Banka Kombetare Tregtare Sh.a.

Independent auditor’s report and
Consolidated financial statements
as at and for the year ended 31 December 2018

Contents

Independent Auditor's Report

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To the Shareholders and Board of Directors of Banka Kombetare Tregtare Sh.a

Qualified Opinion

We have audited the consolidated financial statements of Banka Kombetare Tregtare Sh.a (hereafter referred as the "Bank" or the "Group"), which comprise the consolidated statement of financial position as at 31 December 2018, 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, except for the effects of the matter described in the *'Basis for Qualified Opinion'* section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Bank as at 31 December 2018, its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Qualified Opinion

The Bank has treated its share capital issued in United States Dollar (USD) as a monetary item in the consolidated financial statements and recognized the revaluation differences for the year ended 31 December 2018 within the net profits in the consolidated statement of profit or loss and other comprehensive income. This treatment is not in accordance with International Accounting Standard (IAS) 21 "The Effects of Changes in Foreign Exchange Rates" which requires share capital to be treated as a non-monetary item and carried at the exchange rate of the date of the transaction. Had the Bank treated its share capital in accordance with IAS 21 requirements, the share capital as at 31 December 2018 would have been increased by USD 12,817,771, retained earnings would have been decreased by USD 3,883,315 and the net profit would have been decreased by USD 8,934,456 for the year ended 31 December 2018. Nevertheless, this would not have affected the total shareholders' equity.

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 Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Albania, and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

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

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Consolidated 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.

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 Group'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 Group'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 Group 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.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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.

Kledian Kodra, FCCA

Grant Thornton sh.p.k.

Tirana, Albania
20 March 2019

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Banka Kombetare Tregtare Sh.a.

Consolidated statement of financial position as at 31 December 2018

(Amounts in USD)

	Notes	31 December 2018	31 December 2017
Assets			
Cash and balances with Central Bank	7	285,134,696	295,119,649
Placement and balances with banks	8	658,318,886	293,887,630
Investment securities	9	1,486,663,848	1,372,431,232
Loans to banks	10	195,676,165	424,728,134
Loans to customers	11	1,215,625,631	1,172,497,193
Investment in associates	12	1,373,165	1,435,525
Property and equipment	13	41,051,400	38,905,448
Intangible assets	14	3,700,900	3,080,573
Other assets	15	53,424,153	57,251,927
Total assets		**3,940,968,844**	**3,659,337,311**
Liabilities and shareholder's equity			
Liabilities			
Customer deposits	16	3,129,749,851	2,867,899,348
Due to banks and financial institutions	17	323,861,645	343,706,001
Due to third parties	18	3,408,125	4,856,919
Deferred tax liabilities	19	411,719	431,014
Accruals and other liabilities	20	20,126,345	21,054,729
Subordinated debt	21	28,678,547	29,989,497
Total liabilities		**3,506,236,232**	**3,267,937,508**
Shareholder's equity			
Share capital	22	300,000,000	274,350,310
Translation reserve	22	119,742	3,004,286
Fair value reserve	22	24,707,662	4,908,867
Retained earnings	22	109,905,208	109,136,340
Total shareholder's equity		**434,732,612**	**391,399,803**
Total liabilities and shareholder's equity		**3,940,968,844**	**3,659,337,311**

The consolidated statement of financial position is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 83.

The consolidated financial statements were authorised for release by the Board of Directors on 05 February 2019 and signed on its behalf by:

Seyhan Pencabligil
CEO and Board Member

Skender Emini
Head of Finance Group

Consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2018

(Amounts in USD)

	Notes	Year ended 31 December 2018	Year ended 31 December 2017
Interest			
Interest income	23	158,055,738	138,624,420
Interest expense	24	(27,615,353)	(27,282,800)
Net interest margin		**130,440,385**	**111,341,620**
Non-interest income, net			
Fees and commissions, net	25	18,029,753	18,623,051
Foreign exchange revaluation, net	26	(6,798,395)	(10,520,992)
Foreign exchange trading activities income, net		(4,766,793)	324,702
Securities trading gain, net		3,164,176	3,582,910
Other (expense) / income, net	27	(5,688,851)	(3,952,938)
Total non-interest income, net		**3,939,890**	**8,056,733**
Operating expenses			
Personnel expenses	28	(19,731,402)	(18,021,107)
Administrative expenses	29	(31,841,144)	(26,302,101)
Depreciation and amortization	13,14,15	(4,674,689)	(3,855,229)
Total operating expenses		**(56,247,235)**	**(48,178,437)**
Impairment losses on loans to customers	11	(5,837,834)	(1,546,308)
Impairment losses on financial assets, other than loans to customers	30	(1,917,149)	-
Profit before taxes		**70,378,057**	**69,673,608**
Income tax	31	(11,944,968)	(10,797,108)
Net profit for the year		**58,433,089**	**58,876,500**
Foreign currency translation differences		(2,884,544)	4,827,893
Net change in fair value reserves		19,798,795	4,146,365
Other comprehensive income/(expense) for the year, net of income tax		**16,914,251**	**8,974,258**
Total comprehensive income for the year		**75,347,340**	**67,850,758**

The consolidated statement of profit or loss and comprehensive income is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 83.

Consolidated statement of changes in equity for the year ended 2018

(Amounts in USD)

	Share capital	Legal reserve	Translation reserve	Fair value reserve	Retained earnings	Total
Balance as at 1 January 2017	**250,000,000**	**-**	**(1,823,607)**	**762,502**	**98,400,277**	**347,339,172**
Transactions with owners recorded directly in equity						
Contributions by and distributions to owners	-	-	-	-	-	**-**
Increase in share capital	24,350,310	-	-	-	(24,350,310)	**-**
Dividend payment					(30,000,000)	**(30,000,000)**
Appropriation of year 2017 translation difference	-	-	-	-	(1,823,607)	**(1,823,607)**
Adjustment of retained earnings with 2017 year end exchange rate	-	-	-	-	8,033,480	**8,033,480**
Total transactions with owners recorded in equity	*24,350,310*	-	-	-	*(48,140,437)*	***(23,790,127)***
Comprehensive income for the year						
Net profit for the year	-	-	-	-	58,876,500	**58,876,500**
Other comprehensive income, net of income tax						
Net change in fair value reserve	-	-	-	4,146,365	-	**4,146,365**
Foreign currency translation differences	-	-	4,827,893	-	-	**4,827,893**
Total other comprehensive income	-	-	4,827,893	4,146,365	-	**8,974,258**
Total comprehensive income for the year	-	-	*4,827,893*	*4,146,365*	*58,876,500*	**67,850,758**
Balance as at 31 December 2017	**274,350,310**	**-**	**3,004,286**	**4,908,867**	**109,136,340**	**391,399,803**

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 83.

Consolidated statement of changes in equity for the year ended 2018

(Amounts in USD)

	Share capital	Legal reserve	Translation reserve	Fair value reserve	Retained earnings	Total
Balance as at 31 December 2017	**274,350,310**	**-**	**3,004,286**	**4,908,867**	**109,136,340**	**391,399,803**
Changes on initial application of IFRS 9 (note 3, (u))					**(6,137,861)**	**(6,137,861)**
Restated balance as at 1 January 2018	**274,350,310**	**-**	**3,004,286**	**4,908,867**	**102,998,479**	**385,261,942**
Transactions with owners recorded directly in equity						
Contributions by and distributions to owners						
Creation of legal reserves	-	15,911,492	-	-	(15,911,492)	**-**
Increase in share capital	25,649,690	(15,911,492)	-	-	(9,738,198)	**-**
Dividend payment					(30,000,000)	**(30,000,000)**
Appropriation of year 2017 translation difference	-	-	-	-	3,004,286	**3,004,286**
Adjustment of retained earnings with December 2018 year end exchange rate	-	-	-	-	1,119,044	**1,119,044**
Total transactions with owners recorded in equity	*25,649,690*	-	-	-	*(51,526,360)*	***(25,876,670)***
Comprehensive income for the year						
Net profit for the year	-	-	-	-	58,433,089	**58,433,089**
Other comprehensive income, net of income tax						
Net change in fair value reserve	-	-	-	19,798,795	-	**19,798,795**
Foreign currency translation differences	-	-	(2,884,544)	-	-	**(2,884,544)**
Total other comprehensive income	-	-	(2,884,544)	19,798,795	-	**16,914,251**
Total comprehensive income for the year	-	-	*(2,884,544)*	*19,798,795*	*58,433,089*	**75,347,340**
Balance as at 31 December 2018	**300,000,000**	**-**	**119,742**	**24,707,662**	**109,905,208**	**434,732,612**

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 83.

Banka Kombetare Tregtare Sh.a.

Consolidated statement of cash flows for the year ended 31 December 2018

(Amounts in USD)

	Notes	Year ended 31 December 2018	Year ended 31 December 2017
Cash flows from operating activities:			
Profit before taxes		70,378,057	69,673,608
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Interest expense	24	27,615,353	27,282,800
Interest income	23	(158,055,738)	(138,624,420)
Depreciation and amortization	13,14,15	4,674,689	3,855,229
Gain on sale of property and equipment		(35,200)	(14,556)
Gain on sale of investment securities		(3,164,176)	(3,582,910)
Gain on sale of non-current assets		(184,498)	(129,457)
Gain on recovery of written-off loans to customers		(759,007)	(525,277)
Write-off of property and equipment		10,296	21,265
Write-off of loans to customers		11,556,066	6,296,710
Write off of fixed assets and repossessed assets		94,893	5,600
Provision on other debtors		4,627,031	3,951,143
Reversal of other debtors		(222,215)	(66,935)
Movement in the fair value reserve		17,165,816	3,758,882
Impairment of loans to customers	11	5,837,834	1,546,308
Impairment of financial instruments, other than loans	30	1,917,149	-
Cash flows from operating profits before changes in operating assets and liabilities		(18,543,650)	(26,552,010)
(Increase)/decrease in operating assets:			
Restricted balances with central banks		20,442,632	(47,780,318)
Placements and balances with banks		53,702,243	31,406,849
Loans to banks		211,015,067	(13,580,109)
Loans to customers		(23,973,389)	(17,158,600)
Other assets		(1,197,056)	(18,086,100)
		259,989,497	(65,198,278)
Increase/(decrease) in operating liabilities:			
Customer deposits		152,969,982	149,601,436
Due to third parties		(1,394,747)	(497,623)
Accruals and other liabilities		(1,938,607)	8,423,045
		149,636,628	157,526,858
Dividend payment		**(30,000,000)**	**(30,000,000)**
Interest paid		(28,038,392)	(28,484,877)
Interest received		156,503,998	135,607,458
Income taxes paid		(11,376,948)	(11,856,656)
Net cash flows from operating activities		**478,171,133**	**131,042,495**
Cash flows from investing activities			
Purchases of investment securities		(304,069,823)	(347,469,818)
Investment in associates		92,628	22,967
Purchases of property and equipment		(6,044,377)	(20,857,680)
Proceeds from sale of property and equipment		93,782	11,619
Proceeds from sale of investment securities		245,447,727	337,979,653
Net cash flows used in investing activities		**(64,480,063)**	**(30,313,259)**
Cash flows from financing activities			
Proceeds from short term borrowings	17	(26,493,022)	22,484,540
Subordinated debt		(1,930,400)	(478,630)
Net cash from financing activities		**(28,423,422)**	**22,005,910**
Net change in cash and cash equivalents		**385,267,648**	**122,735,146**
Effects of exchange rate changes on the balance of cash held in foreign currencies / (Translation difference)		(10,443,402)	(5,821,523)
Cash and cash equivalents at the beginning of the year	7	**335,441,946**	**218,528,323**
Cash and cash equivalents at the end of the period	7	**710,266,192**	**335,441,946**

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 83.

1. General

Banka Kombetare Tregtare Sh.a. is a commercial bank offering a wide range of universal services. The consolidated financial statements comprise the bank in Albania and in Kosovo and its associate Albania Leasing (together referred to as the "Bank" "BKT" or the "Group).

The Bank provides banking services to state and privately owned enterprises and to individuals. The main sources of funding for the Bank are deposits, which are accepted in various forms including current accounts, demand and term deposits, in both Lek and foreign currency. BKT offers a variety of corporate and consumer loans, Europay / MasterCard / Visa ("EMV") – compliant debit and credit cards, ATMs, internet banking, mobile banking, on-line banking facilities, qualified international banking services and various treasury products. It also invests in securities and takes part actively in the local and international inter-bank markets.

BKT was established in its present legal form on 30 December 1992, although its first branch was opened on 30 November 1925.

BKT is subject to Law no. 8269 "On the Bank of Albania" dated December 1997 and Law no. 9662 "On Banks on the Republic of Albania", dated 18 December 2006.

Upon the Shareholder's Decision dated 13 August 2018, the Bank increased its paid-up capital by Lek 2,828,905 thousand (equivalent of USD 25,649,690.3) and distributed Lek 3,308,700 thousand (equivalent of USD 30,000,000) as dividends, using the legal reserves of Lek 1,754,879 thousand (equivalent of USD 15,911,491.92) and part of the retained earnings of Lek 1,074,026 thousand (equivalent of USD 9,738,198.38). The capital increase was translated into USD using the exchange rate published by Bank of Albania as at 13 August 2018 (110.29 Lek per USD).

Following this increase, the shareholding structure remained the same as did the nominal value of shares at USD 12.35, while the number of shares increased by 2,076,898. The shareholding structure as at 31 December 2018 and 31 December 2017 was as follows:

	31 December 2018			***31 December 2017***		
	No. of shares	**Total in USD**	**%**	**No. of shares**	**Total in USD**	**%**
Calik Finansal Hizmetler A.S.	24,291,498	300,000,000.3	100	22,214,600	274,350,310	100

The headquarters of BKT is located in Tirana. The network of the Bank in Albania includes 65 branches and 2 custom agencies. Twenty-six branches are located in Tirana, and the other branches are located in Durres, Elbasan, Vlora, Shkodra, Fier, Pogradec, Korca, Bilisht, Gjirokastra, Delvina, Saranda, Orikum, Berat, Kucova, Lushnja, Librazhd, Peqin, Rrogozhina, Shkozet, Kavaja, Vora, Kamza, Fushe Kruja, Lac, Lezha, Rreshen, Kukes, Peshkopi, Bushat, Koplik, Gramsh and Skrapar, followed by custom agencies in Durrës Seaport and Rinas Airport.

The network in Kosovo includes 26 units. Seven units are located in Prishtina, and the other units are located in Prizren, Peja, Gjilan, Ferizaj, Mitrovica, Gjakova, Vushtrri, Fushe Kosova, Podujeva, Drenas, Rahovec, Viti and Lipjan, Dheu i Bardhe, Prishtina Airport and Skenderaj.

The Bank had 1,292 (31 December 2017: 1,292) employees as at 31 December 2018, out of which 358 (31 December 2017: 348) employees belong to BKT Kosovo.

2. Basis of preparation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs).

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for trading and available-for-sale financial assets, which are measured at fair value.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

(c) Functional and presentation currency

These consolidated financial statements are presented in USD. Albanian Lek ("Lek") is the Bank's functional currency.

The Bank has chosen to present its financial statements in USD, as its equity is wholly owned by international investors, who have issued the start-up capital in USD and view the performance of the investment in terms of USD.

(d) Use of estimates and judgements

The preparation of consolidated financial statements 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 estimate is revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described in notes 4 and 5.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Bank entities.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has power over the investee; is exposed, or has rights, to variable returns from its involvement with the investee; and has the ability to use its power to affect its returns. The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Bank gains control until the date when the Bank ceases to control the subsidiary.

3. Significant accounting policies (continued)

(a) Basis of consolidation (continued)

(i) Subsidiaries (continued)

The consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances.

On 3 September 2007 BKT opened its first branch outside of the territory of the Republic of Albania. The Administrative Office of this branch was opened in Prishtina, Kosovo. Pursuant to the request of "Banka Kombetare Tregtare" Kosovo dated 14.02.2018, in reference to the change of the transformation from a *branch* to a *subsidiary,* the Central Bank of Kosovo has approved on 30 April 2018 the transformation into subsidiary of Banka Kombetare Tregtare – Kosovo Branch. Under this decision, all the rights and obligations deriving from BKT – Kosovo Branch shall remain rights and obligations of BKT Kosovo Sh.A as a subsidiary. The Spin Off date of BKT Kosovo is effective as at 1 January 2019. The functional currency is the EURO. The effect of translating foreign operations into the Bank's functional currency is explained in note 3.(b).(ii) below.

(ii) Transactions eliminated on consolidation

All intragroup assets and liabilities, equity, income, expenses and cash flows (except for foreign currency transaction gains or losses) relating to transactions between members of the Group are eliminated in full on consolidation. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(iii) Business combinations

The Group applies the acquisition method in accounting for business combinations. The consideration transferred by the Group to obtain control of a subsidiary is calculated as the sum of the acquisition-date fair values of assets transferred, liabilities incurred and the equity interests issued by the Group, which includes the fair value of any asset or liability arising from a contingent consideration arrangement. Acquisition costs are expensed as incurred. Assets acquired and liabilities assumed are generally measured at their acquisition-date fair values.

(b) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currency of the operation at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency 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 period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss.

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historic cost, are translated at the foreign exchange rate ruling at the date of the transaction, with the exception of the share capital, which is issued and maintained in USD as per the legislation in Albania as well as per Special Law No. 8634, dated 6 July 2000, between the Bank's shareholders and the Republic of Albania on the Bank's privatisation.

Furthermore, the Operating Policy Guidelines of the Bank require that the share capital be hedged by USD assets, and it is therefore treated as a monetary item, with the revaluation difference being taken to profit or loss together with the revaluation difference of the corresponding USD asset, which offset each other in a natural hedge.

3. Significant accounting policies (continued)

(b) Foreign currency (continued)

(ii) Foreign operations

The assets and liabilities of foreign operations are translated into Lek at spot exchange rates at the reporting date. The income and expenses of foreign operations are translated into Lek at spot exchange rates at the dates of the transactions. Foreign currency differences on the translation of foreign operations are recognised directly in other comprehensive income. Such differences have been recognised in the foreign currency translation reserve.

(iii) Translation of financial statements from functional currency to presentation currency

Translation of financial statements from functional currency to presentation currency is done as follows:

- assets and liabilities for reporting date (including comparatives) are translated at the closing rate at the date of that reporting date, which is Bank of Albania’s rate at 1 USD = 107.82 Lek (2017: 111.10).
- income and expenses (including comparatives) are translated at exchange rates at the dates of the transactions.
- equity items other than the net profit for the period and share capital, are translated at exchange rates at the dates of the transactions.
- share capital has been translated as described in paragraph 3.(b).(i) above; and
- all resulting exchange differences are recognised through other comprehensive income as a separate component of equity in the “Translation reserve” account.

(iv) Spot foreign exchange transactions

The Bank during the normal course of business enters into spot foreign exchange transactions with settlement dates 1 or 2 days after the trade date. These transactions are recorded in the financial statements on the settlement date. Foreign currency differences are recognised in profit or loss on the settlement date.

(c) Interest

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

The calculation of the effective interest rate includes all fees 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.

(d) Fees and commission

Fees and commission income and expenses 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 fees and commission income are recognised as the related services are performed. Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

(e) Lease payments made

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.

(f) Income tax expense

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income. Current tax is the expected tax payable on the taxable income 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)

(f) Income tax expense (continued)

The Bank determines taxation at the end of the year in accordance with the Albanian tax legislation. In 2018, tax on profit is equal to 15% of the taxable income. Taxable income is calculated by adjusting the statutory profit before taxes for certain income and expenditure items as required under the Albanian law. The statutory profit is based on the financial records kept by the Bank for regulatory purposes and may differ from the International Financial Reporting Standards reported financial result. However, current income tax payable for the 2018 financial year is equal according to both standards.

Deferred tax is provided for 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 the following temporary differences: the initial recognition of goodwill, 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, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

In determining the amount of current and deferred tax the Bank takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Bank believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Bank to change its judgment 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.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset 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. Additional income taxes that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

(g) Financial assets and liabilities

(i) Recognition

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the financial instrument.

The Bank initially recognises loans, deposits, debt securities issued and subordinated liabilities on the date at which they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase or sell the asset, with the exception of spot foreign exchange transactions which are recognized on settlement date (see note 3(b) (iv)). All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

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

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(ii) Derecognition

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred.

A financial liability is derecognised when it is extinguished, discharged, cancelled or expires.

The Bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received. The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

The Bank 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 from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if it does not retain control over the asset. The rights and obligations retained in the transfer are recognised separately as assets and liabilities as appropriate. In transfers in which control over the asset is retained, the Bank 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.

In certain transactions the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised in its entirety if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract, depending on whether the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

The Bank writes off certain loans and investment securities when they are determined to be uncollectible.

(iii) Classification and initial measurement of financial assets

All financial assets are initially measured at fair value adjusted for transaction costs (where applicable). Financial assets, other than those designated and effective as hedging instruments, are classified into the following categories:

- amortised cost
- fair value through profit or loss (FVTPL)
- fair value through other comprehensive income (FVOCI).

The classification is determined by both:

- the entity's business model for managing the financial asset
- the contractual cash flow characteristics of the financial asset.

All income and expenses relating to financial assets are recognised in profit or loss.

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(iii) Classification and initial measurement of financial assets (continued)

– ***Assessment of whether contractual cash flows are solely payments of principal and interest (SPPI)***
As per the new standard, one of the conditions for financial assets to be classified either under 'amortised cost' or 'Fair Value Through Profit or Loss ("FVTPL") category is that the contractual terms of the financial asset should give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. The Bank has performed the SPPI test and has determined the business models for its financial assets.

– ***Business model assessment***
There are three business models under IFRS 9 – 'Held to Collect ("HTC")', 'Held to Collect and Sell ("HTCS")' and 'Other ("Other BM")'.

1. Under the HTC model, cash flows result from collecting contractual payments. If an SPPI product is HTC, it is measured at amortised cost.
2. Under HTCS, cash flows result from contractual payments, as well as from selling the financial assets. If an SPPI product is HTCS, it is measured at fair value though other comprehensive income ("FVOCI").
3. Other BM are those that are neither HTC, nor HTCS. One example could be a model under which trading is the primary purpose with contractual payment collection not constituting an integral part of the model. If a product (SPPI or not) is held under Other BM, it is measured at fair value though profit or loss ("FVTPL").

The Bank has assessed the business model for its financial assets as follows;

Treasury
Treasury assets consist of cash or equivalents, Government Bonds, Investment securities such as Eurobonds, Bonds and Certificates.
The Bank also considers Loans to banks such as Syndicated Loans, Bilateral Loans and Murabaha as treasury products.
Investment securities are accounted for depending on their classification as either Held-to-Maturity ("HTM"), or Available-for-Sale ("AFS") and in some cases as Held-for-Trading ("TRD").

The business model of the Bank under IFRS 9 is:
- "HTC" for HTM products. Such products shall be measured at amortised cost;
- "HTCS" for AFS products. Such products shall be measured at FVOCI; and
- "Other BM" for TRD products and shall be measured at FVTPL.

Retail
The Retail assets consist of various financing facilities to individuals (e.g. Mortgage loans, Consumer loans, Home improvement loans, Car loans, Credit cards). These products are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are held for collection of contractual cash flows of principal and interest.
The fair value of the Retail assets is not a critical aspect in the Bank's management of the portfolio.

The business model of the Banks under IFRS 9 is "HTC" and the Retail loans shall be measured at amortised cost.

Corporate
The Corporate assets consist of various financing facilities to corporates (e.g. Cash loans, Non-cash loans, Agro loans, Project & structured finance, Business credit cards). These products are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are held for collection of contractual cash flows of principal and interest.
The fair value of the Corporate assets is not a critical aspect in the Bank's management of the portfolio.
The business model of the Banks under IFRS 9 is "HTC" and the corporate loans shall be measured at amortised cost.

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(iv) Classification - (comparative periods)

Financial assets are classified into the following specified categories: financial assets ‘held for trading, ‘held-to-maturity' investments, ‘available-for-sale' (AFS) financial assets and ‘loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

(v) Subsequent measurement of financial assets

Financial assets at amortised cost

Financial assets are measured at amortised cost if the assets meet the following conditions (and are not designated as FVTPL):

- they are held within a business model whose objective is to hold the financial assets and collect its contractual cash flows
- the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding

After initial recognition, these are measured at amortised cost using the effective interest method.

Discounting is omitted where the effect of discounting is immaterial. The Group’s cash and cash equivalents, loans and most of other receivables fall into this category of financial instruments as well as government bonds and forfeiting instruments that were previously classified as held-to-maturity under IAS 39.

Financial assets at fair value through profit or loss (FVTPL)

Financial assets that are held within a different business model other than ‘hold to collect’ or ‘hold to collect and sell’ are categorised at fair value through profit and loss. Further, irrespective of business model financial assets whose contractual cash flows are not solely payments of principal and interest are accounted for at FVTPL. All derivative financial instruments fall into this category, except for those designated and effective as hedging instruments, for which the hedge accounting requirements apply (see below). The category also contains an equity investment. The Group accounts for the investment at FVTPL and did not make the irrevocable election to account for the investment in Albania Leasing Sh.a and equity securities at fair value through other comprehensive income (FVOCI). The equity investment in Albania Leasing Sh.a. and certain equity securities were measured at cost less any impairment charges in the comparative period under IAS 39, as it was determined that their fair value could not be estimated reliably. In the current financial year, the fair value was determined in line with the requirements of IFRS 9, which does not allow for measurement at cost. Assets in this category are measured at fair value with gains or losses recognised in profit or loss. The fair values of financial assets in this category are determined by reference to active market transactions or using a valuation technique where no active market exists. The Bank determined that in the current period the Fair Value of these investments approximates to their carrying amount. The Group’s government bonds that were previously classified as held-for-trading under IAS 39 fall into this category.

Financial assets at fair value through other comprehensive income (FVOCI)

The Group accounts for financial assets at FVOCI if the assets meet the following conditions:

- they are held under a business model whose objective it is “hold to collect” the associated cash flows and sell and
- the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Any gains or losses recognised in other comprehensive income (OCI) will be recycled upon derecognition of the asset. The Group’s government bonds and treasury bills, corporate bonds, promissory notes, assets backed securities and equity portfolio that were previously classified as available for sale under IAS 39 fall into this category.

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(vi) Offsetting

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the amounts and intends either to settle 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 by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(vii) 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.

(viii) 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.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). In many cases the transaction price equals the fair value (that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold). When determining whether fair value at initial recognition equals the transaction price, the Bank takes into account factors specific to the transaction and to the asset or liability.
When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss depending on the individual facts and circumstances of the transaction but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(ix) Impairment of financial assets

IFRS 9's impairment requirements use more forward-looking information to recognise expected credit losses – the 'expected credit loss (ECL) model'. This replaces IAS 39's 'incurred loss model'.

Instruments within the scope of the new requirements included loans and other debt-type financial assets measured at amortised cost and FVOCI, trade receivables, contract assets recognised and measured under IFRS 15 and loan commitments and some financial guarantee contracts (for the issuer) that are not measured at fair value through profit or loss.

Recognition of credit losses is no longer dependent on the Group first identifying a credit loss event. Instead the Group considers a broader range of information when assessing credit risk and measuring expected credit losses, including past events, current conditions, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the instrument.

In applying this forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk ('Stage 1') and
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low ('Stage 2').

'Stage 3' would cover financial assets that have objective evidence of impairment at the reporting date.

'12-month expected credit losses' are recognised for the first category while 'lifetime expected credit losses' are recognised for the second category.

Measurement of the expected credit losses is determined by a probability-weighted estimate of credit losses over the expected life of the financial instrument.

(x) Impairment of financial assets (comparative period)

In the prior year, the impairment of financial assets was based on the incurred loss model. The Bank assessed whether there was objective evidence that financial assets not carried at fair value through profit or loss were impaired. Financial assets were impaired when objective evidence demonstrated that a loss event had occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that could be estimated reliably.

The Bank considered evidence of impairment for loans and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and held-to-maturity investment securities were assessed for specific impairment. All individually significant loans and held-to-maturity investment securities found not to be specifically impaired were then collectively assessed for any impairment that has been incurred but not yet identified.

Loans and advances and held-to-maturity investment securities that were not individually significant were collectively assessed for impairment by grouping together loans and held-to-maturity investment securities with similar risk characteristics.

Impairment losses on assets carried at amortised cost were measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Losses were recognised in profit or loss and reflected in an allowance account against loans. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities were recognised by transferring the cumulative loss that had been recognised directly in other comprehensive income to profit or loss. The cumulative loss that was reclassified from other comprehensive income to profit or loss was the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value were reflected as a component of interest income. If, in a subsequent period, the fair value of an impaired available-for-sale debt security increased and the increase could be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss was reversed, with the amount of the reversal recognised in profit or loss.

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(xi) Classification and measurement of financial liabilities

As the accounting for financial liabilities remains largely the same under IFRS 9 compared to IAS 39, the Group's financial liabilities were not impacted by the adoption of IFRS 9. The Group's financial liabilities include Customer deposits borrowings from banks and other financial institutions, subordinated debt and other payables.

Financial liabilities are initially measured at fair value, and, where applicable, adjusted for transaction costs unless the Group designated a financial liability at fair value through profit or loss.

Subsequently, financial liabilities are measured at amortised cost using the effective interest method except for derivatives and financial liabilities designated at FVTPL, which are carried subsequently at fair value with gains or losses recognised in profit or loss (other than derivative financial instruments that are designated and effective as hedging instruments). All interest-related charges and, if applicable, changes in an instrument's fair value that are reported in profit or loss are included within finance costs or finance income.

(xii) Derivative financial instruments and hedge accounting

The Group applies the new hedge accounting requirements in IFRS 9 prospectively.

Derivative financial instruments are accounted for at fair value through profit and loss (FVTPL) except for derivatives designated as hedging instruments in cash flow hedge relationships, which require a specific accounting treatment. To qualify for hedge accounting, the hedging relationship must meet all of the following requirements:

- there is an economic relationship between the hedged item and the hedging instrument
- the effect of credit risk does not dominate the value changes that result from that economic relationship
- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item.

All derivative financial instruments used for hedge accounting are recognised initially at fair value and reported subsequently at fair value in the statement of financial position. To the extent that the hedge is effective, changes in the fair value of derivatives designated as hedging instruments in cash flow hedges are recognised in other comprehensive income and included within the cash flow hedge reserve in equity. Any ineffectiveness in the hedge relationship is recognised immediately in profit or loss.

At the time the hedged item affects profit or loss, any gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss and presented as a reclassification adjustment within other comprehensive income. However, if a non-financial asset or liability is recognised as a result of the hedged transaction, the gains and losses previously recognised in other comprehensive income are included in the initial measurement of the hedged item. If a forecast transaction is no longer expected to occur, any related gain or loss recognised in other comprehensive income is transferred immediately to profit or loss. If the hedging relationship ceases to meet the effectiveness conditions, hedge accounting is discontinued and the related gain or loss is held in the equity reserve until the forecast transaction occurs.

3. Significant accounting policies (continued)

(h) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(i) Derivatives held for risk management purposes

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position.

(j) Loans

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

When the Bank 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 Bank's financial statements.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except when the Bank chooses to carry the loans at fair value through profit or loss as described in accounting policy 3(g),(iii).

(k) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.
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.

(ii) Subsequent costs

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

(iii) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

- Buildings and leasehold improvements 20 years
- Motor vehicles and other equipment 5 years
- Office equipment 5 years
- Computers and electronic equipment 4 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

3. Significant accounting policies (continued)

(l) Intangible assets

Intangible assets comprise software acquired by the Bank. Software acquired by the Bank is stated at cost less accumulated amortisation and accumulated impairment losses.

Expenditure on internally developed software is recognised as an asset when the Bank is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and impairment.

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 on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimated useful life of software is four years.

(m) Assets acquired through legal process (repossessed collateral)

Repossessed collateral represents financial and non-financial assets acquired by the Group in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, other financial assets, investment properties or inventories within other assets depending on their nature and the Group's intention in respect of recovery of these assets, and are subsequently remeasured and accounted for in accordance with the accounting policies for these categories of assets. The Group applies its accounting policy for non-current assets held for sale or disposal groups to repossessed collateral where the relevant conditions for such classification are met at the end of the reporting period.

Where repossessed collateral results in acquiring control over a business, the business combination is accounted for using the purchase method of accounting with fair value of the settled loan representing the cost of acquisition (refer to the accounting policy for consolidation). Accounting policy for associates is applied to repossessed shares where the Group obtains significant influence, but not control. The cost of the associate is the fair value of the loan settled by repossessing the pledged shares.

(n) Impairment of non-financial assets

The carrying amounts of the Bank'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 or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit 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 recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. 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 amortization, if no impairment loss had been recognized.

3. Significant accounting policies (continued)

(p) Investments in associates and joint ventures

Investments in associates and joint ventures are accounted for using the equity method. The carrying amount of the investment in associates and joint ventures is increased or decreased to recognise the Group's share of the profit or loss and other comprehensive income of the associate and joint venture, adjusted where necessary to ensure consistency with the accounting policies of the Group. Unrealised gains and losses on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in those entities. Where unrealised losses are eliminated, the underlying asset is also tested for impairment.

(q) Deposits, borrowings and subordinated liabilities

Deposits, borrowings and subordinated liabilities are part of the Bank's sources of debt funding.

When the Bank 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" or "stock lending"), the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the Bank's financial statements.

Deposits, borrowings and subordinated liabilities are initially measured at fair value plus directly attributable transaction costs, and subsequently measured at their amortised cost using the effective interest method.

(r) Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.
A provision for restructuring is recognised when the Bank has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Bank from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Bank recognises any impairment loss on the assets associated with that contract.

(s) Employee benefits

(i) 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 Bank 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.

3. Significant accounting policies (continued)

(s) Employee benefits (continued)

(ii) Defined benefit plans

The Bank created a fully employer sponsored pension plan fund-Staff Support Program (See note 20), during 2002. The amount charged to this fund (SSP) was decided as 5% of yearly budgeted personnel salary expenses.

The amount due to employees based on the above plan would be grossed up by the interest that will accrue from the date the employees leave the Bank until their retirement. It would be paid to employees only when they reach the Albanian statutory retirement age, in monthly instalments equal to a minimum of 75% of their state monthly pension until the accumulated fund for the employee is consumed.

Based on the Board of Directors resolution effective on 30 September 2010, the Bank stopped the investment in this fund (SSP), by transforming it into the Staff Retention Credit Program (SRCP). The demographic changes in labour force during the last ten years and the employees' average age at 31, where 80% of employees are below the age of 40, has resulted in SSP not being attractive for most employees of the Bank, as it can only be enjoyed at retirement. In contrast, SRCP will be more readily beneficial for all the Bank's staff, as it will provide consumer and home loans with preferential terms. The entire due amount calculated for eligible employees in Staff Support Program has been frozen on the same date. The frozen amount due to change of SSP into SRCP on 30 September 2010 and the corresponding annual interest that will be gained by the investment in AAA sovereign bonds in the future until retirement age, is recorded as a liability by the Bank.

(iii) 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 Bank 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.

(t) Segment reporting

An operating segment is a component of the Bank that engages in business activities from which may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Bank's other Components, whose operating results are reviewed regularly by the management to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available (see Note 6). The Bank's format for segment reporting is based on geographical segments.

3. Significant accounting policies (continued)

(u) New Standards adopted as at 1 January 2018

IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 presents new requirements for the recognition of revenue, replacing IAS 18 'Revenue', IAS 11 'Construction Contracts', and several revenue-related Interpretations.
IFRS 15 'Revenue from Contracts with Customers' and the related 'Clarifications to IFRS 15 Revenue from Contracts with Customers' (hereinafter referred to as 'IFRS 15') replace IAS 18 'Revenue', IAS 11 'Construction Contracts', and several revenue-related Interpretations.
The new standard establishes a control-based revenue recognition model and provides additional guidance in many areas not covered in detail under existing IFRSs, including how to account for arrangements with multiple performance obligations, variable pricing, customer refund rights, supplier repurchase options, and other common complexities.
The implementation of this new guidance did not have a significant impact on the timing or amount of revenue recognised by the Group in any year. Had the implementation resulted in a significant impact, the new Standard would have been applied retrospectively without restatement, with the cumulative effect of initial application recognised as an adjustment to the opening balance of retained earnings at 1 January 2018.

IFRS 9 "Financial Instruments"

IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement'. It makes major changes to the previous guidance on the classification and measurement of financial assets and introduces an 'expected credit loss' model for the impairment of financial assets.

When adopting IFRS 9, the Group has applied transitional relief and opted not to restate prior periods. Differences arising from the adoption of IFRS 9 in relation to classification, measurement, and impairment are recognised in retained earnings.

The Bank has adopted new accounting policies, implementing the requirements of IFRS 9, effective as of 1 January 2018. The Bank also assessed the impact of IFRS 9 on its financial assets and upgraded and customized existing business applications and adopted new regulations to include IFRS 9 requirements.

The Bank assessed the impact of IFRS 9, in the following areas:

1) Classifications of the financial assets

Classification and measurement of financial instruments on or after 1 January 2018 is based on new criteria that take into account the contractual cash flows of financial instruments and the business model in which they are managed. IFRS 9 includes three principal classification categories for financial assets: measured at amortised cost (AC), measured at fair value through other comprehensive income (FVOCI) and measured at fair value through profit and loss (FVPL). It eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

3. Significant accounting policies (continued)

(u) New Standards adopted as at 1 January 2018

1) Classifications of the financial assets (continued)

Based on selected business models, the Bank has decided to classify its financial assets into following categories as at 1 January 2018:

Portfolio reviewed as at 31 December 2017	**IAS 39 Classification Measurement**		**SPPI Test**	**Business Model**	**IFRS 9 Classification measurement**	**Conclusion**
Treasury						
Cash and other advances to banks	HTM	AC	Meet SPPI criteria	Held to collect contractual cash flows	AC	No financial impact identified
Placement and balances with banks	HTM	AC	Meet SPPI criteria	Held to collect contractual cash flows	AC	No financial impact identified
Treasury bills	AFS	FVOCI	Meet SPPI criteria	Held to collect and sell	FVOCI	No financial impact identified
Available to sale Securities	AFS	FVOCI	Meet SPPI criteria	Held to collect and sell	FVOCI	No financial impact identified at this stage. However any new instruments failing the SPPI test in the future will be measured at FVPL with consequential P&L volatility due to change in FV.
Held to maturity Securities	HTM	AC	Meet SPPI criteria	Held to collect contractual cash flows	AC	
Loans to Banks	LAR	AC	Meet SPPI criteria	Held to collect contractual cash flows	AC	Only 3% of loans to bank portfolio was sold in 2017, 13% in 2016 and 10.4% in 2015. Given their frequency and insignificance in prior years the sales may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. More over the Bank's management intention is to keep these assets until maturity.
Loans to customers			Meet SPPI criteria			
Retail and corporate Loans	LAR	AC	Meet SPPI criteria	Held to collect contractual cash flows	AC	No financial impact identified

3. Significant accounting policies (continued)

(u) New Standards adopted as at 1 January 2018

2) Expected credit losses as at 1 January 2018

The most significant impact on the Group's financial statements from the implementation of IFRS 9 results from the new impairment requirements. Impairment losses are increased and became more volatile for financial instruments in the scope of the IFRS 9 impairment model.

The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). See note 5 (b), (ii).

The key inputs into the measurement of ECLs estimated and adjusted on the opening balance of the Banks's equity at 1 January 2018 are the same as those in note 5 (b), (ii), with the exception of the LGD which was estimated as follows:

As at 1 January 2018, the Bank assumed the fixed Based Estimates. The Banks mapped each collateral type in BKT portfolios to the Basel LGD segments, each with the corresponding LGD rate: Eligible financial collateral (0%), secured (25%), senior unsecured (45%) and subordinated unsecured (75%). When an account has collateral(s) belonging to the same Basel LGD segment, the LGD value assigned to that segment is used for all accounts under the concerning counterparty. In the case where an account has several types of collateral, the collateral value-weighted LGD is used for all accounts under the concerning counterparty. For the Treasury and Project and Structured Finance portfolios, LGD values are assigned on an asset type level.

During the year 2018, the Bank revised the estimation of LGD as explained in note 5 (b), (ii). As 31 December 2018, the Bank applied the change in ECL, deriving from the estimation of the LGD, prospectively.

Based on assessments undertaken, the total estimated adjustment of the adoption of IFRS 9 on the opening balance of the Banks's equity at 1 January 2018 was approximately USD 6,137,861.
The total provisions amount to USD 55,921,887, or equivalently 1.84% of the total exposure.

The Bank has decided to not restate comparative periods at initial application of IFRS 9.

3. Significant accounting policies (continued)

(u) New Standards adopted as at 1 January 2018 (continued)

2) Expected credit losses as at 1 January 2018 (continued)

i. Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 (continued)

In USD	Original classification under IAS 39	New classification under IFRS 9		Original carrying amount under IAS 39	Remeasurement	New carrying amount under IFRS 9
Financial assets			**Financial assets**			
Cash and cash balances with central Banks	Loans and receivables	Amortised cost	Cash and cash balances with central Banks	295,119,649	-	295,119,649
Placements and Balances with the Banks	Loans and receivables	Amortised cost	Placements and Balances with the Banks	293,887,630	-	293,887,630
Treasury bills	AFS	FVOCI	Investment securities - measured at FVOCI	209,396,356	-	209,396,356
Held-for-trading securities	FVTPL	FVTPL	Investment securities - measured at FVTPL	-	-	-
Available-for-sale securities	AFS	FVOCI	Investment securities - measured at FVOCI	1,002,510,212	435,063	1,002,075,149
Held-to-maturity securities	HTM	Amortised cost	Investment securities - measured at amortised cost	160,524,664	135,930	160,388,734
Loans to Banks	Loans and receivables	Amortised cost	Loans to Banks	424,728,134	827,877	423,900,257
Loans to customers	Loans and receivables	Amortised cost	Loans to customers	1,172,497,193	4,578,049	1,167,919,144
Other Assets	Loans and receivables	Amortised cost	Other Assets	14,285,515	160,942	14,124,573
Total financial assets				**3,572,949,353**	**6,137,861**	**3,566,811,492**
Financial liabilities						
Customer deposits	Amortised cost	Amortised cost	Customer deposits	2,867,899,348	-	2,867,899,348
Due to banks and financial institutions	Amortised cost	Amortised cost	Due to banks and financial institutions	343,706,001	-	343,706,001
Due to third parties	Amortised cost	Amortised cost	Due to third parties	4,856,919	-	4,856,919
Accruals and other liabilities	Amortised cost	Amortised cost	Accruals and other liabilities	17,492,677	-	17,492,677
Subordinated debt	Amortised cost	Amortised cost	Subordinated debt	29,989,497	-	29,989,497
Total financial liabilities				**3,263,944,442**	**-**	**3,263,944,442**

3. Significant accounting policies (continued)

(u) New Standards adopted as at 1 January 2018 (continued)

2) Expected credit losses as at 1 January 2018 (continued)

i. Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 (continued)

The following table analyses the impact, net of tax, of transition to IFRS 9 on reserves and retained earnings. The impact relates to liability credit reserve, the fair value reserve and retained earnings. There is no impact on other components of equity.

In USD	Impact of adopting IFRS 9 at 1 January 2018
Fair value reserve (IAS 39 AFS)	
Closing balance under IAS 39 (31 December 2017)	4,908,867
Reclassification of investment securities (debt) from available-for-sale to FVTPL	-
Reclassification of investment securities (equity) measured at cost from available-for-sale to FVOCI	-
Recognition of expected credit losses under IFRS 9 for debt financial assets at FVOCI	-
Opening balance under IFRS 9 (1 January 2018)	4,908,867
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	109,136,340
Reclassifications under IFRS 9	6,137,861
Recognition of expected credit losses under IFRS 9 (including lease receivables, loan commitments and financial guarantee contracts)	-
Opening balance under IFRS 9 (1 January 2018)	**102,998,479**

The following table reconciles the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets at 31 December 2017, to the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

Allowance in USD	**31 December 2017 (IAS 39/IAS 37)**	**Reclassification to FVTPL measurement**	**Remeasurement**	**1 January 2018 (IFRS 9)**
Financial Assets				
Cash and cash balances with central Banks	-		-	-
Placements and Balances with the Banks	-		-	-
Investment securities (HTM under IAS 39)	-		135,930	135,930
Loans to Banks (L&R under IAS 39)	-		827,877	827,877
Loans to customers (L&R under IAS 39)	49,784,026		4,578,049	54,362,075
Other Assets	-		160,942	160,942
Total Allowance for amortised cost measurement	**49,784,026**	**-**	**5,702,798**	**55,486,824**
Investment securities (AFS under IAS 39)	-		435,063	435,063
Total Allowance for FVOCI measurement	**-**	**-**	**435,063**	**435,063**

Further information on the measurement of the impairment allowance under IFRS 9 can be found in note 3 (g) (ix) and 5 (b) (ii).

3. Significant accounting policies (continued)

(v) Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Group

At the date of authorisation of these financial statements, certain new standards and amendments to existing standards have been published by the IASB that are not yet effective, and have not been adopted early by the Group. Information on those expected to be relevant to the Group's financial statements is provided below. Management anticipates that all relevant pronouncements will be adopted in the Group's accounting policies for the first period beginning after the effective date of the pronouncement. New Standards, amendments and Interpretations neither adopted nor listed below have not been disclosed as they are not expected to have a material impact on the Group's financial statements.

IFRS 16 'Leases'

IFRS 16 will replace IAS 17 'Leases' and three related Interpretations. It completes the IASB's long running project to overhaul lease accounting. Leases will be recorded in the statement of financial position in the form of a right-of-use asset and a lease liability. There are two important reliefs provided by IFRS 16 for assets of low value and short-term leases of less than 12 months.
IFRS 16 is effective from periods beginning on or after 1 January 2019. Early adoption is permitted; however, the Group have decided not to early adopt.

Management is in the process of assessing the full impact of the Standard. So far, the Group:

- has decided to make use of the practical expedient not to perform a full review of existing leases and apply IFRS 16 only to new or modified contracts. As some leases will be modified or renewed in 2019, the Group has reassessed these leases and concluded they will be recognised on the statement of financial position as a right-of-use asset
- believes that the most significant impact will be that the Group will need to recognise a right of use asset and a lease liability for the office and buildings currently treated as operating leases. This will mean that the nature of the expense of will change from being an operating lease expense to depreciation and interest expense
- considers the IT system requirements and whether a new leasing system is needed.
- is assessing their current disclosures for finance leases and operating leases (Note 33, Section, 'Lease commitments') as these are likely to form the basis of the amounts to be capitalised and become right-of-use assets
- is assessing the additional disclosures that will be required.

The Group is planning to adopt IFRS 16 on 1 January 2019 using the Standard's modified retrospective approach. Under this approach the cumulative effect of initially applying IFRS 16 is recognised as an adjustment to equity at the date of initial application. Comparative information is not restated.
Choosing this transition approach results in further policy decisions the Group need to make as there are several other transitional reliefs that can be applied. These relate to those leases previously held as operating leases and can be applied on a lease-by-lease basis. The Group are currently assessing the impact of applying these other transitional reliefs. IFRS 16 has not made any significant changes to the accounting for lessors, and therefore the Group does not expect any changes for leases where they are acting as a lessor.

4. Use of estimates and judgements

Management discusses with the Audit Committee the development, selection and disclosure of the Bank's critical accounting policies and estimates, and the application of these policies and estimates.

These disclosures supplement the commentary on financial risk management (see note 5).

The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the management has made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in financial statements:

Business model assessment: Classification and measurement of financial assets depends on the results of the SPPI and the business model test (note 3, (g), (iii)). The Group determines the business model at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. This assessment includes judgement reflecting all relevant evidence including how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed and how the managers of the assets are compensated. The Group monitors financial assets measured at amortised cost or fair value through other comprehensive income that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Group's continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets.

Significant increase of credit risk: As explained in note 3 (g) (ix) and 5 (b) (ii), ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL assets for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Group takes into account qualitative and quantitative reasonable and supportable forward looking information. Refer to note 3 (g) (ix) and 5 (b) (ii), for more details.

Establishing groups of assets with similar credit risk characteristics: When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics. Refer to note 3 (g) (ix) and 5 (b) (ii), for details of the characteristics considered in this judgement. The Group monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.

Models and assumptions used: The Group uses various models and assumptions in measuring fair value of financial assets as well as in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk. See note 3 (g) (ix) and 5 (b) (ii), for more details on ECL and note 3 (g) (viii) for more details on fair value measurement.

Determining fair values

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy 3 (g) (viii). For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. See also "Valuation of financial instruments" below.

4. Use of estimates and judgements (continued)

Critical accounting judgments made in applying the Bank's accounting policies include:

Valuation of financial instruments

The Bank's accounting policy on fair value measurements is discussed under note 3 (g) (viii).

The Bank 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.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Bank uses widely recognized valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgment and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which usually are developed from recognized valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgment and estimation in determination of fair value. Management judgment and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

4. Use of estimates and judgements (continued)

Fair values

The table below sets out the carrying amounts and fair values of the financial assets and liabilities and analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised:

31 December 2018	**Note**	**Carrying Amount**			**Fair Value**	
			Level 1	**Level 2**	**Level 3**	**Total**
Placement and balances with banks	8	658,318,886	-	658,318,886	-	658,318,886
Investment securities	9	1,486,663,848	446,193,390	1,037,008,393	-	1,483,201,783
Loans to banks	10	195,676,165	-	195,676,165	-	195,676,165
Loans to customers	11	1,215,625,631	-	-	1,215,625,631	1,215,625,631
Total financial assets		**3,556,284,530**	**446,193,390**	**1,891,003,444**	**1,215,625,631**	**3,552,822,465**
Customer deposits	16	3,129,749,851	-	-	3,129,749,851	3,129,749,851
Due to banks and financial institutions	17	323,861,645	-	323,861,645	-	323,861,645
Subordinated debt	21	28,678,547	-	28,678,547	-	28,678,547
Total financial liabilities		**3,482,290,043**	**-**	**352,540,192**	**3,129,749,851**	**3,482,290,043**
31 December 2017	**Note**	**Carrying Amount**	**Level 1**	**Level 2**	**Level 3**	**Total**
Placement and balances with banks	8	293,887,630	-	293,887,630	-	293,887,630
Investment securities	9	1,372,431,232	382,958,758	995,490,896	-	1,378,449,654
Loans to banks	10	424,728,134	-	424,728,134	-	424,728,134
Loans to customers	11	1,172,497,193	-	-	1,172,497,193	1,172,497,193
Total financial assets		**3,263,544,189**	**382,958,758**	**1,714,106,660**	**1,172,497,193**	**3,269,562,611**
Customer deposits	16	2,867,899,348	-	-	2,867,899,348	2,867,899,348
Due to banks and financial institutions	17	343,706,001	-	343,706,001	-	343,706,001
Subordinated debt	21	29,989,497	-	29,989,497	-	29,989,497
Total financial liabilities		**3,241,594,846**	**-**	**373,695,498**	**2,867,899,348**	**3,241,594,846**

The fair value of foreign exchange contracts approximates their carrying amount, which is disclosed in Notes 15 and 20. The Fair value of loan to customers and customer deposits approximates to their carrying value either due to interest rates approximating the market rates or due to short term maturities.

5. Financial risk management

(a) Introduction and overview

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

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

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

A financial instrument is any contract that gives rise to the right to receive cash or another financial asset from another party (financial asset) or the obligation to deliver cash or another financial asset to another party (financial liability).

Financial instruments result in certain risks to the Bank. The most significant risks facing the Bank are credit risk, liquidity risk and market risk. Market risk includes foreign currency risk, interest rate risk and other price risks.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Bank Asset and Liability Committee (ALCO), Risk Management Group and Credit Committees, which are responsible for developing and monitoring Bank risk management policies in their specified areas. All these bodies report regularly to the Board of Directors on their activities.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Bank Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(b) Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's Loans to customers and other banks and investment securities. For risk management reporting purposes, the Bank considers all elements of credit risk exposure (such as individual obligor default risk, country and sector risk). The Bank has formed a Credit Committee to oversee the approval of requests for credits. Credit requests with amounts over EUR 2,000,000 are approved only upon decision of the Board of Directors of the Bank. There is a continuous focus on the quality of credits extended both at the time of approval and throughout their lives.

Each business unit is required to comply with Bank credit policies and procedures. Regular audits of business units and Bank Credit Risk Management Department processes are undertaken by Internal Audit.

5. Financial risk management (continued)

(b) Credit Risk (continued)

i. Maximum credit exposure

The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets. Maximum exposures to credit risk before collateral and other credit enhancements as at 31 December 2018 and 31 December 2017 are as follows:

Financial Instruments Credit Risk

	31 December 2018			31 December 2017		
	Exposure before impairment	**Impairment**	**Net exposure for credit risk**	**Exposure before impairment**	**Impairment**	**Net exposure for credit risk**
A. Credit risk exposure relating to balance sheet items						
Cash and Cash Balances with Central Banks	285,134,696	-	285,134,696	295,119,649	-	295,119,649
Placements and Balances with the Banks	658,330,851	(11,965)	658,318,886	293,887,630	-	293,887,630
Treasury bills	-	-	-	209,396,356	-	209,396,356
Held-for-trading Securities	-	-	-	-	-	-
Available-for-sale Securities	-	-	-	1,002,510,212	-	1,002,510,212
Held-to-maturity Securities	-	-	-	160,524,664	-	160,524,664
Investment securities - measured at FVTPL	3,019,074	-	3,019,074	-	-	-
Investment securities - measured at FVOCI	1,302,036,061	(2,047,956)	1,299,988,105	-	-	-
Investment securities - measured at amortised cost	183,912,909	(256,240)	183,656,669	-	-	-
Loans to banks	195,982,788	(306,623)	195,676,165	424,728,134	-	424,728,134
Loans to customers	1,268,131,639	(52,506,008)	1,215,625,631	1,222,281,219	(49,784,026)	1,172,497,193
Other assets	14,285,515	(853,998)	13,431,517	19,278,692	-	19,278,692
Total Assets	**3,910,833,533**	**(55,982,790)**	**3,854,850,743**	**3,627,726,556**	**(49,784,026)**	**3,577,942,530**
Off balance sheet items						
Undrawn credit commitments	136,960,838	-	136,960,838	110,429,590	-	110,429,590
Outstanding cheques of non-resident banks	400,384	-	400,384	493,368	-	493,368
Spot foreign currency contract	162,187,847	-	162,187,847	148,408,727	-	148,408,727
Collaterals for loan portfolio	3,335,436,936	-	3,335,436,936	2,821,969,922	-	2,821,969,922
Securities pledged as collateral	305,464,320	-	305,464,320	340,865,572	-	340,865,572
Total off balance sheet	**3,940,450,325**	**-**	**3,940,450,325**	**3,422,167,179**	**-**	**3,422,167,179**
Total credit risk exposure	**7,851,283,858**	**(55,982,790)**	**7,795,301,068**	**7,049,893,735**	**(49,784,026)**	**7,000,109,709**

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii. Expected credit loss measurement

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD).

The guiding principle of the expected credit loss model is to reflect the general pattern of deterioration or improvement in the credit quality of financial instruments. This credit quality depends on the extent of credit deterioration since initial recognition and will spread over three stages:

"Stage 1" comprises of assets that have not suffered any significant deterioration of credit quality since initial recognition;

"Stage 2" comprises of assets that have suffered significant deterioration since initial recognition;

"Stage 3" concerns all assets where a default has occurred.

Under this general approach, the ECL for an asset is calculated over different time horizons according to the stage it was assigned to:

ECL over one year for assets in stage 1;

ECL over remaining lifetime for assets in stage 2 and stage 3.

The stage assignment is done according to the following rules:

Impairment: if the counterparty for the considered asset has defaulted, the asset is assigned to "Stage 3". An asset is considered as having defaulted if any repayment (principal or interest) is overdue for more than 90 days or if the counterparty is in a proven situation of default (bankruptcy).

Rating D (lower than C): Assets with this rating are currently considered to be in stage 3.

Qualitative factors: IFRS 9 has advised to take into account qualitative factors such as watch lists or financial analysis by experts. Similarly to the previous case, there is also a second time threshold. In case the repayment of an asset is overdue for more than 30 days and less than 90 days, it is assigned to "Stage 2".

Relative Threshold: if the counterparty has suffered significant deterioration in credit risk, that is if its credit quality since initial recognition has dropped more than a specific pre-defined relative threshold, then it is assigned to "Stage 2".

All assets that are not in the previous cases are assigned to "Stage 1".

Grouping of instruments for losses measured on a collective basis

For expected credit loss provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogeneous.

In performing this grouping, there must be sufficient information for the group to be statistically credible.

Where sufficient information is not available internally, the Group has considered benchmarking internal/external supplementary data to use for modelling purposes.

The Bank has three main portfolios, which are:

- Loan portfolio

  This category includes wholesale and individual/retail accounts loans.

- Treasury portfolio

  This category includes bonds, treasury bills and equity accounts.

- Project and Structured Finance

  This category includes letters of credit and bank guarantees.

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii Expected credit loss measurement (continued)

Significant Deterioration through relative threshold
The bank computes a relative threshold matrix that gives for each rating a prediction of what the expected rating for each time horizon should be.

Through-the-cycle (TTC) transition matrices give the percentage of counterparties which moved from one rating to another over a specific time interval. TTC matrices over a 10 year horizon are taken since this gives a comfortable horizon for a relative threshold.

Credit risk grading
The bank relied on proxies provided by external credit rating agencies. External TTC transition matrices for all European entities provided by international credit rating agencies are used. The following steps are then carried out:

First the mapping between the internal and external rating systems is performed;

From there, a TTC transition matrix with the number of observations (number of entities that changed from one specific rating to another) is used and a weighted average per mapped rating is computed in order to compute the internal ratings TTC matrix.

Forward-looking information incorporated in the ECL models
The TTC PDs are transformed into PIT PDs by taking into account the macroeconomic environment through a set of macroeconomic variables: real GDP growth rate, inflation rate and unemployment rate. These variables were sourced from the IMF[2], including historical data spanning 1990 – 2016 and baseline projections for 2017 – 2020. The first PD model includes a simplified form of the Merton model. In this framework, a systemic variable X_t which represents the macroeconomic environment is introduced. The sensitivity of each rating's PD to this variable is obtained via the calibration of the ρ parameter. The model takes into account the global default rate of each year and calculates X_t for each year, which is then regressed over with the different combinations of macro-economic variables. Using projections of the macroeconomic variables, the regression formula is used to deduce projections of X_t, and based on the one factor Merton model the PIT PDs are obtained. The second PD model considers the default rate per rating in each year, which enables the calibration of the sensitivity ρ_i for all ratings.

Measuring ECL – Explanation of inputs, assumptions and estimation techniques
The key inputs into the measurement of ECLs are likely to be the term structures of the following variables:

1. Probability of default (PD);
2. Loss given default (LGD); and
3. Exposure at default (EAD).

ECL is estimated under Baseline (typical), Best (favourable) and Adverse (unfavourable) conditions.
The only Point-in-Time estimates are for Probability of Default. LGD assumes Basel estimates and EAD uses amortisation type payment schedules. Once all components (PD, EAD, LGD) have been computed, the ECL is estimated under three different scenarios: Baseline (typical), Best (favourable) and Adverse (unfavourable) condition, with weights 52%, 18% and 30% respectively. The final ECL is the probability-weighted ECL under those three scenarios.

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii Expected credit loss measurement (continued)

1. Probability of Default

The probability of default has been modelled on the basis of the one factor Merton model. The approach to model the point-in-time forward looking and macroeconomic PD is divided into three different steps: - The first step is to calibrate the cumulated TTC PDs; - The second step is to include the forward looking information and transform the cumulated TTC PDs to PIT PDs; - The final step is to describe the conversion of PIT PDs to TTC PDs after a certain horizon.

Default rates are essential for the calculation of Point-in-Time Probability of Default (PD) and for the estimation of ECL.

The Bank used external default rate data for each relevant sector and region. A number of macro-economic variables sourced from the IMF2, including historical data spanning 1990 – 2016 and baseline projections for 2017 – 2020, were considered in modelling of PIT PD.

For non-rated accounts, PD are estimated using the nominal weighted average PD of all rated accounts within the same rating system. However, this does not guarantee that the PD for non-rated accounts in stage 2 (NRB2) is higher than for stage 1 (NRB1). To account for the higher risk of NRB2 exposures, the Bank mapped NRB2 to an equivalent risk grade with similar PIT PD as the PD for NRB1 exposure for a time horizon equal to the average residual lifetime of all unexpired accounts within the same sector.

2. Loss Given Default (LGD)

Loss Given Default is defined as the percentage of the Exposure at Default (EAD) that is ultimately lost in case of default of a counterparty, after all possible recoveries through selling of collateral or collection procedures. As regards to the loan to customers' portfolio, LGD is modelled using historical recovery rates or using the collateral value of the asset. The bank has considered information about past collateral value, time in default, time to sale, sale costs, in calculating the LGD.

A defaulted collateralised asset can move through different stages post default. The bank can seize the collateral ("Possession") in order to sell it ("Sale") and make up for the potential loss due to the default of the counterparty. Possession of collateral can occur voluntarily ("handing over the keys") or via litigation (court proceedings). And sales may be carried out by the institution (after obtaining possession) or by means of a customer self-sale. On the date of collateral sale, any shortfall is recognised in the P&L (write-off expense) and subsequent recoveries (debt collection either internal or external) may occur. Write-off occurs when there is a shortfall on collateral sale. Closed and cures occur when the full outstanding is recovered with the former resulting in the account closing (i.e. no lending). Cure refers to both closed and curing accounts. For the unsecured/uncollateralised types of assets the value of the collateral is supposed to be 0 and the actual model is still applied taking into account pure debt collection. In the light of this recovery process, the Bank defines LGD as the expected severity (loss) given a default.

As regards to the non-loan accounts (Treasury and Project and Structured Finance accounts), the Bank assumed the fixed Based Estimates. The Banks mapped each collateral type in BKT portfolios to the Basel LGD segments1, each with their own LGD estimate: Eligible financial collateral (0%), secured (25%) and unsecured (45%). For the Treasury and Project and Structured Finance portfolios, LGD values are assigned on an asset type level.

3. Exposure at Default (EAD)

An asset can have a customised, linear or bullet amortisation type. For assets with a customised amortisation type, repayment schedules are used to estimate EAD. For assets without any amortisation type, a linear repayment plan is assumed. For off balance sheet exposures, it is required that provisions are held against undrawn commitments. BKT's calculation of the credit conversion factor (CCF) values is in line with Basel II requirements under the standardised approach: "Commitments with an original maturity up to one year and commitments with an original maturity over one year will receive a CCF of 20% and 50%, respectively." Early repayment/refinance assumptions are also incorporated into the calculation. However the early repayments are considered to be 0 for all assets as the Bank's historical data suggests insignificant material impact.

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii Expected credit loss measurement (continued)

The following table sets out the changes in gross carrying amount of loans to customers at amortised cost.

CHANGES IN GROSS CARRYING AMOUNT OF LOANS TO CUSTOMERS AT AMORTISED COST

31 December 2018	Retail lending				Corporate lending			
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balance at 1 January 2018	**349,016,533**	**16,461,687**	**16,253,532**	**381,731,752**	**746,930,855**	**25,884,945**	**72,224,756**	**845,040,556**
Transfer to Stage 1 (from 2 or 3)	6,637,341	(5,523,165)	(1,114,176)	-	23,008,424	(10,190,878)	(12,817,546)	**-**
Transfer to Stage 2 (from 1 or 3)	(7,931,383)	8,551,442	(620,059)	-	(45,737,127)	51,079,512	(5,342,385)	**-**
Transfer to Stage 3 (from 1 or 2)	(3,555,303)	(2,554,734)	6,110,037	-	(7,497,954)	(4,714,097)	12,212,051	**-**
New financial assets originated or purchased	121,820,645	961,483	282,088	123,064,216	280,446,747	37,386,130	834,535	**318,667,412**
Derecognition of financial assets	(32,426,681)	(1,404,601)	(1,320,500)	(35,151,782)	(184,958,354)	(5,149,108)	(13,263,281)	**(203,370,743)**
Changes due to modifications that did not result in derecognition	(45,591,437)	(1,570,367)	(1,366,785)	(48,528,589)	(74,144,326)	(15,067,491)	(3,078,765)	**(92,290,582)**
Write-offs	(17)	-	(1,701,154)	(1,701,171)	-	-	(9,652,473)	**(9,652,473)**
Foreign exchange and other changes	3,275,283	136,004	134,525	3,545,812	(8,113,381)	435,180	(894,951)	**(8,573,152)**
Gross Balance at 31 December 2018	**391,244,981**	**15,057,749**	**16,657,508**	**422,960,238**	**729,934,884**	**79,664,193**	**40,221,941**	**849,821,018**

The gross carrying amounts include principal and interest. Unamortized deferred fee is not included.

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii Expected credit loss measurement (continued)

The following table sets out the changes in allowance of loans to customers at amortised cost

ALLOWANCE OF LOANS TO CUSTOMERS AT AMORTISED COST

31 December 2018	Retail lending				Corporate lending			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January 2018	**2,885,607**	**2,177,070**	**3,990,958**	**9,053,635**	**27,263,652**	**2,352,906**	**15,691,854**	**45,308,412**
Transfer to Stage 1 (from 2 or 3)	399,997	(261,910)	(138,087)	-	6,976,940	(694,250)	(6,282,690)	-
Transfer to Stage 2 (from 1 or 3)	(263,137)	288,460	(25,323)	-	(1,169,157)	1,169,157	-	-
Transfer to Stage 3 (from 1 or 2)	(1,164,061)	(762,503)	1,926,564	-	(1,946,615)	(1,227,057)	3,173,672	-
New financial assets originated or purchased	691,846	27,024	197,053	915,923	12,777,496	1,649,662	195,891	14,623,049
Derecognition of financial assets	(270,492)	(169,798)	(355,684)	(795,974)	(4,509,830)	(182,858)	(364,903)	(5,057,591)
Changes due to modifications that did not result in derecognition	-	-	(1,106,458)	(1,106,458)	-	-	(3,237,471)	(3,237,471)
Write-offs	(2,287,633)	(457,653)	1,552,763	(1,192,523)	1,999,985	553,227	2,359,113	4,912,325
Foreign exchange and other changes	1,862,886	(407,964)	(784,817)	670,105	(8,734,787)	1,054,959	(3,907,596)	(11,587,424)
Gross Balance at 31 December 2018	**1,855,013**	**432,726**	**5,256,969**	**7,544,708**	**32,657,684**	**4,675,746**	**7,627,870**	**44,961,300**

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii Expected credit loss measurement (continued)

The following table sets out the changes in in gross carrying amount of financial assets where impairment requirements apply (other than loans to customers).

CHANGES IN GROSS CARRYING AMOUNT OF FINANCIAL ASSETS WHERE IMPAIRMENT REQUIREMENTS APPLY (OTHER THAN LOANS TO CUSTOMERS)

31 December 2018	Due from Banks				Investment Securities at FVOCI			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January 2018	**423,246,411**	**-**	**-**	**423,246,411**	**1,141,384,106**	**14,000,000**	**-**	**1,155,384,106**
Transfer to Stage 1 (from 2 or 3)	-	-	-	**-**	14,000,000	(14,000,000)	-	**-**
Transfer to Stage 2 (from 1 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 3 (from 1 or 2)	-	-	-	**-**	-	-	-	**-**
New financial assets originated or purchased	494,011,866	-	-	**494,011,866**	758,548,225	2,839,455	-	**761,387,680**
Derecognition of financial assets	(367,944,656)	-	-	**(367,944,656)**	(583,955,149)	-	-	**(583,955,149)**
Changes due to modifications that did not result in derecognition	500,000	-	-	**500,000**	(70,814,842)	-	-	**(70,814,842)**
Write-offs	-	-	-	**-**	-	-	-	**-**
Foreign exchange and other changes	(1,532,913)	-	-	**(1,532,913)**	(65,128)	-	-	**(65,128)**
Gross Balance at 31 December 2018	**548,280,708**	**-**	**-**	**548,280,708**	**1,259,097,212**	**2,839,455**	**-**	**1,261,936,667**

31 December 2018	Investment Securities at amortised cost				Loan Commitments and financial guarantee contracts			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January 2018	**175,977,576**	**-**	**-**	**175,977,576**	**36,280,220**	**-**	**-**	**36,280,220**
Transfer to Stage 1 (from 2 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 2 (from 1 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 3 (from 1 or 2)	-	-	-	**-**	-	-	-	**-**
New financial assets originated or purchased	80,366,727	4,006,400	-	**84,373,127**	49,830,188	-	-	**49,830,188**
Derecognition of financial assets	(38,594,932)	-	-	**(38,594,932)**	(14,328,750)	-	-	**(14,328,750)**
Changes due to modifications that did not result in derecognition	(36,500,818)	-	-	**(36,500,818)**	11,685,304	-	-	**11,685,304**
Write-offs	-	-	-	**-**	-	-	-	**-**
Foreign exchange and other changes	(1,774,285)	-	-	**(1,774,285)**	(940,123)	-	-	**(940,123)**
Gross Balance at 31 December 2018	**179,474,268**	**4,006,400**	**-**	**183,480,668**	**82,526,839**	**-**	**-**	**82,526,839**

The gross carrying amounts include only Nominal amounts. Unamortized discount; Accrued interest and Marked to market gain/ (loss) are not included.

5. Financial risk management (continued)

(b) Credit Risk (continued)

ii Expected credit loss measurement (continued)

The following table sets out the changes in in gross carrying amount of financial assets where impairment requirements apply (other than loans to customers).

RECONCILATION OF THE ACCUMULATED IMPAIRMENT ALLOWANCE OF FINANCIAL ASSETS WHERE IMPAIRMENT REQUIREMENTS APPLY (OTHER THAN LOANS TO CUSTOMERS)

31 December 2018	Due from Banks				Investment Securities at FVOCI			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January 2018	**827,877**	**-**	**-**	**827,877**	**356,598**	**78,465**	**-**	**435,063**
Transfer to Stage 1 (from 2 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 2 (from 1 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 3 (from 1 or 2)	-	-	-	**-**	-	-	-	**-**
New financial assets originated or purchased	188,286	-	-	**188,286**	940,716	263,249	-	**1,203,965**
Derecognition of financial assets	(645,218)	-	-	**(645,218)**	(295,981)	(78,465)	-	**(374,446)**
Write-offs	-	-	-	**-**	-	-	-	**-**
Changes in models/risk parameters	(81,227)	-	-	**(81,227)**	(33,184)	-	-	**(33,184)**
Foreign exchange and other movements	28,870	-	-	**28,870**	816,558	-	-	**816,558**
Gross Balance at 31 December 2018	**318,588**	**-**	**-**	**318,588**	**1,784,707**	**263,249**	**-**	**2,047,956**

31 December 2018	Debt Investment Securities at amortised cost				Loan Commitments and financial guarantee contracts			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Balance at 1 January 2018	**135,930**	**-**	**-**	**135,930**	**160,942**	**-**	**-**	**160,942**
Transfer to Stage 1 (from 2 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 2 (from 1 or 3)	-	-	-	**-**	-	-	-	**-**
Transfer to Stage 3 (from 1 or 2)	-	-	-	**-**	-	-	-	**-**
New financial assets originated or purchased	162,049	5,603	-	**167,652**	260,984	-	-	**260,984**
Derecognition of financial assets	(33,580)	-	-	**(33,580)**	(35,955)	-	-	**(35,955)**
Write-offs	-	-	-	**-**	-	-	-	**-**
Changes in models/risk parameters	-	-	-	**-**	(96,694)	-	-	**(96,694)**
Foreign exchange and other movements	(13,762)	-	-	**(13,762)**	564,721	-	-	**564,721**
Gross Balance at 31 December 2018	**250,637**	**5,603**	**-**	**256,240**	**853,998**	**-**	**-**	**853,998**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis

The following table sets out information about the credit quality of loan to customers in 2018 by asset quality at amortised cost. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

LOANS TO CUSTOMERS BY ASSET QUALITY AT AMORTISED COST

	Stage 1					Stage 2				
31 December 2018	**Non Past Due**	**Past due**	**Total**	**Allowance**	**Total Carrying Amount**	**Non Past Due**	**Past due**	**Total**	**Allowance**	**Total Carrying Amount**
Retail lending	**359,510,271**	**29,079,506**	**388,589,777**	**1,700,506**	**386,889,271**	**358,950**	**14,697,372**	**15,056,322**	**432,726**	**14,623,596**
Mortgage	221,103,727	21,894,226	242,997,953	678,258	242,319,695	326,380	11,174,839	11,501,219	363,544	11,137,675
Consumer	129,818,598	6,876,023	136,694,621	902,475	135,792,146	32,570	3,275,254	3,307,824	58,618	3,249,206
Credit cards	8,587,946	309,257	8,897,203	119,773	8,777,430	-	247,279	247,279	10,564	236,715
Corporate lending	**661,600,841**	**66,348,559**	**727,949,400**	**32,593,616**	**695,355,784**	**64,328,127**	**15,318,226**	**79,646,353**	**4,675,746**	**74,970,607**
Corporate	569,553,826	58,872,693	628,426,519	29,295,167	599,131,352	53,276,182	10,006,513	63,282,695	3,517,809	59,764,886
SME	58,826,181	3,086,054	61,912,235	1,622,142	60,290,093	8,186,129	3,539,854	11,725,983	731,572	10,994,411
Micro	33,220,834	4,389,812	37,610,646	1,676,307	35,934,339	2,865,816	1,771,859	4,637,675	426,365	4,211,310
Total	**1,021,111,112**	**95,428,065**	**1,116,539,177**	**34,294,122**	**1,082,245,055**	**64,687,077**	**30,015,598**	**94,702,675**	**5,108,472**	**89,594,203**

Off balance sheet	**-**	**-**	**-**	**218,575**
Retail Credit cards	-	-	-	154,507
Business Credit cards	-	-	-	64,068

	Stage 3						
31 December 2018	**Non Past Due**	**Past due**	**Total**	**Allowance**	**Total Carrying Amount**	**Total net amount at amortised cost**	**Value of collateral**
Retail lending	**44,158**	**16,612,932**	**16,657,090**	**5,256,969**	**11,400,121**	**412,912,988**	**613,997,913**
Mortgage	6,690	9,899,340	9,906,030	2,008,857	7,897,173	261,354,543	458,592,214
Consumer	32,174	5,323,579	5,355,753	2,270,293	3,085,460	142,126,812	155,405,699
Credit cards	5,294	1,390,013	1,395,307	977,819	417,488	9,431,633	-
Corporate lending	**546,829**	**39,685,868**	**40,232,697**	**7,627,870**	**32,604,827**	**802,931,218**	**1,481,628,175**
Corporate	296,646	29,864,370	30,161,016	5,660,842	24,500,174	683,396,412	1,131,822,507
SME	209,087	4,341,439	4,550,526	818,088	3,732,438	75,016,942	232,052,426
Micro	41,096	5,480,059	5,521,155	1,148,940	4,372,215	44,517,864	117,753,242
Total	**590,987**	**56,298,800**	**56,889,787**	**12,884,839**	**44,004,948**	**1,215,844,206**	**2,095,626,088**

Past due related to each stage is referred as follows:

Stage 1: Past due 1-30 dpd, otherwise Non Past Due, Stage 2: Past due 31-90 dpd, otherwise Non Past Due, Stage 3: Past due over 90 dpd, otherwise Non Past Due.

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

The following table sets out information about the credit quality of loan to customers in the comparative period by asset quality at amortised cost.

	Loans to customers			
31 December 2017	**Retail**	**Business**	**Advances**	**Total**
Neither past due nor impaired	330,752,200	682,698,398	746,667	1,014,197,265
Past due and individually tested but not impaired	33,137,407	96,757,292	45,663	129,940,362
Individually impaired	13,857,852	63,547,710	738,030	78,143,592
Total Loans, gross (Note 11)	**377,747,459**	**843,003,400**	**1,530,360**	**1,222,281,219**
Allowance for individual impairment	(7,288,061)	(29,380,874)	(683,056)	(37,351,991)
Allowance for collective impairment	(3,907,179)	(8,516,140)	(8,716)	(12,432,035)
Total Loans, net of impairment	**366,552,219**	**805,106,386**	**838,588**	**1,172,497,193**

Past due in 2017 refers to all exposures which are more than 90 days in delay of their contractual cash flows.

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

The following table sets out information about the aging analyses of loan to customers in 2018 by product line.

LOANS TO CUSTOMERS AT AMORTISED COST

Retail lending

31 December 2018	Mortgage				Consumer				Credit cards			
	Stage 1	Stage 2	Stage 3	**Total**	Stage 1	Stage 2	Stage 3	**Total**	Stage 1	Stage 2	Stage 3	**Total**
Current	220,485,229	316,660	2,353	**220,804,242**	128,950,792	30,291	-	**128,981,083**	8,471,068	-	1,182	**8,472,250**
1 - 30 days	21,834,466	-	-	**21,834,466**	6,841,354	1,420	4,965	**6,847,739**	277,681	-	21	**277,702**
31 - 90 days	-	10,821,015	4,338	**10,825,353**	-	3,195,443	12,955	**3,208,398**	28,681	224,172	58	**252,911**
91 - 180 days	-	-	1,823,984	**1,823,984**	-	22,052	487,480	**509,532**	-	12,543	384,361	**396,904**
181 - 360 days	-	-	814,664	**814,664**	-	-	488,630	**488,630**	-	-	31,866	**31,866**
> 361 days	-	-	5,251,834	**5,251,834**	-	-	2,091,430	**2,091,430**	-	-	-	**-**
Total	**242,319,695**	**11,137,675**	**7,897,173**	**261,354,543**	**135,792,146**	**3,249,206**	**3,085,460**	**142,126,812**	**8,777,430**	**236,715**	**417,488**	**9,431,633**
Value of collateral	416,444,604	22,617,542	19,530,068	**458,592,214**	142,809,978	5,004,202	7,591,519	**155,405,699**	-	-	-	-

LOANS TO CUSTOMERS AT AMORTISED COST

Corporate lending

31 December 2018	Large Corporate				SME Corporate				Micro Corporate			
	Stage 1	Stage 2	Stage 3	**Total**	Stage 1	Stage 2	Stage 3	**Total**	Stage 1	Stage 2	Stage 3	**Total**
Current	547,302,962	50,690,950	90,342	**598,084,254**	57,251,513	7,142,228	10,764	**64,404,505**	31,745,975	2,410,288	11,317	**34,167,580**
1 - 30 days	51,828,390	678,687	103,153	**52,610,230**	3,037,306	555,714	98,819	**3,691,839**	4,187,317	243,621	6,338	**4,437,276**
31 - 90 days	-	8,395,249	81,493	**8,476,742**	1,274	3,101,702	49,426	**3,152,402**	1,047	1,557,401	2,640	**1,561,088**
91 - 180 days	-	-	4,611,703	**4,611,703**	-	194,767	346,742	**541,509**	-	-	360,146	**360,146**
181 - 360 days	-	-	1,382,470	**1,382,470**	-	-	509,197	**509,197**	-	-	952,195	**952,195**
> 361 days	-	-	18,231,013	**18,231,013**	-	-	2,717,490	**2,717,490**	-	-	3,039,579	**3,039,579**
Total	**599,131,352**	**59,764,886**	**24,500,174**	**683,396,412**	**60,290,093**	**10,994,411**	**3,732,438**	**75,016,942**	**35,934,339**	**4,211,310**	**4,372,215**	**44,517,864**
Value of collateral	1,001,763,298	86,621,443	43,437,766	**1,131,822,507**	190,531,445	28,665,434	12,855,547	**232,052,426**	93,565,833	9,358,848	14,828,561	**117,753,242**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

Set out below is the ageing analysis of all past due loans either impaired or not impaired individually in the comparative period:

	Loans to customers			
31 December 2017	**Retail**	**Corporate**	**Advances**	**Total Loans**
Past due up to 31 days	27,454,550	62,248,602	235,553	89,938,705
Past due 32-60 days	8,063,792	8,568,834	128,310	16,760,936
Past due 61-90 days	8,249,831	9,107,730	31,330	17,388,891
Past due 91-180 days	2,593,247	1,515,605	-	4,108,852
Past due 181 days- 365 days	3,406,466	1,613,604	20,901	5,040,971
Past due 1-2 years	2,734,558	8,788,201	21,069	11,543,828
Past due over 2 years	6,947,534	32,474,238	247,205	39,668,977
Total	**59,449,978**	**124,316,814**	**684,368**	**184,451,160**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

The following table sets out information about the credit quality of financial assets, other than loans to customers, measured at amortised cost, FVOCI debt investments (2018) and available-for-sale debt assets (2017). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

FINANCIAL INSTRUMENTS CREDIT RISK - OTHER THAN LOANS TO CUSTOMERS

	2018					2017
	12-month ECL	**Lifetime ECL not credit-impaired**	**Lifetime ECL credit-impaired**	**Purchased credit-impaired**	**Total**	**Total**
Placements and Balances with banks at amortised cost						
Aa1 to Aa3	57,230,782	-	-	-	**57,230,782**	**-**
A1 to A3	50,010,917	-	-	-	**50,010,917**	**28,504,354**
Baa1 to Baa3	200,111,850	-	-	-	**200,111,850**	**152,875,986**
Ba1 to Ba3	12,580,884	-	-	-	**12,580,884**	**6,065,629**
B1 to B3	3,475,704	-	-	-	**3,475,704**	**-**
Unrated	29,773,599	-	-	-	**29,773,599**	**32,402,215**
Exposure before impairment	*353,183,736*	-	-	-	**353,183,736**	**219,848,184**
Loss allowance	11,965	-	-	-	**11,965**	-
Carrying amount	**353,171,771**	**-**	**-**	**-**	353,171,771	219,848,184
Loans to Banks at amortised cost						
Aa1 to Aa3	-	-	-	-	**-**	**-**
A1 to A3	-	-	-	-	**-**	**-**
Baa1 to Baa3	13,013,986	-	-	-	**13,013,986**	**31,843,365**
Ba1 to Ba3	120,289,234	-	-	-	**120,289,234**	**298,937,650**
B1 to B3	51,228,897	-	-	-	**51,228,897**	**21,240,922**
Caa1 to Caa3	-	-	-	-	**-**	**10,030,981**
Unrated	11,450,671	-	-	-	**11,450,671**	**62,675,216**
Exposure before impairment	*195,982,788*	-	-	-	***195,982,788***	***424,728,134***
Loss allowance	306,623	-	-	-	**306,623**	**-**
Carrying amount	**195,676,165**	**-**	**-**	**-**	195,676,165	424,728,134
Investment Securities at FVOCI						
Aa1 to Aa3	1,225,138	-	-	-	**1,225,138**	**-**
A1 to A3	29,357,285	-	-	-	**29,357,285**	**11,012,830**
Baa1 to Baa3	95,889,487	-	-	-	**95,889,487**	**104,496,003**
Ba1 to Ba3	84,480,250	-	-	-	**84,480,250**	**106,471,627**
B1 to B3	976,927,129	2,804,558	-	-	**979,731,687**	**896,914,866**
Unrated	111,352,214	-	-	-	**111,352,214**	**93,011,242**
Exposure before impairment	*1,299,231,503*	*2,804,558*	-	-	***1,302,036,061***	***1,211,906,568***
Loss allowance	1,784,707	263,249	-	-	**2,047,956**	-
Carrying amount	**1,297,446,796**	**2,541,309**	**-**	**-**	1,299,988,105	1,211,906,568
Investment Securities at Amortised Cost						
Aa1 to Aa3	-	-	-	-	**-**	**-**
A1 to A3	-	-	-	-	**-**	**-**
Baa1 to Baa3	59,585,083	-	-	-	**59,585,083**	**59,585,083**
Ba1 to Ba3	25,095,483	4,006,903	-	-	**29,102,386**	**53,646,420**
B1 to B3	65,592,268	-	-	-	**65,592,268**	**38,791,094**
Unrated	29,633,172	-	-	-	**29,633,172**	**8,502,067**
Exposure	*179,906,006*	*4,006,903*	-	-	***183,912,909***	***160,524,664***
Loss allowance	250,637	5,603	-	-	**256,240**	-
Carrying amount	**179,655,369**	**4,001,300**	**-**	**-**	**183,656,669**	**160,524,664**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

Credit quality of financial assets other than loan and advances to customers, based on the internal rating system of the Bank is categorised as follows:

31 December 2018	Cash and balances with Central Bank	Due from other banks	Investment securities	Other Assets	Total
Good	285,134,696	853,995,051	1,486,663,848	14,285,515	2,640,079,110
Acceptable	-	-	-	-	-
Close monitoring	-	-	-	-	-
Total	**285,134,696**	**853,995,051**	**1,486,663,848**	**14,285,515**	**2,640,079,110**

31 December 2017	Cash and balances with Central Bank	Due from other banks	Investment securities	Other Assets	Total
Good	295,119,649	718,615,764	1,372,431,232	19,278,692	2,405,445,337
Acceptable	-	-	-	-	-
Close monitoring	-	-	-	-	-
Total	**295,119,649**	**718,615,764**	**1,372,431,232**	**19,278,692**	**2,405,445,337**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

The following table sets out information about the credit quality loans to customers for the corporate portfolio in 2018. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

DISCLOSURES BY CREDIT RISK RATING GRADES – LOANS TO CUSTOMERS AT AMORTISED COST - CORPORATE PORTFOLIO

31 December 2018	**12-month ECL**	**Lifetime ECL not credit-impaired**	**Lifetime ECL credit-impaired**	**Total**
Large Corporate				
Strong (rating A)	7,869,252	-	-	**7,869,252**
Satisfactory(rating B&C)	402,909,395	39,039,552	116,192	**442,065,139**
Watch list (higher risk) (rating D lower than C)	14,132,987	19,872,035	-	**34,005,022**
Default (Lower than D and over 90 days past due)	-	-	30,040,471	**30,040,471**
Total Rated	*424,911,634*	*58,911,587*	*30,156,663*	***513,979,884***
Non Rated	203,514,630	4,371,107	4,353	**207,890,090**
Total gross amount	**628,426,264**	**63,282,694**	**30,161,016**	**721,869,974**
Loss allowance	29,295,167	3,517,809	5,660,842	**38,473,818**
Carrying amount	**599,131,097**	**59,764,885**	**24,500,174**	**683,396,156**
Collateral held for credit impaired assets & assets at FVPL	1,001,763,298	86,621,443	43,437,766	**1,131,822,507**
SME Corporate				
Strong (rating A)	1,536,745	-	-	**1,536,745**
Satisfactory(rating B&C)	45,359,788	9,364,864	181,731	**54,906,383**
Watch list (higher risk) (rating D lower than C)	1,886,425	938,274	9,718	**2,834,417**
Default (Lower than D and over 90 days past due)	-	-	4,349,249	**4,349,249**
Total Rated	*48,782,958*	*10,303,138*	*4,540,698*	***63,626,794***
Non Rated	13,129,277	1,422,845	9,827	**14,561,949**
Total gross amount	**61,912,235**	**11,725,983**	**4,550,525**	**78,188,743**
Loss allowance	1,622,142	731,572	818,088	**3,171,802**
Carrying amount	**60,290,093**	**10,994,411**	**3,732,437**	**75,016,941**
Collateral held for credit impaired assets & assets at FVPL	190,531,445	28,665,434	12,855,547	**232,052,426**
Micro Corporate				
Strong (rating A)	724,754	-	-	**724,754**
Satisfactory(rating B&C)	16,803,011	2,260,597	15,467	**19,079,075**
Watch list (higher risk) (rating D lower than C)	644,325	407,763	-	**1,052,088**
Default (Lower than D and over 90 days past due)	-	-	5,482,690	**5,482,690**
Total Rated	*18,172,090*	*2,668,360*	*5,498,157*	***26,338,607***
Non Rated	19,438,555	1,969,315	22,998	**21,430,868**
Total gross amount	**37,610,645**	**4,637,675**	**5,521,155**	**47,769,475**
Loss allowance	1,676,307	426,365	1,148,940	**3,251,612**
Carrying amount	**35,934,338**	**4,211,310**	**4,372,215**	**44,517,863**
Collateral held for credit impaired assets & assets at FVPL	93,565,833	9,358,848	14,828,561	**117,753,242**
OFF BALANCE SHEET				
Credit cards Loss allowance	63,473	-	-	**63,473**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

The following table sets out information about the credit quality loans to customers for the retail portfolio in 2018. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

DISCLOSURES BY CREDIT RISK RATING GRADES – LOANS TO CUSTOMERS AT AMORTISED COST – RETAIL PORTFOLIO

31 December 2018	12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Total
Mortgage				
Defaults	-	-	9,903,456	**9,903,456**
Non Rated	242,998,211	11,501,219	2,574	**254,502,004**
Total gross amount	**242,998,210**	**11,501,219**	**9,906,030**	**264,405,460**
Loss allowance	678,258	363,544	2,008,857	**3,050,659**
Carrying amount	**242,319,953**	**11,137,675**	**7,897,173**	**261,354,801**
Collateral held for credit impaired assets & assets at FVPL	416,444,604	22,617,542	19,530,068	**458,592,214**
Consumer				
Defaults	-	-	5,338,753	**5,338,753**
Non Rated	136,694,619	3,307,824	17,000	**140,019,443**
Total gross amount	**136,694,619**	**3,307,824**	**5,355,753**	**145,358,196**
Loss allowance	902,474	58,618	2,270,293	**3,231,385**
Carrying amount	**135,792,145**	**3,249,206**	**3,085,460**	**142,126,811**
Collateral held for credit impaired assets & assets at FVPL	142,809,978	5,004,202	7,591,519	**155,405,699**
Credit_cards				
Defaults	-	-	1,395,014	**1,395,014**
Non Rated	8,897,203	247,279	293	**9,144,775**
Total gross amount	**8,897,203**	**247,279**	**1,395,307**	**10,539,789**
Loss allowance	119,773	10,564	977,819	**1,108,156**
Carrying amount	**8,777,430**	**236,715**	**417,488**	**9,431,633**
Collateral held for credit impaired assets & assets at FVPL	-	-	-	**-**
OFF BALANCE SHEET				
Credit cards Loss allowance	155,101	-	-	**155,101**

Set out below is an analysis about the credit quality of corporate loans to customers in the comparative period:

Rating	31 December 2017
A – Good	7,342,143
B – Acceptable	731,956,938
C – Close Monitoring	63,069,547
D – Unacceptable	34,247,199
(Note 11)	**836,615,827**
Accrued interest	8,424,729
Less: unamortized deferred fee income	(2,037,156)
Total	**843,003,400**

5. Financial risk management (continued)

(b) Credit Risk (continued)

iii. Credit quality analysis (continued)

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, its performance is closely monitored for the purpose of impairment testing.

Set out below are the carrying amounts of loans to customers whose term have been renegotiated and are under monitoring:

FORBORNE LOANS TO CUSTOMERS ACCORDING TO THEIR CREDIT QUALITY AT AMORTISED COST

31 December 2018	**Total amount of Loans**	**Total amount of Forborne Loans**	**Forborne Loans (%)**
Stage 1	1,116,539,179	27,804,487	2.5%
Stage 2	94,702,674	17,011,179	18.0%
Stage 3	56,889,786	24,807,419	43.6%
Exposure before impairment	**1,268,131,639**	**69,623,085**	5.5%
Stage 1 Allowance	34,294,122	1,392,729	4.1%
Stage 2 Allowance	5,108,473	2,432,308	47.6%
Stage 3 Allowance	12,884,839	5,390,616	41.8%
Total net amount	**1,215,844,205**	**60,407,432**	**5.0%**
Value of collateral	2,095,626,085	120,460,571	5.7%
OFF BALANCE SHEET			
Allowance	**218,574**	**-**	**-**

	Loans to customers			
	Retail	**Corporate**	**Advances**	**Total Loans**
31 December 2017	4,604,362	77,894,876	18,230	82,517,468

iv. Collateral and other credit enhancements

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.
The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically.

The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Financial Assets
- Charges over business assets such as premises, machineries, and accounts receivable;

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured.

5. Financial risk management (continued)

(b) Credit Risk (continued)

iv. Credit Collateral and other credit enhancements (continued)

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial instruments.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

Set out below is an analysis of collateral and credit enhancement obtained during the years:

	Loans to customers		
31 December 2018	**Retail**	**Corporate**	**Total Loans**
Residential, commercial or industrial Property	897,233,698	1,297,191,555	2,194,425,253
Financial assets	36,884,143	594,067,642	630,951,785
Other	240,375,159	269,684,739	510,059,898
Total	**1,174,493,000**	**2,160,943,936**	**3,335,436,936**

	Loans to customers		
31 December 2017	**Retail**	**Corporate**	**Total Loans**
Residential, commercial or industrial Property	845,197,410	1,259,185,632	2,104,383,042
Financial assets	28,521,738	200,444,266	228,966,004
Other	173,823,699	314,797,178	488,620,877
Total	**1,047,542,847**	**1,774,427,076**	**2,821,969,923**

Impaired loans and securities

Impaired loans and securities are loans and securities for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan / securities agreement(s). The Risk Committee of BKT is engaged with the grading of the customers and their scoring according to the appropriate categories. It decides the changes of grading and takes the necessary actions according to the monitoring procedures. The Risk Committee grades each loan according to these factors:

- Ability to Pay
- Financial Condition
- Management ability
- Collateral and Guarantors
- Loan Structure
- Industry and Economics

Past due but not impaired loans

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

5. Financial risk management (continued)

(b) Credit Risk (continued)

v. ***Impaired Financial Assets –Comparative information under IAS 39***

Allowances for impairment

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

Write-off policy

The Bank writes off a loan / security balance (and any related allowances for impairment losses) with the decision of the Board of Directors, in accordance with the regulation of Bank of Albania “On Credit Risk Management”. The write-off decision is taken 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.

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5. Financial risk management (continued)

(b) Credit Risk (continued)

vi. Concentrations of credit risk

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from loans and investment securities as at 31 December 2018 and 31 December 2017 is shown below:

	Note	Loans to customers		Loans to banks		Investment Securities	
		31 December 2018	31 December 2017	31 December 2018	31 December 2017	31 December 2018	31 December 2017
Carrying amount	9,10,11	1,215,625,631	1,172,497,193	195,676,165	424,728,134	1,486,663,848	1,372,431,232
Concentration by sector							
Corporate		798,548,846	800,111,348	-	-	107,669,159	111,486,142
Government		4,318,304	4,995,038	-	-	1,154,761,681	1,026,158,372
Banks		-	-	195,676,165	424,728,134	224,233,008	234,786,718
Retail		412,758,481	367,390,807	-	-	-	-
Total		**1,215,625,631**	**1,172,497,193**	**195,676,165**	**424,728,134**	**1,486,663,848**	**1,372,431,232**

Concentration by location	Note	Loans to customers		Loans to banks		Investment securities	
		31 December 2018	31 December 2017	31 December 2018	31 December 2017	31 December 2018	31 December 2017
Albania		727,543,495	681,065,501	-	-	1,013,541,838	926,554,882
Kosovo		284,401,425	253,791,951	-	-	73,541,200	67,060,492
Europe		151,636,982	214,969,694	155,646,092	370,036,599	343,835,206	344,890,969
Asia		-	-	-	12,077,986	9,416,360	
Middle East and Africa		15,251,096	22,670,047	-	32,529,155	43,240,895	29,646,961
America		36,792,633	-	40,030,073	10,084,394	3,088,349	4,277,928
Total	9,10,11	**1,215,625,631**	**1,172,497,193**	**195,676,165**	**424,728,134**	**1,486,663,848**	**1,372,431,232**

5. Financial risk management (continued)

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The purpose of Liquidity Risk Management (LRM) is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation. Bank’s LRM policy includes how the Bank identifies, measures, monitors and control that risk.

Organization of LRM: Bank’s LRM Organization includes two different bodies in the monitoring and management of liquidity. The involvement of different bodies helps provide clear allocation of the responsibility for monitoring/reporting and management of Liquidity Risk. Day-to-day management of liquidity belongs to the Treasury Group but day-to-day monitoring of Liquidity risk and compliance to the limits belongs to the Risk Management Group. The main purpose of the Risk Management Group, which conducts daily overview of LRM reports, is to provide an early warning signal of liquidity risk to the senior management of the Bank.

LRM Reports: Bank’s LRM policy includes sets of daily and monthly reports to be reviewed and monitored by Operational & Market Risk Department. Daily reports include Maximum Cumulative Outflow table and Cumulative Assets and Liabilities Breakdown table, which control respectively daily and monthly inflows/outflows of liquidity till 1-year maturity under “business as usual” scenario. Monthly reports include stress testing liquidity breakdown tables, which control daily and monthly inflows/ outflows of liquidity under separate bank specific and market specific crisis scenarios till 3-months maturity.

The LRM approach of the Bank results in positive liquidity gaps for all time stages up to one year as at 31 December 2018. This resulted mainly because of the following three assumptions:

- Using statistical method and historical data (derived since 2001), the actual LRM reports include analysis into the behavioural re-investment pattern of deposits;
- Short term securities available for sale are considered liquid through the secured funding from Bank of Albania;
- Bank’s reserve requirements held with BoA are considered as non-liquid assets.

An analysis of the Bank’s expected timing of cash flows by simple remaining maturity is shown in the following tables.

5. Financial risk management (continued)

(c) Liquidity risk (continued)

As at 31 December 2018, the Bank's monetary assets and liabilities have remaining contractual maturities as follows:

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and balances with Central Bank	285,134,696	-	-	-	-	285,134,696
Placement and balances with banks	606,436,667	21,641,501	29,083,048	1,157,670	-	658,318,886
Investment securities	42,534,988	70,894,239	309,475,615	668,735,124	395,023,882	1,486,663,848
Loans to banks	87,389	15,899,922	125,998,231	53,690,623	-	195,676,165
Loans to customers	49,330,345	35,638,447	381,852,968	475,972,318	272,831,553	1,215,625,631
Other assets	14,285,515	-	-	-	-	14,285,515
Total assets	**997,809,600**	**144,074,109**	**846,409,862**	**1,199,555,735**	**667,855,435**	**3,855,704,741**
Liabilities						
Customer deposits	1,387,850,987	260,433,238	1,097,030,479	362,240,994	22,194,153	3,129,749,851
Due to banks and financial institutions	242,071,226	75,079,247	4,118,459	2,592,713	-	323,861,645
Due to third parties	3,408,125	-	-	-	-	3,408,125
Accruals and other liabilities	16,568,359	-	-	-	924,318	17,492,677
Subordinated debt	-	-	61,407	-	28,617,140	28,678,547
Total liabilities	**1,649,898,697**	**335,512,485**	**1,101,210,345**	**364,833,707**	**51,735,611**	**3,503,190,845**
Net Position	**(652,089,097)**	**(191,438,376)**	**(254,800,483)**	**834,722,028**	**616,119,824**	**352,513,896**
Cumulative Net Position	**(652,089,097)**	**(843,527,473)**	**(1,098,327,956)**	**(263,605,928)**	**352,513,896**	**-**

LRM reports are produced for each single currency Lek, Euro and USD and for the total statement of financial position as well. Maximum cumulative outflow limits, which are managed and monitored on a daily-basis, have been assigned for each of the above currencies.

5. Financial risk management (continued)

(c) Liquidity risk (continued)

As at 31 December 2017, the Bank's monetary assets and liabilities have remaining contractual maturities as follows:

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and balances with Central Bank	295,119,649	-	-	-	-	295,119,649
Placement and balances with banks	217,209,617	68,256,300	8,421,713	-	-	293,887,630
Investment securities	34,125,812	106,098,643	376,347,469	608,010,529	247,848,779	1,372,431,232
Loans to banks	337,547	60,921,699	295,978,789	67,490,099	-	424,728,134
Loans to customers	53,311,916	43,174,486	335,860,985	491,550,117	248,599,689	1,172,497,193
Other assets	19,278,692	-	-	-	-	19,278,692
Total assets	**619,383,233**	**278,451,128**	**1,016,608,956**	**1,167,050,745**	**496,448,468**	**3,577,942,530**
Liabilities						
Customer deposits	1,162,285,761	260,990,885	1,052,579,509	363,913,673	28,129,520	2,867,899,348
Due to banks and financial institutions	237,385,471	99,252,588	1,090,577	5,977,365	-	343,706,001
Due to third parties	4,856,919	-	-	-	-	4,856,919
Accruals and other liabilities	16,187,794	-	-	-	914,883	17,102,677
Subordinated debt	-	-	72,756	-	29,916,741	29,989,497
Total liabilities	**1,420,715,945**	**360,243,473**	**1,053,742,842**	**369,891,038**	**58,961,144**	**3,263,554,442**
Net Position	**(801,332,712)**	**(81,792,345)**	**(37,133,886)**	**797,159,707**	**437,487,324**	**314,388,088**
Cumulative Net Position	**(801,332,712)**	**(883,125,057)**	**(920,258,943)**	**(123,099,236)**	**314,388,088**	**-**

5. Financial risk management (continued)

(c) Liquidity risk (continued)

Exposure to liquidity risk

One of the key ratios used by the Bank for managing liquidity risk, which is required by Bank of Albania (BoA) at the same time, is the ratio of total liquid assets to total short-term liabilities on a daily basis. Based on the regulation No.71 dated 14.10.2009 "Liquidity risk management policy" amended with decision No. 75 dated 26.10.2011 the total liquidity ratio should be at a minimum of 25%, whereas the minimum of individual ratios for local and foreign currencies (FX) at 20%. Meanwhile, based on the changes of this regulation effective 15 May 2013, the minimum of total liquidity ratio was decreased to 20% and that of individual ratios to 15%. In addition, in March 2018 BoA has increased again the minimum of liquidity ratio for foreign currencies to 20%.

As per this regulation, article 19 point 4, liquid assets are considered: cash balance, current accounts with BoA including mandatory reserve, T-bills and securities according to their remaining maturity and ability to turn into liquidity, where the non-resident counterparties' balances are discounted with the respective haircuts according to international credit rating. Short-term liabilities are considered all liabilities with remaining maturity up to one year.

Details of the reported Bank ratio at the reporting dates were as follows:

	31-Dec-2018	**31-Dec-2017**
Total Liquid Assets/Total Short Term Liabilities Ratio	42.43%	31.52%
Liquid Assets in local currency/Short Term Liabilities in local currency Ratio	47.59%	50.42%
Liquid Assets in foreign currency/Short Term Liabilities in foreign currency Ratio	38.74%	17.62%

(d) Market risk

1) Foreign currency risk

Foreign currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Bank manages this risk by establishing and monitoring limits on open positions and also ensuring that these positions remain in compliance with the Bank of Albania guidelines and Bank's internal operational covenants. The Bank has in place procedures for the independent checking of open foreign currency positions.

5. Financial risk management (continued)

(d) Market risk (continued)

1) Foreign currency risk (continued)

The following tables present the USD equivalent amounts of monetary assets and liabilities by currency as at 31 December 2018 and 31 December 2017:

31 December 2018	*Lek*	*USD*	*Euro*	*Other*	*Total*
Assets			*(In USD equivalent)*		
Cash and balances with Central Bank	77,514,564	16,105,196	180,466,685	11,048,251	285,134,696
Placements and balances with banks	6,304	199,475,559	422,669,900	36,167,123	658,318,886
Investment securities	935,603,243	207,961,603	256,722,087	86,376,915	1,486,663,848
Loans to banks	-	29,602,403	166,073,762	-	195,676,165
Loans to customers	534,628,074	95,284,619	585,712,938	-	1,215,625,631
Other assets	8,632,585	180,097	4,992,076	480,757	14,285,515
Total assets	**1,556,384,770**	**548,609,477**	**1,616,637,448**	**134,073,046**	**3,855,704,741**
Foreign exchange contracts	**802,124**	**50,094,942**	**89,015,102**	**22,275,679**	**162,187,847**
Liabilities					
Customer deposits	1,316,708,131	139,315,846	1,607,030,957	66,694,917	3,129,749,851
Due to banks and financial institutions	258,991,271	43,777,344	19,041,102	2,051,928	323,861,645
Due to third parties	3,408,125	-	-	-	3,408,125
Accruals and other liabilities	6,812,502	5,092,484	5,482,666	105,025	17,492,677
Subordinated debt	-	-	28,678,547	-	28,678,547
Total liabilities	**1,585,920,029**	**188,185,674**	**1,660,233,272**	**68,851,870**	**3,503,190,845**
Foreign exchange contracts	**499,444**	**47,311,153**	**33,086,582**	**81,290,668**	**162,187,847**
Net position (GAP)	**(29,232,579)**	**363,207,592**	**12,332,696**	**6,206,187**	**352,513,896**
Total assets / Total liabilities	98.16%	254.23%	100.73%	104.13%	109.62%
GAP / FX denominated assets		0.61	0.007	0.0397	0.09
Sensitivity analysis					
Lek depreciates by 10%		33,018,872	1,121,154	564,199	34,704,225
Lek depreciates by 5%		17,295,600	587,271	295,533	18,178,404
Lek appreciates by 5%		(19,116,189)	(649,089)	(326,641)	(20,091,919)
Lek appreciates by 10%		(40,356,399)	(1,370,300)	(689,576)	(42,416,275)

5. Financial risk management (continued)

(d) Market risk (continued)

1) Foreign currency risk (continued)

31 December 2017	*Lek*	*USD*	*Euro*	*Other*	*Total*
Assets			*(In USD equivalent)*		
Cash and balances with Central Bank	77,514,564	16,105,196	180,466,685	11,048,251	285,134,696
Placements and balances with banks	6,304	199,475,559	422,669,900	36,167,123	658,318,886
Investment securities	935,603,243	207,961,603	256,722,087	86,376,915	1,486,663,848
Loans to banks	-	29,602,403	166,073,762	-	195,676,165
Loans to customers	534,628,074	95,284,619	585,712,938	-	1,215,625,631
Other assets	8,632,585	180,097	4,992,076	480,757	14,285,515
Total assets	**1,555,719,754**	**548,612,346**	**1,617,299,595**	**134,073,046**	**3,855,704,741**
Foreign exchange contracts	**802,124**	**50,094,942**	**89,015,102**	**22,275,679**	**162,187,847**
Liabilities					
Customer deposits	1,316,708,131	139,315,846	1,607,030,957	66,694,917	3,129,749,851
Due to banks and financial institutions	258,991,271	43,777,344	19,041,102	2,051,928	323,861,645
Due to third parties	3,408,125	-	-	-	3,408,125
Accruals and other liabilities	6,812,502	5,092,484	5,482,666	105,025	17,492,677
Subordinated debt	-	-	28,678,547	-	28,678,547
Total liabilities	**1,585,920,029**	**188,185,674**	**1,660,233,272**	**68,851,870**	**3,503,190,845**
Foreign exchange contracts	**499,444**	**47,311,153**	**33,086,582**	**81,290,668**	**162,187,847**
Net position (GAP)	**(29,232,579)**	**363,207,592**	**12,332,696**	**6,206,187**	**352,513,896**
Total assets / Total liabilities	98.16%	254.23%	100.73%	104.13%	109.62%
GAP / FX denominated assets		0.61	0.007	0.0397	0.09
Sensitivity analysis					
Lek depreciates by 10%		33,018,872	1,121,154	564,199	34,704,225
Lek depreciates by 5%		17,295,600	587,271	295,533	18,178,404
Lek appreciates by 5%		(19,116,189)	(649,089)	(326,641)	(20,091,919)
Lek appreciates by 10%		(40,356,399)	(1,370,300)	(689,576)	(42,416,275)

2) Interest rate risk

Interest rate risk is the risk that the value of financial instruments will fluctuate due to changes in market interest rates. The Treasury Department of the Bank manages the interest rate risk through monitoring the market conditions and taking necessary re-pricing or reallocation decisions with the approval of the Asset and Liability Committee. The sensitivity analysis has been determined based on the exposure to interest rates for both financial assets and financial liabilities assuming that their amounts outstanding at the reporting date were outstanding for the whole year.

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk (continued)

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

	Lek	*USD*	*Euro*
Assets			
Cash and balances with Central Bank	0.70%	N/A	N/A
Placement and balances with banks	N/A	2.65%	0.84%
Investment securities	4.39%	5.70%	3.24%
Loans to banks	N/A	6.74%	1.64%
Loans to customers	5.67%	8.25%	5.53%
Liabilities			
Customer deposits	1.02%	0.70%	0.38%
Due to banks and financial institutions	1.09%	3.22%	0.77%
Subordinated debt	-	-	5.15%

The average effective yields of significant categories of financial assets and liabilities of the Bank as at 31 December 2017 were as follows:

	Lek	*USD*	*Euro*
Assets			
Cash and balances with Central Bank	0.88%	N/A	N/A
Placement and balances with banks	N/A	2.47%	2.40%
Investment securities	4.32%	5.20%	3.10%
Loans to banks	N/A	4.38%	1.45%
Loans to customers	6.03%	7.65%	5.87%
Liabilities			
Customer deposits	1.07%	0.66%	0.41%
Due to banks and financial institutions	1.31%	2.50%	2.73%
Subordinated debt	-	-	5.15%

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk (continued)

The interest re-pricing dates of significant categories of financial assets and liabilities of the Bank as at 31 December 2018 are as follows:

	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 year*	*Total*
Cash and balances with Central Bank	285,134,696	-	-	-	-	285,134,696
Placement and balances with banks	606,436,667	21,641,501	29,083,048	1,157,670	-	658,318,886
Investment securities	43,067,683	73,654,061	314,682,327	660,698,568	394,561,209	1,486,663,848
Loans to banks	37,231,329	81,283,430	77,161,406	-	-	195,676,165
Loans to customers	676,692,628	28,013,453	389,414,240	115,906,498	5,598,812	1,215,625,631
Total	**1,648,563,003**	**204,592,445**	**810,341,021**	**777,762,736**	**400,160,021**	**3,841,419,226**
Liabilities						
Customer deposits	1,387,850,987	260,433,238	1,097,030,479	362,240,994	22,194,153	3,129,749,851
Due to banks and financial institutions	242,071,226	79,755,647	2,034,772	-	-	323,861,645
Subordinated debt	-	-	28,678,547	-	-	28,678,547
Total	**1,629,922,213**	**340,188,885**	**1,127,743,798**	**362,240,994**	**22,194,153**	**3,482,290,043**

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk (continued)

The interest re-pricing dates of significant categories of financial assets and liabilities of the Bank as at 31 December 2017 were as follows:

	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Total*
Assets						
Cash and balances with Central Bank	295,119,649	-	-	-	-	295,119,649
Placement and balances with banks	217,209,617	68,256,300	8,421,713	-	-	293,887,630
Investment securities	34,582,397	111,060,779	384,537,495	594,436,951	247,813,610	1,372,431,232
Loans to banks	93,392,213	182,835,291	148,500,630	-	-	424,728,134
Loans to customers	692,765,944	30,945,251	292,250,898	147,377,448	9,157,652	1,172,497,193
Total	**1,333,069,820**	**393,097,621**	**833,710,736**	**741,814,399**	**256,971,262**	**3,558,663,838**
Liabilities						
Customer deposits	1,162,285,761	260,990,885	1,052,579,509	363,913,673	28,129,520	2,867,899,348
Due to banks and financial institutions	237,385,472	106,320,529	-	-	-	343,706,001
Subordinated debt	-	-	29,989,497	-	-	29,989,497
Total	**1,399,671,233**	**367,311,414**	**1,082,569,006**	**363,913,673**	**28,129,520**	**3,241,594,846**

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk (continued)

Interest rate sensitivity

The sensitivity analysis below has 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 to the net profit, when the change is applied to the GAP position as per re-pricing terms presented in note above, assuming all the other variables are held constant:

	31 December 2018		*31 December 2017*	
	Up to 1 year	**Over 1 year**	**Up to 1 year**	**Over 1 year**
Interest rate increases by 2%	12,327,508	28,197,260	10,785,495	22,920,345
Interest rate increases by 1.5%	9,245,631	21,147,945	8,089,121	17,190,258
Interest rate increases by 1%	6,163,754	14,098,630	5,392,748	11,460,172
Interest rate decreases by 1%	(6,163,754)	(14,098,630)	(5,392,748)	(11,460,172)
Interest rate decreases by 1.5%	(9,245,631)	(21,147,945)	(8,089,121)	(17,190,258)
Interest rate decreases by 2%	(12,327,508)	(28,197,260)	(10,785,495)	(22,920,345)

(e) Operational risks

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

The Bank’s objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank’s reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The implementation of controls to address operational risk is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective.

Compliance with internal standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank.

5. Financial risk management (continued)

(f) Capital management

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. There have been no material changes in the Bank's management of capital during the period.

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 new regulations "On the capital adequacy ratio" and "On the regulatory capital" entered into force in 2015 are issued pursuant to Law No. 8269 date 23.12.1997 "On the Bank of Albania", and Law No. 9662 date 18.12.2006 "On Banks in the Republic of Albania".

Capital Adequacy Ratio

The Capital Adequacy Ratio is the proportion of the regulatory capital to risk weighted exposures, calculated as the sum of the risk-weighted exposure amounts, on- and off-balance sheet for credit risk and for credit counterparty risk, capital requirement for market and operational risk.

The minimum Regulatory Capital Ratio against the risk weighted exposures required by Bank of Albania is 12%. The minimum Tier 1 Capital Ratio is 6.0% and the minimum Common Equity Tier 1 Ratio is 4.5%.

In December 2018, BKT has reported the following ratios:

- Regulatory Capital Ratio 17.53% (December 2017: 14.28%);
- Tier 1 Capital Ratio 16.19% (December 2017: 13.08%);
- Common Equity Tier 1 Ratio 16.19% (December 2017: 13.08%).

Risk-Weighted Assets (RWAs)

For calculation of credit risk, exposures, on- and off-balance sheet are classified in 15 exposure classes. In general terms, client/ issuer type, loan destination and collateral are the main determinants of the exposure class. Each exposure class has its own specific requirements on how to assess the appropriate risk weight and respective risk weighted exposures. For credit risk and counterparty risk is applied the Standardised Approach. Market risk capital requirements are calculated in case the Bank has a Trading portfolio that fulfils the requirements defined by the regulation and/ or a total net open currency position that is larger than the defined minimum threshold. Operational risk capital requirement is calculated based on the Basic Indicator Approach.

Bank of Albania has abrogated in May 2018 the countercyclical measure on non-resident Treasury investments, applied since March 2013, which has affected positively the total RWAs and the Capital Adequacy Ratio of the Bank as at 31 December 2018.

6. Segmental reporting

	31 December 2018			31 December 2017		
Geographical Segments	**Albania**	**Kosovo**	**Combined**	**Albania**	**Kosovo**	**Combined**
Assets						
Cash and balances with Central Bank	224,100,345	61,034,351	285,134,696	251,423,002	43,696,647	295,119,649
Placement and balances with banks	637,403,684	20,915,202	658,318,886	292,243,354	1,644,276	293,887,630
Investment securities	1,398,742,978	87,920,870	1,486,663,848	1,306,063,623	66,367,609	1,372,431,232
Loans to banks	195,676,165	-	195,676,165	388,184,367	36,543,767	424,728,134
Loans to customers	932,464,464	283,161,167	1,215,625,631	918,705,242	253,791,951	1,172,497,193
Investment in associates	1,373,165	-	1,373,165	1,435,525	-	1,435,525
Property and equipment	39,000,687	2,050,713	41,051,400	36,502,306	2,403,142	38,905,448
Intangible assets	3,700,900	-	3,700,900	3,080,573	-	3,080,573
Other assets	36,539,469	16,884,684	53,424,153	48,721,959	8,529,968	57,251,927
Total assets	**3,469,001,857**	**471,966,987**	**3,940,968,844**	**3,246,359,951**	**412,977,360**	**3,659,337,311**
Liabilities and shareholder’s equity						
Liabilities						
Customer deposits	2,727,559,612	402,190,239	3,129,749,851	2,506,890,356	361,008,992	2,867,899,348
Due to banks and financial institutions	298,742,170	25,119,475	323,861,645	336,614,115	7,091,886	343,706,001
Due to third parties	3,408,125	-	3,408,125	4,856,919	-	4,856,919
Deferred tax liabilities	411,719	-	411,719	431,014	-	431,014
Accruals and other liabilities	17,995,355	2,130,990	20,126,345	17,603,465	3,451,264	21,054,729
Subordinated debt	28,678,547	-	28,678,547	29,989,497	-	29,989,497
Total liabilities	**3,076,795,528**	**429,440,704**	**3,506,236,232**	**2,896,385,366**	**371,552,142**	**3,267,937,508**
Shareholder’s equity						
Share capital			300,000,000			274,350,310
Translation reserve			119,742			3,004,286
Fair value reserve			24,707,662			4,908,867
Retained earnings			109,905,208			109,136,340
Total shareholder’s equity			**434,732,612**			**391,399,803**
Total liabilities and shareholder’s equity			**3,940,968,844**			**3,659,337,311**

Within “Other assets” for BKT Kosovo, it is included the amount of USD 14,653,848, which represents intragroup transactions between Head Office/Branches in Albania and Kosovo as at 31 December 2018, and has been eliminated on combination (31 December 2017: USD 4,285,337).

6. Segmental reporting (continued)

Geographical Segments	2018			2017		
	Albania	**Kosovo**	**Combined**	**Albania**	**Kosovo**	**Combined**
Interest						
Interest income	139,848,338	18,207,400	158,055,738	121,023,455	17,600,965	138,624,420
Interest expense	(24,308,793)	(3,306,560)	(27,615,353)	(23,971,695)	(3,311,105)	(27,282,800)
Net interest margin	**115,539,545**	**14,900,840**	**130,440,385**	**97,051,760**	**14,289,860**	**111,341,620**
Non-interest income, net						
Fees and commissions, net	13,666,527	4,363,226	18,029,753	13,882,479	4,740,572	18,623,051
Foreign exchange revaluation gain, net	(6,821,546)	23,151	(6,798,395)	(10,518,077)	(2,915)	(10,520,992)
Foreign exchange trading activities income, net	(4,854,995)	88,202	(4,766,793)	425,681	(100,979)	324,702
Securities trading gain, net	2,686,710	477,466	3,164,176	3,582,910	-	3,582,910
Other (expense) / income, net	(5,820,360)	131,509	(5,688,851)	(4,122,709)	169,771	(3,952,938)
Total non-interest income, net	**(1,143,664)**	**5,083,554**	**3,939,890**	**3,250,284**	**4,806,449**	**8,056,733**
Operating expenses						
Personnel expenses	(15,206,038)	(4,525,364)	(19,731,402)	(13,314,076)	(4,707,031)	(18,021,107)
Administrative expenses	(26,028,350)	(5,812,794)	(31,841,144)	(20,818,042)	(5,484,059)	(26,302,101)
Depreciation and amortization	(3,940,087)	(734,602)	(4,674,689)	(3,003,595)	(851,634)	(3,855,229)
Total operating expenses	**(45,174,475)**	**(11,072,760)**	**(56,247,235)**	**(37,135,713)**	**(11,042,724)**	**(48,178,437)**
Impairment of loans	(3,214,288)	(2,623,546)	(5,837,834)	(1,114,842)	(431,466)	(1,546,308)
Impairment of other financial instruments	(1,128,206)	(788,943)	(1,917,149)			
Profit before taxes	**64,878,912**	**5,499,145**	**70,378,057**	**62,051,489**	**7,622,119**	**69,673,608**
Income tax	(11,457,696)	(487,272)	(11,944,968)	(10,151,342)	(645,766)	(10,797,108)
Net profit for the year	**53,421,216**	**5,011,873**	**58,433,089**	**51,900,147**	**6,976,353**	**58,876,500**

Interest income of USD 150,621 (31 December 2017: USD 97,326), which represents interest earned from BKT Kosovo on intra-group balances was eliminated on combination.

7. Cash and balances with Central Bank

Cash and balances with Central Bank as at 31 December 2018 and 31 December 2017 are detailed as follows:

	31 December 2018	31 December 2017
Cash on hand	63,500,138	43,261,846
Deposits with the Central Bank of Kosovo	35,815,604	26,503,139
Bank of Albania		
Current account	-	17,133,208
Statutory reserve	185,812,671	208,212,605
Accrued interest	6,283	8,851
	185,818,954	225,354,664
	285,134,696	**295,119,649**

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 the Bank of Albania as a statutory reserve account, which during the month can be decreased to 70% of this level, provided that the monthly average is maintained.

Balances with CBK include the minimum required statutory reserve of 10% of customer deposits in Kosovo and the minimum cash deposit pledged as capital equivalency deposit.

Cash and cash equivalents as at 31 December 2018 and 31 December 2017 are presented as follows:

	31 December 2018	31 December 2017
Cash and balances with Central Bank	285,134,696	295,119,649
Statutory reserve in Albania	(185,812,671)	(208,212,605)
Statutory reserve in Kosovo	(28,070,540)	(26,113,238)
Current accounts with banks	292,808,458	68,717,775
Placements with maturities of 3 months or less	346,206,249	205,930,365
	710,266,192	**335,441,946**

8. Placements and balances with banks

Placements and balances with banks as at 31 December 2018 and 31 December 2017 consisted as follows:

	31 December 2018	31 December 2017
Placements	352,801,298	219,374,592
Cash collateral held by financial institutions	12,338,657	5,321,671
Current accounts	292,808,458	68,717,775
Accrued interest	382,438	473,592
Impairment	(11,965)	-
	658,318,886	**293,887,630**

Placements are held with non-resident banks from Organisation for Economic Cooperation and Development ("OECD") countries and have contractual maturities up to 1 year. Current accounts represent balances with correspondent banks in the OECD countries.

Cash collateral represents mostly collateral held by financial institutions in relation to letters of credit issued to the Bank's clients and cash deposits that secure risks in relation to the credit cards activity of the Bank.

9. Investment securities

Investment securities as at 31 December 2018 and 31 December 2017 are presented as follows:

	31 December 2018	31 December 2017
Investment securities - measured at FVOCI (Treasury bills available-for-sale)	181,505,892	209,396,356
Investment securities - measured at FVOCI (Available-for-sale securities)	1,118,482,213	1,002,510,212
Investment securities - measured at FVTPL (Held-for-trading securities)	3,019,074	-
Investment securities - measured at amortised cost (Held-to-maturity securities)	183,656,669	160,524,664
Total	**1,486,663,848**	**1,372,431,232**

a) Investment securities - measured at FVOCI (Treasury bills available-for-sale)

Treasury bills available-for-sale by original maturity as at 31 December 2018 and 31 December 2017 are presented as follows:

	31 December 2018				
	Purchase Value	Amortized discount	Marked to market gain (loss)	Impairment	Fair Value
6 months	10,274,642	12,554	12,992	(7,450)	10,292,738
12 months	168,542,163	2,487,505	303,628	(120,142)	171,213,154
	178,816,805	**2,500,059**	**316,620**	**(127,592)**	**181,505,892**

	31 December 2017			
	Purchase Value	Amortized discount	Marked to market gain (loss)	Fair Value
6 months	298,906	118	85	299,109
12 months	206,388,523	2,823,118	(114,394)	209,097,247
	206,687,429	**2,823,236**	**(114,309)**	**209,396,356**

b) Investment securities - measured at FVOCI (Available-for-sale securities)

Available-for-sale securities as at 31 December 2018 comprise as follows:

Type	Nominal value	Unamortized discount	Accrued interest	Marked to market gain/ (loss)	Impairment	Fair Value
Lek denominated	716,026,049	8,307,495	10,668,623	34,853,718	(1,193,227)	768,662,658
USD denominated	119,192,000	(434,529)	1,102,073	(3,537,752)	(165,773)	116,156,019
EUR denominated	147,951,712	(56,030)	1,650,485	(1,999,743)	(259,803)	147,286,621
TRY denominated	44,193,065	7,061,156	-	(904,248)	(265,867)	50,084,106
CAD denominated	8,071,603	-	-	-	(30,717)	8,040,886
GBP denominated	25,146,509	721,593	569,505	(240,088)	(4,522)	26,192,997
SEK denominated	22,904	-	-	-	(216)	22,688
CHF denominated	2,033,018	4,367	6,509	(7,417)	(239)	2,036,238
	1,062,636,860	**15,604,052**	**13,997,195**	**28,164,470**	**(1,920,364)**	**1,118,482,213**

9. Investment securities (continued)

Available-for-sale securities as at 31 December 2017 comprise as follows:

Type	Nominal value	Unamortized discount	Accrued interest	Marked to market gain/ (loss)	Fair Value
Lek denominated	642,862,754	10,980,460	9,841,939	7,330,526	671,015,679
USD denominated	117,842,000	1,228,643	1,013,995	(1,121,060)	118,963,578
EUR denominated	123,126,891	2,078,061	1,288,404	2,569,026	129,062,382
TRY denominated	61,414,994	-	4,017,278	(369,471)	65,062,801
CAD denominated	10,671,500	-	-	(2,932,775)	7,738,725
GBP denominated	9,758,222	600,028	138,905	144,037	10,641,192
SEK denominated	75,018	-	-	(49,163)	25,855
	965,751,379	**14,887,192**	**16,300,521**	**5,571,120**	**1,002,510,212**

c) Investment securities - measured at FVTPL (Held-for-trading securities)

Held for trading securities as at 31 December 2018 comprise as follows:

Type	Nominal value	Unamortized discount	Accrued interest	Marked to market gain/ (loss)	Fair Value
EUR denominated	3,205,120	(141,941)	60,196	(104,301)	3,019,074
	3,205,120	**(141,941)**	**60,196**	**(104,301)**	**3,019,074**

There were no held-for-trading securities as at 31 December 2017.

d) Investment securities - measured at amortised cost (Held-to-maturity securities)

Held-to-maturity securities as at 31 December 2018 comprise as follows:

Type	Nominal Value	Unamortized Premium / (Discount)	Accrued interest	Impairment	Net Value
USD denominated	92,000,000	(992,433)	895,994	(97,977)	91,805,584
EUR denominated	91,480,668	(297,468)	826,148	(158,263)	91,851,085
	183,480,668	**(1,289,901)**	**1,722,142**	**(256,240)**	**183,656,669**

Held-to-maturity securities as at 31 December 2017 comprise as follows:

Type	Nominal Value	Unamortized Premium / (Discount)	Accrued interest	Net Value
USD denominated	80,350,000	8,204	926,167	81,284,371
EUR denominated	78,487,155	(101,641)	854,779	79,240,293
	158,837,155	**(93,437)**	**1,780,946**	**160,524,664**

10. Loans to banks

The Bank has purchased syndicated loans of some non-resident banks with ratings as follows:

	31 December 2018				31 December 2017		
	Principal	**Interest**	**Impairment**	**Total**	**Principal**	**Interest**	**Total**
USD denominated	29,500,000	185,732	(83,329)	29,602,403	48,000,000	335,967	48,335,967
EUR denominated	165,979,410	317,646	(223,294)	166,073,762	375,246,412	1,145,755	376,392,167
	195,479,410	**503,378**	**(306,623)**	**195,676,165**	**423,246,412**	**1,481,722**	**424,728,134**

11. Loans to customers

Loans to customers consisted of the following:

	31 December 2018	31 December 2017
Loans to customers, gross	1,263,257,434	1,216,722,383
Accrued interest	9,523,822	10,049,925
Less allowances for impairment on loans	(52,506,008)	(49,784,026)
Less unamortized deferred fee income	(4,649,617)	(4,491,089)
	1,215,625,631	**1,172,497,193**

Movements in the allowance for impairment on loans:

	31 December 2018	31 December 2017
At 31 December	**49,784,026**	**47,182,080**
Impact of adopting IFRS 9 as at 1 January 2018	4,578,049	
At 1 January	54,362,075	
Impairment charge for the year, net	5,837,834	1,546,308
Provision reversal of written off loans	(9,208,697)	(5,881,869)
Translation difference	1,514,796	6,937,507
At the end of the period	**52,506,008**	**49,784,026**

All the loans are denominated in Lek, Euro and USD and bear interest at the following rates:

Loans in Lek	0.50% to 25.00%
Loans in Euro	0.50% to 22.09%
Loans in USD	3.20% to 10.11%

The Bank 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 Bank, and are covered by cash collaterals or are granted to personnel under special conditions.

11. Loans to customers (continued)

The classification of business loans by industry is as follows:

	31 December 2018		31 December 2017	
	USD	**%**	**USD**	**%**
Construction	157,414,280	18%	115,732,038	13%
Wholesale Trade	129,181,711	14%	117,568,923	14%
Electricity, Gas and Water Supply	75,480,763	9%	125,670,775	15%
Financial Intermediation	74,528,539	9%	59,545,681	7%
Mining and Quarrying	60,244,448	7%	54,905,046	7%
Retail Trade	55,842,375	7%	53,076,519	6%
Real Estate, Renting and Business Activity	39,750,676	5%	62,812,823	7%
Hotels and Restaurants	27,576,437	3%	23,281,395	3%
Manufacturing of Basic Metals and Fabricated Metal Products	23,763,269	3%	23,218,930	3%
Manufacturing of Other Non-metallic Products	21,153,257	3%	27,113,500	3%
Transport, Storage and Communication	16,095,951	2%	17,793,052	2%
Agriculture, Hunting and Forestry	15,421,987	2%	14,041,910	2%
Manufacture of Food Products, Beverages	12,962,923	2%	14,164,973	2%
Other Community, Social and Personal Activities	12,457,653	1%	22,171,853	3%
Personal Needs	8,494,209	1%	10,266,072	1%
Education	5,964,919	1%	4,958,145	1%
Manufacture of Rubber and Plastic Products	3,504,796	1%	5,090,817	1%
Health and Social Work	3,175,012	1%	3,468,185	1%
Manufacture of Wood and Wood Products	2,680,379	1%	2,588,949	1%
Manufacture of Pulp, Paper and Paper Products	1,595,527	1%	2,615,916	1%
Other Sectors	94,665,099	9%	76,530,325	7%
	841,954,210	**100%**	**836,615,827**	**100%**

The classification of retail loans by type is as follows:

	31 December 2018		31 December 2017	
	USD	**%**	**USD**	**%**
Home purchase	238,323,906	57%	224,586,216	58%
Super Loan	79,429,674	19%	62,755,514	17%
Home improvement	24,739,930	6%	23,705,961	6%
Overdraft and credit cards	22,588,286	5%	19,511,525	5%
Shop purchase	17,285,606	4%	15,309,417	4%
Home reconstruction	6,745,240	2%	6,426,525	2%
Home advances	1,894,576	1%	1,522,493	1%
Car purchase	1,854,077	1%	1,193,379	1%
Technical equipment	805,949	1%	733,445	1%
Other types	27,635,980	4%	24,362,081	5%
	421,303,224	**100%**	**380,106,556**	**100%**

12. Investment in associates

Investment in associates of USD 1,373,165 (31 December 2017: 1,435,525) represents the equivalent amount of an investment of EUR 1,199,600 into the share capital of Albania Leasing Sh.a (the "Company") at a participation ratio of 29.99%. The Company was established in August 2, 2013 (inception date) as a Joint Stock Company. The Company obtained the license from the Bank of Albania on April 21, 2014 and started its leasing activity in June 2014.

13. Property and equipment

Property and equipment as at 31 December 2018 and 31 December 2017 are composed as follows:

	Land, buildings and leasehold improvements	Vehicles and other equipment	Computers and electronic equipment	Office equipment	Total
Gross value					
At 1 January 2017	**26,270,220**	**5,041,920**	**16,199,848**	**2,084,374**	**49,596,362**
Additions	17,366,794	1,006,135	1,778,022	148,333	20,299,284
Disposals / transfers	(81,040)	(308,694)	(1,237)	(9,298)	(400,269)
Translation difference	3,722,859	746,606	2,650,420	309,735	7,429,620
At 31 December 2017	**47,278,833**	**6,485,967**	**20,627,053**	**2,533,144**	**76,924,997**
Additions	1,200,501	1,452,444	3,180,238	210,683	**6,043,866**
Disposals / transfers	(64,545)	(756,923)	(730,301)	(120,953)	**(1,672,722)**
Translation difference	(56,931)	74,305	189,309	30,284	**236,967**
At 31 December 2018	**48,357,858**	**7,255,793**	**23,266,299**	**2,653,158**	**81,533,108**
Accumulated depreciation					
At 1 January 2017	**(11,406,907)**	**(4,250,646)**	**(13,245,080)**	**(1,732,112)**	**(30,634,745)**
Charge for the year	(1,001,228)	(440,266)	(1,377,559)	(180,032)	(2,999,085)
Disposals / write offs	70,235	297,963	1,237	9,298	378,733
Translation difference	(1,784,273)	(656,431)	(2,053,640)	(270,108)	(4,764,452)
At 31 December 2017	**(14,122,173)**	**(5,049,380)**	**(16,675,042)**	**(2,172,954)**	**(38,019,549)**
Charge for the year	(1,045,343)	(586,741)	(1,603,278)	(167,209)	**(3,402,571)**
Disposals / write offs	-	664,148	613,258	120,679	**1,398,085**
Translation difference	(244,193)	(39,583)	(149,790)	(24,107)	**(457,673)**
At 31 December 2018	**(15,411,709)**	**(5,011,556)**	**(17,814,852)**	**(2,243,591)**	**(40,481,708)**
Net book value					
At 1 January 2017	**14,863,313**	**791,274**	**2,954,768**	**352,262**	**18,961,617**
At 31 December 2017	**33,156,660**	**1,436,587**	**3,952,011**	**360,190**	**38,905,448**
At 31 December 2018	**32,946,149**	**2,244,237**	**5,451,447**	**409,567**	**41,051,400**

As at 31 December 2018 the gross value of the assets which were fully depreciated and still in use was USD 27,931,954 (2017: USD 26,155,498).

14. Intangible assets

Intangible assets as at 31 December 2018 and 31 December 2017 are composed as follows:

	Software
Gross value	
At 1 January 2017	**7,670,956**
Additions	2,084,545
Translation difference	1,178,606
At 31 December 2017	**10,934,107**
Additions	1,798,847
Translation difference	332,627
At 31 December 2018	**13,065,581**
Accumulated depreciation	
At 1 January 2017	**(6,019,264)**
Charge for the year	(856,144)
Translation difference	(978,126)
At 31 December 2017	**(7,853,534)**
Charge for the year	(1,272,118)
Translation difference	(239,029)
At 31 December 2018	**(9,364,681)**
Net book value	
At 1 January 2017	**1,651,692**
At 31 December 2017	**3,080,573**
At 31 December 2018	**3,700,900**

Software represents mainly the upgraded Bank's operating and accounting system, and the license and software for providing internet and mobile banking services.

15. Other assets

Other assets as at 31 December 2018 and 31 December 2017 are as follows:

	31 December 2018	31 December 2017
Assets acquired through legal process, net	34,385,667	36,307,721
Payments in transit	7,189,552	11,153,396
Prepaid expenses	4,085,691	977,302
Administration costs receivable from borrowers	2,531,432	2,716,627
Advances to suppliers	357,295	329,442
Inventory	290,932	358,770
Foreign exchange contracts revaluation gain	19,053	-
Other debtors, net	4,564,531	5,408,669
	53,424,153	**57,251,927**

Assets acquired through legal process represent the repossessed collaterals of some unrecoverable loans, the ownership of which was taken on behalf of the Bank. Repossessed collateral represents real estate assets acquired by the Group in settlement of overdue loans. The Group expects to dispose of the assets in the foreseeable future. The Bank has established an Asset Sale Committee, responsible for the disposal of these assets.

15. Other assets (continued)

The assets do not meet the definition of non-current assets held for sale, and are classified as inventories in accordance with IAS 2 “Inventories”. The assets were initially recognised at fair value when acquired. These assets are measured at the lower of their carrying amount and fair value less cost to sell. The Bank has estimated an impaired amount of USD 8,420,995 to the total gross amount of USD 42,806,662.
A number of these properties are leased to third parties. Subsequent renewals are negotiated with the lessee on an annual basis. Rental income from these properties of USD 122,770 (31 December 2017: USD 121,613) is recognised in other income.

Payments in transit represent customers’ payments drawn on other banks that are in the process of being collected.

Other debtors, net are composed as follows:

	31 December 2018	31 December 2017
Other debtors	7,941,486	8,058,127
Provision for other debtors	(3,376,955)	(2,649,458)
Other debtors, net	**4,564,531**	**5,408,669**

Provision for other debtors represents mainly the 100% specific provision allocated for the debt under collection amounting to TRL 9,840,829 (equivalent of USD 1,862,839).

The debt under collection represents the uncollected amount of cheques issued from non-resident counterparties.

The movement in provision for other debtors is detailed as below:

	31 December 2018	31 December 2017
Balance at 1 January	(2,649,458)	(1,395,851)
Provision charge	-	(1,344,729)
Impairment charge of LG&LC	(853,998)	-
Translation difference	126,501	91,122
Balance at the end of the year	**(3,376,955)**	**(2,649,458)**

16. Customer deposits

Customer deposits as at 31 December 2018 and 31 December 2017 are composed as follows:

	31 December 2018	31 December 2017
Current accounts:		
Individuals	441,934,845	361,213,478
Private enterprises	365,989,977	287,833,210
State owned entities	32,531,636	32,928,980
	840,456,458	**681,975,668**
Deposits:		
Individuals	2,111,807,117	1,998,431,746
Private enterprises	95,583,395	93,302,854
State owned entities	24,979,999	34,790,608
	2,232,370,511	**2,126,525,208**
Other customer accounts:		
Individuals	24,232,820	26,243,639
Private enterprises	32,003,619	32,441,102
State owned entities	686,443	713,731
	56,922,882	**59,398,472**
	3,129,749,851	**2,867,899,348**

16. Customer deposits (continued)

Current accounts and deposits can be further analysed by original maturity and currency as follows:

	31 December 2018			31 December 2017		
	Local currency	**Foreign currency**	**Total**	**Local currency**	**Foreign currency**	**Total**
Current accounts	**330,053,633**	**510,402,825**	**840,456,458**	**285,378,195**	**396,597,473**	**681,975,668**
Deposits						
On demand	59,555,519	214,221,993	**273,777,512**	41,663,186	148,571,232	**190,234,418**
Up to 39 days	17,256,847	36,271,491	**53,528,338**	20,909,064	40,627,364	**61,536,428**
40-99 days	35,601,588	56,263,919	**91,865,507**	38,328,436	56,112,159	**94,440,595**
100-189 days	76,380,293	90,032,005	**166,412,298**	83,798,944	88,189,303	**171,988,247**
190- 370 days	505,104,593	608,152,035	**1,113,256,628**	523,578,866	581,494,788	**1,105,073,654**
371 days and over	259,264,351	265,615,757	**524,880,108**	245,075,583	249,293,107	**494,368,690**
Accrued interest on deposits	5,360,243	3,289,877	**8,650,120**	5,580,895	3,302,281	**8,883,176**
Total deposits	**958,523,434**	**1,273,847,077**	**2,232,370,511**	**958,934,974**	**1,167,590,234**	**2,126,525,208**
Other customer accounts	**28,131,064**	**28,791,818**	**56,922,882**	**26,905,169**	**32,493,303**	**59,398,472**
Total customer deposits	**1,316,708,131**	**1,813,041,720**	**3,129,749,851**	**1,271,218,338**	**1,596,681,010**	**2,867,899,348**

Other customer accounts are composed as follows:

	31 December 2018			31 December 2017		
	Local currency	**Foreign currency**	**Total**	**Local currency**	**Foreign currency**	**Total**
Guarantees for letters of credit	927	83,933	**84,860**	-	11	**11**
Escrow accounts	18,585,704	20,592,303	**39,178,007**	18,349,852	21,368,613	**39,718,465**
Payment orders to be executed	823,846	689,467	**1,513,313**	630,518	597,989	**1,228,507**
Other	8,720,587	7,426,115	**16,146,702**	7,924,799	10,526,690	**18,451,489**
	28,131,064	**28,791,818**	**56,922,882**	**26,905,169**	**32,493,303**	**59,398,472**

Deposit guarantee for letters of credit represent the cash collateral held by the Bank against similar collateral provided by the Bank to correspondent banks for letters of credit opened on behalf of its customers.

Escrow accounts balance represents sums blocked until the completion of an operation or the extinction of a risk. Amounts registered in these accounts mostly relate to cash coverage received from customers due to the issuance of bid and performance bonds by the bank or due to treasury bill transactions with Bank of Albania intermediated by the Bank. Other represents deposits that are pending to be allocated into the relevant deposit category.

17. Due to banks and financial institutions

Due to banks as at 31 December 2018 and 31 December 2017 consisted as follows:

	31 December 2018	31 December 2017
Treasury bills sold under Repo agreements with Central Bank	218,323,635	246,552,737
Securities sold under Repo agreement	57,596,641	50,985,741
Deposits from banks	41,868,967	38,723,134
Current accounts of non-resident banks	1,292,110	267,913
Current accounts of resident banks	103,892	108,535
Borrowing from financial institutions	4,676,400	7,067,941
	323,861,645	**343,706,001**

Treasury bills and Albanian Government Bonds and Securities with a total value of USD 305,464,320 (31 December 2017: USD 340,865,572) were used to secure Repo agreements and borrowings from banks.

Deposits from banks as at 31 December 2018 represent short-term borrowings obtained from resident and non-resident banks.

Borrowing from financial institutions represents seven-year borrowings of EUR 4,085,000 outstanding as at 31 December 2018 (31 December 2017: EUR 5,905,000), disbursed from (European Fund for Southeast Europe) EFSE to BKT Kosovo, during December 2013 and June 2014, bearing an interest rate of 2.76%.

18. Due to third parties

The Bank acts as an agent for the tax authorities, either in the collection of taxes or in performing advance payments for the budget. In return, the Bank charges a commission to the taxpayers for the service rendered. The credit balance as at 31 December 2018 of USD 3,408,125 (31 December 2017: USD 4,856,919) represents the net outstanding amount of payments and collections made by the Bank to and from third parties, on behalf of tax authorities.

19. Deferred tax liabilities

Deferred income taxes are calculated using a tax rate of 15%. The movement on the deferred income tax account is as follows:

	31 December 2018	31 December 2017
Liability at 1 January	431,014	1,338,585
(Income) / expense for the period	(32,410)	(1,038,549)
Exchange differences	13,115	130,978
Liability at the end of the year	**411,719**	**431,014**

Deferred income tax liabilities/ (assets) are attributable to the following items:

	31 December 2018	31 December 2017
Deferred income on fees on loans	(697,443)	(673,663)
Decelerated depreciation	(934,476)	(865,211)
Provision of other debtors	(538,555)	(522,656)
Allowance for loan impairment	930,729	977,877
Fair value reserve for AFS securities	1,651,464	1,514,667
	411,719	**431,014**

20. Accruals and other liabilities

	31 December 2018	31 December 2017
Payments in transit	8,057,255	9,952,773
Foreign exchange contracts revaluation loss	4,091,200	1,827,896
Creditors	1,942,809	1,896,555
Bonus payable	1,787,831	1,892,104
Due to tax authorities	1,259,458	2,117,517
Accrued expenses	1,149,398	1,638,392
Liability for retiring employees	924,318	914,882
Payables to constructors for home loans	552,788	500,708
Social insurance	224,812	196,143
Cash guarantees from suppliers	136,476	117,759
	20,126,345	**21,054,729**

Creditors represent balances that relate to old transactions of the Albanian Government and are pending on the future determination of the rightful owner of these amounts.

Bonus payable represents the accrued yearly performance bonus for the bank’s staff and management, which is expected to be paid within the first quarter of 2019.

Liability for retiring employees represents a specific fund created in 2002 by the Bank, which will be paid to staff on their retirement. The investment in this fund has been stopped by the Bank on 30 September 2010 (See to note 3(s).ii.).

21. Subordinated debt

Subordinated debt of USD 28,678,547 (31 December 2017: 29,989,497) represents the equivalent amount of a ten-year facility of EUR 25 million, bearing an interest rate of 5.15% and payable on its maturity date with bullet payment. Subordinated debt was obtained from the Green for Growth Fund Southeast Europe, under the Subordinated Term Loan Facility Agreement, signed on 22 December 2015 with the purpose of granting loans related to Energy Efficiency and Renewable Energy investments.

Pursuant to the approvals granted by Bank of Albania, the subordinated debt was classified as second-tier capital and included in the regulatory capital of the Bank.

22. Shareholder's equity and reserves

Share Capital

At 31 December 2018 the authorised share capital comprised 24,291,498 ordinary shares (31 December 2017: 22,214,600). The shares have a par value of USD 12.35. All issued shares are fully paid. The holder of ordinary shares is entitled to receive dividends, if declared. All shares rank equally with regard to the Bank's residual assets.

Reserves

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations as well as from the translation of consolidated financial statements from functional currency to presentation currency.

Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of available-for-sale investments, excluding impairment losses, until the investment is derecognised or impaired.

Retained earnings

Retained earnings as at 31 December 2018, includes the cumulative non distributed earnings. As described in Note 1, the Bank increased its paid-up capital by Lek 2,828,905 thousand (equivalent of USD 25,649,690.3) and distributed Lek 3,308,700 thousand (equivalent of USD 30,000,000) as dividends, using part of the statutory net profit for the year ended December 31, 2017 and part of the retained earnings. Retained earnings are distributable.

23. Interest income

Interest income is composed as follows:

	Year ended 31 December 2018	Year ended 31 December 2017
Placements with banks and balances with Central Bank	13,245,513	9,855,302
Investment securities	66,980,859	53,495,215
Loans to customers	77,829,366	75,273,903
	158,055,738	**138,624,420**

Interest income from investment securities can be further detailed as follows:

	Year ended 31 December 2018	Year ended 31 December 2017
Treasury bills	4,405,889	3,793,899
Trading and available-for-sale financial assets	53,545,186	42,058,661
Held-to-maturity investments	9,029,784	7,642,655
	66,980,859	**53,495,215**

24. Interest expense

Interest expense raised from financial liabilities measured at amortized cost is composed as follows:

	Year ended 31 December 2018	Year ended 31 December 2017
Due to banks and financial institutions	8,522,494	9,197,217
Customer deposits	19,092,859	18,085,583
	27,615,353	**27,282,800**

25. Fees and commissions, net

Fee and commission revenue and expense are comprised of the following items:

	Year ended 31 December 2018	Year ended 31 December 2017
Fee and commission income		
Payment services to clients	6,344,932	5,618,889
Electronic banking transactions	4,733,299	3,526,488
Customer accounts' maintenance	2,839,688	2,498,340
Inter-bank transactions	2,596,782	5,666,290
Cash transactions with clients	1,186,136	892,013
Lending activity	954,241	1,067,754
Other fees and commissions	505,410	353,068
	19,160,488	*19,622,842*
Fee and commission expense		
Inter-bank transactions	(842,963)	(774,418)
Payment services to clients	(178,869)	(113,607)
Transactions with clients	(63,811)	(63,080)
Customer accounts' maintenance	(44,140)	(48,681)
Other fees and commissions	(952)	(5)
	(1,130,735)	*(999,791)*
Fees and commissions, net	**18,029,753**	**18,623,051**

26. Foreign exchange revaluation gain/(loss), net

Foreign exchange revaluation gain/(loss) represents the net revaluation of the Bank's foreign currency monetary assets and liabilities. In addition, as described in Note 3(b) it also includes the revaluation of the Bank's share capital. The revaluation gain on the share capital revaluation for the year ended 31 December 2018 is USD 8,934,456 (year ended 31 December 2017 gain: USD 38,799,055).

27. Other (expense) / income, net

Other income and expenses are composed as follows:

	Year ended 31 December 2018	**Year ended 31 December 2017**
Other income		
Gain on recovery of written off loans to customers	759,007	525,277
Reversal of provisions on assets acquired through legal process	222,215	66,935
Gain on sale of assets acquired through legal process	184,498	129,457
Income from operating lease	122,770	121,613
Reversal of other debtors	63,491	-
Gain on sale of property and equipment	35,200	14,556
Reversal of staff pension fund	4,418	2,378
Sundry	77,279	41,697
	1,468,878	*901,913*
Other expense		
Provisions on assets acquired through legal process	(4,675,818)	(2,509,820)
Write off of loans to customers, net	(2,347,369)	(414,841)
Loss on sale or write off of fixed assets and repossessed assets	(105,189)	(26,865)
Provision of other debtors	-	(1,344,729)
Loss from other debtors	-	(354,932)
Sundry	(29,353)	(203,664)
	(7,157,729)	*(4,854,851)*
Other (expense) / income, net	**(5,688,851)**	**(3,952,938)**

A reconciliation of expenses related to write off of loans to customers is as follows:

	Year ended 31 December 2018	**Year ended 31 December 2017**
Write off of loans to customers, gross	(11,556,066)	(6,296,710)
Provision reversal of written off loans	9,208,697	5,881,869
Write off of loans to customers, net	**(2,347,369)**	**(414,841)**

28. Personnel expenses

Personnel expenses are composed as follows:

	Year ended 31 December 2018	**Year ended 31 December 2017**
Salaries	14,847,121	13,520,182
Performance bonus	1,727,414	1,892,679
Social insurance	1,550,660	1,339,095
Training	265,595	313,267
Life insurance	157,114	126,900
Other	1,183,498	828,984
	19,731,402	**18,021,107**

29. Administrative expenses

Administrative expenses are composed as follows:

	Year ended 31 December 2018	**Year ended 31 December 2017**
Deposit insurance expense	8,595,869	7,276,321
Credit/debit cards expenses	5,751,417	4,419,482
Lease payments	2,772,548	2,703,535
Telephone, electricity and IT expenses	2,554,794	2,479,659
Repairs and maintenance	2,527,929	2,445,834
Other external services (including external audit fees)	2,388,834	1,557,725
Extraordinary fund expenses (established by BoA)	1,586,903	-
Security and insurance expenses	1,452,940	1,352,838
Marketing expenses	1,321,196	1,249,131
Transportation and business related travel	739,293	784,795
Office stationery and supplies	361,444	400,275
Representation expenses	250,015	332,416
Taxes other than tax on profits	216,798	300,434
Sundry	1,321,164	999,656
	31,841,144	**26,302,101**

30. Impairment of financial assets, other than loans to customers

Movements in the allowance for impairment financial assets other than loan:

At 31 December 2017	**-**
Impact of adopting IFRS 9 as at 1 january 2018	**1,559,812**
- on investment securities	570,993
- on placements	-
- on loans to banks	827,877
- on other assets	160,942
At 1 January	**1,559,812**
Impairment charge for the period	**1,917,149**
- on investment securities	1,733,364
- on placements	11,966
- on loans to banks	(521,302)
- on other assets	693,121
Translation difference	(179)
At the end of the period	**3,476,782**

31. Income tax

Income tax is comprised of:

	Year ended 31 December 2018	**Year ended 31 December 2017**
Current income tax	11,977,377	11,835,657
Deferred tax (income)/expense (note 19)	(32,409)	(1,038,549)
	11,944,968	**10,797,108**

31. Income tax (continued)

The tax on profit before tax differs from the theoretical amount that would arise using the basic tax rate as follows:

	31 December 2018	31 December 2017
Profit before taxes	**70,378,057**	**69,673,608**
Computed tax using applicable tax rate of 15 %	10,556,709	10,451,041
Non tax deductible expenses	898,255	611,810
Foreign exchange difference	490,004	(265,743)
Income tax	**11,944,968**	**10,797,108**
Effective tax rate	**16.97%**	**15.50%**

32. Related party transactions

In accordance with IAS 24 "Related Party Disclosures", a related party is any party that has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

Identity of related parties

The Bank has related party relationships with its shareholders and affiliates, directors and executive officers. The Bank's sole shareholder is Calik Finansal Hizmetler, which is owned by Calik Holding at 100% as at 31 December 2018. The ultimate controlling party is Mr. Ahmet Calik.

ALBtelecom Sh.a., Eagle Mobile Sh.a., Albania Leasing, Aktif Yatirim Bankasi A.S. ("Aktifbank"), GAP Pazarlama FZE, Gap İnşaat Yatırım ve Dış Ticaret A.Ş., Calik Elektrik Dagitim A.S and Calik Enerji Sanayi Ve. Ticaret A.S, Kosovo Electricity Distribution and Supply Company J.S.C (KEDS) and Kosovo Electricity Supply Company J.S.C (KESCO) are controlled by Calik Holding. Related parties with Albtelecom represent two companies financially dependent from Albtelecom for their loan repayment.

Balances and transactions with related parties

	31 December 2018	31 December 2017
Assets		
Placement and balances with banks:		
Current accounts with Aktifbank	444,006	15,164,172
Placements with Aktifbank	102,142,640	99,867,949
Loans to customers:		
KEDS / KESCO	282,965	591,802
Albtelecom	9,396,490	10,515,796
Albania Leasing	199,749	298,015
Related Parties with Albtelecom	20,594	50,696
Other assets:		
Prepaid expenses to Calik Holding	11,908	
Receivables from Albtelecom Sh.a	10,247	5,863
Total assets	**112,508,599**	**126,494,293**
Liabilities		
Due to banks and financial institutions:		
Borrowings from Aktifbank	8,525,174	-
Customer deposits:		
Albtelecom Sh.a.	669,747	498,097
Albania Leasing	384,193	88,938
Sara-AT	54	56
KEDS / KESCO	7,975,517	12,382,483
Total liabilities	**17,554,685**	**12,969,574**

32. Related party transactions (continued)

Balances and transactions with related parties (continued)

	2018	2017
Statement of comprehensive income		
Interest income from:		
GAP Pazarlama FZE	22,922	80,210
KEDS / KESCO	550,026	36,444
Albtelecom Sh.a.	-	663,024
Gap İnşaat Yatırım ve Dış Ticaret A.Ş.	-	909,865
Albania Leasing	12,492	19,851
Aktifbank	2,926,614	351,411
Related Parties with Albtelecom	24,987	15,428
Interest expenses for:		
Albtelecom Sh.a. and Eagle Mobile Sh.a.	(530)	(28,742)
Aktifbank	(1,213)	(197,471)
Albania Leasing	-	(1,427)
KEDS / KESCO	-	(2,226)
Fees and commissions:		
Letters of guarantee:		
Albtelecom Sh.a.	1,582	-
KEDS / KESCO	4,427	333
Calik Enerji Sanayi Ve. Ticaret A.S	49,399	102,159
Account maintenance and lending fees from Albtelecom Sh.a. and Eagle Mobile Sh.a.	266,884	502,345
Account maintenance and lending fees from Albania Leasing	2,468	1,846
Account maintenance and lending fees from KEDS / KESCO	172,728	175,830
Other income:		
Operating lease income from Albtelecom Sh.a.	65,490	66,177
Operating expenses:		
Albtelecom Sh.a., Eagle Mobile Sh.a. and Calik Holding	(1,752,952)	(1,649,027)
Net	**2,345,324**	**1,046,030**

Balances and transactions with directors and executive officers

The remuneration of directors and executive officers is included in personnel expenses. It can be detailed as follows:

	Year ended 31 December 2018	**Year ended 31 December 2017**
Directors	110,297	118,741
Executive officers	3,120,942	2,956,408
	3,231,239	**3,075,149**

As at 31 December 2018, the total deposits of directors held with the Bank were USD 1,056,056 (31 December 2017: USD 1,174,069), while the outstanding loans granted to directors were USD 349,879 (31 December 2017: USD 261,098).

33. Contingencies and commitments

Guarantees and letters of credit

	31 December 2018	31 December 2017
Guarantees in favour of customers	80,494,996	106,584,007
Guarantees received from credit institutions	5,885,019	25,604,355
Letters of credit issued to customers	3,034,097	2,100,965

Guarantees and letters of credit issued in favour of customers mostly are counter guaranteed by other financial institutions or fully cash collateralised.

At present the Bank is operating as an agent of the Government in the administration and implementation of certain loans to state owned entities utilising credit lines received from international donors. These donors have received individual guarantees from the Government of Albania to cover the reimbursement of their lines of credit.

Other

	31 December 2018	31 December 2017
Undrawn credit commitments	136,960,838	110,429,590
Outstanding cheques of non-resident banks	400,384	493,368
Spot foreign currency contract	162,187,847	148,408,727
Collaterals for loan portfolio	3,335,436,936	2,821,969,922
Securities pledged as collateral (note 17)	305,464,320	340,865,572

Legal

In the normal course of business the Bank is presented with legal claims and litigation; the Bank's management is of the opinion that no material losses will be incurred in relation to legal claims outstanding as at 31 December 2018.

Lease commitments

Such commitments for the years ended 31 December 2018 and 31 December 2017 are composed as follows:

	31 December 2018	31 December 2017
Not later than 1 year	2,368,310	2,033,734
Later than 1 year and not later than 5 years	7,109,025	4,678,242
Later than 5 years	4,352,292	2,549,793
Total	**13,829,627**	**9,261,769**

The Bank has entered into lease commitments for all the branches and agencies opened during the years 2003-2018 with a maximum duration of ten years.

The Bank had 88 rented buildings as at 31 December 2018, in which are included the rented space dedicated to offsite disaster recovery and the 27 buildings rented for units of BKT Kosovo.

The Bank may cancel these leases upon giving three months' notice. Therefore, at 31 December 2018, the maximum non-cancellable commitment payable not later than one year is USD 592,078 (31 December 2017: USD 508,434).

The Bank leases a number of properties under operating leases. The leases typically run for a period of up to 1 year, with an option to renew the lease after that period.

34. Subsequent events

However, there are no subsequent events that would require either adjustments or other additional disclosures in the financial statements.