additions	15,565	12,631	8,242	-	(3,971)	28,174	60,641
Disposals	(42,362)	(3,133)	(2,304)	-	-	(4,689)	(52,488)
Adjustments	-	25	59	-	-	-	84
Depreciation charge	(13,772)	(9,975)	(4,458)	(55)	-	(13,181)	(41,441)
Depreciation charge for disposals	39,171	2,645	1,964	-	-	4,123	47,903
Adjustments for depreciation	290	(207)	(167)	-	-	-	(84)
<b>Closing net book amount</b>	<b>46,823</b>	<b>47,142</b>	<b>22,514</b>	<b>1,301</b>	<b>8,753</b>	<b>87,885</b>	<b>214,418</b>
<b>At 31 December 2016</b>							
Cost	179,272	132,455	63,070	3,331	8,753	213,508	600,389
Accumulated depreciation	(132,449)	(85,313)	(40,556)	(2,030)	-	(125,623)	(385,971)
<b>Net book amount</b>	<b>46,823</b>	<b>47,142</b>	<b>22,514</b>	<b>1,301</b>	<b>8,753</b>	<b>87,885</b>	<b>214,418</b>
<b>Year ended December 2016</b>							
Additions	13,659	8,266	5,486	1,112	18,411	12,168	59,102
Disposals	(18,773)	(473)	(278)	-	-	-	(19,524)
Depreciation charge	(12,841)	(9,994)	(5,055)	(248)	-	(13,460)	(41,598)
Depreciation charge for disposals	17,373	262	246	-	-	-	17,881
<b>Closing net book amount</b>	<b>46,241</b>	<b>45,203</b>	<b>22,913</b>	<b>2,165</b>	<b>27,164</b>	<b>86,593</b>	<b>230,279</b>
<b>At 31 December 2017</b>							
Cost	174,158	140,248	68,278	4,443	27,164	225,677	639,968
Accumulated depreciation	(127,917)	(95,045)	(45,365)	(2,278)	-	(139,084)	(409,689)
<b>Net book amount</b>	<b>46,241</b>	<b>45,203</b>	<b>22,913</b>	<b>2,165</b>	<b>27,164</b>	<b>86,593</b>	<b>230,279</b>

Leasehold improvements relate to expenditures made by the Group for the reconstruction of leased premises used for the branches. No pledges or collateral have been placed as at December 31, 2017 (2016: none).

**14. INVESTMENT PROPERTY**

The Group holds investment property as a consequence of the acquisitions through enforcement of security over loans and advances.

Total income from leased investment property in 2017 was LEK 5,213 thousand (2016: LEK 3,168 thousand).

**Measurement of fair value - Fair value hierarchy**

The fair value of investment property was determined by property valuers, having professional qualifications and recent experience in the location and category of the property being valued. The valuers provide the fair value of the Group's investment property portfolio every year.

The fair values of the Group's investment property are categorized into Level 3 of the fair value hierarchy.

**Level 3 fair value**

The following table shows a reconciliation from the beginning balances to the closing balances for the fair value measurements of the Group's investment property.

	2017	2016
<b>Balance at 1 January</b>	<b>372,790</b>	<b>347,944</b>
Transferred from repossessed collaterals (note 15)	51,464	82,082
Acquired during the year	2,863	10,458
Transferred to repossessed collaterals (note 15)	(46,045)	(45,062)
Net changes in fair value (unrealized)	(22,095)	(22,632)
<b>Balance at 31 December</b>	<b>358,977</b>	<b>372,790</b>

**Valuation techniques and significant unobservable inputs**

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

Valuation technique	Significant unobservable inputs
Reference to the current market: The valuation model uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities (e.g. a business)	Market prices were modified to reflect the following: <ul style="list-style-type: none"> <li>• The level of market transactions when the market activity is low or the price for an identical property is difficult to obtain</li> <li>• Specific condition of each property (construction, position etc.)</li> </ul>

**15. OTHER ASSETS**

Other assets are detailed as follows:

	As at 31 December 2017	As at 31 December 2016
Repossessed collaterals	303,319	354,020
Monetary values in transit	96,460	154,218
Vat receivable	64,084	58,775
Clients' receivables	14,430	31,114
Accrued income	13,000	21,183
Prepayments	21,511	12,216
Assets held for sale	648	5,164
Guarantee deposit paid	665	4,208
Consumption Inventory	5,395	3,511
Payment in transit	14,233	-
Other	834	7,687
Sundry debtors	55,832	266,720
<b>Total</b>	<b>590,411</b>	<b>918,816</b>

**15. OTHER ASSETS (CONTINUED)**

Reposessed collaterals are properties acquired through enforcement of security over loans and advances to customers. The Group intends and is taking steps to sell them for the best offer.

The following table shows a reconciliation from the beginning balances to the closing balances for the Bank's reposessed collaterals.

	<b>2017</b>	<b>2016</b>
<b>Balance at 1 January</b>	<b>354,020</b>	<b>403,550</b>
Transferred to investment property (Note 14)	46,045	(82,082)
Acquired during the year	17,018	12,208
Transferred from investment property (Note 14)	(51,464)	45,062
Assets sold during the year	(9,803)	(12,032)
Net write-down of NRV for the year	(52,497)	(12,686)
<b>Balance at 31 December</b>	<b>303,319</b>	<b>354,020</b>

Assets held for sale are properties acquired through enforcement of security over leased assets of the Subsidiary.

The following table shows a reconciliation from the beginning balances to the closing balances for the assets held for sale.

	<b>2017</b>	<b>2016</b>
<b>Balance at 1 January</b>	<b>5,164</b>	<b>4,168</b>
Reposessed during the year	1,519	9,656
Assets sold during the year	(4,354)	(9,995)
Impairment of assets held for sale	(1,681)	1,335
<b>Balance at 31 December</b>	<b>648</b>	<b>5,164</b>

Monetary values in transit represent cash sold with correspondent banks with agreed settlement date in the first days of the subsequent year.



**16. DUE TO CENTRAL BANK**

	As at 31 December 2017	As at 31 December 2016
Treasury bills sold under repurchased agreements	2,372,181	2,167,067
Accrued interest	2,284	1,505
<b>Total</b>	<b>2,374,465</b>	<b>2,168,572</b>

Treasury bills sold under repurchase agreements “Repos” are short term liquidity management instruments issued by the Central Bank to inject liquidity in the banking system. Repos at the end of 2017 bear interest at market rates ranging from 1.34% p.a. to 1.40% p.a. (2016: 1.35% p.a. to 1.40% p.a.) and are denominated in LEK.

**17. DUE TO BANKS AND FINANCIAL INSTITUTIONS**

Amounts due to banks and financial institutions are detailed as follows:

	As at 31 December 2017	As at 31 December 2016
<b>Current accounts</b>		
Resident	849,518	639,400
Non-resident	313,367	343,115
	<b>1,162,885</b>	<b>982,515</b>
<b>Term deposits</b>		
Resident	345,931	232,520
Non-resident	43,015	43,531
	<b>388,946</b>	<b>276,051</b>
<b>Borrowings</b>		
Resident	-	128,170
	<b>-</b>	<b>128,170</b>
<b>Other accounts</b>		
Resident	6,183	1,858
	<b>6,183</b>	<b>1,858</b>
Accrued interest	1,196	1,663
<b>Total</b>	<b>1,559,210</b>	<b>1,390,257</b>

Current accounts from resident financial institutions include LEK 455 million (2016: LEK 377 million) deposited by Unioni Financiar Tirane ('UFT'), out of which LEK 99.7 million (2016: LEK 101 million) represent collateral for loans issued by the Bank to related parties.

Current accounts from non-resident financial institutions include balances deposited from 'Union of Financial Corners' and 'Unioni Financiar Prishtine', both related parties, of LEK 243 million (2016: LEK 207 million).

Term deposits from non-resident financial institutions include annual deposits from 'Union of Financial Corners', a related party, of LEK 43,015 thousand (2016: LEK 43,274 thousand), which are held as collateral for loans issued by the Bank, and bear interest at rates 0.3% p.a. (2016: 0.6% p.a.).

Borrowings on 2016 represented short term borrowings from resident banks in USD, amounting at LEK 128 million with an initial maturity of 7 days and bearing interest from 0.7%p.a. to 0.9% p.a.

**18. DUE TO CUSTOMERS**

Customer accounts for enterprises, private entrepreneurs and individuals consisted of current and deposit accounts as follows:

	As at December 31, 2017	As at December 31, 2016
<b>Government and public administration:</b>		
Local currency	407,927	349,053
Foreign currency	125,814	29,155
	<b>533,741</b>	<b>378,208</b>
<b>Current accounts:</b>		
Local currency	3,073,541	2,525,457
Foreign currency	4,229,753	3,322,654
	<b>7,303,294</b>	<b>5,848,111</b>
<b>Saving accounts:</b>		
Local currency	1,437,361	1,238,776
Foreign currency	4,348,297	3,044,890
	<b>5,785,658</b>	<b>4,283,666</b>
<b>Term deposits:</b>		
Local currency	13,153,953	12,556,932
Foreign currency	10,722,718	9,631,788
	<b>23,876,671</b>	<b>22,188,720</b>
<b>Other customer accounts:</b>		
Local currency	97,621	361,813
Foreign currency	415,239	709,505
	<b>512,860</b>	<b>1,071,318</b>
Prepaid interest on customer deposits	(150)	(138)
Accrued interest	224,749	324,087
<b>Total</b>	<b>38,236,823</b>	<b>34,093,972</b>

Current and saving accounts bear interest in the range of 0.1% p.a. to 0.5% p.a. (2016: 0.1% p.a. to 0.7% p.a.) and term deposits bear interest as follows:

Currency	2017	2016
LEK	0.60% p.a. to 4.60% p.a.	0.20% p.a. to 4.60% p.a.
EUR	0.05% p.a. to 1.50% p.a.	0.05% p.a. to 2.50% p.a.
USD	0.20% p.a. to 1.10% p.a.	0.10% p.a. to 1.20% p.a.
GBP	0.10% p.a. to 0.45% p.a.	0.05% p.a. to 0.50% p.a.

Other customer accounts represent blocked accounts for tender or contract guarantees, other bank guarantees and initial capital blocked by customers in the process of registration of their businesses.

**Union Bank Sh.a**
**Notes to the Consolidated Financial Statements as at and for the year ended 31 December 2017**
*(Amounts in LEK '000 unless otherwise stated)*
**18. DUE TO CUSTOMERS (CONTINUED)**

Customer accounts and deposits could be further analyzed by products as follows:

	31 December 2017			31 December 2016		
	LEK	Foreign currency	Total	LEK	Foreign currency	Total
<b>Government and admin accounts</b>						
On demand	388,927	125,814	514,741	349,053	29,155	378,208
Twelve months	19,000	-	19,000	-	-	-
<b>Total government and admin accounts</b>	<b>407,927</b>	<b>125,814</b>	<b>533,741</b>	<b>349,053</b>	<b>29,155</b>	<b>378,208</b>
<b>Current accounts</b>	<b>3,073,541</b>	<b>4,229,753</b>	<b>7,303,294</b>	<b>2,525,457</b>	<b>3,322,654</b>	<b>5,848,111</b>
<b>Saving accounts</b>	<b>1,437,361</b>	<b>4,348,297</b>	<b>5,785,658</b>	<b>1,238,776</b>	<b>3,044,890</b>	<b>4,283,666</b>
<b>Term deposits:</b>						
Three months	280,615	599,521	880,136	301,746	429,412	731,158
Six months	512,255	550,843	1,063,098	560,672	517,571	1,078,243
Twelve months	4,185,201	4,930,426	9,115,627	3,004,365	3,517,979	6,522,344
Fourteen months	977,722	833,772	1,811,494	1,052,312	741,761	1,794,073
Twenty-five months	1,133,084	688,225	1,821,309	1,445,473	822,632	2,268,105
Thirty-five months	2,400,854	1,404,023	3,804,877	3,114,105	1,516,031	4,630,136
Sixty months	3,544,741	1,653,972	5,198,713	1,820,255	1,016,880	2,837,135
Other deposits	119,481	61,936	181,417	1,258,004	1,069,522	2,327,526
<b>Total deposits</b>	<b>13,153,953</b>	<b>10,722,718</b>	<b>23,876,671</b>	<b>12,556,932</b>	<b>9,631,788</b>	<b>22,188,720</b>
<b>Other customer accounts:</b>						
On demand	7,706	5,318	13,024	39,404	10,954	50,358
Three months	-	-	-	12,736	135	12,871
Twelve months	12,021	41,632	53,653	23,130	49,806	72,936
Other	77,894	368,289	446,183	286,543	648,610	935,153
<b>Total other customer accounts</b>	<b>97,621</b>	<b>415,239</b>	<b>512,860</b>	<b>361,813</b>	<b>709,505</b>	<b>1,071,318</b>
<b>Total</b>	<b>18,170,403</b>	<b>19,841,821</b>	<b>38,012,224</b>	<b>17,032,031</b>	<b>16,737,992</b>	<b>33,770,023</b>

“Other deposits” includes deposits with initial maturities of 10 months, 11 months and 24 months.

"Other" includes accounts of notary offices that are used to perform transactions with Mortgage Office.

**19. OTHER LIABILITIES**

Other liabilities are comprised of the following:

	As at December 31, 2017	As at December 31, 2016
Payments in transit	173,133	176,988
Other payables	29,132	26,238
Invoices to be received	49,779	30,058
Deferred income and accrued expenses	10,644	12,290
Advances from clients	2,404	10,350
Other provisions for risk and expenses	9,461	961
Loans from government	34,100	12,087
<b>Total</b>	<b>308,653</b>	<b>268,972</b>

Payments in transit represent outbound international money transfers with agreed settlement dates in the first days of the subsequent year.

The Group, as part of the “Programme for Development of the Albanian Private Sector” received funds as a loan from Ministry of Economy for the purpose of financing projects of SME’s in Albania. The amount under “Loans from government” represents the outstanding balance of such loans. This loan has an initial maturity of 5 years and bears interest of 0.5% p.a.

**20. SHARE CAPITAL**

At 31 December 2017, the subscribed capital was divided into 2,097,143 shares (2016: 2,097,143 shares) with a nominal value of EUR 10 each.

The movements in the paid up share capital in 2017 and 2016 were as follows:

	31 December 2017		31 December 2016	
	No. of shares	Value of shares	No. of shares	Value of shares
Balance at the beginning of the year	2,097,143	2,717,813	2,097,143	2,717,813
Capital increase	-	-	-	-
<b>Paid-up share capital</b>	<b>2,097,143</b>	<b>2,717,813</b>	<b>2,097,143</b>	<b>2,717,813</b>

The structure of subscribed capital is as follows:

	As at December 31, 2017	As at December 31, 2016
Unioni Financiar Tirane (UFT) Sh.p.k	86.34%	86.34%
European Bank for Reconstruction and Development (EBRD)	10.12%	10.12%
Edmond Leka	1.77%	1.77%
Niko Leka	1.77%	1.77%

Paid-up share capital represents ordinary share capital and has no preferences or restrictions attached thereto.

Based on Shareholders' Decision dated 21 June 2017, the amount of LEK 25,088 thousand from the profit of 2016 was distributed as dividends proportionately to their existed shareholding. The remaining amount of this profit was decided to be retained for investments.

Based on Shareholders' Decision dated 30 June 2016, a legal reserve of LEK 154,173 thousand was created from the profit of 2015. The remaining amount of this profit was decided to be retained for investments.

**21. INTEREST INCOME**

Interest income was earned on the following assets:

	<b>For the year ended December 31, 2017</b>	<b>For the year ended December 31, 2016</b>
Loans and advances to customers	1,343,811	1,288,633
Investment securities	784,497	744,147
Loans and advances to financial institutions	15,336	7,521
Placements and balances with banks	11,994	10,850
<b>Total</b>	<b>2,155,638</b>	<b>2,051,151</b>

Interest income includes LEK 121,427 thousand (2016: LEK 114,512 thousand) interest income recognized on impaired loans and advances to customers.

**22. INTEREST EXPENSE**

Interest expense was incurred on the following liabilities:

	<b>For the year ended December 31, 2017</b>	<b>For the year ended December 31, 2016</b>
Due to customers	308,443	386,210
Due to banks and financial institutions	6,080	10,293
Repurchase agreements	30,605	10,005
Other	94	85
<b>Total</b>	<b>345,222</b>	<b>406,593</b>

**23. FEE AND COMMISSION INCOME**

Fees and commissions received were comprised as follows:

	<b>For the year ended December 31, 2017</b>	<b>For the year ended December 31, 2016</b>
Banking services	209,805	185,083
Lending activity	21,804	14,500
Other	22,620	23,893
<b>Total</b>	<b>254,229</b>	<b>223,476</b>

**24. FEE AND COMMISSION EXPENSES**

Fees and commissions expense were comprised as follows:

	<b>For the year ended December 31, 2017</b>	<b>For the year ended December 31, 2016</b>
Treasury operations	3,165	2,815
Banking services	32,065	18,437
Other	11,685	11,532
<b>Total</b>	<b>46,915</b>	<b>32,784</b>

**25. NET FOREIGN EXCHANGE RESULT**

Net foreign exchange gain includes net gains from trading activities and foreign currency differences arising on open position revaluation at the year end. Net foreign exchange result in 2017, is a gain of LEK 14,008 thousand (2016: loss of LEK 13,192 thousand). The effect of the open position revaluation at the year-end for the paid-up share capital (denominated in Eur) was loss of LEK 51,072 thousand (2016: loss of LEK 45,920 thousand).

**26. PERSONNEL COSTS**

Personnel costs were comprised as follows:

	<b>For the year ended December 31, 2017</b>	<b>For the year ended December 31, 2016</b>
Salaries and other compensations	429,145	397,127
Social insurance	50,060	46,565
<b>Total</b>	<b>479,205</b>	<b>443,692</b>

As at 31 December 2017 the Group had 386 employees (2016: 371).

**27. OTHER OPERATING EXPENSES**

Other operating expenses were comprised as follows:

	<b>For the year ended December 31, 2017</b>	<b>For the year ended December 31, 2016</b>
Rent	215,707	195,970
Other external services	129,877	108,494
Premium insurance of deposits	101,933	88,242
Software maintenance	39,337	36,795
Security services	36,153	31,874
Communication expenses	34,329	36,188
Marketing	32,804	38,342
Utilities energy, water etc.	24,144	22,550
Consulting and Legal fees	15,953	13,289
Office supplies	14,173	17,955
Maintenance and repairs	13,220	15,326
Transportation and business trip expense	9,992	9,563
Insurance	7,358	4,616
Board remuneration	3,974	4,434
Representation	2,235	2,532
Trainings	965	2,012
<b>Total</b>	<b>682,154</b>	<b>628,182</b>

Other external services include expenses made for services related to debit and credit cards offered by MasterCard Europe SA, expenses for customization of cards, expenses made for local taxes, expenses made for personalized printing etc.

**28. INCOME TAX**

	For the year ended December 31, 2017	For the year ended December 31, 2016
Current tax expense	83,678	46,015
Deferred tax income	(10,094)	(4,602)
<b>Total tax expense</b>	<b>73,584</b>	<b>41,413</b>

Income tax in Albania is assessed at the rate of 15% (2016: 15%) of taxable income. The following represents a reconciliation of the accounting profit to the income tax:

	Effective Tax rate	2017	Effective Tax rate	2016
<b>Profit before tax</b>		<b>450,750</b>		<b>245,430</b>
Income tax at 15% (2015: 15%)	15.00%	67,612	15.00%	36,814
Non-deductible expenses	1.37%	6,190	2.04%	5,001
Income exempted from income tax	2%	9,875	2%	4,200
<b>Income tax expense</b>	<b>18.56%</b>	<b>83,677</b>	<b>18.75%</b>	<b>46,015</b>

Deferred tax is calculated based on the enacted tax rate for 2017 of 15%. Deferred tax assets recognized in respect of tax losses are based on the management estimate of future probable taxable profit that will be available against which the losses can be utilized.

The movements in deferred tax assets and liabilities are presented as follows:

	For the year ended December 31, 2017	For the year ended December 31, 2016
Deferred tax asset at the beginning of the year	8,313	5,098
Recognized in profit or loss	9,875	4,602
<b>Deferred tax asset at the end of the year</b>	<b>18,188</b>	<b>9,700</b>
<b>Deferred tax liability at the end of the year</b>	<b>-</b>	<b>-</b>
<b>Net deferred tax asset</b>	<b>18,188</b>	<b>9,700</b>

Deferred tax assets and liabilities are attributable to the following items:

	2017	Recognized in Profit or loss	2016	Recognized in Profit or loss	2015
<b>Deferred tax asset:</b>					
Non-current assets held for sale	9,607	6,300	3,307	1,634	1,673
Investment property	8,581	3,575	5,006	2,569	2,437
Finance lease receivable	1,606	219	1,387	399	988
	<b>19,794</b>	<b>10,094</b>	<b>9,700</b>	<b>4,602</b>	<b>5,098</b>



**28. INCOME TAX (CONTINUED)**

Based on the local accounting law, starting from 1 January 2008 the Group must report in accordance with IFRS. In addition, Law No. 10364, dated 16.12.2010 provides for certain amendments (effective as of 24 January 2011). Based on these amendments, the impairment allowances on loans and advances charged by banks in accordance with IFRS shall be considered as tax deductible expenses, provided that they are certified by the external auditors and are not in excess of the limits determined by the Central Bank.

Income tax is prepaid in monthly installments. Due to application of elimination of double taxation treatment, income tax resulted from transactions with non residents (foreign tax credit) is prepaid to nonresident authorities and is held from nonresidents in monthly installments. The table below shows the total amount due to tax authorities for income tax after taking into consideration the amount of it paid in respective years.

	<b>2017</b>	<b>2016</b>
<b>Income tax (receivable)/payable as at 1 January</b>	<b>(16,437)</b>	<b>46,093</b>
Income tax paid (due as at the end of previous year)	(1,759)	(56,933)
Income tax prepaid	(51,313)	(51,401)
Income tax prepaid to nonresidents (due to elimination of double taxation)	(103)	(211)
Current tax	83,678	46,015
<b>Income tax payable/(receivable) as at 31 December</b>	<b>14,066</b>	<b>(16,437)</b>

**29. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consisted of the following:

	<b>2017</b>	<b>2016</b>
Cash on hand	1,102,623	957,043
Accounts with Central Bank	1,614,870	1,412,198
Financial institutions with maturity of 3 months or less	3,936,731	2,903,503
<b>Total</b>	<b>6,654,224</b>	<b>5,272,744</b>

**30. RELATED PARTIES**

Parties are considered to be related if one of them has the ability to control the other or exercise significant influence over the one making financial and operating decisions.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not the merely to the legal form.

The Group has related party relationships with its shareholders and affiliates, directors and executive officers. The shareholding structure of the Group as at 31 December 2017 and 2016 is presented in Note 19. Unioni Financiar Tirane (UFT) Sh.p.k is the ultimate parent of the Group.

Associated entities (owed directly or indirectly by UFT) include: Union Distribucion Servis Albania Shpk, Media Union Shpk, Union Travel Shpk, Albanian Courier Shpk, United Transport, Union Group Shpk, Uni-Com Sha, Albanian Cargo Service Shpk, Auto Master Sha, United Motors Shpk, S-Systems Sha, Atex Shpk, Auto City Sha, Pluton Investor Shpk, Arch Investor Shpk, Plus Communication, Auto Net Shpk, Qendra Kerkime Monitor, Uni-Cons Shpk, Union Net Shpk, Paylink Sha, Union of Financial Corners sa, Unioni Financiar Prishtine, Expo City shpk, ASL Construc 2 shpk, E-ticketing systems, Union net Kroaci, Prestige Service Shpk, Digit-alb sha, Tirana Real Invest Capital, Niko Leka pf, Kato Vora Albania, Kato Aromatic Albania, Sicily by car- Autoeuropa, Automobile Touring Club, Automaster Service Shpk, Klubi i Automobilit te Shqiperise. In associated entities are also included some entities owned by other Bank's related parties: Inovation ne krijim, Locomotives Shpk, Start Plus, Intergrafika Shpk.

As at each reporting date the Group has the following balances with its related parties:

	2017	2016
<b>Assets:</b>		
Loans and advances to customers:		
Other Shareholders	1,609	1,694
Associated entities	1,417,793	1,343,998
Key management personnel of the entity and their relatives	94,335	96,910
Other Assets:		
Parent company	423	186
Other Shareholders	2	3
Associated entities	100	2,266
Key management personnel of the entity and their relatives	10	19
<b>Liabilities:</b>		
Due to banks and financial institutions:		
Parent company	454,861	376,964
Associated entities	286,170	250,384
Due to customers:		
Other Shareholders	41,638	66,371
Associated entities	534,166	403,939
Key management personnel of the entity and their relatives	196,627	211,340
Other Liabilities:		
Parent company	2,729	203
Other Shareholders	247	203
Associated entities	7,939	8,460
Key management personnel of the entity and their relatives	7	585

Loans to associated entities in the amount of LEK 1,417,793 thousand (2016: LEK 1,343,998 thousand) are covered by cash collateral of LEK 972,513 thousand (2016: LEK 548,491 thousand) and the remaining balance is covered by other collaterals provided by the parent company and associated entities.

**30. RELATED PARTY (CONTINUED)**

<b>Off balance sheet commitments</b>	<b>2017</b>	<b>2016</b>
Un-drawn credit facilities from the Bank:		
Other Shareholders	10,097	10,152
Associated entities	158,411	16,013
Key management personnel of the entity and their relatives	10,715	9,861
Guarantees received:		
Parent company	99,733	101,443
Other Shareholders	47,525	188,716
Associated entities	2,248,960	2,242,865
Key management personnel of the entity and their relatives	205,754	173,718
Guarantees given:		
Parent company	20	20
Associated entities	2,908	10,657
The Group has entered into the following transactions with related parties:		
	<b>2017</b>	<b>2016</b>
Interest income:		
Other Shareholders	161	228
Associated entities	54,438	59,475
Key management personnel of the entity and their relatives	4,295	5,573
Interest expense:		
Parent company	-	-
Other Shareholders	61	93
Associated entities	1,288	2,755
Key management personnel of the entity and their relatives	800	856
Fees and commission income:		
Parent company	2,135	2,522
Other Shareholders	236	254
Associated entities	4,635	4,697
Key management personnel of the entity and their relatives	476	394
Operating income:		
Associated entities	1,079	1,943
Operating expense:		
Parent company	2,412	2,470
Other shareholders	2,086	4,712
Associated entities	5,134	143,889
Key management personnel of the entity and their relatives	150,222	78,366
Sale of Fixed assets:		
Associated entities	-	246
Purchase of Fixed assets:		
Associated entities	6,635	13,128

**31. COMMITMENTS AND CONTINGENCIES**

Commitments and contingencies in the normal course of the business include the following :

	<b>2017</b>	<b>2016</b>
Guarantees given in favor of customers	280,321	236,462
Un-drawn credit facilities	1,016,261	1,028,867
Commitments for LC	22,785	24,209

**Guarantees and commitments**

The Group issues guarantees for its customers. These instruments bear a credit risk similar to that of loans granted. Guarantees received from customers and credit institutions include cash collateral, mortgages pledged in favor of the bank from its borrowers.

Commitments represent the undrawn balances of loans, overdraft and card limits granted to the customers.

**Legal**

The Group was involved in various claims and legal proceedings of a nature considered normal to its business as at 31 December 2017. The level of these claims and legal proceedings corresponds to the level of claims and legal proceedings in previous years. The Group's management is of the opinion that no material losses will be incurred in relation to legal claims.

**Operating lease commitments**

The Group has entered into non-cancelable lease commitments. Such commitments are composed as follows:

	<b>2017</b>	<b>2016</b>
Not later than 1 year	110,547	109,860
<b>Total</b>	<b>110,547</b>	<b>109,860</b>

**32. FINANCIAL RISK MANAGEMENT**

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

The Group's risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up to date information systems.

The most important types of risk are discussed further.

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk**

Credit risk is the risk that the counterparty to a financial instrument will fail to repay the obligation and cause the Group to incur a loss. The Group is subject to credit risk through its lending and investment activities (including financial leasing), and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees in this respect, the credit risk for the Group stems from the possibility that different counterparties might default on their contractual obligations.

Based on the policies approved by the Board of Directors, the Bank Credit Committee is responsible for the management of credit risk. In addition, a separate Bank Credit Department for the Bank, reporting to the Bank Chief Executive Officer; and, Supervisory Board in cooperation with Lease Committee for the Subsidiary, are responsible for management of the Group's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorization structure for the approval and renewal of credit facilities. Credit facilities approvals and renewals require approval by Credit Department or Lease Committee, Head of Credit Department, Bank Credit Committee or the Board of Directors as appropriate.
- Reviewing and assessing credit risk. Bank Credit Department or/and Lease Committee assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances).
- Developing and maintaining the Group's risk grading in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by Bank's Executive Management or Subsidiary Lease Committee.
- Reviewing compliance of business units with agreed exposure limits. Regular reports on the credit quality of local portfolios are provided to Bank Credit Department or to the Subsidiary Lease Committee who may require appropriate corrective action to be taken.
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of credit risk.

Each business unit is required to implement Group credit policies and procedures, with credit approval authorities delegated from the Bank's Credit Department and Credit Committee or Subsidiary Lease Committee. Each business unit has a responsible officer who reports on all credit related matters to local management and the Bank Credit Committee or Subsidiary Lease Committee. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval. In addition, regular audits of business units and Group Credit processes are undertaken by Internal Audit.

Based on the policies approved by the by the Board of Directors, the Bank's Assets and Liabilities Management Committee is responsible for the management of credit risk related to investments. In addition, the Treasury Department, Reporting to the Bank Chief Financial Officer and a separate Bank Risk Department, reporting to the Bank Chief Executive Officer are also responsible for monitoring of the Bank's credit risk related to investments.

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk (continued)***Maximum credit exposure*

Maximum exposure to credit risk before collateral held or other credit enhancements are as follows:

	<b>2017</b>	<b>2016</b>
Treasury Bills held-to-maturity	1,051,668	1,539,380
Bonds held-to-maturity	3,960,261	14,032,927
Placements and balances with banks	246,969	2,926,633
Loans and advances to financial institutions	18,948,934	245,068
Loans and advances to customers	15,732,455	16,608,651
Financial guarantees	145,271	236,462
Standby letters of credit	79,722	24,209
Commitments to extend credit	1,208,406	1,028,867
<b>Maximum exposures to credit risk</b>	<b>41,373,686</b>	<b>36,642,197</b>

Exposure to credit risk is also managed in part by obtaining collateral and guarantees. The principal collateral types are:

- Mortgage over residential properties
- Pledges over business assets and inventories
- Deposits and accounts placed (cash collateral)
- Personal guarantee for the loan

In addition to the term loans and business overdrafts that are secured by the above type of collateral, overdrafts on payroll accounts are extended to individuals as well. No pledges are taken for these advances as the monthly salary offsets the used part of the limit given. Financial guarantees and stand-by letters of credit are cash-collateralized.

*Impaired loans and advances*

Impaired loans and advances are loans and advances for which the Group 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 agreement(s).

*Past due but not impaired loans*

Loans and advances where contractual interest or principal payments are past due but the Group 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 Group.

*Loans with renegotiated terms*

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independently from eventual satisfactory performance after restructuring.

*Allowances for impairment*

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. It consists in the specific loss component that relates to individually significant exposures.

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk (continued)**

Loans and advances are summarized as follows:

**As at 31 December 2017**

	Loans and advances to customers					Loans and advances to financial institutions	Placements and balances with banks
	Retail	Corporate	Advances	Finance Lease	Total Loans		
Neither past due nor impaired	6,319,725	5,643,636	2,371,902	404,686	14,739,949	254,638	3,934,951
Past due but not impaired	1,361,328	931,863	379,771	497,478	3,170,440	-	-
Individually impaired	390,033	1,769,262	437,688	108,536	2,705,519	-	-
<b>Total Gross</b>	<b>6,319,725</b>	<b>5,643,636</b>	<b>2,371,902</b>	<b>404,686</b>	<b>14,739,949</b>	<b>254,638</b>	<b>3,934,951</b>
Less: allowance for individually impaired loans	166,559	805,843	262,256	14,681	1,249,339	-	-
Less: allowance for collectively impaired loans	90,856	219,811	79,312	27,656	417,635	7,669	-
<b>Total Allowance for impairment</b>	<b>257,415</b>	<b>1,025,654</b>	<b>341,568</b>	<b>42,337</b>	<b>1,666,974</b>	<b>7,669</b>	<b>-</b>

**As at 31 December 2016**

	Loans and advances to customers					Loans and advances to financial institutions	Placements and balances with banks
	Retail	Corporate	Advances	Finance Lease	Total Loans		
Neither past due nor impaired	5,146,867	4,864,764	1,908,893	266,134	12,186,658	254,694	2,899,375
Past due but not impaired	1,041,015	1,094,617	411,857	656,665	3,204,154	-	-
Individually impaired	344,375	2,070,742	341,443	36,767	2,793,327	-	-
<b>Total Gross</b>	<b>6,532,257</b>	<b>8,030,123</b>	<b>2,662,193</b>	<b>959,566</b>	<b>18,184,139</b>	<b>254,694</b>	<b>2,899,375</b>
Less: allowance for individually impaired loans	151,549	778,156	237,708	11,161	1,178,574	-	-
Less: allowance for collectively impaired loans	66,223	219,380	85,249	26,062	396,914	9,626	-
<b>Total Allowance for impairment</b>	<b>217,772</b>	<b>997,536</b>	<b>322,957</b>	<b>37,223</b>	<b>1,575,488</b>	<b>9,626</b>	<b>-</b>



**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk (continued)***Loans and advances neither past due nor impaired*

As per Group's internal credit rating, loans and advances that are neither past due nor impaired are classified as below:

Rating						As at 31 December 2017	
	Loans and advances to customers					Loans and advances to financial institutions	Placements and balances with banks
	Retail	Corporate	Advances	Finance Lease	Total Loans		
Good	6,263,040	5,333,804	2,329,534	404,686	14,331,064	254,638	3,934,951
Acceptable	56,685	309,832	42,368		408,885		
Close monitoring	-	-	-	-	-	-	-
Unacceptable	-	-	-	-	-	-	-
<b>Total</b>	<b>6,319,725</b>	<b>5,643,636</b>	<b>2,371,902</b>	<b>404,686</b>	<b>14,739,949</b>	<b>254,638</b>	<b>3,934,951</b>

Rating						As at 31 December 2016	
	Loans and advances to customers					Loans and advances to financial institutions	Placements and balances with banks
	Retail	Corporate	Advances	Finance Lease	Total Loans		
Good	5,105,538	4,594,023	1,856,272	266,134	11,821,967	254,694	2,899,375
Acceptable	41,329	270,741	52,621	-	364,691	-	-
Close monitoring	-	-	-	-	-	-	-
Unacceptable	-	-	-	-	-	-	-
<b>Total</b>	<b>5,146,867</b>	<b>4,864,764</b>	<b>1,908,893</b>	<b>266,134</b>	<b>12,186,658</b>	<b>254,694</b>	<b>2,899,375</b>

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk (continued)***Loans and advances past due but not impaired*

Below is the ageing analysis of loans past due but not individually impaired.

As at 31 December 2017 Time band	Loans and advances to customers				
	Retail	Corporate	Advances	Finance Lease	Total Loans
Past due up to 30 days	1,027,426	433,396	96,539		1,557,361
Past due 31-60 days	218,452	370,438	107,286	218,659	914,835
Past due 61-90 days	114,815	42,110	80,501	81,502	318,928
Past due 91-180 days	-	85,919	93,189	197,317	376,425
Past due over 180 days	635	-	2,256	-	2,891
<b>Total</b>	<b>1,361,328</b>	<b>931,863</b>	<b>379,771</b>	<b>497,478</b>	<b>3,170,440</b>
<b>Estimation of fair value of collateral</b>	<b>3,198,525</b>	<b>3,025,275</b>	<b>645,095</b>	<b>497,478</b>	<b>7,366,373</b>

As at 31 December 2016 Time band	Loans and advances to customers				
	Retail	Corporate	Advances	Finance Lease	Total Loans
Past due up to 30 days	734,030	781,928	43,629	304,653	1,864,240
Past due 31-60 days	166,542	103,123	205,116	103,784	578,565
Past due 61-90 days	140,009	207,432	78,756	245,222	671,419
Past due 91-180 days	434	2,134	82,789	3,006	88,363
Past due over 180 days	-	-	1,567	-	1,567
<b>Total</b>	<b>1,041,015</b>	<b>1,094,617</b>	<b>411,857</b>	<b>656,665</b>	<b>3,204,154</b>
<b>Estimation of fair value of collateral</b>	<b>2,738,247</b>	<b>5,066,677</b>	<b>1,251,860</b>	<b>656,665</b>	<b>9,713,449</b>

Loans and advances past due over 90 days are collateralized by cash amounting to LEK 48,887 thousand (2016: LEK 51,087 thousand).

*Loans and advances individually impaired*

The individually impaired loans and advances before taking into consideration the cash flows from collateral held is LEK 2,705,519 thousand (2016: LEK 2,793,327 thousand).

The breakdown of the gross amount of the individually impaired loans and advances by class, along with the fair value of the collateral held by the Group as security, are as follows:

As at 31 December 2017	Loans and advances to customers				
	Retail	Corporate	Advances	Finance Lease	Total Loans
Individually impaired	390,033	1,769,262	437,688	108,536	2,705,519
Collateral	753,702	4,530,752	139,717	108,536	5,532,707

As at 31 December 2016	Loans and advances to customers				
	Retail	Corporate	Advances	Finance Lease	Total Loans
Individually impaired	344,375	2,070,742	341,443	36,767	2,793,327
Collateral	1,124,473	3,860,833	461,201	36,767	5,483,274

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk (continued)***Loans and advances renegotiated*

Restructuring activities include extended payment agreements, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to normal status and managed together with other similar accounts. The total restructured portfolio during 2017 is LEK 612,386 thousand (2016: LEK 684,980 thousand). The increase in the total restructured portfolio in 2017 is a consequence of the management decision to use loan restructuring for certain borrowers that are facing financial difficulties with negative impact in their cash flows, when the restructuring is deemed to increase the probability that the borrower will be able to repay the credit exposure and the new payment plan is in line with the actual and expected future payment capacity of the borrower.

*Write-off policy*

The Group writes off a loan / security balance (and any related allowances for impairment losses) when Risk Committee determines that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The total amount written off during 2017 is LEK 157,948 thousand (2016: LEK 16,359 thousand).

The Group holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

The collateral structure referring to loans past due but not impaired is similar to the collaterals structure referring to impaired loans presented below.

<b>31 December 2017</b>	<b>Against individually impaired</b>	<b>Against collectively impaired</b>	<b>Total</b>
Property	4,988,883	31,946,146	<b>36,935,029</b>
Pledge	534,827	9,912,678	<b>10,447,505</b>
Cash	8,997	2,057,355	<b>2,066,352</b>
<b>Total</b>	<b>5,532,707</b>	<b>43,916,179</b>	<b>49,448,886</b>

<b>31 December 2016</b>	<b>Against individually impaired</b>	<b>Against collectively impaired</b>	<b>Total</b>
Property	4,484,144	36,508,129	<b>40,992,273</b>
Pledge	979,878	10,250,768	<b>11,230,646</b>
Cash	19,254	1,635,252	<b>1,654,506</b>
<b>Total</b>	<b>5,483,276</b>	<b>48,394,149</b>	<b>53,877,425</b>

The table below shows the breakdown of the carrying amount of loans and advances given to customers and financial institution by ranges of their collateral coverage:

<b>31 December 2017</b>	<b>Over-collateralized portfolio</b>		<b>Under-collateralized portfolio</b>	
	<b>Carrying amount of portfolio</b>	<b>Fair value of collateral</b>	<b>Carrying amount of portfolio</b>	<b>Fair value of collateral</b>
Retail	5,433,467	16,317,940	2,811,904	57,618
Businesses	8,910,699	32,286,751	1,793,115	301,135
Financial institutions	246,865	443,106	104	-
<b>Total</b>	<b>14,591,031</b>	<b>49,047,797</b>	<b>4,605,123</b>	<b>358,753</b>

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(a) Credit risk (continued)**

31 December 2016	Over-collateralized portfolio		Under-collateralized portfolio	
	Carrying amount of portfolio	Fair value of collateral	Carrying amount of portfolio	Fair value of collateral
Retail	5,099,652	18,808,329	1,580,050	149,131
Businesses	8,318,827	33,717,654	1,647,345	745,910
Financial institutions	245,027	456,401	40	-
<b>Total</b>	<b>13,663,506</b>	<b>52,982,384</b>	<b>3,227,435</b>	<b>895,041</b>

**(b) Liquidity risk**

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with financial instruments, and, in general to retain continuity of its core business lines.

For the Bank

On an operational basis, the Bank monitors the performance of its customer deposits, and on that basis adjusts the balance of its current assets' access to funding, in order to maintain a satisfactory payment capability. On a more strategic level, the Bank through its Asset and Liability Committee ("ALCO") manages this risk by continually monitoring expected cash flows from financial instruments and adjusting its investments to match the timing of payments and receipts.

When an operating branch is subject to a liquidity limit imposed, the branch is responsible for managing its overall liquidity within regulatory limit in co-ordination with Bank's Treasury Department. Treasury Department monitors compliance for all operating branches with limits set on daily basis.

All liquidity policies and procedures are subject to annual review and approval by Board and ALCO respectively. Daily reports cover the liquidity position of both the Bank and operating branches.

The Bank relies on deposits from customer and banks, Repos and short term borrowings as its primary source of funding. The short term nature of this source of funding increases the Bank's liquidity risk and the Bank actively manages this risk through maintaining competitive pricing and constant monitoring of market trends.

One of the key measures used by the Bank for managing liquidity risk is the ratio of liquid assets to short term liabilities. This ratio was within the limits set by Central Bank in each and all currencies converted for the period.

To manage the liquidity risk arising from financial liabilities, the Bank holds liquid assets comprising cash and cash equivalents and investment securities for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements.

The monitoring and control function for the Bank's investments are performed by ALCO. Bank's ALCO policy includes sets of daily, weekly and monthly reports to be prepared and analyzed. Daily report, "Liquidity Position Report", controls respectively daily inflows/outflows of liquidity till 1-year maturity, under business usual scenario. Monthly reports include ratio, gap and simulated gap analyses under separate bank specific and market crisis scenarios. Reports are produced for each single currency LEK, USD and EUR and for the total assets and liabilities as well. Specific limits are set and monthly monitored on liquidity and simulated maturity gap result.

For the Subsidiary

The Subsidiary approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking damage to the Subsidiary and Group reputation.

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(b) Liquidity risk (continued)**

One of the key measures used by the Subsidiary for managing liquidity risk is the ratio of liquid assets to short term liabilities.

The Supervisory Board reviews the liquidity situation of the Subsidiary frequently and makes appropriate recommendations.

An analysis of contractual maturities of undiscounted cash flows of financial assets and liabilities is as follows:

	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 to 6 Months</b>	<b>6 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
<b>31December 2017</b>							
<b>Assets</b>							
Cash and balances with Central Bank	5,300,462	-	-	-	-	-	<b>5,300,462</b>
Placements and balances with banks	3,936,812	-	-	-	-	23,449	<b>3,960,261</b>
Treasury Bills held-to-maturity	149,963	199,196	422,735	279,774	-	-	<b>1,051,668</b>
Bonds held-to-maturity	317,873	282,812	961,277	1,893,308	7,996,042	4,281,143	<b>15,732,455</b>
Loans and advances to financial institutions	5,500	12,734	19,433	39,285	170,017	-	<b>246,969</b>
Loans and advances to customers	1,673,250	869,134	1,425,924	3,132,404	7,374,107	4,474,115	<b>18,948,934</b>
Other assets	257,974	899	-	-	-	665	<b>259,538</b>
<b>Total financial assets</b>	<b>11,641,834</b>	<b>1,364,775</b>	<b>2,829,369</b>	<b>5,344,771</b>	<b>15,540,166</b>	<b>8,779,372</b>	<b>45,500,287</b>
<b>Liabilities</b>							
Due to Central Bank	1,091,548	1,287,927	-	-	-	-	<b>2,379,475</b>
Due to banks and Financial institutions	1,192,504	84,062	53,339	168,821	62,224	3,333	<b>1,564,283</b>
Due to customers	15,500,876	2,285,984	2,702,780	8,697,402	9,845,801	10,073	<b>39,042,916</b>
Other liabilities	264,559	780	786	2,723	19,512	9,716	<b>298,076</b>
Income tax payable	-	14,066	-	-	-	-	<b>14,066</b>
<b>Total undiscounted financial liabilities</b>	<b>18,049,487</b>	<b>3,672,819</b>	<b>2,756,905</b>	<b>8,868,946</b>	<b>9,927,537</b>	<b>23,122</b>	<b>43,298,816</b>
Net commitments and Foreign Exchange Spot	101,420	55,549	282,431	849,981	65,309	-	<b>1,354,690</b>
<b>Net financial assets/ undiscounted liabilities</b>	<b>(6,306,233)</b>	<b>(2,252,495)</b>	<b>354,895</b>	<b>(2,674,194)</b>	<b>5,677,938</b>	<b>8,756,250</b>	<b>3,556,161</b>

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(b) Liquidity risk (continued)**

<b>31 December 2016</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 to 6 months</b>	<b>6 to 12 months</b>	<b>1 to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
<b>Assets</b>							
Cash and balances with Central Bank	2,766,708	-	-	-	-	-	<b>2,766,708</b>
Placements and balances with banks	2,903,562	-	-	-	-	23,071	<b>2,926,633</b>
Treasury Bills held-to-maturity	149,964	389,398	465,818	534,200	-	-	<b>1,539,380</b>
Treasury Bonds held-to-maturity	410,159	362,030	363,639	986,985	8,174,858	3,735,256	<b>14,032,927</b>
Loans and advances to financial institutions	3,008	7,423	78,054	22,848	133,735	-	<b>245,068</b>
Loans and advances to customers	1,395,387	764,615	1,275,624	2,995,991	6,752,654	3,424,380	<b>16,608,651</b>
Income tax receivable	16,437	-	-	-	-	-	<b>16,437</b>
Other assets	505,629	34,068	-	-	-	4,208	<b>543,905</b>
<b>Total financial assets</b>	<b>8,150,854</b>	<b>1,557,534</b>	<b>2,183,135</b>	<b>4,540,024</b>	<b>15,061,247</b>	<b>7,186,915</b>	<b>38,679,709</b>
<b>Liabilities</b>							
Due to Central Bank	809,592	1,363,347	-	-	-	-	<b>2,172,939</b>
Due to banks and Financial institutions	1,117,531	25,383	109,528	139,503	-	-	<b>1,391,945</b>
Due to customers	13,296,148	2,135,576	2,841,838	8,820,669	7,587,292	-	<b>34,681,523</b>
Other liabilities	246,353	5,939	582	1,161	9,908	-	<b>263,943</b>
<b>Total undiscounted financial liabilities</b>	<b>15,469,624</b>	<b>3,530,245</b>	<b>2,951,948</b>	<b>8,961,333</b>	<b>7,597,200</b>	<b>-</b>	<b>38,510,350</b>
Net commitments and Foreign Exchange Spot	62,952	37,450	291,241	696,121	32,214	-	<b>1,119,978</b>
<b>Net financial assets/ undiscounted liabilities</b>	<b>(7,255,818)</b>	<b>(1,935,261)</b>	<b>(477,572)</b>	<b>(3,725,188)</b>	<b>7,496,261</b>	<b>7,186,915</b>	<b>1,289,337</b>

**(c) Market risk**

The Group is exposed to the market risk whenever the fair value or future cash flows of a financial instrument fluctuates because of changes in market prices. Market risks arise from open positions in interest rates and currency, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates.

**Currency risk**

The Group is exposed to currency risk through transactions in foreign currencies. Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Group attempts to manage this risk by closing daily open foreign currency positions and by establishing and monitoring limits on open positions. As the currency in which the Group presents its consolidated financial statements is the LEK, the Group's consolidated financial statements are affected by movements in the exchange rates between the LEK and other currencies.

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(c) Market risks (continued)****Currency risk (continued)**

The Group's transactional exposures give rise to foreign currency gains and losses that are recognized in the statement of profit or loss and other comprehensive income. These exposures comprise the monetary assets and liabilities of the Group that are not denominated in the measurement currency of the Group. The applicable exchange rates for the principal currencies are as follows:

	<b>2017</b>	<b>2016</b>
EUR:LEK	132.95	135.23
USD:LEK	111.10	128.17

The analysis of monetary assets and liabilities as at 31 December 2017 and 2016 by the foreign currencies in which they were denominated is shown below:

<b>31 December 2017</b>	<b>LEK</b>	<b>USD</b>	<b>EUR</b>	<b>Other</b>	<b>Total</b>
<b>Assets</b>					
Cash and balances with Central Bank	1,479,173	381,365	3,275,087	164,837	<b>5,300,462</b>
Placements and balances with banks	324,483	263,185	2,972,414	400,179	<b>3,960,261</b>
Treasury Bills held-to-maturity	1,051,668	-	-	-	<b>1,051,668</b>
Bonds held-to-maturity	13,864,000	508,140	1,360,315	-	<b>15,732,455</b>
Loans and advances to financial institutions	-	-	246,969	-	<b>246,969</b>
Loans and advances to customers	4,712,432	160,548	14,075,954	-	<b>18,948,934</b>
Other assets	113,928	98,088	47,365	157	<b>259,538</b>
<b>Total</b>	<b>21,545,684</b>	<b>1,411,326</b>	<b>21,978,104</b>	<b>565,173</b>	<b>45,500,287</b>
<b>Liabilities</b>					
Due to Central Bank	2,374,465	-	-	-	<b>2,374,465</b>
Due to banks and financial institutions	431,916	143,153	966,058	18,083	<b>1,559,210</b>
Due to customers	18,357,287	1,420,756	17,983,170	475,610	<b>38,236,823</b>
Other liabilities	132,612	7,860	150,980	6,557	<b>298,009</b>
Income tax payable	14,066	-	-	-	<b>14,066</b>
<b>Total</b>	<b>21,310,346</b>	<b>1,571,769</b>	<b>19,100,208</b>	<b>500,250</b>	<b>42,482,573</b>
Net commitments and FX Spot	<b>56,738</b>	<b>152,959</b>	<b>10,224</b>	<b>(47,384)</b>	<b>172,537</b>
<b>Net Position</b>	<b>235,338</b>	<b>(7,484)</b>	<b>2,888,120</b>	<b>17,539</b>	<b>3,017,714</b>

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(c) Market risks (continued)****Currency risk (continued)**

<b>31 December 2016</b>	<b>LEK</b>	<b>USD</b>	<b>EUR</b>	<b>Other</b>	<b>Total</b>
<b>Assets</b>					
Cash and balances with Central Bank	1,485,229	304,550	2,731,112	104,526	<b>4,625,417</b>
Placements and balances with banks	103,244	89,101	2,534,942	199,346	<b>2,926,633</b>
Treasury Bills held-to-maturity	1,539,380	-	-	-	<b>1,539,380</b>
Bonds held-to-maturity	12,043,034	465,564	1,524,329	-	<b>14,032,927</b>
Loans and advances to financial institutions	-	-	245,068	-	<b>245,068</b>
Loans and advances to customers	4,142,717	242,122	12,223,812	-	<b>16,608,651</b>
Income tax receivable	16,437	-	-	-	<b>16,437</b>
Other assets	106,475	62,185	281,987	93,258	<b>543,905</b>
<b>Total</b>	<b>19,436,516</b>	<b>1,163,522</b>	<b>19,541,250</b>	<b>397,130</b>	<b>40,538,418</b>
<b>Liabilities</b>					
Due to Central Bank	2,168,572	-	-	-	<b>2,168,572</b>
Due to banks and financial institutions	261,022	211,847	914,641	2,747	<b>1,390,257</b>
Due to customers	17,293,429	1,055,075	15,426,672	318,796	<b>34,093,972</b>
Other liabilities	98,547	9,923	145,544	2,668	<b>256,682</b>
<b>Total</b>	<b>19,821,570</b>	<b>1,276,845</b>	<b>16,486,857</b>	<b>324,211</b>	<b>37,909,483</b>
Net commitments and FX Spot	<b>87,525</b>	<b>25,665</b>	<b>131,405</b>	<b>(57,079)</b>	<b>187,516</b>
<b>Net Position</b>	<b>(297,529)</b>	<b>(87,658)</b>	<b>3,185,798</b>	<b>15,840</b>	<b>2,816,451</b>



**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(c) Market risks (continued)****Interest rate risk**

Interest rate price risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates relative to the interest rate that applies to the financial instrument. Interest rate cash flow risk is the risk that the interest cost will fluctuate over time. The Group attempts to mitigate this risk by maintaining the Repricing Gap fully matched, so that both its assets and liabilities mature and re-price simultaneously. This limits the risk of the Group becoming over-sensitive to interest rate changes.

The Group's interest rate gap as at 31 December 2017 is analyzed below. As at 31 December 2017, majority of the Group's short-term financial assets and liabilities, except for the loan portfolio, carry fixed interest rates.

*i. Interest rate information*

The weighted average interest rate of significant categories of financial assets and liabilities of the Group were as follows:

	Weighted average interest rate							
	LEK		USD		EUR		Other	
	2017	2016	2017	2016	2017	2016	2017	2016
<b>Assets:</b>								
Statutory reserves	0.88%	0.88%	N/A	N/A	-0.40%	N/A	N/A	N/A
Placements and balances with banks	1.28%	1.30%	N/A	N/A	0.20%	0.23%	N/A	N/A
Investment securities	5.12%	5.06%	2.58%	3.60%	4.22%	4.05%	N/A	N/A
Loans to financial institutions	N/A	N/A	N/A	N/A	5.20%	5.35%	N/A	N/A
Loans to customers	8.93%	8.91%	5.49%	5.88%	5.59%	6.19%	N/A	N/A
<b>Liabilities:</b>								
Due to banks	1.58%	1.62%	0.00%	0.74%	0.33%	0.56%	N/A	N/A
Due to customers	1.78%	2.01%	0.65%	0.60%	0.49%	0.67%	0.31%	0.33%
T-Bills under Repos	1.37%	1.38%	N/A	N/A	N/A	N/A	N/A	N/A
Loans from government	N/A	N/A	N/A	N/A	0.50%	0.50%	N/A	N/A

*ii. Interest rate repricing analysis*

The following table presents the interest rate repricing dates for the Group's assets and liabilities. Variable-rate assets have been reported according to their next rate revision date. Fixed-rate assets and liabilities have been reported according to their scheduled principal repayment dates.

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(c) Market risks (continued)****Interest rate risk (continued)**

<b>31 December 2017</b>	<b>Up to 1 month</b>	<b>1-3 Month</b>	<b>3-6 Months</b>	<b>6-12 Months</b>	<b>Over 1 year</b>	<b>Non-interest bearing</b>	<b>Total</b>
<b>Assets</b>							
Cash and balances with Central Bank	3,806,661	-	-	-	-	1,493,801	<b>5,300,462</b>
Placements and balances with banks	3,911,502	-	-	-	-	48,759	<b>3,960,261</b>
Treasury Bills held-to-maturity	149,963	199,196	422,735	279,774	-	-	<b>1,051,668</b>
Bonds held-to-maturity	400,000	300,000	1,378,052	1,626,530	11,812,997	214,876	<b>15,732,455</b>
Loans and advances to financial institutions	7,301	13,263	20,178	40,929	174,633	(9,335)	<b>246,969</b>
Loans and advances to customers	4,282,463	1,749,177	3,160,022	5,073,961	6,438,750	(1,755,439)	<b>18,948,934</b>
Other assets	-	-	-	-	-	259,538	<b>259,538</b>
<b>Total</b>	<b>12,557,890</b>	<b>2,261,636</b>	<b>4,980,987</b>	<b>7,021,194</b>	<b>18,426,380</b>	<b>252,200</b>	<b>45,500,287</b>
<b>Liabilities</b>							
Due to Central Bank	1,088,625	1,283,556	-	-	-	2,284	<b>2,374,465</b>
Due to banks and financial institutions	28,286	83,285	53,280	164,956	60,680	1,168,723	<b>1,559,210</b>
Due to customers	14,507,941	2,188,754	2,717,363	8,569,905	9,156,452	1,096,408	<b>38,236,823</b>
Other liabilities	786	-	1,542	1,195	30,577	263,909	<b>298,009</b>
Income tax payable	-	-	-	-	-	14,066	<b>14,066</b>
<b>Total</b>	<b>15,625,638</b>	<b>3,555,595</b>	<b>2,772,185</b>	<b>8,736,056</b>	<b>9,247,709</b>	<b>2,545,390</b>	<b>42,482,573</b>
<b>Gap</b>	<b>(3,067,748)</b>	<b>(1,293,959)</b>	<b>2,208,802</b>	<b>(1,714,862)</b>	<b>9,178,671</b>	<b>(2,293,190)</b>	<b>3,017,714</b>
<b>Cumulative gap</b>	<b>(3,067,748)</b>	<b>(4,361,707)</b>	<b>(2,152,905)</b>	<b>(3,867,767)</b>	<b>5,310,904</b>	<b>3,017,714</b>	

**32. FINANCIAL RISK MANAGEMENT (CONTINUED)****(c) Market risks (continued)****Interest rate risk (continued)**

<b>31 December 2016</b>	<b>Up to 1 month</b>	<b>1-3 Month</b>	<b>3-6 Months</b>	<b>6-12 Months</b>	<b>Over 1 year</b>	<b>Non-interest bearing</b>	<b>Total</b>
<b>Assets</b>							
Cash and balances with Central Bank	3,510,651	-	-	-	-	1,114,766	<b>4,625,417</b>
Placements and balances with banks	2,876,245	-	-	-	-	50,388	<b>2,926,633</b>
Treasury Bills held-to-maturity	149,964	389,398	465,818	534,200	-	-	<b>1,539,380</b>
Bonds held-to-maturity	3,783,917	432,629	417,755	1,541,429	7,664,858	192,339	<b>14,032,927</b>
Loans and advances to financial institutions	859	-	67,615	42	187,651	(11,099)	<b>245,068</b>
Loans and advances to customers	4,825,732	1,027,198	2,573,096	5,761,146	4,072,890	(1,651,411)	<b>16,608,651</b>
Income tax receivable	-	-	-	-	-	16,437	<b>16,437</b>
Other assets	-	-	-	-	-	543,905	<b>543,905</b>
<b>Total</b>	<b>15,147,368</b>	<b>1,849,225</b>	<b>3,524,284</b>	<b>7,836,817</b>	<b>11,925,399</b>	<b>255,325</b>	<b>40,538,418</b>
<b>Liabilities</b>							
Due to Central Bank	807,754	1,359,313	-	-	-	1,505	<b>2,168,572</b>
Due to banks and financial institutions	134,794	25,007	108,454	138,042	-	983,960	<b>1,390,257</b>
Due to customers	11,913,455	2,098,942	2,803,695	8,584,665	7,082,319	1,610,896	<b>34,093,972</b>
Other liabilities	-	567	567	1,135	9,818	244,595	<b>256,682</b>
<b>Total</b>	<b>12,856,003</b>	<b>3,483,829</b>	<b>2,912,716</b>	<b>8,723,842</b>	<b>7,092,137</b>	<b>2,840,956</b>	<b>37,909,483</b>
<b>Gap</b>	<b>2,291,365</b>	<b>(1,634,604)</b>	<b>611,568</b>	<b>(887,025)</b>	<b>4,833,262</b>	<b>(2,585,631)</b>	<b>2,628,935</b>
<b>Cumulative gap</b>	<b>2,291,365</b>	<b>656,761</b>	<b>1,268,329</b>	<b>381,304</b>	<b>5,214,566</b>	<b>2,628,935</b>	

## **32. FINANCIAL RISK MANAGEMENT (CONTINUED)**

### **(c) Market risks (continued)**

#### *Sensitivity analyses*

The sensitivity analysis below have been determined based on the exposure to interest rates at the reporting date and the stipulated change taking place at the beginning of the financial year and held constant throughout the reporting period. The following is a stipulation of effects of changes in interest rate in the net profit, assuming all the other variables are held constant:

	<b>31 December 2017</b>	<b>31 December 2016</b>
Interest rate increases by 2%	106,218	104,291
Interest rate increases by 1.5%	79,664	78,218
Interest rate increases by 1%	53,109	52,146
Interest rate decreases by 1%	(53,109)	(52,146)
Interest rate decreases by 1.5%	(79,664)	(78,218)
Interest rate decreases by 2%	(106,218)	(104,291)

The sensitivity rate, used when reporting foreign currency risk internally to key management personnel, represents management's assessment of the reasonably possible change in foreign exchange rates based on information available after the balance sheet date. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for the change in exchange rates as described above.

Below is a stipulation of effects of changes in exchange rates in the net profit, assuming that all the other variables are held constant:

	<b>31 December 2017</b>	<b>31 December 2016</b>
LEK depreciates against USD by 5%	(374)	(4,383)
LEK appreciates against USD by 5%	374	4,383
LEK depreciates against EUR by 5%	144,406	159,290
LEK appreciates against EUR by 5%	(144,406)	(159,290)
LEK depreciates against other ccys by 5%	877	792
LEK appreciates against other ccys by 5%	(877)	(792)

### **(d) Operational risk**

The operational risk is incurred on the delivery of all of the Group's products and services and arises on a daily basis as transactions are being processed. It may occur also as a result of inadequate information systems, technology failures, breaks of internal controls, and fraud or unforeseen catastrophes.

To cover for operational risk, the Group has established a framework that incorporates clear definitions of operational risk throughout the organization, and a philosophy of business processes self-assessment. It has also developed, and is actively monitoring, the performance of key risk indicators.

The Bank's Operational Risk Committee (ORC) is periodically monitoring the occurrences of operational losses and has assigned responsibilities for mitigating losses and providing back-up solutions and risk coverage for activities subject to operational risk.

**33. DISCLOSURE AND ESTIMATION OF FAIR VALUE**

Fair value estimates are based on existing financial instruments on the Group's financial position statement without attempting to estimate the value of anticipated future business and the value of assets and liabilities not considered financial instruments.

***Financial instruments not measured at fair value – fair value hierarchy***

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorized.

	As at 31 December 2017			
	Carrying amount	Fair value Level 1	Fair value Level 2	Fair value Level 3
Financial assets				
Placements and balances with banks	3,960,261	-	-	3,960,261
Treasury Bills held-to-maturity	1,051,668	-	1,051,072	-
Loans and advances to fin. institutions	246,969	-	-	246,969
Loans and advances to customers	18,948,934	-	-	18,948,934
Bonds held-to-maturity	15,732,454	1,613,122	14,476,881	-
Financial liabilities				
Due to Central Bank	2,374,465	-	2,374,465	-
Due to banks and financial institutions	1,629,222	-	-	1,685,879
Due to customers	38,236,823	-	-	38,177,190
Due to government	34,100	-	-	34,100

	As at 31 December 2016			
	Carrying amount	Fair value Level 1	Fair value Level 2	Fair value Level 3
Financial assets				
Placements and balances with banks	2,926,633	-	-	2,926,633
Treasury Bills held-to-maturity	1,539,380	-	1,533,905	-
Loans and advances to fin. institutions	245,068	-	-	245,068
Loans and advances to customers	16,608,651	-	-	16,608,651
Bonds held-to-maturity	14,032,927	1,786,707	12,618,555	-
Financial liabilities				
Due to Central Bank	2,168,572	-	2,168,572	-
Due to banks and financial institutions	1,626,273	-	-	1,393,774
Due to customers	38,236,273	-	-	33,720,997
Due to government	12,087	-	-	12,087

### **33. DISCLOSURE AND ESTIMATION OF FAIR VALUE (CONTINUED)**

#### *Treasury Bills held-to-maturity*

Treasury Bills held-to-maturity include treasury bills issued by Government which are bought with the intention to hold till maturity. Since no active market exists for treasury bills, the fair value has been estimated using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

#### *Placements and balances with banks*

Due from other banks include inter-bank placements and items in the course of collection. As loans, advances and overnight deposits are short term and at floating rates, their fair value is considered to equate to their carrying amount.

#### *Loans and advances to customers*

Where available, the fair value of loans and advances is based on observable market transactions. Where observable market transactions are not available, fair value is estimated using valuation models, such as discounted cash flow techniques. Input into the valuation techniques includes expected lifetime credit losses, interest rates and prepayment rates. For collateral-dependent impaired loans, the fair value is measured based on the value of the underlying collateral. To improve the accuracy of the valuation estimate for retail and smaller commercial loans, homogeneous loans are grouped into portfolios with similar characteristics.

The Group's loan portfolio has an estimated fair value approximately equal to its book value due either to their short term nature or to underlying interest rates which approximate market rates. The majority of the loan portfolio is subject to re-pricing within a year.

#### *Bonds held-to-maturity*

Bonds held-to-maturity include treasury bonds issued by Albanian Government in LEK, bonds issued by Albanian and foreign Governments in EUR and Corporate bonds issued in EUR which are bought with the intention to hold till maturity. Quoted prices in active markets were not available for securities issued in LEK. However, there was sufficient information available to measure the fair values of these securities based on observable market inputs. Therefore, whenever the quoted prices exist, the securities are included in the Level 1 of the fair value hierarchy, whereas those securities that observable market inputs were used to determine their fair value were transferred to Level 2 of the fair value hierarchy.

#### *Due to banks, financial institutions and customers*

The fair value of deposits from banks and customers is estimated using discounted cash flow techniques, applying the rates that are offered for deposits of similar maturities and terms. The fair value of deposits payable on demand is the amount payable at the reporting date.

### **34. CAPITAL MANAGEMENT**

#### *Regulatory capital*

The Bank monitors the adequacy of its capital using, among other measures, the rules and ratios established by the Albanian regulator, the Bank of Albania ("BoA"), which ultimately determines the statutory capital required to underpin its business. The regulation "On capital adequacy" is issued pursuant to Law No. 8269 date 23.12.1997 "On the Bank of Albania", and Law No. 8365 date 02.07.1998 "Banking Law of the Republic of Albania".

#### *Capital Adequacy Ratio*

Starting from 1 April 2015, the Capital Adequacy Ratio ("CSR") is the proportion of the regulatory capital to total risk weighted exposures, expressed as a percentage. The minimum required Capital Adequacy Ratio is 12%.

#### *Risk-Weighted Exposures (RWEs)*

#### **34. CAPITAL MANAGEMENT (CONTINUED)**

Risk- weighted exposures are calculated as a sum of the followings:

- (a) risk weighted exposures due to credit and counterparty risk where the balance and off balance sheet exposures are weighted according to standardized approach of the BOA regulation on 'Capital Adequacy Ratio'. According to this method all exposures and possible exposures are grouped on certain exposure categories and within each of them into smaller groups according to risk associated to them.
- (b) capital requirement to cover market risk
- (c) capital requirement to cover operational risk, using the basic indicator approach

Based on amendments to the regulation effective from June 2013, the risk-weighted exposures are adjusted to: (a) add the increase of balances due from/ (to) nonresident banks, net from 31 December 2015 to the reporting date (December 2016: from 31 March 2013 to the reporting date); (b) only for December 2016, deduct 50% of the annual increase in gross loans and advances to resident customers up to the maximum level of 10% increase, when such increase is at least 4% of the balances in the previous year (from February 2017 this is not applicable). The Bank's policy is to maintain a strong capital base so as to sustain future development of the business and to maintain market confidence. The impact of the level of capital on future shareholders' 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 within regulatory and prudential limits and the advantages and security afforded by a sound capital position. The Bank monitors all externally imposed capital requirements throughout the period and anticipates future needs on an ongoing basis. The Group has complied with the minimum capital requirements during 2017 and 2016.

#### **35. EVENTS AFTER THE REPORTING DATE**

There are no other events after the reporting date that would require either adjustments or additional disclosures in the consolidated financial statements.