United Bank of Albania Sh.a.

Independent Auditor's Report
and Financial Statements as at and
for the year ended December 31, 2016

Contents:

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Management of United Bank of Albania Sh.A.

Opinion

We have audited the financial statements of United Bank of Albania Sh.A. ("the Bank"), which comprise the statement of financial position as at December 31, 2016, and the statement of profit or loss and other comprehensive income, statement of changes in equity and cash flows statement for the year ended, and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

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

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

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

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

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Engagement Partner
Elvis Ziu

April 3, 2017
Tirana, Albania

United Bank of Albania Sh.a.

Statement of Financial Position as at December 31, 2016

(Amounts in Lek'000)

	Notes	December 31, 2016	December 31, 2015
Assets			
Cash and cash equivalents	6	2,965,941	2,162,560
Restricted balances with Central Bank	7	486,424	461,330
Investments with banks and financial institutions	8	234,253	469,119
Mudaraba - investment funds	9	77,404	94,958
Treasury bills held-to-maturity	10	-	298,540
Murabaha - financial receivables	11	3,325,689	2,312,716
Assets acquired through legal process	12	236,518	236,483
Property, equipment and intangible assets	13	184,983	198,480
Prepaid income tax	24	6,651	17,958
Other assets	14	13,763	12,200
Total assets		**7,531,626**	**6,264,344**
Liabilities			
Due to banks and financial institutions	15	794,893	121,941
Due to customers	16	5,176,179	4,577,817
Other liabilities	17	30,786	65,862
Total liabilities		**6,001,858**	**4,765,620**
Equity			
Share capital	18	1,762,717	1,762,717
Reserves	18	97,929	88,929
Accumulated losses		(330,876)	(352,922)
Total equity		**1,529,770**	**1,498,724**
Total liabilities and equity		**7,531,626**	**6,264,344**

The statement of financial position is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 43.

The financial statements were authorized for release by the Board of Directors and signed on April 3, 2017 its behalf by:

Muhamed Prlja
General Director

Zinaida Musaj
Head of Finance Department

United Bank of Albania Sh.a.

Statement of Profit or Loss and Other Comprehensive Income for the year ended December 31, 2016

(Amounts in Lek '000)

	Notes	Year ended December 31, 2016	Year ended December 31, 2015
Income from banking operations	19	230,825	210,358
Customers' share in profit	20	(47,649)	(54,788)
Net income from banking operations		**183,176**	**155,570**
Net fee and commission income		21,588	21,297
Foreign exchange gain, net	21	43,503	164,271
Other income		4,597	2,948
Total non-interest income, net		**69,688**	**188,516**
Impairment loss on Murabaha - financial receivables, net of reversals	11	52,613	(52,559)
Impairment loss on Mudaraba investment funds, net of reversals	9	6,840	(7,021)
Gain from disposal of properties		1,123	254
Other provision		(31,353)	(12,390)
Depreciation and amortization	13	(22,558)	(18,862)
Personnel expenses	22	(106,730)	(99,553)
Operating lease expenses		(19,640)	(19,933)
Other administrative expenses	23	(90,806)	(94,240)
Total operating expenses		**(210,511)**	**(304,304)**
Profit before income tax		**42,353**	**39,782**
Current income tax	24	(11,307)	(10,278)
Net profit for the year		**31,046**	**29,504**
Other comprehensive income		-	-
Total comprehensive income for the year		**31,046**	**29,504**

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 43.

United Bank of Albania Sh.a.

Statement of Cash Flows for the year ended December 31, 2016

(Amounts in Lek '000)

	Note	Year ended December 31, 2016	Year ended December 31, 2015
Cash flows from operating activities			
Profit/(loss) before income tax		42,353	39,782
Adjustments for non cash items:			
Impairment loss on Murabaha - financial receivables, net of reversals	11	(52,613)	(52,559)
Impairment loss on Mudaraba funds & other, net of reversals		(6,840)	19,412
Depreciation and amortization	13	22,558	18,862
Gain from monetary positions revaluations	21	(17,993)	(101,424)
Income from banking operations	19	(230,825)	(210,358)
Customers' share in profit	20	47,649	54,788
		(195,711)	**(126,379)**
Changes in operating assets and liabilities:			
Increase in Murabaha – financial receivables		(989,114)	(600,883)
Decrease / (increase) in other assets		36,174	(6,390)
Decrease/ (increase) in balances with financial institutions		209,772	(59,554)
Increase / (decrease) in due to customers		595,765	(49,957)
Increase in due to banks		672,952	
Decrease / (increase0 in other liabilities		(35,076)	44,028
		294,762	**(799,135)**
Income tax paid		(11,307)	(2,225)
Cash received from banking operations		223,848	216,101
Customers' share in profit paid		(45,052)	(85,173)
Net cash generated from/(used in) operating activities		**462,251**	**(670,432)**
Cash flows from investing activities			
Proceeds from treasury bills		298,540	657,065
Change in Investment in Equity		24,394	6,785
Purchases of equipment and intangible assets	13	(9,061)	(11,824)
Net cash used in investing activities		**313,873**	**652,026**
Cash flows from financing activities			
Increase in due to banks		-	8,966
Net cash provided by financing activities		-	**8,966**
Net decrease in cash and cash equivalents		776,124	(9,440)
Impact of foreign exchange in cash and cash equivalents		27,257	103,483
Cash and cash equivalents at beginning of the year		**2,162,560**	**2,068,517**
Cash and cash equivalents at the end of the year	6	**2,965,941**	**2,162,560**

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 43.

United Bank of Albania Sh.a.

Statement of Changes in Equity as at and for the year ended December 31, 2016

(Amounts in Lek '000)

	Share Capital	Reserves	Accumulated losses	Total
Balance at January 1, 2015	**1,762,717**	**64,105**	**(357,602)**	**1,469,220**
Transactions with owners recorded directly in equity		24,824	(24,824)	-
Total comprehensive income for the year				
Net profit for the year	-	-	29,504	29,504
Total comprehensive loss for the year	-	-	29,504	29,504
Balance at December 31, 2015	**1,762,717**	**88,929**	**(352,922)**	**1,498,724**
Transfer to Reserves	-	9,000	(9,000)	-
Comprehensive income for the year	-	-	-	-
Net profit for the year	-	-	31,046	**31,046**
Total comprehensive income for the year			31,046	**31,046**
Balance at December 31, 2016	**1,762,717**	**97,929**	**(330,876)**	**1,510,352**

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 43.

(Amounts in Lek '000 unless otherwise stated)

1. General

(a) Reporting entity

United Bank of Albania (hereinafter "the Bank" or "UBA") was established in Albania to carry out banking operations in accordance with Albanian laws. Based on its Articles of Association, the Bank follows the Sharia Principles. The Bank's activities include acting as manager, on a trustee basis, of funds invested in accordance with Islamic laws and principles. The Bank is subject to Law no. 9662 "On Banks on the Republic of Albania", dated December 18, 2006 and is under the supervision of the Bank of Albania.

On November 5, 1992, the Bank received approval from the Bank of Albania for carrying out banking operations. The registration procedures were completed on 1 July 1994, the incorporation date. On 11 January 1999, pursuant to the Decision No.165, dated December 11, 1998 of the Bank of Albania, the Bank obtained the license, "For continuing the banking activity in the Republic of Albania", in accordance with Law No.8365, dated July 2, 1998, "On banks in the Republic of Albania".

The registered shareholding structure was as follows:

Islamic Development Bank Jeddah	86.7%
Ithmaar Bank B.S.C.	4.63%
Dallah Albaraka Holding Co	2.32%
Other investors	6.35%

The Head Office of the Bank is located in Tirana. Currently, the Bank has an Albanian network of 4 branches located in Tirana, Shkodra, Fier and Durres and 2 agencies located in Tirana. As at December 31, 2016, the Bank employs 77 staff (2015: 74 staff).

(b) Management assessment of the ability to continue as going concern

The Bank has incurred losses in the previous financial years, and a profit in the current year. In order to meet minimum capital requirements, to limit the risks from significant exposures and to continue operations, the shareholders assess on a regular basis whether there is a need for capital injections.

Following such analysis and capital injections made, the Management believes that the Bank's ability to continue as going concern will not be impaired. Therefore, the Bank has prepared these financial statements on a going concern basis.

2. Basis of preparation

(a) Statement of compliance

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

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis, except for Mudaraba- Investment fund.

(c) Functional and presentation currency

These financial statements are presented in Albanian Lek ('Lek'), which is the Bank's functional currency. Except as otherwise indicated, financial information presented in Lek has been rounded to the nearest thousand.

(d) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRSs 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 recognized 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 recognized in the financial statements are described in note 5.

3. Significant accounting policies

The Bank has consistently applied the following accounting policies to all periods presented in these financial statements.

(a) 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 spot exchange rate at the end of the period.

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historic cost, are translated at the prevailing foreign exchange rate at the date of the transaction. 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 recognized in profit or loss.

3. Significant accounting policies (continued)

(b) Income and expenses from banking operations

Income and expenses from banking operations are recognized in profit or loss using the effective interest rate 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 and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Income and expense from banking operations presented in profit or loss include income on financial assets and financial liabilities measured at amortised cost calculated on an effective interest rate basis.

Income and expense on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented separately.

(i) Customers' share on profit

The Bank's profit is allocated to the depositors and shareholders in accordance with the Sharia principles using the main pool method. Payments are made to the depositors and charged to the account of customers' share in profits in accordance with the contractual maturities of the investments. For the service provided from Mudarib a certain fee is gained. The Profit Share allocation from Mudarabah transactions is paid and presented net of Mudarib Charge.

(ii) Income from banking operations

Income from banking operations including income from Murabaha transactions and income from banks and other financial institutions are recognized in profit or loss using the effective interest rate method.

Income from Mudaraba contracts is recognized in profit or loss when the Bank becomes entitled to that profit. Any share of losses for the period is recognized to the extent such losses are deducted from the Mudaraba capital. See accounting policy 3(j).

(c) Fees and commission

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

Other fees and commission income, including account servicing fees, investment management fees, and placement fees are recognized 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.

3. Significant accounting policies (continued)

(d) Leases

i. Lease payments - Lessee

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

ii. Lease assets - Lessor

If the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, then the arrangement is classified as a finance lease and a receivable equal to the net investment in the lease is recognised and presented within Murabaha - Financial receivables (see (h)).

(e) Income tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

i. Current tax

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

The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects uncertainty related to income taxes, if any. It is measured using tax rates enacted or substantively enacted at the reporting date.

ii. Deferred tax

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on business plans of the Bank and the reversal of temporary differences. 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.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

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.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

iii. Tax exposures

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.

3. Significant accounting policies (continued)

(d) Tax exposures

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 recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilized. 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 realized.

(f) Financial assets and financial liabilities

(i) Recognition

The Bank initially recognizes financial receivables, deposits and investment accounts on the date at which they are originated. Regular way purchases and sales of financial assets are recognized on the trade date at which the Bank commits to purchase or sell the asset. All other financial instruments are initially recognized on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

(ii) Classification

The Bank classifies its financial assets into one of the following categories:

— loans and receivables;

— held to maturity;

See accounting policies 3(i) and (j).

(iii) Derecognition

Financial assets

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for de-recognition that is created or retained by the Bank is recognized as a separate asset or liability in the statement of financial position.

On de-recognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of the consideration received and any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

The Bank may enter into transactions whereby it transfers assets recognized 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 derecognized. Transfers of assets with retention of all or substantially all risks and rewards include, for example 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 as the Bank retains all or substantially all the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognize 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.

3. Significant accounting policies (continued)

(f) Financial assets and financial liabilities (continued)

(iii) Derecognition (continued)

In certain transactions the Bank may retain the obligation to service the transferred financial asset for a fee. The transferred asset is derecognized if it meets the de-recognition criteria. An asset or liability is recognized 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.

Financial liabilities

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

(iv) Offsetting

Financial assets and liabilities are offset 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 recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

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

(v) Amortized cost measurement

The 'amortized 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 amortization using the effective interest rate method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

(vi) Fair value measurement

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

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received.

3. Significant accounting policies (continued)

(f) Financial assets and financial liabilities (continued)

(vi) Fair value measurement (continued)

If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

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

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

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

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

Objective evidence that financial assets (including equity securities) are impaired includes:

- significant financial difficulty of the borrower or issuer,
- default or delinquency by a borrower,
- restructuring of a financial receivables terms by the Bank on terms that the Bank would not otherwise consider,
- indications that a borrower or issuer will enter bankruptcy,
- the disappearance of an active market for a security, or
- other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Bank, or economic conditions that correlate with defaults in the Bank. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Bank considers evidence of impairment for financial receivables, Mudaraba investments and held-to-maturity investments at both a specific asset and collective level. All individually significant assets are assessed for specific impairment. All individually significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified.

Assets that are not individually significant are collectively assessed for impairment by grouping together financial receivables, Mudaraba investments and held-to-maturity investments with similar risk characteristics.

Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

3. Significant accounting policies (continued)

(f) Financial assets and financial liabilities (continued)

(vii) Identification and measurement of impairment (continued)

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

A collective component of the total allowance is established for:

- groups of homogeneous loans that are not considered individually significant; and
- groups of assets that are individually significant but that were not found to be individually impaired (loss 'incurred but not reported' or IBNR).

The collective allowance for groups of homogeneous loans is established using statistical methods such as roll rate methodology or, for small portfolios with insufficient information, a formula approach based on historical loss rate experience. The roll rate methodology uses statistical analysis of historical data on delinquency to estimate the amount of loss. Management applies judgement to ensure that the estimate of loss arrived at on the basis of historical information is appropriately adjusted to reflect the economic conditions and product mix at the reporting date. Roll rates and loss rates are regularly benchmarked against actual loss experience.

The IBNR allowance covers credit losses inherent in portfolios of Murabaha - Financial receivables, and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired items but the individual impaired items cannot yet be identified.

The IBNR allowance is based on historical loss rates, adjusted to reflect the current economic conditions affecting the portfolio. It reflects assumptions made about the loss emergence period – i.e. the period between a loss event occurring and it being identified. Management estimates a loss emergence period for each identified portfolio and back-tests these estimates against past experience. The factors that may influence the loss emergence period include economic and market conditions, customer behavior, portfolio management information, credit management process and collection experience.

In assessing the collective loss allowance, management considers factors such as credit quality, portfolio size, concentrations and economic factors. To estimate the required allowance, assumptions are made to define how inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowance depends on the model assumptions and parameters used in determining the collective allowance.

Measurement

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

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

3. Significant accounting policies (continued)

(f) Financial assets and financial liabilities (continued)

(vii) Identification and measurement of impairment (continued)

The impairment loss before an expected restructuring is measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on the impaired assets continues to be recognized through the unwinding of the discount. If an event occurring after the impairment was recognized causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognized by reclassifying the losses accumulated in the fair value reserve in equity to profit or loss. The cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in profit or loss. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income.

Reversal of impairment and write-offs

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognized, then the impairment loss is reversed through profit or loss; otherwise, any increase in fair value is recognized through OCI. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is always recognized in OCI.

The Bank writes off a financial receivable or an investment debt security, either partially or in full, and any related allowance for impairment losses, when Bank Credit determines that there is no realistic prospect of recovery.

(g) Cash and cash equivalents

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

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

(h) Murabaha - Financial receivables

Financial receivables 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.

Murabaha - Financial receivables to banks are classified as loans and receivables and include:

- those classified as loans and receivables;
- those designated as at FVTPL; and
- finance lease receivables.

3. Significant accounting policies (continued)

(h) Murabaha - Financial receivables (continued)

Financial receivables are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest rate method.

Loans and advances also include finance lease receivables in which the Group is the lessor (see 3.d(ii)).

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 recognized in the Bank's financial statements.

(i) Investment securities

i. Held-to-maturity

Investment securities are initially measured at fair value plus, in the case of investment securities not at FVTPL, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held to maturity, FVTPL or available-for-sale.

Held-to-maturity

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

Held-to-maturity investments are carried at amortized cost using the effective interest rate method. A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available for sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years.

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

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

(j) Investment in Mudaraba

Investments in Mudaraba are partnerships, whereby the Bank in the role of the investor provides capital to the entrepreneur (the 'Mudarib') in order to undertake an investment activity. Investments in Mudaraba are initially recognized at fair value. Impairment losses are recognized in profit or loss (see accounting policy 3(f)(vii)).

(k) Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities issued and subordinated liabilities are 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 (sale and repurchase agreement), the arrangement is accounted for as a deposit, and the underlying asset continues to be recognized in the Bank's financial statements.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Bank's redeemable preference shares bear non-discretionary coupons and are redeemable by the holder, and are therefore included within subordinated liabilities.

Deposits, debt securities issued and subordinated liabilities are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method, except where the Bank chooses to carry the liabilities at fair value through profit or loss.

3. Significant accounting policies (continued)

(k) Deposits, debt securities issued and subordinated liabilities (continued)

Customers' deposist principally include special investment deposits, where the depositors instruct the Bank to invest the funds in specific investments or on predetermined terms. These deposits are invested by the Bank in its own name under the terms of specific Mudarib contracts entered into with depositors. These special investment deposits, which are classified within due to customers, share the direct profit or losses of their respective investments once realised and do not, otherwise, share the Bank's profit or loss.

(l) Assets acquired through legal process

Assets acquired through legal process represent properties acquired through the enforcement of security over financial receivables. These assets are classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than through continuing use and the sale is highly probable if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such asset (or disposal group) and its sale is highly probable. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

They are initially recognized with the lower of their carrying amount if they were not classified previously as held for sale, and the fair value less cost to sell. Non-current assets held for sale are subsequently measured at the lower of their carrying amount and fair value less costs to sell. Any impairment on these assets is recognized in the statement of profit and loss and other comprehensive income in the period when the impairment is identified.

When these assets do not meet the definition of non-current assets held for sale because either the sale is not expected to be completed within one year from the date of their classification as non-current assets held for sale or the properties are not available for immediate sale in its present condition, these assets are classified as inventories in accordance with IAS 2 "Inventories". The assets were initially recognized at fair value when acquired and adjusted for write downs to their recoverable amount.

(m) 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. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalized borrowing costs.

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment. When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

The gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item of property and equipment, and are recognized net within other income in profit or loss.

(ii) Subsequent costs

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

3. Significant accounting policies (continued)

(m) Property and equipment (continued)

(iii) Depreciation

Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognized in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

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

• Buildings	20 years
• Motor vehicles	5 years
• Office equipment	5 years
• Computers and electronic equipment	4 years
• Furniture and fixtures	5 years

Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

(n) Intangible assets

Software

Software acquired by the Bank is stated at cost less accumulated amortization and accumulated impairment losses. Expenditure on internally developed software is recognized 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 capitalized costs of internally developed software include all costs directly attributable to developing the software and capitalized borrowing costs, and are amortized over its useful life. Internally developed software is stated at capitalized cost less accumulated amortization and impairment.

Subsequent expenditure on software assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred. Amortization is recognized 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 since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful life of software is four years. Assets in process are not amortized until software is implemented. Amortization methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate..

3. Significant accounting policies (continued)

(o) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property and 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.

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.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

The Bank's corporate assets do not generate separate cash inflows and are used by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGUs to which the corporate assets are allocated.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(p) Provisions

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

A provision for restructuring is recognized when the Bank has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

(q) Financial guarantees and loan commitments

'Financial guarantees' are contracts that require the Group to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

Liabilities arising from financial guarantees or commitments to provide a loan at a below-market interest rate are initially measured at fair value and the initial fair value is amortized over the life of the guarantee or the commitment. The liability is subsequently carried at the higher of this amortized amount and the present value of any expected payment to settle the liability when a payment under the contract has become probable. Financial guarantees and commitments to provide a loan at a below-market interest rate are included within other liabilities.

3. Significant accounting policies (continued)

(r) Employee benefits

i. Defined contribution plans

Obligations for contributions to defined contribution plans are expensed as the related service is provided and recognized as personnel expenses in profit or loss. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The Bank makes only compulsory social security contributions that provide pension benefits for employees upon retirement. The Government of Albania is responsible for providing the legally set minimum threshold for pensions in Albania under a defined contribution pension plan. The Bank's contributions to the benefit pension plan are charged to the profit or loss as incurred. The Bank recognizes as a liability the undiscounted amount of the estimated costs related to annual leave expected to be paid in exchange of the employee's service for the period completed.

(ii) Termination benefits

Termination benefits are recognized as an expense when the Bank is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognized if the Bank has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

3. Significant accounting policies (continued)

(s) Standards and Interpretations effective in the current period

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

- **Amendments to IAS 1 "Presentation of Financial Statements"** - Disclosure Initiative - adopted by the EU on 18 December 2015 (effective for annual periods beginning on or after 1 January 2016),
- **Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets"** - Clarification of Acceptable Methods of Depreciation and Amortisation - adopted by the EU on 2 December 2015 (effective for annual periods beginning on or after 1 January 2016),
- **Amendments to IAS 16 "Property, Plant and Equipment" and IAS 41 "Agriculture"** - Bearer Plants - adopted by the EU on 23 November 2015 (effective for annual periods beginning on or after 1 January 2016),
- **Amendments to IAS 19 "Employee Benefits"** - Defined Benefit Plans: Employee Contributions - adopted by the EU on 17 December 2014 (effective for annual periods beginning on or after 1 February 2015),
- **Amendments to various standards "Improvements to IFRSs (cycle 2010-2012)"** resulting from the annual improvement project of IFRS (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) primarily with a view to removing inconsistencies and clarifying wording - adopted by the EU on 17 December 2014 (amendments are to be applied for annual periods beginning on or after 1 February 2015),
- **Amendments to various standards "Improvements to IFRSs (cycle 2012-2014)"** resulting from the annual improvement project of IFRS (IFRS 5, IFRS 7, IAS 19 and IAS 34) primarily with a view to removing inconsistencies and clarifying wording - adopted by the EU on 15 December 2015 (amendments are to be applied for annual periods beginning on or after 1 January 2016).

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

(t) Standards and Interpretations in issue not yet adopted

At the date of authorisation of these financial statements, the following new standards, amendments to existing standards and new interpretation were in issue, but not yet effective:

- **IFRS 9 "Financial Instruments"** issued on 24 July 2014 is the IASB's replacement of IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting.

  Classification and Measurement - IFRS 9 introduces new approach for the classification of financial assets, which is driven by cash flow characteristics and the business model in which an asset is held. This single, principle-based approach replaces existing rule-based requirements under IAS 39. The new model also results in a single impairment model being applied to all financial instruments.

  Impairment - IFRS 9 has introduced a new, expected-loss impairment model that will require more timely recognition of expected credit losses. Specifically, the new standard requires entities to account for expected credit losses from when financial instruments are first recognised and to recognise full lifetime expected losses on a more timely basis.

  Hedge accounting - IFRS 9 introduces a substantially-reformed model for hedge accounting, with enhanced disclosures about risk management activity. The new model represents a significant overhaul of hedge accounting that aligns the accounting treatment with risk management activities.

  Own credit - IFRS 9 removes the volatility in profit or loss that was caused by changes in the credit risk of liabilities elected to be measured at fair value. This change in accounting means that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognised in profit or loss.

3. Significant accounting policies (continued)

(t) Standards and Interpretations in issue not yet adopted (continued)

The Bank currently plans to apply IFRS 9 initially on 1 January 2018. The actual impact of adopting IFRS 9 on the Bank's financial statements in 2018 is not known and cannot be reliably estimated because it will be dependent on the financial instruments that the Bank holds and economic conditions at that time as well as accounting elections and judgements that it will make in the future. The new standard will require the Bank to revise its accounting processes and internal controls related to reporting financial instruments and these changes are not yet complete.

- **IFRS 15 "Revenue from Contracts with Customers**" and further amendments (effective for annual periods beginning on or after 1 January 2018),
- **IFRS 16 "Leases"** (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IFRS 2 "Share-based Payment"** - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- **Amendments to IFRS 4 "Insurance Contracts"** - Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 "Financial Instruments" is applied first time),
- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),
- **Amendments to IAS 7 "Statement of Cash Flows"** - Disclosure Initiative (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IAS 12 "Income Taxes"** - Recognition of Deferred Tax Assets for Unrealised Losses (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IAS 40 "Investment Property"** - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- **Amendments to various standards "Improvements to IFRSs (cycle 2014-2016)"** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),
- **IFRIC 22 "Foreign Currency Transactions and Advance Consideration"** (effective for annual periods beginning on or after 1 January 2018).

The Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Bank anticipates that except for IFRS 9, whose impact cannot be reliably estimated, the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

4. 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.

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 internal units and committees, which are responsible for developing and monitoring risk management policies in their specified areas.

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 aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The 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's 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 financial receivables and investments. For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, location and sector risk).

Management of credit risk

The Board of Directors has delegated responsibility for the oversight of credit risk to the Credit risk unit. This unit is responsible for management of the credit risk, including:

- Formulating credit policies, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities.
- Reviewing and assessing credit risk prior to facilities being committed to customers. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposure to counterparties, geographies and industries.
- Developing and maintaining the risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures.

The Credit Committee of the Bank approves credit requests of Lek 40,000 thousand or less, while credit requests of more than Lek 40,000 thousand are approved by the Board of Directors of the Bank.

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(b) Credit risk (continued)

Exposure to credit risk

Maximum exposures to credit risk before collateral and other credit enhancements as at December 31, 2016 and 2015 are as follows:

	Grade	Notes	December 31, 2016	December 31, 2015
Carrying amount at amortized cost				
Balances with Banks	A	6	2,641,425	1,895,558
Restricted balances with Central Bank	A	7	486,424	461,330
Investments with banks and financial institutions	A	8	234,253	469,119
Mudaraba - investment funds	E	9	77,404	94,958
Treasury bills held-to-maturity	A	10	-	298,540
Murabaha - financial receivables	See below	11	3,325,689	2,312,716
Unused part of the credit commitments			1,040	14,239
Guarantees issued to customers	A	25	26,051	23,355
Total			**6,792,286**	**5,569,720**

Impaired financial receivables and investments

Individually impaired financial receivables and investments are financial receivables and investments for which the Bank determines that there is objective evidence of impairment and it does not expect to collect all principal and interest due according to the contractual terms. These financial receivables are graded A to E in the Bank's internal credit risk grading system.

Past due but not impaired financial receivables and investments

Past due but not impaired financial receivables and investments, other than those carried at fair value through profit or loss, are those for which contractual income 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.

Allowances for impairment

The Bank establishes an allowance for impairment losses on assets carried at amortised cost or classified as available for sale that represents its estimate of incurred losses in its portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on financial receivables that are considered individually insignificant as well as individually significant exposures that were subject to individual assessment for impairment but not found to be individually impaired.

Financial receivables with renegotiated terms

Financial receivables with renegotiated terms are financial receivables 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.

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(b) Credit risk (continued)

Write-off policy

The Bank writes off an asset balance, and any related allowances for impairment losses, when the Credit unit determines that the asset is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's / 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. For smaller balance standardised financial receivables, write-off decisions generally are based on a product-specific past due status.

During year 2016 Bank has written off some financial receivables which were in execution for several years and was not possible any recovery. The amount of write off is 5,656 thousand lek (In 2015: 146,101 thousand lek).

The table below shows an analysis of the impairment for the financial receivables as of December 31, 2016 and 2015

Murabaha – financial receivables		**December 31, 2016**	**December 31, 2015**
At amortized cost			
Individually impaired: Grade B-E		550,620	704,077
Collectively impaired: Grade A (low – fair risk)		2,775,069	1,941,606
Gross amount	11	3,601,868	2,645,683
Allowance for impairment	11	(276,178)	(332,967)
Carrying amount		**3,325,689**	**2,312,716**

At December 31, 2016 and 2015, the Bank had the following undrawn credit commitments:

	December 31, 2016	**December 31, 2015**
Unused part of the credit commitments	1,040	14,239

The Bank holds collateral against financial receivables in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when an asset is individually assessed as impaired. An estimate of the fair value of collateral held against financial receivables at December 31, 2016 and 2015 is shown below:

	December 31, 2016	**December 31, 2015**
Real Estate	11,540,918	5,805,820
Machinery, Equipment and Inventories	360,593	335,962
Cash collateral	221,826	31,514
Other	957	301,047
Total	**12,124,295**	**6,474,343**

Collateral generally is not required for balances with banks and financial institutions, and no such collateral was held at December 31, 2016 or 2015.

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(b) Credit risk (continued)

Details of assets obtained by the Bank through taking possession of collateral held as security against financial receivables are shown in Note 12. The Bank's policy is to pursue realisation of the collateral. The Bank generally does not use the non-cash collateral for its own operations.

Details of Mudaraba-investment funds held by the Bank at December 31, 2016 and 2015, are shown in Note 9.

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from cash and cash equivalents, investments with banks and financial institutions, and restricted balances with Central Bank (together as 'Cash and balances with banks'), Murabaha – financial receivables and Treasury bills held-to-maturity ('Treasury bills') at the reporting date is shown below:

	Cash and balances with banks		Murabaha – financial receivables		Treasury bills		Total			
	2016	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
Carrying amount	3,686,618	3,093,009	3,325,689	2,312,716	-	298,540	7,012,307	5,704,264		
Concentration by sector										
Corporate	-	-	2,551,948	1,793,098	-	-	2,550,422	1,793,098	36%	31%
Government	519,312	557,420	-	-	-	298,540	519,312	855,960	7%	15%
Financial institutions	3,167,306	2,535,589	67,289	68,083	-	-	3,234,595	2,603,672	46%	46%
Retail	-	-	706,452	451,535	-	-	706,452	451,535	10%	8%
Total	**3,686,618**	**3,093,009**	**3,325,689**	**2,312,716**	**-**	**298,540**	**7,010,780**	**5,704,264**	**100%**	**100%**
% of concentration for each instrument	53%	54%	47%	41%	0%	5%				

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(b) Credit risk (continued)

	Cash and balances with banks		Murabaha – financial receivables		Treasury bills		Total			
	2016	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
Carrying amount	3,686,618	3,093,009	3,325,689	2,312,716	-	298,540	7,012,307	5,704,264		
Concentration by location										
Albania	1,453,901	840,646	3,325,689	2,312,716	-	298,540	4,779,590	3,451,901	68%	61%
Europe	76,305	82,270	-	-	-	-	76,305	82,270	1%	1%
Asia	1,802,673	1,943,670	-	-	-	-	1,802,673	1,943,670	26%	34%
Middle East and Africa	353,740	226,422	-	-	-	-	353,740	226,422	5%	4%
Total	**3,686,618**	**3,093,009**	**3,325,689**	**2,312,716**	-	**298,540**	**7,012,307**	**5,704,264**	**100%**	**100%**
% of concentration for each instrument	53%	54%	47%	41%	0%	5%	100%			

Concentration by location for balances with banks and financial institutions is measured based on the location of the Bank entity holding the asset, which has a high correlation with the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security.

The cash and balances with banks are held with the Central Bank of Albania which is rated B+ (2015: B) and banks and financial institutions that based on Standard & Poor's ratings were rated as follows:

	2016	**2015**
Rated A to BBB+	538	1,095,446
Rated BBB to B-	3,361,200	1,725,494
Not rated	363	5,068
	3,362,102	**2,826,008**
Cash on hand (Note 6)	**324,516**	267,001
Total	**3,686,618**	**3,093,009**

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(c) Liquidity risk (continued)

2015	Unallocated	Up to 1 month	1-3 months	3-6 months	Up to 1 year	Over 1 year	Total
Assets							
Cash and balances with banks*	461,330	1,398,667	1,225,222	242,669	-	226,450	3,093,009
Murabaha – financial receivables	-	157,047	98,154	157,047	490,771	1,409,697	2,312,716
Treasury bills held-to-maturity	-	99,812	99,468	99,260	-	-	298,540
Mudaraba - investment funds	-	-	-	-	-	94,958	94,958
Total	**461,330**	**1,194,196**	**1,422,844**	**498,975**	**490,771**	**1,731,106**	**5,799,222**
Liabilities							
Due to banks & financial institutions	-	69,738	52,203	-	-	-	121,941
Due to customers	-	2,316,983	477,191	423,479	1,116,739	243,425	4,577,817
Total	**-**	**2,386,721**	**529,394**	**423,479**	**1,116,739**	**243,425**	**4,699,758**
Liquidity gap	**461,330**	**1,192,525**	**893,450**	**75,497**	**(625,968)**	**1,487,681**	**1,099,465**
Cumulative gap	**461,330**	**(731,195)**	**162,255**	**237,751**	**(388,216)**	**1,099,465**	

*Cash and cash equivalents, investments with banks and financial institutions, and restricted balances with Central Bank are presented together as 'Cash and balances with banks'.

The previous table shows the discounted cash flows on the Bank's financial instruments, on the basis of their earliest possible contractual maturity. The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance.

The table below set out the remaining contractual maturities, undiscounted, for non-derivative financial liabilities including commitments and financial guarantees:

31 December 2016	Carrying amount	Gross nominal outflow				
		Up to 1 month	1-3 months	3-6 months	Up to 1 year	Over 1
Due to banks & financial institutions	794,893	631,159	-	-	128,170	35
Due to customers	5,176,179	2,532,335	513,854	520,840	1,340,903	437
Commitments/ Financial guarantees	27,091	2,568	-	3,381	21,142	
Total	**5,998,163**	**3,166,062**	**513,854**	**524,222**	**1,490,215**	**473,**

31 December 2015	Carrying amount	Gross nominal outflow				
		Up to 1 month	1-3 months	3-6 months	Up to 1 year	Over 1 year
Due to banks & financial institutions	121,941	69,763	52,238	-	-	-
Due to customers	4,577,817	2,317,753	478,266	425,567	1,127,359	248,835
Commitments/ Financial guarantees	37,594	14,239	3,432	3,432	16,491	
Total	**4,737,352**	**2,401,755**	**553,936**	**428,999**	**1,143,850**	**248,8355**

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Bank's approach to managing liquidity 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.

Treasury receives information from other units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid treasury bills and balances with banks and other financial institutions, to ensure that sufficient liquidity is maintained within the Bank as a whole.

Treasury monitors compliance with local regulatory limits on a daily basis. All liquidity policies and procedures are subject to review and approval by Bank Asset and Liability Committee ('ALCO').

The Bank relies on deposits from customers and banks, and contributions from its shareholders as its primary sources of funding. While contributions from shareholders do not have specified maturities, deposits from customers and banks generally have short maturities and a large proportion of them are repayable on demand. The short-term nature of these deposits increases the Bank's liquidity risk and the Bank actively manages this risk through maintaining competitive pricing and constant monitoring of market trends.

As at December 31, 2016 the twenty largest balances due to customers represent 26% of the total deposits (in 2015: 18%).

The following table shows the Bank's financial assets and liabilities by remaining maturity at December 31 2016 and 2015:

2016	Unallocated	Up to 1 month	1-3 months	3-6 months	Up to 1 year	Over 1 year	Total
Assets							
Cash and balances with banks*	486,424	1,333,070	1,632,870	-	-	234,253	3,686,617
Murabaha – financial receivables	-	416,305	277,407	209,589	867,560	1,554,828	3,325,689
Treasury bills held-to-maturity	-	-	-	-	-	-	-
Mudaraba - investment funds	-	-	-	-	-	77,404	77,404
Total	**486,424**	**1,749,375**	**1,910,278**	**209,589**	**867,560**	**1,866,485**	**7,089,711**
Liabilities							
Due to banks & financia institutions	-	630,728	-	-	128,576	35,617	794,920
Due to customers	-	2,363,011	513,854	520,840	1,340,903	437,522	5,176,129
Total	**-**	**2,993,738**	**513,854**	**520,840**	**1,469,479**	**473,139**	**5,971,049**
Liquidity gap	**486,424**	**(1,244,364)**	**1,396,424**	**(311,251)**	**(601,919)**	**1,393,347**	**1,118,661**
Cumulative gap	**486,424**	**(758,117)**	**638,307**	**327,056**	**(274,863)**	**1,118,485**	

*Cash and cash equivalents, investments with banks and financial institutions, and restricted balances with Central Bank are presented together as 'Cash and balances with banks'.

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(c) Liquidity risk (continued)

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

(d) Market risks

Market risk is the risk that changes in market prices, such as rates and foreign exchange rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Exposure to market rates risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market rates. The Bank attempts to mitigate this risk by monitoring the repricing dates of its assets and liabilities. In addition, the actual effect will depend on a number of other factors, including the extent to which repayments are made earlier or later than the contracted dates and variations in sensitivity within repricing periods and among currencies.

Interest rate re-pricing analysis

The following table presents re-pricing dates for the Bank's assets and liabilities. Variable-rate assets and liabilities have been reported according to their next rate change date. Fixed-rate assets and liabilities have been reported according to their scheduled principal repayment dates.

2016	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Over 1 year	Non-interest bearing	Total
Assets							
Cash and balances with banks	1,086,486	1,632,871	-	-	234,253	733,008	3,686,617
Murabaha – financial receivables	382,458	291,657	597,383	1,775,405	278,785		3,325,689
Treasury bills held-to-maturity	-	-	-	-	-	-	-
Mudaraba - investment funds	-	-	-	-	-	77,404	77,404
Total	**1,468,944**	**1,924,528**	**597,383**	**1,775,405**	**513,038**	**810,412**	**7,089,710**
Liabilities							
Due to banks & financial institutions	627,904	-	-	128,576	35,617	2,823	627,904
Due to customers	1,039,657	513,854	520,840	1,340,903	434,317	1,326,558	1,039,657
Total	**1,667,562**	**513,854**	**520,840**	**1,469,479**	**469,933**	**1,329,381**	**1,667,562**
Gap	**(198,618)**	**1,410,674**	**76,543**	**305,926**	**43,105**	**(518,969)**	**(198,618)**
Cumulative gap	**(198,618)**	**1,212,056**	**1,288,599**	**1,594,525**	**1,637,630**	**1,118,661**	**(198,618)**

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(d) Market risk (continued)

2015	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Over 1 year	Non-interest bearing	Total
Assets							
Cash and balances with banks	547,068	1,225,222	242,669	-	226,450	851,599	3,093,009
Murabaha – financial receivables	300,480	263,501	160,037	572,056	1,011,814	4,828	2,312,716
Treasury bills held-to-maturity	99,812	99,468	99,260	-	-	-	298,540
Mudaraba - investment funds	-	-	-	-	-	94,958	94,958
Total	**947,360**	**1,588,191**	**501,965**	**572,056**	**1,238,265**	**951,385**	**5,799,222**
Liabilities							
Due to banks & financial institutions	62,498	17,262	-	-	-	42,182	121,941
Due to customers	1,127,305	477,191	423,479	1,1116,479	243,177	1,190,186	4,577,817
Total	**1,189,803**	**494,453**	**423,479**	**1,116,479**	**243,177**	**1,232,367**	**4,699,758**
Gap	**(242,443)**	**1,093,738**	**78,487**	**(544,423)**	**995,088**	**(280,983)**	**1,099,465**
Cumulative gap	**(242,443)**	**851,295**	**929,782**	**385,359**	**1,380,447**	**1,099,465**	

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various rate scenarios. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates, assuming no asymmetrical movement in yield curves and a constant financial position, is as follows:

2016	up to 1 Year scenarios		over 1 Year scenarios	
	100 bp Increase	100 bp Decrease	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	9,945	(9,945)	431	(431)

2015	up to 1 Year scenarios		over 1 Year scenarios	
	100 bp Increase	100 bp Decrease	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	7,899	(7,899)	7,762	(7,762)

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(d) Market risk (continued)

Interest rate movements affect retained earnings arising from increases or decreases in net income from banking operations and the fair value changes reported in profit or loss

The equivalent weighted average interest rates for the main financial assets and liabilities are as follows:

	Equivalent weighted average interest rate					
	(Lek)		(USD)		(EUR)	
December 31	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
Assets						
Due from banks and financial institutions	1.25%	2.04%	1.79%	1.96%	0.94%	1.54%
Financial receivables	8.71%	9.56%	6.51%	6.3%	7.38%	6.19%
Treasury Bills	0.00%	3.03%	0.00%	-	0.00%	2.5%
Liabilities						
Due to banks and financial institutions	0.00%	1.95%	0.67%	0.53%	0.23%	0.98%
Due to customers	1.76%	3.66%	0.69%	1.28%	0.77%	1.96%

Foreign currency risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Bank attempts to manage this risk by closing daily open foreign currency positions and by establishing and monitoring limits on open positions.

The following table summarizes the Bank's net foreign currency position of financial assets and liabilities at December 31, 2016 and 2015, presented in Lek thousand, and a sensitivity analysis of the profits of banks due to changes in the exchange rate of LEK versus other major currencies to which the Bank has exposures.

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(d) Market risk (continued)

December 31, 2016	LEK	USD	EUR	Other	Total
Assets					
Cash and balances with banks	911,347	1,617,042	1,123,728	34,500	3,686,617
Murabaha – financial receivables	1,302,685	658,866	1,364,139	-	3,325,690
Treasury bills held-to-maturity	-	-	-	-	0
Mudaraba - investment funds	-	77,404	-	-	77,404
Total	**2,214,032**	**2,353,312**	**2,487,867**	**34,500**	**7,089,711**
Liabilities					
Due to banks &financial institutions	685	318,788	475,420	-	794,893
Due to customers	2,646,326	518,545	1,976,310	34,998	5,176,179
Total	**2,647,011**	**837,333**	**2,451,730**	**34,998**	**5,971,072**
Net position	**(432,979)**	**1,515,979**	**36,137**	**(498)**	**1,118,639**
Cumulative Gap	**(432,979)**	**1,083,000**	**1,119,137**	**1,118,639**	
Sensitivity analysis					
Lek depreciates by 10%		151,598	3,614	(50)	
Lek depreciates by 5%		75,799	1,807	(25)	
Lek appreciates by 10%		(151,598)	(3,614)	50	
Lek appreciates by 5%		(75,799)	(1,807)	25	

December 31, 2015	LEK	USD	EUR	Other	Total
Assets					
Cash and balances with banks	381,385	1,561,371	1,119,965	30,287	3,093,009
Murabaha – financial receivables	1,039,971	448,081	824,664	-	2,312,716
Treasury bills held-to-maturity	298,540	-	-	-	298,540
Mudaraba - investment funds	-	94,958	-	-	94,958
Total	**1,719,896**	**2,104,410**	**1,944,629**	**30,287**	**5,799,222**
Liabilities					
Due to banks &financial institutions	15,146	81,868	24,907	20	121,941
Due to customers	2,243,666	516,574	1,804,349	13,227	4,577,817
Total	**2,258,812**	**598,442**	**1,829,256**	**13,247**	**4,699,758**
Net position	**(538,916)**	**1,505,968**	**115,373**	**17,041**	**1,099,465**
Cumulative Gap	**(538,916)**	**967,052**	**1,082,424**	**1,099,465**	
Sensitivity analysis					
Lek depreciates by 10%		150,597	11,537	1,704	
Lek depreciates by 5%		75,298	5,769	852	
Lek appreciates by 10%		(150,597)	(11,537)	(1,704)	
Lek appreciates by 5%		(75,298)	(5,769)	(852)	

(Amounts in Lek'000 unless otherwise stated)

4. Financial risk management (continued)

(e) Operational risks

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

(d) Capital management

Regulatory capital

The Bank monitors the adequacy of its capital using, among other measures, the rules and ratios established by the Albanian regulator, the Bank of Albania ("BoA"), which ultimately determines the statutory capital required to underpin its business. The regulation "On capital adequacy" is issued pursuant to the Banking Law. The regulatory capital at December 31 2016 and 2015 was as follows:

	December 31, 2016	December 31, 2015
Total shareholders' fund*	1,442,613	1,397,566
Deductible intangible assets*	(3,064)	(4,865)
Deductible portion of fixed assets*	-	-
Regulatory capital (see note 1 (b))*	**1,439,549**	**1,392,701**

*The amounts in the table represent amounts based on Bank of Albania requirements, which differ from those amounts reported in accordance with IFRS. The financial statements prepared in accordance with Bank of Albania requirements are not finalised at the time of completion of these financial statements. However, the Management believes that the Bank's ability to continue as going concern will not be impaired.

Capital Adequacy Ratio

The Capital Adequacy Ratio is the proportion of the regulatory capital to risk weighted assets and 'off balance-sheet' items, expressed as a percentage. The minimum Capital Adequacy Ratio required by Bank of Albania is 12%.

The Modified Capital Adequacy Ratio is the proportion of the base capital to risk-weighted assets and 'off balance-sheet' items, expressed as a percentage. The minimum modified capital adequacy is 6%.

4. Financial risk management (continued)

(f) Capital management (continued)

The Bank has complied with imposed Capital Adequacy Ratios during the period. As at 31 December 2016, the capital adequacy ratio was 28.3% (in 2015: 37.3%)

Risk-Weighted Assets (RWAs)

Assets are weighted according to broad categories of notional risk, being assigned a risk weighting according to the amount of capital deemed to be necessary to support them. Four categories of risk weights (0%, 20%, 50%, and 100%) are applied; for example, cash and money market instruments with Bank of Albania have a zero risk weighting, which means that no capital is required to support the holding of these assets. Property and equipment carries a 100% risk weighting, meaning that capital equal to 12% of the carrying amount must support it.

Credit related commitments are taken into account and are weighted for risk using the same percentages as for assets.

5. Use of estimates and judgments

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 4).

Allowances for credit losses

Assets accounted for at amortised cost are evaluated for impairment on a basis described in accounting policy 3(f)(vii).

The Bank reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in profit or loss, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

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(f)(vi).

Financial receivables

Financial receivables are net of allowances for impairment. The Bank's portfolio has an estimated fair value approximately equal to its book value due to their underlying equivalent interest rates, which approximate market rates. A significant portion of the portfolio is subject to re-pricing within a year.

Treasury bills held-to-maturity

Due to the short-term up to one year, the fair value of the Treasury Bills held-to-maturity at December 31, 2016 approximates their carrying amount.

Investment in Mudaraba

At December 31, 2016, the Bank measured the value of this investment with reference to the market prices as per appraisal reports and recognized an allowance for impairment of Lek 182,630 thousand (2015: Lek 153,176 thousand) (see Note 9).

(Amounts in Lek'000 unless otherwise stated)

5. Use of estimates and judgments (continued)

Deposits and borrowings

The time deposits have an estimated fair value approximately equal to their carrying amount, because of their short-term nature and underlying interest rates, which approximate market rates. The majority of the deposits mature within one year.

6. Cash and cash equivalents

	December 31, 2016	December 31, 2015
Cash on hand	324,516	267,001
Current accounts with Central Bank	32,888	96,090
Current accounts with other banks	375,604	574,229
Term investments with maturities of three months or less	2,232,933	1,225,222
	2,965,941	**2,162,560**

7. Restricted balances with Central Bank

Restricted balances with Central Bank are detailed as follows:

	December 31, 2016	December 31, 2015
Statutory reserves with Central Bank	486,424	461,330
	486,424	**461,330**

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 60% of this level, provided that the monthly average is maintained.

8. Investments with banks and financial institutions

Investments with banks and financial institutions are detailed as follows:

	December 31, 2016	December 31, 2015
Term investments	234,253	469,119
	234,253	**469,119**

Term investments represent funds with initial maturities of more than three months, invested by the Bank through banks and financial institutions, mainly acting as agents of the Bank. The agents invest the Bank's funds in instruments selected by them, including commodities and pay the profit generated there-from as per the return estimated by them in accordance with the offer made to the Bank for every investment. Term investments are held on non-resident participation banks in with contractual maturities up to 1 year and are based on Wakala or Investment agreement contracts.

9. Mudaraba - investment funds

	December 31, 2016	December 31, 2015
Mudaraba - investment funds	260,034	248,134
Less allowances for impairment	(182,630)	(153,176)
	77,404	**94,958**

(Amounts in Lek'000 unless otherwise stated)

9. Mudaraba - investment funds (continued)

The Bank invested in an Islamic investment fund that operates on the basis of a joint Mudaraba between investors and the Islamic Investment Company of the Gulf (the 'Mudarib'). The investors share the profits from the operations that have not yet reached the stage of final settlement until the liquidation of this special fund. Under this agreement, the Bank has restricted the use of funds only for the purpose of investing in the European Real Estate Portfolio (EREP). This portfolio comprises four properties located in the center of Brussels, Belgium and in Germany.

Based on appraisal reports sent to investors by the Mudarib, the European economic crisis severely impacted the value of the EREP assets and the ability to refinance, rent or sell them. Based on Mudarib report, two of properties are sold and one is under finalization of selling process. The Bank estimated its share of the losses, as a proportion of its investment in the total initial investment fund.

Based on such estimation, the Bank recognized an allowance for impairment of Lek 182,630 thousand (2015: 153,176). Movements in the allowances for impairment are as follows:

	2016	2015
Balance at January 1	153,176	133,960
Net charge for the year	19,351	7,021
Foreign exchange effect	12,194	12,194
Balance at December 31	**182,630**	**153,176**

10. Treasury bills held-to-maturity

	December 31, 2016	December 31, 2015
Nominal value of treasury bills	-	300,000
Unamortized discount	-	(1,460)
	-	**298,540**

11. Murabaha – financial receivables

The Murabaha balances as at December 31, 2016 and 2015 are detailed as follows:

	December 31, 2016	December 31, 2015
Financial receivables at amortised cost	3,601,870	2,645,682
Less allowances for impairment	(276,181)	(332,967)
	3,325,689	**2,312,716**

Accrued income from non-performing financial receivables at December 31, 2016 is Lek 46,173 thousand (2015: Lek 42,955 thousand).

Movements in the allowances for impairment are as follows:

	2016	2015
Balance at January 1	332,967	426,809
Impairment loss net of reversals / (Reversal of impairment losses)	(52,613)	52,559
Write off	(5,656)	(146,101)
Foreign exchange effect	1,483	300
Balance at December 31	**276,181**	**332,967**

(Amounts in Lek'000 unless otherwise stated)

12. Assets acquired through legal process

The Bank assets acquired through legal process are a consequence of the acquisitions through enforcement of security over financial receivables. These assets were classified as non-current assets held for sale in 2015 and tested for impairment on an annual basis.

In 2016 none of the assets acquired through legal process did meet the definition of non-current assets held for sale and as a result the Bank reclassified these assets as inventories held at the lower of cost and net realizable value. This transfer is prospectively applied.

Measurement of net reliable value - Fair value hierarchy

Property appraisers, having professional qualifications and recent experience in the location and category of the property being valued, determine the fair value of these assets. The appraisers provide the fair value of the assets portfolio every year, following the year of acquisition.

Although the ownership has been transferred to the Bank, certain properties are still used by the borrowers, until identification of a potential buyer. The Bank does not aim to make profit from leases of these properties, however agreed to rent them with the purpose of allowing for their maintenance and preservation of the current physical conditions. The total rent income earned in 2016, was Lek 34 thousand (2015: lek 1,025 thousand). In April 2015 Bank transfer to financial lease the property which was rented before.

The fair values of the Bank's assets acquired through legal processes are categorized into Level 3 of the fair value hierarchy.

Level 3 fair value

The following table shows a reconciliation from the beginning balances to the closing balances for the fair value measurements of the Bank's assets acquired through legal process.

	2016	2015
Balance at 1 January	236,483	334,097
Acquired during the year	35,731	42,307
Sold during the year	(34,879)	(4,918)
Transfer to Financial Lease	-	(142,275)
Net changes in fair value from de-evaluation	(817)	7,272
Balance at 31 December	**236,518**	**236,483**

Valuation techniques and significant unobservable inputs

When measuring the fair value of an investment property at initial recognition, the Bank generally refers to the final auction for the execution that has resulted in the transfer of ownership of that property to the Bank.

Based on the local legislation, the fair value of such properties is measured by independent appraisers that provide such value to the execution offices upon initiation of the auction procedures. The fair value that is measured with reference to the market prices is used as an initial offer in the first auction, and such offer may be reduced to a limit of 64% of the initial valuation, in cases when the initial auction did not result in a sale to a third party. In cases when no buyer is identified for the final reduced offer, the ownership is transferred to the Bank.

Based on the most recent valuations performed in 2015, the market value of some properties exceeded the auction value, meanwhile some other properties are de-evaluated. Given the recent market conditions and the lack of offers in the auction and afterwards, the Management decided to use the discounted value of 64%, based on the final auction valuation and did not increase the fair value above the existing carrying amount and has impaired those which are de-evaluated.

Notes to the financial statements for the year ended 31 December 2016

(Amounts in Lek'000 unless otherwise stated)

13. Property, equipment and intangible assets

	Buildings	Office equipment	Computers & electronic equipment	Motor Vehicles	Furniture and fixtures	Intangible assets	Fixed Assets in Process	Total
Cost								
At January 1, 2015	**282,846**	**58,078**	**39,765**	**16,502**	**21,377**	**47,963**	-	**466,531**
Additions	-	594	9,403	-	62	1,004	760	**11,824**
Disposals	-	-	-	-	-	-		-
At December 31, 2015	**282,846**	**58,672**	**49,168**	**16,502**	**21,439**	**48,967**	**760**	**478,354**
Additions	-	112	9,395	-	315	-	-	**9,823**
Disposals	-	-	-	(1,872)	-	-	(760)	**(2,632)**
At December 31, 2016	**282,846**	**58,784**	**58,563**	**14,630**	**21,754**	**48,967**	-	**485,544**
Accumulated Depreciation								
At January 1, 2015	**(84,854)**	**(53,993)**	**(37,635)**	**(16,502)**	**(21,206)**	**(46,822)**	-	**(261,012)**
Charge for the year	(14,142)	(1,458)	(2,526)	-	(161)	(575)		**(18,862)**
Disposals	-	-	-	-	-	-		-
At December 31, 2015	**(98,996)**	**(55,450)**	**(40,161)**	**(16,502)**	**(21,367)**	**(47,397)**		**(279,873)**
Charge for the year	(15,726)	(1,570)	(4,614)	-	(39)	(612)	-	**(22,561)**
Disposals	-	-	-	1,872	-	-	-	**1,872**
At December 31, 2016	**(114,722)**	**(57,020)**	**(44,775)**	**(14,630)**	**(21,406)**	**(48,009)**	-	**(300,562)**
Carrying amount								
At January 1, 2015	**197,994**	**4,086**	**2,130**	-	**169**	**1,141**	-	**205,519**
At December 31, 2015	**183,850**	**3,221**	**9,007**	-	**72**	**1,570**	**760**	**198,480**
At December 31, 2016	**168,124**	**1,764**	**13,788**	-	**348**	**958**	-	**184,983**

As at December 31, 2016 the historical cost of the assets which were fully depreciated was Lek 3,997 thousand (2015: Lek 4,067 thousand).

(Amounts in Lek'000 unless otherwise stated)

14. Other assets

	December 31, 2016	December 31, 2015
Prepaid expenses	3,659	2,705
Sundry assets	10,104	9,495
	13,763	**12,200**

15. Due to banks and financial institutions

	December 31, 2016	December 31, 2015
Current accounts	2,824	7,240
Term deposits	620,624	79,178
Borrowings from First Investment Bank (FIB)	135,230	-
Borrowings from IDB	35,602	34,941
Accrued share on profit	613	581
	794,893	**121,941**

At December 31, 2016 and 2015, current and term deposits represent deposits from local Banks and Financial Institution, with a remaining maturity of less than one month. Borrowings from IDB at December 31, 2015 represent financing received from IDB with the purpose of paying consultancy fees to Bosna Bank International (BBI), a related party. This borrowing is repayable within the year 2017.

16. Due to customers

	December 31, 2016	December 31, 2015
Current accounts	1,322,922	1,189,678
Investment deposits	3,817,224	3,357,831
Accrued Customers' Share on Profit	32,397	29,800
Other customer accounts	3,636	508
Total	**5,176,179**	**4,577,817**

Current accounts at December 31, 2016 include a balance of Lek 91 million (2015: Lek 25 million), which represents amounts blocked by regulatory authorities or by the Bank. Certain balances are not available for use, without prior consent of the authorities. Managed funds relate to investment deposits belonging to customers (refer to note 16), for which the Bank has assumed management responsibility. The customers assume the ultimate investment risk arising from investment of these funds.

Current accounts and investment deposits by currencies are as follows:

Current accounts	December 31, 2016	December 31, 2015
In USD	306,955	338,037
In ALL	468,903	259,289
In EUR	512,067	579,125
In GBP	34,997	13,227
Total	**1,322,922**	**1,189,673**

Investment deposits:	December 31, 2016	December 31, 2015
In USD	210,136	177,367
In EUR	1,454,881	1,220,111
In ALL	2,152,207	1,960,354
Total	**3,817,224**	**3,357,831**

(Amounts in Lek'000 unless otherwise stated)

17. Other liabilities

Other liabilities are detailed as follows:

	December 31, 2016	December 31, 2015
Accrued expenses	3,832	3,893
Remittances in transit	15,459	52,351
Due to third parties	30	3,036
Other liabilities	3,247	6,582
	22,568	**65,862**

Remittances as at December 31, 2016 represent outgoing transfers in transit for which the Bank acted as intermediary.

18. Equity

Share capital

The registered share capital is Lek 1,762,717 thousand (equivalent of USD 13,144 thousand), divided into 547,421 shares with a nominal value of Lek 3,220.04 (USD 24.01). There were no movements in the share capital in 2015 and 2016.

Reserves

Reserves of Lek 88,929 thousand (2015: Lek 88,929 thousand) were created pursuant to Article 8 of the Decision No. 51, dated April 22, 1999 of the Bank of Albania, which required the appropriation of 20% of the net profit for the year, Article 213 of the Law No. 7638, dated November 19, 1992 "On commercial companies" which required the appropriation of 5% of the net profit, and the Bank's Statute, which required the appropriation of 10% of net profit for the year.

19. Income from banking operations

	2016	2015
Income from Murabaha operation	188,055	152,516
Income from banks and other financial institutions	41,426	37,066
Income from treasury bills held-to-maturity	1,344	20,777
	230,825	**210,359**

(Amounts in Lek'000 unless otherwise stated)

20. Customers' share on profits

Customers' share on profit of Lek 47,649 thousand (2015: Lek 54,788 thousand) represents the profit share allocation from Mudarabah Transactions, net of Mudarib Charge.

21. Foreign exchange (losses)/gain, net

Foreign exchange gains/loss arise from the re-translation at year-end of the Bank's foreign currency position and gains and losses from transactions in foreign currencies. Bank realized a gain of Lek 22,156 thousand from foreign currency transaction (in 2015: Lek 31,011 thousand) and a gain from revaluation of monetary position of Lek 21,347 thousand (in 2015: loss Lek 133,260 thousand)

	2016	**2015**
Gain on revaluation of monetary positions	21,347	133,260
Gain on foreign currency transactions	22,156	31,011
	43,503	**164,271**

22. Personnel expenses

	2016	**2015**
Expatriate staff	18,939	17,010
Local employees	74,707	63,930
Social insurance	10,511	10,016
Bonuses & rewards	2,573	8,597
	106,730	**99,553**

23. Other administrative expenses

Other administrative expenses include the following:

	2016	**2015**
Legal, consultancy and audit fees	9,234	10,555
Office expenses	16,410	16,918
Deposit insurance	13,758	13,838
Security expenses	11,573	11,063
Swift, Reuters and on-line connections	12,397	12,104
Software maintenance	11,483	11,711
Board of Directors and Audit Committee	6,604	7,767
Fees, taxes and duties	2,949	2,830
Telephone and mail	1,574	1,925
Travel and transportation	1,191	806
Advertising and representation expenses	3,683	4,381
Other expenses	(50)	342
	90,806	**94,240**

(Amounts in Lek'000 unless otherwise stated)

24. Income tax

The Bank determines taxation at the end of the year in accordance with the Albanian tax legislation. Income tax in Albania is assessed at the rate of 15% (2015: 15%) of taxable income.

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

	Tax rate	2016	Tax rate	2015
Profit /(Loss) before income tax		**42,353**		**39,782**
(Income Tax expense)/ Loss carried forward calculated at tax rate 15% **(A)**	15%	6,353	15%	(5,967)
Non-deductible expenses		33,028		28,741
Tax impact of non-deductible expenses **(B)**	12%	(4,954)	11%	(4,311)
Current tax expense / Effective tax rate (A+B)	**27%**	**11,307**	**26%**	**(10,278)**

In 2016, the Bank did not made tax prepayments (2015: Lek 2,225 thousands). Prepaid income tax at December 31, 2016 was Lek 6,651 thousand (2015: Lek 17,958 thousand).

Based on the local accounting law, starting from January 1, 2008 the Bank must report in accordance with IFRS. In addition, Law No. 10364, dated 16.12.2010 provides for certain amendments (effective as of 24 January 2011). Based on these amendments, the impairment allowances charged by banks in accordance with IFRS shall be considered as tax deductible expenses, provided that they are certified by the external auditors and are not in excess of the limits determined by the Central Bank. Effective from 1 January 2014, the limits determined by the Central Bank are not applicable and the impairment charges recognized in accordance with IFRS are considered as tax deductible expenses. Due to this change in the legislation, there were no temporary differences between the book value and the tax value of financial receivables as of December 31, 2016.

(Amounts in Lek'000 unless otherwise stated)

25. Commitments and contingencies

Guarantees

	December 31, 2016	December 31, 2015
Guarantees	27,091	23,355

The Bank issues guarantees for its customers. These instruments bear a credit risk similar to that of credits granted. Based on management's estimate, no material losses related to guarantees outstanding at December 31, 2016 will be incurred and thus no provision have been included in these financial statements.

Legal

In the normal course of business the Bank is presented with legal claims; the Bank's management is of the opinion that no material losses will be incurred in relation to legal claims outstanding at December 31, 2016.

Lease commitments

The Bank has entered into non-cancellable lease commitments for all branches. Such commitments for the years ended December 31, 2016 and 2015 are detailed as follows:

	December 31, 2016	December 31, 2015
Less than one year	18,453	17,687
Between one and five years	36,634	27,002
	55,087	**44,690**

The Bank has rental agreements for all its branches.

26. Related party transactions

The Bank enters into transactions with its shareholders in the ordinary course of business. The balances with minority shareholders and entities owned by them, are as follows:

	December 31, 2016	December 31, 2015
Assets		
Accounts and investments with banks and financial institutions	415,756	751,038
Mudaraba - investment funds (note 9)	252,829	248,134
Provision for Mudáraba - investment funds (note 9)	(175,425)	(153,176)
Financing activities	-	-
Provision for financing activities	-	-
Liabilities		
Due to customers	11,138	(10,880)
Payables to Bosna Bank International d.d	-	-
Borrowings from IDB (due to shareholders) (note 15)	(35,602)	(34,941)

The balances presented above are with shareholders that own less than 5% of the share capital of the Bank and are not considered as related for purposes of compliance with Article 64 of the Banking Law of the maximum exposures with related parties.

Related parties are defined in accordance with the Article 4 'Definitions', paragraphs 9 and 10, of the Law No. 9662, dated December 18, 2006 "On Banks in the Republic of Albania", and the maximum exposures with related parties are monitored for compliance with Article 64 of this Law.

(Amounts in Lek'000 unless otherwise stated)

26. Related party transactions (continued)

Transactions with directors

The remuneration of directors is included in personnel expenses. It is detailed as follows:

	Year ended December 31, 2016	Year ended December 31, 2015
Salaries	16,280	17,010
Bonuses and other benefits	-	3,290
Remuneration of the Board of Directors	3,896	4,232
	13,908	**24,532**

The income and expenses arising from transactions with related parties are as follows:

	Year ended December 31, 2016	Year ended December 31, 2015
Income from Dallah Holding subsidiaries	2,480	5,262
Consultancy fees (BBI)	-	-
Customers' share on profit	(78)	(74)

27. Subsequent events

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