“YELO BANK” OPEN JOINT STOCK COMPANY

The International Financial Reporting Standards Financial Statements and Independent Auditors’ Report
For the Year Ended December 31, 2019

"YELO BANK" OPEN JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2019

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the financial statements of "Yelo Bank" Open Joint Stock Company (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at December 31, 2019, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud, errors and other irregularities.

The financial statements for the year ended December 31, 2019 were authorized for issue on April 20, 2020 by the Management Board of the Bank.

On behalf of the Executive Board:

Mr. Nikoloz Shurgaia	**Mr. Emil Dushdurov**
Chairman of the Management Board	Chief Financial Officer
Baku, the Republic of Azerbaijan	Baku, the Republic of Azerbaijan
April 20, 2020	April 20, 2020

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City Point Baku, 9th floor
J. Mammadguluzadeh str., 102A
Baku, AZ1022, Azerbaijan

T: +994 (12) 404 7 666
F: +994 (12) 404 7 667

office@bakertilly.az
www.bakertilly.az

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Supervisory Board of "Yelo Bank" Open Joint Stock Company.

Opinion

We have audited the financial statements of "Yelo Bank" Open Joint Stock Company (the "Bank"), which comprise the statement of financial position as at December 31, 2019, 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 December 31, 2019, 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), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements of the Bank for the year ended December 31, 2018, were audited by another auditor who expressed an unqualified opinion on those financial statements.

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 responsible for overseeing the Bank's financial reporting process.

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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 scepticism 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.

Baker Tilly Azerbaijan

April 20, 2020
Baku, the Republic of Azerbaijan

"YELO BANK" OPEN JOINT-STOCK COMPANY

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2019

	Notes	Year ended December 31, 2019 AZN'000	Year ended December 31, 2018 AZN'000
Interest income calculated using the effective interest method	5, 30	35,762	36,810
Interest expense	5, 30	(17,466)	(15,508)
Net interest income		**18,296**	**21,302**
Fee and commission income	6	3,067	3,804
Fee and commission expense	7	(2,762)	(1,628)
Net fee and commission income		**305**	**2,176**
Net gain on trading in foreign currencies		1,327	3,532
Net result from foreign currency derivatives		(31)	-
Net foreign exchange translation loss		(19)	(157)
Other operating income		95	62
Operating income		**19,973**	**26,915**
Recovery/(charge) of expected credit losses on financial assets	8, 30	12,458	(63,827)
Personnel expenses	9, 30	(17,532)	(10,603)
Other general administrative expenses	10, 30	(14,697)	(11,125)
Fair value gain on other borrowed funds at initial recognition	20	1,007	-
Recovery of expected credit losses on loan commitments and financial guarantees		-	719
Change in fair value of assets held for sale	18	1,155	(7,289)
Fair value loss on loans to customers at initial recognition		-	(4,975)
Profit/(loss) before income tax		**2,364**	**(70,185)**
Income tax expense	11	-	-
Net profit/(loss) for the year		**2,364**	**(70,185)**
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		**2,364**	**(70,185)**
Earnings/(loss) per share			
Basic and diluted (expressed in AZN)	25	0.01	(0.52)

*The Bank has initially applied IFRS 16 at January 1, 2019. Under the transition methods chosen, comparative information is not restated (See Note 3). As a result of adoption of IFRS 16, the Bank changed presentation of certain captions, comparative information is re-presented accordingly (See Note 4).

The financial statements as set out on pages 8 to 85 were approved by management on April 20, 2020 and were signed on its behalf by:

Mr. Nikolay Shurgaia
Chairman of the Management Board

Mr. Emil Dushdurov
Chief Financial Officer

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.

"YELO BANK" OPEN JOINT-STOCK COMPANY

STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2019

	Note	December 31, 2019 AZN'000	December 31, 2018 AZN'000
ASSETS			
Cash and cash equivalents	12	147,275	117,118
Due from banks	13	9,634	37,842
Loans to customers	14, 30	287,353	226,117
Investment securities	15	7,819	13,601
Property, equipment and intangible assets	16	14,351	11,898
Right-of-use assets	17	13,147	-
Assets held for sale	18	5,974	5,053
Other assets	19	7,624	2,711
Total assets		**493,177**	**414,340**
LIABILITIES			
Current accounts and deposits from customers	20, 30	323,616	234,260
Other borrowed funds	21	70,874	97,524
Subordinated borrowings	21, 30	9,170	8,912
Lease liability	22	13,365	-
Provisions		885	885
Deposits and balances from banks		5	6
Other liabilities	23	3,417	2,934
Total liabilities		**421,332**	**344,521**
EQUITY			
Share capital	24	348,000	348,000
Share premium		401	401
Accumulated losses		(276,556)	(278,582)
Total equity		**71,845**	**69,819**
Total liabilities and equity		**493,177**	**414,340**

*The Bank has initially applied IFRS 16 at January 1, 2019. Under the transition methods chosen, comparative information is not restated (See Note 3). As a result of adoption of IFRS 16, the Bank changed presentation of certain captions, comparative information is re-presented accordingly (See Note 4).

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Emil Dushdurov
Chief Financial Officer

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

"YELO BANK" OPEN JOINT-STOCK COMPANY

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2019

	Note	Year ended December 31, 2019 AZN'000	Year ended December 31, 2018 AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		37,181	24,293
Interest payments		(15,866)	(16,424)
Fee and commission receipts		3,067	3,804
Fee and commission payments		(2,762)	(1,628)
Net receipts from trading in foreign currencies		1,327	3,532
Other income receipts		95	60
Personnel expenses payments		(16,650)	(10,603)
Other general administrative expenses payments		(10,975)	(8,583)
(Increase)/decrease in operating assets			
Due from banks		28,456	7,731
Loans to customers		(52,029)	(57,846)
Assets held for sale		2,034	504
Other assets		(1,989)	1,493
Increase/(decrease) in operating liabilities			
Deposits and balances from banks		(1)	(1)
Current accounts and deposits from customers		88,057	(2,396)
Other liabilities		(840)	211
Net cash from/(used in) operating activities		**59,105**	**(55,853)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Net proceeds from sale of/(payment for) investment securities		5,347	(11,806)
Payment for property, equipment and intangible assets		(6,970)	(1,412)
Cash flows used in investing activities		**(1,623)**	**(13,218)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from other borrowed funds	21	13,446	21,389
Repayment of other borrowed funds	21	(39,075)	(21,218)
Repayment of principal portion of lease liabilities		(1,631)	-
Proceeds from issue of share capital		-	111,000
Cash flows/(used in) provided from financing activities		**(27,260)**	**111,171**
Net increase in cash and cash equivalents		**30,222**	**42,100**
Effect of changes in exchange rates on cash and cash equivalents		(65)	(305)
Cash and cash equivalents as at the beginning of the year		117,118	75,323
Cash and cash equivalents as at the end of the year	12	**147,275**	**117,118**

*The Bank has initially applied IFRS 16 at January 1, 2019. Under the transition methods chosen, comparative information is not restated (see Note 3). As a result of adoption of IFRS 16, the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 4).

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Mr. Emil Dushdurov
Chief Financial Officer

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

"YELO BANK" OPEN JOINT-STOCK COMPANY

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2019

AZN'000	Share capital	Share premium	Accumulated losses	Total equity
Balance as at January 1, 2018	**220,000**	**401**	**(208,397)**	**12,004**
Total comprehensive loss				
Total comprehensive loss for the year	-	-	(70,185)	(70,185)
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 December 31, 2018	**348,000**	**401**	**(278,582)**	**69,819**
Balance as at December 31, 2018	**348,000**	**401**	**(278,582)**	**69,819**
Adjustment on initial application of IFRS 16, (See Note 4)	-	-	(338)	(338)
Balance as at January 1, 2019	**348,000**	**401**	**(278,920)**	**69,481**
Total comprehensive income				
Total comprehensive income for the year	-	-	2,364	2,364
Total comprehensive income for the year	**-**	**-**	**2,364**	**2,364**
Balance as at December 31, 2019	**348,000**	**401**	**(276,556)**	**71,845**

*The Bank has initially applied IFRS 16 at January 1, 2019. Under the transition methods chosen, comparative information is not restated (See Note 3). As a result of adoption of IFRS 16, the Bank changed presentation of certain captions, comparative information is re-presented accordingly (See Note 4).

Mr. Nikolai Shurgaia
Chairman of the Management Board

Mr. Emil Dushdurov
Chief Financial Officer

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

1 BACKGROUND

(a) Organization and operations

These financial statements comprise the financial statements of “Yelo Bank” Open Joint Stock Company (the “Bank”) for the year ended December 31, 2019.

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 Republic of Azerbaijan (the “CBRA”) since May 2, 2002. On July 2008, “Topaz Investments” LLC has acquired the controlling interest in the bank. On November 2019, The “Nikoil Bank” OJSC has implemented rebranding and was renamed to “Yelo Bank” OJSC. 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 Central Bank 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 participates in the state deposit insurance scheme, which was introduced by the “Law on Deposit Insurance” dated December 29, 2006. The Azerbaijan Deposit Insurance Fund guarantees repayment of 100% of individual deposits meeting the following criteria:

Upper limit of annual interest rate on protected deposits in foreign currency is 2.5% and deposits in national currency is 10%. In accordance with the Law of the Republic of Azerbaijan on “Deposit Insurance”, these deposits are fully insured by the Fund. According to the Law in question effective from March 4, 2016, all protected deposits with an annual interest rate established by the Board of Custodians of the Deposit Insurance Fund are fully insured for 3 years irrespective their amount. Under the amendments made to the Law on February 19, 2019 the period was extended by one year (until March 4, 2020). Based on the amendment made to the Law on March 13, 2020, the period was extended from March 4, 2020 till December 4, 2020.

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

As at December 31, 2019, the Bank had eleven branches (2018: twelve). The majority of its assets and liabilities are located in the Republic of Azerbaijan.

The Bank is owned by:

	December 31, 2019, %	December 31, 2018, %
Shareholder		
“Topaz Investments Limited” LLC	95.68	95.68
Marina Kulishova	4.22	4.22
“ISR Holding” LLC	0.10	0.10
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 conducted in the Republic of Azerbaijan. Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan’s economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Government as well as crude oil prices and stability of Azerbaijani Manat.

The Azerbaijan’s economy has been negatively impacted by decline of oil prices and devaluation of Azerbaijani Manat during 2015. This resulted in reduced access to capital, a higher cost of capital, inflation and uncertainty regarding economic growth. In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support financial system. On December 6, 2016 President of the Republic of Azerbaijan approved “Strategic road maps for the national economy and main economic sectors of Azerbaijan”. The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond.

Furthermore, during 2018 the government continued its monetary policy with respect to stability of Azerbaijani Manat as well as allocated foreign currency resources, which stabilized Azerbaijani Manat. This policy continued in 2019 with the aim of maintaining macroeconomic stability.

On February 28, 2019, the President of the Republic of Azerbaijan signed a decree “On the additional measures related to the solution of problematic 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 devaluations of the national currency on February 21, 2015 and December 21, 2015 with total exposure up to USD 10 thousand in all banks had to be compensated by the government and CBRA had to provide loans to the banks with 0.1% interest rate and for 5 years under the state guarantee in order to restructure loans to individuals with overdue days more than 360 as at the date of the Decree and issued starting January 1, 2012 till the date of the Decree with exposure of up to USD 10 thousand or AZN 17 thousand.

The Bank received compensation for such problematic loans from the government in the amount of AZN 16,448 thousand during the year ended December 31, 2019. Additionally, the Bank obtained loan from CBRA under favorable conditions in the amount of AZN 4,685 thousand with 0.1% for 5 years and restructured the overdue loans in the amount of AZN 7,427 thousand under the Decree.

The Bank’s management is monitoring changes in macroeconomic environment and taking precautionary measures it considers necessary in order to support the sustainability and development of the Bank’s business in the foreseeable future.

International credit rating agencies regularly evaluate credit rating of the Republic of Azerbaijan. Fitch and S&P evaluated rating of the Republic of Azerbaijan as “BB+”. Moody’s Investors Service set “Ba2” credit rating for the country.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Bank’s operations and consequently what effect, if any, they could have on the financial position of the Bank. The management is currently performing sensitivity analyses under different oil prices scenarios and elaborating relevant action plans for mainlining sustainability of the business.

2 BASIS OF PREPARATION

(a) Statement of compliance

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, financial instruments categorised at fair value through profit or loss (“FVPL”) and at fair value through other comprehensive income (“FVOCI”). The principal accounting policies applied in the preparation of these financial statements are set out below. Apart from the accounting policy changes resulting from the adoption of IFRS 16 effective from January 1, 2019, these policies have been consistently applied to all the periods presented, unless otherwise stated.

This is the first set of the Bank’s annual financial statements in which IFRS 16 “Leases” have been applied. Changes to significant accounting policies are described in Note 4.

Going concern

These financial statements have been prepared on the assumption that the Bank is a going concern and will continue in operation for the foreseeable future.

(b) Basis of measurement

The financial statements are prepared on the historical cost basis (2018: prepared on the historical cost basis).

(c) Functional and presentation currency

The functional currency of the Bank is 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 December 31, 2019, the principal rate of exchange used for translating foreign currency balances was USD 1=AZN 1,7000 and EUR 1=AZN 1,9035 (December 31, 2018: USD 1=AZN 1,7000 and EUR 1=AZN 1,9468).

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

The Bank makes estimates and assumptions that affect the amounts recognized in the financial statements, and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognized in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Measurement of ECL allowance

Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 27. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default (“PD”), exposure at default (“EAD”), and loss given default (“LGD”), as well as models of macro-economic scenarios. The Bank regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience. For details of ECL measurement including incorporation of forward-looking information refer to Note 27.

Credit exposure on revolving credit facilities (e.g. credit cards, overdrafts)

For certain loan facilities, the Bank’s exposure to credit losses may extend beyond the maximum contractual period of the facility. This exception applies to certain revolving credit facilities, which include both a loan and an undrawn commitment component and where the Bank’s contractual ability to demand repayment and cancel the undrawn component in practice does not limit its exposure to credit losses.

For such facilities, the Bank measures ECLs over the period that the Bank is exposed to credit risk and ECLs are not mitigated by credit risk management actions. Application of this exception requires judgement. Management applied its judgement in identifying the facilities, both retail and commercial, to which this exception applies. The Bank applied this exception to facilities with the following characteristics: (a) there is no fixed term or repayment structure, (b) the contractual ability to cancel the contract is not in practice enforced as a result of day-to-day management of the credit exposure and the contract may only be cancelled when the Bank becomes aware of an increase in credit risk at the level of an individual facility, and (c) the exposures are managed on a collective basis. Further, the Bank applied judgement in determining a period for measuring the ECL, including the starting point and the expected end point of the exposures.

The Bank considered historical information and experience about: (a) the period over which the Bank is exposed to credit risk on similar facilities, including when the last significant modification of the facility occurred and that therefore determines the starting point for assessing SICR, (b) the length of time for related defaults to occur on similar financial instruments following a SICR and (c) the credit risk management actions (eg. the reduction or removal of undrawn limits), prepayment rates and other factors that drive expected maturity. In applying these factors, the Bank segments the portfolios of revolving facilities into sub-groups and applies the factors that are most relevant based on historical data and experience as well as forward-looking information.

Significant increase in credit risk (“SICR”).

In order to determine whether there has been a significant increase in credit risk, the Bank compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Bank considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioural aspects of particular customer portfolios. The Bank identifies behavioural indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 27.

Business model assessment

The business model drives classification of financial assets. Management applied judgement in determining the level of aggregation and portfolios of financial instruments when performing the business model assessment. When assessing sales transactions, the Bank considers their historical frequency, timing and value, reasons for the sales and expectations about future sales activity. Sales transactions aimed at minimizing potential losses due to credit deterioration are considered consistent with the "hold to collect" business model. Other sales before maturity, not related to credit risk management activities, are also consistent with the "hold to collect" business model, provided that they are infrequent or insignificant in value, both individually and in aggregate. The Bank assesses significance of sales transactions by comparing the value of the sales to the value of the portfolio subject to the business model assessment over the average life of the portfolio. In addition, sales of financial asset expected only in stress case scenario, or in response to an isolated event that is beyond the Bank's control, is not recurring and could not have been anticipated by the Bank, are regarded as incidental to the business model objective and do not impact the classification of the respective financial assets.

The "hold to collect and sell" business model means that assets are held to collect the cash flows, but selling is also integral to achieving the business model's objective, such as, managing liquidity needs, achieving a particular yield, or matching the duration of the financial assets to the duration of the liabilities that fund those assets.

The residual category includes those portfolios of financial assets, which are managed with the objective of realizing cash flows primarily through sale, such as where a pattern of trading exists. Collecting contractual cash flow is often incidental for this business model.

Assessment whether cash flows are solely payments of principal and interest ("SPPI")

Determining whether a financial asset's cash flows are solely payments of principal and interest required judgement. The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument's underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument's cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument's cash flows are not SPPI and the instrument is then carried at FVTPL.

The Bank identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset's principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual paramount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (ii) the fair value of the prepayment feature is immaterial at initial recognition.

The Bank's loan agreements allow adjusting interest rates in response to certain macro-economic or regulatory changes. Management applied judgement and assessed that competition in the banking sector and the practical ability of the borrowers to refinance the loans would prevent it from resetting the interest rates at an above-market level and hence cash flows were assessed as being SPPI.

Modification of financial assets

When financial assets are contractually modified (e.g. renegotiated), the Bank assesses whether the modification is substantial and should result in derecognition of the original asset and recognition of a new asset at fair value. This assessment is based primarily on qualitative factors, described in the relevant accounting policy and it requires significant judgment. In particular, the Bank applies judgment in deciding whether credit impaired renegotiated loans should be derecognized and whether the new recognized loans should be considered as credit impaired on initial recognition. The derecognition assessment depends on whether the risks and rewards, that is, the variability of expected (rather than contractual) cash flows, change as a result of such modifications.

Useful life of property and equipment

The Bank assesses the remaining useful lives of items of property and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of property and equipment and on depreciation recognized in profit or loss.

Deferred income tax asset recognition

The management of the Bank provided valuation allowance against deferred income tax asset in the amount of AZN 51,670 thousand as at December 31, 2019 (2018: AZN 52,734 thousand). The carrying value of deferred tax assets amounted to nil as at December 31, 2019 and 2018, respectively.

Valuation of lease liabilities and right of use assets

The application of IFRS 16 requires to make judgements of right-of-use assets and lease liabilities. In determining the lease term, the Bank considers all facts and circumstances that create an economic incentive to exercise renewal options (or not to exercise termination options). Assessing whether a contract includes a lease also requires judgement. Estimates are required to determine the appropriate discount rate used to measure lease liabilities.

Fair value of restructured loans to customers and borrowing from CBRA under below market rate originated under the Decree

As disclosed in Note 21 to the financial statements, the Bank obtained borrowings from CBRA in the amount of AZN 4,685 thousand with 0.1% annual interest rate and restructured the loans to customers in the amount of AZN 7,427 thousand with interest rate of 1% under the Decree. Terms and conditions both for borrowings and loans originated under this decree did not match the normal market conditions as at the initial recognition therefore the Bank recognized these financial instruments at fair value utilizing the market rate for similar financial instruments. The market rate used for discounting the similar loans was 19-20% and 7.5% for borrowings received from CBRA.

3 SIGNIFICANT ACCOUNTING POLICIES

(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 amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized 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 recognized 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 recognized in other comprehensive income are reclassified to profit or loss.

(b) Interest

Effective interest rate

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

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

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not 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.

Amortized cost and gross carrying amount

The 'amortized cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative 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.

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

Calculation of interest income and expense

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

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

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

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 amortized cost.

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

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 amortized 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 recognized 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 recognized on a straight-line basis over the commitment period.

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

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

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
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 recognized 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 recognized over the period until maturity date of such contracts.

(d) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances (nostro accounts) held with the CBRA 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 CBRA is not considered to be a cash equivalent due to restrictions on its withdrawability. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

(e) Financial assets and financial liabilities

(i) Classification

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

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

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

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.

(ii) Derecognition

Financial assets

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

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

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

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

Financial liabilities

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

(iii) Modification of financial assets and financial liabilities

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

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

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 CBRA 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).

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 amortized 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 recognizes the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortized over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower (see 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 derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognized at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognized in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

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 amortized cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognized in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognized as an adjustment to the carrying amount of the liability and amortized over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

(iv) Expected credit losses

See also Note 27(e).

The Bank recognizes 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 27(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 recognized 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 recognized 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.

See also Note 27(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 derecognized (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 27(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 amortized 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.

Presentation of allowance for ECL in the statement of financial position

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

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

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

Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision.

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.

(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 recognized 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 recognizes 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 recognized 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.

(f) Loans to customers

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

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

(g) Investment securities

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

- debt investment securities measured at amortized cost (See Note 3(e)(i)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized 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 recognized immediately in profit or loss.

(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.

(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	4-10 years
Vehicles	10 years
Other fixed assets	4 years
Leasehold improvements	lower of expected lease term and usefull life
Right-of-use assets	over the term of the underlying lease

(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) IFRS 16 “Leases”

IFRS 16 “Leases” replaces IAS 17 “Leases” along with three Interpretations (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”). The Bank has applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continue to be reported under

IAS 17 and IFRIC 4. The details of accounting policies under IAS 17 and IFRIC 4 are disclosed separately if they are different from those under IFRS 16 and the impact of changes is disclosed in Note 4.

The new Standard has been applied using the modified retrospective approach, with the cumulative effect of adopting IFRS 16 being recognised in equity as an adjustment to the opening balance of accumulated losses for the current period. Prior periods have not been restated.

For contracts in place at the date of initial application, the Bank has elected to apply the definition of a lease from IAS 17 and IFRIC 4 and has not applied IFRS 16 to arrangements that were previously not identified as lease under IAS 17 and IFRIC 4.

Instead of performing an impairment review on the right-of-use assets at the date of initial application, the Bank has relied on its historic assessment as to whether leases were onerous immediately before the date of initial application of IFRS 16.

On transition, for leases previously accounted for as operating leases with a remaining lease term of less than 12 months and for leases of low-value assets the Bank has applied the optional exemptions to not recognize right-of-use assets but to account for the lease expense on a straight-line basis over the remaining lease term.

For those leases previously classified as Lease liability, the right-of-use asset and lease liability are measured at the date of initial application at the same amounts as under IAS 17 immediately before the date of initial application.

On transition to IFRS 16 the incremental borrowing rate applied to lease liability recognized under IFRS 16 was 10%.

The Bank has benefited from the use of hindsight for determining lease term when considering options to extend and terminate leases.

The management of the Bank utilized certain judgement in determination of lease terms, based on past history.

Operating leases

Before January 1, 2019 where the Bank was a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments were charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

(l) Provisions

A provision is recognized 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.

(m) 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. They are measured as follows:

- at the higher of the loss allowance determined in accordance with IFRS 9 (See Note 3(e)(iv)) and the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15.

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

For other loan commitments:

- the Bank recognizes a loss allowance (See Note 3(e)(iv)).

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

(n) 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 recognized 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.

(o) 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 recognized 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 recognized.

(p) Taxation

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

(ii) Deferred tax

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized 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 recognized 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 recognize a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on the business plans 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.

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

Deferred tax is measured at the tax rates that are expected to be applied to 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.

(q) Standards issued but not yet effective

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

IFRS 3 ***Business Combinations. Amendment of the definition of "Business"*** – The amendments will help companies determine whether an acquisition made is of a business or a group of assets.

The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. Distinguishing between a business and a group of assets is important because an acquirer recognizes goodwill only when acquiring a business. According to the amendment new definition a "business" is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

The Bank is required to apply the amended definition of a business to acquisitions that occur on or after January 1, 2020. Earlier application is permitted.

New definition of "Material" – The IASB has issued amendments to its definition of material to make it easier for companies to make materiality judgements. The updated definition amends IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. According to the new definition, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The changes are effective from January 1, 2020. Earlier application is permitted.

IASB has published **"Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)"** as a first reaction to the potential effects the IBOR reform could have on financial reporting. The changes in Interest Rate Benchmark Reform will:

- modify specific hedge accounting requirements so that entities would apply those hedge accounting requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows from the hedging instrument are based will not be altered as a result of interest rate benchmark reform;
- are mandatory for all hedging relationships that are directly affected by the interest rate benchmark reform;
- are not intended to provide relief from any other consequences arising from interest rate benchmark reform (if a hedging relationship no longer meets the requirements for hedge accounting for reasons other than those specified by the amendments, discontinuation of hedge accounting is required); and
- require specific disclosures about the extent to which the entities' hedging relationships are affected by the amendments.

The amendments are be effective for annual periods beginning on or after January 1, 2020 and must be applied retrospectively. Early application is permitted.

IFRS 17 "Insurance contracts" was issued in May 2017 and replaced IFRS 4 "Insurance contracts". The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 "Insurance Contracts" to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2023. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

Amendments to IAS 1 to clarify the classification of liabilities – In January 2020 the IASB has issued **"Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)"** providing a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments in Classification of Liabilities as Current or Non-Current (Amendments to IAS 1) affect only the presentation of liabilities in the statement of financial position — not the amount or timing of recognition of any asset, liability income or expenses, or the information that entities disclose about those items.

The amendments are effective for annual reporting periods beginning on or after January 1, 2022 and are to be applied retrospectively. Earlier application is permitted.

IFRS 10 "Consolidated Financial Statements" and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognized in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the re-measurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

(r) Adoption of new or revised standards and interpretations

In the current year, the Bank has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2019.

IFRIC 23 "Uncertainty over Income Tax Treatments" addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- whether tax treatments should be considered collectively;
- assumptions for taxation authorities' examinations;
- the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- the effect of changes in facts and circumstances.

Annual Improvements to IFRS Standards 2015-2017 Cycle contains amendments to four International Financial Reporting Standards (IFRSs) as result of the IASB's annual improvements project.

Standard	Subject of amendment
IFRS 3 "Business Combinations" and IFRS 11 "Joint Arrangements"	The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
IAS 12 "Income Taxes"	The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises.
IAS 23 "Borrowing Costs"	The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

Amendments to IAS 19 "Employee Benefits Plan Amendment, Curtailment or Settlement" – The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognized in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied.

Amendments to IAS 28 "Investments in Associations and Joint Ventures" – The IASB has published amendments to IAS 28 regarding the long-term interest in associates and joint Ventures. According to the amendment the entity should apply IFRS 9 to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendment is effective for annual periods beginning on or after January 1, 2019.

Amendments to IFRS 9 "Financial Instruments" – The IASB has published amendments to IFRS 9 regarding prepayment features with negative compensation and modifications of financial liabilities.

Prepayment Features with Negative Compensation amends the existing requirement of IFRS 9 regarding termination rights in order to allow measurement at amortized cost even in the case of negative compensation payments. The IASB also clarifies that the entity recognizes any adjustment to the amortized cost of the financial liability arising from a modification or exchange in profit or loss at the date of modification or exchange.

4 TRANSITION TO IFRS 16

IFRS 16 "Leases", specifies how an IFRS reporter recognizes, measures, presents and discloses leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 16 was issued on January 13, 2016 and applies to an annual reporting period beginning on or after January 1, 2019.

The new Standard has been applied using the modified retrospective approach, with the cumulative effect of adopting IFRS 16 being recognised in equity as an adjustment to the opening balance of accumulated losses for the current period. Prior periods have not been restated.

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. The Bank was effected by application of new standard as a Lessee.

IFRS 16 changes how the Bank accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet. On initial application of IFRS 16, for all leases (except as noted below), the Bank:

a) Recognizes right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments;
b) Recognizes depreciation of right-of-use assets and interest on lease liabilities in the statement of profit or loss;
c) Separates the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the cash flow statement.

Lease incentives (e.g. rent-free period) are recognized as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease liability incentive, amortized as a reduction of rental expenses on a straight-line basis.

Under IFRS 16, right-of-use assets are tested for impairment in accordance with IAS 36 "Impairment of Assets". This replaces the previous requirement to recognize a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as personal computers and office furniture), the Bank opts to recognize a lease expense on a straight-line basis as permitted by IFRS 16.

The Bank has evaluated the effects of application of this standard and made changes on its financial statements.

The following is a reconciliation of total operating lease commitments at January 1, 2019 to the lease liabilities recognized at January 1, 2019:

	in AZN'000
Total operating lease commitments disclosed at January 1, 2019	2,081
Discounted using incremental borrowing rate	(213)
Total lease liabilities recognized under IFRS 16 at January 1, 2019	**1,868**

The effect of adoption IFRS 16 on the financial statements as at January 1, 2019 was as follows:

	Carrying value as at December 31, 2018	**Re-measurement**	**Carrying value per IFRS 16 as at January 1, 2019**
Right-of-use asset	-	1,530	1,530
Lease liability	-	(1,868)	(1,868)
Accumulated losses	-	(338)	(338)

The following summarises the impact of transation to IFRS 16 on the opening balance of accumulated losses:

	December 31, 2019
Closing accumulated loss disclosed at December 31, 2018	**(278,582)**
Discounted using incremental borrowing rate	(338)
Related deferred income tax asset (not recognized)	-
Opening accumulated loss disclosed at January 1, 2019	**(278,920)**

5 NET INTEREST INCOME

	Year ended December 31, 2019 AZN'000	**Year ended December 31, 2018 AZN'000**
Interest income calculated using the effective interest method		
Loans to customers	31,283	31,650
Cash and cash equivalents	2,836	4,126
Investment securities	830	731
Due from banks	813	303
	35,762	**36,810**
Interest expense		
Current accounts and deposits from customers	14,057	11,489
Other borrowed funds	2,494	3,453
Lease liability	657	-
Subordinated borrowings	258	566
	17,466	**15,508**
	18,296	**21,302**

6 FEE AND COMMISSION INCOME

	Year ended December 31, 2019 AZN'000	Year ended December 31, 2018 AZN'000
Settlements	1,236	1,738
Plastic cards operations	862	697
Cash withdrawals	524	706
Guarantee and letter of credit issuance	234	189
Others	211	474
	3,067	**3,804**

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.

in AZN'000	**Retail Banking**		**Corporate Banking**		**Total**	
For the year ended December 31	**2019**	**2018**	**2019**	**2018**	**2019**	**2018**
Settlements	402	710	834	1,028	1,236	1,738
Plastic cards operations	452	568	410	129	862	697
Cash withdrawals	130	354	394	352	524	706
Guarantee and letter of credit issuance	-	32	234	157	234	189
Others	120	90	91	384	211	474
Total fee and commission income	**1,104**	**1,754**	**1,963**	**2,050**	**3,067**	**3,804**
Fee and commission expense	(904)	(282)	(1,858)	(1,346)	(2,762)	(1,628)
Net fee and commission income	**200**	**1,472**	**105**	**704**	**305**	**2,176**

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 recognizes revenue when it transfers control over a service to a customer.

7 FEE AND COMMISSION EXPENSE

	Year ended December 31, 2019 AZN'000	Year ended December 31, 2018 AZN'000
Plastic cards operations	1,040	643
Agency fees	1,327	412
Settlement	220	268
Brokerage services	140	233
Cash withdrawals	30	46
Others	5	26
	2,762	**1,628**

8 RECOVERY/(CHARGE) OF EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS

The following table provides a reconciliation between loss allowance roll-forward and the expected credit losses on debt financial assets in the statement of profit or loss and other comprehensive income per class of financial instrument as at December 31, 2019:

	Loans to customers at amortized cost	**Due from banks**	**Other financial assets**	**Total**
Net remeasurement of loss allowance	17,618	(16)	442	18,044
New financial assets originated or purchased	(5,586)	-	-	(5,586)
Total	**12,032**	**(16)**	**442**	**12,458**

The following table provides a reconciliation between loss allowance roll-forward and the expected credit losses on debt financial assets in the statement of profit or loss and other comprehensive income per class of financial instrument as at December 31, 2018:

	Loans to customers at amortized 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

	Year ended December 31, 2019	**Year ended December 31, 2018**
	AZN'000	**AZN'000**
Employee compensation	15,096	8,685
Contributions to Social Security Fund	2,436	1,918
	17,532	**10,603**

10 OTHER GENERAL ADMINISTRATIVE EXPENSES

	Year ended December 31, 2019 AZN'000	Year ended December 31, 2018 AZN'000 (reclassified)
Depreciation and amortization	3,739	2,048
Professional services	1,987	2,554
Advertising and marketing expenses	1,580	413
Payment to the Deposit Insurance Fund	942	778
Computer software cost	814	452
Office supplies and printing expenses	651	263
Security expenses	597	647
Representation expenses	509	204
Communication expenses	483	490
Loss on disposal of fixed assets	472	128
Office utilities and cleaning expenses	432	370
Repair and maintenance expenses	414	268
Taxes other than on income	371	231
Membership fee	316	321
Rent expenses	378	1,531
Travel expenses	229	105
Vehicle running cost	214	86
Insurance expenses	178	6
Legal and court expenses	132	209
Other expenses	259	21
	14,697	**11,125**

11 INCOME TAX EXPENSE

	2019 AZN'000	2018 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 2019, the applicable tax rate for current and deferred tax is 20 % (2018: 20%).

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

	2019 AZN'000	%	2018 AZN'000	%
Profit/(loss) before income tax	**2,364**		**(70,185)**	
Income tax at the applicable tax rate	(473)	(20.00)	14,037	20.00
Non-deductible costs	(591)		(1,983)	
Change in unrecognized deferred tax assets	1,064		(12,054)	
	-		-	

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 December 31, 2019 and December 31, 2018. The deferred tax assets are not recognized 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 recognized due to uncertainties concerning their realisation.

Movements in temporary differences during the years ended December 31, 2019 and 2018 are presented as follows.

2019 **AZN’000**	**Balance at January 1, 2019**	**Recognized in profit or loss**	**Balance at December 31, 2019**
Tax loss carry-forwards	56,442	(2,837)	53,605
Right-of-use assets	306	(4)	302
Other liablities	-	269	269
Provisions	-	177	177
Property, equipment and intangible assets	423	(248)	175
Other assets	305	(142)	163
Due from banks	36	(33)	3
Subordinated borrowings	(145)	145	-
Deposits and balances from banks	-	(11)	(11)
Lease liability	(374)	242	(132)
Other borrowed funds	-	(201)	(201)
Assets held for sale	-	(202)	(202)
Loans to customers	(4,259)	1,781	(2,478)
Net deferred tax asset	52,734	(1,064)	51,670
Deferred tax asset not recognized	(52,734)	1,064	(51,670)
	-	-	-

2018 **AZN’000**	**Balance at January 1, 2018**	**Recognized in profit or loss**	**Balance at December 31, 2018**
Tax loss carry-forwards	32,767	23,675	56,442
Property, equipment and intangible assets	264	159	423
Other assets	5	300	305
Due from banks	23	13	36
Subordinated borrowings	-	(145)	(145)
Loans to customers	7,689	(11,948)	(4,259)
Net deferred tax asset	40,748	12,054	52,802
Deferred tax asset not recognized	(40,748)	(12,054)	(52,802)
	-	-	-

12 CASH AND CASH EQUIVALENTS

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Cash on hand	**20,229**	**8,090**
Nostro accounts with the CBRA	**14,021**	**6,549**
Nostro accounts and overnight placements with other banks		
- rated from A- to A+	753	-
- rated from BBB- to BBB+	314	343
- rated from BB- to BB+	342	1,759
- rated from B- to B+	177	164
- not rated	1	22
Total nostro accounts and overnight placements with other banks	**1,587**	**2,288**
Cash equivalents		
CBRA notes	**46,635**	**66,640**
Ministry of Finance notes	**2,488**	**-**
Term deposits with the CBRA	**6,203**	**15,358**
Term deposits with non-resident banks	**59,336**	**18,193**
- rated from A- to A+	55,256	-
- rated from BBB- to BBB+	-	18,193
- rated from BB- to BB+	4,080	-
	150,499	**117,118**
Less: overdrawn facility from foreign financial institutions	(3,224)	-
	147,275	**117,118**

As at December 31, 2019, besides the CBRA the Bank had one corresponding bank rated from "A- to A+" (December 31, 2018: one), where the balance exceeded 10% of Bank's equity. The gross value of these balances as at December 31, 2019 were AZN 56,009 thousand (December 31, 2018: AZN 18,536 thousand).

Loss allowance

As at December 31, 2019 and 2018, all balances included in cash and cash equivalents are classified as Stage 1 and no loss allowance is recognized.

13 DUE FROM BANKS

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Mandatory reserve with the CBRA	**2,150**	**1,744**
Blocked account with the CBRA	**-**	**30,804**
Loans and deposits		
- rated from BBB- to BBB+	-	5,124
- rated below B+	272	170
- not rated	7,228	-
Total loans and deposits	**7,500**	**5,294**
Less: Allowance for expected credit loss	(16)	-
Total due from banks	**9,634**	**37,842**

As at December 31, 2019 and 2018 the Bank had no bank whose balance exceeded equity.

Loss allowance

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from banks during the year ended December 31, 2019 is as follows:

	Stage 1	**Stage 2**	**Stage 3**	**Total**
Gross carrying value as at January 1, 2019	**37,842**	-	**-**	**37,842**
Net change in carrying value	(28,192)	-		(28,192)
Transfers to Stage 1	(16)	-	16	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
As at December 31, 2019	**9,634**	**-**	**16**	**9,650**

	Stage 1	**Stage 2**	**Stage 3**	**Total**
ECL allowance as at January 1, 2019	**-**	-	**-**	**-**
Net change in ECL value	-	-	(16)	(16)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
As at December 31, 2019	**-**	**-**	**(16)**	**(16)**

An analysis of changes in gross carrying value on amounts due from banks during the year ended December 31, 2018 is as follows:

	Stage 1	**Stage 2**	**Stage 3**	**Total**
Gross carrying value as at January 1, 2018	**45,567**	-	**-**	**45,567**
Net change in carrying value	(7,725)	-	-	(7,725)
Transfers to Stage 1	-	-	**-**	-
Transfers to Stage 2	-	-	**-**	-
Transfers to Stage 3	-	-	**-**	-
As at December 31, 2018	**37,842**	**-**	**-**	**37,842**

Mandatory reserve with the CBRA

The mandatory reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBRA and whose withdrawal ability is restricted. Reserves are measured in accordance with regulations issued by the CBRA 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 CBRA

As at December 31, 2018, included in loans and deposits were AZN 30,804 thousand blocked by the CBRA as a collateral for the loans issued to the Bank. During the year ended December 31, 2019, the Bank repaid those loans and blocked amounts were released.

14 LOANS TO CUSTOMERS

	December 31, 2019 AZN'000	% of total gross loans	December 31, 2018 AZN'000	% of total gross loans
Corporate loans	133,040	32%	183,022	43%
Total loans to corporate customers	**133,040**		**183,022**	
Consumer loans	98,361	24%	79,957	19%
Entrepreneur loans	82,821	20%	55,875	13%
Mortgage loans	72,872	17%	72,698	17%
Auto loans	30,716	7%	36,050	8%
Total loans to individuals	**284,770**		**244,580**	
Gross loans to customers	**417,810**		**427,602**	
Less: Allowance for expected credit loss	**(130,457)**	31%	**(201,485)**	47%
Net loans to customers	**287,353**		**226,117**	

(a) Loss allowance

The following tables show reconciliations from the opening to the closing balances of the loss allowance of loans to customers for the ended December 31, 2019.

			2019		
in AZN'000	**Stage1**	**Stage2**	**Stage3**	**POCI**	**Total**
Allowance for ECL of loans to customers					
Balance at January 1	3,893	4,337	193,255	-	201,485
Transfer to Stage 1	3,822	(3,061)	(761)	-	-
Transfer to Stage 2	(654)	721	(67)	-	-
Transfer to Stage 3	(390)	(234)	624	-	-
Net remeasurement of loss allowance	(3,148)	773	(15,243)	-	(17,618)
New financial assets originated or purchased	2,824	519	2,243	-	5,586
Write-offs	-	-	(111,907)	-	(111,907)
Recoveries of amounts previously written off	-	-	30,695	-	30,695
Unwinding of discount on present value of ECLs	-	-	22,216	-	22,216
Balance at December 31	**6,347**	**3,055**	**121,055**	**-**	**130,457**

	2019				
in AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Allowance for ECL of loans to customers– corporate loans					
Balance at January 1	1,930	3,985	92,955	-	98,870
Transfer to Stage 1	2,997	(2,997)	-	-	-
Transfer to Stage 2	(580)	580	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net remeasurement of loss allowance	(1,389)	722	9,824	-	9,157
New financial assets originated or purchased	245	98	99	-	442
Write-offs	-	-	(91,076)	-	(91,076)
Recoveries of amounts previously written off	-	-	25,154	-	25,154
Unwinding of discount on present value of ECLs	-	-	6,841	-	6,841
Balance at December 31	**3,203**	**2,388**	**43,797**	**-**	**49,388**

	2019				
AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Allowance for ECL of loans to customers– loans to individuals					
Balance at January 1	**1,963**	**352**	**100,300**	**-**	**102,615**
Transfer to Stage 1	825	(64)	(761)	-	-
Transfer to Stage 2	(74)	141	(67)	-	-
Transfer to Stage 3	(390)	(234)	624	-	-
Net remeasurement of loss allowance	(1,759)	51	(25,067)	-	(26,775)
New financial assets originated or purchased	2,579	421	2,144	-	5,144
Write-offs	-	-	(20,831)	-	(20,831)
Recoveries of amounts previously written off	-	-	5,541	-	5,541
Unwinding of discount on present value of ECLs	-	-	15,375	-	15,375
Balance at December 31	**3,144**	**667**	**77,258**	**-**	**81,069**

The following tables show reconciliations from the opening to the closing balances of the loss allowance of loans to customers for the ended December 31, 2018.

	2018				
AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Allowance for ECL of loans to customers					
Balance at January 1	**1,160**	**251**	**231,710**	**934**	**234,055**
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
New financial assets originated or purchased	5,759	-	-	-	5,759
Write-offs	-	-	(130,334)	(2,040)	(132,374)
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 December 31	**3,893**	**4,337**	**193,255**	**-**	**201,485**

	2018				
AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Allowance for ECL of loans to customers – corporate loans					
Balance at January 1	**316**	**91**	**117,402**	**934**	**118,743**
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
New financial assets originated or purchased	3,403	-	-	-	3,403
Write-offs	-	-	(65,898)	(2,040)	(67,938)
Recoveries of amounts previously written off	-	-	378	-	378
Unwinding of discount on present value of ECLs	-	-	10,337	31	10,368
Balance at December 31	**1,930**	**3,985**	**92,955**	**-**	**98,870**

	2018				
AZN'000	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Allowance for ECL of loans to customers – loans to individuals					
Balance at January 1	**844**	**160**	**114,308**	**-**	**115,312**
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
New financial assets originated or purchased	2,356	-	-	-	2,356
Write-offs	-	-	(64,436)	-	(64,436)
Recoveries of amounts previously written off	-	-	4,028	-	4,028
Unwinding of discount on present value of ECLs	-	-	21,395	-	21,395
Balance at December 31	**1,963**	**352**	**100,300**	**-**	**102,615**

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

- The Bank made change in its approach to secured loans issued before August 2016. This change was applied to collectively assessed loans. Change in approach resulted in an increase in loss allowance by AZN 8,309 thousand (December 31, 2018: AZN 68,613 thousand). Provision rate for these loans increased from 71.2% to 81%.

(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 151,254 thousand (December 31, 2018: AZN 107,342 thousand) with a corresponding increase in loss allowance by AZN 5,586 thousand (as at December 31, 2018: AZN 5,759 thousand).
- the write-off of loans with a total gross carrying amount of AZN 111,907 thousand resulted in the reduction of Stage 3 loss allowance by the same amount (as at December 31, 2018: AZN 130,334 thousand).

The following table sets out information about the credit quality of loans to customers measured at amortized cost as at December 31, 2019. 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).

in AZN'000	**December 31, 2019**				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortized cost – corporate loans					
Not overdue	41,870	15,490	2,799	-	60,159
Overdue less than 30 days	1,360	506	66	-	1,932
Overdue 30-89 days	-	7,800	24	-	7,824
Overdue 90-179 days	-	-	105	-	105
Overdue 180-360 days	-	-	8,792	-	8,792
Overdue more than 360 days	-	-	54,228	-	54,228
	43,230	**23,796**	**66,014**	**-**	**133,040**
Loss allowance	**(3,203)**	**(2,388)**	**(43,797)**	**-**	**(49,388)**
Carrying amount	**40,027**	**21,408**	**22,217**	**-**	**83,652**

in AZN'000	**December 31, 2019**				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortized cost – entrepreneur loans					
Not overdue	53,635	1,240	82	-	54,957
Overdue less than 30 days	3,530	6	-	-	3,536
Overdue 30-89 days	94	313	9	-	416
Overdue 90-179 days	-	-	325	-	325
Overdue 180-360 days	-	-	751	-	751
Overdue more than 360 days	-	-	22,836	-	22,836
	57,259	**1,559**	**24,003**	**-**	**82,821**
Loss allowance	**(632)**	**(126)**	**(19,467)**	**-**	**(20,225)**
Carrying amount	**56,627**	**1,433**	**4,536**	**-**	**62,596**

in AZN'000	**December 31, 2019**				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Loans to customers at amortized cost – consumer loans					
Not overdue	56,241	712	1,261	-	58,214
Overdue less than 30 days	2,666	87	200	-	2,953
Overdue 30-89 days	63	1,369	328	-	1,760
Overdue 90-179 days	-	7	2,132	-	2,139
Overdue 180-360 days	-	-	5,317	-	5,317
Overdue more than 360 days	-	-	27,978	-	27,978
	58,970	**2,175**	**37,216**	**-**	**98,361**
Loss allowance	**(2,382)**	**(440)**	**(26,622)**	**-**	**(29,444)**
Carrying amount	**56,588**	**1,735**	**10,594**	**-**	**68,917**

in AZN'000	December 31, 2019				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized cost – mortgage loans					
Not overdue	62,058	377	1,643	-	64,078
Overdue less than 30 days	1,815	-	48	-	1,863
Overdue 30-89 days	70	476	-	-	546
Overdue 90-179 days	-	-	156	-	156
Overdue 180-360 days	-	-	2,861	-	2,861
Overdue more than 360 days	-	-	3,368	-	3,368
	63,943	**853**	**8,076**	**-**	**72,872**
Loss allowance	**(130)**	**(101)**	**(5,520)**	**-**	**(5,751)**
Carrying amount	**63,813**	**752**	**2,556**	**-**	**67,121**

AZN'000	December 31, 2019				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized cost – auto loans					
Not overdue	7	-	3	-	10
Overdue less than 30 days	-	-	3	-	3
Overdue 30-89 days	-	-	1	-	1
Overdue 90-179 days	-	-	39	-	39
Overdue 180-360 days	-	-	195	-	195
Overdue more than 360 days	-	-	30,468	-	30,468
	7	**-**	**30,709**	**-**	**30,716**
Loss allowance	**-**	**-**	**(25,649)**	**-**	**(25,649)**
Carrying amount	**7**	**-**	**5,060**	**-**	**5,067**

The following table provides information on the credit quality of loans to customers as at December 31, 2018. Unless specially indicated, the amounts in the table represent gross carrying amounts.

in AZN'000	December 31, 2018				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized 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**

in AZN'000	December 31, 2018				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized 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**

in AZN'000	December 31, 2018				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized 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	-	1,004
Overdue 90-179 days	-	-	956	-	956
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	**(1,136)**	**(148)**	**(33,340)**	**-**	**(34,624)**
Carrying amount	**26,275**	**3,075**	**15,983**	**-**	**45,333**

in AZN'000	December 31, 2018				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized 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**

in AZN’000	December 31, 2018				
	Stage 1	Stage 2	Stage 3	POCI	Total
Loans to customers at amortized 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**

(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.

Changes in these estimates could effect the ECL allowance. For example, to the extent that the net present value of the estimated cash flows differs by one percent, the ECL allowance on loans to customers as at December 31, 2019 would be AZN 2,874 thousand lower/higher (December 31, 2018: AZN 2,261 thousand lower/higher).

(d) Changes in estimates

The Bank made change in its approach to secured loans issued before August 2016 that are evaluated collectively, collateral values were discounted with the following rates: real estate – 70%, precious metals – 60%, motor vehicles - 80%. After this adjustments, expected credit loss amount increased by AZN 8,309 thousand.

(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 December 31, 2019. The fair value of collaterals are updated as at the reporting date.

				Fair value of collateral held				
in 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								
Loans to individuals								
Consumer loans								
Entrepreneur loans								
Mortgage loans								
Auto loans								
Total credit-impaired loans to customers	**166,018**	**(121,055)**	**44,963**	**1,149**	**5,466**	**20,919**	**39**	**27,573**

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 December 31, 2018. The fair value of collaterals are updated as at the reporting date.

				Fair value of collateral held				
in 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								
Loans to individuals								
Consumer loans								
Entrepreneur loans								
Mortgage loans								
Auto loans								
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 December 31, 2019:

				Fair value of collateral held				
in 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								
Loans to individuals								
Entrepreneur loans								
Consumer loans								
Mortgage loans								
Auto loans								
Total loans to customers								

As at December 31, 2019 the Bank held loans to customers in the amount of AZN 4,912 thousand for which no loss allowance was recognized as they are collateralised fully by cash and deposits.

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

				Fair value of collateral held				
in 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								
Loans to individuals								
Entrepreneur loans								
Consumer loans								
Mortgage loans								
Auto loans								
Total loans to customers								

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

Repossessed collateral

During the year ended December 31, 2019, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 1,964 thousand (2018: AZN 3,887 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 18.

(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:

	December 31, 2019 AZN'000	**%**	**December 31, 2018 AZN'000**	
Corporate loans				
- trade and services	67,903	16.3	83,429	19.5
- manufacturing	22,215	5.3	35,272	8.3
- financial services	20,121	4.8	28,641	6.7
- agriculture	12,912	3.1	21,058	4.9
- construction	9,299	2.2	14,232	3.3
- other	590	0.1	390	0.1
Total corporate loans	**133,040**	**31.8**	**183,022**	**42.6**
Loans to individuals				
- enterpreneurs	82,821	19.8	55,875	13.1
- consumer loans	96,624	23.1	74,999	17.5
- mortgage loans	72,872	17.5	72,698	17.0
- auto loans	30,716	7.4	36,050	8.4
- credit cards	1,737	0.4	4,958	1.2
Total loans to individuals	**284,770**	**68.2**	**244,580**	**57.2**
Total loans to customers	**417,810**	**100.0**	**427,602**	**100.0**
Impairment allowance	(130,457)		(201,485)	
Net loans to customers	**287,353**		**226,117**	

(g) Significant credit exposures

As at December 31, 2019, the Bank had thirty four borrowers (December 31, 2018: forty one borrowers) with gross loan balances exceeding AZN 1,000 thousand. The gross value of these loans as at December 31, 2019 was AZN 130,513 thousand or 31% of the total loans to customers (December 31, 2018: AZN 200,530 thousand or 47%).

(h) Loan modification

As disclosed in Note 1 to the financial statements, the Bank received compensation from the government in the amount of AZN 4,685 thousand for the problematic loans under the Decree during the year ended December 31, 2019. Additionally, the Bank restructured loans in the amount of AZN 7,427 thousand under the Decree with 1% of interest and 5 years of maturity. Before restructuring these loans were either written off or presented in Stage 3. The restructured loans were also granted with 1 year of grace period for payment of principal amount as stipulated in the Decree. As the modification of terms of these loans were substantially different from their original conditions, the Bank applied derecognition approach regarding these loans. The fair value of these loans was estimated as nil as at December 31, 2019.

(i) Loan maturities

The maturity of the loan portfolio is presented in Note 27, 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

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Investment securities measured at amortized cost	7,819	13,601
Total investment securities	**7,819**	**13,601**

	December 31, 2019 AZN'000	December 31, 2019 AZN'000
Corporate bonds		
Bonds of the Ministry of Finance of the Republic of Azerbaijan	4,508	11,778
Bonds of the financial institution	2,550	1,737
Bonds of the Central Bank of the Republic of Azerbaijan	676	-
Bonds of the State Oil Company of the Republic of Azerbaijan	85	86
Total investment securities	**7,819**	**13,601**

As at December 31, 2019, the debt securities included corporate bonds of State Oil Company of Azerbaijan Republic, carrying an annual interest rate of 5% with maturities in October 2021, bonds of the Ministry of Finance of the Republic of Azerbaijan, carrying an annual interest rate of 3.5% - 9.9% with maturities in January 2020 - September 2020, and corporate bond of foreign companies "TBC Bank" JSC and "Silknet" JSC, carrying an annual interest rate of

5.75% and 8.50% with maturity in March 2021 and June 2024. These corporate bonds are quoted in active market and their fair value approximated carrying value at December 31, 2019.

As at December 31, 2019, accrued interest income included in investment securities amounted to AZN 121 thousand (2018: AZN 556 thousand).

Loss allowance

For the purpose of ECL measurement investment securities are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Bank did not recognize any credit loss allowance for investment securities.

There were no transfers between stages in gross carrying values and ECL allowance on investment securities during the years ended December 31, 2019 and 2018.

Credit quality analysis

The following table sets out information about the credit quality of investment securities measured at amortized cost as at December 31, 2019 and 2018. Explanation of the term "Stage 1" included in Note 3(e)(iv).

AZN'000	**December 31, 2019**		**December 31, 2018**	
	Stage 1	**Total**	**Stage 1**	**Total**
Debt investment securities at amortized cost				
Rated from BB- to BB+	6,969	6,969	-	-
Rated B+	850	850	887	887
Rated from BBB- to BBB+	-	-	12,714	12,714
Carrying amount	**7,819**	**7,819**	**13,601**	**13,601**

16 PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

in AZN'000	Buildings	Furniture and fixtures	Computers and communication equipment	Vehicles	Other fixed assets	Leasehold imporvements	Intangible assets	Total
Cost amount								
Balance at January 1, 2019	**3,169**	**4,264**	**4,899**	**1,063**	**284**	**5,817**	**5,465**	**24,961**
Additions	-	1,471	2,224	184	12	260	1,002	5,153
Disposals	-	(182)	(290)	-	-	(568)	-	(1,040)
Transfer in/(out)	-	(2,174)	2,192	-	(6)	-	(12)	-
Balance at December 31, 2019	**3,169**	**3,379**	**9,025**	**1,247**	**290**	**5,509**	**6,455**	**29,074**
Depreciation and amortisation								
Balance at January 1, 2019	**(1,013)**	**(2,622)**	**(3,923)**	**(616)**	**(237)**	**(2,205)**	**(2,447)**	**(13,063)**
Depreciation and amortisation for the year	(158)	(226)	(791)	(81)	(28)	(402)	(542)	(2,228)
Disposals	-	40	251	-	-	277	-	568
Transfer in/(out)	-	1,427	(1,441)	-	5	-	9	-
Balance at December 31, 2019	**(1,171)**	**(1,381)**	**(5,904)**	**(697)**	**(260)**	**(2,330)**	**(2,980)**	**(14,723)**
Carrying amount								
At December 31, 2019	**1,998**	**1,998**	**3,121**	**550**	**30**	**3,179**	**3,475**	**14,351**
Cost amount								
Balance at January 1, 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 December 31, 2018	**3,169**	**4,264**	**4,899**	**1,063**	**284**	**5,817**	**5,465**	**24,961**

	Buildings	Furniture and fixtures	Computers and communication equipment	Vehicles	Other fixed assets	Leasehold imporvements	Intangible assets	Total
Depreciation and amortisation								
Balance at January 1, 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 December 31, 2018	**(1,013)**	**(2,622)**	**(3,923)**	**(616)**	**(237)**	**(2,205)**	**(2,447)**	**(13,063)**
Carrying amount								
At December 31, 2018	**2,156**	**1,642**	**976**	**447**	**47**	**3,612**	**3,018**	**11,898**

As at December 31, 2019 included in the closing balance of property, equipment and intangible assets were fully depreciated assets still in use with the total initial cost of AZN 5,214 thousand (2018: AZN 4,087 thousand).

As at December 31, 2019 and 2018, included in property, equipment and intangible assets insured in the amount of AZN 1,247 thousand and AZN 1,063 thousand, respectively.

As at December 31, 2019 and 2018, property, equipment and intangible assets were not pledged as collateral for borrowings.

17 RIGHT-OF-USE ASSETS

AZN'000	Office buildings	Total
Cost amount		
Balance at December 31, 2018	-	-
Adjustment on application of IFRS 16	1,530	1,530
Balance at January 1, 2019	**1,530**	**1,530**
Additions	13,128	13,128
Balance at December 31, 2019	**14,658**	**14,658**
Depreciation and amortisation		
Balance at January 1, 2019	-	-
Depreciation and amortisation for the year	(1,511)	(1,511)
Balance at December 31, 2019	**(1,511)**	**(1,511)**
Carrying amount		
At December 31, 2019	**13,147**	**13,147**
At January 1, 2019	**1,530**	**1,530**
At December 31, 2018	**-**	**-**

18 ASSETS HELD FOR SALE

During the years ended December 31, 2019 and 2018 the Bank received non-financial assets classified as held for by taking possession of collateral held as security against loans to customers. As at December 31, 2019 and 2018 such assets amounted to AZN 5,974 thousand and AZN 5,053 thousand, respectively, net of change in fair value less costs to sell. 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 December 31, 2019, 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. During the year end December 31, 2019, the Bank recognized fair value gain in the amount of AZN 1,155 thousand (December 31, 2018: fair value loss in the amount of AZN 7,289 thousand).

Assets held for sale are comprised of the following assets:

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Real estate	11,745	12,849
Other assets	14	14
Cumulative change in fair value less costs to sell	(5,785)	(7,810)
Balance at the end of the year	**5,974**	**5,053**

Analysis of movements in the cumulative change in fair value less costs to sell:

	2019 AZN'000	2018 AZN'000
Balance at the beginning of the year	**7,810**	**523**
Change in fair value of assets held for sale	(1,155)	7,289
Write-offs	(870)	(2)
Balance at the end of the year	**5,785**	**7,810**

19 OTHER ASSETS

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Settlements on monetary transfers	3,702	1,514
Amounts in course of settlement	285	171
Compensation receivable	410	-
Derivatives	83	-
Others	68	68
Less: loss allowance for other financial assets	(324)	-
Total other financial assets	**4,224**	**1,753**
Prepayments for purchase of intangible assets	2,208	391
Prepaid expenses	817	291
Other taxes receivable	162	4
Others	213	272
Total other non-financial assets	**3,400**	**958**
Total other assets	**7,624**	**2,711**

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 3.

	2019		2018	
in AZN'000	**Stage 3**	**Total**	**Stage 3**	**Total**
Other assets				
Balance at January 1,	**-**	**-**	**179**	**179**
Net remeasurement of loss allowance	(442)	(442)	178	178
Recovery of write-offs	766	766	-	-
Write-offs	-	-	(357)	(357)
Balance at December 31,	**324**	**324**	**-**	**-**

20 CURRENT ACCOUNTS AND DEPOSITS FROM CUSTOMERS

	December 31, 2019	December 31, 2018
Current accounts and demand deposits		
- Retail	31,838	15,743
- Corporate	31,026	41,790
Term deposits		
- Retail	247,503	172,032
- Corporate	13,249	4,695
	323,616	**234,260**

As at December 31, 2019, the Bank had thirty one customers (December 31, 2018: twenty five customers), whose balances exceeded AZN 1,000 thousand. The total amount of these balances as at December 31, 2019 was AZN 93,577 thousand (December 31, 2018: AZN 103,979 thousand).

As at December 31, 2019, the Bank maintained customer deposit balances of AZN 16,962 thousand (December 31, 2018: AZN 12,955 thousand) that served as collateral for loans and unrecognized credit instruments granted by the Bank.

21 OTHER BORROWED FUNDS AND SUBORDINATED BORROWINGS

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Subordinated borrowings	**9,170**	**8,912**
Other borrowed funds		
Azerbaijan Mortgage and Credit Guarantee Fund	61,920	62,932
Central Bank of Azerbaijan Republic	3,678	27,211
Entrepreneurship Development Fund	3,250	4,541
Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture	2,026	2,840
Total other borrowed funds	**70,874**	**97,524**
	80,044	**106,436**

Azerbaijan Mortgage and Credit Guarantee Fund

On February 17, 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%-8% per annum. At December 31, 2019 the Bank had AZN 61,920 thousand (December 31, 2018: AZN 62,932 thousand) payable to the State Mortgage Fund of Azerbaijan Republic. There are no financial covenants with regard to borrowing from the Azerbaijan Mortgage and Credit Guarantee Fund that the Bank should comply with.

Entrepreneurship Development Fund

On November 26, 2009, the Bank signed a credit agreement with the Entrepreneurship Development Fund, 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 December 31, 2019, the Bank had AZN 3,250 thousand (2018: AZN 4,541 thousand) payable to the Entrepreneurship Development Fund. There are no financial covenants with regard to the borrowing from the Entrepreneurship Development Fund that the Bank should comply with.

Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture

On September 30, 2015, the Bank signed a credit agreement with the Azerbaijan State Agency on Agricultural Credits, 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 December 31, 2019, the Bank had AZN 2,026 thousand (2018: AZN 2,840 thousand) payable to the Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture. There are no financial covenants with regard to the borrowing from the Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture that the Bank should comply with.

Central Bank of Azerbaijan Republic

In November and December 2019 the Bank received borrowings from CBRA in the amount of AZN 4,685 thousand with annual interest rate of 0.1% per annum for 5 years under the Decree. The interest rate of borrowings received from the CBRA for the purpose of financing the restructured loans were of below market rate as at the date of origination, therefore the Bank recognized gain in the amount of AZN 1,007 thousand at initial recognition of these borrowings. The fair value of these borrowings at initial recognition was AZN 3,678 thousand.

Subordinated borrowings

As at December 31, 2019, subordinated borrowings included deposit placed by related party in the amount AZN 9,170 thousand (December 31, 2018: AZN 8,912 thousand) maturing in 2023 (December 31, 2018: 2023) and carried annual interest rate of 3% (December 31, 2018: 3%). In case of bankruptcy, the repayment of the subordinated borrowings will be made after repayment in full of all other liabilities of the Bank.

Included in other borrowed funds and subordinated borrowings AZN 878 thousand and AZN 634 thousand as at December 31, 2019 and 2018, respectively represent accrued interest payable.

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

in AZN'000	Other borrowed funds	Subordinated borrowings	Total
Balance at January 1, 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 December 31, 2018	**97,524**	**8,912**	**106,436**

in AZN'000	Other borrowed funds	Subordinated borrowings	Total
Balance at January 1, 2019	**97,524**	**8,912**	**106,436**
Changes from financing cash flows			
Receipt of other borrowed funds	13,446	-	13,446
Repayment of other borrowed funds	(39,075)	-	(39,075)
Total changes from financing cash flows	**(25,629)**	**-**	**(25,629)**
Fair value gain on other borrowed funds at initial recognition	(1,007)	-	(1,007)
Other changes			
Interest expense	2,494	258	2,752
Interest paid	(2,508)	-	(2,508)
Balance at December 31, 2019	**70,874**	**9,170**	**80,044**

22 LEASE LIABILITY

	December 31, 2019	January 1, 2019	December 31, 2018
Lease liability (current)	1,474	1,042	-
Lease liability (non-current)	11,891	826	-
Total lease liability	**13,365**	**1,868**	**-**

Future minimum lease payments as at December 31, 2019 were as follows:

	Minimum lease payments due		
	Within one year	**One to ten years**	**Total**
Lease payments	2,767	17,323	20,090
Finance charges	(1,293)	(5,432)	(6,725)
Net present value as at December 31, 2019	**1,474**	**11,891**	**13,365**

Future minimum lease payments as at January 1, 2019 were as follows:

	Minimum lease payments due		
	Within one year	**One to ten years**	**Total**
Lease payments	1,190	891	2,081
Finance charges	(148)	(65)	(213)
Net present value as at January 1, 2019	**1,042**	**826**	**1,868**

A reconciliation of the opening and closing amounts of lease liability with relevant cash and non-cash changes from financing activities is stated below:

in AZN'000	**Amount**
Balance as at January 1, 2019	**1,868**
Cash flows	
Repayment of principal	(1,631)
Interest paid	(657)
Non-cash changes	
New leases	13,128
Interest expense	657
Balance as at December 31, 2019	**13,365**

23 OTHER LIABILITIES

	December 31, 2019 AZN'000	**December 31, 2018 AZN'000**
Settlement on other operations	1,079	1,241
Settlements with employees	882	-
Derivatives	376	-
Compensation payable	291	-
Payables to Deposit Insurance Fund	264	193
Accrued expenses	211	49
Payables on purchased loans	122	1,166
Others	19	-
Total other financial liabilities	**3,244**	**2,649**
Other taxes payable	154	251
Other non-financial liabilities	19	34
Total other non-financial liabilities	**173**	**285**
Total other liabilities	**3,417**	**2,934**

24 SHARE CAPITAL AND RESERVES

(a) Issued capital

The authorised, issued and outstanding share capital comprises 174,000,000 ordinary shares (2018: 174,000,000). All shares have a nominal value of AZN 2 per share. During the year ended December 31, 2019 there was no share issue (2018: 55,500,000 ordinary shares were issued for cash and 8,500,000 ordinary shares were issued as transfer from subordinated borrowing).

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 2019 (2018: nil).

25 EARNINGS/(LOSS) PER SHARE

Basic and diluted earnings/(loss) per share

The calculation of basic earnings/(loss) per share as at December 31, 2019 is based on the earnings /(loss) attributable to ordinary shareholders of AZN 2,364 thousand (2018: AZN 70,185 thousand), and a weighted average number of ordinary shares outstanding of 174,000,000 (2018: 135,763,000) calculated as follows.

	2019	2018
Net earnings /(loss) attributable to ordinary shareholders (AZN’000)	2,364	(70,185)
Weighted average number of ordinary shares for the year ended December 31, (thousands of shares)	174,000	135,763
Basic and diluted earnings /(loss) per share (AZN)	**0.01**	**(0.52)**

26 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.

27 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 December 31, 2019 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 December 31, 2019, 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 December 31, 2019 the Management Board included:

Nikoloz Shurgaia – Chairman of the Management Board;
Fuad Tagiyev – Deputy Chairman of the Management Board;
Yashar Karimov – Deputy Chairman of the Management Board.

During the year ended December 31, 2019 the following changes occurred in composition of the Management Board:

Resignation of Farhad Hajinski as First Deputy Chairman of the Management Board December 30, 2019.

Appointment of Yashar Karimov as Deputy Chairman of the Management Board December 9, 2019.

(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. 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;
- 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 CBRA 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.

(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:

in AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Carrying amount
December 31, 2019							
ASSETS							
Cash and cash equivalents	97,261	14,280	-	-	-	35,734	147,275
Due from banks	-	2,890	2,768	-	-	3,976	9,634
Loans to customers	36,055	20,174	71,748	102,560	56,816	-	287,353
Investment securities	121	1,167	3,900	2,631	-	-	7,819
Other financial assets	-	-	-	-	-	4,224	4,224
	133,437	**38,511**	**78,416**	**105,191**	**56,816**	**43,934**	**456,305**
LIABILITIES							
Deposits and balances from banks	-	-	-	-	-	5	5
Current accounts and deposits from customers	15,714	31,118	159,960	53,952	8	62,864	323,616
Other borrowed funds	645	871	3,871	17,441	48,046	-	70,874
Subordinated borrowings	670	-	-	8,500	-	-	9,170
Lease liability	60	116	1,298	6,672	5,219	-	13,365
Other financial liabilities	-	-	-	-	-	3,244	3,244
	17,089	**32,105**	**165,129**	**86,565**	**53,273**	**66,113**	**420,274**
	116,348	**6,406**	**(86,713)**	**18,626**	**3,543**	**(22,179)**	**36,031**

in AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Carrying amount
December 31, 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
Subordinated borrowings	-	-	412	8,500	-	-	8,912
Other financial liabilities	-	-	-	-	-	2,649	2,649
	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**

Average effective interest rates

The table below displays average effective interest rates for interest bearing assets and liabilities as at December 31, 2019 and 2018. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	2019 Average effective interest rate, %			2018 Average effective interest rate, %		
	AZN	**USD**	**EUR**	**AZN**	**USD**	**EUR**
Interest bearing assets						
Cash and cash equivalents	5.6%	1.17%	-	8.04%	1.65%	-
Due from banks	-	1.02%	-	-	1.30%	-
Loans to customers	15.68%	10.77%	4.16%	13.72%	12.57%	10.69%
Investment securities	7.45%	6.61%	-	8.93%	8.57%	-
Interest bearing liabilities						
Current accounts and deposits from customers	9.17%	2.49%	0.01%	10.53%	3.10%	7.50%
Other borrowed funds	3.18%	-	-	3.41%	-	-
Subordinated borrowings	-	3.00%	-	-	3.00%	-
Lease liability	10%	-	-	-	-	-

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 December 31, 2019 and 2018 is as follows:

	2019 AZN'000	2018 AZN'000
100 bp parallel fall	(288)	(425)
100 bp parallel rise	288	425

(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 December 31, 2019:

ASSETS	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
Cash and cash equivalents	76,079	69,062	1,835	299	147,275
Due from banks	3,832	5,802	-	-	9,634
Loans to customers	225,850	60,849	654	-	287,353
Investment securities	5,184	2,635	-	-	7,819
Other financial assets	3,786	417	9	12	4,224
Total financial assets	**314,731**	**138,765**	**2,498**	**311**	**456,305**
Swap agreements	-	**17,000**	-	-	**17,000**
LIABILITIES					
Deposits and balances from banks	2	2	1	-	5
Current accounts and deposits from customers	180,528	140,463	2,400	225	323,616
Other borrowed funds	70,874	-	-	-	70,874
Subordinated borrowings	-	9,170	-	-	9,170
Lease liability	13,365	-	-	-	13,365
Other financial liabilities	2,247	954	34	9	3,244
Total financial liabilities	**267,016**	**150,589**	**2,435**	**234**	**420,274**
Swap agreements	**17,000**	-	-	-	**17,000**
Net position	**30,715**	**5,176**	**63**	**77**	

The following table shows the foreign currency exposure structure of financial assets and liabilities as at December 31, 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
Subordinated borrowings	-	8,912	-	-	8,912
Other financial liabilities	1,975	641	17	16	2,649
Total financial liabilities	**196,980**	**143,753**	**2,530**	**88**	**343,351**
Net position	**68,699**	**(15,931)**	**(211)**	**523**	

A weakening of the AZN, as indicated below, against the following currencies at December 31, 2019 and 2018, 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.

	2019 AZN'000	2018 AZN'000
20% appreciation of USD against AZN	828	2,538
20% appreciation of EUR against AZN	10	214

A strengthening of the AZN against the above currencies at December 31, 2019 and 2018 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 recognized financial assets and unrecognized 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 unrecognized contractual commitment amounts. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

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

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
ASSETS		
Cash and cash equivalents (excluding cash on hand)	127,046	109,028
Due from banks	9,634	37,842
Loans to customers (excluding cash deposits and precious metals)	275,458	212,830
Investment securities (excluding equity securities)	7,819	13,601
Other financial assets	4,224	1,753
Total maximum exposure	**424,181**	**375,054**

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.

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.

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

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.

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 expected credit loss impairment model in PD component level.

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 CBRA, 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. Using an analysis of historical data, the Bank has estimated relationships between macro-economic variables and default rates.

The key drivers depend on portfolio segment. The economic scenarios used as at December 31, 2019 included the following key indicators for the Republic of Azerbaijan for the years ending December 31, 2019 through 2022.

Key driver	2019	2020	2021	2022
Average salary	623.1	716.7	768.6	809.2
Real GDP Growth	2.2%	2.1%	2.1%	2.2%
Nominal GDP (in thousands AZN)	81681	81664	83986	87580

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 derecognized and the renegotiated loan recognized 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.

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 (excluding cash on hand)	127,046	Moody's default study	Moody's recovery studies
Due from banks	9,634	Moody's default study	Moody's recovery studies
Investment securities	7,819	Moody's default study	Moody's recovery studies
Other financial assets	4,224	Moody's default study	Moody's recovery studies

(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.

The maturity analysis for financial liabilities as at December 31, 2019 is as follows:

in 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	5	-	-	-	-	5	5
Current accounts and deposits from customers	80,506	33,954	167,836	58,851	17	341,164	323,616
Other borrowed funds	830	1,242	5,495	24,810	75,338	107,715	70,874
Subordinated borrowings	691	43	64	128	9,252	10,178	9,170
Lease liability	78	151	2,538	10,723	6,600	20,090	13,365
Other financial liabilities	3,244	-	-	-	-	3,244	3,244
Total financial liabilities	**85,354**	**35,390**	**175,933**	**94,512**	**91,207**	**482,396**	**420,274**
Credit related commitments	**24,877**	**-**	**-**	**-**	**-**	**24,877**	**24,877**

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

in 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
Subordinated borrowings	-	-	667	9,499	-	10,166	8,912
Other financial liabilities	2,649	-	-	-	-	2,649	2,649
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 December 31, 2019 is as follows:

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.The table below shows an analysis, by expected maturities, of the amounts recognized in the statement of financial position as at December 31, 2019:

in 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	132,995	14,280	-	-	-	-	-	147,275
Due from banks	2,463	2,890	2,768	1,513	-	-	-	9,634
Loans to customers	21,503	20,174	71,748	61,513	56,816	-	55,599	287,353
Investment securities	121	1,167	3,900	2,631	-	-	-	7,819
Other financial assets	4,224	-	-	-	-	-	-	4,224
Total financial assets	**161,306**	**38,511**	**78,416**	**65,657**	**56,816**	**-**	**55,599**	**456,305**
Deposits and balances from banks	5	-	-	-	-	-	-	5
Current accounts and deposits from customers	15,714	31,118	159,960	53,952	8	62,864	-	323,616
Other borrowed funds	645	871	3,871	17,441	48,046	-	-	70,874
Subordinated borrowings	670	-	-	8,500	-	-	-	9,170
Lease liability	60	116	1,298	6,672	5,219	-	-	13,365
Other financial liabilities	3,244	-	-	-	-	-	-	3,244
Total financial liabilities	**20,338**	**32,105**	**165,129**	**86,565**	**53,273**	**62,864**	**-**	**420,274**
Net position	**140,968**	**6,406**	**(86,713)**	**(20,908)**	**3,543**	**(62,864)**	**55,599**	**36,031**
Cumulative liquidity gap	**140,968**	**147,374**	**60,661**	**39,753**	**43,296**			

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

in 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

in 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
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
Subordinated borrowings	-	-	412	8,500	-	-	-	8,912
Other financial liabilities	2,649	-	-	-	-	-	-	2,649
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**			

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

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

The Bank was in compliance with these ratios as at December 31, 2019 and 2018. The following table shows the mandatory liquidity ratios calculated as at December 31, 2019 and 2018.

	Requirement	2019, %	2018, %
Instant liquidity ratio	Not less than 30%	181.34%	128.59%

(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.

28 CAPITAL MANAGEMENT

The CBRA sets and monitors capital requirements for the Bank.

According to the Order of the President of the Republic of Azerbaijan "On improving management of the regulation and supervision of financial services market" issued on November 28, 2019 the Financial Market Supervisory Authority was liquidated. The authorities of the financial market supervisor stipulated by the applicable law, including rights and responsibilities in the areas of licensing of financial market services, regulation and supervision, protection of rights of investors and consumers of financial services, as well as FIMSA's property were handed over to the Central Bank of the Republic of Azerbaijan.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the CBRA, banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level. As at December 31, 2019, this minimum level was (December 31, 2018: 10%). The Bank was in compliance with the statutory capital ratio as at December 31, 2019 and 2018.

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

The Bank provides the CBRA 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 CBRA and Bank's internal policy this information is communicated to the Supervisory Board.

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

	December 31, 2019 AZN'000 (unaudited)	**December 31, 2018 AZN'000 (unaudited)**
Total statutory capital	68,957	67,895
Risk-weighted assets	361,374	264,756
Capital adequacy ratio (%)	**19%**	**26%**

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 December 31, 2018 presented in the Bank`s financial statements prepared under IFRS and total statutory capital determined under the rules and regulations of the CBRA.

	December 31, 2019 AZN'000 (unaudited)	December 31, 2018 AZN'000 (unaudited)
Total statutory capital	**68,957**	**67,895**
Differences between regulatory capital and IFRS net assets:		
- share premium	**(449)**	**(449)**
- retained earnings	**8,816**	**6,859**
- expected credit loss	94,386	69,103
- interest income	(83,767)	(61,097)
- administrative expenses	(1,774)	(1,095)
- interest expense	(806)	-
- adjustment on initial application of IFRS 16	(338)	-
- fair value gain on term borrowings at initial measurement	1,007	-
- income tax expense	39	39
- other differences	69	(91)
- differences arising from deductions for statutory calculation	**5,035**	**4,577**
- intangible assets	3,729	3,271
- deferred tax assets	1,306	1,306
- statutory general allowance for impairment	**(3,714)**	**(2,263)**
- available subordinated debt for regulatory calculations	**(6,800)**	**(6,800)**
Total IFRS equity	**71,845**	**69,819**

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.

	December 31, 2019 AZN'000	December 31, 2018 AZN'000
Contracted amount		
Guarantees issued	10,709	10,589
Undrawn credit lines	14,168	12,024
Total credit related commitments and guarantees	**24,877**	**22,613**
Provision	**(885)**	**(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.

	2019		2018	
AZN’000	**Stage 1**	**Total**	**Stage 1**	**Total**
Provisions				
Balance at January 1	**885**	**885**	**1,604**	**1,604**
Net remeasurement of loss allowance	-	-	(719)	(719)
Balance at December 31	**885**	**885**	**885**	**885**

At December 31, 2019 and 2018, the provision amount in respect of financial guarantee and undrawn credit lines is equal to AZN 612 thousand and AZN 273 thousand, respectively.

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 December 31, 2019 and 2018 is as follows:

	2019 AZN’000	2018 AZN’000
Short term employee benefits	4,287	1,830
	4,287	**1,830**

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 December 31, 2019 and 2018 for transactions with the members of the Supervisory Board and the Management Board are as follows:

	2019 AZN’000	Average effective interest rate	2018 AZN’000	Average effective interest rate
Statement of financial position				
Loans issued (gross)	2,688	12%	2,337	11%
Loan impairment allowance	-	-	(42)	-
Customer accounts	1,081	13%	807	18%
Commitments on loans and undrawn credit lines	442	12%	354	11%

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 December 31, are as follows:

	2019 AZN’000	2018 AZN’000
Profit or loss		
Interest income calculated using the effective interest rate	242	134
Interest expense	(102)	(5)
Other general and administrative expenses	(179)	-
Impairment gains	42	18

(c) Transactions with other related parties

The outstanding balances and the related average effective interest rates as at December 31, 2019 and related profit or loss amounts of transactions for the year ended December 31, 2019 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	-	-	-	-	228	24%	228
Impairment allowance	-	-	-	-	(227)	-	(227)
LIABILITIES							
Customer accounts	10,867	9%	4,964	-	15,946	1%	31,777
Subordinated borrowings	-	-	8,500	3%	-	-	8,500
Profit (loss)							
Interest income	-	-	-	-	-	-	
Interest expense	(127)	-	(258)	-	(3)	-	(388)
Other general and administrative expenses	-	-	-	-	(104)	-	(104)

The outstanding balances and the related average effective interest rates as at December 31, 2018 and related profit or loss amounts of transactions for the year ended December 31, 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
Profit (loss)							
Interest income	-	-	-	-	-	-	-
Interest expense	(32)	-	(566)	-	-	-	(598)

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 December 31, 2019:

AZN '000	Amortized cost	Total carrying amount	Fair value
Cash and cash equivalents	147,275	147,275	147,275
Due from banks	9,634	9,634	9,634
Loans to customers	287,353	287,353	287,353
Investment securities	7,819	7,819	7,819
Other financial assets	4,224	4,224	4,224
	456,305	**456,305**	**456,305**
Deposits and balances from banks	5	5	5
Current accounts and deposits from customers	323,616	323,616	323,616
Other borrowed funds	70,874	70,874	70,874
Subordinated borrowings	9,170	9,170	9,170
Lease liability	13,365	13,365	13,365
Other financial liabilities	3,244	3,244	3,244
	420,274	**420,274**	**420,274**

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at December 31, 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	226,117
Investment securities	13,601	13,601	13,601
Other financial assets	1,753	1,753	1,753
	396,431	**396,431**	**396,431**
Deposits and balances from banks	6	6	6
Current accounts and deposits from customers	234,260	234,260	234,260
Other borrowed funds	97,524	97,524	97,524
Subordinated borrowings	8,912	8,912	8,912
Other financial liabilities	2,649	2,649	2,649
	343,351	**343,351**	**343,351**

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.

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 recognized 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.

(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 December 31, 2019.

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 December 31, 2019:

AZN'000	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS					
Cash and cash equivalents	147,275	-	-	147,275	147,275
Due from banks	-	-	9,634	9,634	9,634
Loans to customers	-	-	287,353	287,353	287,353
Investment securities	7,819	-	-	7,819	7,819
Other financial assets	-	-	4,224	4,224	4,224
LIABILITIES					
Deposits and balances from banks	-	-	5	5	5
Current accounts and deposits from customers	-	-	323,616	323,616	323,616
Other borrowed funds	-	-	70,874	70,874	70,874
Subordinated borrowings	-	-	9,170	9,170	9,170
Lease liabililty	-	-	13,365	13,365	13,365
Other financial liabilities	-	-	3,244	3,244	3,244

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 December 31, 2018:

AZN'000	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
ASSETS					
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	226,117
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	-	-	234,260	234,260	234,260
Other borrowed funds	-	-	97,524	97,524	97,524
Subordinated borrowings	-	-	8,912	8,912	8,912
Other financial liabilities	-	-	2,649	2,649	2,649

32 EVENTS AFTER THE REPORTING PERIOD

On January 31, 2020 the Central Bank of the Republic of Azerbaijan decided to reduce the refinancing rate from 7.50% to 7.25%, the ceiling of the interest rate corridor from 9.25% to 9.00% and the floor from 5.75% to 5.50%.

In late 2019 the outbreak of coronavirus occurred in Wuhan, China. The situation at December 31, 2019 was limited in number of reported cases and geography and therefore this event was considered as non-adjusted event for the financial reporting purposes under IFRS. However, after January 2020 the situation changed drastically, and in March 2020 the World Health Organization (WHO) announced that the coronavirus outbreak can be characterized as a pandemic.

Many governments, including the government of the Republic of Azerbaijan have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain area. These measures have affected the global supply chain as well as demand for goods and services and resulted in significant disruption to business operations and a significant increase in economic uncertainty, with more volatile asset prices and currency exchange rates, and a marked decline in long-term interest rates in developed economies. These government responses and their corresponding effects are still evolving.

In addition to slowdown in world economy, oil prices have declined dramatically after OPEC and Russia were unable to agree on production cuts at their March 2020 meeting. These events and conditions create a level of uncertainty and risk that companies may not have encountered before, and may result in significant financial reporting implications.

Currently, the management is working on action plans under different scenarios of future developments. The Bank management estimates that if the current situation does not improve in the nearest future, the Bank might go to certain loan restructuring with their customers and enter into Non-Deliverable Forward agreements with the CBRA in case of dollarization of customer accounts.

Mr. Nikoloz Kurtgaia
Chairman of the Management Board

Mr. Emil Dushdurov
Chief Financial Officer