INTESA SANPAOLO BANK ALBANIA SH.A.

Financial Statements as at and for the year ended

31 December 2019

(with independent auditors' report thereon)

Contents

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INDEPENDENT AUDITORS' REPORT

To the Management and Shareholder of Intesa Sanpaolo Bank Albania sh.a.

Opinion

We have audited the financial statements of Intesa Sanpaolo Bank Albania sh.a. ("the Bank"), which comprise the statement of financial position as at 31 December 2019, and the statement of profit or loss and comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the 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.

Other matters

The financial statements of Intesa Sanpaolo Bank Albania sh.a for the year ended 31 December 2018 were audited by another auditor who expressed an unmodified opinion on those statements on 4 March 2019.

Other information

Other information consist of information that will be included in the Bank's Annual Report other than the financial statements and our auditor's report thereon. Management is responsible for the other information. The Bank's 2019 Annual report is expected to be made available to us after the date of this report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

When we read the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of the 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 IFRSs, 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.

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 annual financial statements, including the disclosures, and whether the annual 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.

BDO ALBAMIA SHPK

BDO Albania sh.p.k.
26 February 2020
Tirana, Albania

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BDO ALBANIA sh.p.k.
NIPT L02407004C
TIRANA - ALBANIA

Besjana Doda
Engagement Partner

(in thousands of Lek)

Statement of financial position

	Notes	31 December 2019	31 December 2018
Assets			
Cash and cash equivalents	10	30,240,115	35,290,306
Loans and advances to banks	11	29,146,303	20,253,667
Investment securities	12	66,919,643	63,727,118
Loans and advances to customers	13	44,864,090	43,928,731
Non-current assets held for sale	14	20,711	1,132,672
Current tax assets		347,992	551,650
Property and equipment	15	2,211,673	2,190,495
Right-of-use assets	16	460,883	-
Intangible assets	17	600,977	494,336
Investment property	18	545,556	545,556
Deferred tax assets	22	531,687	568,492
Inventory and other assets	19	1,682,647	2,666,634
Total Assets		**177,572,277**	**171,349,657**
Liabilities			
Due to banks	20	2,250,043	2,762,419
Due to customers	21	150,941,625	145,483,303
Lease liabilities	16	445,944	-
Deferred tax liabilities	22	213,684	138,439
Provisions	23	1,065,558	1,234,359
Other liabilities	24	1,018,663	1,452,227
Total Liabilities		**155,935,517**	**151,070,747**
Equity			
Share capital	25	5,562,518	5,562,518
Share premium	25	1,383,880	1,383,880
Reserves	26	6,169,157	6,031,724
Retained earnings		8,521,205	7,300,788
Total Equity		**21,636,760**	**20,278,910**
Total Liabilities and Equity		**177,572,277**	**171,349,657**

The Statement of financial position is to be read in conjunction with the accompanying notes on pages 6 to 72 forming an integral part of these financial statements.

(in thousands of Lek)

Statement of profit or loss and other comprehensive income

	Notes	2019	2018
Interest income		4,326,621	4,513,522
Interest expense		(888,984)	(819,303)
Net interest income	27	**3,437,637**	**3,694,219**
Fee and commission income		1,208,021	1,112,574
Fee and commission expense		(355,321)	(327,280)
Net fee and commission income	28	**852,700**	**785,294**
Net other income	29	548,308	104,276
Other operating expenses, net	30	(456,762)	(44,754)
Operating income		**4,381,883**	**4,539,035**
Net impairment on financial assets	9(a)	(201,791)	(227,691)
Net impairment loss on off-balance sheet	23	28,106	21,182
Write down of inventory	19	267,260	(80,583)
Personnel expenses	31	(1,065,593)	(1,389,366)
Operating lease expenses	35	(47,783)	(257,610)
Depreciation and amortization	16,17,18	(462,332)	(381,086)
Impairment of investment property	18	-	(29,762)
Amortization of leasehold improvements	19	(14,192)	(26,271)
Other administrative expenses	32	(876,596)	(1,323,974)
Provisions for risk and expenses	23	15,082	(30,353)
Total expenses		**(2,357,839)**	**(3,725,514)**
Net income before taxes		**2,024,044**	**813,521**
Income tax (expense)/credit	33	(322,170)	30,640
Profit for the year		**1,701,874**	**844,161**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss			
Change in fair value of investment securities at FVOCI		161,528	(181,720)
Related tax		(24,095)	27,953
Items that will not be reclassified to profit or loss			
Change in revaluation of functional properties		-	-
Related tax		-	-
Other comprehensive income/(loss) for the year, net of tax		**137,433**	**(153,767)**
Total comprehensive income for the year, net of tax		**1,839,307**	**690,394**

The Statement of profit or loss and other comprehensive income is to be read in conjunction with the accompanying notes on pages 6 to 72 forming an integral part of these financial statements.

(in thousands of Lek)

Statement of changes in equity

	Share capital	Share premium	Legal and regulatory reserves	Fair value reserve	Revaluation reserve	Other capital reserve	Merger Reserve	Retained earnings	Total
Balance at 31 December 2018	**5,562,518**	**1,383,880**	**1,825,623**	**(97,281)**	**775,431**	**714,555**	**2,813,396**	**7,300,788**	**20,278,910**
Profit for the year	-	-	-	-	-	-	-	1,701,874	**1,701,874**
Other comprehensive income									**-**
Change in fair value of debt investment at FVOCI, net of income tax	-	-	-	137,433	-	-	-	-	**137,433**
Change in the DTA of FTA reserve								(44,750)	(44,750)
Total comprehensive income for the year	**-**	**-**	**-**	**137,433**	**-**	**-**	**-**	**1,657,124**	**1,794,557**
Transaction with owners, recorded directly in equity									
Dividends to equity holders	-	-	-	-	-	-	-	(436,707)	**(436,707)**
Total contributions by and distribution to owners	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(436,707)**	**(436,707)**
Balance at 31 December 2019	**5,562,518**	**1,383,880**	**1,825,623**	**40,152**	**775,431**	**714,555**	**2,813,396**	**8,521,205**	**21,636,760**

The Statement of changes in equity is to be read in conjunction with the accompanying notes on pages 6 to 72 forming an integral part of these financial statements.

Intesa Sanpaolo Bank Albania Sh.a.
Statement of changes in equity for the year ended 31 December 2019
(in thousands of Lek)

	Share capital	Share premium	Legal and regulatory reserves	Fair value reserve	Revaluation reserve	Other capital reserve	Merger Reserve	Retained earnings	Total
Balance at 31 December 2017, as previously reported	**5,562,518**	**1,383,880**	**1,825,623**	**56,030**	**775,431**	**714,555**	**-**	**9,391,405**	**19,709,442**
Restatement due to merger*	-	-	-	456	-	-	2,813,396	(140,270)	**2,673,582**
Balance at 31 December 2017, as restated*	**5,562,518**	**1,383,880**	**1,825,623**	**56,486**	**775,431**	**714,555**	**2,813,396**	**9,251,135**	**22,383,024**
Adjustment on initial application of IFRS 9, net of tax (see note 10 (c))	-	-	-	-	-	-	-	(1,137,753)	**(1,137,753)**
Restated balance at 1 January 2018	**5,562,518**	**1,383,880**	**1,825,623**	**56,486**	**775,431**	**714,555**	**2,813,396**	**8,113,382**	**21,245,271**
Profit for the year	-	-	-	-	-	-	-	844,161	**844,161**
Other comprehensive income									**-**
Change in fair value of debt investment at FVOCI, net of income tax	-	-	-	(153,767)	-	-	-	-	**(153,767)**
Total comprehensive income for the year	**-**	**-**	**-**	**(153,767)**	**-**	**-**	**-**	**844,161**	**690,394**
Transaction with owners, recorded directly in equity									
Dividends to equity holders	-	-	-	-		-	-	(1,656,755)	**(1,656,755)**
Total contributions by and distribution to owners	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(1,656,755)**	**(1,656,755)**
Balance at 31 December 2018	**5,562,518**	**1,383,880**	**1,825,623**	**(97,281)**	**775,431**	**714,555**	**2,813,396**	**7,300,788**	**20,278,910**

The Statement of changes in equity is to be read in conjunction with the accompanying notes on pages 6 to 72 forming an integral part of these financial statements.

(in thousands of Lek)

Statement of cash flows

	2019	2018
Net profit for the year	**1,701,874**	**844,161**
Adjustments for:		
Depreciation and amortization	462,332	381,086
Impairment loss on property and equipment	-	10,030
Impairment of investment property	-	29,762
Disposal of property and equipment and intangibles	32,332	59,581
Net impairment reversal on loans and advances to customers	201,791	227,691
Write down of inventory	(267,260)	80,583
Net interest income	(3,437,637)	(3,694,219)
Net impairment loss on off-balance sheet items	(28,106)	(21,182)
Tax expense/(credit)	322,170	(30,640)
Changes in		
Loans and advances to banks	(8,892,636)	1,625,638
Loans and advances to customers	(1,109,734)	7,336,180
Due to banks	(512,376)	(4,627,444)
Due to customers	5,473,807	(1,626,839)
Non-current assets held for sale	1,111,961	(521,846)
Inventory and other assets	1,454,907	3,312,844
Other liabilities and provisions	(128,517)	(239,940)
Deferred tax asset	171,620	(80,929)
Deferred tax liability	80,765	209,317
Interest received	4,299,205	3,895,046
Interest paid	(904,469)	(817,436)
Income taxes paid	(525,831)	(289,081)
Net cash (used)/from in operating activities	**(493,802)**	**6,062,363**
Cash flows from investing activities		
Acquisition of property and equipment	(784,984)	(217,436)
Acquisition of intangible assets	(298,181)	(140,378)
Net acquisitions of investments securities	(3,036,517)	(4,372,508)
Net cash used in investing activities	**(4,119,682)**	**(4,730,322)**
Cash flows from financing activities		
Dividend paid to shareholders	(436,707)	(1,656,755)
Net cash used in financing activities	**(436,707)**	**(1,656,755)**
Net increase in cash and cash equivalents	**(5,050,191)**	**(324,714)**
Cash and cash equivalents at 1 January	35,290,306	35,615,020
Cash and cash equivalents at 31 December	**30,240,115**	**35,290,306**

The Statement of cash flows is to be read in conjunction with the accompanying notes on pages 6 to 72 forming an integral part of these financial statements.

These financial statements have been approved by the Board of Directors of Intesa Sanpaolo Bank Albania sh.a. on 24 February 2020 and signed on its behalf by:

Silvio Pedrazzi
Chief Executive Officer

Julian Cela
Chief Financial Officer

1. Reporting entity

Intesa Sanpaolo Bank Albania Sh.a, (the "Bank"), is a company domiciled in Albania. The Bank's registered office is at "Ismail Qemali" street, no. 27, and operates through a network of 35 branches and agencies, located in different cities of Albania: Tirana, Durres, Vlora, Elbasan, Fier, Berat, Gjirokastra, Korca, Lushnja, Shkoder, Lezhe, Kavaje (2018: 34 branches and agencies).

The Bank was incorporated on May 1998, and is primarily involved in banking activities in Albania. The Bank started operations on 24 September 1998. On October 1rst 2018, the Bank and "Veneto Banka sh.a." (also known as "VBA") legally merged by incorporating VBA assets and liabilities into the Bank. Prior to the merger, the Bank and VBA were under common control of Intesa Sanpaolo SpA being the same and only shareholder since 5 December 2017 when Intesa Sanpaolo SpA acquired VBA. The Bank and VBA shareholder approved the terms and conditions of the merger on 18 September 2018.

The Bank had 663 employees as at 31 December 2019 (2018: 641).

2. Basis of accounting

These financial statements have been prepared in accordance with IFRS Standards. They were authorized for issue by Management on 24 February for approval by the Board of Directors.

This is the first set of the Bank's financial statements in which IFRS 16 Leases has been applied. The related changes to significant policies are described in Note 6.

3. Basis of measurement

The financial statements are prepared on the amortized or historical cost basis except for financial assets at FVOCI, investment properties and own used properties, which are stated at fair value.

4. Functional and presentation currency

The financial statements are presented in Lek, which is the Bank's functional and presentation currency. Except as indicated otherwise, financial information presented in Lek has been rounded to the nearest thousand.

5. Use of estimates and judgments

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Bank's 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 estimates are recognized prospectively.

A. Judgements

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognized in the financial statements is included in the following notes.

- Note 7 (g) (ii): classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding.

- Note 8 (a): establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

5. Use of estimates and judgments (continued)

B. Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2019 is included in the following notes.

- Note 8 (a): impairment of financial instruments: determining inputs into the ECL impairment model, including incorporation of forward-looking information

- Note 7 (g) (vi): determination of the fair value of financial instruments with significant unobservable inputs

- Note 7 (f) (ii): recognition of deferred tax assets

- Note 7 (r): recognition and measurement of contingencies: key assumption about the likelihood and magnitude of an outflow of resources

- Note 7 (o): net realizable value of inventory: fair value measurement with significant unobservable inputs

- Note 7 (g) (vii): impairment of financial instruments: key assumptions used in estimating recoverable cash flows

6. Changes in accounting policy

The Bank initially applied IFRS 16 from 1 January 2019.

The Bank adopted IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognized in retained earnings as 1 January 2019, if any. Accordingly, the comparative information presented for 2018 is not restated-i.e. it is presented, as previously reported, under IAS 17 and related interpretations. The details of the changes in accounting policies are disclosed below. Additionally, the disclosures requirements in IFRS 16 have not generally been applied to comparative information.

i. Definition of a lease

Previously, the Bank determined at contract inception whether an arrangement is or contains a lease under IFRIC 4 *Determining whether an Arrangement contains a Lease*. The Bank now assesses whether a contract is or contains a lease based on the definition of a lease as explained in note 7.

On transition to IFRS 16, the Bank elected to apply the practical expedient to grandfather the assessment of which transactions are leases. The Bank applied IFRS 16 only to contracts that were previously identified as leases. Contract that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is lease under IFRS 16.

ii. As a lessee

As a lessee, the Bank leases some branches office premises and vehicles. The Bank previously classified these leases as operating leases under IAS 17 bases on its assessment of whether the lease transferred substantially all of the risks and rewards incidental to ownership of the underlying asset to the Bank. Under IFRS 16, the Bank recognizes right-of-use assets and lease liabilities for leases of branch and office premises-i.e these leases are on-balance sheet.

At commencement or on modification of a contract that contains a lease component, the Bank allocates the consideration in the contract to each lease component on the basis of its relative stand-alone prices.

On transition, for these leases, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Bank’s incremental borrowing rate as at 1 January 2019 (see note 16).

Right-of-use assets are measure at their carrying amount as if IFRS 16 had been applied IFRS 16 to leases the commencement date, discounted using the lessee’s incremental borrowing rate at the date of initial application.

(in thousands of Lek, unless otherwise stated)

6. Changes in accounting policy (continued)

ii. As a lessee (continued)

The Bank used a number of practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17. In particular, the Bank:

- did not recognize right-of-use assets and liabilities for leases for which the lease term ends within 12 months of the date of initial application;
- did not recognize right-of-use assets and liabilities for leases of low-value assets;
- excluded initial direct costs from measuring the right-of-use asset at the date of initial application; and
- Used hindsight when determining the lease term.

iii. As a lessor

The Bank leases out certain property and equipment. The Bank has classified these leases as follows:

- operating leases of investment property: see Notes 18.

The Bank is not required to make any adjustments on transition to IFRS 16 for leases in which it acts as a lessor.

The Bank has applied IFRS 15 Revenue from Contracts with Customers to allocate consideration in the contract to each lease and non-lease component.

iv. Impact on financial statements

Impact on transition

On transition to IFRS 16, the Bank recognized additional right-of-use assets and additional lease liabilities. The impact on transition is summarized below.

	1 January 2019
Right-of-use asset presented in property and equipment	337,299
Deferred tax assets	50,595
Lease liabilities	337,299
Deferred tax liabilities	50,595

For impact of IFRS 16 on profit or loss for the period, see Note 16. For impact of IFRS 16 on segment information, see Note 16. For details of accounting policies under IFRS 16 and IAS 17, see Note 7.

When measuring lease liabilities for leases that were classified as operating leases, the Bank discounted lease payments using its incremental borrowing rate 1 January 2019. The weighted-average rate applied is 1.77%

Operating lease commitments as at 31 December 2018 as disclosed under IAS 17 in the Bank's financial statements	**380,977**
Discounted using the incremental borrowing rate at 1 January 2019	(20,977)
Recognition exemption for leases of low-value assets	(703)
Recognition exemption for leases with less than 12 months of lease term at transition	(21,998)
Lease liabilities recognized at 1 January 2019	**337,299**

7. Significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these financial statements by the Bank, except for the changes explained in Note 6.

(a) Transfer of control of interest in entities under common control

In the absence of specific guidance, entities involved in common control transactions should develop an appropriate accounting policy, to be applied consistently, using the hierarchy described in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Management has elected to account for transfers of control of interests in entities that are under the control of the shareholder that ultimately controls the Bank for using book value accounting. The assets and liabilities acquired are recognized at the carrying amounts recognized previously in the financial statements of the acquired entity.

(b) Foreign currency

Transactions in foreign currencies are translated into the functional currency at the spot exchange rates at the date of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the spot exchange rate at the end of the year. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated to the functional currency at the spot exchange rate at the date that the fair value was determined.

Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are generally recognized in profit or loss. Foreign currency differences arising from retranslation of transactions with owners are recorded directly in equity.

(c) Interest

Effective Interest rate

Interest income and expense are recognized in profit or loss using the effective interest method. The ‘effective interest rate’ is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to

- The gross carrying amount of the financial asset; or
- The amortized cost of the financial liability

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL. The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability

Amortized cost and gross carrying amount

The ‘amortized cost’ of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance. The ‘gross carrying amount of a financial asset’ is the amortized cost of a financial asset before adjusting for any expected credit loss allowance.

7. Significant accounting policies (continued)

(c) Interest (continued)

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortized cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortized cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortized cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, see Note 7(g)(vii).

(d) Fees and commissions

Fees, 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 (see 7 (c)).

If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognized on straight-line basis over the commitment period.

Other fee and commission income, including account servicing fees, investment management fees, sales commission and placement fees are recognized as the related services are performed. If a loan commitment is not expected to result in a draw-down of a loan, then the related loan commitment fees are recognized on a straight-line basis over the commitment period.

A contract with a customer that results in a recognized financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Other fee and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

7. Significant accounting policies (continued)

(e) Leases

The Bank has applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17 and IFRIC 4. The details of accounting policies under IAS 17 and IFRIC 4 are disclosed separately.

The policy is applied to contracts entered into (or changed) on or after 1 January 2019.

i. Bank acting as a lessee

At commencement or on modification of a contract that contains a lease component, the Bank allocates consideration in the contract to each lease component on the basis of its relative stand-alone prices. However, for leases of branches and offices premises the Bank has elected not to separate non-lease components and accounts for the lease and non-lease components as a single lease component.

The Bank recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to branches or office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain measurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rare cannot be readily determined, the Bank’s incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate.

The Bank determines its incremental borrowing rate by analyzing its borrowings from various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Lease payment included in the measurement of the lease liability comprise the following:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index of rate as the commencement date;
- amounts expected to be payable under a residual value guarantee; and
- the exercise price under a purchase option that the Bank is reasonably certain to exercise, lease payments in an optional renewal period if the Bank is reasonably to exercise an extension option, and penalties for early termination of a lease unless the Bank is reasonably certain not to terminate early.

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is change in the Bank’s estimate of the amount expected to payable under a residual value guarantee, if the Bank changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset is reduced to zero.

7. Significant accounting policies (continued)

(e) Leases (continued)

i. Bank acting as a lessee (continued)

The Bank presents right-of-use assets in and lease liabilities as part of “other liabilities” in the face of statement of financial position.

Short-term leases and leases of low-value assets

The Bank has elected not to recognize right-of-use assets and lease liabilities for leases of low-value assets and short-term leases. The Bank recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

ii. Bank acting as a lessor

At inception or on modification of a contract that contains a lease component, the Bank allocates the consideration in the contract to each lease component on the basis of their relative stand-alone selling prices.

When the Bank acts as a lessor, it determines at lease inception whether the lease is a financial lease or an operating lease.

To classify each lease, the Bank makes an overall assessment of whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying lease. As part of this assessment, the Bank considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

The Bank applies the derecognition and impairment requirements in IFRS 9 to the net investment in the lease. The Bank further regularly reviews estimated unguaranteed residual values used in calculating the gross investment in the lease.

Policy applicable before 1 January 2019

For contracts entered into before 1 January 2019, the Bank determined whether the arrangement was or contained a lease based on the assessment of whether:

- fulfillment of the arrangement was dependent on the use of a specific asset or assets, and
- the arrangement had conveyed a right to use the asset.

i. As a lessee

The Bank did not have any finance leases under IAS 17

Assets held under other leases were classified as operating leases and were not recognized in the Bank’s statement of financial position. Payments made under operating leases were recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received were recognized as an integral part of the total lease expense, over the term of the lease.

ii. As a lessor

When the Bank acted as a lessor, it determined at lease inception whether each lease was a finance lease or an operating lease.

To classify each lease, the Bank made an overall assessment of whether the lease transferred substantially all of the risks and rewards incidental to ownership of the underlying assets. If this was the case, then the lease was a finance lease; if not, the it was an operating lease. As part of this assessment, the Bank considered certain indicators such as whether the lease was for the major part of the economic life of the asset.

7. Significant accounting policies (continued)

(f) Income Tax

Income tax expense comprises current and deferred tax. It is recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in OCI. Interest and penalties related to income taxes, including uncertain tax treatments, are accounted for under IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

(i) Current Tax

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable 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.

Current tax assets and liabilities are offset only if certain criteria are met.

(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 recognized for unused tax losses 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 the reversal of relevant taxable temporary differences. If the amount of taxable temporary differences is insufficient to recognize a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on the business plans. 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; such reductions are reversed when the probability of future taxable profits improves.

Unrecognized deferred tax assets are reassessed at each reporting date and recognized 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 temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

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

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities

(i) Recognition and initial measurement

The Bank initially recognizes loans and advances, deposits and debt securities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are initially recognized on the trade date on 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 and loss, transaction costs that are directly attributable to its acquisition or issue.

(ii) Classification

On initial recognition, the Bank classified a financial asset as measured at amortized cost, FVOCI or FVTPL.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

– the asset is held within a business model whose objective is to hold assets to collect contractual cash flows;

- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

– the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets;

- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities (continued)

(ii) Classification (continued)

Business model assessment

The Bank assesses the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

-the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;

- how the performance of the portfolio is evaluated and reported to the Bank's management;

-the risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed;

-how managers of the business are compensated (e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected);

-the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank stated objective for managing the financial assets is achieved and how cash flows are realized.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

– contingent events that would change the amount and timing of cash flows; - leverage features; - prepayment and extension terms;

- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse loans);

- and features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities (continued)

(ii) Classification (continued)

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Financial liabilities

The Bank classifies its financial liabilities as other financial liabilities, subsequently measured at amortized cost.

See notes 7 (q).

(iii) De-recognition

Financial Assets

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognized) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognized as a separate asset or liability.

The Bank enters 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. In such cases, the transferred assets are not derecognized. Examples of such transactions are securities lending and sale and repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all of 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

Financial liabilities

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

(iv) Modification of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities (continued)

(iv) Modification of financial assets and financial liabilities (continued)

If the cash flows 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 derecognized (see (iii)) and a new financial asset is recognized at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

– fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and

– other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximize recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortized cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognizes the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification.

Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortized over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower (see 7.g.(vii)), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method (see 7 (c)).

Financial liabilities

The Bank derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognized at fair value. The difference between the carrying amount of the financial liability derecognized and consideration paid is recognized in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortized cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognized in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognized as an adjustment to the carrying amount of the liability and amortized over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities (continued)

(v) Off-setting

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

(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 maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would consider in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. If the 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 recognized in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is entirely supported by observable market data or the transaction is closed out.

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

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities (continued)

(vii) Impairment

The Bank recognizes loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- financial guarantee contracts issued; and
- loan commitments issued.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply the low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognized are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognized but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- *financial assets that are not credit-impaired at the reporting date*: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- *financial assets that are credit-impaired at the reporting date*: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- *undrawn loan commitments*: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- *financial guarantee contracts*: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

See also Note 8(a).

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortized cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

7. Significant accounting policies (continued)

(g) Financial assets and financial liabilities (continued)

(vii) Impairment (continued)

Credit-impaired financial assets (continued)
Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the statement of financial position
Loss allowances for ECL are presented in the statement of financial position as follows:

- *financial assets measured at amortized cost*: as a deduction from the gross carrying amount of the assets;
- *loan commitments and financial guarantee contracts*: generally, as a provision;
- *where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component*: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; *and*
- *debt instruments measured at FVOCI*: no loss allowance is recognized in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level. Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and OCI.
Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

7. Significant accounting policies (continued)

(h) Cash and cash equivalents

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

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

(i) Loans and advances

Loans and advances captions in the statement of financial position include loans and advances measured at amortized cost. They are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized cost using the effective interest method.

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 or stock borrowing), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognized in the Bank's financial statements.

(j) Investment securities

The "investment securities" caption in the statement of financial position includes

- debt investment securities measured at amortized cost (see g (ii)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized cost using the effective interest method;
- debt securities measured at FVOCI;

For debt securities measured at FVOCI, gains and losses are recognized in OCI, except for the following, which are recognized in profit or loss in the same manner as for financial assets measured at amortized cost:

- Interest revenue using the effective interest method
- ECL and reversals, and
- Foreign exchange gains and losses

When debt security measured at FVOCI is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss.

(in thousands of Lek, unless otherwise stated)

7. Significant accounting policies (continued)

(k) Non-current assets held for sale

Non-current assets for which a disposal process has commenced are classified as held-for-sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use. Such assets are generally measured at the lower of their carrying amount and fair value less costs to sell.

(l) Property and equipment

(i) Recognition and measurement

Equipment are measured at cost less accumulated depreciation and any accumulated impairment losses. Property are measured at revalued amounts, being the fair value at the date of revaluation less accumulated depreciation and any accumulated impairment losses (see Note 17). If significant parts of an item of property or equipment have different useful lives, then they are accounted for as separate items (major components) of property and equipment. Any gain or loss on disposal of an item of property and equipment is recognized within other income in profit or loss.

(ii) Subsequent costs

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

(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. Land and art work are not depreciated.
The estimated useful live for the current and comparative periods are as follows:

	2019	2018
• Buildings	33 years	33 years
• IT and Electrical Equipment	4 to 8 years	4 to 8 years
• Furniture	3 to 10 years	3 to 10 years
• Other non-electrical assets	5 years	5 years

(m) Intangible assets

Software, licenses and trademarks compose intangible assets and are stated at cost less accumulated amortization. Subsequent expenditure on intangible 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 charged on a straight-line basis in profit or loss over the estimated useful lives, from the date that it is available for use. The estimated useful lives for the current and comparative periods are as follows:

	2019	2018
• Software	5 years	5 years
• Licenses and trademarks	10 years	10 years

(n) Investment property

Investment property is initially measured at cost and subsequently at fair value, with any change therein recognized in profit or loss within other income. Any gain or loss on disposal of investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognized in profit or loss.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting

7. Significant accounting policies (continued)

(o) Inventory

Inventory comprises repossessed assets acquired through enforcement of security over non-performing loans and advances to customers which do not earn rental, and are not used by the Bank and are intended for disposal in a reasonably short period of time, without significant restructuring. Repossessed assets are measured at the lower of cost and net realizable value and any write-down is recognized in the profit or loss.

(p) Impairment of non-financial assets

At each reporting date, the Bank reviews the carrying amount of its non-financial assets (other than inventory and deferred tax assets) to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate which reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in profit or loss. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(q) Deposits

Deposits are the Bank's sources of debt funding.

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

When the Bank sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date ("repo" or "stock lending"), the arrangement is accounted for as a deposit, and the underlying asset continues to be recognized in the Bank's financial statements.

7. Significant accounting policies (continued)

(r) 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 where appropriate, the risks specific to the liability.

A provision for bank levies is recognized when the condition that triggers the payment of the levy is met. If a levy obligation is subject to a minimum activity threshold so that the obligating event is reaching a minimum activity, then a provision is recognized when that minimum activity threshold is reached.

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.

(s) Financial guarantees and loan commitments

Financial guarantees are contracts that require the Bank 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.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured as follows:

- at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15.

For other loan commitments:

- the Bank recognizes a loss allowance

Liabilities arising from financial guarantees and loan commitments are included within provisions.

(t) Employee benefits

(i) Defined contribution plans

The Bank makes only compulsory social security contributions that provide pension benefits for employees upon retirement. In Albania, the local authorities are responsible for providing the legally set minimum threshold for pensions under a defined contribution pension plan. The Bank’s contributions to the benefit pension plan are expensed in profit or loss as incurred.

(ii) Short-term benefits

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

7. Significant accounting policies (continued)

(u) New standards and interpretation not yet adopted

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Bank has not early adopted them in preparing these financial statements.

The following amended standards are not expected to have a significant impact on the Bank's Financial Statements:

- Amendments to References to *Conceptual Framework in IFRS Standards*.
- Definition of Business *(Amendments to IFRS 3).*
- IFRS 17 *Insurance Contracts.*

8. Financial Risk Management

The Bank is exposed to the following risks from financial instruments:

a. credit risk
b. liquidity risk
c. market risk
d. operational risk

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 of the Bank has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Bank's Governance Committees (Executive Directors Committee, Credit Committee, Asset Liability Committee, Operational Risk Committee, Credit Risk Governance Committee, Problematic Loans Committee and other committees) that have the authority for decision-making in their specified areas.

Risk Management Division is responsible for developing and monitoring the Bank's risk management policies in these areas. All the Bank's committees have both executive and non-executive members and report regularly to the Board of Directors on their activities. The Bank's risk management policies are established to identify and analyze 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.

(a) Credit Risk

In the normal course of its business, the Bank is exposed to credit risk on its loans and advances to customers and financial institutions, investment securities and other off-balance-sheet items. Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers, debt securities, on funds with other financial institutions and other off-balance sheet items. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk). The Bank manages its exposure to credit risk on a regular basis by closely monitoring credit limits, its loan portfolio and concentration of exposure.

(i) Management of credit risk

The Board of Directors has delegated responsibility for decision-making to Committees in Credit Area. The Risk Management Division, reporting to the CEO, is responsible for the oversight and management of the Bank's credit risk, including:

- *Formulating credit policies* in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- *Reviewing and assessing credit risk*. The Bank's Underwriting Department assesses all credit exposures, before facilities are committed to customers by the Bank. Renewals and reviews of facilities are subject to the same review process.
- *Limiting concentrations of exposure* to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(i) Management of credit risk (continued)

- *Developing and maintaining the Bank's risk classifications* in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk classification is used in determining where impairment may be required against specific credit exposures.

  According to the Bank's methodology, all exposures are classified between Performing (including Stage 1 and Stage 2) and Non- Performing exposures (Stage 3 - including Past Due, Unlikely to Pay and Doubtful). The bank classifies the performing portfolio in two clusters Stage 1 and Stage 2 based on a set of rules harmonized with the guidelines of Intesa Sanpaolo Group, driven by the signs of deterioration of the exposure as per below specifications:

Stage 1	Stage 2	Stage 3
• Performing exposures without days past due • Performing exposures with less than 30 days past due	• Performing exposures with more than 30 days past due • Forborne performing exposures • Performing exposures showing Early Warning signals (orange, red and light blue) and PCM.	• Exposures with more than 90 days past due • Unlikely to Pay • Doubtful

  The Non-Performing portfolio is classified by analyzing the exposures also based on a set of rules harmonized with the guidelines of Intesa Sanpaolo Group. These rules include objective evidence being: breach of contract (such as default or delinquency in interest or principal payments); significant financial difficulty of the borrower; and other significant adverse financial information relating to the customer.

  Starting from the 1st of November 2019, the new Definition of Default has been introduced in accordance with EBA's (European Banking Authority) Guidelines on application of the definition of default (EBA/GL/2016/07) and the Regulatory Technical Standards on the materiality threshold (EBA/RTS/2016/06) that specify how default definition should be applied. Under the new guidelines two new materiality thresholds have been introduced, a relative threshold equal to 1% of the obligor cash exposure and an absolute threshold on obligor level equal to 500 Euros for non-retail exposures and 100 Euros for retail exposures. The new days past due, used as objective criteria for Stage 2 classification (Over 30 days past due) and the Past Due Classification (Over 90 days past due), are counted incrementally when both the relative and the absolute thresholds are breached. In addition, once an obligor has defaulted, it will remain on default status for at least 90 days after no signs of default are present. Furthermore, a new trigger of Unlikeliness to Pay has been introduced for Forborne distressed restructuring which net present value has decreased with more than 1% compared to previous agreement.

  The New Definition of Default was accounted retrospectively starting from 1st of November 2019.

- *Reviewing compliance* of business units with agreed exposure limits, including those for selected industries and product types. Detailed analyses are provided monthly to the Problem Assets Committee on the credit quality of customer exposures and specific actions are proposed.
- *Providing advice, guidance and specialist skills* to business units to promote best practice throughout the Bank in the management of credit risk.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(ii) Maximum Exposure to Credit Risk

The following table shows the current maximum exposure to credit risk for the applicable components of statement of financial position:

	Gross Maximum Exposure	
	31 December 2019	**31 December 2018**
Cash and cash equivalents (excluding cash on hand)	28,796,627	33,844,583
Loans and advances to banks	29,146,303	20,253,667
Investment securities	66,919,643	63,727,118
Loans and advances to customers	44,864,090	43,928,731
Sundry debtors	53,399	443,042
Total on-balance-sheet risk	**169,780,062**	**162,197,141**
Undrawn credit commitments	4,868,368	4,378,023
Letters of credit	1,316,966	948,692
Guarantees in favor of customers	4,456,046	4,245,210
Total credit related commitments	**10,641,380**	**9,571,925**
Total Credit Risk Exposure	**180,421,442**	**171,769,066**

Where financial assets are recorded at fair value, the amounts shown represent the current credit risk exposure, but not the maximum risk exposure that could arise in the future as a result of changes in values. The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees commit the Bank to make payments on behalf of customers in the event of a specific act or event, generally related to the import or export of goods, and payment and performance guarantees. Such commitments expose the Bank to similar credit risks, which are mitigated by the same control processes and policies. Every month, the Bank assesses the credit related commitments for impairment. Amounts subject to individual impairment assessment are non-cancellable commitments granted to non-performing customers or customers with restructured credit facilities.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(iii) Credit Quality by class of financial assets

The following table sets out information about the credit quality of financial assets measured at amortized cost and FVOCI debt investments. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 7(g)(vii).

				31 December 2019
	Stage 1	**Stage 2**	**Stage3**	**Total**
Loans and advances to customers				
Performing	43,720,062	635,684	-	**44,335,746**
Past Due	-	-	104,414	**104,414**
Unlikely to Pay	-	-	1,466,978	**1,466,978**
Doubtful	-	-	951,266	**951,266**
Total	**43,720,062**	**635,684**	**2,522,658**	**46,878,404**
Loss allowance	**710,117**	**136,858**	**1,167,339**	**2,014,314**
Carrying amount	**43,009,945**	**498,826**	**1,355,319**	**44,864,090**

				31 December 2018
	Stage 1	**Stage 2**	**Stage3**	**Total**
Loans and advances to customers				
Performing	41,106,026	2,347,997	-	**43,454,023**
Past Due	-	-	151,825	**151,825**
Unlikely to Pay	-	-	1,149,101	**1,149,101**
Doubtful	-	-	1,745,476	**1,745,476**
Total	**41,106,026**	**2,347,997**	**3,046,402**	**46,500,425**
Loss allowance	**663,165**	**456,354**	**1,452,175**	**2,571,694**
Carrying amount	**40,442,861**	**1,891,643**	**1,594,227**	**43,928,731**

				31 December 2019
PD Range	**Stage 1**	**Stage 2**	**Stage3**	**Total**
Loans and advances to customers				
0-0.18	43,720,062	-	2,048,023	**45,768,085**
0.19-0.66	-	635,684	1,317	**637,001**
0.67-1	-	-	473,318	**473,318**
Total	**43,720,062**	**635,684**	**2,522,658**	**46,878,404**
Loss allowance	**710,117**	**136,858**	**1,167,339**	**2,014,314**
Carrying amount	**43,009,945**	**498,826**	**1,355,319**	**44,864,090**

				31 December 2018
PD Range	**Stage 1**	**Stage 2**	**Stage3**	**Total**
Loans and advances to customers				
0-0.18	41,106,026	-	2,652,923	**43,758,949**
0.19-0.66	-	2,347,997	9,395	**2,357,392**
0.67-1	-	-	384,084	**384,084**
Total	**41,106,026**	**2,347,997**	**3,046,402**	**46,500,425**
Loss allowance	**663,165**	**456,354**	**1,452,175**	**2,571,694**
Carrying amount	**40,442,861**	**1,891,643**	**1,594,227**	**43,928,731**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(iii) Credit Quality by class of financial assets (continued)

				31 December 2019
	Stage 1	**Stage 2**	**Stage3**	**Total**
Loans and advances to banks				
Performing	39,204,886	3,288,711	-	**42,493,597**
Total	**39,204,886**	**3,288,711**	**-**	**42,493,597**
Loss allowance	**8,634**	**608**	**-**	**9,242**
Carrying amount	**39,196,252**	**3,288,103**		**42,484,355**
Investment securities at FVOCI				
Performing	4,289,282	-	-	**4,289,282**
Total	**4,289,282**	**-**	**-**	**4,289,282**
Carrying amount	**4,289,282**	**-**	**-**	**4,289,282**
Loss allowance	**5,517**	**-**	**-**	**5,517**
Investment securities at amortized cost				
Performing	60,831,517	2,107,366	-	**62,938,883**
Total	**60,831,517**	**2,107,366**	**-**	**62,938,883**
Loss allowance	**301,928**	**6,594**	**-**	**308,522**
Carrying amount	**60,529,589**	**2,100,772**	**-**	**62,630,361**

				31 December 2018
	Stage 1	**Stage 2**	**Stage3**	**Total**
Loans and advances to banks				
Performing	35,069,277	3,714,468	-	**38,783,745**
Total	**35,069,277**	**3,714,468**	**-**	**38,783,745**
Loss allowance	**9,509**	**6,539**	**-**	**16,048**
Carrying amount	**35,059,768**	**3,707,929**	**-**	**38,767,697**
Investment securities at FVOCI				
Performing	6,323,591	-	-	**6,323,591**
Total	**6,323,591**	**-**	**-**	**6,323,591**
Carrying amount	**6,323,591**	**-**	**-**	**6,323,591**
Loss allowance*	**4,629**	**-**	**-**	**4,629**
Investment securities at amortized cost				
Performing	55,566,406	2,110,759	-	**57,677,165**
Total	**55,566,406**	**2,110,759**	**-**	**57,677,165**
Loss allowance	**265,837**	**7,801**	**-**	**273,638**
Carrying amount	**55,300,569**	**2,102,958**	**-**	**57,403,527**

*Loss allowance for investment securities at FVOCI is recognized in other comprehensive income and not as a contra account to the carrying amount of the financial asset in the statement of financial position (see Note 7 (g) (vii) Presentation of allowance for ECL in the statement of financial position).

**Loans and advances to banks include current accounts with banks, money market placements (see Note 10) and deposits with correspondent banks (see Note 11).

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(iii) Credit Quality by class of financial assets (continued)

The following table sets out information about the overdue status of loans and advances to customers in Stages 1, 2 and 3.

				31 December 2019
Loans and advances to customers	**Stage 1**	**Stage 2**	**Stage3**	**Total**
Up to 30 days in arrears	43,720,062	417,094	553,401	**44,690,557**
More than 30 days in arrears	-	218,590	1,969,257	**2,187,847**
Total	**43,720,062**	**635,684**	**2,522,658**	**46,878,404**

				31 December 2018
Loans and advances to customers	**Stage 1**	**Stage 2**	**Stage3**	**Total**
Up to 30 days in arrears	40,653,651	1,682,259	24,748	**42,360,658**
More than 30 days in arrears	452,374	665,738	3,021,655	**4,139,767**
Total	**41,106,025**	**2,347,997**	**3,046,403**	**46,500,425**

All loans and advances to banks and investment securities fall in the overdue status of less than 30 days in arrears as of 31 December 2019 and 31 December 2018.

The following table sets out the credit quality of debt securities and loans and advances to banks based on Moody's ratings, Staging and IFRS Category:

Investments debt securities

			31 December 2019
Sovereign	**Stage 1**	**Stage 2**	**Total**
Rate Baa2	**2,827,008**	**2,100,772**	**4,927,780**
FOCI	*2,827,008*	-	***2,827,008***
AC	-	2,100,772	**2,100,772**
Rate B1	**61,251,450**	**-**	**61,251,450**
FVOCI	721,861	-	**721,861**
AC	60,529,589	-	**60,529,589**
	64,078,458	**2,100,772**	**66,179,230**
Financial Institutions	**Stage 1**	**Stage 2**	**Total**
Rated Aaa	**740,413**	**-**	**740,413**
FVOCI	740,413	-	**740,413**
Total carrying amount	**64,818,871**	**2,100,772**	**66,919,643**

			31 December 2018
Sovereign	**Stage 1**	**Stage 2**	**Total**
Rate Baa2	**3,574,631**	**2,102,958**	**5,677,589**
FOCI	*3,574,631*	-	***3,574,631***
AC	-	*2,102,958*	***2,102,958***
Rate B1	**57,512,156**	**-**	**57,512,156**
FVOCI	2,211,587	-	**2,211,587**
AC	55,300,569	-	**55,300,569**
	61,086,787	**2,102,958**	**63,189,745**
Financial Institutions	**Stage 1**	**Stage 2**	**Total**
Rated Aaa	**537,373**	**-**	**537,373**
FVOCI	537,373	-	**537,373**
Total carrying amount	**61,624,160**	**2,102,958**	**63,727,118**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(iii) Credit Quality by class of financial assets (continued)

Loans and advances to Banks

			31 December 2019
	Stage 1	Stage 2	Total
Rated Aa1	-	-	
Rated Aa2	-	-	
Rated Aa3	13,762	-	13,762
Rated A1	7,764,149	-	7,764,149
Rated A2	5,962,337	3,239,897	9,202,234
Rated A3	-	-	-
Rated Baa1	-	48,814	48,814
Rated Baa2	20,891,230	-	20,891,230
Rated Baa3	2,496,226	-	2,496,226
Rated Ba3	1,094,419	-	1,094,419
Rated B1	800,104	-	800,104
Rated B2	-	-	-
Rated CAA	182,660	-	182,660
Non rated	-	-	-
	39,204,887	**3,288,711**	**42,493,598**

			31 December 2018
	Stage 1	Stage 2	Total
Rated Aa1	11,672	-	11,672
Rated Aa2	24,093	-	24,093
Rated Aa3	6,944,439	-	6,944,439
Rated A1	38,631	-	38,631
Rated A2	-	-	-
Rated A3	4,887,532	17,114	4,904,646
Rated Baa1	16,464,970	-	16,464,970
Rated Baa3	4,927,241	3,690,815	8,618,056
Rated Ba3	1,499,513	-	1,499,513
Rated B1	76,677	-	76,677
Rated B2	185,000	-	185,000
Rated CAA	-	-	-
Non rated	-	-	-
	35,059,768	**3,707,929**	**38,767,697**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(iv) Collateral held and other credit enhancements

The estimated cash flows derived from the collateral, including guarantees securing the exposures, are usually the main source of future cash flows from non-performing loans. Some of the valuation parameters used for the calculation are:

- *Realizable value of collaterals*, which is estimated by reducing the appraised market value of the collateral with a discount factor. This considers the characteristics of similar groups of collaterals. It presumes an average recoverable value of specific collateral, based on the Bank's experience.
- *Timing of the expected cash flow*, which represents the expected recovery time (in years) for a specific type of collateral.

The recovery costs are deducted from estimated future cash flows. Collateral, generally, is not held over loans and advances to financial institutions, except when securities are held as part of reverse repurchase and securities borrowing activity. Usually, collateral is not held against investment securities, and no such collateral was held at 31 December 2019 and 2018. Estimates of fair value are based on the value of collateral assessed at the time of borrowing and are updated every three years. An estimate of the undiscounted and discounted fair value of collaterals and other security enhancements held against financial assets is shown below:

	Collateral of Loans and advances to customers 31 December 2019		Collateral of Loans and advances to customers 31 December 2018	
	Undiscounted	**Discounted**	**Undiscounted**	**Discounted**
Against individually impaired				
Property	4,765,766	1,709,133	5,156,673	1,930,937
Debt securities	421,236	1,523	5,950	-
Cash	193	193	-	-
Pledges and guarantees	39,700	-	296,532	247
Other	-	-	-	-
Total	**5,226,895**	**1,710,849**	**5,459,155**	**1,931,184**
Net carrying amount		**1,355,319**		**1,258,002**

The gross amount of collaterals includes the value of collaterals before testing the individually impaired loans. The net amount shows the present value of the same collaterals under this test. The table below shows the total amount of collaterals for the loans assessed under the category of collectively impaired including all the Stage 3 exposures that are lower than EUR 100 thousand.

These collaterals do not undergo the same testing procedures as the above group. The information on the table below provides information on how much the collectively impaired loans and advances to customers are secured against their respective collaterals.

	Collateral of Loans and advances to customers 31 December 2018		Collateral of Loans and advances to customers 31 December 2017	
	Undiscounted	**Discounted**	**Undiscounted**	**Discounted**
Against Collectively Impaired				
Property	79,525,887	34,465,256	76,090,868	33,216,469
Pledges and guarantees	19,023,744	1,483,977	17,393,858	1,208,001
Cash	1,381,122	1,331,340	1,621,477	1,565,114
Debt securities	2,604,292	42,981	2,797,132	24,647
Other	1,204,056	-	1,646,216	-
Total	**103,739,101**	**37,323,554**	**99,549,551**	**36,014,231**
Net carrying amount		**43,508,771**		**42,670,729**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(iv) Collateral held and other credit enhancements (continued)

It is the Bank's policy to dispose of assets repossessed through the recovering process. The amounts collected from the proceeds are used to reduce or liquidate the carrying amount of the non-performing loans.

The table below sets out the carrying amount and the value of undiscounted collateral of the loans and advances to customers measured at amortized cost.

	31 December 2019		31 December 2018	
	Carrying amount	**Collateral**	**Carrying amount**	**Collateral**
Stage 1 and Stage 2	44,355,746	102,462,453	43,454,022	97,062,977
Stage 3	2,522,658	6,503,543	3,046,403	7,945,729
	46,878,404	**108,965,996**	**46,500,425**	**105,008,706**

When the Bank holds repossessed assets in its ownership, their conversion into cash is the Bank's first aim, through marketing the properties for sale. If there is no satisfactory offer collected, the Bank's practice is to keep the asset for sale until receiving the best offer. The amounts of repossessed properties are disclosed in note 19. Depending on operational needs and the suitability of the asset to fulfill those needs, management may decide to make use of the property; in such cases a reclassification into property and equipment (see note 15) of the Bank is performed.

(v) Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

See accounting policy in Note 7 (g)(vii).

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information. The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Bank uses three criteria for determining whether there has been a significant increase in credit risk:

- quantitative test based on movement in PD, for loans to banks and investment securities only;
- qualitative indicators based on forbearance and early warning signals; and
- a backstop of 30 days past due.

New Definition of default

The Bank considers a financial asset to be in default when:

- the borrower is in a state of insolvency (even though not legally insolvent) or in a de facto equivalent status. By "state of insolvency" the following shall be intended: structural and permanent (not transitory) inability to satisfy, regularly and through ordinary sources, the Counterparty's obligations due to lack of liquidity and/or access to external funding
- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse to actions such as the enforcement of guarantees/ collateral.
- the borrower is more than 90 days past due as described in 8/(a)/(i) in this document

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(v) Amounts arising from ECL (continued)

Incorporation of forward-looking information

The Bank incorporates forward-looking information into the measurement of ECL. The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between EBA (European Banking Authority) stress coefficients and credit losses. The Bank considers three economic scenarios: baseline, adverse scenario, as published by EBA, and best scenario, an internal estimate as a symmetrical reflection of adverse scenario toward baseline one.

Inputs, assumptions and techniques used for estimating impairment (continued)

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognized and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 7 (g)(iv).

Measurement of ECL (Expected Credit Losses)

The framework, IFRS 9 (International Financial Reporting Standard) – Financial Instruments, is based on the estimation of expected losses, different from the incurred losses used under IAS 39. When significant deterioration of the credit quality is recognized, the new concept of Lifetime expected loss is introduced. Lifetime expected loss covers expected loss for the whole IFRS 9 specifies that if the credit risk on a financial instrument has increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to Lifetime expected credit losses and if the credit risk on such instrument has not increased significantly, 12-months expected losses should be calculated instead.

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.
The Bank employs statistical models to analyze the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time. The Bank collects performance and default information about its credit risk exposures analyzed by type of product and borrower as well as by credit risk grading. For some portfolios, information purchased from external credit reference agencies is also used.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of loss rates from defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortization. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts.

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(v) Amounts arising from ECL (continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Measurement of ECL (Expected Credit Losses) (continued)

Low Default Portfolio

A new category of financial instruments are considered for impairment purposes under the IFRS 9 rules, called "Low Default Portfolio". It includes securities and loans to banks, and as defined by Parent Company consists of exposures with the following parties:

- Sovereign (Central Banks, Governments, Municipalities, Public Sector Entities);
- Institutions (Banks, and other financial institutions);
  Intragroup exposures are exposures with the following parties:
- Parent Company;
- Other ISP subsidiaries.

Intragroup transactions are generally classified as Stage 1 with a 12- months ECL following the staging rules for Low Default Portfolio and intragroup exposures based on parent company driven methodologies including validation. Exposures are classified to Stage 2 based on the significant increase of credit risk criterion measured by Lifetime PD comparison. This criterion for Low Default Portfolio is defined based on the specific rating and residual maturity of exposure. Thresholds are provided by Parent Company.

The criteria used to access whether the debt securities credit quality deteriorated significantly since origination is Lifetime PDs comparison. The instrument issuer rating (counterparty rating) is used for the Lifetime PD comparison rather than rating of the single instrument (i.e. at the reporting date different instruments or tranches related to the same issuer will be assigned with the rating of the counterparty at a given date). Debt securities purchased in tranches PD at origination is determined through First In First Out (FIFO) methodology.

Debt securities include "Low Credit Risk Exemption" based on the assumption that the credit risk on has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. Therefore, Investment grade instruments at the reporting date are classified to Stage 1. This exemption is applicable only for instruments belonging to Available For Sale (AFS) portfolio upon the IFRS 9 transition. The following criteria are approved for each stage for Bonds residual maturity of the financial instrument.

Stage 1	**Stage 2**	**Stage 3**
• Debt with no significant credit quality deterioration • Investment grade debts	• Debt with significant increase in PD since origination	• Defaulted Debt

For Stage 3 – Defaulted debt the impairment testing process for any individually securities is applied. If the fair value is less than the carrying amount or if the issuer is delinquent in its debtor obligations or defaults on payments as demonstrated by any one of the following events:

1. Default;
2. Bankruptcy proceedings;
3. Delinquency in interest or principal payments.

Where any one of these events occurs, given the gravity and the irreversibility of the confirmed situation, an impairment loss should be recorded directly. If the fair value is not more than 20% less than the carrying amount and no other impairment indicators are found, there is no need to test the securities further for impairment. The impairment test for this stage classification is performed according to the rules defined in the ISP Group accounting policy.

Both collective assessment and individual assessment on portfolio basis are approaches to impairment evaluation based on statistical methods by using credit risk parameters which are estimated based on historical data for homogenous groups of assets.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(v) Amounts arising from ECL (continued)

Loss allowances

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, as well as collectively assessed and less significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of expected losses that have not been identified.

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument.

Movements in impairment allowance funds for:

Loans and advances to banks	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balances at 1 January 2019	**9,509**	**6,539**	**-**	**16,048**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Financial Assets that have been derecognized	(6,488)	-	-	**(6,488)**
Net remeasurement of loss allowances	1,155	(5,880)	-	**(4,725)**
New financial assets originated or purchased	4,538		-	**4,538**
Foreign exchange and other movements	(80)	(51)	-	**(131)**
Balances at 31 December 2019	**8,634**	**608**	**-**	**9,242**

Loans and advances to banks	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balances at 1 January 2018	**62,923**	**15,202**	**-**	**78,125**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Financial Assets that have been derecognized	(8,579)	-	-	**(8,579)**
Net remeasurement of loss allowances	(50,589)	(12,592)	-	**(63,181)**
New financial assets originated or purchased	6,467	4,306	-	**10,773**
Foreign exchange and other movements	(713)	(377)	-	**(1,090)**
Balances at 31 December 2019	**9,509**	**6,539**	**-**	**16,048**

Investment securities at FVOCI	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balances at 1 January 2019	**4,629**	**-**	**-**	**4,629**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Financial Assets that have been derecognized	(2,077)	-	-	**(2,077)**
Net remeasurement of loss allowances	(169)	-	-	**(169)**
New financial assets originated or purchased	3,158	-	-	**3,158**
Foreign exchange and other movements	(24)	-	-	**(24)**
Balances at 31 December 2019	**5,517**	**-**	**-**	**5,517**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(v) Amounts arising from ECL (continued)

	Stage 1	Stage 2	Stage 3	Total
Balances at 1 January 2018	**27,515**	**-**	**-**	**27,515**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Financial Assets that have been derecognized	(6,028)	-	-	**(6,028)**
Net remeasurement of loss allowances	(16,239)	-	-	**(16,239)**
New financial assets originated or purchased	544	-	-	**544**
Foreign exchange and other Movements	(1,163)	-	-	**(1,163)**
Balances at 31 December 2018	**4,629**	**-**	**-**	**4,629**

Investment securities at amortized cost	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balances at 1 January 2019	**265,837**	**7,801**	**-**	**273,638**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Financial Assets that have been derecognized	(88,037)		-	**(88,037)**
Net remeasurement of loss allowances	(25,823)	(1,266)	-	**(27,089)**
New financial assets originated or purchased	150,137		-	**150,137**
Foreign exchange and other movements	(186)	59	-	**(127)**
Balances at 31 December 2019	**301,928**	**6,594**	**-**	**308,522**

Investment securities at amortized cost	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balances at 1 January 2018	**232,723**	**9,732**	**-**	**242,455**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Financial Assets that have been derecognized	(70,136)	-	-	**(70,136)**
Net remeasurement of loss allowances	(39,947)	(1,648)	-	**(41,595)**
New financial assets originated or purchased	144,241	-	-	**144,241**
Foreign exchange and other movements	(1,044)	(283)	-	**(1,327)**
Balances at 31 December 2018	**265,837**	**7,801**	**-**	**273,638**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(v) Amounts arising from ECL (continued)

Loss allowances (continued)

Loans and advances to customers

	Stage 1	Stage 2	Stage 3	Total
Balances at 1 January 2019	**663,165**	**456,354**	**1,452,175**	**2,571,694**
Transfer to Stage 1	(218,731)	77,027	141,704	-
Transfer to Stage 2	3,769	(300,063)	296,294	-
Transfer to Stage 3	451	3,978	(4,429)	-
Transfer to Non-current assets held for sale	-	-		-
Financial assets de-recognized / repaid	(82,111)	(188,125)	(99,121)	**(369,357)**
Net remeasurement of loss allowances	89,053	46,706	15,336	**151,095**
New financial assets originated or purchased	257,528	42,957	90,319	**390,804**
Write offs	-	-	(696,935)	**(696,935)**
Foreign exchange and other movements	(3,007)	(1,976)	(28,004)	**(32,987)**
Balances at 31 December 2019	**710,117**	**136,858**	**1,167,339**	**2,014,314**

Loans and advances to customers

	Stage 1	Stage 2	Stage 3	Total
Balances at 1 January 2018	**936,079**	**488,406**	**1,665,031**	**3,089,516**
Transfer to Stage 1	215,511	(90,834)	(124,677)	0
Transfer to Stage 2	(13,377)	51,953	(38,576)	0
Transfer to Stage 3	(114,700)	(227,616)	342,316	0
Transfer to Non-current assets held for sale	-	-	(151,544)	(151,544)
				0
Net remeasurement of loss allowances	(602,439)	30,816	(245,699)	(817,322)
New financial assets originated or purchased	267,576	220,152	607,485	1,095,213
Write offs	-	-	(513,464)	(513,464)
Foreign exchange and other movements	(25,485)	(16,523)	(88,697)	(130,705)
Balances at 31 December 2018	**663,165**	**456,354**	**1,452,175**	**2,571,694**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(v) Amounts arising from ECL (continued)

The following table provides a reconciliation between:

amounts shown in the above tables reconciling opening and closing balances of loss allowance per class of financial instrument; and

the 'impairment losses on financial instruments' line item in the consolidated statement of profit or loss and other comprehensive income.

	Loans and advances to banks	Loans and advances to customers	Investment securities at FVOCI	Investment securities at amortized cost	Total
Net remeasurement of loss allowance	11,212	218,262	2,246	115,126	346,846
New financial assets originated or purchased	(4,538)	(390,804)	(3,158)	(150,137)	(548,637)
Balances at 31 December	**6,674**	**(172,542)**	**(912)**	**(35,011)**	**(201,791)**

(vi) Write-off policy

The Bank writes off a loan (and any related allowances for impairment losses) when the Bank's Board of Directors determines that the loans are uncollectible. This is generally the case when the Board of Directors determines that significant changes in the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. The Bank's policy is also in compliance with the Regulation no.62 "On Administration of Credit Risk for Banks and Foreign Banks Subsidiaries".

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(vii) Concentration of Credit Risk

The Bank monitors concentration of credit risk by sector and location. An analysis of credit risk at the reporting date is shown below:

	Net Loans and advances to customers	
Concentration by sector	**31 December 2019**	**31 December 2018**
Services	14,994,397	12,996,807
Wholesale	8,957,759	10,311,235
Construction	2,464,497	2,494,865
Manufacturing	5,578,467	5,201,578
Real Estate	487,818	726,549
Other	1,539,817	1,955,755
Corporate	**34,022,755**	**33,686,789**
Mortgage	8,521,717	8,166,442
Consumer	2,319,618	2,075,500
Retail	**10,841,335**	**10,241,942**
Carrying amount	**44,864,090**	**43,928,731**

	Loans and advances to banks	
Concentration by sector	**31 December 2019**	**31 December 2018**
Bank	29,146,303	20,253,667
Carrying amount	**29,146,303**	**20,253,667**

	Investment securities	
Concentration by sector	**31 December 2019**	**31 December 2018**
Sovereign	66,179,213	63,189,745
Bank	-	-
Other Financial l Institutions	740,430	537,373
Carrying amount	**66,919,643**	**63,727,118**

The following concentrations of credit risk arise in the Bank's credit-risk portfolio.

	31 December 2019	Exposure In %	31 December 2018	Exposure In %
Republic of Albania securities	58,773,316	34%	57,511,936	35%
Balances with Bank of Albania	15,458,575	9%	15,330,553	9%
Total direct Albanian Sovereign risk	**74,231,891**	**43%**	**72,842,489**	**44%**
Largest bank	16,564,712	10%	16,466,776	10%
Largest customer	3,256,625	2%	1,426,673	1%
Total largest bank and customer	**19,821,337**	**12%**	**17,893,449**	**11%**
Total on-balance-sheet risk	**94,053,228**	**55%**	**90,735,938**	**55%**

The largest exposure toward the banks is exposure to the Group bank and the largest customer is a private company.

8. Financial Risk Management (continued)

(a) Credit Risk (continued)

(viii) Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honor its obligations to deliver cash, securities or other assets as contractually agreed. The settlement risk with financial institutions and government counterparties is included within a system of limits for all the transactions with such counterparties and is subject to daily monitoring, defined and regulated in the internal documents "ISBA Credit Autonomy Level" and "ISBA Rules for the management and maintenance of the FI-s limits" and the Central Bank of Albania regulation "On risk management arising from the large exposures of the Bank".

The Bank of Albania regulation "On risk management arising from the large exposures of Bank" was revised during 2014 and entered in force in March 2015. The Bank has been within the limits in accordance with Central Bank of Albania regulation up to 31 December 2019.

With the aim to prevent any breaches of local regulatory counterparty limits with Financial Institutions, generated by fluctuations of exchange rates, the bank has integrated warning level limits (soft limits), 23.4 % of regulatory capital for the exposures toward ISP Group and 18.7 % of regulatory capital for the exposures toward other Financial Institutions/Governments, as approved by FRCO on 24 January 2017 and reapproved the same level of soft limits by ALCO 21 March 2019.

(b) Liquidity Risk

Liquidity risk is defined as the possibility that an institution is unable to meet its payment obligations due to its incapacity to liquidate assets or obtain adequate funding from the market (funding liquidity risk), or due to the difficulty of easily unwinding positions in financial assets without negatively and significantly affecting their price due to inadequate market depth or temporary market disruptions.

(i) Management of liquidity risk

The Bank's approach to managing liquidity risk is to ensure, as much 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. The Bank defines the guidelines for liquidity risk management and the contingency liquidity plan, which are subject to review by Group structures and approval by the Bank's Financial Risk Committee and Board of Directors. The Treasury and ALM Department is responsible for liquidity management and the Risk Management Division is responsible for monitoring indicators and verifying adherence to the limits and the Bank's Regulation on Liquidity Risk Management is annually updated.

The Bank monitors liquidity, in accordance with this regulation, in order to manage its obligations when they fall due and activate emergency procedures in case of escalation.

A balanced ratio should be maintained between incoming sources and outflows, in both the short and medium-long term. This target is organized through the use of the following specific metrics "Liquidity Coverage Ratio up to 30 days" and "Net Stable Funding Ratio".

- **Liquidity Coverage Ratio (LCR)** up to 30 days**:** aims to ensure that the Bank maintains an adequate level of unencumbered high-quality liquid assets (HQLA) to meet its short-term liquidity needs under liquidity stress scenario (LCR≥100%).
- **Net Stable Funding Ratio (NSFR):** aims to guarantee an adequate liquidity position over a medium/long-term time horizon. It establishes a minimum "acceptable" amount of funding over one-year horizon in relation to the needs arising from the liquidity characteristics and the residual maturities of assets and off-balances exposures (NSFR≥100%).

Holding reserves of liquid assets (so-called Liquidity Buffer) is one of the main tools for mitigating liquidity risk. For the purpose of identifying and measuring this risk, both short and medium-long term, the classification of highly-liquid assets takes on crucial importance.

8. Financial Risk Management (continued)

(b) Liquidity Risk (continued)

(i) Management of liquidity risk (continued)

In its Liquidity Policy, the Bank projects an LCR indicator of up to 3 months by including the estimated market effect of specific acute liquidity tensions (at bank level) combined with a widespread and general market crisis, based on assumptions provided by the Group's guidelines. (LCR up to 3 months ≥90%).

A similar, but not identical, calculation is used to measure the Bank's compliance with the liquidity limits established by the Bank of Albania, which should be above 20% for all currencies and foreign currencies and above 15% for the local currency.

A new indicator is introduced by the Bank of Albania, LCR as per Banka of Albania (BOA) regulation requirements regulation. The limits for LCR BOA will enter in force on 1 March 2020 and are as below:

A limit of total currencies is defined at least 100% and for total significant foreign currencies with a gradually implementation as below:

LCR TOTAL SIGNIFICANT CURRENCY

- 1st of Mar 2020 50%
- 1st of Jan 2021 70%
- 1st of Jan 2022 80%

in accordance with risk appetite framework, the bank should decide internal limits for Lek and each significant currency (Eur and USD). The limits of LCR in LEK, USD and EUR are not decided yet.

(ii) Compulsory reserve

On 7 February 2018 Bank of Albania approved the decision no.14 for the change on the Compulsory Reserve requirement. These changes has entered in force during June 2018 up to August 2019 and consist of the following:

- Decrease for the obligatory reserve requirement rate for local currency liabilities to 7.5% and 5% (previous rate applied: 10%).
- The new obligatory reserve requirement rate for foreign currency liabilities is 12.5% and 20%. Liabilities in foreign currency up to 50% of the total liabilities have a 12.5% requirement rate and for the part of above 50% of the total liabilities the requirement rate is 20% (previous rate applied: 10 %).

All the above liquidity ratios are periodically monitored by the Bank with reference to the Group internal limits and guidelines and to the Bank of Albania requirements. During the year 2019, the bank has been within the internal and regulatory limits.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(b) Liquidity Risk (continued)

The table enclosed is only for representative purposes and shows breakdown by the earliest contractual residual maturity of financial assets and liabilities. The classification of securities portfolio in Level 1 is done based on the criteria's defined in ISBA Liquidity Risk policy. The other securities are positioned as per left maturity, since are considered as not liquid assets. Behavioral coefficients of ISP Group are applied for the drawdown percentages for off-balance-sheet categories such as committed credit lines and guarantees. The breakdown considers the cash flows in/out of the Bank for on and off-balance-sheet financial assets and liabilities, according to the earliest contractual residual maturity and not reflecting any retention history assumptions or earlier repayment. The expected cash flows differ from this representation, for example the current account from customers are expected to be stable or to be increased.

31 December 2019	Up to 1 month	1-3 months	3-12 months	1-5 years	> 5 years	Total
Assets (Cash Flow IN)	**96,851,459**	**17,207,028**	**17,337,804**	**42,945,476**	**13,194,228**	**187,535,995**
Net Cash	1,444,030	-	-	-	-	1,444,030
Minimum reserve requirements	-	-	-	15,462,646	-	15,462,646
Advances to banks	15,469,686	-	-	-	-	15,469,686
Investment Securities	58,898,355	-	-	-	-	58,898,355
Other Investment Securities	249,589	6,917,706	2,106,637	7,854,245	2,227,022	19,355,199
Loans to banks	8,358,483	9,046,721	9,624,816	-	-	27,030,020
Loans and advances to customers (*gross performing loans*)	12,431,316	1,242,601	5,606,351	19,628,585	10,967,206	49,876,059
31 December 2019						
Liabilities (Cash flow OUT)	**(100,062,308)**	**(9,548,652)**	**(25,982,861)**	**(19,459,282)**	**(200,977)**	**(155,254,080)**
Deposits from banks and customers- Current accounts	(93,661,120)	-	-	-	-	(93,661,120)
Current accounts with banks	(48,146)	-	-	-	-	(48,146)
Current accounts with customers	(93,612,974)	-	-	-	-	(93,612,974)
Deposits from banks	(2,074,049)	-	-	-	-	(2,074,049)
Deposits from customers- Time deposits	(4,327,139)	(9,548,652)	(25,982,861)	(19,459,282)	(200,977)	(59,518,911)
Total gap on-balance sheet	**(3,210,849)**	**7,658,376**	**(8,645,057)**	**23,486,194**	**12,993,251**	**32,281,915**
Off-Balance sheet (Cash flow in)	-	-	-	-	-	-
Off- Balance sheet (Cash flow out)	(281,462)	-	-	-	-	(281,462)
Total gap off-balance sheet	**(281,462)**	-	-	-	-	**(281,462)**
Total gap 31 December 2019	**(3,492,311)**	**7,658,376**	**(8,645,057)**	**23,486,194**	**12,993,251**	**32,000,453**
Cumulated gap 31 December 2019	**(3,492,311)**	**4,166,065**	**(4,478,992)**	**19,007,202**	**32,000,453**	

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(b) Liquidity Risk (continued)

31 December 2018	Up to 1 month	1-3 months	3-12 months	1-5 years	> 5 years	Total
Assets (Cash Flow IN)	**94,855,485**	**27,637,888**	**17,092,080**	**49,102,574**	**16,915,330**	**205,603,357**
Net Cash	1,445,991	-	-	-	-	1,445,991
Minimum reserve requirements	-	-	-	14,993,585	-	14,993,585
Advances to banks	14,170,513	-	-	-	-	14,170,513
Investment Securities	55,425,060	8,205,840	2,926,227	7,320,997	3,235,165	77,113,289
Other Investment Securities	2,138,932	8,205,840	2,926,227	7,320,997	3,235,165	23,827,161
Loans to banks	9,751,918	9,948,950	5,255,447	-	-	24,956,315
Loans and advances to customers (gross performing loans)	11,923,071	1,277,258	5,984,179	19,466,995	10,445,000	49,096,503
31 December 2018						
Liabilities (Cash flow OUT)	**(93,051,713)**	**(11,860,355)**	**(28,674,589)**	**(15,869,827)**	**(710,759)**	**(150,167,243)**
Deposits from banks and customers- Current accounts	(86,635,435)	-	-	-	-	(86,635,435)
Current accounts with banks	*(1,526,913)*	-	-	-	-	*(1,526,913)*
Current accounts with customers	*(85,108,522)*	-	-	-	-	*(85,108,522)*
Deposits from banks	(1,244,774)		-	-	-	(1,244,774)
Deposits from customers- Time deposits	(5,171,504)	(11,860,355)	(28,674,589)	(15,869,827)	(710,759)	(62,287,034)
Total gap on-balance sheet	**1,803,772**	**15,777,533**	**(11,582,509)**	**33,232,747**	**16,204,571**	**55,436,114**
Off-Balance sheet (Cash flow in)	-	-	-	-	-	-
Off- Balance sheet (Cash flow out)	(290,009)	-	-	-	-	(290,009)
Total gap off-balance sheet	**(290,009)**	**-**	**-**	**-**	**-**	**(290,009)**
Total gap 31 December 2018	**1,513,763**	**15,777,533**	**(11,582,509)**	**33,232,747**	**16,204,571**	**55,146,105**
Cumulated gap 31 December 2018	**1,513,763**	**17,291,296**	**5,708,787**	**38,941,534**	**55,146,105**	**-**

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(b) Liquidity Risk (continued)

The information provided relates to cash flows deriving from financial off-balance-sheet liabilities, therefore it considerably differs from the face of the statement of financial position. The analysis does not include non-financial liabilities and equity, and comprises of cash flows of contractual interest.

The table below shows the Bank's financial contingent liabilities and financial commitments.

31 December 2019	1 Month	1-3 Months	3-12 Months	1-5 Years	>5 Years	Total
Commitments	4,868,368	-	-	-	-	**4,868,368**
Guarantees	5,773,011	-	-	-	-	**5,773,011**
31 December 2018						
Commitments	4,378,023	-	-	-		**4,378,023**
Guarantees	5,193,902	-	-	-	-	**5,193,902**

The Bank expects only a small part of the commitments to be demanded within one month and guarantees to be closed at maturity date. (Refer also to note 30 Commitment and contingencies)

Reconciliation between contingent liabilities and commitments maturity table and note 30 Commitment and contingencies is as follows:

	31 December 2019	31 December 2018
Commitments	**4,868,368**	**4,378,023**
Un-drawn credit facilities	4,868,368	4,378,023
Guarantees	**5,773,011**	**5,193,902**
Letters of credit	1,316,966	948,692
Guarantees in favor of customers	4,456,045	4,245,210

(c) Market Risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) 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 optimizing the return on risk.

Management of market risks

The Bank holds its securities portfolio in accordance with IFRS 9 as either Held to Collect (HTC) or Held to collect and sell (HTCS). ISBA Security Portfolio is managed by "ISBA Financial Portfolio Policy "which defines the below specific limits:

- Hold to collect and sell portfolio is not allowed to exceed the 55% of the sum of customer's deposits and shareholder's equity.
- Hold to collect portfolio has the maximum weighted average modified duration, 3 years.
- The security portfolio should obey the specific limits related to type of issuer limits (presented on the next slide) with the following further constraints for HTC Securities: a) country of issuer must be an OECD member and b) issuer rating must be not below A-.
- The overall portfolio must comply with some pre-defined type of issuer limits, which are categorized based on the issuer type, rating and currency.

For all the investments in debt securities, classified as HTCS or HTC, issued by countries considered "at risk" according to ISP Country Risk Guidelines (i.e. countries not belonging to euro area with an internal rating lower than AA-), the approval process and authorization procedure required by the guidelines in force must be followed.

8. Financial Risk Management (continued)

(c) Market Risk (continued)

(i) Exposure to Foreign Exchange rate risk

Foreign exchange rate risk is defined as the possibility that foreign exchange rate fluctuations will produce significant changes, both positive and negative, in the Bank's statement of financial position. The key sources of exchange rate risk consist of:

- Foreign currency loans and deposits held by corporate and retail customers;
- Investment securities in foreign currencies;
- Trading of foreign banknotes;
- Collection and/or payment of interest, commissions, administrative costs, etc. in foreign currencies.

The Bank's exposure to exchange rate risk is monitored on a daily basis by Market and Operational Risk Office ensuring compliance with the internal and regulatory limits. Internal regulations set limits for each open currency position, global open position, maximum loss and Value at Risk (VaR). A detailed analysis was carried out on a one-year historical data in order to confirm/establish the aforementioned limits. The local regulatory limits refer to a maximum of 20% of the regulatory capital for each open currency position and 30% for the overall open currency position.

The Bank has been within the limits in accordance with Bank of Albania regulation during the year 2019

Financial assets denominated in foreign currencies are disclosed in each relevant note to the financial statements.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(c) Market Risk (continued)

(i) Exposure to Foreign Exchange rate risk (continued)

Assets	**LEK**	**USD**	**EUR**	**OTHER**	**TOTAL**
Cash and cash equivalents	1,577,820	2,754,534	23,546,047	2,361,714	**30,240,115**
Loans and advances to banks	2,970,099	1,422,215	24,753,989	0	**29,146,303**
Investment securities at FVOCI	725,988	543,636	3,019,658	-	**4,289,282**
Investment securities at amortized cost	58,051,455	2,100,772	2,478,134	-	**62,630,361**
Loans and advances to customers	15,877,228	3,171,659	25,815,126	77	**44,864,090**
Property and equipment's	2,211,673	-	-	-	**2,211,673**
Right of use	460,883	-	-	-	**460,883**
Intangible assets	600,977	-	-	-	**600,977**
Investment Property	545,556	-	-	-	**545,556**
Deferred tax assets	531,687	-	-	-	**531,687**
Current tax assets	347,992	-	-	-	**347,992**
Non-current assets held for sale	1,805	-	18,906	-	**20,711**
Other assets	427,383	36,541	1,215,637	3,086	**1,682,647**
Total Assets (1)	**84,330,546**	**10,029,357**	**80,847,497**	**2,364,877**	**177,572,277**
Liabilities					
Due to Banks	1,846,338	1,063	386,430	16,212	**2,250,043**
Due to customers	58,712,339	9,864,334	80,032,151	2,332,801	**150,941,625**
Provisions	502,909	32,946	529,703	-	**1,065,558**
Lease liabilities	3,598	-	442,346	-	**445,944**
Other liabilities	600,488	24,482	392,661	1,031	**1,018,662**
Deferred tax liabilities	213,684	-	-	-	**213,684**
Net Equity	21,613,702	(1,125)	24,184	**-**	**21,636,761**
Total Liabilities (2)	**83,493,058**	**9,921,700**	**81,807,475**	**2,350,044**	**177,572,277**
Net FX Position at 31 December 2019 (1)-(2)	**837,488**	**107,657**	**-959,978**	**14,833**	**0**
Off balance sheet Assets	10,672,352	4,484,681	129,231,596	-	**144,388,629**
Off balance sheet Liabilities	10,915,887	4,574,800	128,897,942	-	**144,388,629**
Net Off BSH FX Position at 31 December 2019	**(243,535)**	**(90,119)**	**333,654**	**-**	**-**
Total Net FX Position at 31 December 2019	**593,953**	**17,538**	**(626,324)**	**14,833**	**-**
Balance sheet Assets as at 31 December 2018	82,453,727	10,941,361	75,754,550	2,200,019	**171,349,657**
Balance sheet Liabilities as at 31 December 2018	82,376,894	10,787,015	76,003,730	2,182,018	**171,349,657**
Net Off BSH FX Position at 31 December 2018	**(256,102)**	**(149,113)**	**417,207**	**(11,992)**	**-**
Total Net FX Position at 31 December 2018	**(179,269)**	**5,233**	**168,027**	**6,009**	

8. Financial Risk Management (continued)

(c) Market Risk (continued)

(ii) Exposure to Interest Rate risk

The principal Interest Rate risk to which the Bank's portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of the change in market interest rates. This risk arises primarily from securities portfolio, retail and corporate banking. Interest rate risk is managed principally through periodic monitoring of interest rate spreads between the Bank's assets and liabilities and also preparing related scenario analysis on interest rates for decision making purposes.

The method used to measure Interest Rate risk of the Bank's assets and liabilities is based on the sensitivity analysis. The measurement system adopted by the Bank must ensure that the risk profile can be examined from two distinctive but complementary points of view:

- the economic value perspective (EVE - Economic Value of Equity), that evaluates the impact of interest rates shocks (and their volatilities) on the present value of future cash flows;
- the net interest income perspective (NII - Net Interest Income), that evaluates the impact of interest rates shocks (and their volatilities) on net interest income.

The Bank's financial assets and liabilities have mainly variable interest rate or have a re-pricing date of less than one year, except for Albanian Securities and for certain non-Albanian securities investment, which have coupon rates between 2 - 6.9% for USD denominated securities (2018: 1.3 - 6.9%) and between 0.3 - 5.8% for EUR denominated securities (2018: 0.4 - 5.8%)

The Bank's Regulation on Interest Rate Risk Management, "ISBA Guidelines on the governance of IRRBB" and "ISBA Rules on the measurement and control of IRRBB" have been approved by the ISBA Board of Directors on July 30th, 2019.

These documents implement the latest regulatory provisions, recently defined in the Guidelines issued by the Parent Company on January 2019, based on the EBA regulation (EBA/GL/2018/02), and keeping the provisions of the Bank of Albania guideline "On managing interest rate risk in the banking book", approved as per decision No. 33, dated 30 April 2013. Interest rate risk generated by the Bank's assets and liabilities, as measured through shift sensitivity of Fair Value analysis of ± 100 basis points, registered at the end of December 2019 a value of ALL -619 million (for +100 basis points) compared to the end of year 2018 ALL -659 million.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(c) Market Risk (continued)

(ii) Exposure to Interest Rate risk (continued)

The table below shows the currency breakdown of the shift sensitivity for the year end 2019 and 2018.

Shift sensitivity 31 December 2019	Increase in basis points	Total	Sensitivity of Profit & Loss	Sensitivity of Equity
EUR	+100 b.p. / -100 b.p.	(214,693)/(143,471)	(206,040)/138,733	(8,654)/4,738
USD	+100 b.p. / -100 b.p.	(99,150)/(108,806)	(96,935)/106,652	(2,215)/2,155
ALL	+100 b.p. / -100 b.p.	(307,181)/307,609	(290,312)/291,657	(16,869)/15,952
Other (GBP & CHF)	+100 b.p. / -100 b.p.	1,763/(1,804)	1,763/(1,804)	0/0

Shift sensitivity 31 December 2018	crease in basis points	Total	Sensitivity of Profit & Loss	Sensitivity of Equity
EUR	+100 b.p. / -100 b.p.	(225,240)/ 111,277	(216,998)/ 105,218	(8,242)/ 6,059
USD	+100 b.p. / -100 b.p.	(107,348)/ 118,124	(105,428)/ 116,178	(1,920)/ 1,946
ALL	+100 b.p. / -100 b.p.	(327,223)/ 332,664	(322,341)/ 327,540	(4,882)/ 5,125
Other (GBP & CHF)	+100 b.p. / -100 b.p.	1,235/ (1,269)	1,235/(1,269)	0/ 0

The limits on shift sensitivity of Fair Value (EVE) for shock +100bp and the NII Sensitivity for shocks +/-50bp are part of the RAF limits for ISBA 2019.

The NII sensitivity records the NII effects generated by the market rates movement on the renewal/re-pricing of the banking book. It quantifies the short-term impact on the net interest income of a parallel, instantaneous, permanent shock of ±50 basis points to the interest rate curve. This measure highlights the effect of variations in market rates on the interest margin generated by the portfolio that is being measured, excluding potential effects deriving from the new operations and future changes in the mix of assets and liabilities. The reference time horizon is typically limited to 1 year and according to the hypothesis that the institution is able to continue its activities ("going concern" approach).

The Interest rate risk generated by the Bank's assets and liabilities, as measured through shift sensitivity of Net Interest Income analysis of ± 50 basis points, registered at 31 December 2019 a value of Lek 258 million (for +50 basis points) and a value of Lek -260 million (for -50 basis points), compared to December 2018 Lek 218 million (for +50 basis points) and a value of Lek -269 million (for -50 basis points).

The sight positions with customers in ALL and EUR are treated based on behavioral model for the NII sensitivity defining the customer interest rate in the long-term and including the behavioral features and delayed reaction to market interest rates (in the short-term) resulting from the model. The behavioral model is developed by ISP Financial and Market Risks Head Office Department, based on the ISBA historical data provided from the Local Risk structure.

A different method used to measure Interest Rate risk is required by the Bank of Albania, which consists of quarterly monitoring of the interest rate risk exposure towards a parallel shock of ±200 basis points of the interest rate curve. For all the financial categories of assets and liabilities divided into either fixed or floating rate, their present value is calculated and is distributed in 14-time buckets. The total present value is then multiplied accordingly with the estimated modified duration of each time bucket. The limit for this exposure is 20% of the Bank's regulatory capital. The Bank has been within the limit with the interest rate risk exposures at 31 December 2019 being 7.9% of the Bank's regulatory capital (31 December 2018: 6.3%).

The Bank has been within the limits in accordance with Bank of Albania regulation and the internal regulation during the year 2019.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(c) Market Risk (continued)

(ii) Exposure to Interest Rate risk (continued)

The tables below summarize the Bank's interest-bearing financial assets and liabilities with both fixed and floating interest rates, as reported to Parent company and management of the Bank. The information is not reconcilable as it is provided by management and adjusted as per below.

Based on the management of Interest Rate risk regulation, each financial instrument is mapped to the repricing gap based on contractual undiscounted cash – flows or behavioral re-pricing date. The contractual includes instruments where the Bank knows exactly when the maturity or next re – pricing takes place.

31 December 2019		**O/N**	**0-3 months**	**3-18 months**	**18 moths - 3 years**	**3 - 5 years**	**>5 years**	**Total**
Assets	**Interest rate type**							
Loans and advances to banks	Fix	15,477,295	32,865,605	9,624,816	-	-	-	**57,967,716**
	Floating	-	-	-	-	-	-	**-**
Loans and advances to customers	Fix	12,360,484	773,965	4,727,470	2,588,225	1,285,437	1,097,731	**22,833,312**
	Floating	74,407	5,694,239	20,070,008	625,210	488,603	567,739	**27,520,206**
Investment Securities	Fix	146,340	6,667,894	31,562,700	13,920,677	8,644,785	5,056,626	**65,999,022**
	Floating	-	2,609,430	3,046,786	30,826	24,517	-	**5,711,559**
Other financial assets		-	-	-	-	-	-	**-**
Total financial assets		**28,058,526**	**48,611,133**	**69,031,780**	**17,164,938**	**10,443,342**	**6,722,096**	**180,031,815**
Liabilities								
Deposits to banks	Fix	(193,861)	(1,690,188)	(71,417)	-	(312,444)	-	**(2,267,910)**
	Floating	-	-	-	-	-	-	**-**
Due to customers	Fix	(93,764,582)	(13,578,466)	(28,441,551)	(6,073,294)	(10,927,298)	(200,977)	**(152,986,170)**
	Floating	-	-	-	-	-	-	-
Other liabilities		-	-	-	-	-	-	**-**
Total financial liabilities		**(93,958,443)**	**(15,268,654)**	**(28,512,968)**	**(6,073,294)**	**(11,239,742)**	**(200,977)**	**(155,254,080)**
Reprising gap		**(65,899,917)**	**33,342,479**	**40,518,812**	**11,091,644**	**(796,400)**	**6,521,119**	**24,777,735**

The behavioral includes instruments not amenable, whose residual life and/or interest rate have high levels of uncertainty that may depend on specific behaviors by customers, as the sight loans (advances to banks and advances to customers) and sight deposits (current accounts to customers) are positioned in the O/N (on demand) bucket, until the definition of behavioral coefficients.

The reprising gap is calculated according to the internal rules on Interest rate risk as the difference between interest-bearing assets and interest-bearing liabilities in a given time bucket. Other financial assets/liabilities, capital and reserves, are items not included in the reprising gap, not considered interest-bearing.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(c) Market Risk (continued)

(ii) Exposure to Interest Rate risk (continued)

31 December 2018		O/N	0-3 months	3-18 months	18 moths - 3 years	3 - 5 years	>5 years	Total
Assets	**Interest rate type**							
Loans and advances to banks	Fix	18,793,707	30,071,336	5,255,447	-	-	-	**54,120,490**
	Floating	-	-	-	-	-	-	**-**
Loans and advances to customers	Fix	11,445,250	659,437	3,459,693	3,615,549	1,085,042	1,021,695	**21,286,666**
	Floating	37,782	5,860,770	20,142,929	636,721	502,526	576,274	**27,757,002**
Investment Securities	Fix	-	10,285,273	23,145,054	9,618,471	13,304,548	4,074,342	**60,427,688**
	Floating	-	4,609,943	4,058,005	47,359	38,216	4,785	**8,758,308**
Other financial assets		-	-	-	-	-	-	**-**
Total financial assets		**30,276,739**	**51,486,759**	**56,061,128**	**13,918,100**	**14,930,332**	**5,677,096**	**172,350,154**
Liabilities								
Deposits to banks	Fix	(1,526,913)	(1,100,158)	-	(144,616)	-	-	**(2,771,687)**
	Floating	-	-	-	-	-	-	**-**
Due to customers	Fix	(85,462,198)	(16,848,806)	(31,272,669)	(4,437,328)	(8,688,016)	(686,539)	**(147,395,556)**
	Floating	-	-	-	-	-	-	**-**
Other liabilities	-	-	-	-	-	-	-	**-**
Total financial liabilities		**(86,989,111)**	**(17,948,964)**	**(31,272,669)**	**(4,581,944)**	**(8,688,016)**	**(686,539)**	**(150,167,243)**
Reprising gap		**(56,712,372)**	**33,537,795**	**24,788,459**	**9,336,156**	**6,242,316**	**4,990,557**	**22,182,911**

8. Financial Risk Management (continued)

(d) Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems or external events. This definition includes: legal risk, or the risk of losses resulting from violations of law or regulations, from contractual or constructive liability or from other disputes; model risk, defined as the potential loss which can be suffered by an entity, resulting from decisions mainly based on the results of internal models, caused by errors occurred during their development, implementation or use; Compliance risk, defined as the risk to incur judicial or administrative penalties, relevant financial losses resulting from the violation of mandatory rules or self-regulation; ICT risk (Information and Communication Technology, or simply computer risk), defined as the risk to incur economic losses related to the use of information and communication technology. Strategic and reputational risks are excluded.

The Bank's Board of Directors has approved the guidelines on the overall operational risk management framework adopting a policy and an organizational process for measuring, managing and controlling operational risk. The Bank's Regulation on Guideline for Operational Risk Management is fully in compliance with the Group Guidelines on Operational Risk Management issued on December 2014.

The Bank's Operational Risk Management Committee (hereinafter as ORCO) is responsible for the management of the operational risk of the Bank in terms of reviewing operational risk governance documentation and approving changes, preparing policies, standards and methodologies regarding operational risk management. One of the tools introduced for the management of operational risk is the definition of Operational Risk Key Indicators (KRIs). The final list of KRIs and thresholds was approved in ISBA Operational Risk Committee on October 2015. Since their approval, the Internal KRIs have been monitored and reported on quarterly bases in the ORCO and BoD meetings. The Internal KRIs are subject of an annual review process in order to ensure that they are aligned with the dynamic of the operational context and the significant risks that the Bank faces. Any amendment on KRIs policy will be submitted in ORCO and BoD for approval.

Thresholds for Bank of Albania KRI-s are defined and integrated within "ISBA KRIs Policy", approved in ISBA BOD 4 May 2018. The KRI-s are monitored on quarterly basis as per regulation BoA "On Operational Risk Management" in place, and reported in ORCO and BoD meetings.

The Bank's Risk Management Division is responsible for the identification, assessment, management and mitigation of operational risks, the verification of mitigation effectiveness and reporting to the Bank Senior Management and Group Risk Management with the aim of assessing the potential economic impact of particularly serious operational events.

The Bank carries out an annual assessment campaign set up by Intesa Sanpaolo Group, Self-Diagnosis process, which consists on the operational risk identification and assessment linked to the activity of each single unit within a structure.

The objectives of the Self Diagnosis process are to identify, measure, monitor, and mitigate operational risks. The Self Diagnosis process contributes to the spread of risk - control culture within the Bank. This process is composed of phases relative to the Assessment of the Business Environment, which determines the quality of each structure's risk control profile through the analysis of the importance and the level of management of risk factors in the operating context and phases relative to Scenario Analysis, which determine the size of each structure's risk profile by collecting estimated quantitative data from Business and Operational Units Responsible.

The Bank has the same responsibilities towards the Bank of Albania, based on the regulation on management of operational risk, entered into force on January 2011. The Bank reports regularly on the key indicators and classifications of effective operational losses as per business lines according to the regulatory requirements.

(in thousands of Lek, unless otherwise stated)

8. Financial Risk Management (continued)

(e) Capital Management

The Bank's lead regulator, the Central Bank of Albania, sets and monitors capital requirements for the Bank. The Bank's policy is to maintain the capital base within limits, capitalizing all activity earnings so as to sustain future development of the business recognizing the impact of the level of capital on shareholders' return. The Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

Implementing the current capital requirements, the Central Bank of Albania requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets and off-balance sheet items, at a minimum level of 12%. During financial year 2019 the Bank achieved an adequacy ratio well above the minimum required which as at 31 December 2019 is calculated at 22.69% (2018: 23.17%).

The modified capital adequacy ratio, which represents the ratio of base capital to risk-weighted assets and off-balance sheet items, is another limit set by the Central Bank of Albania at a level of 6%. Throughout the period, there were no material changes in the Bank's management of capital and all externally imposed capital requirements were complied with.

In March 2015 regulation on Capital Adequacy Ratio entered into force. The regulation is based on Basel II criteria and is in line with the European Directives for Financial Institutions.

Capital Adequacy Ratio remained well above the minimum level required during 2019.

	Note	31 December 2019	31 December 2018
Tier 1 capital - CET1			
Share capital	25	5,562,518	5,562,518
Share premium	25	1,383,880	1,383,880
Legal and regulatory reserves	26	1,825,623	1,825,623
Regulatory retained earnings		10,368,316	10,736,321
		19,140,337	**19,508,342**
Deductions:			
Regulatory intangible assets		(695,485)	(591,149)
Total qualifying Tier 1 capital		**18,444,852**	**18,917,193**
Risk-weighted assets:			
On and off balance sheet		72,237,271	72,182,375
Risk assets for operational risk		9,038,279	9,459,017
Total risk-weighted assets		**81,275,550**	**81,641,392**
Tier I capital to risk- weighted asset ratio		**22.69%**	**23.17%**

During 2017, the Bank of Albania issued and approved the guideline "On the internal capital adequacy assessment process" which entered in force on 31 December 2017. The purpose of this guideline is to set out the requirements for banks on drafting and implementing the Internal Capital Adequacy Assessment Process (ICAAP), as well as the expectations of the supervisor on the structure and content of the regulatory report of this process. ICAAP, which is independently realized by the bank and approved from its governing bodies by acknowledging also regulatory requirements, shall ensure the assessment of the current and future levels of capital adequacy, based on its risk profile and strategies. ICAAP has been prepared by the Bank starting from year 2013 following also the ISP Group requirement and also have been timely submitted to the regulator during May 2019.

(in thousands of Lek, unless otherwise stated)

9. Financial Assets and Financial Liabilities

(a) Fair values of financial assets and financial liabilities

		Carrying Amount					Fair Value			
31 December 2019		**Investment securities at amortized cost**	**Investment securities at FVOCI**	**Loans and advances to banks**	**Other financial liabilities**	**Total carrying amount**	**Level 1**	**Level 2**	**Level 3**	**Total**
Loans and advances to banks	12	-	-	29,146,303	-	**29,146,303**	-	-	29,146,303	**29,146,3**
Investments securities at amortized cost	13	62,630,361	-	-	-	**62,630,361**	4,925,469	-	60,483,346	**65,408,8**
Investment securities at FVOCI	13	-	4,289,282	-	-	**4,289,282**	3,563,294	-	725,988	4,289,2
Total		**62,630,361**	**4,289,282**	**29,146,303**	**-**	**96,065,946**	**8,488,763**	**-**	**90,355,637**	**98,844,4**
Deposits from customers	21	-	-	-	150,941,625	**150,941,625**	-	-	151,780,649	**151,780,6**
Total		**-**	**-**	**-**	**150,941,625**	**150,941,625**	**-**	**-**	**151,780,649**	**151,780,6**
31 December 2018	**Note**	**Investment securities at amortized cost**	**Investment securities at FVOCI**	**Loans and advances to banks**	**Other financial liabilities**	**Total carrying amount**	**Level 1**	**Level 2**	**Level 3**	**Total**
Loans and advances to banks	12	-	-	20,253,667	-	**20,253,667**	-	-	20,253,667	**20,253,66**
Investments securities at amortized cost	13	57,403,527	-	-	-	**57,403,527**	4,315,199	372,000	54,058,023	**58,745,22**
Investment securities at FVOCI	13	-	6,323,591	-	-	**6,323,591**	4,112,004	1,990,558	221,029	**6,323,59**
Total		**57,403,527**	**6,323,591**	**20,253,667**	**-**	**83,980,785**	**8,427,203**	**2,362,558**	**74,532,719**	**85,322,48**
Deposits from customers	21	-	-	-	145,483,303	**145,483,303**	-	-	146,483,751	**146,483,75**
Total		**-**	**-**	**-**	**145,483,303**	**145,483,303**	**-**	**-**	**146,483,751**	**146,483,75**

HTC Albanian Government securities are fixed and floating rate bonds. The floating rate bond is given as the average yield of the last three Treasury bill auctions with the maturity of one year plus the spread. The measurement of the fair value for these securities is performed using the mark-to-market model valuation technique, by discounting all future cash flows deriving from such instruments. The rest of the HTC foreign securities denominated in foreign currencies represent Banks and Financial Institutions' securities whose fair value is measured according the "ISBA fair value internal rules".

Loans and advances to customers have carrying amount, which is considered also their fair value, as the major part of portfolio is based on floating interest rates. The fair value of Time Deposits from customers is re-priced using the net present value. The interest rates applied are the market interest rates published from Bank of Albania. These rates are an estimate of the market rates. The fair value of current accounts, savings accounts is considered to approximate their carrying amount, given they have short-term maturity.

(in thousands of Lek, unless otherwise stated)

9. Financial Assets and Liabilities (continued)

(b) Classification of financial assets and financial liabilities

See accounting policies in Notes 7 (g)(ii).

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

	Note	Amortized cost	FVOCI	Total carrying amount
31 December 2019				
Financial Assets				
Cash and cash equivalents	11	30,240,115	-	**30,240,115**
Loans and advances to banks	12	29,146,303	-	**29,146,303**
Investments securities	13	62,630,361	4,289,282	**66,919,643**
Loans and advances to customers	14	44,864,090	-	**44,864,090**
Total		**166,880,869**	**4,289,282**	**171,170,151**
Financial Liabilities				
Due to banks	20	2,250,043	-	**2,250,043**
Due to customers	21	150,941,625	-	**150,941,625**
Total		**153,191,668**	**-**	**153,191,668**

	Note	Amortized cost	FVOCI	Total carrying amount
31 December 2018				
Financial Assets				
Cash and cash equivalents	11	35,290,306	-	**35,290,306**
Loans and advances to banks	12	20,253,667	-	**20,253,667**
Investments securities	13	57,403,527	6,323,591	**63,727,118**
Loans and advances to customers	14	43,928,731	-	**43,928,731**
Total		**156,876,231**	**6,323,591**	**163,199,822**
Financial Liabilities				
Due to banks	20	2,762,419	-	**2,762,419**
Due to customers	21	145,483,303	-	**145,483,303**
Total		**148,245,722**	**-**	**148,245,722**

(in thousands of Lek, unless otherwise stated)

10. Cash and cash equivalents

Cash and cash equivalents as at 31 December 2019 and 31 December 2018 are detailed as follows:

	31 December 2019	31 December 2018
Cash on hand	1,443,488	1,445,723
Current accounts with banks	15,454,727	13,832,185
Unrestricted balances with Bank of Albania	7,602	336,849
Money market placements	13,334,849	19,687,599
Less impairment loss allowance	(551)	(12,050)
Total	**30,240,115**	**35,290,306**

11. Loans and advances to banks

Loans and advances to banks as at 31 December 2019 and 31 December 2018 are composed as follows:

	31 December 2019	31 December 2018
Compulsory reserve with Bank of Albania	15,450,973	14,993,704
Deposits with correspondent banks	13,699,125	5,263,961
Less impairment loss allowance	(3,795)	(3,998)
Total	**29,146,303**	**20,253,667**

In accordance with the Bank of Albania requirements, the Bank at the reporting date should maintain a minimum of compulsory reserve as per percentages determined by the regulator (See note 8 (b) (ii)).

Such reserves are maintained in original currency for due to customer balances denominated in local currency. For due to customer balances denominated in foreign currency the Bank is obliged to maintain in original currency.

The amount required to be deposited is calculated monthly in arrears. According to the Bank of Albania regulation 70% of this reserve in Lek is available for daily use by the Bank.

The remuneration interest rate of obligatory reserve denominated in Lek is 70% of repurchase agreements rate equal to 1.00% for 31 December 2019 (31 December 2018: 1.00%).

The remuneration interest rate of the obligatory reserve in EUR is equal to the European Central Bank base rate equal to minus 0.50% for EUR for 31 December 2019 (31 December 2018: minus 0.40%).

Deposits with banks comprise money market placements with an original maturity of over three months.

(in thousands of Lek, unless otherwise stated)

12. Investment securities

	31 December 2019	31 December 2018
Investment securities measured at FVOCI-debt instruments	4,289,282	6,323,591
Investment securities measured at amortized cost- debt instruments	62,630,361	57,403,527
Total	**66,919,643**	**63,727,118**

Investment securities measured at FVOCI as at 31 December 2019 and 31 December 2018 can be detailed as follows:

	31 December 2019	31 December 2018
Corporate issuers		
Bank issuers	**-**	**-**
Unlisted	-	-
Listed	-	-
Sovereign issuers		
Republic of Albania	**725,988**	**2,211,587**
Unlisted	725,988	2,211,587
Listed	-	-
EU member states	**2,822,864**	**3,574,631**
Listed	2,822,864	3,574,631
Other Financial Institutions	**740,430**	**537,373**
Listed	740,430	537,373
Total	**4,289,282**	**6,323,591**

Investment securities measured at amortized cost as at 31 December 2019 and 31 December 2018 can be detailed as follows:

	31 December 2018	31 December 2018
Sovereign issuers		
Republic of Albania	**58,051,455**	**55,300,570**
Unlisted	58,051,455	53,191,287
Listed	-	2,109,283
US and EU member states	**4,578,906**	**2,102,957**
Listed	4,578,906	2,102,957
Total	**62,630,361**	**57,403,527**

As at 31 December 2019 and 31 December 2018 no Albanian Government securities have been pledged as collateral for repurchase agreements (see note 20).

(in thousands of Lek, unless otherwise stated)

13. Loans and advances to customers

Loans and advances to customers measured at amortized cost are composed as follows:

	31 December 2019	31 December 2018
Loans	34,780,008	35,462,579
Overdrafts	12,241,665	11,187,135
Deferred disbursement fees	(143,270)	(149,289)
Gross amount	**46,878,403**	**46,500,425**
Less impairment loss allowance (see Note 8 (a) (v))	(2,014,313)	(2,571,694)
Total net amount	**44,864,090**	**43,928,731**

	2019			2018		
	Gross carrying amount	**ECL allowance**	**Carrying amount**	**Gross carrying amount**	**Impairment allowance**	**Carrying amount**
Retail customers	**23,525,741**	**1,103,207**	**22,422,534**	**15,727,382**	**960,755**	**14,766,627**
Mortgage lending	8,893,106	371,877	8,521,229	12,193,829	557,035	11,636,794
Personal loans	14,549,288	715,401	13,833,887	3,516,213	400,576	3,115,637
Credit cards	73,058	14,740	58,318	17,340	3,144	14,196
Leasing	10,289	1,189	9,100	-	-	-
Corporate customers	**23,352,662**	**911,106**	**22,441,556**	**30,773,043**	**1,610,939**	**29,162,104**
Investment loans	21,650,397	750,001	20,900,396	18,935,002	874,788	18,060,214
Working capital	1,625,668	160,488	1,465,180	11,838,041	736,151	11,101,890
Leasing	76,597	617	75,980	-	-	-
Total	**46,878,403**	**2,014,313**	**44,864,090**	**46,500,425**	**2,571,694**	**43,928,731**

14. Non-current assets held for sale

The Bank holds under non-current assets held for sale, loans issued from VBA identified during Board of Experts due diligence as non-performing loans to be transferred back to Veneto Banca in compulsory administrative liquidation and high risk loans already classified as non performing (unlikely to pay or doubtful) which shall be transferred to the Veneto Banca in compulsory administrative liquidation, with customized guarantee from the Government of Italy, during the next retrocession windows envisaged by contract. The related loans carrying amount was determined based on the contractual indications, which set out a consideration equal to their gross value net of impairment allowance recognized only 50% of the value of those ISP Group would have had to account by complying with its own loan loss impairment policies with the price that will be payable to retransfer the corresponding exposure to the Veneto Banca in compulsory administrative liquidation.

(in thousands of Lek, unless otherwise stated)

15. Property and Equipment

Property and Equipment as at 31 December 2019 and 31 December 2018 is as follows:

	Land and Building	IT and Electrical Equipment	Furniture and Fine Art Works	Other non-Electrical Assets	Assets acquired not put into use	Total
Cost						
Balance as at 1 January 2018	**1,685,142**	**1,506,335**	**305,461**	**318,427**	**164,889**	**3,980,254**
Additions	39,843	87,856	15,744	17,626	56,367	**217,436**
Disposals	-	- 123,635	- 19,353	- 22,808	-	**- 165,796**
Balance as at 31 December 2018	**1,724,985**	**1,470,556**	**301,852**	**313,245**	**221,256**	**4,031,894**
Additions	55,910	57,781	9,583	13,613	47,070	183,957
Disposals	-	- 403,026	- 152,626	- 87,946	-	- 643,598
Balance as at 31 December 2019	**1,780,895**	**1,125,311**	**158,809**	**238,912**	**268,326**	**3,572,253**
Accumulated Depreciation						
Balance as at 1 January 2018	**-**	**1,253,489**	**255,721**	**285,832**	**-**	**1,795,042**
Depreciation for the year	57,270	104,911	16,528	13,831	-	192,540
Disposals	-	- 117,595	- 16,844	- 21,774	-	- 156,213
Impairment loss	-	10,030		-	-	10,030
Balance as at 31 December 2018	**57,270**	**1,250,835**	**255,405**	**277,889**	**-**	**1,841,399**
Depreciation for the year	59,596	77,044	11,916	12,002	-	**160,558**
Disposals	-	- 400,187	- 151,824	- 86,776	-	**- 638,787**
Used on the Impairment loss	-	- 2,590	-	-	-	**- 2,590**
Balance as at 31 December 2019	**116,866**	**925,102**	**115,497**	**203,115**	**-**	**1,360,580**
Carrying amount						
At 1 January 2018	**1,685,142**	**252,846**	**49,740**	**32,595**	**164,889**	**2,185,212**
At 31 December 2018	**1,667,715**	**219,721**	**46,447**	**35,356**	**221,256**	**2,190,495**
At 31 December 2019	**1,664,029**	**200,209**	**43,312**	**35,797**	**268,326**	**2,211,673**

(in thousands of Lek, unless otherwise stated)

16. Leases

A. Leases as lessee (IFRS 16)

The Bank leases a number of branch and office premises. This leases typically run for a period of 10 years, with an option to renew the lease after that date. For some leases, payments are renegotiated every five years to reflect market rentals. Some lease provides for additional rent payments that are based on changes in local price indices.

The Bank also leases IT equipment with contract terms of one to three years. These leases are short-term and/or leases of low-value items. The Bank has elected not to recognize right-of-use assets and lease liabilities for these leases. Previously, these leases were classified as operating leases under IAS 17.

There are no leases where the Bank is a lessor whereas information about leases for which the Group is a lessee is presented below:

i. Right-of use assets

Right-of-use assets relate to leased branch and office premise are presented below:

	Branch and office premises **2019**
Balance at 1 January	337,298
Depreciation charge for the year	(137,555)
Additions	261,140
Balance at 31 December	**460,883**

At 31 December 2018, the future minimum lease payments under non-cancellable operating leases were payable as follows.

Maturity analysis-Contractual undiscounted cash flows	**2018**
Less that one year	45,274
Between one and five years	-
More than five years	-
Total undiscounted lease liabilities at 31 December	**45,274**

ii. Amounts recognized in profit or loss

	2019
2019-Leases under IFRS 16	
Interest on lease liabilities	7,262
Expenses relating to short term leases	32,705
Expense relating to leases of low-value assets, excluding short-term leases of low-value assets	809

The Bank has rental agreements with renewal options for its offices in Albania. During 2019, the amount of Lek 55,797 thousand was recognized as operating lease expense under IAS 17 in respect of lease rentals.

Amounts recognized in statement of cash flows

	2019
Total cash outflow for leases	140,489

iii. Extension options

Some leases of office premises contain extension options exercisable by the Bank up to one year before the end of the non-cancellable contract period. Where applicable, the Bank seeks to include extension options in new leases to provide operational flexibility. The extension options held are exercisable only by the Bank and not by the lessors. The Bank assesses at lease commencement date whether it is reasonably certain to exercise the extension options. The Bank reassesses whether it reasonably certain to exercise the options if there is a significant event or significant changes in circumstances within its control.

(in thousands of Lek, unless otherwise stated)

17. Intangible Assets

Intangible assets as at 31 December 2019 and 31 December 2018 are as follows:

	Software and Licenses	Advances for Software	Total
Cost			
Balance as at 1 January 2018	**1,903,739**	**85,015**	**1,988,754**
Additions during period	140,378	-	**140,378**
Transfers	(144,193)	(9,209)	**(153,402)**
Balance as at 31 December 2018	**1,899,924**	**75,806**	**1,975,730**
Additions during period	178,246	93,814	**272,060**
Transfers	(28,920)	0	**(28,920)**
Balance as at 31 December 2019	**2,049,250**	**169,620**	**2,218,870**
Amortization and Impairment Losses			
Balance as at 1 January 2018	**1,396,252**	**0**	**1,396,252**
Amortization charge for the year	188,546	0	**188,546**
Disposals	(103,404)	0	**(103,404)**
Balance as at 31 December 2018	**1,481,394**	**0**	**1,481,394**
Amortization charge for the year	164,020	0	**164,020**
Disposals	(27,521)	0	**(27,521)**
Balance as at31 December 2019	**1,617,893**	**0**	**1,617,893**
Carrying amount			
At 1 January 2018	**507,487**	**85,015**	**592,502**
At 31 December 2018	**418,530**	**75,806**	**494,336**
At 31 December 2019	**431,357**	**169,620**	**600,977**

18. Investment property

The Bank holds investment property as consequence of acquisitions through enforcement of security over loans and advances. As at 31 December 2019, the investment property represents a foreclosed collateral repossessed during 2017. During 2019, investment property rentals of Lek 17,347 thousand (2018: Lek 18,056 thousand) have been recognized in other income. Based on the agreement between parties the annual rent for the first year is calculated 2.8% of the historical cost. The annual rent change over the period based on the payment of instalment for purchase of the property.

	Buildings	Total
Cost		
Balance as at 1 January 2018	**721,488**	**721,488**
Additions during period	-	**-**
Balance as at 31 December 2018	**721,488**	**721,488**
Additions during period	**-**	**-**
Balance as at 31 December 2019	**721,488**	**721,488**
Depreciation and Impairment Losses		
Balance as at 1 January 2018	**146,170**	**146,170**
Depreciation charge for the year	-	**-**
Impairment Losses	29,762	**29,762**
Balance as at 31 December 2018	**175,932**	**175,932**
Depreciation charge for the year	-	**-**
Balance as at 31 December 2019	**175,932**	**175,932**
Carrying amount		
At 1 January 2018	**575,318**	**575,318**
At 31 December 2018	**545,556**	**545,556**
At 31 December 2019	**545,556**	**545,556**

The fair value of investment property was determined by external, independent property valuers, having appropriate recognized professional qualifications and recent experience in the location and category of the property being valued. The independent valuers provide the fair value of the Bank’s investment property portfolio every year and its fair value measurement is categorized as a Level 2 fair value based on the inputs to comparable approach used.

(in thousands of Lek, unless otherwise stated)

19. Inventory and other assets

Other assets as at 31 December 2019 and 31 December 2018 are as follows:

	31 December 2019	31 December 2018
Inventory	1,308,124	1,892,768
Sundry debtors	53,399	443,042
ATM & POS transactions	57,907	117,837
Leasehold improvements	114,999	31,407
Prepayments	43,462	47,934
Cheques for collection	4,949	4,301
Others	99,807	129,345
Total	**1,682,647**	**2,666,634**

Inventory represents repossessed assets acquired in the process of collection of defaulted loans. The movement of “repossessed assets” item during the reporting period is presented as follows:

	2019	2018
At beginning of the period	**1,892,768**	**2,478,167**
Additions during period	11,428	228,961
Disposals of the period	(819,162)	(589,308)
Write down/up to net realizable value	267,260	(80,583)
Effect of movements in foreign exchange	(44,170)	(144,469)
At end of the period	**1,308,124**	**1,892,768**

The movement of leasehold improvements during the reporting period is presented as follows:

	31 December 2019	31 December 2018
At beginning of the period	**31,407**	**110,037**
Additions during period	120,597	3,103
Write off	(22,813)	(55,462)
Amortization of the period	(14,192)	(26,271)
At end of the period	**114,999**	**31,407**

20. Due to banks

Due to banks as at 31 December 2019 and 31 December 2018 are as follows:

	31 December 2019	31 December 2018
Correspondent banks		
Current accounts	**414,299**	**1,662,306**
Resident	6,841	3,271
Non-resident	407,458	1,659,035
Deposits	**1,690,029**	**1,100,113**
Resident	1,690,029	1,100,113
Non-resident	-	-
Current Accounts with Central Bank	**145,715**	**-**
Total	**2,250,043**	**2,762,419**

As at 31 December 2019 and 31 December 2018, no Albanian Government securities have been pledged as collateral for repurchase agreements (see note 12).

(in thousands of Lek, unless otherwise stated)

21. Due to customers

Due to customers as at 31 December 2019 and 31 December 2018 are composed as follows:

	31 December 2019			31 December 2018		
Current accounts	**Local Currency**	**Foreign Currency**	**Total**	**Local Currency**	**Foreign Currency**	**Total**
Retail	9,540,860	19,844,042	29,384,902	8,084,405	17,921,842	26,006,247
Corporate	10,412,605	25,935,406	36,348,011	10,799,571	24,580,301	35,379,872
	19,953,465	**45,779,448**	**65,732,913**	**18,883,976**	**42,502,143**	**61,386,119**
Deposits						
Retail	36,959,156	42,109,382	79,068,538	36,697,461	40,617,936	77,315,397
Corporate	1,799,717	4,340,457	6,140,174	2,231,880	4,549,907	6,781,787
	38,758,873	**46,449,839**	**85,208,712**	**38,929,341**	**45,167,843**	**84,097,184**
Total	**58,712,338**	**92,229,287**	**150,941,625**	**57,813,317**	**87,669,986**	**145,483,303**

Balances due to customers by maturity and currency type are as follows:

	31 December 2019			31 December 2018		
	Local Currency	**Foreign Currency**	**Total**	**Local Currency**	**Foreign Currency**	**Total**
Current Accounts	**19,953,465**	**45,779,448**	**65,732,913**	**18,883,976**	**42,502,143**	**61,386,119**
Deposits						
On demand	5,383,679	22,316,741	27,700,420	3,838,216	18,325,653	22,163,869
One month	2,490,773	2,347,266	4,838,039	1,059,056	172,393	1,231,449
Three months	3,028,586	6,000,625	9,029,211	751,773	1,721,161	2,472,934
Six months	3,761,328	4,216,905	7,978,233	1,926,418	2,894,538	4,820,956
Nine months	4,199,641	6,075,214	10,274,855	432	16,684	17,116
Twelve months	3,518,010	3,631,322	7,149,332	11,366,650	18,008,943	29,375,593
Twenty-four months	3,585,348	1,417,011	5,002,359	5,859,493	2,425,759	8,285,252
Other	12,791,508	444,755	13,236,263	14,127,303	1,602,712	15,730,015
	38,758,873	**46,449,839**	**85,208,712**	**38,929,341**	**45,167,843**	**84,097,184**
Total	**58,712,338**	**92,229,287**	**150,941,625**	**57,813,317**	**87,669,986**	**145,483,303**

(in thousands of Lek, unless otherwise stated)

21. Due to customers (continued)

For current accounts (for which is paid interest) and time deposits, the annual published interest rates applicable for the various fixed terms were:

2019	ALL (%)	USD (%)	EUR (%)
Current accounts and demand deposits	0.03-2.06	0.05-2.31	0.002-0.65
Time deposits – 1 month	0.20-0.20	0.05-0.10	0.002 - 0.002
Time deposits – 3 months	0.20 - 0.85	0.10 - 0.20	0.001 - 0.002
Time deposits – 6 months	0.20 - 1.05	0.10 -0.25	0.003 - 0.005
Time deposits – 9 months	0.40 - 0.40		0.006 - 0.006
Time deposits – 12 months	0.20-1.35	0.10-0.30	0.005 - 0.01
Time deposits – 24 months	1.10 - 2.00	0.20 - 0.30	0.02 -0.05
Time deposits – 36 months	1.50 - 2.60	0.25 - 0.25	0.05 - 0.10
Time deposits – 60 months			
Time deposits – 84 months			

2018	ALL (%)	USD (%)	EUR (%)
Current accounts and demand deposits	0.05 -2.81	0.05 - 1.90	0.002 - 0.65
Time deposits – 1 month	0.20 - 0.20	0.05 -0.05	0.002 - 0.05
Time deposits – 3 months	0.20 - 0.85	0.10 - 0.20	0.001 - 0.002
Time deposits – 6 months	0.20 - 1.05	0.10 - 0.25	0.003 - 0.005
Time deposits – 9 months	0.40 - 0.40		0.006 - 0.006
Time deposits – 12 months	0.20 - 1.50	0.20 - 0.30	0.005 - 0.01
Time deposits – 24 months	1.70 - 2.00	0.20 - 0.30	0.02 - 0.05
Time deposits – 36 months	1.80 - 2.20	0.25 - 0.90	0.05 - 0.60
Time deposits – 60 months	2.38 - 4.50	0.25 - 1.20	0.10 - 1.00
Time deposits – 84 months	3.41 - 3.60		

All individual and cooperate customer deposits, in accordance with the Law No. 52, dated 25.05.2014 "On the Insurance of Deposits" amended, are protected without any cost for customers, up to the amount of Lek 2,500,000 (or in Lek equivalent if in foreign currency) with the Deposit Insurance Agency (DIA).

22. Deferred Tax

Recognized deferred tax assets and liabilities are attributable to the following:

	31 December 2019			31 December 2018		
	Assets	**Liabilities**	**Net**	**Assets**	**Liabilities**	**Net**
Investment securities measured at FVOCI	-	6,112	(6,112)	17,984	-	17,984
Allowance for expected credit losses	115,821	-	115,821	160,571	-	160,571
Investment Property	-	1,599	(1,599)	-	1,599	(1,599)
Repossessed assets	256,457	-	256,457	300,192	-	300,192
Properties	-	136,841	(136,841)	-	136,840	(136,840)
Right-of-use assets	66,892	69,132	(2,240)	-	-	-
Equipment and intangible assets	92,517	-	92,517	89,745	-	89,745
Net deferred tax assets	**531,687**	**213,684**	**318,003**	**568,492**	**138,439**	**430,053**

(in thousands of Lek, unless otherwise stated)

22. Deferred Tax (continued)

Movements in temporary differences during the year are as follows:

31 December 2019	Opening balance	Recognized in profit or loss	Recognized in other comprehensive income	Closing Balance
Investment securities measured at FVOCI	17,984	-	(24,095)	(6,112)
Allowance for expected credit losses	160,571	-	(44,750)	115,821
Investment Property	(1,599)	-	-	(1,599)
Repossessed assets	300,192	(43,735)	-	256,457
Properties	(136,841)	-	-	(136,841)
Right-of-use assets	-	(2,241)	-	(2,241)
Equipment and intangible assets	89,745	2,772	-	92,517
Total	**430,052**	**(43,204)**	**(68,845)**	**318,003**

31 December 2018	Opening balance	Recognized in profit or loss	Recognized in other comprehensive income	Closing Balance
Investment securities measured at FVOCI	(9,969)	-	27,953	17,984
Allowance for expected credit losses	-	-	160,571	160,571
Investment Property	(1,599)	-	-	(1,599)
Repossessed assets	102,580	197,612	-	300,192
Properties	(136,840)	-	-	(136,840)
Equipment and intangible assets	96,024	(6,279)	-	89,745
Total	**50,196**	**191,333**	**188,524**	**430,053**

23. Provisions

Movements in provisions during the year are as follows:

	Tax Litigation	Other Litigations	Off-Balance Sheet	Integrati on costs	Total
Balance at 1 January 2018	**323,540**	**567,640**	**82,926**	**260,253**	**1,234,359**
Provisions made/(reversed) during the year	-	(15,082)	(28,106)	-	**(43,188)**
Provisions used during the year	(41,532)	-	-	(81,563)	**(123,095)**
Effect of movements in foreign exchange	-	(6,945)	(378)	4,805	**(2,518)**
Balance at 31 December 2018	**282,008**	**545,613**	**54,442**	**183,495**	**1,065,558**

(in thousands of Lek, unless otherwise stated)

24. Other liabilities

Other liabilities as at 31 December 2019 and 31 December 2018 are composed as follows:

	31 December 2019	31 December 2018
Accrued expenses	454,564	494,163
Sundry creditors	24,764	43,931
Suspense accounts	241,642	413,091
Bank cheques issued and payments in transit	163,349	363,625
Other tax liabilities	49,822	49,379
Due to third parties	22,618	20,458
Other accrued expenses	61,904	67,580
Total	**1,018,663**	**1,452,227**

25. Share capital and share premium

The issued share capital comprises one class of shares as follows:

	Number of Shares (In number)	**Nominal Value** (In Lek)	**Total Shares Value** (In Lek)
Share Capital at 31 December 2019	**15,581,282**	**357**	**5,562,517,674**

Share premium represents the amount paid from the shareholder in excess of the registered share capital. Intesa Sanpaolo S.p.A is the sole shareholder at 31 December 2019 and 31 December 2018.

26. Reserves

As at 31 December 2019 and 31 December 2018, the reserves were:

	31 December 2019	31 December 2018
Regulatory reserve (*refer to a below*)	1,130,983	1,130,983
Legal reserve (*refer to b below*)	694,640	694,640
Fair value reserve (*refer to c below*)	40,152	(97,281)
Revaluation reserve (*refer to d below*)	775,431	775,431
Other capital reserve (*refer to e below*)	714,555	714,555
Merger reserve (*refer to f below*)	2,813,396	2,813,396
Total	**6,169,157**	**6,031,724**

Nature and purpose of the reserves

b. The regulatory reserve was established according to the Central Bank of Albania regulation "On the Bank's Regulatory Capital", no.69, dated 18 December 2014. Banks and branches of foreign banks are required to create reserves of 1.25% to 2% of total risk-weighted assets, by appropriating one fifth of the profit after taxes and before payment of dividends, until the balance on this measure reaches at least 1.25% of total risk-weighted assets. At 31 December 2019, the regulatory reserve represented 1.38% of total risk-weighted assets (2018: 1.39%).

c. The legal reserve was established according to the provisions of the Commercial Law requiring the creation of reserves of 5% of the Bank's net income after deduction of accumulated losses from previous years, until the balance of this reserve reaches 10% of the Bank's share capital. At 31 December 2019, the balance represented 10% of the Bank's share capital (2018: 10%). This threshold is not mandatory, when the existing reserves are not less than one tenth of the Bank's share capital.

d. The Fair value reserve represent the cumulative net change in fair value of the securities at FVOCI until the asset are derecognized or reclassified.

e. The revaluation reserve relates to the revaluation of owed used property. The fair value reserve comprises the cumulative net change in the fair value of available-for-sale financial assets until the assets are derecognized or impaired.

f. Other capital reserve represents the differences arising from the conversion of the Bank's share capital from USD to Lek. Out of this balance, the amount of Lek 297,666 thousand was received as at 1 January 2008 from the merger with former BIA, as raised by the same denomination currency change of the share capital.

g. As further disclosed in note 7, the merger reserve represents the contribution by owner equal to the net assets transferred considering that the Bank did not pay anything to acquire net assets of VBA.

(in thousands of Lek, unless otherwise stated)

27. Net Interest income

Interest income	**2019**	**2018**
Loans and advances to customers	2,262,668	2,262,829
Investment securities at amortised cost	1,888,249	1,999,109
Loans and advances to banks	129,550	163,380
Investment securities at FVOCI	46,154	88,204
Total interest income	**4,326,621**	**4,513,522**
Interest expenses		
Demand and time deposits	738,275	629,755
Deposits from banks	89,070	129,578
Current accounts of customers	54,377	59,970
Lease liability	7,262	-
Total interest expenses	**888,984**	**819,303**
Net interest income	**3,437,637**	**3,694,219**

28. Net fee and commission income

	2019			**2018**		
	Retail Banking	**Corporate Banking**	**Total**	**Retail Banking**	**Corporate Banking**	**Total**
Collection and payment services	206,078	315,839	**521,917**	181,572	294,055	**475,627**
Active current accounts	248,447	26,748	**275,195**	238,034	28,568	**266,602**
ATMs and POSs	283,908	67,146	**351,054**	252,903	67,273	**320,176**
Guarantees given	663	17,904	**18,567**	626	20,820	**21,446**
Unused/advanced liquidated credit lines	7,569	14,174	**21,743**	6,146	17,196	**23,342**
Arrangement fees and others	2,847	16,698	**19,545**	3,205	2,176	**5,381**
Fee and commission income	**749,512**	**458,509**	**1,208,021**	**682,486**	**430,088**	**1,112,574**
ATMs and POSs	233,078	65,647	**298,725**	231,236	62,945	**294,181**
Banking services-foreign branches	604	8,131	**8,735**	128	10,589	**10,717**
Collection and payment services	11,835	19,865	**31,700**	18,722	2,469	**21,191**
	7,574	259	**7,833**	-	-	**-**
Guarantees received	0	8,328	**8,328**	-	1,191	**1,191**
Fee and commission expenses	**253,091**	**102,230**	**355,321**	**250,086**	**77,194**	**327,280**
Net fee and commission income	**496,421**	**356,279**	**852,700**	**432,400**	**352,894**	**785,294**

Fee and commissions do not include fees received for loans and advances to customers (transaction costs), which are adjusted on initial recognition for the carrying value of these financial assets as per effective interest rate method. Fee and commission income from contracts with customers are measured based on the consideration specified in a contract with a customer. The Bank recognizes revenue when it transfers control over a service to only a customer.

The Bank provides banking services only to retail and corporate customers, including account management, provision of overdraft facilities, foreign currency transactions, credit card and servicing fees. Fees for ongoing account management are charged to the customer's account on a monthly basis. The Bank sets the rates separately for retail and corporate banking customers in each jurisdiction on a regular basis. Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when the transaction takes place Servicing fees are charged on a monthly basis and are based on fixed rates reviewed regularly by the Bank. Revenue from account service and servicing fees is recognized over time as the services are provided Revenue related to transactions is recognized at the point in time when the transaction takes place.

(in thousands of Lek, unless otherwise stated)

29. Net other income

	2019	2018
Foreign exchange gains	545,344	(27,092)
Other	2,964	131,368
Total	**548,308**	**104,276**

30. Other operating expenses, net

	2019	2018
Premium on deposits insurance	407,856	322,047
Loss on sale of fixed assets	329,627	72,099
(Gain)/loss on sundry net operational	(280,721)	(349,392)
Total	**456,762**	**44,754**

31. Personnel expenses

	2019	2018
Salaries	828,367	1,062,347
Social Insurance	126,304	131,550
Total salaries and social insurance	**954,671**	**1,193,897**
Personnel on secondment	53,717	98,171
Training & similar	892	10,435
Termination indemnities and others	56,313	86,863
Total	**1,065,593**	**1,389,366**

Salaries and social insurance for the year ended 31 December 2019 and 2018 are further breakdowns as follows:

	2019	2018
Board of Directors	7,632	8,888
Executive Management	279,312	365,388
Other personnel	667,727	819,622
Total	**954,671**	**1,193,898**

For the year ended 31 December 2019 the Bank had an average number of 651 employees (2018: 600).

32. Other administrative expenses

	2019	2018
Integration costs	-	349,069
Software maintenance	342,189	333,121
Telephone and electricity	63,343	107,610
Advertising and publications	50,231	28,951
Maintenance and repair	64,460	80,802
Stationery	41,210	50,271
Consulting, legal and professional fees	47,785	69,387
Security	70,851	75,206
Transport and security services	40,577	52,162
Travel and business trips	14,949	10,364
Insurance	12,966	16,360
Other	128,035	150,671
Total	**876,596**	**1,323,974**

Consulting, legal and professional fees for the year ended 31 December 2019 include statutory and non-statutory audit fees amounting to Lek 16.3 Million (2018: Lek 16.7 Million).

(in thousands of Lek, unless otherwise stated)

33. Income tax expenses

The components of income tax expense for the year ended 31 December 2019 and 2018 are:

	2019	2018
Current year	254,164	160,693
Current income tax in respect of prior years	24,802	-
Current tax expense	**278,966**	**160,693**
Origination and reversal of temporary differences	43,204	(191,333)
Deferred tax income	**43,204**	**(191,333)**
Income tax expense/(benefit)	**322,170**	**(30,640)**

Reconciliation of the income tax expense with the accounting profit for the year ended 31 December 2019 and 2018 is presented as follows:

	2019		2018	
Accounting Profit before tax		**2,024,044**		**813,521**
Income tax at domestic corporate tax rate	15.00%	303,607	15.00%	122,028
Tax effect of prior year taxes recognition	1.23%	24,802		
Non-deductible expenses	(2.44)%	(49,443)	4.75%	38,665
Origination and reversal of temporary differences	2.13%	43,204	(23.52%)	(191,333)
Income tax Expense	**15.92%**	**322,170**	**(3.77%)**	**(30,640)**

Non-deductible expenses are detailed as follows:

	2019	2018
Representations & Sponsorships expenses	192	165
Sundry operational losses	3,336	22,054
Operating leases expenses	2,459	4,132
Personnel expenses	7,855	9,031
Office expenses	6,776	49,565
Other provisions expenses	264,438	59,916
Litigation expenses	(14,763)	12,879
Losses on unrecoverable loans and overdrafts	135,802	303,573
Write down of inventory	(267,260)	110,346
Reversal of accruals related to prior years	(188,204)	-
Depreciation and amortization expenses	13,555	30,973
Changes to estimates related to prior years	-	(117,013)
Pre-merge unrecognized tax losses	4,527	-
Allowance reversals for expected credit losses	(298,331)	(227,853)
Total	**(329,618)**	**257,768**
At 15%	**(49,443)**	**38,665**

The Bank prepaid income tax in the amount of Lek 92,250 thousand were paid during 2019 (2018: Lek 289,081 thousand).

(in thousands of Lek, unless otherwise stated)

34. Commitments and contingencies

Commitments and contingencies as at 31 December 2019 and 31 December 2018 are as follows:

	31 December 2019	31 December 2018
Contingent Assets	**133,747,250**	**134,614,733**
Guarantees received from credit customers	117,960,745	116,320,718
Guarantees received from Government	1,270,000	1,270,000
Money market future dated deals	-	1,862,000
Forward foreign exchange contracts	689,180	1,239,005
Other	13,827,325	13,923,010
Contingent Liabilities	**10,641,380**	**9,571,925**
Guarantees in favor of customers	4,456,045	4,245,210
Un-drawn credit facilities	4,868,369	4,378,023
Letters of credit	1,316,966	948,692

Guarantees are mainly represented by bid and performance bonds. Guarantees and letters of credit are collateralized by cash and deposits. The Bank issues guarantees to its customers. These instruments bear a credit risk similar to that of loans granted.

Contingent assets, like letters of credit and un-drawn credit facilities, are off-balance sheet items representing future commitments where the Bank acts as the beneficiary. Forward foreign exchange contracts are off- balance sheet items used to offset currency fluctuations and the effect on the income statement is reflected on the maturity date when the contract is executed.

Litigation

The Bank is defending an action related to a partial payment of a bank guarantee amounting EUR 4,830 thousand. The guarantee was issued in favor of an Albanian entity upon the request of its Parent Company Intesa Sanpaolo S.P.A. The Bank has successfully defended itself in a legal process, in which both the First Instance Court and Court of Appeal judged in favor of the Bank.

The plaintiff has appealed to the Supreme Court which has not yet issued its decision. Management does not consider that there are any legal grounds for the existing judgments in its favor to be overturned.

Nevertheless, given the complexity of the case, involving also the Italian Jurisdiction, and taking into consideration no other cases of that kind have been ever judged in the Albanian courts, some operational risks may occur. In the ordinary course of business, the Bank may be involved in other various claims and legal actions which in the opinion of management, the ultimate settlement of these matters will not have a material adverse effect on the Bank's financial position or changes in net assets, other than those for which a provision has already been included in these financial statements.

(in thousands of Lek, unless otherwise stated)

35. Related parties

The Bank's immediate parent is Intesa Sanpaolo S.p.A, which ultimately holds a 100% interest. The Bank, therefore, considers that it has a related-party relationship, in accordance with International Accounting Standard 24 Related Party Disclosures ("IAS 24") with the following:

Shareholders and parties related to shareholders:

- Intesa Sanpaolo S.p.A and its subsidiaries and associates

Key management personnel and parties related to key management personnel:

- Supervisory Board members, Management Board members and other key management personnel defined as persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly, including any director (whether executive or otherwise) of the Bank, collectively "key management personnel", close family members of key management personnel, and companies and un-incorporated businesses controlled, or jointly controlled by key management personnel and/or their close family members.

The following transactions have taken place during the year ended 31 December 2019 and 31 December 2018:

	ISP Group companies		**Key management personnel and Other related parties**	
	31 Dec 2019	**31 Dec 2018**	**31 Dec 2019**	**31 Dec 2018**
Assets at end of year	**15,144,703**	**16,549,651**	25,146	54,199
Loans and advances to credit institutions	15,120,270	16,466,776	-	-
Loans and advances to customers	-	-	25,146	54,199
Other assets	24,433	82,875	-	-
Liabilities at end of year	**101,961**	**1,560,027**	**415,919**	**482,606**
Loans and advances from credit institutions	-	1,491,880	-	-
Customer deposits	-	-	415,919	482,606
Invoices to be received	101,961	68,147	-	-
Off balance sheet	**3,004,220**	**1,709,028**	**-**	**-**
Letter of credit/Letter of Guarantees given	966,605	497,322	-	-
Letter of credit/Letter of Guarantees received	1,845,237	903,347	-	-
Foreign currency contracts	192,378	308,359	-	-
Commitments given	-	-	-	-
Collaterals	-	-	-	-
Income for year ending	**126,015**	**127,515**	**2,091**	**3,821**
Interest income	78,897	89,428	1,857	3,493
Commission Income	47,118	38,087	234	328
Expenses for the year ending	**260,655**	**114,922**	**319**	**260**
Interest expense	28,332	14,200	319	260
Commission expense and others	21,669	17,458	-	-
Other Administrative Costs	210,653	83,264	-	-
Compensation of Key Managers			**130,942**	**163,324**
Net Salary			74,566	86,674
Net Bonus paid			25,667	31,750
Social & Health Insurance			4,354	5,746
Other expenses (Lecoip)			13,240	17,093
Other expenses			13,115	22,061

36. Subsequent events

The management of the Bank is not aware of any subsequent events that would require either adjustments or additional disclosures in the financial statements.