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# Independent auditors' report to the Shareholders of Afghan United Bank

Grant Thornton Afghanistan

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## **Opinion**

We have audited the financial statements of Afghan United Bank (the Bank), which comprise the statement of financial position as at December 31, 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

## **Basis for Opinion**

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



### **Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the year ended December 31, 2016. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. We concluded to report following key audit matter.

The provision against non-performing loans and advances as disclosed in note 8.6 of the financial statements amounts to Afs 411.05 million. The management has followed a time-based system-automated provisioning criteria combined with periodic subjective provisioning. For all loans and advances, the identification of impairment event and determination of impairment charge require significant judgment by management, in particular, the timing, quantum, and viability of future cash flows.

In testing the completeness of impairment, we identified a case where specific provision was under-recorded by Afs 2.42 million which was considered insignificant according to our materiality threshold. Overall, we found management to have implemented appropriate controls in determining the quantum of impairment as per DAB specified time-based criteria.

### **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 IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

### **Auditor's Responsibilities for the Audit of the Financial Statements**

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



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From the matters communicated with those charged with governance, we determine the matter that was of most significance in the audit of the financial statements of the current period and is, therefore, the key audit matter. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

*Grant Thornton Afghanistan*

**Grant Thornton Afghanistan**

**Chartered Accountants**

Engagement Partner: Saqib Rehman Qureshi



Kabul, Afghanistan

Date: March 27, 2017





**ANNEXURE – Auditor's Responsibilities**

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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company'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, 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 Company 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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

**AFGHAN UNITED BANK**  
**STATEMENT OF FINANCIAL POSITION**  
**AS AT DECEMBER 31, 2016**

	Note	2016 ..... Afs '000' .....	2015
<b>ASSETS</b>			
Cash and balances with central bank	5	8,545,896	7,944,097
Balances with other banks	6	1,346,359	2,274,301
Investments	7	1,293,680	341,850
Loans and advances to customers	8	6,896,571	6,094,660
Property and equipment	9	1,013,837	1,092,352
Intangible assets	10	11,429	13,094
Other assets	12	1,814,392	1,405,068
<b>Total assets</b>		<b>20,922,164</b>	<b>19,165,422</b>
<b>EQUITY AND LIABILITIES</b>			
<b>EQUITY</b>			
Share capital	13	1,522,030	1,522,030
Revaluation reserve	14	541,683	574,960
Retained earning		59,439	1,523
<b>Total equity</b>		<b>2,123,152</b>	<b>2,098,513</b>
<b>LIABILITIES</b>			
Deposits from customers	15	18,357,459	16,780,372
Deferred tax liability	11	149,441	162,708
Provision for tax		3,585	20,484
Other liabilities	16	288,527	103,345
<b>Total liabilities</b>		<b>18,799,012</b>	<b>17,066,909</b>
<b>Total equity and liabilities</b>		<b>20,922,164</b>	<b>19,165,422</b>

**CONTINGENCIES AND COMMITMENTS**

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

  
 DIRECTOR

  
 CHIEF EXECUTIVE OFFICER

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**AFGHAN UNITED BANK**  
**STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

	Note	2016 ..... Afs '000' .....	2015
Interest income		1,014,666	846,329
Interest expense		(102,466)	(80,379)
<b>Net interest income</b>	17	912,200	765,950
Fee and commission income		341,840	241,708
Fee and commission expense		(27,447)	(19,286)
<b>Net fee and commission income</b>	18	314,393	222,422
Other operating income	19	53,736	126,359
<b>Operating income</b>		1,280,329	1,114,731
Net impairment loss on financial assets	8.6 & 12.2	(602,384)	(610,904)
Net losses on disposal and de-recognition of fixed assets	9	(19,517)	-
Depreciation	9	(38,005)	(46,913)
Amortization	10	(12,100)	(14,779)
Employee compensation	20	(223,440)	(208,534)
Operating lease expenses		(48,074)	(45,182)
Other expenses	21	(262,334)	(221,690)
<b>Profit/ (Loss) before tax</b>		74,475	(33,271)
Income tax expense	22	(16,559)	34,794
<b>Profit/ (Loss) for the year</b>		57,916	1,523
<b>Other comprehensive income</b>			
Profit for the year		57,916	1,523
Incremental (depreciation)/ movement in revaluation		(33,277)	122,808
<b>Total comprehensive income for the year</b>		24,639	124,331

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

  
**DIRECTOR**

  
**CHIEF EXECUTIVE OFFICER**



**AFGHAN UNITED BANK**  
**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

	Share capital	Revaluation reserve	Retained earning	Total
	..... Afs '000' .....			
Balance as at January 01, 2015	1,000,000	452,152	522,030	1,974,182
Total comprehensive income for the year				
Profit for the year	-	-	1,523	1,523
Other comprehensive income	-	122,808	-	122,808
	-	122,808	1,523	124,331
Transactions with owners				
Issuance of shares	522,030	-	(522,030)	-
Balance as at December 31, 2015	<u>1,522,030</u>	<u>574,960</u>	<u>1,523</u>	<u>2,098,513</u>
Balance as at January 01, 2016	1,522,030	574,960	1,523	2,098,513
Total comprehensive income for the year				
Profit for the year	-	-	57,916	57,916
Other comprehensive income	-	(33,277)	-	(33,277)
	-	(33,277)	57,916	24,639
Transactions with owners				
Issuance of shares	-	-	-	-
Balance as at December 31, 2016	<u>1,522,030</u>	<u>541,683</u>	<u>59,439</u>	<u>2,123,152</u>

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

  
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**AFGHAN UNITED BANK**  
**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

	Note	2016 ..... Afs '000' .....	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit before tax		74,475	(33,271)
<b>Adjustments for:</b>			
Net impairment loss on financial assets	8.6	602,384	571,965
Depreciation	9	38,005	46,913
Amortization	10	12,100	14,779
Net (gain)/ loss on disposal of fixed assets		19,517	-
		<u>746,481</u>	<u>600,386</u>
<b>Increase /decrease in current assets and liabilities</b>			
Investments		(951,830)	241,350
Loans and advances to customers		(1,404,295)	(1,280,339)
Other assets		(409,324)	(98,236)
Deposits from customers		1,577,087	1,028,177
Other liabilities		185,087	(21,755)
		<u>(256,794)</u>	<u>469,583</u>
Income tax paid		(46,632)	(58,211)
<b>Net cash generated from/ (used in) operating activities</b>		<u>(303,426)</u>	<u>411,372</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property and equipment		(12,494)	(27,422)
Purchase of intangible assets		(10,435)	(1,539)
Proceeds from disposal of property and equipment		212	-
<b>Net cash used in investing activities</b>		<u>(22,717)</u>	<u>(28,961)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from issue of shares		-	-
<b>Net cash generated from/ (used in) financing activities</b>		<u>-</u>	<u>-</u>
<b>Net increase/ (decrease) in cash and cash equivalents</b>		<u>(326,143)</u>	<u>382,411</u>
Cash and cash equivalents, beginning of year		10,218,398	9,835,987
<b>Cash and cash equivalents, end of year</b>		<u><u>9,892,255</u></u>	<u><u>10,218,398</u></u>

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

  
 DIRECTOR

  
 CHIEF EXECUTIVE OFFICER

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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**1 STATUS AND NATURE OF BUSINESS**

Afghan United Bank ("the Bank") is a commercial bank registered and operating in Afghanistan. The registered office of the bank is located at Shahre Naw, Kabul, Afghanistan.

The bank commenced its operations on October 04, 2007 under the license for commercial banking issued by Da Afghanistan bank (DAB) under the law of banking in Afghanistan. It is a full fledge bank principally engaged in the business of commercial banking with a network of 26 branches (2015: 26 branches) including two full fledge Islamic banking branches in different provinces of Afghanistan. The bank also holds license from Afghanistan Investment Support Agency (AISA) bearing license no: D-27284.

The financial statements for the year ended December 31, 2016 (including comparatives) have been approved and authorized for issue by the board of supervisors on March 27, 2017.

**2 STATEMENT OF COMPLIANCE**

2.1 These financial statements have been prepared in accordance with the requirements of the Law of Banking in Afghanistan, International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as applicable in Afghanistan and directives issued by the Central Bank of Afghanistan (DAB). In case where IFRS requirements differ, the provisions of the law of banking in Afghanistan shall prevail.

**2.2 Standards, amendments and IFRIC interpretations to approved accounting standards that are not yet effective**

The following revised standards, amendments and interpretations with respect to the approved accounting standards will be effective for accounting periods on or after January 01, 2017:

- Amendments to IAS 12 'Income Taxes' are effective for annual periods beginning on or after 1 January 2017. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments further clarify that when calculating deferred tax asset in respect of insufficient taxable temporary differences, the future taxable profit excludes tax deductions resulting from the reversal of those deductible temporary differences. The amendments are not likely to have an impact on unconsolidated financial statements of the Bank.
- Amendments to IAS 7 'Statement of Cash Flows' are part of IASB's broader disclosure initiative and are effective for annual periods beginning on or after 1 January 2017. The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both from cash flow and non - cash changes.

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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- Amendments to IFRS 2 - Share - based Payment clarify the accounting for certain types of arrangements and are effective for annual periods beginning on or after 1 January 2018. The amendments cover three accounting areas (a) measurement of cash - settled share - based payments; (b) classification of share - based payments settled net of tax withholdings; and (c) accounting for a modification of a share - based payment from cash - settled to equity - settled. The new requirements could affect the classification and / or measurement of these arrangements and potentially the timing and amount of expense recognized for new and outstanding awards. The amendments are not likely to have an impact on Bank's unconsolidated financial statements.
- Transfers of Investment Property (Amendments to IAS 40 'Investment Property' effective for annual periods beginning on or after 1 January 2018) clarifies that an entity shall transfer a property to, or from, investment property when, and only when there is a change in use. A change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use. The amendments are not likely to have an impact on Bank's unconsolidated financial statements.
- Annual improvements to IFRS standards 2014 - 2016 cycle. The new cycle of improvements addresses improvements to following approved accounting standards:

Amendments to IFRS 12 'Disclosure of Interests in Other Entities' (effective for annual periods beginning on or after 1 January 2017) clarify that the requirements of IFRS 12 apply to an entity's interests that are classified as held for sale or discontinued operations in accordance with IFRS 5 - 'Non - current Assets Held for Sale and Discontinued Operations'. The amendments are not likely to have an impact on Bank's unconsolidated financial statements.

Amendments to IAS 28 'Investments in Associates and Joint Ventures' (effective for annual periods beginning on or after 1 January 2018) clarifies that a venture capital organization and other similar entities may elect to measure investments in associates and joint ventures at fair value through profit or loss, for each associate or joint venture separately at the time of initial recognition of investment. Furthermore, similar election is available to non-investment entity that has an interest in an associate or joint venture that is an investment entity, when applying the equity method, to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture. The amendments are not likely to have an impact on Bank's unconsolidated financial statements.

IFRIC 22 'Foreign Currency Transactions and Advance Consideration' (effective for annual periods beginning on or after 1 January 2018) clarifies which date should be used for translation when a foreign currency transaction involves payment or receipt in advance of the item it relates to. The related item is translated using the exchange rate on the date the advance foreign currency is received or paid and the prepayment or deferred income is recognized. The date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) would remain the date on which receipt of payment from advance consideration was recognized. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration

The above amendments are not likely to have an impact on Bank's financial statements

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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**3 BASIS OF PREPARATION**

**3.1 Basis of measurement**

These financial statements have been prepared on the historical cost basis except for non-banking assets acquired in satisfaction of claims, financial assets carried at fair value and certain fixed assets (including land, building and other assets revalued as disclosed in note 14 to the financial statements).

**3.2 Use of critical accounting estimates and judgments**

The preparation of financial statements in conformity with approved accounting standards requires management to make judgments, estimates and assumptions that effect the application of accounting policies and reported amount of assets, liabilities, income, and expenses. The estimates and underlying assumptions are reviewed on an ongoing basis. Actual results may differ from these estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future period if the revision affects both current and future periods.

The estimates and judgments that have a significant effect on the financial statements are in respect of the following:

- a) Note 8.6 Provision against non-performing loans and advances to customers
- b) Note 9 Valuation and depreciation rates for fixed assets
- c) Note 11 Deferred taxation
- d) Note 22 Income taxes
- e) Note 12.2 Other assets

**3.2 Functional And Presentation Currency**

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

**4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies adopted in the preparation of these financial statements are consistent with those of the previous financial year, except for certain standards, which became effective during the year. However, these don't have material effect on the financial statements of the Bank

**4.1 Cash and cash equivalents**

For the purposes of cash flow statement, cash and cash equivalents comprise of cash and balances with central bank (unrestricted) and current account balances with other bank less overdrawn nostro account.

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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**4.2 Financial assets and liabilities**

**Recognition, initial measurement and de-recognition**

Financial assets and financial liabilities are recognized when the bank becomes a party to the contractual provisions of the financial instrument and are measured initially at fair value adjusted by transactions costs, except for those carried at fair value through profit or loss which are measured initially at fair value. Subsequent measurement of financial assets and financial liabilities are described below.

Financial asset are de-recognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is de-recognized when it is extinguished, discharged, cancelled or expires.

**Classification and subsequent measurement of financial assets**

For the purpose of subsequent measurement, financial assets other than those designated and effective as hedging instruments are classified into the following categories upon initial recognition:

- a) loans and receivables
- b) financial assets at fair value through profit or loss (FVTPL)
- c) held-to-maturity (HTM) investments
- d) available-for-sale (AFS) financial assets

All financial assets except for those at FVTPL are subject to review for impairment at least at each reporting date to identify whether there is any objective evidence that a financial assets or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described below.

**Held-to-maturity (HTM) investments**

HTM investments are non-derivative financial assets with fixed or determinable payments and fixed maturity other than loans and receivables. Investments are classified as HTM if the bank has the intention and ability to hold them until maturity. This category includes bank holdings of capital notes issued from Da Afghanistan Bank and term placements with other banks

HTM investments are measured subsequently at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in statement of comprehensive income.

**Classification and subsequent measurement of financial liabilities**

Financial liabilities are measured subsequently at amortized cost using the effective interest method, except for financial liabilities held for trading or designated at FVTPL, that are carried subsequently at fair value with gains or losses recognized in statement of comprehensive income.

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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**4.3 Loans and advances**

These are stated net of provisions for non-performing advances and general provisions as required under the law. Provision for non-performing advances is determined in accordance with "Asset Classification and Provisioning Regulation (2015)" issued by DAB and is charged to the statement of comprehensive income. The Bank also maintains general provision in addition to the requirements of the Prudential Regulations on the basis of the management's risk assessment. Advances are charged-off when there are no realistic prospects of recovery.

The provisions made /reversed during the year are charged to the statement of comprehensive income and accumulated provision is netted off against loans and advances. Loans and advances are written off when there is no realistic prospect of recovery or when the regulation requires.

In determining the potential loss in specific loans, groups of loans, or in the aggregate loan portfolio, all relevant factors are considered including, but not limited to current economic conditions, historical loss experience, delinquency trends, the effectiveness of the Bank's lending policies and collection procedures, and the timelines and accuracy of its loan review function.

**Ijarah finance**

In accordance with the requirements of AAOIFI 'Ijarah', assets leased out under ijarah arrangements are stated at cost less depreciation and impairment, if any, and included under Loans and advances. Such assets are depreciated over the terms of Ijarah contracts. Ijarah arrangements executed before the above referred date are accounted for as finance lease.

**Murabaha**

Funds disbursed under murabaha arrangements for purchase of goods are recorded as advance for murabaha. On culmination of murabaha i.e. sale of goods to customers, murabaha receivables are recorded at the sale price net of deferred income. Goods purchased but remaining unsold at the reporting date are recorded as inventories.

The Bank determines provisions against Islamic financing and related assets in accordance with the applicable regulations.

**4.4 Property and equipment**

**Tangible operating assets - owned**

Property and equipment are stated at cost or revalued amounts less accumulated depreciation and accumulated impairment losses thereon. Cost includes expenditure that is directly attributable to the acquisition of fixed assets. Furniture and fixtures, computer equipments and office equipments are stated at revalued amounts less accumulated depreciation.

Subsequent costs are included in the asset's carrying amount or are 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. All other repairs and maintenance expenditures are charged to statement of comprehensive income during the financial period in which they are incurred.

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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Surplus arising on revaluation is credited to the 'revaluation reserve' account (net of deferred tax) whereas deficit (if any) is adjusted against the balance in the above-mentioned surplus account. The revaluation is carried out with sufficient regularity to ensure that the carrying amount does not differ materially from that which would have been determined using fair value at the balance sheet date.

Surplus on revaluation of fixed assets (net of deferred tax) is transferred to other comprehensive income to the extent of incremental depreciation charged on related assets.

Land is not depreciated. Depreciation on all other fixed assets is calculated using the straight line method to allocate their depreciable cost or revalued amount to their residual values over their estimated useful lives. The residual values and useful lives of fixed assets are reviewed, and adjusted (if appropriate) at each balance sheet date.

Net gains and losses on disposal or derecognition of fixed assets are included in statement of comprehensive income currently.

**Leased**

Fixed assets held under finance lease are stated at the lower of fair value of asset and present value of minimum lease payments at the inception of lease, less accumulated depreciation. Financial charges are allocated over the period of lease term so as to provide a constant period rate of financial charge on the outstanding liability. Depreciation is charged on the basis similar to owned assets.

**Intangible operating assets**

Intangibles are stated at cost less accumulated amortization and accumulated impairment losses thereon. Computer software are capitalized on the basis of costs incurred to acquire and bring to use the specific software. Subsequent expenditure on software asset is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

These costs are amortized over their useful lives using the straight line method from the date it is available for use since this most closely reflects the pattern of consumption of the future economic benefits embodied in the asset. The estimated useful life of software is three years. Amortization methods, useful lives and residual values are reassessed at each financial year end and adjusted, if appropriate.

**Impairment of non-financial assets**

The carrying amounts of the bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

**4.5 Taxation**

Income tax expense comprises of current and deferred tax. Income tax expense is recognized in the statement of comprehensive income except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

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**AFGHAN UNITED BANK**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

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**Current**

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

**Deferred**

Deferred tax is provided for using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on temporary differences relating to: (i) the initial recognition of goodwill; (ii) the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profits; and (iii) differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax is measured at tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

As deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

**4.6 Employee compensation**

Short-term employee benefits are measured on an undiscounted basis and are expensed at the related service is provided.

**4.7 Foreign currency transactions**

Transactions in foreign currencies are translated to Afghani at exchange rate prevailing at the date of transaction.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to Afghani at the exchange rate prevailing at that reporting date. Foreign currency differences arising on retranslation are recognized in statement of comprehensive income.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction. Non-monetary items measured at fair value in a foreign currency are translated using exchange rates at the date when the fair value was determined.

**4.8 Revenue recognition**

Mark-up /interest /return on advances and investments is recognized on accrual basis, except in case of advances classified as doubtful or loss under the credit regulations on which mark - up is recognized on receipt basis. Mark-up /interest /return on rescheduled /restructured loans and advances and investments is recognized as permitted by DAB.

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The rentals from ijarah are recognized as income over the term of the contract net of depreciation expense relating to the ijarah assets.

Income from murabaha is accounted for on a time proportionate basis over the period of murabaha transaction.

Gain or loss on sale of investments are recognized in statement of comprehensive income in the year in which these arise.

As per "Asset Classification and Provisioning Regulation (2015)" issued by DAB, accrued interest is reversed on the loans and advances that are classified as doubtful or loss status. Thereafter, interest from such loans and advances is recognized on receipt basis.

Interest income and expense are recognized in the statement of comprehensive income using the effective interest 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 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. The calculation includes all fee paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

**Fee and commission**

Fees and commission income includes account servicing fees and sales commissions and are recognized as the related services are performed.

**4.9 Lease payments**

Payments under operating leases are recognized in statement of comprehensive income on straight line basis over the term of the lease. Lease incentives are recognized as an integral part of the total lease expense, over the term of the lease.

**4.10 Provisions**

Provisions for restructuring costs and legal claims are recognized when:

- a) the bank has present legal or constructive obligation as a result of past events;
- b) it is more likely than not that an outflow of resources will be required to settle the obligation; and
- c) the amount has been reliably estimated.

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The Bank, in the ordinary course of business, issues letters of credit, acceptances, guarantees, bid bonds, performance bonds etc. The commission against such contracts is recognized in the profit and loss account under fee and commission income over the period of contracts. The Bank's liability under such contracts is measured at the higher of the amount representing unearned commission income at the reporting date and the best estimate of the amount expected to settle any financial obligation arising under such contracts.

**4.11 Off-setting**

Financial assets and financial liabilities are set off and the net amount presented in the statement of financial position when, and only when, the bank has a legal right to set off the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Income and expense items of such assets and liabilities are also off - set and the net amount is reported in the financial statements.

**4.12 Dividend and appropriations to reserves**

Dividends and appropriations to reserves are recognized in the year in which these are approved, except appropriations required by the law which are recorded in the period to which they pertain.

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	Note	2016	2015
		..... Afs '000'	.....
<b>5 CASH AND BALANCES WITH CENTRAL BANK</b>			
<b>In hand</b>			
Local currency		840,022	970,116
Foreign currencies		3,128,516	4,239,164
		<u>3,968,538</u>	<u>5,209,280</u>
<b>With Da Afghanistan Bank in:</b>			
Local currency current accounts		723,716	55,498
Foreign currency current accounts		2,600,722	2,581,847
Placements - Capital Notes	5.1	699,277	97,472
Overnight Deposit with Central Bank		553,643	-
		<u>4,577,358</u>	<u>2,734,817</u>
		<u>8,545,896</u>	<u>7,944,097</u>

5.1 This represents capital notes from Da Afghanistan bank carrying interest rate from 1.80% to 3.53% (2015: 5.13%) per annum and having maturity date in January 2017.

**6 BALANCES WITH OTHER BANKS**

	Note	2016	2015
		..... Afs '000'	.....
<b>In Afghanistan</b>			
National Bank of Pakistan		503	342,364
Pashtany Bank		342,419	309,447
New Kabul Bank		-	7
		<u>342,922</u>	<u>651,818</u>
<b>Outside Afghanistan</b>			
Commerz Bank, Germany		-	62,654
CSC Bank, Lebanon		20,007	15,927
Aktif Bank, Turkey		539,946	1,026,236
Axis Bank, China		5,080	511,038
Mashreq Bank, UAE		930	949
Yinzhou Bank, China		-	19
BMCE Bank, Spain		437,475	5,660
		<u>1,003,438</u>	<u>1,622,483</u>
		<u>1,346,359</u>	<u>2,274,301</u>

**7 INVESTMENTS**

<b>Held to maturity</b>			
Aktif Bank, Turkey	7.1	334,100	341,850
Habib Bank - Kabul	7.1	400,920	-
Bank Alfalah, Bahrain	7.1	133,640	-
BMCE Bank, Spain	7.1	233,870	-
Capital Notes with DAB	7.2	191,150	-
		<u>1,293,680</u>	<u>341,850</u>

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- 7.1 This represents foreign currency fixed term placements with local and foreign banks carrying interest ranging from 1.00% to 2.50% (2015: 3.1%) per annum and having maturity by May 2017.
- 7.2 This represents capital notes issued from Da Afghanistan Bank carrying interest rate ranging from 5.15% to 6.66% (2015: 5.13%) per annum. These placements are maturing during May-August 2017.

**8 LOANS AND ADVANCES TO CUSTOMERS**

	Note	2016 ..... Afs '000' .....	2015
<b>Conventional financing</b>			
Running finance	8.2	3,806,767	5,309,287
Term finance	8.3	1,868,789	382,357
		<u>5,675,557</u>	<u>5,691,644</u>
<b>Islamic financing</b>			
Murabaha	8.4	702,529	264,013
Ijara	8.5	839,635	710,968
		<u>7,217,721</u>	<u>6,666,625</u>
Loans and advances to customers - gross			
Provision against non-performing loans and advances	8.6	(321,150)	(571,965)
Loans and advances to customers - net of provision		<u>6,896,571</u>	<u>6,094,660</u>

**8.1 Particulars of loans and advances to customers - gross**

In local currency	963,245	1,149,281
In foreign currencies	6,254,476	5,517,344
	<u>7,217,721</u>	<u>6,666,625</u>

- 8.2 These carry interest ranging between 12% to 16% per annum (2015: 13 % to 16% per annum). All facilities are extended for maximum period of 12 months and are expected to be recovered within 12 months of the reporting date. These are secured against personal guarantees, mortgage of immoveable properties and hypothecation over stock in trade.
- 8.3 These carry interest rate at 10% to 16% per annum (2015: 15% to 16% per annum). These loans have been extended for periods ranging from one year to five years (2015: one year to three years) and are secured against personal guarantees, mortgage of immoveable commercial & residential properties and assignment of receivables.
- 8.4 These represent sale and purchase agreement under which the Bank had paid finance for the purchase of goods and then sold the requisite goods to the customer on profit margin which is ranging from 15% to 17% and per annum (2015: 15% to 18% per annum). These facilities are extended for the period of one month to four years (2015: 8 months to 1 year) and secured against personal guarantees, mortgage of immovable properties and goods supplied under the sale and purchase agreement.
- 8.5 These represent sale and purchase agreement under which the Bank had paid finance for the purchase of goods and then sold the requisite goods to the customer on profit margin which is ranging from 12% to 18% per annum (2015: 14% to 18%).

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	2016	2015
	..... Afs '000' .....	
<b>8.6 Particulars of provision against non-performing loans and advances</b>		
Opening balance	571,965	36,145
Charge for the year	411,048	610,904
Write off during the year	(645,079)	(83,004)
Currency Fluctuation effect	(16,785)	7,920
	(250,815)	535,820
Closing balance	321,150	571,965

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9 PROPERTY AND EQUIPMENT

Note

Land	Office Buildings	Furniture and fixtures	Computer equipment	Vehicles	Office equipment	Total
..... Afs '000' .....						
241,934	1,023,756	67,893	131,154	92,441	92,280	1,649,458
-	-	810	12,676	2	13,934	27,422
-	-	-	-	(17)	-	(17)
-	-	-	-	-	-	-
241,934	1,023,756	68,703	143,830	92,427	106,214	1,676,863
241,934	1,023,756	68,703	143,830	92,427	106,214	1,676,864
-	-	2,521	3,936	886	5,151	12,494
(19,510)	-	(91)	-	-	(265)	(19,866)
-	-	-	-	-	-	-
222,424	1,023,756	71,133	147,766	93,313	111,100	1,669,492
-	160,163	60,070	126,762	78,322	79,022	504,339
-	17,911	4,599	6,665	10,726	7,012	46,913
-	-	-	-	(17)	-	(17)
-	33,276	-	-	-	-	33,276
-	211,350	64,669	133,427	89,031	86,034	584,511
-	211,350	64,669	133,427	89,031	86,034	584,511
-	17,912	2,184	7,462	2,790	7,657	38,005
-	-	(15)	-	-	(121)	(137)
-	33,276	-	-	-	-	33,276
-	262,538	66,838	140,889	91,821	93,570	655,655
241,934	812,406	4,034	10,403	3,396	20,180	1,092,352
222,424	761,218	4,295	6,877	1,492	17,530	1,013,837
Nil	5	20	33	25	25	

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9.1 There were no capitalized borrowing costs related to the acquisition of property and equipment during the year (2015: nil).

9.2 The Bank's land and building were revalued by an independent accredited professional valuer from May 28, 2012 to July 29, 2012. The revaluation resulted in a net surplus of Afs 1,210 million over the book value. Da Afghanistan Bank approved 70% of this surplus on July 21, 2012 which aggregates to Afs 847.22 million. Moreover, furniture and fixtures, computer equipment and office equipment were also revalued by two independent valuers on 31 December 2012. The valuation performed by the valuers was based on active market prices after adjusting for nature, and/or condition of the assets. This revaluation resulted in a net surplus of Afs 29.395 million over the book value. The movement in surplus on revaluation is given in note 14 to the financial statements.

9.3 The gross carrying amount of fully depreciated property and equipment still in use are as follows:

	2016	2015
	..... Afs '000' .....	..... Afs '000' .....
Furniture and fixtures	55,732	49,150
Computer equipment	84,421	81,605
Vehicles	88,001	80,741
Office equipment	42,840	34,971
	<u>270,994</u>	<u>246,467</u>

9.4 This includes de-recognition of land costing Afs. 19.51 million as advised by central bank due to unavailability of the title deeds of the land.

**10 INTANGIBLE ASSETS**

	2016	2015
	..... Afs '000' .....	..... Afs '000' .....
<b>Gross carrying amount</b>		
Opening balance	223,136	221,597
Additions during the year	10,435	1,539
Closing balance	<u>233,571</u>	<u>223,136</u>
<b>Less: Accumulated amortization</b>		
Opening balance	210,042	195,263
Charge for the year	12,100	14,779
Closing balance	<u>222,142</u>	<u>210,042</u>
<b>Written down value</b>	<u>11,429</u>	<u>13,094</u>

10.1 Intangible assets include computer software and licenses which are being amortized over the life of these assets. The amortization rate of intangible assets is 33.33% (2015: 33.33%). The gross carrying amount of fully amortized intangible assets still in use is Afs. 218, 813 thousand.

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**11 DEFERRED TAX ASSETS AND LIABILITIES**

Deferred taxes arising from temporary differences and unused tax losses are summarized as follows:

Deferred tax liabilities (assets)	January 01, 2016	Recognized in		December 31, 2016
		other comprehensive income	income statement	
		..... Afs '000' .....		
Property and equipment	163,598	-	(14,051)	149,547
Intangible assets	2,314	-	(2,420)	(106)
Unused tax losses	(3,204)	-	3,204	-
	162,708	-	(13,267)	149,441
Recognized as:				
- Deferred tax asset	(3,204)	-	3,204	-
- Deferred tax liability	165,912	-	(16,471)	149,441

  

Deferred tax liabilities (assets)	January 01, 2015	Recognized in		December 31, 2015
		other comprehensive income	income statement	
		..... Afs '000' .....		
Property and equipment	360,721	(156,083)	(41,040)	163,598
Intangible assets	8,589	-	(6,275)	2,314
Unused tax losses	(15,725)	-	12,521	(3,204)
	353,585	(156,083)	-	162,708
Recognized as:				
- Deferred tax asset	(15,725)	(15,725)	-	(3,204)
- Deferred tax liability	369,310	156,083	-	165,912

- 11.1** The amounts recognized in other comprehensive income is related to revaluation of land, building, furniture and fixtures, computer equipment and office equipment.

**12 OTHER ASSETS**

	Note	2016	2015
		..... Afs '000' .....	
Advances to suppliers and employees		2,704	4,413
Security deposits		67,287	71,273
Prepayments		50,536	36,548
Receivable from Xpress Money and Money Gram		44,806	8,502
Restricted deposits with Da Afghanistan Bank	12.1	1,390,610	1,193,663
Interest receivables		248,096	75,896
Others	12.2	10,353	14,773
		1,814,392	1,405,068

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**12.1** This represents statutory reserve maintained with DAB as minimum reserve in accordance with Banking Regulations issued by Da Afghanistan Bank. These minimum reserves carry no interest (2015: 0.02548% to 0.0256% per annum).

		<u>2016</u>	<u>2015</u>
		..... Afs '000' .....	
<b>12.2 Others</b>			
Gross amount	12.2.1	201,453	14,773
Provision against other assets		<u>(191,100)</u>	<u>-</u>
		<u>58,128</u>	<u>14,773</u>

**12.2.1** This includes Afs 191.10 million recorded as receivable against employee theft. Being prudent, the management has recorded 100% provision against the receivable however, the accused is currently in the custody of law enforcement bodies and proceedings are underway in Justice Department.

### **13 SHARE CAPITAL**

#### **13.1 Authorized capital**

<u>2016</u>	<u>2015</u>		<u>2016</u>	<u>2015</u>
Number of shares		Note	..... Afs '000' .....	
40,000,000	40,000,000	Ordinary shares of Afs 250 each	<u>10,000,000</u>	<u>10,000,000</u>

#### **13.2 Issued and paid up capital**

<u>2016</u>	<u>2015</u>		<u>2016</u>	<u>2015</u>
Number of shares				
6,088,120	6,088,120	Ordinary shares of Afs 250 each	<u>1,522,030</u>	<u>1,522,030</u>

#### **13.3 Movement in issued and paid up number of shares**

		<u>2016</u>	<u>2015</u>
		Number of shares	
Number of shares at beginning of the year		6,088,120	4,000,000
Shares issued during the year			
- against cash	13.3.1	-	2,088,120
<b>Number of shares at end of the</b>		<u>6,088,120</u>	<u>6,088,120</u>

**13.3.1** This represents transference of retained earnings to the share capital of the Bank. The Bank has also amended its articles of association after approval of Da Afghanistan Bank.

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**14 REVALUATION RESERVE**

	Note	2016 ..... Afs '000' .....	2015
Furniture and fixtures		2,812	2,812
Computer equipment		11,124	11,124
Office equipment		15,458	15,458
Land		149,069	149,069
Building		698,158	698,158
	9.2	<u>876,621</u>	<u>876,621</u>
Accumulated incremental depreciation/adjustment	9.2	(189,587)	(156,311)
Related deferred tax liability		<u>(145,350)</u>	<u>(145,350)</u>
		<u>541,684</u>	<u>574,960</u>

**15 DEPOSITS FROM CUSTOMERS**

Current deposits		11,453,444	9,391,379
Saving deposits	15.1	2,366,891	4,200,952
Term deposits	15.2	1,472,408	1,322,937
Margin deposits		3,064,716	1,865,104
		<u>18,357,459</u>	<u>16,780,372</u>

**15.1** Saving deposits carry interest ranging from 1% to 4% (2015: 1% to 3% per annum) per annum. The profit disbursed during the year on the Islamic saving deposits ranged from 0.33% to 0.50% (2014: 0.49% to 1%) per annum.

**15.2** Term deposits carry interest ranging from 2% to 5% per annum (2015: 2% to 6% per annum), based on the term, with maturity ranging from three to twelve months (2015: three to twelve months). Profit distribution rates on Islamic term deposits during the year ranged from 2% to 4.42% (2015: 0.40% to 6.5%) per annum.

**16 OTHER LIABILITIES**

	2016 ..... Afs '000' .....	2015
Creditors and accruals	27,853	26,221
Auditor's remuneration payable	720	410
Withholding tax payable	2,586	2,491
Murabaha risk and equalization reserve	26,510	21,523
Interest payable	198,567	30,410
Others	32,291	22,290
	<u>288,527</u>	<u>103,345</u>

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**17 NET INTEREST INCOME**

	Note	2016 ..... Afs '000' .....	2015
<b>Interest income</b>			
- On loans and advances to customers		976,899	777,407
- On placements and balances with Da Afghanistan Bank		18,740	46,225
- On held to maturity investments		18,437	21,519
- On overnight deposits with NOSTRO banks		590	1,178
Total interest income		1,014,666	846,329
<b>Interest expense</b>			
Deposits from banks		-	-
Deposits from customers		(102,466)	(80,379)
Total interest expense		(102,466)	(80,379)
<b>Net interest income</b>		912,200	765,950

**18 NET FEE AND COMMISSION INCOME**

<b>Fee and commission income</b>			
- Commission & processing fee on guarantees issued		233,565	121,649
- Commission & processing fee on letters of credit issued		2,209	4,457
- Fund transfer, cheque books issuance fee & other service charges		106,066	115,602
Total fee and commission income		341,840	241,708
<b>Fee and commission expense</b>			
- Inter bank transaction fee		(27,447)	(19,286)
<b>Net fee and commission income</b>		314,393	222,422

**19 OTHER OPERATING INCOME**

Foreign Exchange Gain/ (Loss)	19.1	4,515	76,403
Recovery of written off loans		7,253	298
Loan Processing fee		34,838	46,627
Other income		7,130	3,031
		53,736	126,359
<b>19.1 Foreign Exchange gain / (loss)</b>			
- On dealing in foreign currencies		24,788	32,327
- On translation of monetary assets and liabilities		(20,273)	44,076
		4,515	76,403

**20 EMPLOYEE COMPENSATION**

Salaries and wages	175,421	166,591
BOS remuneration and meeting expenses	15,031	5,089
Other allowances and benefits	32,988	36,854
	223,440	208,534

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**21 OTHER EXPENSES**

	Note	2016 ..... Afs '000' .....	2015
Communication		37,086	31,461
Travelling and conveyance		3,831	5,546
Insurance	21.1	54,715	36,492
Advertisement		19,068	5,839
Fuel expenses		6,402	7,770
Food expenses		478	420
Audit fee		4,810	5,685
Repairs and maintenance		43,739	44,740
Legal and professional charges		1,572	738
Stationery and printing		8,677	3,821
Staff training		2,758	2,415
Utilities		14,070	14,013
Security services		54,387	56,153
Miscellaneous expenses		10,741	6,597
		<u>262,334</u>	<u>221,690</u>

21.1 These represents charges paid to Afghan Deposit Insurance Corporation (ADIC) @0.30% per annum (2015: @0.23% per annum) of the total deposits as required by Da Afghanistan Bank.

**22 INCOME TAX EXPENSE**

The major components of tax expense and the reconciliation of the expected tax expense based on the effective tax rate of 20% (2015: 20%) and the reported tax expense in profit or loss are as follows:

	Note	2016 ..... Afs '000' .....	2015
<b>Taxation:</b>			
Current		29,826	-
Deferred		(13,267)	(34,794)
		<u>16,559</u>	<u>(34,794)</u>
<b>Reconciliation:</b>			
Accounting profit / (loss) before adjustments		74,475	(33,271)
Adjustments for non deductible expenses and temporary differences		34,572	17,252
Taxable profit / (loss) carried forward		109,047	(16,019)
Applicable rate		20%	20%
		<u>21,809</u>	<u>(3,204)</u>
Prior period adjustment		11,221	15,725
Origination and reversal of temporary differences		(16,471)	(47,315)
		<u>16,559</u>	<u>(34,794)</u>

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**23 RELATED PARTY TRANSACTIONS**

**Parent and ultimate controlling party**

The Bank is owned by individual shareholders who owns Bank's shares in different proportions.

**Key management personnel**

Key management personnel includes Board of Supervisors, Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Credit Officer, Chief Risk Officer and Chief HR and Administration Officer

**Transactions with related parties**

Transactions and balances with related parties, including remuneration and benefits paid to key management personnel under the terms of their employment are as follows:

	Balances		Transactions	
	2016	2015	2016	2015
	Afs '000'			
<b>Shareholders</b>				
Loans and advances	94,009	445,373	-	-
Interest income	-	-	51,663	38,793
<b>Transactions with key management personnel</b>				
Short term employee benefits				
Salary and other benefits	-	-	29,910	24,093

- 23.1** In addition to salaries and remuneration, Bank also provides non-cash benefits to executives which include furnished accommodation, meal and travel cost.

2016	2015
..... Afs '000'	.....

**24 CONTINGENCIES AND COMMITMENTS**

Letter of credits and guarantees issued on behalf of customers	7,882,682	6,308,627
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This include outstanding BGs amounting to Afs. 741.9 million (2015: 446.24 million) issued in Islamic mode of finance.

**Commitment for operating lease**

- not later than one year	43,479	45,182
- later than one year and not later than five year	173,916	180,728
	217,395	225,910

Currently, tax assessment for the tax year 2014 is under process by the authorities, of which financial impact is not known till the date of issuance of these financial statements.

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25 FINANCIAL ASSETS AND LIABILITIES

Categories of financial assets and financial liabilities

Note 4.2 provides a description of each category of financial assets and financial liabilities and the related accounting policies. The carrying amounts of financial assets and financial liabilities in each category are as follows:

		Available for sale financial assets	Held for trading (FVTPL)	Derivatives used for hedging	Held to maturity	Loans and receivables	Total	
	Note	(carried at fair value)			(carried at amortized cost)			
		..... Afs '000' .....						
<b>December 31, 2016</b>								
<b>Financial assets</b>								
Cash and balances with central bank	5	-	-	-	-	8,545,896	8,545,896	
Balances with other banks	6	-	-	-	-	1,346,359	1,346,359	
Investments	7	-	-	-	1,293,680	-	1,293,680	
Loans and advances to customers	8	-	-	-	-	6,896,571	6,896,571	
Other assets	12	-	-	-	-	1,763,856	1,763,856	
		-	-	-	1,293,680	18,552,683	19,846,363	
			Derivatives used for hedging	Designated at FVTPL	Other liabilities at FVTPL	Other liabilities (amortized cost)	Total	
	Note		(carried at fair value)					
			..... Afs '000' .....					
<b>Financial liabilities</b>								
Deposits from customers	15		-	-	-	18,357,459	18,357,459	
Other liabilities	16		-	-	-	288,527	288,527	
			-	-	-	18,645,986	18,645,986	

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		Available for sale financial assets	Held for trading (FVTPL)	Derivatives used for hedging	Held to maturity	Loans and receivables	Total
	Note	(carried at fair value)			(carried at amortized cost)		
		..... Afs '000' .....					
December 31, 2015							
Financial assets							
Cash and balances with central bank	5	-	-	-	-	7,846,625	7,846,625
Balances with other banks	6	-	-	-	-	2,274,301	2,274,301
Investments	7	-	-	-	439,322	-	439,322
Loans and advances to customers	8	-	-	-	-	6,094,660	6,094,660
Other assets	12	-	-	-	-	1,354,002	1,354,002
		-	-	-	439,322	17,569,588	18,008,910

		Derivatives used for hedging	Designated at FVTPL	Other liabilities at FVTPL	Other liabilities (amortized cost)	Total
	Note	(carried at fair value)				
		..... Afs '000' .....				
<b>Financial liabilities</b>						
Deposits from customers	15	-	-	-	16,780,372	16,780,372
Other liabilities	16	-	-	-	100,859	100,859
		-	-	-	16,881,231	16,881,231

The carrying values approximate fair values as mostly the assets and liabilities have short maturities and are expected to be recovered/settled at their carrying values.

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## 26 FINANCIAL RISK MANAGEMENT

### 26.1 Introduction and overview

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

- a) credit risks
- b) liquidity risks
- c) market risks
- d) operational risks

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

#### **Risk management framework**

The Board of Supervisor has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Management Board, Risk Management ommittee and Credit Committee which are responsible for developing and monitoring Bank's risk management policies in their specified areas. All committees have both executive and non-executive members and report regularly to the Board of Supervisors on their activities.

The Board's Audit and Risk Committees are responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by the Internal Audit and Compliance department whereas Risk Committee is provided frequent feedback by Risk Department.

#### **a) Credit risk**

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and placements with other banks. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure.

#### **Management of credit risk**

The Bank has both Board of Management and Board of Supervisors level Credit Committees to mitigate the credit risks. Credit department reporting to the Credit Committee is responsible for managing the Bank's credit risk while the Board is responsible for oversight of same. The credit department is headed by Chief Credit Officer (CCO). Credit officer along with credit department staff look after credit risk matters and conduct portfolio analysis 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. 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 amount of credit risk is represented by the carrying amounts of the assets on the balance sheet date. Exposure to credit risk is managed through regular analysis of borrower to met 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 dully registered with the court of law and hypothecation over stock dully verified by the Bank's Credit Officer on monthly basis.

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**Exposure to credit risk**

The Bank's maximum exposure to credit risk is the carrying amount of financial assets at the reporting date, as summarized below:

	2016	2015
	..... Afs '000' .....	
<b>Classes of financial assets</b>		
Cash and balances with central bank	4,577,358	2,734,817
Balances with other banks	1,346,359	2,274,301
Investments	1,293,680	341,850
Loans and advances to customers	6,896,571	6,094,660
Other assets	1,763,856	1,354,002
<b>Total carrying amounts</b>	<u>15,877,825</u>	<u>12,799,630</u>

As at balance sheet date, all the loan portfolio of the Bank is recoverable and all the assets which are past due are provided for as per DAB guidelines.

In addition to the above, the Bank has issued financial guarantees' and letter of credits contracts for which the maximum amount payable by the Bank assuming all guarantees /letter of credits (less margin) are called on, is Afs. 7,882.68 million (2015: Afs. 6,308.60 million).

The Bank's management considers that all the above financial assets that are not impaired or past due for the reporting dates under review are of good credit quality. The credit risk for cash and balances with central bank, balances with other banks, investments and other assets are considered negligible.

**Allowances for impairment**

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

**Write-off policy**

The Bank writes off loans or advances and any related allowances for impairment losses, when the loans are outstanding for more than 361 days, as per DAB regulation. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position 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.

The Bank holds collateral against loans and advances in the form of property documents, pledge of stocks and scratch cards, assignment of receivables and guarantees.

**Settlement risk**

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

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**Concentration of credit risks by industry**

The Bank monitors concentrations of credit risk by industry. An analysis of concentrations of credit risk of loans and advances to customers at reporting date is as follows:

	Note	<u>2016</u>	<u>2015</u>
		..... Afs '000'	.....
<b>Carrying amount</b>	8	<u>7,217,721</u>	<u>6,666,625</u>
<b>Concentration by sector</b>			
Construction		1,169,583	471,865
Communication		1,959,228	986,789
Services		1,172,503	564,913
Commercial/ trading		1,572,872	523,215
Manufacturing		70,736	198,955
Others		<u>1,272,799</u>	<u>3,920,888</u>
		<u>7,217,721</u>	<u>6,666,625</u>

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**b) Liquidity risk**

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

**Management of liquidity risk**

The Board ensures that the Bank has necessary tools and framework to cater the requirements of liquidity risk management and the Bank is capable to confronting uneven liquidity scenarios. The Bank's management is responsible for the implementation of sound policies and procedures keeping in view the strategic direction and risk appetite specified by the Board. Asset & Liability Committee (ALCO) is entrusted with the responsibility of managing the mismatch in maturities to ensure sufficient available cash flow to meet possible withdrawal of deposits, other commitment or challenges associated with sudden changes in market conditions, whilst enabling the Bank to pursue valued business opportunities. 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 Bank relies on deposits from customers as its primary source of funding. Deposits from customers generally have shorter maturities and large proportion of them are repayable on demand. For day to day liquidity risk management, the management relies on several liquidity scenarios to ensure that the Bank is best prepared to respond to any unexpected problem.

**Exposure to liquidity risk**

The key measure used by the Bank for managing liquidity risk is the ratio of net liquidity 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:

	2016	2015
At the end of the year	48%	51%
Average for the year	54%	55%
Maximum for the year	57%	56%
Minimum for the year	48%	51%

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Maturity analysis for financial liabilities

	Note	Carrying amount	Gross nominal outflow	Less than 1 month	1-3 months	3 months to 1 year	More than 01 to 05 years
..... Afs '000' .....							
<b>December 31, 2016</b>							
Deposits from customers	15	18,357,459	(18,357,459)	(11,453,444)	(2,366,891)	(4,537,124)	-
Other liabilities	16	288,527	(288,527)	(262,017)	-		(26,510)
		<u>18,645,986</u>	<u>(18,645,986)</u>	<u>(11,715,461)</u>	<u>(2,366,891)</u>	<u>(4,537,124)</u>	<u>(26,510)</u>
<b>December 31, 2015</b>							
Deposits from customers	15	16,780,372	(16,780,372)	(9,391,379)	(4,200,952)	(3,188,041)	-
Other liabilities	16	103,350	(103,350)	(81,827)	-		(21,523)
		<u>16,883,722</u>	<u>(16,883,722)</u>	<u>(9,473,206)</u>	<u>(4,200,952)</u>	<u>(3,188,041)</u>	<u>(21,523)</u>

The above table shows the undiscounted cash flows on the Bank's financial liabilities on the basis of their earliest possible contractual maturity. The gross nominal outflow disclosed in the above table is the contractual, undiscounted cash flow on the financial liability.

c) **Market risk**

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's/ issuer's credit standing) will affect the Bank's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

**Management of market risks**

Overall authority for market risk is vested in Assets and Liability Committee (ALCO). The Bank's ALCO is responsible for the development of detailed risk management policies and day to day review of their implementation. Risk management department scope covers the market risk identification, evaluation and reporting back with its recommendation to the management.

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**Exposure to interest rate risk**

The risk to which Banks' portfolios are exposed is the risk of loss from fluctuations in the future flows or fair values of financial instrument because of change in market interest rates. Interest rate risk managed principally through monitoring interest rate gaps and by having pre-approved limits for re-pricing bands. ALCO is the monitoring body for compliance with these limits and is assisted by Risk Management in its day to day monitoring activities. A summary of the Bank's interest rate gap position on non-trading portfolio is as follows:

	Note	Carrying amount	Less than 3 months	3 - 6 months	6 - 12 months	1 - 5 years	More than 5 years
..... Afs '000' .....							
<b>December 31, 2016</b>							
Cash and balances with central bank	5	699,277	699,277	-	-	-	-
Investments	7	1,293,679	-	1,199,992	93,687	-	-
Loans and advances to customers	8	7,217,721	1,400,885	828,956	2,679,215	2,308,665	-
Other assets	12	-	-	-	-	-	-
		<u>9,210,677</u>	<u>2,100,163</u>	<u>2,028,948</u>	<u>2,772,902</u>	<u>2,308,665</u>	<u>-</u>
Deposits from customers	15	<u>3,839,299</u>	<u>2,366,891</u>	<u>1,472,408</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>December 31, 2015</b>							
Cash and balances with central bank	5	97,472	97,472	-	-	-	-
Investments	7	341,850	-	-	341,850	-	-
Loans and advances to customers	8	6,666,625	2,900,890	1,567,014	2,198,721	-	-
Other assets	12	1,193,663	1,193,663	-	-	-	-
		<u>8,299,610</u>	<u>4,192,025</u>	<u>1,567,014</u>	<u>2,540,571</u>	<u>-</u>	<u>-</u>
Deposits from customers	15	<u>5,523,889</u>	<u>4,200,952</u>	<u>1,322,937</u>	<u>-</u>	<u>-</u>	<u>-</u>
		<u>5,523,889</u>	<u>2,366,891</u>	<u>1,472,408</u>	<u>-</u>	<u>-</u>	<u>-</u>

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Exposure to currency risk

The Bank's exposure to foreign currency risk based on notional amounts are as follows:

	Note	Total	Afs	USD	EURO	OTHERS
..... Afs '000' .....						
<b>December 31, 2016</b>						
Cash and balances with central bank	5	8,545,896	2,816,658	5,352,919	359,756	16,563
Balances with other banks	6	1,346,360	344,540	643,404	71,349	287,067
Investments	7	1,293,680	191,150	1,102,530	-	-
Loans and advances to customers	8	7,217,721	963,245	6,254,476	-	-
Other assets	12	1,877,188	1,496,730	380,458	-	-
		20,280,844	5,812,322	13,733,787	431,105	303,630
Deposits from customers	15	(18,357,459)	(4,243,466)	(13,679,487)	(413,725)	(20,781)
Other liabilities	16	(288,527)	(55,653)	(232,778)	(92)	(4)
		(18,645,986)	(4,299,119)	(13,912,265)	(413,817)	(20,785)
<b>Net foreign currency exposure</b>		<b>1,634,858</b>	<b>1,513,203</b>	<b>(178,478)</b>	<b>17,288</b>	<b>282,845</b>
<b>December 31, 2015</b>						
Cash and balances with central bank	5	7,944,097	1,123,086	6,461,781	345,998	13,232
Balances with other banks	6	2,274,301	286,248	1,742,112	1,711	244,230
Investments	7	341,850	-	341,850	-	-
Loans and advances to customers	8	6,666,625	1,149,281	5,517,344	-	-
Other assets	12	1,394,963	1,295,706	99,257	-	-
		18,621,836	3,854,321	14,162,344	347,709	257,462
Deposits from customers	15	(16,780,372)	(2,520,553)	(13,928,093)	(328,844)	(2,881)
Other liabilities	16	(103,350)	(60,970)	(42,356)	(25)	-
		(16,883,722)	(2,581,523)	(13,970,449)	(328,869)	(2,881)
<b>Net foreign currency exposure</b>		<b>1,738,114</b>	<b>1,272,798</b>	<b>191,895</b>	<b>18,840</b>	<b>254,581</b>

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	December 31, 2016		December 31, 2015	
	Average rate	Reporting date rate	Average rate	Reporting date rate
USD	67.84	66.82	63.35	68.37
EURO	74.76	70.01	72.67	74.48

#### Sensitivity analysis

A 10% strengthening of the Afghani, as indicated below, against the USD and EURO at December 31, 2016 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.

	December 31, 2016		December 31, 2015	
	Equity	Profit or loss	Equity	Profit or loss
	..... Afs '000' .....			
USD	14,278	17,848	(15,352)	(19,189)
Euro	(1,383)	(1,729)	(1,507)	(1,884)

A 10% weakening of the Afghani against the above currencies at December 31, 2016 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

#### d) Operational risk

The Bank currently uses Basic Indicator Approach to Operational Risk for regulatory capital calculations. We define the operational risk as the risk of loss resulting from inadequate or failed internal processes, people and system or from external events. With the evolution of Operations Risk Management into a separate distinct discipline, the Bank's strategy is to further strengthen its risk management system along new industry standards. Accordingly the Bank has set up a separate Operational Risk Management function within Risk Management department. Bank's operational risk management process involves a structured and uniform approach across the Bank. It includes risk identification and assessments, the monitoring of Key Risk Indicators and Risk Control Self-Assessment activities for key operational risks.

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**27 CAPITAL MANAGEMENT**

**Regulatory capital**

The Banks' regulator Da Afghanistan Bank sets and monitors capital requirements for the Bank. The capital adequacy of the Bank is assessed in two tiers as per regulations of the Da Afghanistan Bank.

- Tier 1 or core capital, consisting of the highest quality capital elements that fully meet all the essential characteristics of capital; to be 6% of risk weighted assets.
- Tier 2 or supplementary capital, which includes other instruments which, to a varying degree, fall short of the quality of Tier 1 capital, but nonetheless contribute to the overall strength of a bank as a going concern.
- Regulatory capital is the sum of Tier 1 and Tier 2 capital. Besides, Tier 2 capital cannot exceed from total amount of Tier 1 capital. The Bank complies with these regulations.

The Bank's regulatory capital position at December 31, 2016 was as follows:

	2016	2015
	..... Afs '000' .....	
<b>Tier 1 capital</b>		
Total Equity	2,123,152	2,098,513
Less:		
Intangible assets	11,429	13,094
Profit for the year	57,916	1,523
Surplus on revaluation	541,683	574,960
	611,028	589,577
<b>Total tier 1 (core) capital</b>	1,512,124	1,508,936
<b>Tier 2 capital</b>		
Profit for the year	57,916	1,523
Surplus on revaluation	541,683	574,960
<b>Total tier 2 (supplementary) capital</b>	599,599	576,483
<b>Total regulatory capital</b>	2,111,723	2,085,419

**28 POST REPORTING DATE EVENTS**

No adjusting or significant non-adjusting events have occurred between the reporting date, December 31, 2016 and the date of authorization of these financial statements.

**29 CORRESPONDING FIGURES**

Corresponding figures have been rearranged and reclassified, wherever necessary, for the purpose of comparison and better presentation.

  
**DIRECTOR**

  
**CHIEF EXECUTIVE OFFICER**

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