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INDEPENDENT AUDITORS' REPORT TO THE ACTING COUNTRY MANAGER OF BANK ALFALAH LIMITED AFGHANISTAN

Opinion

We have audited the accompanying financial statements of Bank Alfalah Limited Afghanistan (the Bank), which comprise the statement of financial position as at 31 December 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with the accounting framework as stated in note 2 to the financial statements.

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 ethical requirements that are relevant to our audit of the financial statements in Afghanistan, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the accounting framework as stated in note 2 to the financial statements 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.

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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 financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Ernst & Young Ford Rhodes

Ernst & Young Ford Rhodes Sidat Hyder
Chartered Accountants
Date: 23 March 2019
Kabul, Afghanistan
Audit Engagement Partner: Shabbir Yunus

BANK ALFALAH LIMITED AFGHANISTAN
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Assets			
Cash and cash equivalents	5	**10,651,486**	9,935,867
Investments - net	6	**792,828**	5,011,272
Loans and advances to banks - net	7	**117,664**	698,592
Loans and advances to customers - net	8	**1,508**	1,459
Property and equipment	9	**5,081**	7,526
Advance tax - net		**-**	33,732
Other assets	10	**1,196,113**	1,221,515
Total assets		**12,764,680**	16,909,963
Liabilities			
Deposits from banks	11	**690**	2,018,941
Deposits from customers	12	**11,001,887**	13,445,364
Deferred tax liability	13	**120**	307
Current tax liabilities - net		**13,500**	-
Other liabilities	14	**16,830**	43,371
Total liabilities		**11,033,027**	15,507,983
Equity			
Capital contributed by Head Office	15	**1,000,000**	1,000,000
Capital reserve	16	**50,791**	30,813
Revaluation surplus on debt instruments at fair value through other comprehensive income / surplus on revaluation of available for sale investments		**131**	69,051
Retained earnings		**680,731**	302,116
Total equity		**1,731,653**	1,401,980
Total liabilities and equity		**12,764,680**	16,909,963
Contingencies and commitments	17		

The annexed notes 1 to 29 form an integral part of these financial statements.

Country Finance Manager

Acting Country Manager

BANK ALFALAH LIMITED AFGHANISTAN
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Interest income	18	**218,609**	484,537
Interest expense	18	**(11,597)**	(99,728)
Net interest income		**207,012**	384,809
Fee and commission income	19	**93,423**	97,842
Fee and commission expense	19	**(10,924)**	(14,938)
Net fee and commission income		**82,499**	82,904
Income from dealing in foreign currencies		**9,820**	13,721
Other income	20	**304,668**	119,345
Total operating income		**603,999**	600,779
Credit losses reversal / (expense)	21	**74,714**	(72,262)
Net operating income		**678,713**	528,517
Personnel expenses		**(92,055)**	(96,475)
Depreciation	9	**(2,705)**	(3,709)
Other operating expenses	22	**(91,903)**	(115,542)
Total operating expenses		**(186,663)**	(215,726)
Profit before taxation		**492,050**	312,791
Taxation	23	**(92,493)**	(88,753)
Profit for the year		**399,557**	224,038
Other comprehensive income			
Items that may be reclassified to profit or loss subsequently			
Debt instruments at fair value through other comprehensive income:			
Net gain on debt instruments at fair value through other comprehensive income		**164**	-
Related deferred tax		**(33)**	-
		131	-
Available-for-sale financial assets:			
Surplus on revaluation of available for sale investments		-	71,484
Related deferred tax		-	(14,296)
Other comprehensive income, net of tax		-	57,188
Total comprehensive income, net of tax		**399,688**	281,226

The annexed notes 1 to 29 form an integral part of these financial statements.

Country Finance Manager

Acting Country Manager

BANK ALFALAH LIMITED AFGHANISTAN
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	Capital contributed by Head Office	Gain on debt instruments at fair value through other comprehensive income / Surplus on revaluation of available for sale investments	Capital reserve	Retained earnings	Total
		---------- Afs '000' ----------				
As at 01 January 2017		1,000,000	11,863	19,611	329,100	1,360,574
Total comprehensive income:						
Profit for the year		-	-	-	224,038	224,038
Other comprehensive income, net of tax						
Fair value reserve (available-for-sale financial assets):						
Net change in fair value		-	86,313	-	-	86,313
Related tax		-	(17,263)	-	-	(17,263)
Reclassification adjustments relating to available for sale investments disposed off during the year - net		-	(14,829)	-	-	(14,829)
Related tax on disposal of available for sale investments during the year		-	2,967	-	-	2,967
		-	57,188	-	-	57,188
Total comprehensive income		-	57,188	-	224,038	281,226
Transferred to capital reserve	16	-	-	11,202	(11,202)	-
Transactions with owners of the Bank						
Profits remitted to Head Office	15	-	-	-	(239,820)	(239,820)
As at 31 December 2017		1,000,000	69,051	30,813	302,116	1,401,980
Balance as at 01 January 2018		**1,000,000**	**69,051**	**30,813**	**302,116**	**14,019,780**
Effect due to adoption of IFRS 9 - net of tax		-	-	-	(964)	(964)
Restated opening balance under IFRS 9		**1,000,000**	**69,051**	**30,813**	**301,152**	**14,018,816**
Total comprehensive income:						
Profit for the year		-	-	-	**399,557**	**399,557**
Other comprehensive income, net of tax						
Fair value reserve (available-for-sale financial assets):						
Net change in fair value		-	**164**	-	-	**164**
Related tax		-	**(33)**	-	-	**(33)**
Reclassification adjustments relating to available for sale investments disposed off during the year - net		-	**(86,150)**	-	-	**(86,150)**
Related tax on disposal of available for sale investments during the year		-	**17,230**	-	-	**17,230**
		-	**(68,920)**	-	-	**(68,920)**
Total comprehensive income		-	**(68,920)**	-	**399,557**	**330,637**
Transferred to capital reserve	16	-	-	**19,978**	**(19,978)**	-
Transactions with owners of the Bank						
Profits remitted to Head Office	15	-	-	-	-	-
As at 31 December 2018		**1,000,000**	**131**	**50,791**	**680,731**	**14,349,453**

The annexed notes 1 to 29 form an integral part of these financial statements.

Country Finance Manager

Acting Country Manager

BANK ALFALAH LIMITED AFGHANISTAN
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Cash flows from operating activities			
Profit before taxation		**492,050**	312,791
Adjustments for:			
Depreciation	9	**2,705**	3,709
Credit losses (reversal) / expense - excluding cash and cash equivalents	21	**(57,772)**	56,656
Loss on property and equipment written off		**-**	21
Unrealized gain on Interest rate swaps		**-**	(4,884)
		436,983	368,293
Changes in:			
Loans and advances to banks - net		**585,648**	(164,619)
Loans and advances to customers - net		**(42)**	2
Advance tax -net		**(45,448)**	33,718
Other assets		**26,127**	(286,252)
Deposits from banks		**(2,018,251)**	1,776,146
Deposits from customers		**(2,443,477)**	(724,778)
Other liabilities		**(25,488)**	(52,455)
Net cash generated (used in) / from operating activities		**(3,483,948)**	950,056
Cash flows from investing activities			
Investments		**4,199,827**	3,366,700
Acquisition of operating fixed assets	9	**(260)**	(2,449)
Net cash generated from investing activities		**4,199,567**	3,364,251
Cash flows from financing activities			
Remittances to the Head Office	15	**-**	(239,820)
Net cash used in financing activities		**-**	(239,820)
Net increase in cash and cash equivalents		**715,619**	4,074,486
Cash and cash equivalent at beginning of the year		**9,935,867**	5,861,381
Cash and cash equivalents at end of the year	5	**10,651,486**	9,935,867

The annexed notes 1 to 29 form an integral part of these financial statements.

Country Finance Manager

Acting Country Manager

BANK ALFALAH LIMITED AFGHANISTAN
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

1. Status and nature of business

Bank Alfalah Limited Afghanistan ("the Bank") is a foreign branch of Bank Alfalah Limited, Pakistan and is registered and operating in Afghanistan as a commercial bank. The Bank obtained business license from Afghanistan Investment Support Agency which has been renewed by Ministry of Commerce and Industries (MoCI) on 23 July 2017. The Bank commenced its operations on 05 September 2005 under the license for commercial banking issued by Da Afghanistan Bank (DAB) under the Law of Banking in Afghanistan.

Currently, the Bank has two conventional banking branches at Kabul and Herat.

The registered office of the Bank is located in Kabul, Afghanistan.

2. Basis of preparation and measurement

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standard Board, the Law of Banking in Afghanistan and other laws and regulations issued by Da Afghanistan Bank. Whenever the requirement of the Law of Banking in Afghanistan differs with the requirements of the IFRS, the requirement of the Law of Banking in Afghanistan and other laws and regulations issued by Da Afghanistan Bank takes precedence.

These financial statements have been prepared under the historical cost convention except that certain investments, derivative financial instruments and forward foreign exchange contracts are stated at fair value.

These financial statements comprise statement of financial position, statement of comprehensive income as a single statement, statement of changes in equity, statement of cash flows and the accompanying notes.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4.

2.1. During the year, Bank Alfalah Limited, Pakistan signed a Business Transfer Agreement with the potential buyer for the sale of the Afghanistan operations and subsequently an application for approval of the transaction was made to the Da Afghanistan Bank (DAB).

The application for the approval of the transaction was declined by DAB on 27 February 2019 and as a result, the Bank will continue its operations as normal.

2.2. The Bank has adopted the following accounting standards and the amendments and interpretation of IFRSs which became effective for the current year:

Standard or Interpretation
- IFRS 2 - Share-based Payments – Classification and Measurement of Share-based Payments Transactions (Amendments)
- IFRS 4 - Insurance Contracts: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – (Amendments)
- IFRS 9 - Financial Instruments: Classification and Measurement
- IFRS 15 - Revenue from Contracts with Customers
- IFRIC Interpretation 22 - Foreign Currency Transactions and Advance Consideration

Improvements to Accounting Standards Issued by the IASB in December 2016

- IAS 28 - Investments in Associates and Joint Ventures: Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice

The adoption of the above amendments, improvements to accounting standards and interpretations did not have any material effect on the financial statements except IFRS 9 as disclosed in note 3.1 to the financial statements.

2.3. Standards, interpretations and amendments to published approved accounting standards that are not yet effective

The following standards, amendments and interpretations with respect to the approved accounting standards would be effective from the dates mentioned there against:

Standard or Interpretation	**Effective date (annual periods beginning)**
- IFRS 3 - Definition of a Business (Amendments)	January 01, 2020
- IFRS 9 - Prepayment Features with Negative Compensation – (Amendments)	January 01, 2019
- IFRS 10 - Consolidated Financial Statements and IAS 28 Investment in Associates and Joint Ventures - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendment)	Not yet finalized
- IFRS 16 - Leases	January 01,2019
- IFRS 17 – Insurance Contracts	January 01,2021
- IFRIC 23 - Uncertainty over Income Tax Treatments	January 01,2019
- IAS 1/ IAS 8 - Definition of Material (Amendments)	January 01.2020
- IAS 19 - Plan Amendment, Curtailment or Settlement (Amendments)	January 01,2019
- IAS 28 - Long-term Interests in Associates and Joint Ventures (Amendments)	January 01,2019

The above standards, amendments and interpretations are not expected to have any material impact on the Bank's financial statements in the period of initial application.

In addition to the above standards and amendments, improvements to various accounting standards have also been issued by the IASB in December 2017. Such improvements are generally effective for accounting periods beginning on or after 01 January 2019. The Bank expects that such improvements to the standards will not have any material impact on the Bank's financial statements in the period of initial application.

3. Summary of significant accounting policies

The accounting policies adopted in preparation of this financial statements are consistent with those followed in the preparation of the annual financial statements of the Bank for the year ended 31 December 2017 other than as disclosed in note 3.1 below.

3.1 Adoption of IFRS 9 Financial Instruments

In these financial statements, the Bank has applied IFRS 9 and IFRS 7R, effective for annual periods beginning on or after 1 January 2018, for the first time.

3.1.1. IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018 upon adoption of IFRS 9 Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences of AFN 964 thousands arising from the adoption of IFRS 9 have been recognized directly in retained earnings as of 1 January 2018.

The impact of these changes on the Bank's equity as at 01 January 2018 is as follows:

	AFN '000'
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	**302,116**
Recognition of IFRS 9 ECLs	(1,205)
Deferred tax in relation to the above	241
Opening balance under IFRS 9 (1 January 2018)	**301,152**

3.1.1.1. Changes to classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortized cost) have been replaced by:

- Debt instruments at amortized cost
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on de recognition
- Equity instruments at FVOCI, with no recycling of gains or losses o profit or loss on de recognition
- Financial assets FVPL

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to the income statement.

The Bank's classification of its financial assets and liabilities is explained in notes 3.3.1.4 and 3.3.2.

Under IFRS 9, the classification is based on two criteria: the Bank's business model for managing the assets; and whether the instruments' contractual cash flows represent 'solely payments of principal and interest' on the principal amount outstanding (the 'SPPI criterion'). The new classification and measurement of the Bank's debt financial assets is "Debt instruments at amortized cost" for financial assets that are held within a business model with the objective to hold the financial assets in order to collect contractual cash flows that meet the SPPI criterion.

The assessment of the Bank's business models was made as of the date of initial application, 01 January 2018, and then applied retrospectively to those financial assets that were not derecognized before 01 January 2018. The assessment of whether contractual cash flows on debt instruments are solely comprised of principal and interest was made based on the facts and circumstances as at the initial recognition of the assets.

As of 1 January 2018, the Bank did not have any debt instruments that did not meet the SPPI criterion within its available-for-sale and held-to-maturity portfolio. As a result of business modal assessment the Bank concluded that the debt instruments currently classified as HTM are held within the business model of collecting cash flows and not selling such instruments, therefore, it elected to classify all of these instruments as debt instruments measured at amortized cost. For AFS debt instruments, the Bank concluded that these are held within the business model of collecting cash flows from holding and selling such instruments for liquidity purpose and to obtain benefit from favorable market price, therefore, these are classified as debt instruments measured at fair value through OCI.

The Bank did not voluntarily designate any loans previously measured at amortized cost as financial assets measured at FVPL. Loan and advances to banks and customers that were classified as Loans and Receivables and measured at amortized cost under IAS 39 are also measured at amortized cost under IFRS 9.

3.1.1.2. Changes to the impairment calculation

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

Details of the Bank's impairment method are disclosed in Note 3.3.4. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 3.1.3.

3.1.2. *IFRS 7R*

To reflect the differences between IFRS 9, IAS 39 and IFRS 7 *Financial Instruments:*
Disclosures were updated and the Bank has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in Note 3.1.3 below, detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are set out in Note 25.1.1

3.1.3 A reconciliation between the carrying amount under local regulations to the balances reported under IFRS 9 as of 1 January 2018 is as follows:

	Local regulations classification / IAS 39		**Re-measurement**	**IFRS 9**	
Financial Assets	**Category**	**Amount ('000')**	**ECL over and above local regulations**	**Amount ('000')**	**Category**
Cash and cash equivalents	Cash and cash equivalents	9,935,867	-	9,935,867	Amortized cost
Available for sale	Investments – net	4,324,056	-	4,324,056	Debt investment at fair value through OC
Held to Maturity	Investments – net	687,216		687,216	Debt investment at amortized cost
Loans and advances to banks – net	Loans and advances to banks - net	698,592	-	698,592	Amortized cost
Loans and advances to customers – net	Loans and advances to customers - net	1,459	-	1,459	Amortized cost
Other assets	Other assets	1,193,838	-	1,193,838	Amortized cost
Off – balance sheet items – Other liabilities	Other liabilities	2,437	1,205	3,642	Amortized cost
		-	**1,205**	-	

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3.2 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise balances with less than three months maturity including cash in hand and at ATM, unrestricted balances with the DAB, balances with banks and placements.

3.3 Financial instruments

3.3.1. Financial instruments – initial recognition

3.3.1.1 *Date of recognition*

Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, are initially recognized on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Loans and advances to customers are recognized when funds are transferred to the customers' accounts. The Bank recognize balances due to customers when funds are transferred to the Bank.

3.3.1.2 *Initial measurement of financial instruments*

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount. Trade receivables are measured at the transaction price. When the fair value of financial instruments at initial recognition differs from the transaction price, the Bank accounts for the Day 1 profit or loss, as described below.

3.3.1.3 *Day 1 profit or loss*

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Bank recognizes the difference between the transaction price and fair value in net trading income. In those cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognized in profit or loss when the inputs become observable, or when the instrument is derecognized.

3.3.1.4 *Measurement categories of financial assets and liabilities*

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortized cost, as explained in note 3.3.2.1
- FVOCI, as explained in notes 3.3.2.3 and 3.3.2.4
- FVPL

The Bank classifies and measures its trading portfolio at FVPL as explained in Notes3.3.2.2 . The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies, as explained in Note3.3.2.6.

Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortized cost), FVPL, available-for-sale or held-to-maturity (amortized cost), as explained in Notes 3.3.2.1 , 3.3.2.7 and 3.3.2.7.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortized cost or at FVPL when they are held for trading and derivative instruments or the fair value designation is applied, as explained in Note3.3.2.6.

3.3.2 Financial assets and liabilities

3.3.2.1 *Due from banks, Loans and advances to Customers, Financial investments at amortized cost*

Before 1 January 2018, Due from bank and Loans and advances to customers, included non–derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Bank intended to sell immediately or in the near term
- That the Bank, upon initial recognition, designated as at FVPL or as available-for-sale
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

From 1 January 2018, the Bank only measures Due from banks, Loans and advances to customers and other financial investments at amortized cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.
  The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

Second step of its classification process the Bank assesses the contractual terms of financial to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortization of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgment and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than minimum exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash

flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

3.3.2.2 *Financial assets or financial liabilities held for trading*

The Bank classifies financial assets or financial liabilities as held for trading when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets and liabilities are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognized in net trading income. Interest and dividend income or expense is recorded in net trading income according to the terms of the contract, or when the right to payment has been established.

Included in this classification are debt securities, equities, short positions and customer loans that have been acquired principally for the purpose of selling or repurchasing in the near term.

3.3.2.3 *Debt instruments at FVOCI (Policy applicable from 1 January 2018)*

The Bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting
  contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

These instruments largely comprise assets that had previously been classified as financial investments available- for-sale under IAS 39.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognized in OCI. Interest income and foreign exchange gains and losses are recognized in profit or loss in the same manner as for financial assets measured at amortized cost as explained in note . The ECL calculation for Debt instruments at FVOCI is explained in Note 2.6.3.Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first–in first–out basis. On de recognition , cumulative gains or losses previously recognized in OCI are reclassified from OCI to profit or loss.

3.3.2.4 *Equity instruments at FVOCI (Policy applicable from 1 January 2018)*

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of definition of Equity under IAS 32Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by- instrument basis.

Gains and losses on these equity instruments are never recycled to profit. Dividends are recognized in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

3.3.2.5 *Debt issued and other borrowed funds*

After initial measurement, debt issued and other borrowed funds are subsequently measured at amortized cost. Amortized cost is calculated by taking into account any discount or premium on issue funds, and costs that are an integral part of the effective interest rate (EIR). A compound financial instrument which contains both a liability and an equity component is separated at the issue date.

3.3.2.6 *Financial assets and financial liabilities at fair value through profit or loss*

Financial assets and financial liabilities in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management only designates an instrument at FVPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis
  Or

- The liabilities (and assets until 1 January 2018 under IAS 39) are part of a group of financial liabilities (or financial assets, or both under IAS 39), which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy
  Or
- The liabilities (and assets until 1 January 2018 under IAS 39) containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited

Financial assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the Own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, using the EIR, taking into account any discount/ premium and qualifying transaction costs being an integral part of instrument. Interest earned on assets mandatorily required to be measured at FVPL is recorded using contractual interest rate as explained in Note 2.1.2. Dividend income from equity instruments measured at FVPL is recorded in profit or loss as other operating income when the right to the payment has been established.

3.3.2.7 *Available-for-sale financial investments (Policy applicable before 1 January 2018)*

Available-for-sale financial assets are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Available-for-sale financial assets (AFS) are non-derivatives that are either designated as AFS or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Available-for-sale financial assets and financial assets carried at fair value through profit or loss are subsequently carried at fair value. Gains and losses arising from changes in fair value of available-for-sale financial assets are recognized directly in other comprehensive income, until the financial asset is derecognized or impaired.

3.3.2.8 *Held-to-maturity financial investments (Policy applicable before 1 January 2018)*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of held-to-maturity financial assets before its maturity, the entire category would be reclassified as available for sale.

Held-to-maturity investments are carried at amortized cost using the effective interest method, less any impairment losses

3.3.3 Reclassification of financial assets and liabilities

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank acquires, disposes of, or terminates a business line. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets or liabilities in 2017.

3.3.4 Impairment of financial assets (Policy applicable from 1 January 2018)

3.3.4.1 *Overview of the ECL principles*

The adoption of IFRS 9 has fundamentally changed the Bank's loan loss impairment method by replacing IAS 39's incurred loss approach with a forward-looking ECL approach. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL) as outlined in Note 3.3.4.2). The Bank's policies for determining if there has been a significant increase in credit risk are set out in Note 3.3.5.

The 12mECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis depending on the nature of the underlying portfolio of financial instruments.

The Bank has established a policy to perform an assessment at the end of each reporting period of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. This is further explained in note 25.1.1

Based on the above process, the Bank groups its loans into Stage 1, Stage 2,Stage 3 and POCI, as described below:

- Stage 1:When loans are first recognized, the Bank recognizes an allowance based on 12mECLs.Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.

- Stage 2:When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.

- Stage 3:Loans considered credit-impaired .The bank records an allowance for the LTECLs.

- POCI: Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest income is subsequently recognized based on a credit-adjusted EIR. ECLs are only recognized or released to the extent that there is a subsequent change in the expected credit losses.

For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) de recognition of the financial asset.

3.3.4.2 *The calculation of ECLs*

The Bank calculates ECLs based on a four probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

•PD The Probability of Default is an estimate of the likelihood of default over a given time horizon.

A default may only happen at a certain time over the assessed period, if the facility has not been previously de recognized and is still in the portfolio. The concept of PDs is further explained in note 25.1.1.

•EAD The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in note 25.1.1.

•LGD The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realization of any collateral. It is usually expressed as a percentage of the EAD. The LGD is further explained in note 25.1.1.

When estimating the ECLs, the Bank considers three scenarios (a base case, an upside, downside ('average base')). When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset.

With the exception of credit cards and other revolving facilities, for which the treatment is separately set out in Note 2.6.5, the maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the Bank has the legal right to call it earlier.

The mechanics of the ECL method are summarized below:

- Stage 1: The 12mECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date.

  These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the four scenarios, as explained above.

- Stage 2: When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.

- Stage 3: For loans considered credit-impaired (as defined in note 24.1.1.)the Bank recognizes the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.

- POCI POCI assets are financial assets that are credit impaired on initial recognition. The Bank only recognizes the cumulative changes in lifetime ECLs since initial recognition, based on a probability-weighting of the four scenarios, discounted by the credit- adjusted EIR.

Loan commitments and letters of credit

When estimating LTECLs for undrawn loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan. For credit cards and revolving facilities that include both a loan and an undrawn commitment, ECLs are calculated and presented together with the loan. For loan commitments and letters of credit, the ECL is recognized within provisions.

Financial guarantee contracts

The Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs The shortfalls are discounted by the risk-adjusted interest rate relevant to the exposure. The calculation is made using a probability-weighting of the three scenarios. The ECLs related to financial guarantee contracts are recognized within provisions, as disclosed in note 14.2 and 20 to the financial statements.

3.3.4.3 *Debt instruments measured at fair value through OCI*

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortized cost is recognized in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognized in OCI is recycled to the profit and loss upon de recognition of the assets.

3.3.4.4 *Credit cards and other revolving facilities*

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities with one day's notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behavior, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products. is one years for corporate and 3 years for retail products.

The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's internal credit grade, as explained in Note 25.1.1 but greater emphasis is also given to qualitative factors such as changes in usage.

The interest rate used to discount the ECLs for credit cards is based on the average effective interest rate that is expected to be charged over the expected period of exposure to the facilities. This estimation takes into account that many facilities are repaid in full each month and are consequently charged no interest.

The calculation of ECLs, including the estimation of the expected period of exposure and discount rate is made, on an individual basis for corporate and on a collective basis for retail products. The collective assessments are made separately for portfolios of facilities with similar credit risk characteristics.

3.3.4.5 *Forward looking information*

In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, such as:

- GDP growth
- Unemployment rates
- Consumer price indices

3.3.5 Impairment provision under local regulations

Loans and advances to banks and customers

The outstanding principal of the advances are classified in accordance with the Asset Classification and Provisioning Regulation issued by DAB as follows:

i) **Standard:** These are loans and advances, which are paying in a current manner or at most past due for the period of 1-30 days, fully secured and is supported by sound net worth, profitability, liquidity and cash flow of the obligor. Standard assets are sufficiently secured with respect to the repayment of both the principal amount and interest. An overdraft would be regarded as Standard if monthly interest payments and other charges are past due for 1-30 days, and there was regular activity on the account with no sign of a hard core of debt developing. A standard provision is maintained in the books of account at 0% as 1% of provision is declared optional on financial assets classified in standard category as per the revised ACPR regulation effective from 1 January 2018 (31 December 2017: 1%) of value of such loans and advances.

ii) **Watch:** These are loans and advances which are adequately protected, but are potentially weak. Such an asset constitutes an unwarranted credit risk, but not to the point of requiring a classification of Substandard. The credit risk may be minor, and most instances, bank management can correct the noted deficiencies with increased attention. Further, all loans and advances which are past due by 31 to 60 days for principal or interest payments are classified as Watch. A provision is maintained in the books of account not less than 5% of value of such loans and advances.

iii) **Substandard:** These are loans and advances which show clear manifestations of credit weaknesses that jeopardize the liquidation of the debt. Substandard loans and advances include loans to borrowers whose cash flows are not sufficient to meet currently maturing debts, loans to borrowers which are significantly undercapitalized, and loans to borrowers lacking sufficient working capital to meet their operating needs.

Further, all loans and advances which are past due by 61 to 120 days for principal or interest payments are also classified as Substandard. A provision is maintained in the books of account not less than 25% of value of such loans and advances.

iv) **Doubtful:** These are loans and advances which display all the weaknesses inherent in loans and advances classified as Substandard but with the added characteristics that they are not well secured and the weaknesses make collection or liquidation in full, on the basis of currently available information, highly questionable and improbable. The possibility of loss is extremely high, but because of certain mitigating circumstances, which may work to the advantage and strengthening of the facility, its classification as an estimated loss is postponed until its more defined status is ascertained. Further all loans and advances which are past due by 121 to 480 days for principal or interest payments are also classified as Doubtful. A provision is maintained in the books of account not less than 50% of value of such loans and advances.

v) **Loss:** These are loans and advances which are considered uncollectible and of such little value that their continuation as recoverable facilities is not defensible. This classification does not imply that the facility has absolutely no recoverable value, but rather it is not practical or desirable to defer making full provisions for the facility even though partial recover in future may not be entirely ruled out. Loans and advances classified as Loss include those to bankrupt companies and insolvent firms with negative working capital and cash flow or those to judgment debtors with no means or foreclosable collateral to settle the debts. Further, all loans and advances which are past due over 481 days for principal and interest payments are classified as Loss. This category of loans shall be retained in bank balance sheet for the period of 6 month for recovery purposes and 100% loan loss provisioning should be made. After 6 months, they shall be immediately written off with the provisioning made.

The bank has also determine provision for expected credit losses under IFRS 9 which results higher than provision under Asset Classification Provisioning Regulation, accordingly higher provisions were in cooperated in the financial statements as disclosed in note 7.2& 8.2 to the financial statements.

Cash and cash equivalents, Investments, other assets and Off-balance sheet item

The bank has policy of maintaining general provision at 0% as 1% of provision is declared optional on cash and cash equivalents, investments, other assets and Off-balance sheet item classified in standard category as per the revised "Asset Classification and Provision Regulation" issued by DAB, however, bank also determine provision for expected credit losses under IFRS 9, the financial statements are in cooperated with higher provision impact resulting from the mentioned methods, as disclosed in note 6.3, 7.2 ,14.2 & 21 to the financial statements.

3.3.6 Impairment of financial assets (Policy applicable before 1 January 2018)

Loans and advances

The policy for making provision against loan and advances was similar to one disclosed in note 3.3.5 above.

a) Assets carried at amortized cost except for loans and advances to customers

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is an objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Downgrading below investment grade level.

The amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as and improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognized in the statement of comprehensive income in impairment charge for credit losses.

b) Assets classified as available for sale

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on those financial assets previously recognized in the statement of comprehensive income is removed from equity and recognized in the statement of comprehensive income. Impairment losses recognized in the statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income. If in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of comprehensive income, the impairment loss is reversed through the statement of comprehensive income, related to an event occurring after the impairment loss was recognized.

3.4 Financial liabilities

The Bank classifies its financial liabilities in following categories.

a) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss are financial liabilities held for trading. A financial liability is classified in this category if incurred principally for the purpose of trading or payment in the short term. Derivatives (if any) are also categorized as held for trading unless they are designated as hedges

b) Other financial liabilities measured at amortized cost

These are non-derivatives financial liabilities with fixed or determinable payments that are not quoted in an active market. These are recognized initially at fair value, net of transaction costs incurred and are subsequently stated at amortized cost; any differences between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement.

3.5 Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at the 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 maximizes the use of relevant observable inputs and minimize the use of unobservable all of the factors that market participants would take into account in pricing a transaction.

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

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

Portfolio of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market risk or credit risk or measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

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

3.6 Property and equipment

These are stated at historical cost less accumulated depreciation and impairment, if any, except for land and capital work in progress which is stated at cost less impaiment, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the asset.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are recognized in statement of comprehensive income during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate the depreciable amount of the assets over their estimated useful life as follows:

Leasehold improvements	5 years
Furniture and fittings	4 to 10 years
Electrical, office and computer equipment	4 years
Vehicles	4 years

Depreciation is charged on additions during the year from the month they become available for their intended use while no depreciation is charged in the month of disposal of assets.

Gains and losses on disposal of property and equipment are determined by comparing proceeds with the carrying amount. These are included in other income in the statement of comprehensive income.

3.8 Impairment of non-financial assets

Non-financial assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Non-financial assets that are subject to depreciation/ amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss or reversal of impairment loss is recognized in the statement of comprehensive income. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date. Reversal of the impairment losses is restricted to the original cost of the assets.

3.9 Taxation

Current

The current income tax charge is calculated in accordance with Income Tax Law, 2009. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

3.10 Revenue recognition

a) Interest income and expenses for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are recognized within 'interest income' and 'interest expense' in the statement of comprehensive income using the effective interest rate method.

   The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses.

b) Due but unpaid interest income is accrued on overdue advances for periods up to 90 days in compliance with the Banking regulations issued by DAB. After 90 days, overdue advances are classified as non-performing and further accrual of unpaid interest income ceases.

c) Gains and losses on disposal of property and equipment are recognized in the period in which disposal is made.

d) Fees and commission income and expense are recognized on an accrual basis when the service has been provided/received.

e) Fee and commission income that are integral part to the effective interest rate on financial assets and liability are included in the measurement of effective interest rate. Other fee and commission expenses related mainly to the transactions are services fee, which are expensed as the services are received.

3.11 Foreign currency transactions and translation

a) Functional and presentation currency

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the entity operates (the functional currency), which is Afghani (AFN). All amounts have been rounded to the nearest thousands, except when otherwise indicated

3.12 Transactions and balances

Foreign currency transactions are translated into functional currency using the exchange rate prevailing at the date of the transaction. Foreign currency assets and liabilities are translated using the exchange rate at the balance sheet date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of assets and liabilities denominated in foreign currencies are recognized in income currently.

The exchange rate for following currencies against AFN were:

	1 USD	1 Euro	1 GBP
As at 31 December 2018	75.31	86.01	95.21
As at 31 December 2017	69.72	83.27	93.21

3.13 Provisions

Provisions are recognized when there are present, legal or constructive obligations as a result of past events; it is probable that an out flow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate of the amounts can be made. Provision for guarantee claims and other off balance sheet obligations is recognized when intimated and reasonable certainty exists to settle the obligations.

3.14 Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the financial statements when there is a legally enforceable right to offset the recognized amounts and the Bank intends to settle either on a net basis or realize the assets and settle the liabilities simultaneously.

3.15 Employee benefits

Short-term benefits

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

4. Use of critical accounting estimates and judgments

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The resulting accounting estimates and judgments will, by definition, rarely equal the related actual results. The material estimates, assumptions and judgments used to measure and classify the carrying amounts of assets and liabilities are outlined below:

a) Impairment losses on financial assets

The banks accounting framework considers both the provision prescribed under local regulations in Afghanistan and IFRS 9. Therefore, the Bank's level of provision for impairment against financial asset considers the requirements of both regimes.

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgment. in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgments and estimates include:

- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The Bank's internal credit grading model
- The segmentation of financial assets when their ECL is assessed on a collective basis Development of ECL models, including the various formulas and the choice of inputs to such models,
- Determination of associations between macroeconomic scenarios and, economic inputs, such as GDP growth
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models

It has been the Bank's policy to regularly review its models in the context of actual loss experience and adjust when necessary.

The Bank reviews loans to customer balances quarterly for possible impairment and records the provision for possible loan losses as per the Bank's policy and in accordance with DAB regulations.

b) Provision of income taxes

The Bank recognizes tax liability in accordance with the provisions of Income Tax Law 2009. The final tax liability is dependent on assessment by Ministry of Finance, Government of Islamic Republic of Afghanistan.

c) Useful life of property and equipment

The Bank reviews the useful life, depreciation method and residual value of property and equipment and intangible assets at each statement of financial position date. Any change in estimates may affect the carrying amounts of the respective items of property and equipment and intangible assets with a corresponding effect on the depreciation / amortization charge.

		Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
5.	**CASH AND CASH EQUIVALENTS**			
	Cash in hand			
	Local currency		13,319	10,815
	Foreign currency		56,409	111,800
			69,728	122,615
	Unrestricted balances with Da Afghanistan Bank			
	Local currency		613,704	2,639,355
	Foreign currency		728,613	883,677
			1,342,317	3,523,232
	Balances with other banks and financial institutions			
	Current accounts	5.1	1,861,217	547,836
	Short term placements with banks			
	Capital notes (maturity less than three months)	5.2	1,699,850	2,319,536
	Time deposits with other banks	5.3	5,678,374	3,339,588
			7,378,224	5,659,124
	General provision held	5.4	-	(18,942)
			10,651,486	9,935,887

5.1 These represent balances in nostro accounts with various financial institutions.

5.2 These represent investments in capital notes issued by DAB for a maturity period of one month (31 December 2017: one month). These capital notes carry interest rate ranging from 0.15% to 0.34% (31 December 2017: 0.13% to 1.68%) per annum.

5.3 These represent overnight and fixed term placements with financial institutions outside Afghanistan up to a maximum period of one month (31 December 2017: one months) in USD carrying interest at rates ranging from 2.18% to 3.50% (31 December 2017: 1.3% to 2.15%) per annum.

5.4 The bank has policy of maintaining general provision at 0% as 1% of provision is declared optional on financial assets classified in standard category as per the revised "Asset Classification and Provision Regulation" issued by DAB, however, under IFRS 9, provision for expected credit losses on cash and cash equivalents has resulted in nil amount. (31 December 2017: General provision of 1% in accordance with "Asset Classification and Provisioning Regulation" issued by DAB.)

		Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
6.	**INVESTMENTS - NET**			
	Available for sale			
	- Foreign bonds	6.1	-	4,387,733
	Held to maturity			
	- Foreign bonds	6.2	-	694,158
			-	5,081,891
	Debt instruments at fair value through other comprehensive income:			
	Foreign bonds	6.1	43,039	-
	Debt instruments at amortized cost:			
	Foreign bonds	6.2	750,105	-
			793,144	
Less:	Provision for expected credit losses / (2017: general provision)	6.3	(316)	(50,619)
			792,828	5,011,272

6.1 The breakup of foreign bonds is as follows:

	Rating	Rating Agency	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Oman	Baa2	Moody's	-	698,106
The Islamic Republic of Pakistan	B3	Moody's	-	387,364
Third Pakistan International Sukuk Company	B3	Moody's	-	352,473
Saudi Arabia	A1	Moody's	-	342,463
Abu Dhabi Government International	Aa2	Moody's	-	342,451
Oman	Baa2	Moody's	-	339,514
Indonesia Sovereign Bonds (Sukuks)	Baa3	Moody's	-	287,195
South Africa Sovereign Bonds (Sukuks)	Baa3	Moody's	-	283,141
Kazakhstan	B3	Moody's	-	217,765
Republic of Indonesia	Baa3	Moody's	-	188,302
Republic of Indonesia	Baa3	Moody's	-	177,188
Republic of Sri Lanka	B1	Moody's	-	147,512
Kingdom of Jordan	B1	Moody's	-	138,913
Abu Dhabi Government International	Aa2	Moody's	-	138,596
Republic of Sri Lanka	B1	Moody's	-	109,485
Kingdom of Jordan	B1	Moody's	-	71,985
Oman	Baa2	Moody's	-	67,905
United Mexican States	A3	Moody's	43,039	43,458
Republic of Indonesia	Baa3	Moody's	-	35,916
			43,039	4,367,733

6.1.1 The interest rate on this bond is 1.68% (31 December 2017: 1.68% to 8.25%) per annum, having maturity on 8 March 2024.

6.2 This represents investment in the Islamic Republic of Pakistan and State of Qatar bonds amounting to USD 5 million equivalent to Afs 376,550 thousands each (31 December 2017: USD 5 million equivalent to Afs 334,150 thousands each) carrying interest rate of 7.25% (31 December 2017: 7.25%) and 3.25% (31 December 2017: 3.25%) per annum respectively.

6.3 **Impairment allowance for investments**

6.3.1 The table below shows the credit quality and the maximum exposure to credit risk for categories based on the Bank's credit rating grades and year-end stage classification as at 31 December 2018 and 2017, respectively. The amounts presented are gross of impairment allowances. Details of the Bank's rating grades are disclosed in note 6.1.

	31 December 2018				
Internal Rating Grade	**Stage 1 Collective AFS '000'**	**Stage 2 Collective AFS '000'**	**Stage 3 Collective AFS '000'**	**Total AFS '000'**	**31 December 2017 AFS '000'**
Performing					
Investment Grade	416,576	-	-	416,576	1,711,305
Non-Investment Grade	376,568	-	-	376,568	3,350,586
Non-performing	-	-	-	-	-
Total	793,144	-	-	793,144	5,061,891
Provision for expected credit losses - (note 6.3.2)	(316)	-	-	(316)	(21,627)
Provision for Impairment losses as per ACPR - (note 6.3.2)	-	-	-	-	(28,992)
Total	(316)	-	-	(316)	(50,619)
Net balance	792,828	-	-	792,828	5,011,272

6.3.2 The bank has policy of maintaining general provision at 0% as 1% of provision is declared optional on financial assets classified in standard category as per the revised "Asset Classification and Provision Regulation" issued by DAB. However, under IFRS 9, provision for expected credit losses on investments has resulted the higher provision and its impact was taken accordingly (31 December 2017: General provision of 1% in accordance with "Asset Classification and Provisioning Regulation" issued by DAB.)

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
7. LOANS AND ADVANCES TO BANKS - NET			
Foreign bills discounted and purchased		-	585,648
Term loan	7.1	120,000	120,000
		120,000	705,648
Less: Provision for expected credit losses (2017: general provision)	7.2	(2,336)	(7,056)
		117,664	698,592

7.1 Term loan is issued to Foundation for International Community Assistance (FINCA), having maturity of six months and carrying interest rate of one year capital note cut off rate plus 2%, floor 7.5% (31 December 2017: one year capital note cut off rate plus 2%, floor 8%) per annum. This loan is secured against counter gurantee by Citibank.

7.2 Allowance for ECL / Impairment allowance for loans and advances to banks

7.2.1 The table below shows the credit quality and the maximum exposure to credit risk for categories based on the Bank's credit rating grades and year-end stage classification as at 31 December 2018 and 2017, respectively. The amounts presented are gross of impairment allowances.

	31 December 2018				31 December 2017
Internal Rating Grade	**Stage 1 Collective AFS '000'**	**Stage 2 Collective AFS '000'**	**Stage 3 Collective AFS '000'**	**Total AFS '000'**	**AFS '000'**
Performing					
Investment Grade	-	-	-	-	-
Non-Investment Grade	120,000	-	-	120,000	705,648
Non-performing	-	-	-	-	-
Total	120,000	-	-	120,000	705,648
Provision for expected credit losses - (note 7.2.2)	(2,336)	-	-	(2,336)	(3,552)
Provision for Impairment losses as per ACPR - (note 7.2.2)	-	-	-	-	(3,504)
Total	(2,336)	-	-	(2,336)	(7,056)
Net balance	117,664	-	-	117,664	698,592

7.2.2 The bank has policy of maintaining general provision at 0% as 1% of provision is declared optional on financial assets classified in standard category as per the revised "Asset Classification and Provision Regulation" issued by DAB. However, under IFRS 9, provision for expected credit losses on investments has resulted the higher provision and its impact was taken accordingly (31 December 2017: General provision of 1% in accordance with "Asset Classification and Provisioning Regulation" issued by DAB.)

		Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
8.	**LOANS AND ADVANCES TO CUSTOMERS - NET**			
	Loans and advances to customers at amortized cost	8.1	1,530	1,488
Less:	Provision for expected credit losses (2017: general provision)	8.2	(22)	(29)
			1,508	1,459

8.1 These balances carry interest at the rate of 20% (31 December 2017: 20%) per annum. These are fully secured against cash margin.

8.2 Allowance for ECL / Impairment allowance for loans and advances to customers

The table below shows the credit quality and the maximum exposure to credit risk for categories based on the Bank's credit rating grades and year-end stage classification as at 31 December 2018 and 2017, respectively. The amounts presented are gross of impairment allowances.

	31 December 2018				31 December 2017
Internal Rating Grade	**Stage 1 Collective AFS '000'**	**Stage 2 Collective AFS '000'**	**Stage 3 Collective AFS '000'**	**Total AFS '000'**	**AFS '000'**
Performing	-	-	-	-	-
Investment Grade	-	-	-	-	-
Non-Investment Grade	**1,530**	-	-	1,530	1,488
Non-performing	**1,530**	-	-	1,530	1,488
Total					
Provision for expected credit losses - (note 8.2.1)	(22)	-	-	(22)	(27)
Provision for impairment losses as per ACPR - (note 8.2.1)	-	-	-	-	(2)
Total	(22)	-	-	(22)	(29)
Net balance	1,508	-	-	1,508	1,459

8.2.1 The bank has policy of maintaining general provision at 0% as 1% of provision is declared optional on financial assets classified in standard category as per the revised "Asset Classification and Provision Regulation" issued by DAB. However, under IFRS 9, provision for expected credit losses on investments has resulted the higher provision and its impact was taken accordingly (31 December 2017: General provision of 1% in accordance with "Asset Classification and Provisioning Regulation" issued by DAB.)

9. PROPERTY AND EQUIPMENT

	Leasehold improvements	Furniture & fixtures	Electrical, office and computer equipment	Vehicles	Total
	(Afs '000')				
Cost					
Balance at 1 January 2017	22,099	13,591	38,124	9,722	83,536
Additions	-	-	2,449	-	2,449
Disposals	-	(2,468)	(1,909)	-	(4,377)
Balance at 31 December 2017	22,099	11,123	38,664	9,722	81,608
Balance at 1 January 2018	**22,099**	**11,123**	**38,664**	**9,722**	**81,608**
Additions	**-**	**-**	**260**	**-**	**260**
Balance at 31 December 2018	**22,099**	**11,121**	**38,924**	**9,722**	**81,868**
Depreciation					
Balance at 1 January 2017	21,154	10,691	33,162	9,722	74,729
Charge for the year	354	435	2,920	-	3,709
Depreciation on disposals	-	(2,464)	(1,892)	-	(4,356)
Balance at 31 December 2017	21,508	8,662	34,190	9,722	74,082
Balance at 1 January 2018	**21,508**	**8,662**	**34,190**	**9,722**	**74,082**
Charge for the year	**317**	**425**	**1,963**	**-**	**2,705**
Balance at 31 December 2018	**21,825**	**9,087**	**36,153**	**9,722**	**76,787**
Carrying amounts					
Balance at 31 December 2017	591	2,461	4,474	-	7,526
Balance at 31 December 2018	**274**	**2,034**	**2,771**	**-**	**5,081**
Depreciation rate	**0**	**10% - 25%**	**25%**	**25%**	

9.1 Included in cost of property and equipment are fully depreciated assets still in use having cost of Afs 62,418 thousands (31 December 2017: Afs 47,064 thousands).

		Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
10	**OTHER ASSETS**			
	Accrued interest		14,378	60,355
	Advances, deposits and prepayments		2,274	2,535
	Restricted deposits with DAB	10.1	1,172,107	1,149,722
	Receivable against credit card transactions		5,052	209
	Branch adjustment account		-	5,308
	Commission receivable		2,302	1,607
	Interest receivable on Interest Rate Swaps		-	2,201
	Others	20.1	-	275,334
			1,196,113	1,497,574
	Less: Provision for expected credit losses (2017: general provision)		-	(276,059)
			1,196,113	1,221,515
10.1	**RESTRICTED DEPOSITS WITH DAB:**			
	- Local currency deposits	10.1.1	69,238	72,635
	- Foreign currency deposits	10.1.1	1,102,867	1,076,087
			1,172,105	1,148,722

10.1.1 Required reserve account is being maintained with DAB which is denominated in respective currencies to meet minimum reserve requirement in accordance with Article 3 "Required Reserves Regulation" of the Banking Regulations issued by DAB. These balances are interest free.

		Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
11.	**DEPOSITS FROM BANKS**			
	Citibank - New York		666	1,993,113
	The First Microfinance Bank - Kabul		24	22,828
		11.1	690	2,015,941

11.1 These represent current accounts maintained by other banks for their operational activities. These balances are interest free (31 December 2017: interest free).

		Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
12.	**DEPOSITS FROM CUSTOMERS**			
	Current deposits		10,812,582	10,520,794
	Saving deposits	12.1	306,141	1,210,302
	Term deposits	12.2	22,593	1,542,606
	Margin deposits		60,571	171,577
			11,201,887	13,446,354

12.1 Saving deposits carry interest rate ranging from 0% to 0.25% per annum on AFN and 0.25% (31 December 2017: 0% to 0.40%) per annum on USD balances.

12.2 Term deposits carry interest rate ranging from 0.75% to 1.25% (31 December 2017: 0.75% to 6.25%) per annum and have maturity period ranging from 06 to 12 months (31 December 2017: 06 to 12 months).

		31 December 2018 AFS '000'	31 December 2017 AFS '000'
13	**Deferred tax (liabilities) / assets arising in respect tax losses / gains**		
	Surplus on revaluation of available for sale investments	(33)	(17,263)
	Provision for expected credit losses on financial assets and off-balance sheet items	856	16,488
	Unrealized loss on interest rate swaps	-	1,616
	Accelerated tax depreciation and amortization	(943)	(1,148)
		(120)	(307)

13.1 **Movement in temporary differences during the year**

	Balance as at 01 January 2017	Recognized in statement of comprehensive income	Recognized in equity through other comprehensive income	Balance at 31 December 2017	Recognized in statement of comprehensive income	Recognized in equity through other comprehensive income	Balance at 31 December 2018
	(Afs '000')						
Deferred tax assets arising in respect of:							
(Reversal) / provision on financial assets and other off balance sheet items	13,303	3,185	-	16,488	(16,488)	-	-
Unrealized loss on Interest Rate Swaps	883	733	-	1,616	(1,616)	-	-
Provision for expected credit losses on financial assets and off balance sheet items	-	-	-	-	856	-	856
Deferred tax liabilities arising in respect of:							
Accelerated tax depreciation	(1,287)	139	-	(1,148)	205	-	(943)
Surplus on revaluation of available for sale investments	(2,067)	2,067	(17,263)	(17,263)	-	17,230	(33)
	9,812	7,024	(17,263)	(307)	(17,043)	17,230	(120)

14 OTHER LIABILITIES

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Unearned commission on letters of guarantees		2,776	8,297
Unrealized loss on re-measurement of Interest Rate Swaps		-	7,150
Interest payable on Interest Rate Swap		-	5,625
Accrued expenses		4,739	5,241
Interest payable		84	9,350
DAB assessment fee payable		3,060	3,120
Professional charges		1,131	1,072
Bills payable		228	3,659
Branch adjustment account		721	
Provision for expected credit loss provision on off balance sheet items (2017: general provision on off balance sheet items)	14.1	1,526	2,437
Others		2,517	2,250
		16,830	43,371

14.1 This represents provision for expected credit losses on letter of guarantees classified in stage 1, as per the requirements of IFRS 9, effective from 1 January 2018. (31 December 2017: General provision of 1% in accordance with "Asset Classification and Provisioning Regulation" issued by DAB.)

15. CAPITAL CONTRIBUTED BY HEAD OFFICE AND REMITTANCES TO HEAD OFFICE

Da Afghanistan Bank (DAB) vide its Letter No. 3783/3871 dated January 07, 2014 requires all branches of foreign banks to convert their minimum equity from other currencies to local currency Afs 1,000,000 thousands gradually till March 31, 2014. Accordingly, the Board of Directors (BOD) of the Head Office, in its meeting held on March 02, 2014 approved capitalization of unappropriated profit to meet the minimum equity requirements of Afs 1,000,000 thousands. During the year there were no profit remittance to head office (31 December 2017: Afs 239,820 thousands in July 2017).

16. CAPITAL RESERVES

Article 98 "Reserve Capital" of Corporations and Limited Liability Companies Law of Afghanistan, requires that Bank should transfer 5% of its profit to Capital Reserve to compensate for future possible losses to the extent such capital reserves reach up to 25% of the Bank's capital.

17. CONTINGENCIES AND COMMITMENTS

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Guarantees	17.1	221,174	640,392

17.1 These represent bid bonds and performance based guarantees issued by the Bank.

18. NET INTEREST INCOME

	31 December 2018 AFS '000'	31 December 2017 AFS '000'
INTEREST INCOME		
Cash and cash equivalents	136,583	164,920
Loans and advances to banks and customers	13,067	17,575
Investments	69,159	301,042
	218,809	484,537
INTEREST EXPENSE		
Deposits from customers		
Interest on term deposits	(8,945)	(84,740)
Interest on saving deposits	(1,372)	(2,795)
	(10,317)	(87,535)
Net interest expense on interest rate swaps	(1,280)	(12,193)
	(11,597)	(99,728)
	207,012	384,809

19. NET FEE AND COMMISSION INCOME

	31 December 2018 AFS '000'	31 December 2017 AFS '000'
FEE AND COMMISSION INCOME		
Commission on letters of guarantees issued	6,899	15,224
Commission on credit cards	8,656	9,491
Funds transfer fee	49,871	45,364
Accounts servicing fee	28,097	27,063
	93,423	97,542
FEE AND COMMISSION EXPENSE	(10,924)	(14,938)
	82,499	82,604

20. OTHER INCOME

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Capital loss on sale of foreign currency bonds - net		(25,713)	65,672
Gain on settlement of interest rate swaps - net		29,233	
Customer charges		27,591	53,673
Recovery from Department of Justice - DoJ	19.1	273,557	
		304,668	119,345

20.1 This includes recovery of the amount of USD 3,949,141 (equivalent to Afs 273.557 million), placed in nostro account in New York, United States of America which was previously put on hold by a commercial bank pursuant to receipt of notice of seizure based on the order passed by the District Court, District of Columbia, USA, against which the Bank had booked 100% provision in prior years. During the year the said amount was released due to order issued by the Department of Justice (DOJ) and credited into the Bank's nostro account.

21 Credit losses reversal / (expense)

The table below shows the ECL charges on financial instruments for the year recorded in the income statement:

	Note	31 December 2018					31 December 2017
		Stage 1 Collective AFS '000'	Stage 2 Collective AFS '000'	Stage 3 Collective AFS '000'	Regulatory AFS '000'	Total AFS '000'	
Cash and cash equivalents	5.4	-	-	-	16,942	16,942	(15,606)
Investments	6.3	5,080	16,231	-	28,992	50,303	(50,619)
Loans and advances to banks	7.2	1,216	-		3,504	4,720	(2,846)
Loans and advances to customers	8.2	(22)	-	-	29	7	(29)
Other assets	10	-	-	-	725	725	(725)
Bank guarantees	14.1	(420)	-	-	2,437	2,017	(2,437)
Total reversal on impairment / (loss) for the year		5,854	16,231	-	52,629	74,714	(72,262)

22 OTHER OPERATING EXPENSES

	31 December 2018 AFS '000'	31 December 2017 AFS '000'
Rent, taxes, insurance, electricity, etc.	43,770	45,982
Legal and professional charges	16,858	31,100
Communications	4,176	4,257
Repairs and maintenance	3,290	3,524
Stationery and printing	701	1,168
Advertisement and publicity	290	897
Auditors' remuneration	1,989	1,528
Entertainment	2,608	1,407
Travelling and conveyance	2,376	2,725
Security	12,102	12,557
Loss on re-measurement of Interest Rate Swaps - net	-	8,079
Penalties paid to DAB	768	1,236
Other operating expenses	3,790	517
	91,903	115,542

23. TAXATION

	Note	31 December 2018 AFS '000'	31 December 2017 AFS '000'
In respect of current year		29,067	21,189
In respect of prior years		46,383	74,588
		75,450	95,777
Deferred tax	12.1	17,043	(7,024)
		17,043	(7,024)
		92,493	88,753

23.2 Reconciliation of effective tax rate

	2018 Rate	2018 (Afs '000')	2017 Rate	2017 (Afs '000')
Accounting profit for the year		493,050		317,791
Applicable tax @ 20%	20%	98,410	20%	62,558
Effect of tax on dividend to shareholders	0%	-	15%	(47,584)
Effect of difference in assessment of tax losses by MoF	0%	-	0%	-
Effect of tax relating to prior years	9%	46,383	24%	74,588
Effect of admissible / inadmissible expenses - net	-14%	(69,343)	5%	16,056
Deferred tax effect relating to:				
Reversal and (origination) of temporary differences	3%	17,043	-1%	(4,057)
Others	0%	-	-4%	(13,222)
	30%	92,493	28%	88,753

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24. FINANCIAL ASSETS AND LIABILITIES

Accounting classification and fair values

The following table shows the carrying amounts and classification of financial assets and financial liabilities

	Note	Financial assets (other than investments)- At amortized cost	Debt investments at amortized cost	Debt investments at fair value through OCI	Financial liabilities at amorized cost	Total
31 December 2018						
Assets						
Cash and cash equivalents	5	3,273,262	7,378,224	-	-	10,651,486
Investments - net	6	-	749,789	43,039	-	792,828
Loans and advances to banks - net	7	-	117,664	-	-	117,664
Loans and advances to customers - net	8	-	1,508	-	-	1,508
Other assets	10	1,193,839	-	-	-	1,193,839
		4,467,101	8,247,185	43,039	-	12,757,324
Liabilities						
Deposits from banks		-	-	-	690	690
Deposits from customers		-	-	-	11,001,887	11,001,887
Other liabilities		-	-	-	12,428	12,428
		-	-	-	11,015,005	11,015,005
31 December 2017						
Assets						
Cash and cash equivalents	5	4,293,885	5,042,182	-	-	9,336,067
Investments - net	6	-	687,217	4,324,056	-	5,011,273
Loans and advances to banks - net	7	-	686,592	-	-	686,592
Loans and advances to customers - net		-	1,459	-	-	1,459
Other assets	10	1,221,515	-	-	-	1,221,515
		5,515,200	7,029,450	4,324,056	-	16,868,706
Liabilities						
Deposits from banks	11	-	-	-	2,018,941	2,018,941
Deposits from customers	12	-	-	-	13,445,354	13,445,354
Other liabilities	14	-	-	-	24,897	24,897
		-	-	-	15,489,192	15,489,192

24.1 Fair value of financial assets and financial liabilities

(a) Financial instruments measured at fair value using a valuation technique

The table below analyses financial instruments carried at fair value, by valuation method. The various fair value levels have been defined as follows:

Level 1 : quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 : Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Level 3 : inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Level 3
		Afs'000	
Debt investments at fair value through OCI			
As at 31 December 2018	-	43,039	-
As at 31 December 2017	-	4,367,733	-

Valuation technique and key inputs used for investments in bonds were quoted market bid price in active market.

(b) Fair values

Set out below is a comparison of the carrying amounts and fair value of the Bank's financial assets and liabilities, other than those with carrying amounts that are reasonable approximations of fair values:

	Carrying Value		Fair Value	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	---------------------Afs'000		---------------------	
Financial assets				
Cash and cash equivalents	10,661,486	9,935,557	10,651,486	9,935,557
Investments	792,884	4,942,121	792,828	5,011,272
Loans and advances to banks	698,592	698,592	698,592	698,592
Loans and advances to customers	1,459	1,459	1,459	1,459
Other assets	1,193,839	1,221,515	1,193,839	1,221,515
Financial liabilities				
Deposits from banks	690	2,018,941	690	2,018,941
Deposits from customers	11,001,887	13,445,364	11,001,887	13,445,364
Other liabilities	12,428	24,887	12,428	24,887

25. **Risk management policies**

The Bank is a foreign branch of Bank Alfalah Limited Pakistan (Head Office), therefore, the Board of Directors of the Head Office (the Board) has overall responsibility for the establishment and oversight of risk management framework of the Head Office as well as overseas branches. The Head Office has in place an approved integrated risk management framework for managing credit risk, market risk, liquidity risk, and operational risk as evidenced by its Board approved 'Risk Management Policy' and 'Risk Management Manual'. The Board has established the Management Board, Asset and Liability Committee (ALCO), a Credit Committee and Board Risk Management Committee and Board Audit Committee which are responsible for developing and monitoring risk management policies in their specified areas. All Board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities. The Management Board assists in these functions by the Internal Audit, compliance and Risk Management Division at the Head Office. Internal audit function is an independent risk review function that reports directly to the Board Audit Committee at the Head Office. The Head Office appoints Country Head specifically to oversee operations in Afghanistan and to manage the risks in accordance with the risk management policies of the Head Office.

The Bank's Internal Audit and Compliance Departments in Afghanistan are responsible for monitoring compliance with the risk management policies and procedures, and for reviewing adequacy of risk management framework in relation to the risks faced by the Bank. As a policy, the reporting line of the risk management function has been kept completely independent of the business division.

The Bank has exposure to the following risks from its use of financial instruments:
- Credit risk
- Liquidity risk
- Market risk

25.1 **Credit risk**

Credit risk management processes encompass identification, assessment, measurement, monitoring and control of credit risk exposure. In the Bank's experience, a key to effective credit risk management is a well thought out business strategy. The Bank's focus over the coming years will be to further enhance risk models, processes and systems infrastructure, in line with its ambition to bring maximum sophistication to the risk management function. The Board has delegated responsibility for the management of credit risk to its Head Office Credit Committee. A separate credit department has been established by the Bank for its Afghanistan operations that is responsible for oversight of the Bank's credit risk and which is reportable to the Credit Committee. The Credit department is headed by Group Head Credit along with credit department staff who looks after credit risk matters and conduct portfolio analysis and stress testing on regular basis for managing credit risk.

The Bank has established and maintained a sound loan portfolio in terms of well-defined credit policy approved by the Board of Directors. The credit evaluation system comprises of well designed credit appraisal, sanctioning and review procedures for the purposes of emphasizing prudence in lending activities and ensuring the high quality of asset portfolio. The function is also supported by Credit Administration and Credit Monitoring Departments at Head Office level to ensure segregation of duties and efficient management of credit risk. The Banks manages its portfolio of loan assets with a view to limit its concentrations in terms of risk quality, geography, industry, maturity and large exposure.

The amount of credit risk in this regard is represented by the carrying amounts of the assets on the balance sheet date. Exposure to credit risk managed through regular analysis of borrower to meet interest and capital repayment obligations and by changing their lending limits where appropriate. Exposure to credit risk is also managed against personal guarantee of the borrower and mortgage of immoveable property duly registered with the Court of Law and hypothecation over stock and current assets duly verified by the Bank's Credit Officer on monthly basis.

A sophisticated Internal Credit Rating System has been developed by the Bank, which is capable of quantifying counter-party and transaction risk in accordance with the best practices. The system takes into consideration qualitative and quantitative factors of the counter-party, transaction structure, security etc. and generates an internal rating vis-a-vis anticipated customer behavior.

The adherence to Risk-appetite statement approved by the Board is monitored by RMD. Further the compliance of regulatory & internal limits is also monitored and any deviations are ratified from the competent authorities.

25.1.1 Credit risk measurement

Impairment assessment under IFRS 9 (Policy applicable from 01 January 2018)

Definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least 3 consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition. The bank is observing a probationary period of a minimum of 3 instalments (for repayments which are on a quarterly basis or shorter) and 12 months (in cases where instalments are on a longer frequency than quarterly) after the restructuring, before upgrading from Stage 3 to 2.

Credit ratings and PD estimation process

The Bank's Credit Risk Department operates its internal rating models. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilize supplemental external information that could affect the borrower's behavior. PDs for rated portfolios are determined using migration of rating grades from one period to other within the PD observation period. Consumer lending comprises credit cards. PDs models of these products are primarily driven by days past due.

Estimated historical realized default rates are adjusted for IFRS 9 ECL calculations to incorporate forward looking information and the IFRS 9 Stage classification of the exposure. This is repeated for each economic scenarios as appropriate. For debt securities in the Treasury portfolio, external rating agency credit grades are used. The PDs associated with each grade are determined based on realized default rates as published by the rating agency.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

The EADs are determined based on the expected payment profile, which varies by product type. For amortizing products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over the 12 months and lifetime basis. This is also adjusted for any overpayments made by the borrower. For revolving products, the EAD is predicted by taking current drawn balance and adding a credit conversion factor which allows for the expected drawdown of the remaining limit by the time of default.

To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

Loss given default

The bank has used 45% LGD for corporate, sovereign and bank exposures as per the basel II standard credit risk guilines.

Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition. The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition. Significant increase in credit risk is measured by comparing the risk of default estimated at origination with the risk of default at reporting date. The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

Measuring expected credit losses - ECL

PD, EAD and LGD are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in earlier year) on annual basis. This effectively calculates an ECL for each future year, which is then discounted back to the reporting date and summed. The discount rate used in ECL computation is the original effective interest rate or an approximation thereof.

Forward looking economic information is also included in determining the 12 month and lifetime ECL. The bank has performed historical analysis and identified key economic variables impacting credit risk and ECL for each portfolio. These economic variables and their associated impact on PD, EAD and LGD vary by financial instrument. Expert judgment has also been applied in this process. Forecast of these economic variables (the "base economic scenario") are obtained from external sources on a monthly basis.

In addition to the base economic scenario, the management also estimate other possible scenarios along with scenarios weighting. The scenario weighting are determined by an expert credit judgment. As with any economic forecasts, the projections and likelihoods of the occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The bank considers these estimates of the possible outcomes. The bank has used base, upside and downside scenarios for its ECL estimation.

Impairment under local regulations

(i) Over due balances on loans to banks / customers are segmented into four categories as described in note 3.3.5. The percentage of provision created on such over due balances are as per guidelines issued by DAB and reflects the range of default probabilities defined for each category. This means that, in principle, exposures migrate between classes as the assessment of their probability of default changes.

(ii) Exposure at default is based on the amounts, the Bank expects to be owed at the time of default. For example, for a loan this is the face value. For a commitment, the Bank includes any amount already drawn plus the further amount that may have been drawn by the time of default, should it occur.
(iii) Loss given default or loss severity represents the Bank's expectation of the extent of loss on a claim should default occur. It is expressed as percentage loss per unit of exposure and typically varies by type of counterparty, type and seniority of claim and availability of collateral or other credit mitigation.

(b) Other than loans and advances to banks and customers

Other than loans and advances includes balances with other banks and financial institutions and placements with other banks, investments in bonds and held with DAB and other assets. Judgments and instructions from the Bank's treasury are being used by the Bank's management in placing funds with other banks and are viewed as a way to gain better credit quality mapping and maintain a readily available source to meet the funding requirements at the same time when required.

Concentration of risk of financial assets with credit risk exposure

Credit concentration risk arises mainly due to concentration of exposures under various categories viz. industry, geography, and single/group borrower exposures. Within credit portfolio, as a prudential measure aimed at better risk management and avoidance of concentration of risks, Da Afghanistan Bank has prescribed regulatory limits on bank's maximum exposure to single borrower and group borrowers. The Bank's annual credit plan spells out the maximum allowable exposure that it can take on specific industries for every business group.

	Notes	31 December 2018	31 December 2017
		Afs '000'	
Credit risk relating to on-balance sheet items are as follows:			
Cash and cash equivalents	5	7,539,591	3,987,426
Investments	6	792,828	5,011,272
Loans and advances to banks	7	117,664	698,592
Loans and advances to customers		1,508	1,459
Other assets	10	21,732	88,955
		8,473,323	9,787,704
Credit risk relating to off-balance sheet items is as follows:			
Guarantees	17.1	221,174	640,392
		221,174	640,392

The above table represents credit risk exposure to the Bank at 31 December 2018 and 31 December 2017, without taking account of any collateral held or other enhancements attached. For on-balance sheet assets the exposure set out above is based on net carrying amounts as reported in the statement of financial position.

Credit quality of financial assets

The credit qualities of Bank's financial assets have been assessed below by reference to the external credit ratings of counter parties determined by various international credit rating agencies. The counterparties for which external credit ratings were not been available have been assessed by reference to internal credit ratings determined based on their historical information for any defaults in meeting obligations.

Cash and cash equivalents

As of the reporting date, the bank held cash and cash equivalents amounting to Afs 10,651,486 thousands (31 December 2017: Afs 9,964,692 thousands); out of which there is a credit risk on balances amounting to Afs 3,111,897 thousands (31 December 2017: Afs 3,987,426 thousands); as the management believes that there is no credit risk on balances maintained with DAB amounting to Afs 5,854,651 thousands (31 December 2017: Afs 7,539,589 thousands). Balances with other banks/placements are held with reputable banks with high quality external credit rating.

Investments

Investments held carries various credit rating and ranges from to AA to B. These investments are made on defined investment criteria of the Bank. The credit quality and the maximum exposure to credit risk for under expected credit losses model is based on external credit rating grades and year-end stage classification as at 31 December 2018 and 2017 as disclosed in note 8.3 to the financial statements.

Loans and advances	Note	31 December 2018	31 December 2017
		Afs '000'	
Loans and advances to customers and banks	7	119,173	700,051
Neither past due but nor impaired			
Gross amount		121,530	707,136
Provision for expected credit losses - (Stage 1)	7	(2,357)	(7,085)
Carrying amount		119,173	700,051

Carrying amount-amortized cost:
As at balance sheet date, loan portfolio of the Bank was impaired, which was derived from expected credited losses model under IFRS 9, as disclosed in note 8.3 (31 December 2017 1 % of general provision was maintained as per the ACPR regulations issued by DAB.

Past due but not impaired loans
Past due but not impaired loans are those for which contractual interest or principal payments are past due but the Bank believes impairment is not appropriate. As at 31 December 2017, there is no overdue loan to be classified as per IFRS 9 or ACPR issued by DAB.

Write-off policy

The Bank writes off loans or advances and any related allowances for impairment losses, when the Bank's Credit department determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. Before allowing to written off, it is ensured that all possible avenues of recovery, inclusive of legal action are exhausted or legal action is not advisable.

The Bank holds collateral against loans and advances in the form of mortgage interest over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing and generally are not updated except when a loan is individually assessed as impaired.

As at 31 December 2018, an estimate of the fair value of the collateral and other security enhancements held against loans and advances has adequately covered the amount of loans and advances.

25.1.2 Industry sectors

The Bank monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk of loans and advances to customers and banks (gross) at reporting date is as follows:

Segments by class of business-Gross amount	31 December 2018	31 December 2017
	---------- Afs '000' ----------	
Banks and financial institutions	120,000	705,648
Traders / individuals	1,530	1,488
	121,530	707,135

Settlement risk
The Bank's activities may give rise to risk at the time of settlement of transactions and trades, if any. Settlement risk is the risk of loss due to failure of an entity to honor its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions, the Bank mitigate this risk by conducting settlements through a settlement / clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades require transactions specific or counterparty specific approvals from the Bank's risk department.

25.2 Liquidity risk

Liquidity risk is the potential for loss to the bank arising from either its inability to meet its obligations or to fund increase in assets as they fall due without incurring unacceptable cost or losses.

The Bank's Asset and Liability Committee (ALCO) manages the liquidity position on a regular basis and is primarily responsible for the formulation of the overall strategy and oversight of the asset liability function. ALCO monitors the maintenance of liquidity ratios, depositors concentration both in terms of the overall funding mix and avoidance of undue reliance on large individual deposits. Moreover, as a core retail deposits form a considerable part of the Bank's overall funding mix therefore significant importance is being given to the stability and growth of these deposits. The BOD has approved a comprehensive liquidity management policy which stipulates the early warning indicators of liquidity risk and maintenance of various ratios. Further, the Bank has designed different scenarios of cash outflows to stress test efficacy of its liquid assets and its impact on profit and loss. The results are regularly reviewed by ALCO for taking appropriate measures.

The Bank relies on deposits from customers as its primary source of funding. Deposits form customers generally has shorter maturities and large proportion of them are repayable on demand. For day to day liquidity risk management integration of liquidity scenario will ensure that the Bank is best prepared to respond to an unexpected problem.

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalent less any deposits from banks. A similar, but not identical, calculation is used to measure the Bank's compliance with the liquidity limit established by the Bank's Regulator (Da Afghanistan Bank). Detail of the reported Bank ratio of net liquid assets to deposits from customers at the reporting date and during the reporting period was as follows:

	2018	2017
At 31 December	97%	51%
Average for the period	90%	45%
Maximum for the period	97%	63%
Minimum for the period	61%	28%

25.2.1 Maturity analysis for financial liabilities

The tables below set out the remaining contractual maturities of the Bank's financial liabilities.

	Note	Gross nominal outflow	Up to 1 month	1-3 months	3 months to 1 year	1-5 years	More than 5 years	Carrying amount
		Afs '000'						
As at 31 December 2018								
Liabilities								
Deposits from banks	12	690	690	-	-	-	-	690
Deposits from customers	13	11,001,887	1,920,371	999,798	1,299,527	6,782,191	-	11,001,887
Other liabilities	14	12,428	2,078	7,833	2,517	-	-	12,428
		11,015,005	1,923,139	1,007,631	1,302,044	6,782,191	-	11,015,005
As at 31 December 2017								
Liabilities								
Deposits from banks	12	2,018,941	2,018,941	-	-	-	-	2,018,941
Deposits from customers	13	13,445,364	2,620,259	1,184,057	2,207,542	7,433,456	-	13,445,364
Other liabilities	14	24,887	5,231	17,376	2,280		-	24,887
		15,489,192	4,644,471	1,201,443	2,209,822	7,433,456	-	15,489,192

The Bank conducted a behavioral study of non-maturity deposits (non-contractual deposits) and performed regression analysis to determine deposits withdrawal pattern on Current and Savings Accounts (CASA). Regression analysis is used to investigate the relationship between time, the amount of deposits and deposits withdrawals in order to arrive at an estimated deposits withdrawals pattern in line with the best practices.

25.3 Market risk

Market risk is the risk of loss in earnings and capital due to on and off balance sheet positions arising out of adverse changes in interest rates, foreign exchange rates, equity prices and market conditions. It also includes investments and structural positions in the banking books of the Bank. To manage and control market risk a well defined limits structure is in place. These limits reviewed, adjusted and approved periodically. Market risk can be further divided into:

25.3.1 Interest rate risk exposure

The interest rate risk arises from the fluctuation in the value of financial instruments consequent to the changes in the market interest rates. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period. In order to ensure that this risk is managed within acceptable limits, the Bank's Asset and Liability Committee (ALCO) monitors the re-pricing of the assets and liabilities on a regular basis. The Bank's interest rate risk is limited since the majority of customer deposits are retrospectively re-priced on a biannual basis on the profit and loss sharing principles. The Bank's interest rate gap position on its financial assets and financial liabilities is as follows:

	Note	Interest rates	Interest bearing: Less than 3 months	3-6 months	6-12 months	1-5 years	More than 5 years	Non-interest bearing	Total
		Afs '000'							
31 December 2018									
Assets									
Cash and cash equivalents	5	0.13% to 2.16%	9,252,665	-	-	-	-	1,398,821	10,651,486
Investments	6	1.63% to 8.26%	-	376,568	-	-	416,576	-	793,144
Loans and advances to banks	7	3% to 8.68%	-	117,664	-	-	-	-	117,664
Loans and advances to customers	8	20%	1,508	-	-	-	-	-	1,508
Other assets	11		-	-	-	-	-	1,196,113	1,196,113
			9,254,173	494,232	-	-	416,576	2,594,934	12,759,915
Liabilities									
Deposits from banks	12		-	-	-	-	-	690	690
Deposits from customers	13	0% to 6.52%	306,141	22,593		-	-	10,673,843	11,002,577
Other liabilities	14		-	-	-	-	-	12,428	12,428
			306,141	22,593	-	-	-	10,686,960	11,015,695
On balance sheet interest sensitivity gap			8,948,032	471,639	-	-	416,576	(8,092,027)	1,744,220

	Note	Interest rates	Interest bearing: Less than 3 months	3-6 months	6-12 months	1-5 years	More than 5 years	Non-interest bearing	Total
		Afs '000'							
31 December 2017									
Assets									
Cash and cash equivalents	5	0.13%% to 2.15%	6,585,740	-	-	-	-	3,350,127	9,935,867
Investments	6	1.63% to 8.25%	-	-	-	1,649,329	3,361,943	-	5,011,272
Loans and advances to banks	7	3% to 5.88%	348,600	231,192	118,800	-	-	-	698,592
Loans and advances to customers	8	20%	1,458	-	-	-	-		1,458
Other assets	11		-		-	-	-	1,221,515	1,221,515
			6,935,798	231,192	118,800	1,649,329	3,361,943	4,571,642	16,868,705
Liabilities									
Deposits from banks	12		-	-	-	-	-	2,018,941	2,018,941
Deposits from customers	13	0% to 6.52%	720,000	2,032,998		-	-	10,692,366	13,445,364
Other liabilities	14		-		-		-	24,887	24,887
			720,000	2,032,998	-	-	-	12,736,194	15,489,192
On balance sheet interest sensitivity gap			6,215,798	(1,801,806)	118,800	1,649,329	3,361,943	(8,164,552)	1,379,513

If the interest rate increase/(decrease) by 100 bps, the impact on profit or loss for the year would have been Afs 90,362 thousands (2017: Afs 85,440 thousands) lower/higher respectively.

Variable rate instruments

Financial assets and liabilities at variable interest rates	2018	2017
	---------- Afs '000' ----------	
Loans and advances to banks	**120,000**	120,000
	120,000	120,000

Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the year end would have increased / decreased profit and loss for the year and equity by Afs 1,200 thousands (2017: Afs 1,200 thousands). This analysis assumes that all other variables remain constant.

Fixed rate instruments	2018	2017
	---------- Afs '000' ----------	
Financial assets and liabilities at fixed interest rates		
Investments	**793,144**	5,061,891
Loans and advances to banks	**-**	585,646
Loans and advances to customers	**1,530**	1,486
Deposits from customers	**(328,734)**	(2,752,998)
	465,940	2,896,029

Fair value sensitivity analysis for fixed rate instruments

The Bank does not account for any fixed rate financial assets at fair value through profit and loss account therefore a change in interest rates at the reporting date would not affect profit and loss account of the Bank.

25.4 **Currency risk**

Foreign exchange risk arises from the fluctuation in the value of financial instruments consequent to the changes in foreign exchange rates. The Bank manages this risk by setting and monitoring dealer, currency and counter-party limits for on and off-balance sheet financial instruments.

Off-balance sheet financial instruments are contracts which are the resultant outcome of the import and export transactions. Moreover, counterparties enter into forward transactions in inter-bank market on behalf of customers to cover-up their position against stipulated risks. The buy and sell transactions are matched in view of their maturities in the different predefined time buckets.

The Bank's exposure to foreign currency risk, based on notional amount, is as follows:

31 December 2018	AFS	USD	EURO	GBP	Total
			Afs '000'		
Financial assets					
Cash and cash equivalents	2,326,874	8,231,752	92,780	80	10,651,486
Investments	-	750,105	43,038	-	793,143
Loans and advances to banks	120,000	-	-	-	120,000
Loans and advances to customers	-	1,530	-	-	1,530
Other assets	71,512	1,108,699	574	-	1,180,785
	2,518,386	10,092,086	136,392	80	12,746,944
Financial liabilities	AFS	USD	EURO	GBP	Total
Deposits from banks	690	-	-	-	690
Deposits from customers	809,710	10,038,149	153,717	310	11,001,886
Other liabilities	7,383	4,320	-	725	12,428
	817,783	10,042,469	153,717	1,035	11,015,004
Net foreign currency exposure	1,700,603	49,617	(17,325)	(955)	1,731,940

31 December 2017

Financial assets					
Cash and cash equivalents	4,969,707	4,919,892	63,132	78	9,952,809
Investments	-	5,025,975	35,916	-	5,061,891
Loans and advances to banks	120,000	585,648	-	-	705,648
Loans and advances to customers	-	1,488	-	-	1,488
Other assets	1,313	67,537	2,943	-	71,793
	5,091,020	10,600,540	101,991	78	15,793,629
Financial liabilities					
Deposits from banks	2,016,143	2,798	-	-	2,018,941
Deposits from customers	1,805,050	11,433,654	206,330	330	13,445,364
Other liabilities	9,516	14,661	-	710	24,887
	3,830,709	11,451,113	206,330	1,040	15,489,192
Net foreign currency exposure	**1,260,311**	**(850,573)**	**(104,339)**	**(962)**	**304,437**

25.4.1 Sensitivity analysis on foreign currency financial assets and liabilities

A 1% strengthening of the Afghani, as indicated below, against the USD, GBP, Euro at 31 December 2018 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

31 December 2018	USD	EURO	GBP	Total
Effect of 1% increase in exchange rate				
Financial assets				
Cash and cash equivalents	(82,318)	(928)	-	(83,246)
Investments	(7,501)	(430)	-	(7,931)
Loans and advances to banks	-	-	-	-
Loans and advances to customers	(15)	-	-	(15)
Other assets	(11,087)	(6)	-	(11,093)
Losses from financial assets	(100,921)	(1,364)	-	(102,285)
Financial liabilities				
Deposits from banks	-	-	-	-
Deposits from customers	100,381	1,537	3	101,921
Other liabilities	43	-	7	50
Gains from financial liabilities	100,424	1,537	10	101,971
Net-unrealized gains on foreign currency	(497)	173	10	(314)

31 December 2017	USD	Euro	GBP	Total
Effect of 1% increase in exchange rate				
Financial assets				
Cash and cash equivalents	(49,199)	(631)	-	(49,830)
Investments	(50,260)	(359)	-	(50,619)
Loans and advances to banks	(5,856)	-	-	(5,856)
Loans and advances to customers	(15)	-	-	(15)
Other assets	(676)	(29)	-	(704)
Losses from financial assets	(106,005)	(1,019)	-	(107,024)
Financial liabilities				
Deposits from banks	28	-	-	28
Deposits from customers	114,337	2,063	3	116,403
Other liabilities	147	-	7	154
Gains from financial liabilities	114,512	2,063	10	116,586
Net-unrealized gains on foreign currency	8,507	1,044	10	9,561

26 **Related parties**

The Bank is a fully owned branch of Bank Alfalah Limited Pakistan. Related parties comprise associated undertakings, majority shareholders, retirement benefit plans, directors of the Head Office of the Bank and the key management personnel of the Bank and its Head Office. Transactions with key management personnel have been carried out as per terms of their employment. Details of transactions and balances with related parties are as follows:

26.1 Transactions with other related parties

Name of group companies	Nature of transactions	2018	2017
		Afs '000'	
Bank Alfalah Limited Bahrain			
	Interest expense on Borrowing	-	801
	Interest income on Interest Rate Swap	3,622	14,050
	Interest received on Interest Rate Swap	-	2,201
	Interest expense on Interest Rate Swap	4,902	26,243
	Interest paid on Interest Rate Swap	-	5,625
Bank Alfalah Limited - Pakistan	Profit remitted to Head Office	-	239,820
	Reimbursement of insurance premium paid to Alfalah Insurance Company Limited	2,647	6,033

26.2 **Transactions with key management personnel**

(a) Deposits from related parties	2018	2017
	Afs '000'	
Deposits at the beginning of the year	84	330
Deposits received during the year	56,534	48,304
Deposits repaid during the year	(55,534)	(48,537)
Exchange rate difference	6	(13)
Deposits at the end of the year	90	84
(b) Salaries and benefits	30,479	28,868

In addition to their salaries, the Bank also provides non-cash benefits to executives which include furnished accommodation

27. Capital Management

Regulatory Capital

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of balance sheets, are:

(i) to comply with the capital requirements set by the DAB;
(ii) to safeguard the Bank's ability to continue as a going concern so that it can continue to be; and
(iii) to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored regularly by the Bank's management. DAB requires each bank to maintain its Tier 1 Capital ratio and Regulatory Capital ratio to be at least 6 % and 12 % respectively. The Bank is maintaining this ratio well above the required level.

The table below summarizes the composition of the regulatory capital and ratio of the Bank:

	2018	2017
	-------- Afs '000' --------	
Tier 1 (Core) Capital:		
Total equity capital	1,731,653	1,401,980
Less:		
Revaluation surplus	131	69,051
Profit for the year	399,557	224,038
	1,331,965	1,108,891
Tier 2 (Supplementary) Capital:		
General reserves as per DAB's regulation, but restricted to 1.25% of total risk-weighted exposure	-	-
Revaluation reserve on bonds (45%)	59	57,024
Profit for the year	399,557	224,038
	399,616	281,062
Tier 2 (Supplementary) Capital (restricted 100% of Tier 1 (Core) Capital)	399,616	281,062
Regulatory Capital = Tier 1 + Tier 2	1,731,581	1,389,953
Risk-weight categories		
0% risk weight:		
Cash in Afghani and fully-convertible foreign currencies	69,728	122,615
Direct claims on DAB	4,214,099	6,989,783
Total	4,283,827	7,112,398
0% risk-weight total (above total x 0%)	-	-
20% risk weight:		
Balances with other banks	7,659,591	4,693,074
20% risk-weight total (above total x 20%)	1,555,918	938,615
50% risk weight:		
Other assets	793,144	5,061,891
50% risk-weight total (above total x 50%)	396,572	2,530,946
100% risk weight:		
All other assets	30,821	417,444
Less: Deferred tax assets	-	-
All other assets - net	30,821	417,444
100% risk-weight total (above total x 100%)	30,821	417,444

Credit conversion factor

0% risk weight:		
Guarantees	**28,466**	680,830
0% credit conversion factor total (risk-weighted total x 0%)	-	-
0% risk-weight total (above total x 0%)	-	-
20% risk weight:		
Guarantees	**192,708**	-
20% risk-weight total (above total x 20%)	**38,542**	-
50% risk weight:		
Guarantees	-	1,349,901
50% risk-weight total (above total x 50%)	-	674,951
100% risk weight:		
Guarantees	-	-
100% credit conversion factor total (risk-weighted total x 100%)	-	-
100% risk-weight total (above total x 100%)	-	-
Total risk-weighted assets	**2,021,863**	4,561,955
Tier 1 Capital Ratio		
(Tier 1 capital as % of total risk-weighted assets)	**65.88%**	24.31%
Regulatory Capital Ratio		
(Regulatory capital as % of total risk-weighted assets)	**85.64%**	30.47%

28. **General**

27.1 Corresponding figures have been reclassified / re-arranged wherever necessary to facilitate comparison in the presentation in the current year. However, there are no material reclassification / re-arrangement to report.

27.2 The figures in these financial statements have been rounded off to the nearest in thousands in AFN.

29. **Date of authorization of financial statements**

These financial statements were authorized for issue by the Country Finance Manager and Acting Country Manager of the Bank on ____________________

Country Finance Manager

Acting Country Manager