Nikoil OJSC ICB

Financial Statements

for the year ended 31 December 2018

Contents

KPMG Audit Azerbaijan LLC
Port Baku South Towers,
12th floor, 153 Neftchilar Avenue, Baku,
AZ1010, Azerbaijan
Telephone: +994 (12) 404 8910
Fax: +994 (12) 404 8914
Internet: www.kpmg.az

Independent Auditors' Report

To the Shareholders and Supervisory Board of Nikoil Open Joint-Stock Company Investment Commercial Bank

Opinion

We have audited the financial statements of Nikoil Open Joint-Stock Company Investment Commercial Bank ("the Bank"), which comprise the statement of financial position as at 31 December 2018, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' 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) together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Azerbaijan, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

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

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

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

Auditors' 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 auditors' 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 auditors' 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 auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

— Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

The engagement partner on the audit resulting in this independent auditors' report is:

Andrey Kouznetsov
"KPMG Audit Azerbaijan" LLC
Baku, the Republic of Azerbaijan
17 May 2019

	Notes	2018 AZN'000	2017* AZN'000
Interest income calculated using the effective interest method	5	36,810	56,627
Interest expense	5	(15,508)	(19,477)
Net interest income		**21,302**	**37,150**
Fee and commission income	6	3,804	3,689
Fee and commission expense	7	(1,628)	(1,346)
Net fee and commission income		**2,176**	**2,343**
Net gain on trading in foreign currencies		3,532	3,285
Net foreign exchange translation loss		(157)	(4,211)
Other operating income/(losses)		62	(19)
Operating income		**26,915**	**38,548**
Impairment losses on debt financial assets	8	(63,827)	(48,353)
Personnel expenses	9	(10,603)	(8,091)
Other general administrative expenses	10	(11,125)	(12,190)
Impairment recovery on loan commitments and financial guarantees		719	-
Impairment (losses)/recovery on assets held for sale	17	(7,289)	1,417
Losses on recognition of purchased credit-impaired assets		(4,975)	-
Loss before income tax		**(70,185)**	**(28,669)**
Income tax expense	11	-	-
Loss and total comprehensive loss for the year		**(70,185)**	**(28,669)**
Loss per share			
Basic and diluted (expressed in AZN)	23	(0.52)	(0.31)

*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 4). As a result of adoption of IFRS 9 the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 3(p)).

The financial statements as set out on pages 5 to 82 were approved by management on 15 May 2019 and were signed on its behalf by:

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Ayaz Ismayilov
Financial Director

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the financial statements.

	Note	31 December 2018 AZN'000	31 December 2017* AZN'000
ASSETS			
Cash and cash equivalents	12	117,118	75,323
Due from banks	13	37,842	45,567
Loans to customers	14	226,117	239,616
Investment securities	15	13,601	1,239
Advances to the Ministry of Taxes of the Republic of Azerbaijan		4	171
Property, equipment and intangible assets	16	11,898	12,787
Assets held for sale	17	5,053	8,962
Other assets	18	2,707	4,226
Total assets		**414,340**	**387,891**
LIABILITIES			
Deposits and balances from banks		6	7
Current accounts and deposits from customers	19	234,260	237,737
Other borrowed funds	20	97,524	97,296
Provisions	27	885	-
Other liabilities	21	2,934	1,442
Subordinated borrowings	20	8,912	25,961
Total liabilities		**344,521**	**362,443**
EQUITY			
Share capital	22	348,000	220,000
Share premium		401	401
Accumulated losses		(278,582)	(194,953)
Total equity		**69,819**	**25,448**
Total liabilities and equity		**414,340**	**387,891**

*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 4). As a result of adoption of IFRS 9 the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 3(p)).

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Ayaz Ismayilov
Financial Director

The statement of financial position is to be read in conjunction with the notes to, and forming part of, the financial statements.

	Note	2018 AZN'000	2017* AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		24,293	18,083
Interest payments		(16,424)	(21,284)
Fee and commission receipts		3,804	3,689
Fee and commission payments		(1,628)	(1,346)
Net receipts from trading in foreign currencies		3,532	3,285
Other income receipts/(expense payments)		60	(41)
General administrative and personnel expenses payments		(19,186)	(16,999)
(Increase) decrease in operating assets			
Due from banks		7,731	7,923
Loans to customers		(57,846)	11,120
Assets held for sale		504	1,959
Other assets		1,493	(1,549)
Increase (decrease) in operating liabilities			
Deposits and balances from banks		(1)	(7)
Current accounts and deposits from customers		(2,396)	(23,535)
Other liabilities		211	(194)
Net cash used in operating activities		**(55,853)**	**(18,896)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of investment securities		(12,110)	(936)
Sales of investment securities		304	1,641
Purchases of property, equipment and intangible assets		(1,412)	(1,382)
Sales of property, equipment and intangible assets		-	22
Cash flows used in investing activities		**(13,218)**	**(655)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of share capital		111,000	35,500
Receipts of other borrowed funds		21,389	13,135
Repayment of other borrowed funds		(21,218)	(7,706)
Repayment of subordinated borrowings		-	(7,950)
Repayment of debt securities		-	-
Dividends paid		-	-
Cash flows from financing activities		**111,171**	**32,979**
Net increase in cash and cash equivalents		**42,100**	**13,428**
Effect of changes in exchange rates on cash and cash equivalents		(305)	(2,578)
Cash and cash equivalents as at the beginning of the year		75,323	64,473
Cash and cash equivalents as at the end of the year	12	**117,118**	**75,323**

* The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 4). As a result of adoption of IFRS 9 the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 3(p)).

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Ayaz Ismayilov
Financial Director

The statement of cash flows is to be read in conjunction with the notes to, and forming part of, the financial statements.

AZN'000	Share capital	Share premium	Accumulated losses	Total equity
Balance as at 1 January 2017	**184,500**	**401**	**(166,284)**	**18,617**
Total comprehensive income				
Loss and total comprehensive loss for the year	-	-	(28,669)	(28,669)
Loss and total comprehensive loss for the year	**-**	**-**	**(28,669)**	**(28,669)**
Transactions with owners, recorded directly in equity				
Shares issued	35,500	-	-	35,500
Total transactions with owners	**35,500**	**-**	**-**	**35,500**
Balance as at 31 December 2017	**220,000**	**401**	**(194,953)**	**25,448**
Balance as at 1 January 2018	**220,000**	**401**	**(194,953)**	**25,448**
Adjustment on initial application of IFRS 9, net of tax (see Note 4)	-	-	(13,444)	(13,444)
Restated balance as at 1 January 2018*	**220,000**	**401**	**(208,397)**	**12,004**
Total comprehensive loss				
Loss and total comprehensive loss for the year	-	-	(70,185)	(70,185)
Loss and total comprehensive loss for the year	**-**	**-**	**(70,185)**	**(70,185)**
Transactions with owners, recorded directly in equity				
Shares issued	128,000	-	-	128,000
Total transactions with owners	**128,000**	**-**	**-**	**128,000**
Balance as at 31 December 2018	**348,000**	**401**	**(278,582)**	**69,819**

*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 3(p)).

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Ayaz Ismayilov
Financial Director

1 Background

(a) Organization and operations

These financial statements comprise the financial statements of Nikoil OJSC ICB (the "Bank").

Originally, "Ulpar" JSCB was founded in 1994 in the Republic of Azerbaijan and held general banking license No 203 issued in 1994. During 2002, "Nikoil" Closed Joint Stock Company and "Lukoil Azerbaijan" Closed Joint Stock Company acquired the controlling interest in the Bank and the Bank was renamed to "Nikoil" OJSC Investment Commercial Bank. The Bank has started operations under a full banking license No 203 issued by the Central Bank of the Azerbaijan Republic (the "CBAR") since May 2, 2002. On July 2008, "Topaz Investments" LLC has acquired the controlling interest in the Bank. Its principal activities are deposit taking, customer account maintenance, credit operations, issuing guarantees, cash and settlement operations, and securities and foreign exchange transactions. The Bank's activities are regulated by the Financial Markets Supervisory Authority (the "FIMSA") of the Republic of Azerbaijan. The Bank has a general banking license, and is a member of the state deposit insurance system in the Republic of Azerbaijan.

The Bank's registered office is Pushkin Street 30, Baku AZ 1010, the Republic of Azerbaijan.

As at 31 December 2018, the Bank had twelve branches (2017: thirteen). The majority of its assets and liabilities are located in the Republic of Azerbaijan.

The Bank is owned by:

	31 December 2018, %	**31 December 2017, %**
Shareholder		
"Topaz Investments Limited" LLC	95.68	93.16
Marina Kulishova	4.22	6.68
"ISR Holding" LLC	0.10	0.16
Total	**100.00**	**100.00**

The Bank's parent company is "Topaz Investment Limited" LLC (the "Parent"). The Bank is ultimately controlled by a single individual, Mr. V. Alekperov.

(b) Business environment

Azerbaijan business environment

The Bank's operations are primarily located in Azerbaijan. Consequently, the Bank is exposed to the economic and financial markets of Azerbaijan which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Azerbaijan. In addition, the recent significant depreciation of the Azerbaijani Manat, and continuously low level of oil prices, have increased the level of uncertainty in the business environment.

The financial statements reflect management's assessment of the impact of the Azerbaijani business environment on the operations and the financial position of the Bank. The future business environment may differ from management's assessment.

2 Basis of preparation

(a) Statement of compliance

The accompanying financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

This is the first set of the Bank's annual financial statements in which IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers have been applied. Changes to significant accounting policies are described in Note 2(e).

(b) Basis of measurement

The financial statements are prepared on the historical cost basis (2017: prepared on the historical cost basis except that financial instruments available for sale are stated at fair value.)

(c) Functional and presentation currency

The functional currency of the Bank is the Azerbaijani Manat ("AZN") as, being the national currency of the Republic of Azerbaijan, it reflects the economic substance of the majority of underlying events and circumstances relevant to them.

At 31 December 2018, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.7000 and EUR 1 = AZN 1.9468 (31 December 2017: USD 1 = AZN 1.7001 and EUR 1 = AZN 2.0307).

The AZN is also the presentation currency for the purposes of these financial statements.

Financial information presented in AZN is rounded to the nearest thousand, unless otherwise stated.

(d) Use of estimates and judgments

In preparing these financial statements, management has made judgement, estimates and assumptions that affect the application of the Bank's accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Judgements

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

- Applicable to 2018 only
  - classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding – Note 3(e)(i).
  - establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL – Note 25(e).

2 Basis of preparation (continued)

Assumptions and estimations uncertainty

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 is included in the following notes:

- Applicable to 2018 only
  - impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information – Note 25(e) and Note 14(c)(d).
- Applicable to 2018 and 2017
  - impairment of financial instruments – Note 3(e)(iv) and Note 14(c).
  - estimates of fair values of financial assets and liabilities – Note 31
  - recoverability of deferred tax assets – Note 11.

(e) Changes in accounting policies and presentation

The Bank has initially adopted IFRS 9 and IFRS 15 from 1 January 2018.

A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Bank's financial statements.

Due to the transition methods chosen by the Bank in applying IFRS 9, comparative information throughout these financial statements has not generally been restated to reflect its requirements.

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank. Accordingly, the impact on the comparative information is limited to new disclosure requirements.

The effect of initially applying these standards is mainly attributed to the following:

- an increase in impairment losses recognised on financial assets (see Note 25(e));
- additional disclosures related to IFRS 9 (see Notes 25(e) and 4); and
- additional disclosure related to IFRS 15 (see Note 6).

A. IFRS 9 Financial instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Bank has adopted consequential amendments to IAS 1 '*Presentation of Financial Statements*', which require separate presentation in the statement of profit or loss and other comprehensive income of interest revenue calculated using the effective interest method. Previously, the Bank disclosed this amount in notes to the financial statements.

Additionally, the Bank has adopted consequential amendments to IFRS 7 '*Financial Instruments: Disclosures*' that are applied to disclosures about 2018 but have not been applied to the comparative information.

2 Basis of preparation (continued)

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

For an explanation of how the Bank classifies financial assets under IFRS 9, see Note 3(e)(i).

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

For an explanation of how Bank classifies financial liabilities under IFRS 9, see Note 3(e).

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Note 3(e)(iv).

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied as described below:

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings as at 1 January 2018. Accordingly, the information presented as at and for the year ended 31 December 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented as at 31 December 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

  – The determination of the business model within which a financial asset is held.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 4.

B. IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 '*Revenue*', IAS 11 '*Construction Contracts and related interpretations*'.

The Bank initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8. The timing or amount of the Bank's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15. The impact of IFRS 15 was limited to the new disclosure requirements (see note 6).

3 Significant accounting policies

Except for the changes disclosed in Note 2(e), the Bank has consistently applied the following accounting policies to all periods presented in these financial statements.

(a) Foreign currency

Transactions in foreign currencies are translated to the respective functional currencies of the Bank at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments unless the difference is due to impairment in which case foreign currency differences that have been recognised in other comprehensive income are reclassified to profit or loss.

(b) Interest

Policy applicable from 1 January 2018

Effective interest rate

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

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance (or impairment allowance before 1 January 2018).

The 'gross carrying amount of a financial asset' measured at amortised cost is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

3 Significant accounting policies (continued)

Calculation of interest income and expense

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

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

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

For information on when financial assets are credit-impaired, see Note 3(e)(iv).

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and other comprehensive income includes interest on financial assets measured at amortised cost.

Interest expense presented in the statement of profit or loss and other comprehensive income includes interest on financial liabilities measured at amortised cost.

Policy applicable before 1 January 2018

Effective interest rate

Interest income and expense were recognised in profit or loss using the effective interest method. The effective interest rate was the rate that exactly discounted the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimated future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate included transaction costs and fees and points paid or received that were an integral part of the effective interest rate. Transaction costs included incremental costs that were directly attributable to the acquisition or issue of a financial asset or financial liability.

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and other comprehensive income includes interest on financial assets measured at amortised cost. Interest expense presented in the statement of profit or loss and other comprehensive income includes interest on financial liabilities measured at amortised cost.

(c) Fees and commission

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate (see Note 3(b)).

3 Significant accounting policies (continued)

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related transaction costs, are deferred and amortised to interest income over the estimated life of the financial instrument using the effective interest method.

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

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

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

(d) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances (nostro accounts) held with the CBAR and other banks, and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of short-term commitments. The mandatory reserve deposit with the CBAR is not considered to be a cash equivalent due to restrictions on its withdrawability. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(e) Financial assets and financial liabilities

(i) Classification

Financial assets – Policy applicable from 1 January 2018

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

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

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

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

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

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

All other financial assets are classified as measured at FVTPL.

3 Significant accounting policies (continued)

Business model assessment

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

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

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

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

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

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

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

Reclassification

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

The Bank should reclassify financial assets if the Bank changes its business model for managing those financial assets. Such changes are expected to be very infrequent. Such changes are determined by the Bank's senior management as a result of external or internal changes and must be significant to the Bank's operations and demonstrable to external parties. Accordingly, a change in the Bank's business model will occur only when the Bank either begins or ceases to perform an activity that is significant to its operations; for example, when the Bank has acquired, disposed of or terminated a business line.

3 Significant accounting policies (continued)

Financial assets – Policy applicable before 1 January 2018

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

- loans and receivables;
- available-for-sale

See Note 3(f),(g).

Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

Financial liabilities (including deposits and balances from banks, current account and deposits from customers, other borrowed funds, subordinated borrowings and other financial liabilities) are initially measured at fair value, net of transaction costs, and subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

Reclassification

Financial liabilities are not reclassified subsequent to their initial recognition.

(ii) Derecognition

Financial assets

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

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Financial liabilities

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

3 Significant accounting policies (continued)

(iii) Modification of financial assets and financial liabilities

Policy applicable from 1 January 2018

Financial assets

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different (referred to as 'substantial modification'), then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

Changes in cash flows on existing financial assets or financial liabilities are not considered as modification, if they result from existing contractual terms, e.g. changes in interest rates initiated by the Bank due to changes in the CBAR key rate, if the loan agreement entitles the Bank to do so.

The Bank performs a quantitative and qualitative evaluation of whether the modification is substantial, i.e. whether the cash flows of the original financial asset and the modified or replaced financial asset are substantially different. The Bank assesses whether the modification is substantial based on quantitative and qualitative factors in the following order: qualitative factors, quantitative factors, combined effect of qualitative and quantitative factors. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset deemed to have expired. In making this evaluation the Bank analogizes to the guidance on the derecognition of financial liabilities.

The Bank concludes that the modification is substantial as a result of the following qualitative factors:

- change the currency of the financial asset;
- change of terms of financial asset that lead to non-compliance with the SPPI criterion (e.g. inclusion of conversion feature) (applicable from 1 January 2018)

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

If the modification of a financial asset measured at amortised cost does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

3 Significant accounting policies (continued)

If such a modification is carried out because of financial difficulties of the borrower (see Note 3(e)(iv)), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest method. (see Note 3(b)).

For fixed-rate loans, where the borrower has an option to prepay the loan at par without significant penalty, the Bank treats the modification of an interest rate to a current market rate using the guidance on floating-rate financial instruments. This means that the effective interest rate is adjusted prospectively.

Financial liabilities

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

Bank performs a quantitative and qualitative evaluation of whether the modification is substantial considering qualitative factors, quantitative factors and combined effect of qualitative and quantitative factors. The Bank concludes that the modification is substantial as a result of the following qualitative factors:

- change the currency of the financial liability;
- inclusion of conversion option;
- change in the subordination of the financial liability.

For the quantitative assessment the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

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

Policy applicable before 1 January 2018

Financial assets

If the terms of a financial asset were modified, then the Bank evaluated whether the cash flows of the modified asset were substantially different. If the cash flows were substantially different, then the contractual rights to cash flows from the original financial asset were deemed to have expired. In this case, the original financial asset was derecognised (see Note 3(e)(ii)) and a new financial asset was recognised at fair value.

If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the pre-modification interest rate (see Note 3(e)(iv)).

3 Significant accounting policies (continued)

Financial liabilities

The Bank derecognised a financial liability when its terms were modified and the cash flows of the modified liability were substantially different. In this case, a new financial liability based on the modified terms was recognised at fair value. The difference between the carrying amount of the financial liability extinguished and consideration paid was recognised in profit or loss. Consideration paid included non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability was not accounted for as derecognition, then any costs and fees incurred were recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

(iv) Impairment

See also Note 25(e).

Policy applicable from 1 January 2018

The Bank recognises loss allowances for expected credit losses (ECL) on the following financial instruments that are not measured at FVTPL:

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

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

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 25(e)).

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'.

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

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised are referred to as 'Stage 2' financial instruments if the credit risk has increased significantly since initial recognition, but the financial instruments are not credit-impaired and 'Stage 3' financial instruments (if the financial instruments are credit-impaired).

Measurement of ECL

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

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

3 Significant accounting policies (continued)

See also Note 25(e).

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised (see Note 3(e)(iii)) and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset (see Note 25(e)).

If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost are credit-impaired (referred to as 'Stage 3 financial assets'). A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

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

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered credit-impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

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

3 Significant accounting policies (continued)

Presentation of allowance for ECL in the statement of financial position

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

- *financial assets measured at amortised cost*: as a deduction from the gross carrying amount of the assets;
- *loan commitments and financial guarantee contracts*: generally, as a provision;

where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision.

Write-offs

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in ‘impairment losses on financial instruments’ in the statement of profit or loss and other comprehensive income.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank’s procedures for recovery of amounts due.

Policy applicable before 1 January 2018

The Bank assessed at the end of each reporting period whether there was any objective evidence that a financial asset was impaired. If any such evidence existed, the Bank determined the amount of any impairment loss.

Financial asset was impaired and impairment losses were incurred if, and only if, there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset that could be reliably estimated.

Objective evidence that financial assets were impaired could include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlated with defaults in the group.

In addition, for an investment in an equity security available-for-sale a significant or prolonged decline in its fair value below its cost was objective evidence of impairment.

Financial assets carried at amortised cost

Financial assets carried at amortised cost consisted principally of loans and other receivables. The Bank reviewed its loans and receivables to assess impairment on a regular basis.

3 Significant accounting policies (continued)

The Bank first assessesed whether objective evidence of impairment existed individually for loans and receivables that were individually significant, and individually or collectively for loans and receivables that were not individually significant. If the Bank determined that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it included the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assessed them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss was or continued to be recognised were not included in a collective assessment of impairment.

If there were objective evidence that an impairment loss on a loan or receivable had been incurred, the amount of the loss was measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable might be limited or no longer fully relevant to current circumstances. This might be the case when a borrower was in financial difficulties and there was little available historical data relating to similar borrowers. In such cases, the Bank used its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables were recognized in profit or loss and were only reversed if a subsequent increase in recoverable amount could be related objectively to an event occurring after the impairment loss was recognised.

Write-offs

When a loan was uncollectable, it was written off against the related allowance for loan impairment. The Bank writed off a loan balance (and any related allowances for loan losses) when management determines that the loans were uncollectible and when all necessary steps to collect the loan were completed.

Financial assets carried at cost

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that were not carried at fair value because their fair value could not be reliably measured.

If there were objective evidence that such investments were impaired, the impairment loss was calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments were recognized in profit or loss and could not be reversed

Available-for-sale financial assets

Impairment losses on available-for-sale financial assets were recognised by transferring the cumulative loss that was recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that was reclassified from other comprehensive income to profit or loss was the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value were reflected as a component of interest income.

3 Significant accounting policies (continued)

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increased and the increase could be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss was reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security was recognised in other comprehensive income.

Other fair value changes, other than impairment losses, were recognised in other comprehensive income and presented in the fair value reserve within equity. When the investment was sold, the gain or loss accumulated in equity was reclassified to profit or loss.

(v) Fair value measurement principles

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

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

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

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

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

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

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

(vi) Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Bank currently has a legally enforceable right to set off if that right is not contingent on a future event and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the Bank and all counterparties.

3 Significant accounting policies (continued)

(f) Loans to customers

Policy applicable from 1 January 2018

'Loans to customers' caption in the statement of financial position include:

- loans to customers measured at amortised cost (see Note 3(e)(i)); they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

Policy applicable before 1 January 2018

Loans to customers were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market and that the Bank did not intend to sell immediately or in the near term.

Loans to customers included those classified as loans and receivables.

Loans to customers were initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

(g) Investment securities

Policy applicable from 1 January 2018

The 'investment securities' caption in the statement of financial position includes:

- debt investment securities measured at amortised cost (see Note 3(e)(i)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;
- equity investment securities mandatorily measured at FVTPL (see Note 3(e)(i) and (e)(v)); these are measured at fair value with changes recognised immediately in profit or loss.

Policy applicable before 1 January 2018

Investment securities were initially measured at fair value plus, in the case of investment securities not at FVTPL, incremental direct transaction costs, and subsequently accounted for available-for-sale.

Available-for-sale

Available-for-sale investments were non-derivative investments that were designated as available-for-sale or were not classified as another category of financial assets. Available-for-sale investments comprise equity securities and debt securities. Unquoted equity securities whose fair value could not be measured reliably were carried at cost. All other available-for-sale investments were measured at fair value after initial recognition.

Interest income was recognised in profit or loss using the effective interest method. Foreign exchange gains or losses on available-for-sale debt security investments were recognised in profit or loss. Impairment losses were recognised in profit or loss (see Note 3(e)(iv)).

(h) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

3 Significant accounting policies (continued)

(ii) Depreciation

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

The estimated useful lives are as follows:

- buildings	20 years
- furniture and fixtures	10 years
- computers and communication equipment	4 years
- vehicles	10 years
- other fixed assets	5 years
- leasehold improvements	lower of expected lease term and 14 years

(i) Intangible assets

Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses.

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 5 to 10 years.

(j) Assets held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Bank's accounting policies. Thereafter generally, the assets are measured at the lower of their carrying amount and fair value less cost to sell.

(k) Provisions

A provision is recognised in the statement of financial position when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(l) Financial guarantees and loan commitments

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

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

- *from 1 January 2018:* at the higher of the loss allowance determined in accordance with IFRS 9 (see Note 3(e)(iv)) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15; and
- *before 1 January 2018:* at the higher the amount representing the initial fair value amortised over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

3 Significant accounting policies (continued)

The Bank has issued no loan commitments that are measured at FVTPL.

For other loan commitments:

- *from 1 January 2018:* the Bank recognises a loss allowance (see Note 3(e)(iv));
- *before 1 January 2018:* the Bank recognised a provision in accordance with IAS 37 if the contract was considered to be onerous.

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

(m) Share capital

(i) Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

(ii) Dividends

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of the Azerbaijani legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

(n) Impairment of non-financial assets

Other non financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of non financial assets is the greater of their fair value less costs to sell and value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non financial assets are recognized in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(o) Taxation

Income tax comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items of other comprehensive income or transactions with shareholders recognised directly in equity, in which case it is recognised within other comprehensive income or directly within equity.

(i) Current tax

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

3 Significant accounting policies (continued)

(ii) Deferred tax

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences arising from the initial recognition of assets or liabilities in a transaction that affects neither accounting nor taxable profit or loss.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on the reversal of relevant taxable temporary differences. If the amount of taxable temporary differences is insufficient to recognise a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on the business plans for individual subsidiaries in the Bank. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

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

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

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

In determining the amount of current and deferred tax the Bank takes into account the impact of uncertain tax positions and whether additional taxes, penalties and late-payment interest may be due. The Bank believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Bank to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact the tax expense in the period that such a determination is made.

(p) Comparative information

As a result of adoption of IFRS 9 the Bank changed presentation of certain captions in the primary forms of financial statements. Comparative information is reclassified to conform to changes in presentation in the current period.

The effect of main changes in presentation of the statement of financial position is disclosed in Note 4.

The effect of main changes in presentation of the statement of profit or loss and other comprehensive income for the year ended 31 December 2017 is as follows:

- “interest income” line item was re-named as “interest income calculated using the effective interest method”
- the presentation of “impairment losses” was amended to present impairment losses on debt financial assets and assets held for sale separately

3 Significant accounting policies (continued)

The effect of main changes in presentation of the statement of financial position as at 31 December 2017 is as follows:

- “Available-for-sale financial assets” were presented as “Investment securities” line item.

The effect of main changes in presentation of statement of cash flows for the year ended 31 December 2017 is as follows:

- “Purchases of available-for-sale financial assets” and “Sales of available-for-sale financial assets” was presented as “Purchases of investment securities” and “Sales of investment securities” line item, respectively.

There were no changes in the statement of changes in equity for the year ended 31 December 2017.

(q) Standards issued but not yet effective

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

IFRS 16

The Bank is required to adopt IFRS 16 *Leases* from 1 January 2019. The Bank has assessed the estimated impact that initial application of IFRS 16 will have on its financial statements, as described below. The actual impacts of adopting the standard on 1 January 2019 may change because:

– the Bank has not yet finalised the testing and assessment of controls over its new IT systems; and

– the new accounting policies are subject to change until the Bank presents its first financial statements that include the date of initial application.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including 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*.

i. Leases in which the Bank is a lessee

The Bank has completed an initial assessment of the potential impact on its financial statements but has not yet completed its detailed assessment. The actual impact of applying IFRS 16 on the financial statements in the period of initial application will depend on future economic conditions, the development of the Bank’s lease portfolio, the Bank’s assessment of whether it will exercise any lease renewal options and the extent to which the Bank chooses to use practical expedients and recognition exemptions.

The Bank will recognise new assets and liabilities for its operating leases of office buildings. The nature of expenses related to those leases will now change because IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities.

3 Significant accounting policies (continued)

Previously, the Bank recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised.

As at 31 December 2018, the Bank does not have any non-cancellable operating leases.

ii. Leases in which the Bank is a lessor

As at 31 December 2018, the Bank has no leases as a lessor.

iii. Transition

The Bank plans to apply IFRS 16 initially on 1 January 2019, using a modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information.

The Bank plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

- **Other standards**

The following amended standards and interpretations are not expected to have a significant impact on the Bank's financial statements:

- IFRIC 23 *Uncertainty over Tax Treatments*;
- *Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28);*
- *Plan Amendment, Curtailment or Settlement (Amendments to IAS 19);*
- *Annual Improvements to IFRS Standards 2015-2017 Cycle – various standards;*
- *Amendments to References to Conceptual Framework in IFRS Standards;*
- IFRS 17 *Insurance Contracts.*

4 Transition to IFRS 9

Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as at 1 January 2018.

AZN'000	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets					
Cash and cash equivalents		Loans and receivables	Amortised cost	75,323	75,323
Due from banks		Loans and receivables	Amortised cost	45,567	45,567
Loans to customers		Loans and receivables	Amortised cost	239,616	227,776
Investment securities – debt (a)		Available for sale	Amortised cost	935	935
Investment securities – equity		Available for sale	FVTPL	304	304
Other financial assets		Loans and receivables	Amortised cost	3,591	3,591
Total financial assets				**365,336**	**353,496**
Financial liabilities					
Deposits and balances from banks		Amortised cost	Amortised cost	7	7
Current accounts and deposits from customers		Amortised cost	Amortised cost	237,737	237,737
Other borrowed funds		Amortised cost	Amortised cost	97,296	97,296
Other financial liabilities		Amortised cost	Amortised cost	1,389	1,389
Subordinated borrowings		Amortised cost	Amortised cost	25,961	25,961
Total financial liabilities				**362,390**	**362,390**

The Bank's accounting policies on the classification of financial instruments under IFRS 9 are set out in Note 3(e)(i). The application of these policies resulted in the reclassifications set out in the table above and explained below.

a. Before the adoption of IFRS 9, certain debt securities were classified as available for sale. Under IFRS 9, the Bank considers that these securities are held within a business model whose objective is to hold assets to collect the contractual cash flows. The Bank Treasury Department holds those securities in a separate portfolio for long-term yield and these securities may be sold, but such sales are not expected to be more than infrequent. These assets are classified as measured at amortised cost under IFRS 9.

4 Transition to IFRS 9 (continued)

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

AZN'000	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
Financial assets				
Amortised cost				
Cash and cash equivalents:				
Opening balance	75,323			
Closing balance				75,323
Due from banks:				
Opening balance	45,567			
Closing balance				45,567
Loans to customers:				
Opening balance	239,616			
Remeasurement			(11,840)	
Closing balance				227,776
Investment securities:				
Opening balance	-			
From available-for-sale		935		
Remeasurement			-	
Closing balance				935
Other financial assets	3,591	-		3,591
Total amortised cost	**364,097**	**935**	**(11,840)**	**353,192**
Available-for-sale				
Investment securities:				
Opening balance	1,239			
To FVTPL – equity		(304)		
To amortised cost		(935)		
Closing balance				-
Total available-for-sale	**1,239**	**(1,239)**	**-**	**-**
FVTPL – equity				
Investment securities:				
Opening balance	-			
From available-for sale		304		
Closing balance			-	304
Total FVTPL	**-**	**304**	**-**	**304**

As a result of adoption of IFRS 9 there were no reclassification or remeasurement of financial liabilities.

Fair value as at 31 December 2018 and a fair value gain or loss that would have been recognized in other comprehensive income during 2018 would not be material if financial assets were not reclassified from IAS 39 category available-for-sale into an amortised cost category under IFRS 9.

4 Transition to IFRS 9 (continued)

The following table summarises the impact, net of tax, of transition to IFRS 9 on the opening balance of retained earnings.

AZN'000	Impact of adopting IFRS 9 at 1 January 2018
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	(194,953)
Recognition of expected credit losses under IFRS 9 (including loan commitments)	(13,444)
Related tax	-
Opening balance under IFRS 9 (1 January 2018)	**(208,397)**

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as at 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

For financial assets, this table is presented by the related financial assets' measurement categories in accordance with IAS 39 and IFRS 9, and shows separately the effect of the changes in the measurement category on the loss allowance at the date of initial application of IFRS 9, i.e. as at 1 January 2018.

	Impairment allowance and provisions		
AZN'000	**31 December 2017 (IAS 39/IAS 37)**	**Remeasure-ment**	**1 January 2018 (IFRS 9)**
Loans and receivables under IAS 39/financial assets at amortised cost under IFRS 9 (includes cash and cash equivalents, due from banks, loans to customers)	191,328	42,728	234,056
Total measured at amortised cost	**191,328**	**42,728**	**234,056**
Loan commitments and financial guarantee contracts issued	**-**	**1,604**	**1,604**

5 Net interest income

	2018 AZN'000	2017 AZN'000
Interest income calculated using the effective interest method		
Loans to customers	31,650	54,880
Cash and cash equivalents	4,126	1,281
Investment securities	731	383
Due from banks	303	83
	36,810	**56,627**
Interest expense		
Current accounts and deposits from customers	11,489	14,568
Other borrowed funds	3,453	3,137
Subordinated borrowings	566	1,772
	15,508	**19,477**
	21,302	**37,150**

6 Fee and commission income

	2018 AZN'000	2017 AZN'000
Settlements	1,738	1,655
Cash withdrawals	706	876
Plastic cards operations	697	537
Guarantee and letter of credit issuance	189	167
Other	474	454
	3,804	**3,689**

Disaggregation of fee and commission income

In the following table, fee and commission income from contracts with customers in the scope of IFRS 15 is disaggregated by major types of commission income.

AZN'000	**Retail Banking**		**Corporate Banking**		**Total**	
For the year ended 31 December	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Settlements	710	711	1,028	944	1,738	1,655
Plastic cards operations	568	400	129	137	697	537
Cash withdrawals	354	349	352	527	706	876
Guarantee and letter of credit issuance	32	40	157	127	189	167
Other	90	26	384	428	474	454
Total fee and commission income	**1,754**	**1,526**	**2,050**	**2,163**	**3,804**	**3,689**
Fee and commission expense	(282)	(337)	(1,346)	(1,009)	(1,628)	(1,346)
Net fee and commission income	**1,472**	**1,189**	**704**	**1,154**	**2,176**	**2,343**

Performance obligations and revenue recognition policies

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	**Nature and timing of satisfaction of performance obligations, including significant payment terms**	**Revenue recognition under IFRS 15 (applicable from 1 January 2018)**
Retail and corporate banking service	The Bank provides banking services to retail and corporate customers, provision of overdraft facilities, foreign currency transactions, credit card and servicing fee. Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer's account when transaction takes place.	Revenue related to transactions is recognised at the point in time when the transaction takes place.
Guarantee and letter of credit issuance	The Bank issues guarantees and letters of credit to its customers.	Revenue from fees on issuance of guarantees and letters of credit is recognised over the period until maturity date of such contracts

7 Fee and commission expense

	2018 AZN'000	2017 AZN'000
Plastic cards operations	643	664
Agency fees	412	122
Settlement	268	251
Brokerage services	233	42
Cash withdrawals	46	267
Other	26	-
	1,628	**1,346**

8 Impairment losses on debt financial assets

The following table provides a reconciliation between loss allowance roll-forward and the impairment losses on debt financial assets in the statement of profit or loss and other comprehensive income per class of financial instrument.

	Loans to customers at amortised cost	Due from banks	Other financial assets	Total
Net remeasurement of loss allowance	57,876	14	178	58,068
New financial assets originated or purchased	5,759	-	-	5,759
Total	**63,635**	**14**	**178**	**63,827**

9 Personnel expenses

	2018 AZN'000	2017 AZN'000
Employee compensation	8,685	6,647
Contributions to Social Security Fund	1,918	1,444
	10,603	**8,091**

10 Other general administrative expenses

	2018 AZN'000	2017 AZN'000
Professional services	2,554	3,368
Depreciation and amortization	2,048	2,284
Rent expenses	1,531	1,612
Insurance of customer deposits	778	757
Security expenses	647	608
Communication expenses	490	493
Computer software cost	452	264
Advertising and marketing expenses	413	427
Office utilities and cleaning expenses	370	377
Repair and maintenance expenses	268	229
Office supplies and printing expenses	263	255
Taxes other than on income	231	152
Legal and court expenses	209	221
Loss on disposal of fixed assets	128	599
Other expenses	743	544
	11,125	**12,190**

11 Income tax expense

	2018 AZN'000	2017 AZN'000
Current year tax expense	-	-
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences	-	-
Total income tax expense	-	-

In 2018, the applicable tax rate for current and deferred tax is 20 % (2017: 20%).

Reconciliation of effective tax rate for the years ended 31 December:

	2018 AZN'000	%	2017 AZN'000	%
Loss before income tax	**(70,185)**		**(28,669)**	
Income tax at the applicable tax rate	(14,037)	(20.00)	(5,734)	(20.00)
Non-deductible costs	1,983	2.83	182	0.63
Change in unrecognized deferred tax assets	12,054	17.17	5,552	19.37
	-	**0.00**	-	**0.00**

Deferred tax assets and liabilities

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax assets as at 31 December 2018 and 31 December 2017. The deferred tax assets are not recognised in these financial statements. Future tax benefits will only be realised if profits will be available against which unused tax losses can be utilised and there are no changes to the law and regulations that adversely affect the Bank's ability to claim deductions in future periods. These future tax benefits are not recognised due to uncertainties concerning their realisation.

The deductible temporary differences do not expire under current tax legislation. The tax loss carry-forwards in the amount of AZN 1,810 thousand from tax losses for the year 2015, AZN 28,336 thousand from tax losses for the year 2016, AZN 70 thousand from tax losses for the year 2017 and AZN 23,675 thousand from tax losses for the year 2018 expire in 2020, 2021, 2022 and 2023 respectively.

Movements in temporary differences during the years ended 31 December 2018 and 2017 are presented as follows.

2018 AZN'000	**Balance at 1 January 2018**	**Recognised in profit or loss**	**Balance at 31 December 2018**
Loans to customers	7,689	(11,948)	(4,259)
Property, equipment and intangible assets	264	159	423
Due from banks	23	13	36
Investment securities	-	-	-
Assets held for sale	-	-	-
Other assets	5	300	305
Subordinated borrowings	-	(145)	(145)
Tax loss carry-forwards	30,216	23,675	53,891
Net deferred tax asset	38,197	12,054	50,251
Deferred tax asset not recognized	(38,197)	(12,054)	(50,251)
	-	-	-

11 Income tax expense (continued)

2017 AZN'000	Balance at 1 January 2017	Recognised in profit or loss	Balance at 31 December 2017
Loans to customers	2,267	5,422	7,689
Property, equipment and intangible assets	93	171	264
Due from banks	6	17	23
Investment securities	(13)	13	-
Assest held for sale	63	(63)	-
Other assets	41	(36)	5
Subordinated borrowings	42	(42)	-
Tax loss carry-forwards	30,146	70	30,216
Net deferred tax asset	32,645	5,552	38,197
Deferred tax asset not recognized	(32,645)	(5,552)	(38,197)
	-	-	-

12 Cash and cash equivalents

	31 December 2018 AZN'000	31 December 2017 AZN'000
Cash on hand	**8,090**	**7,082**
Nostro accounts with the CBAR	**6,549**	**13,526**
Nostro accounts and overnight placements with other banks		
- rated from BBB- to BBB+	343	9,038
- rated from BB- to BB+	1,759	721
- rated from B- to B+	164	316
- not rated	22	22
Total nostro accounts and overnight placements with other banks	**2,288**	**10,097**
Cash equivalents		
CBAR notes	**66,640**	**7,011**
Term deposits with the CBAR	**15,358**	**18,905**
Term deposits with non-resident banks	**18,193**	**18,702**
- rated from BBB- to BBB+	18,193	18,702
	117,118	**75,323**

As at 31 December 2018, besides the CBAR the Bank had one bank (31 December 2017: one), whose balance exceeded 10% of equity. The gross value of these balances as at 31 December 2018 were AZN 18,536 thousand (31 December 2017: AZN 27,740 thousand).

Loss allowance

As at 31 December 2018, all balances included in cash and cash equivalents are classified as Stage 1 and no loss allowance is recognised.

As at 31 December 2017, no cash and cash equivalents balances are impaired or past due.

13 Due from banks

	31 December 2018 AZN'000	31 December 2017 AZN'000
Mandatory reserve with the CBAR	**1,744**	**2,007**
Blocked account with the CBAR	**30,804**	**43,387**
Loans and deposits		
- rated from BBB- to BBB+	5,124	-
- rated below B+	170	170
- not rated	-	3
Total loans and deposits	**5,294**	**173**
Total due from banks	**37,842**	**45,567**

As at 31 December 2018, besides the CBAR the Bank had one bank (31 December 2017: nil), whose balance exceeded 10% of equity. The gross value of this balance as at 31 December 2018 was AZN 5,124 thousand (31 December 2017: nil).

Loss allowance

As at 31 December 2018, all balances included in due from banks are classified as Stage 1 and no loss allowance is recognised.

As at 31 December 2017, no due from banks balances are impaired or past due.

Mandatory reserve with the CBAR

The mandatory reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBAR and whose withdrawal ability is restricted. Reserves are measured in accordance with regulations issued by the CBAR and equal to 0.5 and 1 % of the average qualifying customer accounts balances denominated in AZN and foreign currency, respectively.

Blocked account with the CBAR

As at 31 December 2018, included in loans and deposits were AZN 30,804 thousand (31 December 2017: AZN 43,387 thousand) blocked by the CBAR as a collateral for the loans issued to the Bank.

14 Loans to customers

	31 December 2018 AZN'000	% of total gross loans	31 December 2017 AZN'000	% of total gross loans
Corporate loans	183,022	43%	189,242	44%
Total loans to corporate customers	**183,022**		**189,242**	
Entrepreneur loans	55,875	13%	81,695	19%
Consumer loans	79,957	19%	71,512	17%
Mortgage loans	72,698	17%	57,255	13%
Auto loans	36,050	8%	31,240	7%
Total loans to individuals	**244,580**		**241,702**	
Gross loans to customers	**427,602**		**430,944**	
Loss allowance	(201,485)	47%	(191,328)	44%
Net loans to customers	**226,117**		**239,616**	

14 Loans to customers (continued)

(a) Loss allowance

The following table shows reconciliation from the opening balances of the loss allowance of loans to customers as at 31 December 2017 accounted for under IAS 39 to the opening balances of the loss allowance of loans to customers as at 1 January 2018 accounted for under IFRS 9:

AZN'000	
Balance at 31 December 2017	**191,328**
Remeasurement of loss allowance (Note 4)	11,840
Unwinding of discount	30,888
Balance at 1 January 2018	**234,056**

The following tables show reconciliations from the opening to the closing balances of the loss allowance of loans to customers. Comparative amounts for 2017 represent allowance account for credit losses and reflect measurement basis under IAS 39.

	2018					2017		
AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Corporate customers**	**Individuals**	**Total**
Loans to customers at amortised cost*								
Balance at 1 January	1,160	251	231,710	934	234,055	68,189	107,489	175,678
Transfer to Stage 1	315	(53)	(262)	-	-			
Transfer to Stage 2	(1,171)	6,986	(5,815)	-	-			
Transfer to Stage 3	(1,668)	(63)	1,731	-	-			
Net remeasurement of loss allowance	(502)	(2,784)	60,087	1,075	57,876	34,842	13,512	48,354
New financial assets originated or purchased	5,759	-	-	-	5,759			
Write-offs	-	-	(130,334)	(2,040)	(132,374)	(558)	(32,146)	(32,704)
Recoveries of amounts previously written off			4,406	-	4,406			
Unwinding of discount on present value of ECLs	-	-	31,732	31	31,763			
Balance at 31 December	**3,893**	**4,337**	**193,255**	**-**	**201,485**	**102,473**	**88,855**	**191,328**

	2018					2017
AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Total**
Loans to customers at amortised cost – corporate loans*						
Balance at 1 January	316	91	117,402	934	118,743	68,189
Transfer to Stage 1	-	-	-	-	-	
Transfer to Stage 2	(1,000)	6,583	(5,583)	-	-	
Transfer to Stage 3	(743)	-	743	-	-	
Net remeasurement of loss allowance	(46)	(2,689)	35,576	1,075	33,916	34,842
New financial assets originated or purchased	3,403	-	-	-	3,403	
Write-offs	-	-	(65,898)	(2,040)	(67,938)	(558)
Recoveries of amounts previously written off	-	-	378	-	378	
Unwinding of discount on present value of ECLs	-	-	10,337	31	10,368	
Balance at 31 December	**1,930**	**3,985**	**92,955**	**-**	**98,870**	**102,473**

14 Loans to customers (continued)

AZN'000	2018					2017
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Total**
Loans to customers at amortised cost – loans to individuals*						
Balance at 1 January	844	160	114,308	-	115,312	107,489
Transfer to Stage 1	315	(53)	(262)	-	-	
Transfer to Stage 2	(171)	403	(232)	-	-	
Transfer to Stage 3	(925)	(63)	988	-	-	
Net remeasurement of loss allowance	(456)	(95)	24,511	-	23,960	13,512
New financial assets originated or purchased	2,356	-	-	-	2,356	
Write-offs	-	-	(64,436)	-	(64,436)	(32,146)
Recoveries of amounts previously written off	-	-	4,028	-	4,028	
Unwinding of discount on present value of ECLs	-	-	21,395	-	21,395	
Balance at 31 December	**1,963**	**352**	**100,300**	**-**	**102,615**	**88,855**

* The loss allowance in these tables includes ECL on loan commitments, because the Bank does not separately recognise the ECL on the loan commitment component from those on the financial instrument component.

Net remeasurement of loss allowance for Stage 3 is mainly explained by the following:

- change in assumptions on time period required to recover an impaired loan from collateral was increased to 48 months that resulted in an increase in loss allowance by AZN 15,645 thousand.
- change in expected cash flows for credit-impaired loans with total gross carrying amount of AZN 156,621 thousand, resulted in an increase in loss allowance by AZN 41,636 thousand.

(b) Credit quality analysis

Significant changes in the gross carrying amount of financial instruments during the period that contributed to changes in loss allowance were as follows:

- the volume of loans originated during the period increased the gross carrying amount of the loan portfolio by AZN 107,342 thousand with a corresponding increase in loss allowance by AZN 5,759 thousand.
- the write-off of loans with a total gross carrying amount of AZN 130,334 thousand resulted in the reduction of stage 3 loss allowance by the same amount.

The following table sets out information about the credit quality of loans to customers measured at amortised cost as at 31 December 2018. Unless specially indicated, the amounts in the table represent gross carrying amounts.

Explanation of the terms: Stage 1, Stage 2 and Stage 3 are included in Note 3(e)(iv).

AZN'000	31 December 2018				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortised cost – corporate loans					
Not overdue	46,936	6,515	8,055	-	61,506
Overdue less than 30 days	1,209	2,617	80	-	3,906
Overdue 30-89 days	-	3,529	21	-	3,550
Overdue 90-179 days	-	-	307	-	307
Overdue 180-360 days	-	-	68,591	-	68,591
Overdue more than 360 days	-	-	44,225	937	45,162
	48,145	**12,661**	**121,279**	**937**	**183,022**
Loss allowance	**(1,930)**	**(3,985)**	**(92,955)**	**-**	**(98,870)**
Carrying amount	**46,215**	**8,676**	**28,324**	**937**	**84,152**

14 Loans to customers (continued)

AZN'000	31 December 2018				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortised cost – entrepreneur loans					
Not overdue	7,479	309	115	-	7,903
Overdue less than 30 days	1,282	1,279	-	-	2,561
Overdue 30-89 days	23	644	45	-	712
Overdue 90-179 days	-	-	213	-	213
Overdue 180-360 days	-	-	2,739	-	2,739
Overdue more than 360 days	-	-	41,747	-	41,747
	8,784	**2,232**	**44,859**	**-**	**55,875**
Loss allowance	**(301)**	**(186)**	**(37,413)**	**-**	**(37,900)**
Carrying amount	**8,483**	**2,046**	**7,446**	**-**	**17,975**

AZN'000	31 December 2018				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortised cost – consumer loans					
Not overdue	25,519	2,156	3,063	-	30,738
Overdue less than 30 days	1,861	361	386	-	2,608
Overdue 30-89 days	31	706	267	-	990
Overdue 90-179 days	-	-	956	-	970
Overdue 180-360 days	-	-	6,057	-	6,057
Overdue more than 360 days	-	-	38,594	-	38,594
	27,411	**3,223**	**49,323**	**-**	**79,957**
Loss allowance	**(1,134)**	**(148)**	**(33,342)**	**-**	**(34,624)**
Carrying amount	**26,277**	**3,075**	**15,981**	**-**	**45,333**

AZN'000	31 December 2018				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortised cost – mortgage loans					
Not overdue	61,221	1,165	1,925	-	64,311
Overdue less than 30 days	1,237	57	90	-	1,384
Overdue 30-89 days	149	253	124	-	526
Overdue 90-179 days	-	-	222	-	222
Overdue 180-360 days	-	-	4,234	-	4,234
Overdue more than 360 days	-	-	2,021	-	2,021
	62,607	**1,475**	**8,616**	**-**	**72,698**
Loss allowance	**(523)**	**(18)**	**(4,994)**	**-**	**(5,535)**
Carrying amount	**62,084**	**1,457**	**3,622**	**-**	**67,163**

AZN'000	31 December 2018				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortised cost – auto loans					
Not overdue	54	6	77	-	137
Overdue less than 30 days	22	23	29	-	74
Overdue 30-89 days	-	19	48	-	67
Overdue 90-179 days	-	-	123	-	123
Overdue 180-360 days	-	-	722	-	722
Overdue more than 360 days	-	-	34,927	-	34,927
	76	**48**	**35,926**	**-**	**36,050**
Loss allowance	**(3)**	**-**	**(24,553)**	**-**	**(24,556)**
Carrying amount	**73**	**48**	**11,373**	**-**	**11,494**

14 Loans to customers (continued)

The following table provides information on the credit quality of loans to customers as at 31 December 2017. Unless specially indicated, the amounts in the table represent gross carrying amounts.

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Loans to corporate customers				
Current loans without signs of impairment	20,293	816	19,477	4.0
Past due but not impaired loans				
- overdue less than 30 days	1,509	74	1,435	4.9
- overdue 30-89 days	6,048	64	5,984	1.1
Total past due but not impaired loans	7,557	138	7,419	1.8
Impaired loans				
- not overdue	5,904	2,301	3,603	39.0
- overdue less than 30 days	263	153	110	58.2
- overdue 30-89 days	-	-	-	-
- overdue 90-179 days	1,408	-	1,408	-
- overdue 180-360 days	11,742	7,423	4,319	63.2
- overdue more than 360 days	141,990	91,642	50,348	64.5
Total impaired loans	161,307	101,519	59,788	62.9
Total loans to corporate customers	**189,157**	**102,473**	**86,684**	**54.2**
Entrepreneur loans				
Current loans without signs of impairment	9,252	1,790	7,462	19.3
Past due but not impaired loans				
- overdue less than 30 days	920	36	884	3.9
- overdue 30-89 days	832	44	788	5.3
Total past due but not impaired loans	1,752	80	1,672	4.6
Impaired loans				
- overdue 90-179 days	980	153	827	15.6
- overdue 180-360 days	2,126	1,231	895	57.9
- overdue more than 360 days	46,961	29,559	17,402	62.9
Total impaired loans	50,067	30,943	19,124	61.8
Total entrepreneur loans	**61,071**	**32,813**	**28,258**	**53.7**

14 Loans to customers (continued)

	Gross loans AZN'000	Impairment allowance AZN'000	Net loans AZN'000	Impairment allowance to gross loans, %
Consumer loans				
Current loans without signs of impairment	12,174	780	11,394	6.4
Past due but not impaired loans				
- overdue less than 30 days	1,664	147	1,517	8.8
- overdue 30-89 days	1,539	254	1,285	16.5
Total past due but not impaired loans	3,203	401	2,802	12.5
Impaired loans				
- not overdue	10	3	7	30.0
- overdue 90-179 days	1,189	255	934	21.4
- overdue 180-360 days	4,461	2,102	2,359	47.1
- overdue more than 360 days	71,159	36,024	35,135	50.6
Total impaired loans	76,819	38,384	38,435	50.0
Total consumer loans	**92,196**	**39,565**	**52,631**	**42.9**
Mortgage loans				
Current loans without signs of impairment	49,447	37	49,410	0.1
Past due but not impaired loans				
- overdue less than 30 days	723	3	720	0.4
- overdue 30-89 days	404	-	404	-
Total past due but not impaired loans	1,127	3	1,124	0.3
Impaired loans				
- not overdue	43	37	6	86.0
- overdue 90-179 days	170	2	168	1.2
- overdue 180-360 days	1,010	170	840	16.8
- overdue more than 360 days	5,458	1,985	3,473	36.4
Total impaired loans	6,681	2,194	4,487	32.8
Total mortgage loans	**57,255**	**2,234**	**55,021**	**3.9**
Auto loans				
Current loans without signs of impairment	519	4	515	0.8
Past due but not impaired loans				
- overdue less than 30 days	122	3	119	2.5
- overdue 30-89 days	224	41	183	18.3
Total past due but not impaired loans	346	44	302	12.7
Impaired loans				
- overdue 90-179 days	349	96	253	27.5
- overdue 180-360 days	979	431	548	44.0
- overdue more than 360 days	29,072	13,668	15,404	47.0
Total impaired loans	30,400	14,195	16,205	46.7
Total auto loans	**31,265**	**14,243**	**17,022**	**45.6**
Total loans to individuals	**241,787**	**88,855**	**152,932**	**36.7**
Total loans to customers	**430,944**	**191,328**	**239,616**	**44.4**

Movement on impairment in POCI assets relates to portfolio of impaired loans purchased by the Bank in prior years. Nominal value of POCI assets purchased during the year ended 31 December 2018 were in the amount of AZN 5,912 thousand, with fair value loss from initial recognition calculated in profit and loss statement in the amount of AZN 4,975 thousand.

14 Loans to customers (continued)

(c) Key assumptions and judgments for estimating the loan impairment

The Bank estimates ECL for significant loans in Stage 3 based on an individual review of each loan and estimation of its future cash flows. This estimate of future cash flows is dependent on factors such as the estimated value of underlying collateral and delay of 12 to 48 months in obtaining proceeds from the foreclosure of collateral. The Bank then calculates the net present value of these cash flows using a discount rate which equates to the original effective interest rate of the loan, in order to determine the required amount of ECL.

For the remaining portfolio of loans the Bank calculates ECL as described in Note 25 (e), on a collective basis. The key areas of uncertainty and assumptions used in the calculation of the collective impairment are:

- a delay in obtaining proceeds from the foreclosure of collateral;
- a discount of 40% and 60% for real estates and motor vehicles to the originally appraised value, respectively, if the property pledged is sold through court procedures.

Changes in these estimates could effect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flows differs by one percent, the impairment allowance on loans to customers as at 31 December 2018 would be AZN 2,261 thousand lower/higher (31 December 2017: AZN 2,396 thousand lower/higher).

(d) Changes in estimates

During the year ended 31 December 2018, due to formation of historical data on repossessed collateral sales, the Bank adjusted its estimates used in calculation of ECL on a collective basis by changing a delay period in obtaining proceeds from the foreclosure of collateral from 12 months to 48 months for real estate and motor vehicles.

The result of this change in estimate resulted in an increase compared to the year ended 31 December 2017 to the ECL on loans to customers by AZN 15,645 thousand as at 31 December 2018.

14 Loans to customers (continued)

(e) Collateral held and other credit enhancements

The following table sets out information on loans to customers that are credit-impaired and related collateral held in order to mitigate potential losses as at 31 December 2018. The fair value of collaterals are updated as at the reporting date.

				Fair value of collateral held				
AZN'000	**Gross carrying amount**	**Loss allowance**	**Carrying amount**	**Cash and deposits**	**Motor vehicles**	**Real estate**	**Precious metals**	**Total**
Loans to corporate customers								
Corporate loans	122,216	(92,955)	29,261	2,363	758	13,512	-	16,633
Loans to individuals								
Entrepreneur loans	44,859	(37,413)	7,446	321	206	6,749	170	7,446
Consumer loans	49,323	(33,342)	15,981	2,307	8	13,654	12	15,981
Mortgage loans	8,616	(4,994)	3,622	-	-	3,496	-	3,496
Auto loans	35,926	(24,553)	11,373	-	11,373	-	-	11,373
Total credit-impaired loans to customers	**260,940**	**(193,257)**	**67,683**	**4,991**	**12,345**	**37,411**	**182**	**54,929**

The following table provides information on collateral securing loans to customers, net of impairment, by types of collateral as at 31 December 2018:

				Fair value of collateral held				
AZN'000	**Gross carrying amount**	**Loss allowance**	**Carrying amount**	**Cash and deposits**	**Motor vehicles**	**Real estate**	**Precious metals**	**Total**
Loans to corporate customers								
Corporate loans	183,022	(98,870)	84,152	2,913	1,060	54,436	3,656	62,065
Loans to individuals								
Entrepreneur loans	55,875	(37,900)	17,975	324	206	17,265	179	17,974
Consumer loans	79,957	(34,624)	45,333	6,201	16	19,435	14	25,666
Mortgage loans	72,698	(5,535)	67,163	-	-	67,027	-	67,027
Auto loans	36,050	(24,556)	11,494	-	11,494	-	-	11,494
Total loans to customers	**427,602**	**(201,485)**	**226,117**	**9,438**	**12,776**	**158,163**	**3,849**	**184,226**

As at 31 December 2018 the Bank held loans to customers in the amount of AZN 5,307 thousand for which no loss allowance was recognised as they are collateralised fully by cash.

The following table provides information on total amount of loans to customers, net of impairment, by types of collateral as at 31 December 2017:

				Fair value of collateral held				
AZN'000	**Gross carrying amount**	**Loss allowance**	**Carrying amount**	**Cash and deposits**	**Motor vehicles**	**Real estate**	**Precious metals**	**Total**
Loans to corporate customers								
Corporate loans	189,242	(102,541)	86,701	4,712	1,529	20,539	-	26,780
Loans to individuals								
Entrepreneur loans	81,695	(44,373)	37,322	13	217	24,513	-	24,743
Consumer loans	71,512	(27,951)	43,561	3,969	178	23,747	78	27,972
Mortgage loans	57,255	(2,233)	55,022	557	34	53,618	-	54,209
Auto loans	31,240	(14,230)	17,010	3	16,193	27	-	16,223
Total loans to customers	**430,944**	**(191,328)**	**239,616**	**9,254**	**18,151**	**122,444**	**78**	**149,927**

14 Loans to customers (continued)

Repossessed collateral

During the year ended 31 December 2018, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 3,887 thousand (2017: AZN 2,293 thousand) and recognized them as assets held for sale. The Bank's policy is to sell these as soon as possible. Assets held for sale are comprised of real estates and other assets. See Note 17.

(f) Industry and geographical analysis of the loan portfolio

Loans to individuals were issued primarily for consumer purposes. Loans to corporate customers and entrepreneurs were issued primarily to customers located within the Republic of Azerbaijan who operate in the following economic sectors:

	31 December 2018 AZN'000	%	31 December 2017 AZN'000	%
Corporate loans				
- trade and services	83,429	19.4	75,762	17.6
- manufacturing	35,272	8.2	34,442	8
- financial services	28,641	6.7	25,659	6
- agriculture	21,058	4.9	17,885	4.2
- construction	14,232	3.3	35,073	8.1
- other	390	0.1	336	0.1
Total corporate loans	**183,022**	**42.8**	**189,157**	**43.9**
Loans to individuals				
- enterpreneurs	55,875	13.1	61,071	14.1
- consumer loans	74,999	17.5	88,895	20.6
- mortgage loans	72,698	17.0	57,255	13.3
- auto loans	36,050	8.4	31,265	7.3
- credit cards	4,958	1.2	3,301	0.8
Total loans to individuals	**244,580**	**57.2**	**241,787**	**56.1**
Total loans to customers	**427,602**	**100.0**	**430,944**	**100.0**
Impairment allowance	(201,485)		(191,328)	
Net loans to customers	**226,117**		**239,616**	

(g) Significant credit exposures

As at 31 December 2018, the Bank had forty one borrowers or groups of connected borrowers (31 December 2017: thirty six borrowers) with gross loan balances exceeding AZN 1,000 thousand. The gross value of these loans as at 31 December 2018 was AZN 200,530 thousand or 47% of the total loans to customers (31 December 2017: AZN 215,399 thousand or 50%).

(h) Loan maturities

The maturity of the loan portfolio is presented in Note 25, which shows the remaining period from the reporting date to the contractual maturity of the loans. Due to the short-term nature of the loans issued by the Bank, it is likely that many of the loans will be prolonged at maturity. Accordingly, the effective maturity of the loan portfolio may be significantly longer than the term based on contractual terms.

15 Investment securities

	31 December 2018 AZN'000	31 December 2017 AZN'000
Investment securities measured at amortised cost	13,601	-
Investment securities available-for-sale	-	1,239
Total investment securities	**13,601**	**1,239**

Investment securities measured at amortised cost

	31 December 2018 AZN'000
Corporate bonds	
Bonds of the Ministry of Finance of the Republic of Azerbaijan	11,778
Bonds of the State Oil Company of the Republic of Azerbaijan	86
Bonds of the financial institution	1,737
Total investment securities	**13,601**
Loss allowance	-
	13,601

At 31 December 2018, the debt securities included corporate bonds of State Oil Company of Azerbaijan Republic, carrying an annual interest rate of 5% with maturities in September 2021, bonds of the Ministry of Finance of the Republic of Azerbaijan, carrying an annual interest rate of 8% - 9.15% with maturities in January 2019 - August 2020, and corporate bond of foreign companies Nikora JSC and Silknet JSC, carrying an annual interest rate of 9% and 8.50% with maturity in June 2019 and March 2021. These corporate bonds are quoted in active market and their fair value approximated carrying value at 31 December 2018.

Investment securities available-for-sale

AZN'000	31 December 2017 AZN'000
Debt and other fixed-income instruments	
Bonds of the State Oil Company of the Republic of Azerbaijan	85
Bonds of the financial institution	850
Equity instruments	
Unquoted equity securities at cost	304
Total available-for-sale investment securities	**1,239**

At 31 December 2017, the debt securities included corporate bonds of State Oil Company of Azerbaijan Republic, carrying an annual interest rate of 5% with maturities in September 2021 and corporate bond of Nikora JSC, carrying an annual interest rate of 9% with maturity in June 2019. These corporate bonds are quoted in active market and their fair value approximated carrying value at 31 December 2017.

As at 31 December 2017, unquoted equity securities at cost comprised shares of Sumgait Ashgarlar OJSC. There was no market for this investment, however sales of the shares at cost equal to nominal value during 2018 provide evidence of the fair value as at 31 December 2017.

Loss allowance

As at 31 December 2018, all balances included in investment securities are classified as Stage 1 and no loss allowance is recognised.

As at 31 December 2017, no investment securities balances are impaired or past due.

15 Investment securities (continued)

Credit quality analysis

The following table sets out information about the credit quality of investment securities measured at amortised cost as at 31 December 2018. Explanation of the term "Stage 1" included in Note 3(e)(iv).

AZN'000	31 December 2018	
	Stage 1	**Total**
Debt investment securities at amortised cost		
Rated from BBB+	12,714	12,714
Rated B+	887	887
	13,601	**13,601**
Loss allowance	**-**	**-**
Carrying amount	**13,601**	**13,601**

The following table sets out information about the credit quality of investment securities available-for-sale as at 31 December 2017.

AZN'000	31 December 2017
	Total
Investment securities available-for-sale	
Rated from BB- to BB+	935
Not rated	304
	1,239
Loss allowance	**-**
Carrying amount	**1,239**

16 Property, equipment and intangible assets

AZN'000	Buildings	Furniture and fixtures	Computers and communication equipment	Vehicles	Other fixed assets	Leasehold imporvements	Intangible assets	Total
Cost amount								
Balance at 1 January 2018	3,169	3,964	4,400	1,129	284	5,779	5,321	24,046
Additions	-	315	541	102	1	57	270	1,286
Disposals	-	(15)	(42)	(168)	(1)	(19)	(126)	(371)
Balance at 31 December 2018	**3,169**	**4,264**	**4,899**	**1,063**	**284**	**5,817**	**5,465**	**24,961**
Depreciation and amortisation								
Balance at 1 January 2018	(855)	(2,319)	(3,421)	(716)	(186)	(1,806)	(1,956)	(11,259)
Depreciation and amortisation for the year	(158)	(317)	(541)	(69)	(52)	(406)	(505)	(2,048)
Disposals	-	14	39	169	1	7	14	244
Balance at 31 December 2018	**(1,013)**	**(2,622)**	**(3,923)**	**(616)**	**(237)**	**(2,205)**	**(2,447)**	**(13,063)**
Carrying amount								
At 31 December 2018	**2,156**	**1,642**	**976**	**447**	**47**	**3,612**	**3,018**	**11,898**

16 Property, equipment and intangible assets (continued)

AZN'000	Buildings	Furniture and fixtures	Computers and communication equipment	Vehicles	Other fixed assets	Leasehold imporvements	Intangible assets	Total
Cost amount								
Balance at 1 January 2017	3,145	3,937	4,323	1,155	470	6,594	4,888	24,512
Additions	24	104	420	82	20	24	503	1,177
Disposals	-	(77)	(343)	(108)	(206)	(839)	(70)	(1,643)
Balance at 31 December 2017	**3,169**	**3,964**	**4,400**	**1,129**	**284**	**5,779**	**5,321**	**24,046**
Depreciation and amortisation								
Balance at 1 January 2017	(698)	(2,060)	(2,990)	(755)	(234)	(1,758)	(1,524)	(10,019)
Depreciation and amortisation for the year	(157)	(305)	(724)	(69)	(90)	(446)	(493)	(2,284)
Disposals	-	46	293	108	138	398	61	1,044
Balance at 31 December 2017	**(855)**	**(2,319)**	**(3,421)**	**(716)**	**(186)**	**(1,806)**	**(1,956)**	**(11,259)**
Carrying amount								
At 31 December 2017	**2,314**	**1,645**	**979**	**413**	**98**	**3,973**	**3,365**	**12,787**

17 Assets held for sale

During the years ended 31 December 2018 and 2017 the Bank received non-financial assets classified as held for by taking possession of collateral held as security against loans to customer. As at 31 December 2018 and 2017 such assets amounted to AZN 4,772 thousand and AZN 8,962 thousand, respectively, net of impairment allowance. Initially, it was intended that these assets would be recovered principally through a sale transaction within one year from the date of classification. However, during the year ended 31 December 2018, the market conditions that existed at the date the assets were classified initially as held for sale significantly deteriorated and as a result, the assets could not be sold within one year period. The Bank continues to actively market the assets held for sale at a price that is reasonable given the change in market conditions. Assets held for sale are comprised of the following assets:

	31 December 2018 AZN'000	31 December 2017 AZN'000
Real estate	12,849	9,485
Other assets	14	-
Impairment allowance	(7,810)	(523)
Balance at the end of the year	**5,053**	**8,962**

Analysis of movements in the impairment

	2018 AZN'000	2017 AZN'000
Balance at the beginning of the year	523	2,795
Net charge / (recovery)	7,289	(1,417)
Write-offs	(2)	(855)
Balance at the end of the year	**7,810**	**523**

18 Other assets

	31 December 2018 AZN'000	31 December 2017 AZN'000
Settlements on monetary transfers	1,514	2,948
Amounts in course of settlement	171	749
Other receivables	68	73
Less: loss allowance for other financial assets	-	(179)
Total other financial assets	**1,753**	**3,591**
Prepayments for purchase of intangible assets and equipment	391	266
Prepaid expenses	291	243
Other	272	126
Total other non-financial assets	**954**	**635**
Total other assets	**2,707**	**4,226**

18 Other assets (continued)

Loss allowance

The following tables show reconciliations from the opening to the closing balances of the loss allowance of other assets. All balances relate to Stage 1. Comparative amounts for 2017 represent allowance account for credit losses and reflect measurement basis under IAS 39.

	2018		2017
AZN'000	**Stage 1**	**Total**	**Total**
Other assets			
Balance at 1 January	179	179	284
Net remeasurement of loss allowance	178	178	(1)
Write-offs	(357)	(357)	(104)
Balance at 31 December	**-**	**-**	**179**

19 Current accounts and deposits from customers

	31 December 2018 AZN'000	31 December 2017 AZN'000
Current accounts and demand deposits		
- Retail	15,743	13,556
- Corporate	41,790	37,359
Term deposits		
- Retail	172,032	185,353
- Corporate	4,695	1,469
	234,260	**237,737**

As at 31 December 2018, the Bank had twenty five customers (31 December 2017: twenty eight customers), whose balances exceeded AZN 1,000 thousand. The total amount of these balances as at 31 December 2018 was AZN 103,979 thousand (31 December 2017: AZN 104,559 thousand).

As at 31 December 2018, the Bank maintained customer deposit balances of AZN 12,955 thousand (31 December 2017: AZN 17,259 thousand) that served as collateral for loans and unrecognized credit instruments granted by the Bank.

20 Other borrowed funds and subordinated borrowings

	31 December 2018 AZN'000	31 December 2017 AZN'000
Subordinated borrowings	**8,912**	**25,961**
Other borrowed funds		
Central Bank of Azerbaijan Republic	27,211	40,320
Azerbaijan Mortgage Fund	62,932	47,078
National Fund for Entrepreneurship Support of Azerbaijan Republic	4,541	5,669
Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture	2,840	4,229
Total other borrowed funds	**97,524**	**97,296**
	106,436	**123,257**

Azerbaijan Mortgage Fund

On 17 February 2006, the Bank signed borrowing agreement with the State Mortgage Fund of Azerbaijan Republic, a programme under the auspices of the Central Bank of Azerbaijan Republic, for granting long-term mortgage loans to individuals. Under this programme, funds are made available to the Bank at an interest rate of 1-4% per annum and the Bank further on lends these funds to eligible borrowers at rates ranging between 1.0%-8.0% per annum. At 31 December 2018 the Bank had AZN 62,932 thousand (31 December 2017: AZN 47,078 thousand) payable to the State Mortgage Fund of Azerbaijan Republic. There are no financial covenants with regard to borrowing from the Azerbaijan Mortgage Fund that the Bank should comply with.

National Fund for Entrepreneurship Support of Azerbaijan Republic

On 26 November 2009, the Bank signed a credit agreement with the National Fund for Support to Entrepreneurship, a programme under the auspices of the Ministry for Economic Development of the Republic of Azerbaijan, for the financing of small and medium size enterprises. Under this programme, funds are made available to the Bank at an interest rate of 1.0%-2.0% per annum and the Bank further on lends these funds to eligible borrowers at rates not higher than 7.0%-8.0% per annum. At 31 December 2018, the Bank had AZN 4,541 thousand (2017: AZN 5,669 thousand) payable to the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan. There are no financial covenants with regard to the borrowing from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan that the Bank should comply with.

Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture

On 30 September 2015, the Bank signed a credit agreement with the National Fund for Support to Entrepreneurship, a programme under the auspices of the Ministry for Agriculture of the Republic of Azerbaijan, for the financing of small and medium size enterprises. Under this programme, funds are made available to the Bank at an interest rate of 2.0% per annum and the Bank further on lends these funds to eligible borrowers at rates not higher than 6.0%-7.0% per annum. At 31 December 2018, the Bank had AZN 2,840 thousand (2017: AZN 4,229 thousand) payable to the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan. There are no financial covenants with regard to the borrowing from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan that the Bank should comply with.

CBAR

The Bank signed agreements on the dates December 2014 – October 2015 with CBAR to borrow in the total amount of AZN 40,320 thousand with an interest rate ranging between 3.2-3.5% per annum, maturing on the dates June 2018 – September 2018. During 2018, AZN 13,100 thousand were repaid and maturity of the rest amount was prolonged till April 2019. The principle amount on the issued loans is repayable upon maturity, and the interest is repayable on quarterly basis starting from the origination date.There are no financial covenants with regard to borrowing from CBAR that the Bank should comply with.

20 Other borrowed funds and subordinated borrowings (continued)

Subordinated borrowings

As at 31 December 2018, subordinated borrowings included deposit placed by related party in the amount AZN 8,912 thousand (31 December 2017: AZN 25,961 thousand) maturing in 2023 (31 December 2017: 2023) and carried annual interest rate of 3% (31 December 2017: 3%). In June 2018, AZN 17,000 thousand of the subordinated debt were transferred to share capital. In case of bankruptcy, the repayment of the subordinated borrowings will be made after repayment in full of all other liabilities of the Bank.

Reconciliation of movements of liabilities to cash flows arising from financing activities:

'000 AZN	Other borrowed funds	Subordinated borrowings	Total
Balance at 1 January 2017	**91,828**	**36,136**	**127,964**
Changes from financing cash flows			
Receipt of other borrowed funds	13,135	-	13,135
Repayment of other borrowed funds	(7,706)	-	(7,706)
Repayment of subordinated borrowings	-	(7,950)	(7,950)
Total changes from financing cash flows	**5,429**	**(7,950)**	**(2,521)**
The effect of changes in foreign exchange rates	-	(1,380)	(1,380)
Other changes			
Interest expense	3,137	1,772	4,909
Interest paid	(3,098)	(2,617)	(5,715)
Balance at 1 January 2018	**97,296**	**25,961**	**123,257**
Changes from financing cash flows			
Receipt of other borrowed funds	21,389	-	21,389
Repayment of other borrowed funds	(21,218)	-	(21,218)
Transfer of subordinated borrowings to share capital	-	(17,000)	(17,000)
Total changes from financing cash flows	**171**	**(17,000)**	**(16,829)**
The effect of changes in foreign exchange rates	**(2)**	**(2)**	**(4)**
Other changes			
Interest expense	3,453	566	4,019
Interest paid	(3,394)	(613)	(4,007)
Balance at 31 December 2018	**97,524**	**8,912**	**106,436**

21 Other liabilities

	31 December 2018 AZN'000	31 December 2017 AZN'000
Settlement on other operations	1,434	1,337
Payables on purchased loans	1,166	-
Accrued expenses	49	52
Total other financial liabilities	**2,649**	**1,389**
Other taxes payable	251	3
Other non-financial liabilities	34	50
Total other non-financial liabilities	**285**	**53**
Total other liabilities	**2,934**	**1,442**

22 Share capital and reserves

(a) Issued capital

The authorised, issued and outstanding share capital comprises 174,000,000 ordinary shares (2017: 110,000,000). All shares have a nominal value of AZN 2 per share. During the year ended 31 December 2018 55,500,000 ordinary shares were issued for cash and 8,500,000 ordinary shares were issued as transfer from subordinated borrowing (2017: 17,750,000 share for cash).

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Bank.

(b) Dividends

Dividends payable are restricted to the maximum retained earnings of the Bank, which are determined according to legislation of the Azerbaijan Republic. Bank are not allowed to pay dividends if net assets are less than Share Capital. There were no dividends declared by the Bank during 2018 (2017: nil).

23 Loss per share

Basic and diluted loss per share

The calculation of basic loss per share as at 31 December 2018 is based on the loss attributable to ordinary shareholders of AZN 70,185 thousand (2017: AZN 28,669 thousand), and a weighted average number of ordinary shares outstanding of 135,763,000 (2017: 93,729,000) calculated as follows.

	2018	2017
Net loss attributable to ordinary shareholders (AZN'000)	(70,185)	(28,669)
Weighted average number of ordinary shares for the year ended 31 December (thousands of shares)	135,763	93,729
Basic and diluted loss per share (AZN)	**(0.52)**	**(0.31)**

24 Analysis by segment

The Bank has one reportable segment and one strategic business unit which includes loans, deposits and other transactions with customers.

The majority of income from external customers relate to residents of the Republic of Azerbaijan.

The majority of non-current assets are located in the Republic of Azerbaijan.

25 Risk management, corporate governance and internal control

Management of risk is fundamental to the business of banking and is an essential element of the Bank's operations. The major risks faced by the Bank are those related to market risk, credit risk and liquidity risk.

(a) Corporate governance framework

The Bank is established as an open joint stock company in accordance with Azerbaijani law. The supreme governing body of the Bank is the General Shareholders' meeting that is called for annual or extraordinary meetings. The General Shareholders' meeting makes strategic decisions on the Bank's operations.

The General Shareholders' meeting elects the Supervisory Board. The Supervisory Board is responsible for overall governance of the Bank's activities.

Azerbaijani legislation and the charter of the Bank establish lists of decisions that are exclusively approved by the general shareholders' meeting and that are approved by the Supervisory Board.

As at 31 December 2018 the Supervisory Board included:

Marina Kulishova – Chairman of the Supervisory Board

Ivan Romanovsky – Member of the Supervisory Board

Nikoloz Enukidze – Member of Supervisory Board

During the year ended 31 December 2018, no changes occurred in composition of the Supervisory Board.

General activities of the Bank are managed by the collective executive body of the Bank. The General Shareholders' meeting elects the Management Board. The executive body of the Bank is responsible for implementation of decisions of the General Shareholders' meeting and the Supervisory Board of the Bank. Executive body of the Bank reports to the Supervisory Board of the Bank and to the general shareholders' meeting.

As at 31 December 2018 the Management Board included:

Nikoloz Shurgaia – Chairman of the Management Board

Farhad Hajinski– First Deputy Chairman of the Management Board

Fuad Tagiyev– Deputy Chairman of the Management Board

During the year ended 31 December 2018 no changes occurred in composition of the Management Board.

(b) Internal control policies and procedures

The Supervisory Board and the Management Board have responsibility for the development, implementation and maintaining of internal controls in the Bank that are commensurate with the scale and nature of operations.

The purpose of internal controls is to ensure:

- proper and comprehensive risk assessment and management
- proper business and accounting and financial reporting functions, including proper authorization, processing and recording of transactions
- completeness, accuracy and timeliness of accounting records, managerial information, regulatory reports, etc.
- reliability of IT-systems, data and systems integrity and protection
- prevention of fraudulent or illegal activities, including misappropriation of assets
- compliance with laws and regulations

Management is responsible for identifying and assessing risks, designing controls and monitoring their effectiveness. Management monitors the effectiveness of the Bank's internal controls and periodically implements additional controls or modifies existing controls as considered necessary.

25 Risk management, corporate governance and internal control (continued)

The Bank developed a system of standards, policies and procedures to ensure effective operations and compliance with relevant legal and regulatory requirements, including the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the recording, reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards and
- risk mitigation, including insurance where this is effective.

There is a hierarchy of requirements for authorization of transactions depending on their size and complexity. A significant portion of operations are automated and the Bank put in place a system of automated controls.

The main functions of internal audit service include the following:

- audit and efficiency assessment of the system of internal control as a whole, fulfillment of the decisions of key management structures
- audit of efficiency of methodology of assessment of banking risks and risk management procedures, regulated by internal documents in credit organisation (methods, programs, rules and procedures for banking operations and transactions, and for the management of banking risks)
- audit of reliability of internal control system over automated information systems
- audit and testing of fairness, completeness and timeliness of accounting and reporting function and the reliability (including the trustworthiness, fullness and objectivity) of the collection and submission of financial information
- audit of applicable methods of safekeeping the credit organisation's property
- assessment of economic reasonability and efficiency of operations and other deals
- audit of internal control processes and procedures
- audit of internal control service and risk management service.

Compliance with the Bank's standards is supported by a program of periodic reviews undertaken by Internal Audit. The Internal Audit function is independent from management and reports directly to the Audit Committee and Supervisory Board. The results of Internal Audit reviews are discussed with relevant business process managers, with summaries submitted to the Audit Committee and Supervisory Board and senior management of the Bank.

The internal control system in the Bank comprises:

- the Supervisory Board and its committees,
- the Management Board
- the Finance Director
- the risk management function
- the security function, including IT-security
- the human resource function

25 Risk management, corporate governance and internal control (continued)

- the internal audit service
- the internal control (compliance) service
- other employees, division and functions that are responsible for compliance with the established standards, policies and procedures, including:
  - heads of branches and heads of business-units
  - business processes managers
  - division responsible for compliance with anti-money laundering requirements
  - professional securities market participant controller – an executive office responsible for compliance with the requirements for securities market participants
  - the legal officer – an employee responsible for compliance with the legal and regulatory requirements
  - other employees with control responsibilities

The Bank complies with the FIMSA requirements related to risk management and internal control systems, including requirements related to the internal audit function, and that risk management and internal control systems are appropriate for the scale, nature and complexity of operations.

(c) Risk management policies and procedures

Management of risk is fundamental to the business of banking and forms an essential element of the Bank's operations. The major risks faced by the Bank are those related to market risk, credit risk, liquidity risk and operational risks.

The risk management policies aim to identify, analyse and manage the risks faced by the Bank, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Supervisory Board has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

The Management Board is responsible for monitoring and implementing risk mitigation measures, and ensuring that the Bank operates within established risk parameters. The Head of the Risk Department is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to the CEO and indirectly to the Supervisory Board.

Credit, market and liquidity risks both at the portfolio and transactional levels are managed and controlled through a system of Risk Management Committee, Credit Committees and an Asset and Liability Management Committee (ALCO). In order to facilitate efficient and effective decision-making, the Bank established a hierarchy of credit committees depending on the type and amount of the exposure

Overall authority for market risk is vested in the ALCO, which is chaired by the Chairman of the Management Board.

Both external and internal risk factors are identified and managed throughout the organisation. Particular attention is given to identifying the full range of risk factors and determination of the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Department monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their areas of expertise.

25 Risk management, corporate governance and internal control (continued)

(d) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimizing the return on risk.

Market risk limits are approved by ALCO based on recommendations of the Risk Department.

The Bank manages its market risk by setting open position limits in relation to financial instruments, interest rate maturity and currency positions and stop-loss limits. These are monitored on a regular basis and reviewed and approved by the Supervisory Board.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may also reduce or create losses in the event that unexpected movements occur.

Interest rate gap analysis

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments is as follows:

AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Carrying amount
31 December 2018							
ASSETS							
Cash and cash equivalents	100,191	-	-	-	-	16,927	117,118
Due from banks	5,294	-	-	-	-	32,548	37,842
Loans to customers	30,063	7,432	28,494	89,677	70,451	-	226,117
Investment securities	1,000	-	9,628	2,973	-	-	13,601
Other financial assets	-	-	-	-	-	1,753	1,753
	136,548	**7,432**	**38,122**	**92,650**	**70,451**	**51,228**	**396,431**
LIABILITIES							
Deposits and balances from banks	-	-	-	-	-	6	6
Current accounts and deposits from customers	15,412	20,205	88,175	52,928	7	57,533	234,260
Other borrowed funds	606	633	30,452	13,346	52,487	-	97,524
Other financial liabilities	-	-	-	-	-	2,649	2,649
Subordinated borrowings	-	-	412	8,500	-	-	8,912
	16,018	**20,838**	**119,039**	**74,774**	**52,494**	**60,188**	**343,351**
	120,530	**(13,406)**	**(80,917)**	**17,876**	**17,957**	**(8,960)**	**53,080**

25 Risk management, corporate governance and internal control (continued)

AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Carrying amount
31 December 2017							
ASSETS							
Cash and cash equivalents	44,618	-	-	-	-	30,705	75,323
Due from banks	173	-	-	-	-	45,394	45,567
Loans to customers	45,062	6,010	31,445	85,567	71,532	-	239,616
Investment securities	-	-	-	935	-	304	1,239
Other financial assets	-	-	-	-	-	3,591	3,591
	89,853	**6,010**	**31,445**	**86,502**	**71,532**	**79,994**	**365,336**
LIABILITIES							
Deposits and balances from banks	-	-	-	-	-	7	7
Current accounts and deposits from customers	14,795	24,376	104,822	43,545	15	50,184	237,737
Other borrowed funds	470	670	43,113	10,775	42,268	-	97,296
Other financial liabilities	-	-	-	-	-	1,389	1,389
Subordinated borrowings	-	-	459	-	25,502	-	25,961
	15,265	**25,046**	**148,394**	**54,320**	**67,785**	**51,580**	**362,390**
	74,588	**(19,036)**	**(116,949)**	**32,182**	**3,747**	**28,414**	**2,946**

Average effective interest rates

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2018 and 2017. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2018 Average effective interest rate, %			2017 Average effective interest rate, %		
	AZN	**USD**	**EUR**	**AZN**	**USD**	**EUR**
Interest bearing assets						
Cash and cash equivalents	8.04%	1.65%	-	8.50%	0.30%	-
Due from banks	-	1.30%	-	-	-	-
Loans to customers	19.31%	24.00%	11.28%	18.69%	22.68%	10.42%
Investment securities	8.93%	8.57%	-	-	8.64%	-
Interest bearing liabilities						
Current accounts and deposits from customers	10.53%	3.10%	7.50%	14.24%	4.43%	7.47%
Other borrowed funds	3.41%	-	-	3.22%	-	-
Subordinated borrowings	-	3.00%	-	-	3.00%	-

25 Risk management, corporate governance and internal control (continued)

Interest rate sensitivity analysis

The management of interest rate risk based on interest rate gap analysis, is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of net profit or loss and equity (net of taxes) to changes in interest rates (repricing risk), based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2018 and 2017 is as follows:

	2018 AZN'000	2017 AZN'000
100 bp parallel fall	(629)	15
100 bp parallel rise	629	(15)

(ii) Currency risk

The Bank has assets and liabilities denominated in several foreign currencies.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. Although the Bank hedges its exposure to currency risk, such activities do not qualify as hedging relationships in accordance with IFRS.

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2018:

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
ASSETS					
Cash and cash equivalents	92,578	22,006	2,209	325	117,118
Due from banks	453	37,389	-	-	37,842
Loans to customers	159,905	66,141	71	-	226,117
Investment securities	11,778	1,823	-	-	13,601
Other financial assets	965	463	39	286	1,753
Total financial assets	**265,679**	**127,822**	**2,319**	**611**	**396,431**
LIABILITIES					
Deposits and balances from banks	6	-	-	-	6
Current accounts and deposits from customers	97,475	134,200	2,513	72	234,260
Other borrowed funds	97,524	-	-	-	97,524
Other financial liabilities	1,975	641	17	16	2,649
Subordinated borrowings	-	8,912	-	-	8,912
Total financial liabilities	**196,980**	**143,753**	**2,530**	**88**	**343,351**
Net position	**68,699**	**(15,931)**	**(211)**	**523**	

25 Risk management, corporate governance and internal control (continued)

The following table shows the currency structure of financial assets and liabilities as at 31 December 2017:

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
ASSETS					
Cash and cash equivalents	43,011	31,220	433	659	75,323
Due from banks	358	45,209	-	-	45,567
Loans to customers	143,501	94,762	1,353	-	239,616
Investment securities	304	935	-	-	1,239
Other financial assets	1,748	1,017	513	313	3,591
Total financial assets	**188,922**	**173,143**	**2,299**	**972**	**365,336**
LIABILITIES					
Deposits and balances from banks	7	-	-	-	7
Current accounts and deposits from customers	80,790	154,427	2,327	193	237,737
Other borrowed funds	97,296	-	-	-	97,296
Other financial liabilities	833	401	34	121	1,389
Subordinated borrowings	-	25,961	-	-	25,961
Total financial liabilities	**178,926**	**180,789**	**2,361**	**314**	**362,390**
Net position	**9,996**	**(7,646)**	**(62)**	**658**	

25 Risk management, corporate governance and internal control (continued)

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2018 and 2017, would have decreased equity and profit or loss by the amounts shown below. This analysis is on net of tax basis and is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

	2018 AZN'000	2017 AZN'000
20% appreciation of USD against AZN	2,538	(1,529)
20% appreciation of EUR against AZN	214	(12)

A strengthening of the AZN against the above currencies at 31 December 2018 and 2017 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

(e) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Bank has policies and procedures for the management of credit exposures (both for recognised financial assets and unrecognised contractual commitments), including guidelines to limit portfolio concentration and the establishment of a Credit Committee, which actively monitors credit risk. The credit policy is reviewed and approved by the Management Board.

The credit policy establishes:

- procedures for review and approval of loan credit applications;
- methodology for the credit assessment of borrowers (corporate and individual);
- methodology for the credit assessment of counterparties, issuers and insurance companies;
- methodology for the evaluation of collateral;
- credit documentation requirements;
- procedures for the ongoing monitoring of loans and other credit exposures.

Corporate loan credit applications are originated by the relevant client managers and are then passed on to the Loan Department, which is responsible for the corporate loan portfolio. Analysis reports are based on a structured analysis focusing on the customer's business and financial performance. The loan credit application and the report are then independently reviewed by the Risk Management Department and a second opinion is given accompanied by a verification that credit policy requirements are met. The Credit Committee reviews the loan credit application on the basis of submissions by the Loan Department and the Risk Department. Individual transactions are also reviewed by the Legal, Accounting and Tax departments depending on the specific risks and pending final approval of the Credit Committee.

The Bank continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Bank. Retail loan credit applications are reviewed by the Retail Lending Department through the use of assessment of eligibility to each loan product criteria and application data verification procedures developed together with the Risk Management Department.

Apart from individual customer analysis, the credit portfolio is assessed by the Risk Management Department with regard to credit concentration and market risks.

The maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets in the statement of financial position and unrecognised contractual commitment amounts. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

25 Risk management, corporate governance and internal control (continued)

The maximum exposure to credit risk from financial assets at the reporting date is as follows:

	31 December 2018 AZN'000	31 December 2017 AZN'000
ASSETS		
Cash and cash equivalents (excluding cash on hand)	109,028	68,241
Due from banks	37,842	45,567
Loans to customers	226,117	239,616
Investment securities (excluding equity securities)	13,601	935
Other financial assets	1,753	3,591
Total maximum exposure	**388,341**	**357,950**

Collateral generally is not held against claims under derivative financial instruments, investments in securities, and loans to banks, except when securities are held as part of reverse repurchase and securities borrowing activities. For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers refer to Note 14.

Credit risk - Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

See accounting policy in Note 3(e)(iv).

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

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

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

- quantitative test based on movement in probability of default (PD);
- qualitative indicators; and
- backstop of 30 days past due, except for transactions with financial institutions and issuers of securities, for which a backstop of 1-7 days past due is applied.

Generating the term structure of PD

The Bank collects performance and default information about its credit risk by type of product as well as by borrower's segment. For some portfolios, information purchased from external credit reference agencies is also used.

The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

Determining whether credit risk has increased significantly

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting period. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region.

25 Risk management, corporate governance and internal control (continued)

What is considered significant will differ for different types of lending, in particular between corporate and retail.

As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, the following qualitative and quantitative criteria exist:

- the presence of the fact of overdue debt for 31-90 days for all segments except transactions with financial institutions and issuers of securities;
- the presence of the fact of debt overdue by 1-7 working days for transactions with financial institutions and issuers of securities;
- the presence of the change of terms of a financial instrument contract resulted not due to the borrower's inability to perform the obligations specified in the contract, and not due to a deterioration in the credit quality of the borrower (referred as " "good" restructuring ");
- for corporate sector, the presence of significant increase in credit risk under other agreements of the borrower;
- cured Stage 3 exposure transferred to Stage 2, which is not yet passed probation period.

Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower;

and quantitative criteria (only for financial institutions and issuers of securities):

- the relative change in the external rating at the reporting date compared to the external rating at the recognition date according to the criteria given in Table 1.

Table 1: Criteria for determining a significant increase in credit risk depending on the value of the external rating upon initial recognition.

	Counterparty external rating at initial recognition			**Significant increase in credit risk assigned:**
	Moody's	**Fitch**	**S&P**	
1	AAA	AAA	AAA	Low credit risk: criterion is not applied
2	Aa1	AA+	AA+	
3	Aa2	AA	AA	
4	Aa3	AA-	AA-	
5	A1	A+	A+	
6	A2	A	A	
7	A3	A-	A-	
8	Baa1	BBB+	BBB+	
9	Baa2	BBB	BBB	
10	Baa3	BBB-	BBB-	
11	Ba1	BB+	BB+	Decrease of rating by 2 notches
12	Ba2	BB	BB	
13	Ba3	BB-	BB-	
14	B1	B+	B+	Decrease of rating by 1 notch
15	B2	B	B	
16	B3	B-	B-	
17	Caa1	CCC-C	CCC-C	
18	Caa2			
19	Caa3			
20	Ca-C			
21	D	D	D	

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL. Some qualitative indicators of an increase in credit risk, such as delinquency of forbearance, may be indicative of an increased risk of default that persists after the indicator itself has ceased to exist.

25 Risk management, corporate governance and internal control (continued)

In these cases the Bank determines a probation period during which the financial asset is required to demonstrate good behaviour to provide evidence that its credit risk has declined sufficiently. Probation criteria for recovery and transfer of financial instruments to Stage 1 is not delinquent by more than 30 days for six consecutive reporting months.

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that:

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired.

Definition of default

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

- there are more than 90 calendar days of overdue debt at the reporting date for all segments except transactions with financial institutions and issuers of securities;
- there are more than 7 working days of overdue debt at the reporting date for transactions with financial institutions and issuers of securities;
- there is default / forced restructuring due to the financial difficulties of the borrower (applicable except for transactions with financial institutions and securities). Default / forced restructuring refers to a change in the terms of a contract recognized as a forced restructuring by the Bank, which are a consequence of the borrower's inability to perform the obligations specified in the contract, and are caused by a deterioration in the credit quality of the borrower, where one of the indicator is the presence of more than 60 days delinquency the day before the restructuring (referred as " "bad" restructuring ");
- there is revocation of the license and the introduction of an interim administration (applicable to financial institutions).

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative – e.g. breaches of covenant;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer/borrower to the Bank: for corporate segment default is set on customer level, i.e. if one of the corporate customer has default under other agreement, all exposures are default. For other segments default is identified on individual exposure level; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Incorporation of forward-looking information

The Bank incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

25 Risk management, corporate governance and internal control (continued)

The Bank formulates one economic scenario: a base case. The base case is aligned with information used by the Bank for other purposes such as strategic planning and budgeting. External information considered includes economic data and forecasts published by governmental bodies and monetary authorities in the country where the Bank operates, such as the CBAR, State Statistic Committee and Ministry of Finance and selected private sector and academic forecasters.

The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

The key drivers depend on portfolio segment. The economic scenarios used as at 31 December 2018 included the following key indicators for the Republic of Azerbaijan for the years ending 31 December 2019 through 2021.

Key driver	2019	2020	2021
Average salary	562.60	575.00	585.50
Budget deficit in GDP	0.20	0.20	0.40
Oil Price (Brent)	65.0	60.0	55.0
Unemployment	5%	4.9%	4.9%
Consumer price index	3.80	4.10	3.80

Predicted relationships between the key indicator and default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 3 years.

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 3(e)(iii).

The modification of contractual terms of a financial asset is an indicator of significant increase in credit risk, unless the modification is default / forced restructuring which is an indicator of default of the financial asset. A customer needs to demonstrate consistently good payment behavior over a period of time before the exposure is no longer considered to be credit-impaired/ in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

The Bank renegotiates loans to customers in financial difficulties (referred to as ‘forbearance activities’) to maximise collection opportunities and minimise the risk of default. Under the Bank’s forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and interest rate. Both retail and corporate loans are subject to the forbearance policy.

For financial assets modified as part of the Bank’s forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank’s ability to collect interest and principal and the Bank’s previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower’s payment performance against the modified contractual terms and considers various behavioural indicators.

25 Risk management, corporate governance and internal control (continued)

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD).

The Bank calculates ECL for loans to customers portfolio on collective basis and on individual review basis for significant default loan exposure on customer level. Individual assessment incorporates estimation of probability weighted recoverable amount. ECL on collective basis described below.

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

The methodology of estimating PDs is discussed above under the heading "Generating the term structure of PD".

The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are recalibrated to reflect possible changes in property prices. They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EAD is the maximum amounts that may be drawn under the contract at the reporting date, if overdue days of the loan is less than 30 days as otherwise the card is blocked; and, in credit limits for business customers, if the credit limit is revolving. For financial guarantees, the EAD represents the guarantee exposure when the financial guarantee becomes payable.

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of instrument type.

The groupings are subject to regular review to ensure that exposures within a particular Bank remain appropriately homogeneous.

For portfolios in respect of which the Bank has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL are as follows.

		External benchmarks used	
	Exposure	**PD**	**LGD**
Cash and cash equivalents	109,028	Moody's default study	Moody's recovery studies
Due from banks	37,842	Moody's default study	Moody's recovery studies
Investment securities	13,601	Moody's default study	Moody's recovery studies

25 Risk management, corporate governance and internal control (continued)

(f) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Supervisory Board.

The Bank seeks to actively support a diversified and stable funding base comprising debt securities in issue, long-term and short-term loans from other banks, core corporate and retail customer deposits, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements. The liquidity management policy requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;
- maintaining debt financing plans;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;
- monitoring liquidity ratios against regulatory requirements.

The Treasury Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury Department then provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term liquid trading securities, loans to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury Department. Under the normal market conditions, liquidity reports covering the liquidity position are presented to senior management on a weekly basis. Decisions on liquidity management are made by ALCO and implemented by the Treasury Department.

The following tables show the undiscounted cash flows on financial liabilities and credit-related commitments on the basis of their earliest possible contractual maturity. The total gross outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial liability or credit related commitment. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee can be called.

25 Risk management, corporate governance and internal control (continued)

The maturity analysis for financial liabilities as at 31 December 2018 is as follows:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total gross amount outflow	Carrying amount
Non-derivative liabilities							
Deposits and balances from banks	6	-	-	-	-	6	6
Current accounts and deposits from customers	72,970	21,665	92,626	55,451	8	242,720	234,260
Other borrowed funds	792	1,016	32,113	21,285	69,293	124,499	97,524
Other financial liabilities	2,649	-	-	-	-	2,649	2,649
Subordinated borrowings	-	-	667	9,499	-	10,166	8,912
Total financial liabilities	**76,417**	**22,681**	**125,406**	**86,235**	**69,301**	**380,040**	**343,351**
Credit related commitments	**22,613**	**-**	**-**	**-**	**-**	**22,613**	**22,613**

The maturity analysis for financial liabilities as at 31 December 2017 is as follows:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total gross amount outflow	Carrying amount
Non-derivative liabilities							
Deposits and balances from banks	7	-	-	-	-	7	7
Current accounts and deposits from customers	63,565	26,868	110,394	46,204	32	247,063	237,737
Other borrowed funds	595	976	44,364	16,067	52,979	114,981	97,296
Other financial liabilities	1,389	-	-	-	-	1,389	1,389
Subordinated borrowings	-	-	1,224	3,761	26,203	31,188	25,961
Total financial liabilities	**65,556**	**27,844**	**155,982**	**66,032**	**79,214**	**394,628**	**362,390**
Credit related commitments	**30,013**	**-**	**-**	**-**	**-**	**30,013**	**30,013**

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, forfeiting in most of the cases the accrued interest. These deposits are classified in accordance with their stated maturity dates in the above undiscounted maturity tables. The Management of the Bank does not expect that individuals and legal entities withdraw their term deposits before their stated maturity dates. Also the Bank developed a liquidity model to manage its liquidity.

25 Risk management, corporate governance and internal control (continued)

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2018:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
Cash and cash equivalents	117,118	-	-	-	-	-	-	117,118
Due from banks	1,914	5,124	30,804	-	-	-	-	37,842
Loans to customers	12,623	7,432	28,494	65,267	70,451	-	41,850	226,117
Investment securities	-	1,000	-	9,628	2,973	-	-	13,601
Other financial assets	1,753	-	-	-	-	-	-	1,753
Total financial assets	**133,408**	**13,556**	**59,298**	**74,895**	**73,424**	**-**	**41,850**	**396,431**
Deposits and balances from banks	6	-	-	-	-	-	-	6
Current accounts and deposits from customers	15,412	20,205	88,175	52,928	7	57,533	-	234,260
Other borrowed funds	606	633	30,452	13,346	52,487	-	-	97,524
Other financial liabilities	2,649	-	-	-	-	-	-	2,649
Subordinated borrowings	-	-	412	8,500	-	-	-	8,912
Total financial liabilities	**18,673**	**20,838**	**119,039**	**74,774**	**52,494**	**57,533**	**-**	**343,351**
Net position	**114,735**	**(7,282)**	**(59,741)**	**121**	**20,930**	**(57,533)**	**41,850**	**53,080**
Cumulative liquidity gap	**114,735**	**107,453**	**47,712**	**47,833**	**68,763**			

25 Risk management, corporate governance and internal control (continued)

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2017:

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
Cash and cash equivalents	75,323	-	-	-	-	-	-	75,323
Due from banks	2,177	-	43,387	-	-	-	3	45,567
Loans to customers	16,340	6,010	31,445	60,384	71,532	-	53,905	239,616
Investment securities	-	-	-	935	-	304	-	1,239
Other financial assets	3,591	-	-	-	-	-	-	3,591
Total financial assets	**97,431**	**6,010**	**74,832**	**61,319**	**71,532**	**304**	**53,908**	**365,336**
Deposits and balances from banks	7	-	-	-	-	-	-	7
Current accounts and deposits from customers	63,429	25,011	105,638	43,635	24	-	-	237,737
Other borrowed funds	470	670	43,113	10,775	42,268	-	-	97,296
Other financial liabilities	1,389	-	-	-	-	-	-	1,389
Subordinated borrowings	-	-	459	-	25,502	-	-	25,961
Total financial liabilities	**65,295**	**25,681**	**149,210**	**54,410**	**67,794**	**-**	**-**	**362,390**
Net position	**32,136**	**(19,671)**	**(74,378)**	**6,909**	**3,738**	**304**	**53,908**	**2,946**
Cumulative liquidity gap	**32,136**	**12,465**	**(61,913)**	**(55,004)**	**(51,266)**			

25 Risk management, corporate governance and internal control (continued)

The key measure used by the Bank for managing liquidity risk is the liquidity ratio stipulated by the FIMSA.

The Bank calculates this mandatory liquidity ratio on a daily basis in accordance with the requirement of the FIMSA. This ratio is represented by the instant liquidity ratio, which is calculated as the ratio of highly liquid assets to liabilities payable on demand.

The Bank was in compliance with these ratios as at 31 December 2018 and 2017. The following table shows the mandatory liquidity ratios calculated as at 31 December 2018 and 2017.

	Requirement	**2018, %**	**2017, %**
Instant liquidity ratio	Not less than 30%		104.60%

(g) Operational risk

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

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and innovation. In all cases, the Bank policy requires compliance with all applicable legal and regulatory requirements.

The Bank manages operational risk by establishing internal controls that management determines to be necessary in each area of its operations.

26 Capital management

The FIMSA sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the FIMSA, banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level. As at 31 December 2018, this minimum level was 10 % (31 December 2017: 10%). The Bank was in compliance with the statutory capital ratio as at 31 December 2018 and 2017.

The Bank maintains capital adequacy at the level appropriate to the nature and volume of its operations.

The Bank provides the FIMSA with information on mandatory ratios in accordance with set form. Risk department controls on a daily basis compliance with capital adequacy ratios.

In case values of capital adequacy ratios become close to set limits set by the FIMSA and Bank's internal policy this information is communicated to the Supervisory Board.

The calculation of capital adequacy based on requirements set by the FIMSA were as follows:

	31 December 2018 AZN'000 (unaudited)	**31 December 2017 AZN'000 (unaudited)**
Total statutory capital	67,895	95,597
Risk-weighted assets	264,756	368,090
Capital adequacy ratio (%)	**26%**	**26%**

26 Capital management (continued)

Reconciliation of total statutory capital to IFRS equity

The table below provides an overview of the differences in composition of the net assets as at 31 December 2018 presented in the Bank`s financial statements prepared under IFRS and total statutory capital determined under the rules and regulations of the FIMSA.

	31 December 2018 AZN'000 (unaudited)	31 December 2017 AZN'000 (unaudited)
Total statutory capital	**67,895**	**95,597**
Differences between regulatory capital and IFRS net assets:		
- share premium	(449)	(449)
- retained earnings	**6,859**	**(44,712)**
- impairment allowance	87,522	(14,237)
- losses on recognition of purchased credit-impaired assets	(4,975)	-
- interest income	(61,097)	(29,402)
- administrative expenses	(1,095)	(1,101)
- adjustment on initial application of IFRS 9, net of tax (see Note 6)	(13,444)	-
- income tax expense	39	39
- other differences	(91)	(11)
- differences arising from deductions for statutory calculation	**4,577**	**4,870**
- intangible assets	3,271	3,564
- deferred tax assets	1,306	1,306
- statutory general allowance for impairment	**(2,263)**	**(4,356)**
- available subordinated debt for regulatory calculations	**(6,800)**	**(25,502)**
Total IFRS equity	**65,392**	**25,448**

27 Credit related commitments and guarantees

The Bank has outstanding credit related commitments to extend loans. These credit related commitments take the form of approved loans and credit card limits and overdraft facilities.

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years. The Bank also provides guarantees by acting as settlement agent in securities borrowing and lending transactions.

The Bank applies the same credit risk management policies and procedures when granting credit commitments, financial guarantees and letters of credit as it does for granting loans to customers.

The contractual amounts of credit related commitments are set out in the following table by category.

	31 December 2018 AZN'000	31 December 2017 AZN'000
Contracted amount		
Guarantees	10,589	23,665
Undrawn credit lines	12,024	6,348
Total credit related commitments and guarantees	**22,613**	**30,013**
Provision	**(885)**	**-**

The total outstanding contractual credit related commitments above do not necessarily represent future cash requirements, as these credit related commitments may expire or terminate without being funded. The majority of loan and credit line commitments do not represent an unconditional credit related commitment by the Bank.

The following tables show reconciliations from the opening to the closing balances of provisions. All balances relate to Stage 1. Comparative amounts for 2017 represent allowance account for credit losses and reflect measurement basis under IAS 37.

	2018		2017
AZN'000	**Stage 1**	**Total**	**Total**
Provisions			
Balance at 1 January	1,604	1,604	-
Net remeasurement of loss allowance	(719)	(719)	-
Balance at 31 December	**885**	**885**	**-**

At 31 December 2018, the provision amount in respect of financial guarantee and undrawn credit lines is equal to AZN 612 thousand and AZN 273 thousand, respectively.

28 Operating leases

Leases as lessee

The Bank leases a number of premises under operating leases. The leases typically run for an initial period of one to ten years, with an option to renew the lease after that date. None of the leases includes contingent rentals. The Bank does not have any non-cancellable leases.

29 Contingencies

(a) Insurance

The insurance industry in the Republic of Azerbaijan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Bank does not have full coverage for its premises and equipment, business interruption, or third party liability in respect of property or environmental damage arising from accidents on its property or relating to operations. Until the Bank obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on operations and financial position.

The Bank has obtained an international comprehensive banking risk insurance policy ("BBB" – Bankers Blanket Bond) covering professional activities and crimes, including electronic and computer crimes.

(b) Litigation

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.

(c) Taxation contingencies

The taxation system in Azerbaijan is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by various levels of authorities, which have the authority to impose severe fines and interest charges. A tax year generally remains open for review by the tax authorities for three subsequent calendar years; however, under certain circumstances a tax year may remain open longer.

These circumstances may create tax risks in the Azerbaijan Republic that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijani tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial position, if the authorities were successful in enforcing their interpretations, could be significant.

30 Related party transactions

(a) Control relationships

The Bank's parent company is "Topaz Investment Limited" LLC . The Bank is controlled by Mr. V. Alekperov.

(b) Transactions with the members of the Supervisory Board and the Management Board

Total remuneration included in personnel expenses for the years ended 31 December 2018 and 2017 is as follows:

	2018 AZN'000	2017 AZN'000
Short term employee benefits	1,830	1,580
	1,830	**1,580**

These amounts include cash benefits in respect of the members of the Supervisory Board and the Management Board.

The outstanding balances and average effective interest rates as at 31 December 2018 and 2017 for transactions with the members of the Supervisory Board and the Management Board are as follows:

	2018 AZN'000	Average effective interest rate	2017 AZN'000	Average effective interest rate
Statement of financial position				
Loans issued (gross)	2,337	11%	615	17%
Loan impairment allowance	(42)		(24)	
Customer accounts	807	18%	223	16%
Commitments on loans and undrawn credit lines	354	11%	165	17%

Amounts included in profit or loss in relation to transactions with the members of the Supervisory Board and the Management Board for the year ended 31 December are as follows:

	2018 AZN'000	2017 AZN'000
Profit or loss		
Interest income calculated using the effective interest rate	134	52
Interest expense	(5)	(84)
Impairment gains (losses)	18	(315)

30 Related party transactions (continued)

(c) Transactions with other related parties

The outstanding balances and the related average effective interest rates as at 31 December 2018 and related profit or loss amounts of transactions for the year ended 31 December 2018 with other related parties are as follows:

	Ultimate controlling party		Shareholders		Other related parties		Total
	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000
Statement of financial position							
ASSETS							
Gross loans to customers	-	-	-	-	193	24%	193
Impairment allowance	-		-		(185)		(185)
LIABILITIES							
Customer accounts	10,850	6%	6,096	-	16,489	-	33,435
Subordinated borrowings	-	-	-	-	8,500	3%	8,500
Commitments on loans	-	-	-	-	-	-	-
Profit (loss)							
Interest income	-		-		-		-
Interest expense	32		566		-		598

The outstanding balances and the related average effective interest rates as at 31 December 2017 and related profit or loss amounts of transactions for the year ended 31 December 2017 with other related parties are as follows:

	Ultimate controlling party		Shareholders		Other related parties		Total
	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000
Statement of financial position							
ASSETS							
Gross loans to customers	-	-	-	-	302	8%	302
Impairment allowance	-		-		(3)		(3)
LIABILITIES							
Customer accounts	4,707	10%	1,959	-	14,003	-	20,669
Subordinated borrowings	-	-	-	-	25,961	3%	25,961
Commitments on loans	-	-	-	-	-	-	-
Profit (loss)							
Interest income	-		-		4		4
Interest expense	(462)		(123)		(1,649)		(2,234)

The majority of balances resulting from transactions with related parties mature within two years. Transactions with related parties are not secured.

31 Financial assets and liabilities: fair values and accounting classifications

(a) Accounting classifications and fair values

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2018:

AZN '000	Amortized cost	Total carrying amount	Fair value
Cash and cash equivalents	117,118	117,118	117,118
Due from banks	37,842	37,842	37,842
Loans to customers	226,117	226,117	226,617
Investment securities	13,601	13,601	13,601
Other financial assets	1,753	1,753	1,753
	396,431	**396,431**	**381,577**
Deposits and balances from banks	6	6	6
Current accounts and deposits from customers	234,260	234,260	234,757
Other borrowed funds	97,524	97,524	97,524
Other financial liabilities	2,649	2,649	2,649
Subordinated borrowings	8,912	8,912	8,912
	343,351	**343,351**	**343,848**

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2017:

AZN '000	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	75,323	-	-	75,323	75,323
Investment securities	-	1,239	-	1,239	1,239
Due from banks	45,567	-	-	45,567	45,567
Loans to customers	239,616	-	-	239,616	215,074
Other financial assets	3,591	-	-	3,591	3,591
	364,097	**1,239**	**-**	**365,336**	**340,794**
Deposits and balances from banks	-	-	7	7	7
Current accounts and deposits from customers	-	-	237,006	237,006	238,240
Other borrowed funds	-	-	97,296	97,296	97,296
Other financial liabilities	-	-	1,389	1,389	1,389
Subordinated borrowings	-	-	25,961	25,961	18,461
	-	**-**	**361,659**	**361,659**	**355,393**

The estimates of fair value are intended to approximate 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. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

31 Financial assets and liabilities: fair values and accounting classifications (continued)

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using other valuation techniques.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

For more complex instruments, the Bank uses proprietary valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Example of instruments involving significant unobservable inputs include certain loans and securities for which there is no active market, certain over the counter structured derivatives, and retained interests in securitisations.

The following assumptions are used by management to estimate the fair values of financial instruments:

- discount rates of 3.29% - 9.46% and 6.13% - 17.11% are used for discounting future cash flows from due from banks and loans to customers (depending on the currency of the loan and the type of the borrower), respectively.
- discount rates of 1.43% - 10.01% are used for discounting future cash flows for current accounts and deposits from customers depending on the currency and the type of the customer account.
- discount rates of 3% is used for discounting future cash flows for subordinated borrowings.
- quoted market prices are used for determination of fair value of available for sale financial assets except unquoted equity securities where there is no market data, as disclosed in Note 15.
- in estimating the discount rates for other borrowed funds the Bank considers this market as a separate market from other commercial borrowing business due to different terms, purposes, conditions and credit risk exposures related to these other borrowed funds.

31 Financial assets and liabilities: fair values and accounting classifications (continued)

(b) Fair value hierarchy

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- **Level 1**: quoted market price (unadjusted) in an active market for an identical instrument
- **Level 2**: inputs other than quotes prices included within Level 1 that are observable either directly (i.e, as prices) or indirectly (i.e, derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- **Level 3**: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The is no financial instruments measured at fair value at 31 December 2018.

The table below analyses financial instruments measured at fair value at 31 December 2017, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

AZN '000	Level 1	Level 3	Total
Available-for-sale financial assets	935	304	1,239
	935	**304**	**1,239**

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2018:

AZN'000	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS					
Cash and cash equivalents		117,117		117,117	117,118
Due from banks		37,842		37,842	37,842
Loans to customers			226,617	226,617	226,117
Investment securities	13,601			13,601	13,601
Other financial assets		1,753		1,753	1,753
LIABILITIES					
Deposits and balances from banks		6		6	6
Current accounts and deposits from customers		234,757		234,757	234,260
Other borrowed funds			97,524	97,524	97,524
Other financial liabilities		2,649		2,649	2,649
Subordinated borrowings			8,912	8,912	8,912

31 Financial assets and liabilities: fair values and accounting classifications (continued)

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2017:

AZN'000	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS				
Cash and cash equivalents	75,323	-	75,323	75,323
Due from banks	45,567	-	45,567	45,567
Loans to customers	-	215,074	215,074	239,616
Other financial assets	3,591	-	3,591	3,591
LIABILITIES				
Deposits and balances from banks	7	-	7	7
Current accounts and deposits from customers	238,240	-	238,240	237,737
Other borrowed funds	-	97,296	97,296	97,296
Other financial liabilities	1,389	-	1,389	1,389
Subordinated borrowings	-	18,461	18,461	25,961

32 Events after the reporting period

On 28 February 2019, the President of the Republic of Azerbaijan signed a decree "On the additional measures related to the solution of problem loans of individuals in the Republic of Azerbaijan" ("the Decree"). According to the Decree the increase in loan balances denominated in foreign currency resulted from devaluation of the national currency on 21 February 2015 and 21 December 2015 with total exposure up to USD 10,000 in all banks will be compensated by the government.

In addition, according to the Decree the CBAR should provide low interest rate loans to banks under the state guarantee totaling to AZN 682 million for the whole banking sector in order to restructure loans to individuals with overdue days more than 360 as at the date of the Decree and issued starting 1 January 2012 till the date of the Decree with exposure of up to USD 10,000 or AZN 17,000.

In order to prevent deterioration of the currency position of banks as a result of the Decree execution, the CBAR should provide banks with securities totalling to USD 215 million for the whole banking sector with annual interest rate of 0.5%.

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Ayaz Ismayilov
Financial Director