

Azer-Turk Bank Open Joint Stock Company

Financial statements

*Year ended 31 December 2018
together with independent auditor's report*

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Independent auditor's report

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Independent auditor's report

To the Shareholders and Management Board of
Azer-Turk Bank OJSC

Opinion

We have audited the financial statements of Azer-Turk Bank OJSC (the "Bank"), which comprise the statement of financial position as at 31 December 2018, and the statement of profit or loss, 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 31 December 2018, 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 for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of management and Audit Committee 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.

The Audit Committee is responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

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

22 April 2019

Baku, Azerbaijan

Statement of financial position**As at 31 December 2018***(Figures in tables are in thousands of Azerbaijani manats)*

	Notes	2018	2017
Assets			
Cash and cash equivalents	5	120,792	170,306
Amounts due from credit institutions	6	15,746	26,061
Loans to customers	7	165,326	116,730
Investment securities	8	51,827	4,053
Property and equipment	9	5,626	6,421
Intangible assets	10	3,076	2,570
Current income tax assets		483	804
Deferred income tax assets	11	-	371
Other assets	13	3,980	2,868
Total assets		366,856	330,184
Liabilities			
Amounts due to credit institutions and government organizations	14	90,337	74,476
Amounts due to customers	15	220,008	200,584
Deferred income tax liabilities	11	95	-
Other liabilities	13	4,522	3,800
Total liabilities		314,962	278,860
Equity			
Share capital	16	50,000	50,000
Retained earnings		1,855	1,324
Fair value reserve		39	-
Total equity		51,894	51,324
Total liabilities and equity		366,856	330,184

Signed and authorized for release on behalf of the Management Board of the Bank:

Orkhan Huseynov

Chairman of the Management Board

Orkhan Gadirbey

Deputy Chairman of the Management Board

22 April 2019

Statement of profit or loss**For the year ended 31 December 2018***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	2018	2017
Interest income			
Loans to customers		12,553	13,661
Amounts due from credit institutions		2,837	2,747
Investment securities		1,536	200
Net interest income calculated using the effective interest method		16,926	16,608
Other interest income		54	--
		16,980	16,608
Interest expense			
Amounts due to customers		(5,286)	(3,888)
Amounts due to credit institutions and government organizations		(2,281)	(2,458)
		(7,567)	(6,346)
Net interest income		9,413	10,262
Credit loss reversal/(expense) on financial assets	8, 12	5,186	(65)
Net interest income after credit loss reversal/(expense)		14,599	10,197
Net fee and commission income	18	3,955	3,963
Net gains/(losses) from foreign currencies:			
- dealing		3,516	4,107
- translation differences		(220)	(1,072)
Other income	19	184	1,040
Non-interest income		7,435	8,038
Personnel expenses	20	(9,666)	(8,457)
General and administrative expenses	20	(7,812)	(7,145)
Depreciation and amortization	9, 10	(2,008)	(1,983)
Impairment of investment securities available-for-sale		X	(135)
Provision reversal for credit losses on guarantees and credit related commitments		892	986
Other impairment and provisions expense		-	(175)
Non-interest expenses		(18,594)	(16,909)
Profit before income tax expense		3,440	1,326
Income tax expense	11	(1,326)	(398)
Profit for the year		2,114	928

The accompanying notes on pages 6 to 48 are an integral part of these financial statements.

Statement of comprehensive income**For the year ended 31 December 2018***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	2018	2017
Profit for the year		2,114	928
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i>			
Unrealised losses on investment securities available-for-sale		X	(103)
Impairment of investment securities available-for-sale reclassified to the statement of profit or loss		X	103
Net change in fair value of debt instruments at fair value through other comprehensive income		49	X
Income tax relating to components of other comprehensive income	11	(10)	-
Other comprehensive income for the year, net of tax		39	-
Total comprehensive income for the year		2,153	928

The accompanying notes on pages 6 to 48 are an integral part of these financial statements.

Statement of changes in equity**For the year ended 31 December 2018***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Share capital</i>	<i>Fair value reserve</i>	<i>Retained earnings</i>	<i>Total equity</i>
31 December 2016	50,000	-	2,296	52,296
Profit for the year	-	-	928	928
Total comprehensive income for the year	-	-	928	928
Dividends declared and paid (Note 16)	-	-	(1,900)	(1,900)
31 December 2017	50,000	-	1,324	51,324
Impact of adopting IFRS 9 (Note 3)	-	-	(655)	(655)
Restated opening balance under IFRS 9	50,000	-	669	50,669
Profit for the year	-	-	2,114	2,114
Other comprehensive income for the year	-	39	-	39
Total comprehensive income for the year	-	39	2,114	2,153
Dividends declared and paid (Note 16)	-	-	(928)	(928)
31 December 2018	50,000	39	1,855	51,894

The accompanying notes on pages 6 to 48 are an integral part of these financial statements.

Statement of cash flows**For the year ended 31 December 2018***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	2018	2017
Cash flows from operating activities			
Interest received		15,378	17,697
Interest paid		(5,748)	(6,010)
Fees and commissions received		7,335	6,330
Fees and commissions paid		(3,609)	(2,745)
Net realized gains from currency dealing operations		3,327	4,107
Personnel expenses paid		(10,364)	(8,455)
General and administrative expenses paid		(7,923)	(7,048)
Other income received		28	6
Cash flows (used in)/from operating activities before changes in operating assets and liabilities		(1,576)	3,882
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		10,025	95,412
Loans to customers		(42,991)	24,563
Other assets		(1,093)	(485)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to credit institutions and government organizations		16,600	(99,051)
Amounts due to customers		17,367	(30,142)
Other liabilities		3,327	(2,588)
Net cash flows from/(used in) operating activities before income tax		1,659	(8,409)
Income tax paid		(385)	(265)
Net cash from/(used in) operating activities		1,274	(8,674)
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities		162,473	33,862
Purchase of investment securities		(209,810)	(33,654)
Purchase of property and equipment		(966)	(422)
Proceeds from sale of property and equipment		-	11
Acquisition of intangible assets		(962)	(720)
Net cash used in investing activities		(49,265)	(923)
Dividends paid to shareholders of the Bank	16	(928)	(1,900)
Net cash used in financing activities		(928)	(1,900)
Effect of exchange rates changes on cash and cash equivalents		(595)	(2,523)
Net decrease in cash and cash equivalents		(49,514)	(14,020)
Cash and cash equivalents, beginning		170,306	184,326
Cash and cash equivalents, ending	5	120,792	170,306

The accompanying notes on pages 6 to 48 are an integral part of these financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

Azer-Turk Bank Open Joint Stock Company (the "Bank") was incorporated in the Republic of Azerbaijan in May 1995. The Bank is regulated by the Financial Markets Supervision Authority of Republic of Azerbaijan (the "FMSA") and conducts its business under license number 234.

The Bank's principal business activity is corporate and retail banking operations. This includes deposit taking and commercial lending in freely convertible currencies and in Azerbaijani manat ("AZN"), transfer payments in Azerbaijan and abroad, support of clients' export/import transactions, foreign currency exchange and other banking services to its commercial and retail customers.

As at 31 December 2018, the Bank's network comprised of head office, 1 customer service department, 6 branches and 3 unit service (2017: head office, 1 customer service department, 6 branches and 3 unit service).

The number of Bank's employees as at 31 December 2018 was 389 (2017: 370).

The Bank's registered address is 85, J. Mammadguluzade str., 192/193, Baku, AZ1078, Azerbaijan.

As at 31 December, the following shareholders owned the outstanding shares of the Bank:

<i>Shareholder</i>	<i>2018, %</i>	<i>2017, %</i>
Government of the Republic of Azerbaijan	75.00	75.00
T.C. Ziraat Bankasi A.Ş.	12.37	12.37
"AzRe Reinsurance" OJSC	6.55	6.55
"Qala Life" Insurance Company OJSC	5.00	5.00
"Ziraat Bank International AG"	1.08	1.08
Total	100.00	100.00

As at 31 December 2018 and 2017, the ultimate shareholder of the Bank is the Government of the Republic of Azerbaijan as represented by the State Committee on Property Issues of Azerbaijan Republic (the "Government").

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Azerbaijani manat ("AZN") is the functional and presentation currency of the Bank as the majority of transactions are denominated, measured, or funded in AZN. Transactions in other currencies are treated as transactions in foreign currencies. The Bank is required to maintain its records and prepare its financial statements in AZN and in accordance with IFRS. The financial statements are presented in thousands of AZN except per share amounts and unless otherwise indicated. The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, investment securities have been measured at fair value.

3. Summary of accounting policies

Changes in accounting policies

The Bank applied IFRS 15 and IFRS 9 for the first time. The nature and effect of the changes as a result of adoption of these new accounting standards are described below.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods on or after 1 January 2018. The 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 arising from the adoption of IFRS 9 have been recognised directly in retained earnings as at 1 January 2018 and are disclosed below.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)**Changes in accounting policies (continued)***(a) Classification and measurement*

Under IFRS 9, all debt financial assets that do not meet a "solely payment of principal and interest" (SPPI) criterion, are classified at initial recognition as fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a "basic lending arrangement", such as instruments containing embedded conversion options or "non-recourse" loans, are measured at FVPL. For debt financial assets that meet the SPPI criterion, classification at initial recognition is determined based on the business model, under which these instruments are managed:

- ▶ Instruments that are managed on a "hold to collect" basis are measured at amortised cost;
- ▶ Instruments that are managed on a "hold to collect and for sale" basis are measured at fair value through other comprehensive income (FVOCI);
- ▶ Instruments that are managed on other basis, including trading financial assets, will be measured at FVPL.

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realised and unrealised gains and losses, except for dividend income, are recognised in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remains largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL. Embedded derivatives are no longer separated from a host financial asset.

(b) Impairment

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan impairment by replacing IAS 39 incurred loss approach with a forward-looking expected credit loss (ECL) approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

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 21. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in section (c) below.

(c) Effect of transition to IFRS 9

The following tables set out the impact of adopting IFRS 9 on the statement of financial position and retained earnings as at 1 January 2018 including the effect of replacing IAS 39 incurred credit loss calculations with IFRS 9 ECL.

<i>Financial assets</i>	<i>Ref</i>	<i>IAS 39 measurement</i>		<i>Reclas- sification</i>	<i>Remeasure- ment</i>	<i>IFRS 9</i>	
		<i>Category</i>	<i>Amount</i>			<i>Amount</i>	<i>Category</i>
Cash and cash equivalents		L&R ¹	170,306	–	–	170,306	Amortised cost
Amounts due from credit institutions		L&R	26,061	–	–	26,061	Amortised cost
Loans to customers – amortised cost		L&R	116,730	(653)	(473)	115,604	Amortised cost
Loans to customers – FVPL	A	–	–	653	558	1,211	FVPL (mandatory)
Investment securities – debt securities at FVOCI		AFS ²	4,008	–	–	4,008	FVOCI (debt)
Investment securities – equity securities at FVOCI	B	AFS	45	–	–	45	FVOCI (equity)
Other financial assets – amortised cost		L&R	238	–	–	238	Amortised cost
Non-financial assets							
Deferred tax assets			371	–	164	535	
Total assets			317,759	–	249	318,008	
Non-financial liabilities							
Provisions			1,280	–	904	2,184	
Total liabilities			1,280	–	904	2,184	

¹ L&R: Loans and receivables.

² AFS: Available-for-sale.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

- A As at 1 January 2018, the Bank's analysis highlighted that certain loans to customers did not meet the SPPI criterion. Therefore, these loans previously measured at amortised cost are classified by Bank as loans to customers at FVPL.
- B The Bank has elected the option to irrevocably designate its previous AFS equity instruments as Equity instruments at FVOCI.

The impact of transition to IFRS 9 on reserves and retained earnings is as follows:

	<u>Reserves and retained earnings</u>
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	1,324
Re-measurement impact of reclassifying financial assets held at amortised cost to FVPL	558
Recognition of IFRS 9 ECL and other re-measurement effects, including those measured at FVOCI	(1,377)
Deferred tax in relation to the above	164
Restated opening balance under IFRS 9 (1 January 2018)	<u>669</u>
Total change in equity due to adopting IFRS 9	<u>(655)</u>

The following table reconciles the aggregate opening loan loss allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 *Provisions Contingent Liabilities and Contingent Assets* to the ECL allowances under IFRS 9.

	<u>Loan loss allowance / provision under IAS 39 / IAS 37 at 31 December 2017</u>	<u>Re-measurement</u>	<u>ECL under IFRS 9 at 1 January 2018</u>
Impairment allowance for			
Loans and receivables at amortised cost	(20,465)	(1,466)	(21,931)
Financial guarantees and letters of credit	(1,280)	(904)	(2,184)
	<u>(21,745)</u>	<u>(2,370)</u>	<u>(24,115)</u>

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the Bank's revenue including interest revenue, gains/(losses) on operations with securities which are covered by IFRS 9 *Financial Instruments*.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Considerations

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transactions for each payment or receipt of advance consideration. This Interpretation does not have any impact on the Bank's financial statements.

Fair value measurement

The Bank measures financial instruments carried at FVPL and FVOCI at fair value at each balance sheet date.

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. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- ▶ In the principal market for the asset or liability; or
- ▶ In the absence of a principal market, in the most advantageous market for the asset or liability.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- ▶ Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- ▶ Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- ▶ Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Financial assets and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets and liabilities are recognised on the trade date i.e. the date that the Bank commits to purchase the asset or liability. Regular way purchases or sales are purchases or sales of financial assets and liabilities that require delivery of assets and liabilities within the period generally established by regulation or convention in the marketplace

Initial measurement

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 and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

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:

- ▶ Amortised cost;
- ▶ FVOCI;
- ▶ FVPL.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Amounts due from credit institutions, loans to customers, investments securities at amortised cost

Before 1 January 2018, amounts due from credit institutions and loans 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 amounts due from credit institutions, loans to customers, investment debt securities 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 on the principal amount outstanding (SPPI).

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 realised 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

As a second step of its classification process the Bank assesses the contractual terms of financial asset 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 amortisation 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 judgement 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 de minimis 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Debt instruments at FVOCI

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.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest revenue and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

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 amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the asset.

Equity instruments at FVOCI

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 equity under IAS 32 *Financial 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 or loss. Dividends are recognised in profit or loss as other 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. Upon disposal of these instruments, the accumulated revaluation reserve is transferred to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and – under IAS 37 (before 1 January 2018) – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 (from 1 January 2018) – an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

Loans and receivables

Before 1 January 2018, loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were not entered into with the intention of immediate or short-term resale and were not classified as trading securities or designated as investment securities available-for-sale. Such assets were carried at amortised cost using the effective interest method. Gains and losses were recognised in profit or loss when the loans and receivables were derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Before 1 January 2018, available-for-sale financial assets were those non-derivative financial assets that were designated as available-for-sale or were not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets were measured at fair value with gains or losses being recognised in other comprehensive income until the investment was derecognised or until the investment was determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income was reclassified to the statement of profit or loss. However, interest calculated using the effective interest method was recognised in profit or loss.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

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 changes the business model for managing financial assets. Financial liabilities are never reclassified.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to customers, amounts due to the government organizations and amounts due to credit institutions. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortization process.

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into general and administrative expenses.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- ▶ The normal course of business;
- ▶ The event of default; and
- ▶ The event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

From 1 January 2018, the Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes. Restructuring of impaired loans does not result in derecognition of financial instrument. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- ▶ Change in currency of the loan;
- ▶ Change in counterparty;
- ▶ If the modification is such that the instrument would no longer meet the SPPI criterion.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Renegotiated loans (continued)

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, presented within interest income calculated using EIR in the statement of profit or loss, to the extent that an impairment loss has not already been recorded.

Impairment of financial assets under IAS 39

Before 1 January 2018, the Bank assessed at each reporting date whether there was any objective evidence that a financial asset or a group of financial assets was impaired. A financial asset or a group of financial assets was deemed to be impaired if, and only if, there was objective evidence of impairment as a result of one or more events that had occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that could be reliably estimated. Evidence of impairment may have included indications that the borrower or a group of borrowers was experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they would enter bankruptcy or other financial reorganisation and where observable data indicated that there was a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlated with defaults. For available-for-sale financial instruments, evidence of impairment also included significant or prolonged decline in fair value of investment below its cost.

The Bank assessed whether objective evidence of impairment existed individually for financial assets that were individually significant, or collectively for financial assets that were not individually significant.

If there was an objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred), discounted using original effective interest rate, or, for financial assets available-for-sale, as the difference between cost of investment and its fair value. The carrying amount of the asset was reduced and the amount of the loss was recognised in profit or loss. Interest income continued to be accrued on the reduced carrying amount based on the original effective interest rate of the asset, or, for financial assets available-for-sale, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Assets together with the associated allowance were written off when there is no realistic prospect of future recovery and all collateral had been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss decreased because of an event occurring after the impairment had been recognised, the previously recognised impairment loss was reversed in statement of profit or loss, except for equity investments available-for-sale, for which increase in their fair value after impairment were recognised in other comprehensive income.

For the purpose of a collective evaluation of impairment, financial assets were grouped on the basis of the Bank's internal credit grading system that considered credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that were collectively evaluated for impairment were estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience was adjusted on the basis of current observable data to reflect the effects of current conditions that had not affected the years on which the historical loss experience was based and to remove the effects of conditions in the historical period that did not exist currently. Estimates of changes in future cash flows reflected, and were directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that were indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows were reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Information on impairment assessment under IFRS 9 is presented in Note 21.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- ▶ The rights to receive cash flows from the asset have expired;
- ▶ The Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; and
- ▶ The Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Write-off

From 1 January 2018, financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Azerbaijan also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of general and administrative expenses.

Current and deferred taxes are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity, respectively.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Property and equipment (continued)

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Furniture and fixtures	5-10
Computer	5
Vehicles	5
Other fixed assets	5-8
Leasehold Improvements	14

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of ten years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Provisions

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Azerbaijan, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank does not provide post-retirement benefits to its employees.

Share capital

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

Dividends

Dividends are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

Contingencies

Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but disclosed when an inflow of economic benefits is probable.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

From 1 January 2018, the Bank calculates interest income on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying EIR to the amortized cost of financial assets). EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest revenue on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in "Other interest revenue" in the statement of profit or loss.

Fees and commissions

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- ▶ Income earned from the provision of service is recognized as revenue as the service are provided (for example, servicing plastic card operations, settlement operations, cash operations and others);
- ▶ Income which forms an integral part of the effective interest rate of a financial instrument is recognized as an adjustment to the effective interest rate and recorded in 'interest income'.

Dividend income

Revenue is recognized when the Bank's right to receive the payment is established.

Foreign currency translation

The financial statements are presented in Azerbaijani manat, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss as net gains (losses) from foreign currency translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains from dealing operations.

The Bank used the following official exchange rates at 31 December in the preparation of these financial statements:

	2018	2017
1 US dollar	AZN 1.7000	AZN 1.7001
1 euro	AZN 1.9468	AZN 2.0307

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Bank plans to adopt IFRS 16 retrospectively with the cumulative effect of initially applying IFRS 16 recognised at the date of initial application. The Bank will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Bank will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as at the date of initial application, and lease contracts for which the underlying asset is of low value. The Bank has not yet determined the effect the standard will have on its financial statements.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- ▶ Whether an entity considers uncertain tax treatments separately;
- ▶ The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- ▶ How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates;
- ▶ How an entity considers changes in facts and circumstances.

An entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Bank will apply the interpretation from its effective date. Since the Bank operates in a complex tax environment, applying the interpretation may affect its financial statements. In addition, the Bank may need to establish processes and procedures to obtain information that is necessary to apply the interpretation on a timely basis.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Amendments to IFRS 9 Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the financial statements of the Bank.

Annual improvements 2015-2017 cycle (issued in December 2017)

These improvements include:

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognises the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events.

An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period. Since the Bank's current practice is in line with these amendments, the Bank does not expect any effect on its financial statements.

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 22.

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, 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 judgements 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 segmentation of financial assets when their ECL is assessed on a collective basis;
- ▶ Development of ECL models, including the various formulae and the choice of inputs;
- ▶ Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs;
- ▶ Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

More details are provided in Notes 8 and 21.

(Figures in tables are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2018	2017
Cash on hand	18,695	31,834
Current accounts with the CBAR	11,096	47,693
Current accounts with other banks	22,246	9,230
Cash in transit	33,250	4,065
Time deposits with the CBAR up to 90 days	35,505	75,784
Time deposits with credit institutions up to 90 days	-	1,700
Cash and cash equivalents	120,792	170,306

Current accounts with other banks consist of correspondent account balances with resident and non-resident banks in the amount of AZN 118 thousand (2017: AZN 217 thousand) and AZN 22,128 thousand (2017: AZN 9,013 thousand), respectively.

As at 31 December 2017, time deposits with credit institutions up to 90 days consist of interest bearing short-term deposit placed in one non-resident bank in the amount of AZN 1,700 thousand.

All balances of cash equivalents are allocated to Stage 1. As at 1 January and 31 December 2018 ECL relating to cash and cash equivalents rounds to zero.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2018	2017
Time deposits for more than 90 days	10,318	18,780
Blocked accounts with credit institutions	3,352	5,788
Obligatory reserve with the CBAR	1,351	1,493
Loans to credit institutions	725	-
Amounts due from credit institutions	15,746	26,061

As at 31 December 2018, time deposits for more than 90 days include interest bearing time deposits in the amount of AZN 1,714 thousand (2017: nil) and AZN 8,604 thousand (2017: AZN 18,780 thousand) placed in one resident credit institution (2017: nil) and in two non-resident credit institutions (2017: two non-resident credit institutions), respectively.

As at 31 December 2018, blocked accounts with credit institutions represented funds blocked by one (2017: two) non-resident credit institutions against letters of guarantee (2017: letters of credit) issued to sixteen customers (2017: eight customers).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 0.5% (2017: 0.5%) of the previous month average balances in AZN and 1% (2017: 1%) of the previous month average balances in foreign currencies respectively, attracted from customers by the credit institution. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

Loans to credit institutions represent two loans issued to two resident non-bank credit institutions.

All balances of due from credit institutions are allocated to Stage 1. As at 1 January and 31 December 2018 ECL relating to amounts due from credit institutions rounds to zero.

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers

Loans to customers comprise:

	2018	2017
Loans to individuals-consumer	51,271	24,231
Corporate loans	48,442	33,129
Loans to individuals-mortgage	48,239	26,606
Loans to government owned entities	27,818	43,051
Loans to individuals-entrepreneurship	6,116	10,178
Gross loans to customers at amortised cost	181,886	137,195
Less: allowance for impairment	(17,088)	(20,465)
Loans to customers at amortised cost	164,798	116,730
Corporate loans	528	X
Loans to customers at FVPL	528	X
Loans to customers	165,326	116,730

Loans to customers at FVPL

Loans to customers at FVPL are mostly represented by project financing loans that are economically or contractually non-recourse. Information on fair value measurement of Loans to customers at FVPL is presented in Note 22.

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the gross carrying value and corresponding ECL in relation to individuals-consumer loans during the year ended 31 December 2018 is as follows:

<i>Loans to individuals-consumer</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2018	21,132	470	2,851	24,453
New assets originated or purchased	35,620	-	-	35,620
Assets repaid	(7,657)	(377)	(1,391)	(9,425)
Transfers to Stage 1	125	(62)	(63)	-
Transfers to Stage 2	(564)	569	(5)	-
Transfers to Stage 3	(360)	(32)	392	-
Unwinding of discount	-	-	51	51
Recoveries	-	-	596	596
Amounts written off	-	-	(24)	(24)
At 31 December 2018	48,296	568	2,407	51,271

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

<i>Loans to individuals-consumer</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	(413)	(67)	(1,857)	(2,337)
New assets originated or purchased	(217)	-	-	(217)
Assets repaid	166	38	1,174	1,378
Transfers to Stage 1	(48)	20	28	-
Transfers to Stage 2	36	(41)	5	-
Transfers to Stage 3	81	15	(96)	-
Impact on period end ECL of exposures transferred between stages during the period	47	(85)	(78)	(116)
Unwinding of discount (recognised in interest revenue)	-	-	(51)	(51)
Changes to models and inputs used for ECL calculations	106	-	(29)	77
Recoveries	-	-	(596)	(596)
Amounts written off	-	-	24	24
At 31 December 2018	(242)	(120)	(1,476)	(1,838)

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate loans during the year ended 31 December 2018 is as follows:

<i>Corporate loans</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2018	12,653	3,963	16,201	32,817
New assets originated or purchased	26,483	-	-	26,483
Assets repaid	(7,590)	(1,195)	(2,065)	(10,850)
Transfers to Stage 1	2,217	(2,217)	-	-
Transfers to Stage 2	-	248	(248)	-
Transfers to Stage 3	-	(551)	551	-
Unwinding of discount	-	-	419	419
Recoveries	-	-	-	-
Amounts written off	-	-	(427)	(427)
At 31 December 2018	33,763	248	14,431	48,442

<i>Corporate loans</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	(1,299)	(1,059)	(10,699)	(13,057)
New assets originated or purchased	(2,031)	-	-	(2,031)
Assets repaid	771	409	1,128	2,308
Transfers to Stage 1	(922)	922	-	-
Transfers to Stage 2	-	(165)	165	-
Transfers to Stage 3	-	130	(130)	-
Impact on period end ECL of exposures transferred between stages during the period	838	(263)	278	853
Unwinding of discount (recognised in interest revenue)	-	-	(419)	(419)
Changes to models and inputs used for ECL calculations	220	-	-	220
Recoveries	-	-	-	-
Amounts written off	-	-	427	427
At 31 December 2018	(2,423)	(26)	(9,250)	(11,699)

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)**Allowance for impairment of loans to customers at amortised cost (continued)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to loans individuals-mortgage during the year ended 31 December 2018 is as follows:

<i>Loans to individuals-mortgage</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2018	26,611	-	-	26,611
New assets originated or purchased	22,731	-	-	22,731
Assets repaid	(1,103)	-	-	(1,103)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	(199)	199	-	-
Transfers to Stage 3	(61)	-	61	-
Unwinding of discount	-	-	-	-
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
At 31 December 2018	47,979	199	61	48,239

<i>Loans to individuals-mortgage</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	(252)	-	-	(252)
New assets originated or purchased	(107)	-	-	(107)
Assets repaid	10	-	-	10
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	2	(2)	-	-
Transfers to Stage 3	1	-	(1)	-
Impact on period end ECL of exposures transferred between stages during the period	-	(61)	(20)	(81)
Unwinding of discount (recognised in interest revenue)	-	-	-	-
Changes to models and inputs used for ECL calculations	121	-	-	121
Recoveries	-	-	-	-
Amounts written off	-	-	-	-
At 31 December 2018	(225)	(63)	(21)	(309)

An analysis of changes in the gross carrying value and corresponding ECL in relation to loans to government owned entities during the year ended 31 December 2018 is as follows:

<i>Loans to government owned entities</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2018	41,102	-	2,009	43,111
New assets originated or purchased	-	-	-	-
Assets repaid	(13,284)	-	(1,678)	(14,962)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Unwinding of discount	-	-	-	-
Recoveries	-	-	-	-
Amounts written off	-	-	(331)	(331)
At 31 December 2018	27,818	-	-	27,818

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)**Allowance for impairment of loans to customers at amortised cost (continued)**

<i>Loans to government owned entities</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	(86)	-	(1,828)	(1,914)
New assets originated or purchased	-	-	-	-
Assets repaid	59	-	1,497	1,556
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	-	-	-	-
Unwinding of discount (recognised in interest revenue)	-	-	-	-
Changes to models and inputs used for ECL calculations	9	-	-	9
Recoveries	-	-	-	-
Amounts written off	-	-	331	331
At 31 December 2018	(18)	-	-	(18)

An analysis of changes in the gross carrying value and corresponding ECL in relation to loans individuals-entrepreneurship during the year ended 31 December 2018 is as follows:

<i>Loans to individuals-entrepreneurship</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Gross carrying value as at 1 January 2018	3,529	1,042	5,972	10,543
New assets originated or purchased	693	-	-	693
Assets repaid	(3,009)	(831)	(1,339)	(5,179)
Transfers to Stage 1	159	(159)	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	(139)	-	139	-
Unwinding of discount	-	-	110	110
Recoveries	-	-	-	-
Amounts written off	-	-	(51)	(51)
At 31 December 2018	1,233	52	4,831	6,116

<i>Loans to individuals-entrepreneurship</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	(282)	(217)	(3,872)	(4,371)
New assets originated or purchased	(43)	-	-	(43)
Assets repaid	254	176	826	1,256
Transfers to Stage 1	(42)	42	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	24	-	(24)	-
Impact on period end ECL of exposures transferred between stages during the period	21	(14)	(28)	(21)
Unwinding of discount (recognised in interest revenue)	-	-	(110)	(110)
Changes to models and inputs used for ECL calculations	6	8	-	14
Recoveries	-	-	-	-
Amounts written off	-	-	51	51
At 31 December 2018	(62)	(5)	(3,157)	(3,224)

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

A reconciliation of the allowance for impairment of loans to customers by class during the year ended 31 December 2017 is as follows:

	<i>Loans to government owned entities</i>	<i>Corporate loans</i>	<i>Loans to individuals- consumer</i>	<i>Loans to individuals- entrepreneur ship</i>	<i>Loans to individuals- mortgage</i>	<i>Total</i>
At 1 January 2017	(1,149)	(13,042)	(7,161)	(6,121)	(150)	(27,623)
Reversal of allowance/(charge) for the year	489	(5,160)	2,815	2,087	(296)	(65)
Recovery	-	-	(227)	-	-	(227)
Amounts written off	-	4,249	2,896	305	-	7,450
At 31 December 2017	(660)	(13,953)	(1,677)	(3,729)	(446)	(20,465)
Individual impairment	-	(8,802)	-	(2,097)	-	(10,899)
Collective impairment	(660)	(5,151)	(1,677)	(1,632)	(446)	(9,566)
	(660)	(13,953)	(1,677)	(3,729)	(446)	(20,465)
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	-	13,474	-	2,969	-	16,443

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For corporate and governmental lending, charges over real estate properties and blocked cash;
- ▶ For retail lending, mortgages over residential properties.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement during its review of the adequacy of the allowance for loan impairment. As at 31 December 2018, maximum exposure of collateralized loans in Stage 3 amounted to AZN 19,715 for which ECL of AZN 12,244 was recognized. If these loans were not collateralized, ECL amount for these loans would be AZN 17,793.

Concentration of loans to customers

Loans are made principally in the following industry sectors:

	2018	2017
Individuals	99,510	50,835
Transport	27,780	39,112
Oil and gas	10,727	-
Trading enterprises	8,367	8,255
Manufacturing	7,257	8,376
Agriculture and food processing	7,397	7,623
Metallurgy	5,338	5,743
Telecommunication	4,680	4,082
Other	11,358	13,169
Loans to customers, gross	182,414	137,195

Corporate loan granted to an entity operating in transport sector amounting to AZN 26,334 thousand (2017: AZN 36,350 thousand) was provided by the funds received from the Ministry of Finance of the Republic of Azerbaijan.

As at 31 December 2018, the Bank had a concentration of loans represented by AZN 49,806 thousand or 27% of gross loan portfolio (2017: AZN 58,018 thousand or 42%) due from ten (2017: ten) largest borrowers of the Bank. An allowance of AZN 5,451 thousand (2017: AZN 5,978 thousand) was recognized against these loans.

(Figures in tables are in thousands of Azerbaijani manats)

8. Investment securities

Investment securities comprises:

	2018	2017
Debt securities at FVOCI		
Notes issued by the CBAR	47,470	X
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	4,312	X
	<u>51,782</u>	<u>X</u>
Equity securities at FVOCI		
Corporate shares	45	X
	<u>45</u>	<u>X</u>
Total investment securities	<u>51,827</u>	<u>X</u>
Investment securities available-for-sale		
Corporate bonds	X	4,008
Corporate shares	X	45
	<u>X</u>	<u>4,053</u>

All balances of investment securities are allocated to Stage 1. As at 1 January and 31 December 2018 ECL relating to investment securities rounds to zero.

9. Property and equipment

The movements in property and equipment were as follows:

	<i>Furniture and fixtures</i>	<i>Computer</i>	<i>Vehicles</i>	<i>Other fixed assets</i>	<i>Leasehold improvements</i>	<i>Total</i>
Cost						
31 December 2016	3,599	3,034	959	219	2,776	10,587
Additions	54	157	-	30	25	266
Disposals	(22)	-	-	-	-	(22)
31 December 2017	<u>3,631</u>	<u>3,191</u>	<u>959</u>	<u>249</u>	<u>2,801</u>	<u>10,831</u>
Additions	226	409	38	16	209	898
Disposals	(81)	(103)	-	(38)	-	(222)
31 December 2018	<u>3,776</u>	<u>3,497</u>	<u>997</u>	<u>227</u>	<u>3,010</u>	<u>11,507</u>
Accumulated depreciation						
31 December 2016	(1,102)	(943)	(394)	(60)	(254)	(2,753)
Depreciation charge	(688)	(558)	(183)	(44)	(195)	(1,668)
Disposals	11	-	-	-	-	11
31 December 2017	<u>(1,779)</u>	<u>(1,501)</u>	<u>(577)</u>	<u>(104)</u>	<u>(449)</u>	<u>(4,410)</u>
Depreciation charge	(672)	(577)	(170)	(45)	(206)	(1,670)
Disposals	73	100	-	26	-	199
31 December 2018	<u>(2,378)</u>	<u>(1,978)</u>	<u>(747)</u>	<u>(123)</u>	<u>(655)</u>	<u>(5,881)</u>
Net book value						
31 December 2016	<u>2,497</u>	<u>2,091</u>	<u>565</u>	<u>159</u>	<u>2,522</u>	<u>7,834</u>
31 December 2017	<u>1,852</u>	<u>1,690</u>	<u>382</u>	<u>145</u>	<u>2,352</u>	<u>6,421</u>
31 December 2018	<u>1,398</u>	<u>1,519</u>	<u>250</u>	<u>104</u>	<u>2,355</u>	<u>5,626</u>

As at 31 December 2018, property and equipment amounting to AZN 791 thousand (2017: AZN 795 thousand) were fully depreciated.

(Figures in tables are in thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost			
31 December 2016	1,021	2,036	3,057
Additions	71	103	174
31 December 2017	1,092	2,139	3,231
Additions	106	780	886
Disposals	(110)	(25)	(135)
31 December 2018	1,088	2,894	3,982
Accumulated amortization			
31 December 2016	(260)	(86)	(346)
Amortization charge	(103)	(212)	(315)
31 December 2017	(363)	(298)	(661)
Amortization charge	(98)	(240)	(338)
Disposal	82	11	93
31 December 2018	(379)	(527)	(906)
Net book value			
31 December 2016	761	1,950	2,711
31 December 2017	729	1,841	2,570
31 December 2018	709	2,367	3,076

11. Taxation

The corporate income tax expense comprises:

	<i>2018</i>	<i>2017</i>
Current tax charge	(706)	(501)
Deferred tax (charge)/credit – origination and reversal of temporary differences	(630)	103
Less: deferred tax recognised in other comprehensive income	10	-
Income tax expense	(1,326)	(398)

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	<i>2018</i>	<i>2017</i>
Net gains on debt instruments designated at FVOCI	(10)	X
Income tax charged to other comprehensive income	(10)	X

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax charge based on statutory rates with actual is as follows:

	<i>2018</i>	<i>2017</i>
Profit before tax	3,440	1,326
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	(688)	(265)
Tax effect of non-deductible expenses	(182)	(163)
Prior year tax actualization	(456)	-
Other	-	30
Income tax charge	(1,326)	(398)

(Figures in tables are in thousands of Azerbaijani manats)

11. Taxation (continued)

Deferred tax assets and liabilities as at 31 December 2018 and their movements for the respective years comprise:

	Origination and reversal of temporary differences			Origination and reversal of temporary differences			2018	
	2016	In the statement of profit or loss	In other comprehensive income	2017	Effect of adoption of IFRS 9 (Note 3)	In the statement of profit or loss		In other comprehensive income
		loss	income		loss	income		
Tax effect of deductible temporary differences								
Loans to customers	761	(134)	-	627	(17)	(532)	-	78
Investment securities	50	27	-	77	-	(30)	-	47
Other liabilities	668	(302)	-	366	181	(84)	-	463
Other assets	-	5	-	5	-	17	-	22
Deferred tax assets	1,479	(404)	-	1,075	164	(629)	-	610
Tax effect of taxable temporary differences								
Cash and cash equivalents	(203)	173	-	(30)	-	4	-	(26)
Amounts due from credit institutions	(231)	195	-	(36)	-	36	-	-
Amount due to customers	(215)	(63)	-	(278)	-	(28)	-	(306)
Loan to customers	-	-	-	-	-	(43)	-	(43)
Investment securities	-	-	-	-	-	-	(10)	(10)
Intangible assets	(79)	20	-	(59)	-	(22)	-	(81)
Property and equipment	(264)	72	-	(192)	-	99	-	(93)
Other assets	(219)	110	-	(109)	-	(37)	-	(146)
Deferred tax liabilities	(1,211)	507	-	(704)	-	9	(10)	(705)
Net deferred tax assets/(liabilities)	268	103	-	371	164	(620)	(10)	(95)

12. Credit loss expense

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2018:

	Note	Stage 1	Stage 2	Stage 3	Total
Loans to customers at amortised cost		(638)	1,129	4,695	5,186
Credit loss on financial assets		(638)	1,129	4,695	5,186
Financial guarantees	17	482	-	391	873
Letter of credits	17	19	-	-	19
Credit related commitments		501	-	391	892
Total credit loss		(137)	1,129	5,086	6,078

Provisions for guarantees and commitments are recorded in other liabilities.

13. Other assets and liabilities

Other assets comprise:

	2018	2017
Other financial assets		
Settlements on money transfers	1,139	228
Settlements on operations with plastic cards	155	10
Total other financial assets	1,294	238
Other non-financial assets		
Reposessed collaterals	1,502	1,099
Prepayments for acquisition of property, equipment and intangible assets	905	761
Settlement with government budget	-	677
Deferred expenses	279	93
Total other non-financial assets	2,686	2,630
Other assets	3,980	2,868

(Figures in tables are in thousands of Azerbaijani manats)

13. Other assets and liabilities (continued)

All balances of other assets are allocated to Stage 1. As at 1 January and 31 December 2018 ECL relating to other assets rounds to zero.

Other liabilities comprise:

	2018	2017
Other financial liabilities		
Funds in settlement	1,953	1,597
Dividends payable	-	51
Total other financial liabilities	1,953	1,648
Other non-financial liabilities		
Accrued expenses	378	376
Payable to employees	374	307
Provision for contingent liabilities (Note 17)	1,292	1,280
Deferred income	277	189
Settlements with government budget	248	-
Total other non-financial liabilities	2,569	2,152
Other liabilities	4,522	3,800

14. Amounts due to credit institutions and government organizations

Amounts due to credit institutions and government organizations comprise:

	2018	2017
Time deposits and loans	26,421	36,437
Amounts due to the Azerbaijan Mortgage Fund	43,388	24,864
Current accounts	17,490	9,567
Loans received from the National Fund for Support of Entrepreneurship	2,607	3,537
Blocked accounts	431	71
Amounts due to credit institutions and government organizations	90,337	74,476
Held as security against letters of guarantee (Note 17)	91	71
Held as security against loans issued to credit institutions (Note 6)	340	-

As at 31 December 2018, the Bank had time deposit placed by the Ministry of Finance in the amount of AZN 26,421 thousand (2017: AZN 36,437 thousand) that matures during 2021 and bears interest rate of monthly LIBOR plus 1.75% p.a. The fund was used for refinancing loan to one related party company. The loan issued matures in 2021 and bears interest rate monthly LIBOR plus 2% p.a.

On 23 December 2010, the Bank signed a credit agreement with the National Fund for Support of Entrepreneurship, a program under the Ministry of Economic Development of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Under this program, funds are made available to the Bank at an interest rate of 1% p.a. (2017: 1% p.a.) which matures through 2019-2023 (2017: 2018-2021). The Bank uses these funds to issue loans to eligible borrowers at rate of 6% p.a.

On 20 December 2006, the Bank signed a credit agreement with the Azerbaijan Mortgage Fund, a program under the CBAR, for granting long term mortgage loans to individuals. Under this program, funds are made available to the Bank at an interest rate of 1-4% p.a. (2017: 1-4% p.a.) which matures through in 2019-2048 (2017: 2019-2047). The Bank relends these funds to eligible borrowers at rates not higher than 8.0% p.a.

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to customers

The amounts due to customers include the following:

	<u>2018</u>	<u>2017</u>
Current accounts	144,508	127,705
Time deposits	75,500	72,879
Amounts due to customers	<u>220,008</u>	<u>200,584</u>
Held as security against letters of guarantee (Note 17)	890	268
Held as security against loans to customers	13,297	852

At 31 December 2018, the Bank had amounts due to 10 (2017: 10) largest customers with aggregate balance of AZN 112,127 thousand or 51% of total amounts due to customers (2017: AZN 103,251 thousand or 51%).

Customer accounts by economic sectors are as follows:

	<u>2018</u>	<u>2017</u>
Individuals	113,414	77,000
Insurance companies and other non-bank financial institutions	50,504	30,081
State and public organizations	18,892	25,914
Trade and services	15,845	15,161
Manufacturing	8,907	525
Construction	7,451	49,156
Transportation and communication	2,724	1,892
Agriculture	943	83
Other	1,328	772
Amounts due to customers	<u>220,008</u>	<u>200,584</u>

16. Equity

Movements in ordinary shares outstanding, issued and fully paid were as follows:

	<i>Number of ordinary shares</i>	<i>Nominal amount per ordinary share, Azerbaijani manat</i>	<i>Total, Azerbaijani manat</i>
31 December 2016	50,000,000	1	50,000,000
Increase in share capital	-	-	-
31 December 2017	50,000,000	1	50,000,000
Increase in share capital	-	-	-
31 December 2018	<u>50,000,000</u>	<u>1</u>	<u>50,000,000</u>

The share capital of the Bank was contributed by shareholders in Azerbaijani manat and they are entitled to dividends and any capital distribution in Azerbaijani manat.

According to the decision of the General Shareholders' Meeting held on 4 May 2017, the Bank declared dividends in respect of the year ended 31 December 2016, totalling AZN 1,900 thousand (including 10% withholding tax to be paid on behalf of shareholders) on ordinary shares. The dividends were fully paid during 2017.

According to the decision of the General Shareholders' Meeting held on 27 June 2018, the Bank declared dividends in respect of the year ended 31 December 2017, totalling AZN 928 thousand (including 10% withholding tax to be paid on behalf of shareholders) on ordinary shares. The dividends were fully paid during 2018.

Fair value reserve

This reserve records fair value changes on available-for-sale investments (before 1 January 2018) and financial assets at-FVOCI (after 1 January 2018).

(Figures in tables are in thousands of Azerbaijani manats)

17. Commitment and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan economy is largely dependent upon these reforms and the effectiveness of economic, financial and monetary measures undertaken by the government as well as crude oil prices and stability of Azerbaijani manat.

The Azerbaijan economy has been negatively impacted by decline of oil prices and devaluation of Azerbaijani manat against USD during 2015. This resulted in reduced access to capital, a higher cost of capital, inflation and uncertainty regarding economic growth.

In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support to financial system. On 6 December 2016 President of the Republic of Azerbaijan approved "Strategic road maps for the national economy and main economic sectors of Azerbaijan". The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond 2025.

Furthermore, during 2018 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani manat. During 2018, CBAR gradually reduced refinancing rate from 15% to 9.75% with aim of normalising monetary policy.

The Bank's management is monitoring economic developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Bank's business in the foreseeable future.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities.

Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit covered second quarter of 2015 and third quarter of 2016.

Management's interpretation of the relevant legislation as at 31 December 2018 is appropriate and the Bank's tax, currency and customs positions will be sustained.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions.

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2018, the Bank was in compliance with these ratios.

Financial commitments and contingencies

The Bank provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorizing a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

*(Figures in tables are in thousands of Azerbaijani manats)***17. Commitment and contingencies (continued)****Financial commitments and contingencies (continued)**

The undrawn loan commitment agreements stipulate the right of the Bank to unilaterally withdraw from the agreement should any conditions unfavourable to the Bank arise, including change of the refinance rate, inflation, exchange rates and others.

As at 31 December, the Bank's financial commitments and contingencies comprised the following:

	2018	2017
Credit related commitments		
Guarantees	36,032	23,960
Undrawn loan commitments	14,953	16,833
Letters of credit	272	158
Less – provisions for ECL for credit related commitments	(1,292)	(1,280)
Less – deposits held as security against letters of guarantee (Note 14, 15)	(981)	(339)
	<u>48,984</u>	<u>39,332</u>
Operating lease commitments		
Not later than 1 year	1,024	192
Later than 1 year but no later than 5 years	602	–
	<u>1,626</u>	<u>192</u>
Commitments and contingencies	<u>50,610</u>	<u>39,524</u>

An analysis of changes in the ECLs during the year ended 31 December 2018 is as follows:

<i>Financial guarantees</i>	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2018	(1,770)	–	(391)	(2,161)
New exposures	(876)	–	–	(876)
Exposures derecognised or matured (excluding write-offs)	843	–	–	843
Transfers to Stage 1	(391)	–	391	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	376	–	–	376
Changes to inputs used for ECL calculations	530	–	–	530
At 31 December 2018	<u>(1,288)</u>	<u>–</u>	<u>–</u>	<u>(1,288)</u>

<i>Letters of credit</i>	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2018	(23)	–	–	(23)
New exposures	(1)	–	–	(1)
Exposures derecognised or matured (excluding write-offs)	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	–
Changes to inputs used for ECL calculations	20	–	–	20
At 31 December 2018	<u>(4)</u>	<u>–</u>	<u>–</u>	<u>(4)</u>

As at 1 January and 31 December 2018 ECL relating to undrawn loan commitments rounds to zero.

*(Figures in tables are in thousands of Azerbaijani manats)***18. Net fee and commission income**

Net fee and commission income comprises:

	<u>2018</u>	<u>2017</u>
Settlements operations	2,475	1,947
Servicing plastic card operations	2,200	1,945
Cash operations	1,571	1,476
Guarantees and letter of credit	900	1,059
Other	312	281
Fee and commission income	<u>7,458</u>	<u>6,708</u>
Servicing plastic card operations	(1,971)	(1,719)
Settlements operations	(716)	(709)
Cash operations	(602)	(156)
Securities operations	(61)	(83)
Other	(153)	(78)
Fee and commission expense	<u>(3,503)</u>	<u>(2,745)</u>
Net fee and commission income	<u>3,955</u>	<u>3,963</u>

19. Other income

As at 31 December 2018, other income of AZN 184 thousand (2017: AZN 1,040 thousand) primarily comprise of penalty fee from customers due to early withdrawal of term deposits.

20. Personnel, general and administrative expenses

Personnel expenses comprise:

	<u>2018</u>	<u>2017</u>
Salaries and bonuses	(7,563)	(6,680)
Social security costs	(1,685)	(1,462)
Other employee related expenses	(418)	(315)
Personnel expenses	<u>(9,666)</u>	<u>(8,457)</u>

General and administrative expenses comprise:

	<u>2018</u>	<u>2017</u>
Occupancy and rent	(2,766)	(2,765)
Marketing and advertising	(724)	(632)
Operating taxes other than income tax	(675)	(807)
Membership expenses	(431)	(225)
Communication	(384)	(273)
Deposit insurance expense	(337)	(302)
Legal and consultancy	(325)	(163)
Security	(308)	(397)
Data processing	(305)	(525)
Office Supplies	(223)	(171)
Repair and maintenance of property and equipment	(208)	(217)
Utility expenses	(158)	(146)
Business travel and related expenses	(123)	(90)
Other	(845)	(432)
Total general and administrative expenses	<u>(7,812)</u>	<u>(7,145)</u>

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities.

The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Committee

The Audit Committee has the overall responsibility for the establishment and development of the audit mission and strategy. It is responsible for the fundamental audit issues and monitoring Internal Audit's activities.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Introduction (continued)

Information compiled from all the businesses is examined and processed in order to analyse, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions and liquidity ratios. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Bank on the utilization of market limits and liquidity, plus any other risk developments.

Risk mitigation

The Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the statement of financial position, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 8.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Impairment assessment

From 1 January 2018, the Bank calculates ECL based on several 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 <i>Probability of Default</i> 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 derecognised and is still in the portfolio.
EAD	The <i>Exposure at Default</i> 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.
LGD	The <i>Loss Given Default</i> 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 realisation of any collateral. It is usually expressed as a percentage of the EAD.

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). The 12mECL is the portion of LTECL 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 LTECL and 12mECL 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. 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 12mECL. 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 LTECL. 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 LTECL.
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 revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

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. The Bank considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

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 unlikelihood 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. Such events include:

- ▶ Default and Credit-impaired assets:
 - ▶ Loans with principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract.
 - ▶ Loans that have been restructured.
 - ▶ Any loan considered by management as non-performing.
- ▶ Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition.
- ▶ Default on other financial instruments of the same borrower.
- ▶ Default according to external rating.

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 six 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.

PD estimation process

The Bank runs separate models for its key portfolios. The models incorporate quantitative information and utilise supplemental external information that could affect the borrower's behaviour. In order to consider the impact of macroeconomic factors on probability of default, sensitivity of probabilities to the macroeconomic factors are calculated by statistical regression method. Where practicable, PDs, incorporate forward looking macroeconomic information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Treasury and interbank relationships

The Bank's treasury and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank analyses publicly available information such as financial information and other external data, e.g., the external ratings.

Consumer lending and residential mortgages

Consumer lending comprises secured and unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by days past due.

The probability of default for consumer loans is calculated using migration matrices. For this purpose, simplified migration matrices, which reflect the change from respective month of one year to the same month of the next year are prepared based on the amounts of loans in each matrices. Other key inputs into the models are non-oil GDP growth, AZN/USD rates, and LTV ratios.

Corporate and small business lending

The same approach and inputs as for consumer lending applies to corporate and small business lending. For corporate loans, migration matrices used in the PD and LGD calculations are determined by the number of loans in each matrices.

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.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Loss given default

For corporate lending assets, LGD values are assessed at least quarterly by account managers and reviewed and approved by the Bank.

The credit risk assessment is based on a standardized LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type) as well as borrower characteristics.

Where appropriate, further recent data is used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

LGD rates are estimated for the Stage 1, Stage 2 and Stage 3 segment of each asset class.

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 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 restructured due to credit event. In certain cases, the Bank may also consider that events explained in "Definition of default" section above are a significant increase in credit risk as opposed to a default. 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.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Bank calculates ECLs either on a collective or on an individual basis.

Asset classes where the Bank calculates ECL on an individual basis include:

- ▶ The treasury and interbank relationships (such as amounts due from banks, cash equivalents and debt investment securities at amortised cost and FVOCI).

ECL on all other assets calculated on collective basis.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Forward-looking information and multiple economic scenarios

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

- ▶ GDP;
- ▶ Non-oil GDP;
- ▶ Real GDP;
- ▶ Non-oil real GDP;
- ▶ Nominal people income;
- ▶ Nominal salaries;
- ▶ Budget income;
- ▶ Budget expenses;
- ▶ Budget deficit;
- ▶ Investments in basic capital;
- ▶ Consumer Price Index;
- ▶ USD/AZN rate;
- ▶ Nominal effective FX rate;
- ▶ Non-oil Nominal effective FX rate;
- ▶ Real effective FX rate;
- ▶ Non-oil Real effective FX rate;
- ▶ Volume of overdue credits in the country;
- ▶ Percentage of overdue loans to total loans.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

Credit quality per class of financial assets

The Bank classifies its credit related assets as follows:

High grade – counterparties with highly liquid collaterals or strong government support, excellent financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Standard grade – counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Sub-standard grade – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Impaired – counterparties with unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)**Credit risk (continued)**

	<i>Note</i>		<i>High grade</i>	<i>Standard grade</i>	<i>Sub-standard grade</i>	<i>Impaired</i>	<i>Total</i>
Cash and cash equivalents, except for cash on hand	5	Stage 1	66,417	35,680	-	-	102,097
Amounts due from credit institutions	6	Stage 1	4,704	11,042	-	-	15,746
Loans to customers at amortised cost	8						
- Government related entities		Stage 1	26,334	1,484	-	-	27,818
- Loans to individuals – consumer loans		Stage 1	12,572	35,724	-	-	48,296
		Stage 2	-	-	568	-	568
		Stage 3	-	-	-	2,407	2,407
- Corporate loans		Stage 1	709	33,054	-	-	33,763
		Stage 2	-	-	248	-	248
		Stage 3	-	-	-	14,431	14,431
- Loans to individuals – entrepreneurs		Stage 1	-	1,233	-	-	1,233
		Stage 2	-	-	52	-	52
		Stage 3	-	-	-	4,831	4,831
- Loans to individuals – mortgage loans		Stage 1	-	47,979	-	-	47,979
		Stage 2	-	-	199	-	199
		Stage 3	-	-	-	61	61
Debt securities at FVOCI	7	Stage 1	51,782	-	-	-	51,782
Other financial assets	13	Stage 1	945	349	-	-	1,294
Undrawn loan commitments	17	Stage 1	2,491	12,430	-	-	14,921
		Stage 2	-	-	32	-	32
Letters of credit	17	Stage 1	-	272	-	-	272
Financial guarantees	17	Stage 1	969	35,063	-	-	36,032
Total			166,923	214,310	1,099	21,730	404,062

The table below shows gross balances under IAS 39 as at 31 December 2017 based on the Bank's internal credit rating system:

	<i>Notes</i>	<i>Neither past due nor impaired</i>			<i>Past</i>	<i>Individually</i>	<i>Total</i>
		<i>High grade 2017</i>	<i>Standard grade 2017</i>	<i>Sub-standard grade 2017</i>	<i>due but not impaired 2017</i>	<i>impaired 2017</i>	
Cash and cash equivalents (excluding cash on hand)	5	47,693	90,779	-	-	-	138,472
Amounts due from credit institutions	6	22,865	3,196	-	-	-	26,061
Securities available for sale (excluding equity shares)	7	-	4,008	-	-	-	4,008
Loans to government owned entities	8	36,350	4,697	-	2,004	-	43,051
Corporate loans	8	-	14,624	2,560	2,471	13,474	33,129
Loans to individuals – mortgage	8	-	26,601	-	5	-	26,606
Loans to individuals – consumer	8	832	19,969	452	2,978	-	24,231
Loans to individuals – entrepreneurship	8	-	677	3,589	2,943	2,969	10,178
Other financial assets	13	-	238	-	-	-	238
Total		107,740	164,789	6,601	10,401	16,443	305,974

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)**Credit risk (continued)**

In the table above cash and cash equivalents, amounts due from credit institution and loan customers of high grade are those having a minimal level of credit risk, normally with a credit rating on or close to sovereign level or very well collateralised. Other borrowers with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade but not individually impaired. Past due loans to customers include those that are only past due by a few days. An analysis of past due loans as at 31 December 2017, by age, is provided below. The majority of the past due loans are not considered to be impaired.

Aging analysis of past due but not impaired loans per class of financial assets

	<i>Less than 30 days 2017</i>	<i>31 to 60 days 2017</i>	<i>61 to 90 days 2017</i>	<i>More than 90 days 2017</i>	<i>Total 2017</i>
Loans to customers					
Loans to government owned entities	-	-	-	2,004	2,004
Corporate loans	-	4	-	2,467	2,471
Loans to individuals-consumer	57	109	68	2,744	2,978
Loans to individuals-entrepreneurship	229	-	-	2,714	2,943
Loans to individuals-mortgage	5	-	-	-	5
Total	291	113	68	9,929	10,401

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

Financial guarantees, letters of credit and loan commitments are assessed and a provision for expected credit losses is calculated in similar manner as for loans.

The geographical concentration of Bank's financial assets and liabilities is set out below:

	<i>2018</i>				<i>2017</i>			
	<i>Azerbaijan</i>	<i>OECD</i>	<i>CIS and other foreign countries</i>	<i>Total</i>	<i>Azerbaijan</i>	<i>OECD</i>	<i>CIS and other foreign countries</i>	<i>Total</i>
Assets								
Cash and cash equivalents	98,664	19,935	2,193	120,792	156,270	12,038	1,998	170,306
Amounts due from credit institutions	3,790	6,830	5,126	15,746	1,493	24,568	-	26,061
Investment securities	51,827	-	-	51,827	4,053	-	-	4,053
Loans to customers	165,326	-	-	165,326	116,730	-	-	116,730
Other financial assets	201	986	107	1,294	158	27	53	238
	319,808	27,751	7,426	354,985	278,704	36,633	2,051	317,388
Liabilities								
Amounts due to credit institutions and government organizations	88,378	12	1,947	90,337	74,476	-	-	74,476
Amounts due to customers	216,135	2,554	1,319	220,008	180,772	19,739	73	200,584
Other financial liabilities	1,151	766	36	1,953	1,599	49	-	1,648
	305,664	3,332	3,302	312,298	256,847	19,788	73	276,708
Net assets	14,144	24,419	4,124	42,687	21,857	16,845	1,978	40,680

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains obligatory reserves with the CBAR, the amount of which depends on the level of customer funds attracted.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)**Liquidity risk and funding management (continued)**

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. The CBAR requires banks to maintain instant liquidity ratio of more than 30%. As at 31 December, these ratios were as follows:

	2018, %	2017, %
Instant Liquidity Ratio (assets receivable or realisable within one day / liabilities repayable on demand)	72.77	100.9

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were given immediately. In accordance with the Azerbaijan legislation, the Bank is obliged to repay the principal amounts of a term deposit upon demand of a depositor. However, in line with its deposit retention history the Bank expects the average deposit tenors to exceed the contractual maturities of its customer deposits that are displayed below.

<i>As at 31 December 2018</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
Financial liabilities					
Amounts due credit institutions and government organizations	18,715	3,245	36,987	40,869	99,816
Amounts due to customers	163,120	32,313	10,669	27,824	233,926
Other liabilities	1,953	-	-	-	1,953
Total undiscounted financial liabilities	183,788	35,558	47,656	68,693	335,695

<i>As at 31 December 2017</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
Financial liabilities					
Amounts due to credit institutions and government organizations	18,715	3,245	36,987	40,869	99,816
Amounts due to customers	163,120	32,313	10,669	27,824	233,926
Other liabilities	1,953	-	-	-	1,953
Total undiscounted financial liabilities	183,788	35,558	47,656	68,693	335,695

The table below shows the contractual expiry by maturity of the Bank's credit related commitments. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee and letters of credit contracts, the maximum amount is allocated to the earliest period in which the contract could be called.

	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>
2018	18,137	25,569	7,550	1	51,257
2017	22,737	13,060	5,154	-	40,951

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of amounts due to government organizations in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. This level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank would be given sufficient notice so as to realise its liquid assets to enable repayment.

The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than three months in the tables above.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Bank does not have any significant equity, corporate fixed income, or derivatives holdings.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December. The sensitivity of equity is calculated by revaluing fixed rate investment securities at 31 December for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. However, as interest rate of investment securities in the local market is based on the carried accrued discount or premiums on these securities at the time of purchase or sale (as included in actual price of purchased or sold securities), thus, any change in the rates to be applied to the fixed-rate investment securities does not have any impact or effect on equity. As at 31 December 2018, the Bank does not have floating rate non-trading financial instruments.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the manat, with all other variables held constant on the statement of profit or loss (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of profit or loss. A negative amount in the table reflects a potential net reduction in statement of profit or loss or equity, while a positive amount reflects a net potential increase.

<i>Currency</i>	<i>Increase in currency rate in % 2018</i>	<i>Effect on profit before tax 2018</i>	<i>Increase in currency rate in % 2017</i>	<i>Effect on profit before tax 2017</i>
USD	14.00%	(32)	11.00%	1,424
EUR	14.00%	2,172	14.00%	318

<i>Currency</i>	<i>Decrease in currency rate in % 2018</i>	<i>Effect on profit before tax 2018</i>	<i>Decrease in currency rate in % 2017</i>	<i>Effect on profit before tax 2017</i>
USD	-3.00%	7	-11.00%	(1,424)
EUR	-3.00%	(466)	-14.00%	(318)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair value measurement**Fair value hierarchy**

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- ▶ Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- ▶ Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- ▶ Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Investment securities at FVOCI	31 December 2018	-	-	51,827	51,827
Loans to customers at FVPL	31 December 2018	-	-	528	528
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2018	-	-	120,792	120,792
Amounts due from credit institutions	31 December 2018	-	-	15,746	15,746
Loans to customers	31 December 2018	-	-	164,798	164,798
Other financial assets	31 December 2018	-	-	1,294	1,294
Liabilities for which fair values are disclosed					
Amounts due to credit institutions and government organizations	31 December 2018	-	-	90,337	90,337
Amounts due to customers	31 December 2018	-	-	220,008	220,008
Other financial liabilities	31 December 2018	-	-	1,953	1,953

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Investment securities available-for-sale	31 December 2017	4,008	-	45	4,053
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2017	170,306	-	-	170,306
Amounts due from credit institutions	31 December 2017	-	-	26,061	26,061
Loans to customers	31 December 2017	-	-	116,730	116,730
Other financial assets	31 December 2017	-	-	238	238
Liabilities for which fair values are disclosed					
Amounts due to credit institutions and government organizations	31 December 2017	-	-	74,476	74,476
Amounts due to customers	31 December 2017	-	-	200,584	200,584
Other financial liabilities	31 December 2017	-	-	1,648	1,648

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair value measurement (continued)

Fair value hierarchy (continued)

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities:

	<i>Carrying value 2018</i>	<i>Fair value 2018</i>	<i>Carrying value 2017</i>	<i>Fair value 2017</i>
Financial assets				
Cash and cash equivalents	120,792	120,792	170,306	170,306
Amounts due from credit institutions	15,746	15,746	26,061	26,061
Loans to customers	164,798	160,156	116,730	107,618
Other financial assets	1,294	1,294	238	238
Financial liabilities				
Amounts due to credit institutions and government organizations	90,337	91,011	74,476	74,968
Amounts due to customers	220,008	228,231	200,584	213,086
Other financial liabilities	1,953	1,953	1,648	1,648

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the financial statements and those items that are not measured at fair value in the statement of financial position, but whose fair value is disclosed.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short-term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity.

Loans at fair value through profit or loss

Loans at fair value through profit or loss are valued using a combination of approaches. Where appropriate, loans are valued with reference to observable prices of debt securities issued by the borrower or by comparable entities. In other cases, valuation is performed using internal models based on present value techniques or, in some circumstances (for example, in respect of cash flow from assets held as collateral), external valuation reports. The non-observable inputs to the models include adjustments for credit, market and liquidity risks associated with the expected cash flows from the borrower's operations or in respect of collateral valuation.

Investment securities

Investment securities valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Financial assets and financial liabilities carried at amortized cost

The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions and government organizations and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair value measurement (continued)**Movements in level 3 assets at fair value**

The following tables show a reconciliation of the opening and closing amount of Level 3 assets which are recorded at fair value:

	At 31 December 2017	Transfers at adoption of IFRS 9	At 1 January 2018	Total gain recorded in profit or loss	Total gain recorded in other compre- hensive income	Purchases	Settlements	At 31 December 2018
Financial Assets								
Loans to customers at FVPL	-	1,211	1,211	-	-	-	(683)	528
Investment securities – debt securities at FVOCI	-	-	-	-	49	209,810	(158,077)	51,782
Investment securities – equity securities at FVOCI	45	-	45	-	-	-	-	45
Total level 3 financial assets	45	1,211	1,256	-	49	209,810	(158,760)	52,355

Significant unobservable inputs and sensitivity of level 3 financial instruments measured at fair value to changes to key assumptions

The following table shows the quantitative information about significant unobservable inputs used in the fair value measurement categorized within Level 3 of the fair value hierarchy:

31 December 2018	Carrying amount	Valuation techniques	Unobservable input	Range (weighted average)
Loans to customers at FVTPL				
Loans to customers at FVTPL	528	Discounted cash flow	Discount rate	5%-7% (6%)
Investment securities measured at FVOCI				
Equity securities	45	Other	n/a	n/a
Debt securities	51,733	Discounted Cash Flow	Discount rate	7%-10% (various)
31 December 2017	Carrying amount	Valuation techniques	Unobservable input	Range (weighted average)
Investment securities – available-for-sale				
Equity securities	45	Other	n/a	n/a

In order to determine reasonably possible alternative assumptions the Bank adjusted the above key unobservable model inputs as follows:

- ▶ For debt securities and loans to customers, the Bank adjusted the discount rate assumption by increasing and decreasing the assumption by 1%.

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair value measurement (continued)

Significant unobservable inputs and sensitivity of level 3 financial instruments measured at fair value to changes to key assumptions (continued)

The following table shows the impact on the fair value of level 3 instruments of using reasonably possible alternative assumptions:

	31 December 2018		31 December 2017	
	Carrying amount	Effect of reasonably possible alternative assumptions	Carrying amount	Effect of reasonably possible alternative assumptions
Financial assets				
Loans to customers at FVTPL	528	518-538	-	-
Equity securities	45	n/a	45	n/a
Debt securities	51,733	51,714-51,837	-	-

23. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be due or settled. See Note 21 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2018			2017		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	120,792	-	120,792	170,306	-	170,306
Amounts due from credit institutions	15,746	-	15,746	26,061	-	26,061
Investment securities available-for-sale	51,782	45	51,827	4,008	45	4,053
Loans to customers	57,203	108,123	165,326	43,796	72,934	116,730
Property and equipment	-	5,626	5,626	-	6,421	6,421
Intangible assets	-	3,076	3,076	-	2,570	2,570
Current income tax assets	483	-	483	-	804	804
Deferred income tax assets	-	-	-	-	371	371
Other assets	3,980	-	3,980	2,868	-	2,868
Total	249,986	116,870	366,856	247,039	83,145	330,184
Amounts due to credit institutions and government organizations	21,234	69,103	90,337	12,293	62,183	74,476
Amounts due to customers	193,523	26,485	220,008	173,547	27,037	200,584
Deferred income tax liability	-	95	95	-	-	-
Other liabilities	4,522	-	4,522	3,800	-	3,800
Total	219,279	95,683	314,962	189,640	89,220	278,860
Net	30,707	21,187	51,894	57,399	(6,075)	51,324

24. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Government of the Republic of Azerbaijan, acting through the Shareholders, controls the Bank activities. The Government of the Republic of Azerbaijan directly and indirectly controls and has significant influence over a significant number of entities through its government agencies and other organizations (together referred to as "government institutions"). The Government of the Republic of Azerbaijan does not provide to the general public or entities under its ownership/control a complete list of the entities, which are owned or controlled directly or indirectly by the government. Under these circumstances, the management of the Bank disclosed only information that its current internal management system allows to present in relation to operations with government-controlled entities and where the management believes such entities could be considered as government-controlled based on its best knowledge.

(Figures in tables are in thousands of Azerbaijani manats)

24. Related party disclosures (continued)

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	2018			2017		
	Shareholders	Entities under common control	Key management personnel	Shareholders	Entities under common control	Key management personnel
Loans outstanding at 1 January, gross	-	43,078	172	-	74,323	102
Loans issued during the year	-	-	117	-	-	161
Loan repayments during the year	-	(14,930)	(58)	-	(30,165)	(91)
Effect of translation difference	-	-	-	-	(1,913)	-
Other movements	-	(330)	-	-	833	-
Loans outstanding at 31 December, gross	-	27,818	231	-	43,078	172
Less: allowance for impairment at 31 December	-	(18)	-	-	(660)	(4)
Loans outstanding at 31 December, net	-	27,800	231	-	42,418	168
Interest income on loans	-	1,373	16	-	2,143	11
Credit loss reversal	-	1,565	4	-	475	-

	2018			2017		
	Shareholders	Entities under common control	Key management personnel	Shareholders	Entities under common control	Key management personnel
Deposits at 1 January	7,327	71,103	-	-	67,317	22
Deposits received during the year	-	19,092	-	9,400	18,163	-
Deposits repaid during the year	(7,327)	(13,235)	-	(2,097)	(12,367)	-
Effect of translation difference	-	-	-	-	(1,924)	-
Other movements	-	-	-	24	(86)	(22)
Deposits at 31 December	-	76,960	-	7,327	71,103	-
Current accounts as at 31 December	11,697	20,568	36	2,583	24,461	47
Cash and cash equivalents	42	46,771	-	257	445	-
Due from credit institutions	5,191	1,351	-	-	1,491	-
Investment securities	-	51,782	-	-	4,008	-
Interest income on due from credit institutions	-	2,177	-	-	1,792	-
Interest income on investment securities	-	1,536	-	-	200	-
Interest expense on deposits	61	2,504	-	166	1,862	-
Other operating expenses	-	2,071	-	-	1,969	-
Operating income	-	794	-	19	1,669	5

Compensation of key management personnel is as follows:

	2018	2017
Salaries and other benefits	602	584
Social security costs	135	128
Total key management personnel compensation	737	712

For the year ended 31 December 2018, key management personnel comprised of nine (2017: ten) members.

(Figures in tables are in thousands of Azerbaijani manats)

25. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored by the FMSA using the ratios established by the CBAR in supervising the Bank.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum Tier 1 and total capital adequacy ratio of 5% (2017: 5%) and 10% (2017: 10%), respectively, of risk-weighted assets for regulatory capital.

As at 31 December 2018 and 2017, the Bank's capital adequacy ratios on this basis were as follows:

	2018	2017
Tier 1 capital	50,223	50,715
Tier 2 capital	2,104	1,156
Less: deductions from capital	(280)	(105)
Total regulatory capital	52,047	51,766
Risk weighted assets	210,664	191,003
Capital adequacy ratio (Tier 1)	23.30%	26.55%
Capital adequacy ratio (Total Capital)	24.18%	27.10%