

**Bank of Baku OJSC**

**Financial Statements**  
**for the year ended 31 December 2018**

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# Independent Auditors' Report

## To the Shareholders and Supervisory Board of Bank of Baku Open Joint Stock Company

### Opinion

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

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

### Basis for Opinion

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

### **Emphasis of Matter**

We draw attention to Note 2 to the financial statements, which describes that the Bank's regulatory capital was below the minimum required level as at 31 December 2018 as described in Note 23. Our opinion is not modified in respect of this matter.

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

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

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

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

### **Auditors' Responsibilities for the Audit of the Financial Statements**

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

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

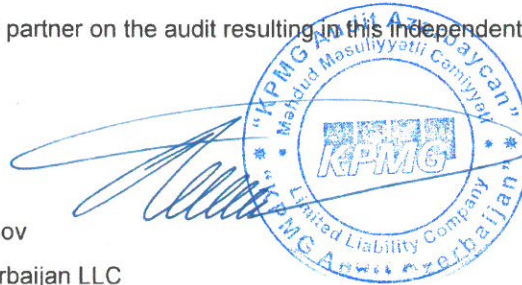
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting 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.

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



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

**Bank of Baku Open Joint-Stock Company**  
**Statement of Profit or Loss and Other Comprehensive Income**  
*for the year ended 31 December 2018*

	Notes	2018 AZN'000	2017* AZN'000
Interest income calculated using the effective interest method	4	39,322	50,483
Interest income on finance lease receivables		48	70
Interest expense	4	(14,501)	(27,732)
<b>Net interest income</b>		<b>24,869</b>	<b>22,821</b>
Impairment recovery on debt financial assets	7	15,044	11,739
<b>Net interest income after impairment charge</b>		<b>39,913</b>	<b>34,560</b>
Fee and commission income	5	6,016	4,626
Fee and commission expense	6	(4,473)	(3,593)
<b>Net fee and commission income</b>		<b>1,543</b>	<b>1,033</b>
Net gain on trading in foreign currencies		1,199	2,374
Net foreign exchange gain/(loss)		76	(4,096)
Other operating income		174	440
<b>Non-interest income/(loss)</b>		<b>2,992</b>	<b>(249)</b>
Other impairment losses	7	(306)	(842)
Personnel expenses	8	(16,055)	(14,410)
Other general administrative expenses	9	(10,439)	(12,357)
<b>Profit before income tax</b>		<b>16,105</b>	<b>6,702</b>
Income tax benefits	10	10,351	-
<b>Profit for the year</b>		<b>26,456</b>	<b>6,702</b>
<b>Profit and total comprehensive income for the year</b>		<b>26,456</b>	<b>6,702</b>

\*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 29). As a result of adoption of IFRS 9 the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 3(p)).

The financial statements as set out on pages 6 to 78 were approved by management on 17 December 2019 and were signed on its behalf by:

  
 Mr. Eldar Hamidov  
 Chairman of the Management Board

  
 Mr. Ali Ibrahimov  
 Chief Financial Officer

*Bank of Baku Open Joint-Stock Company*  
Statement of Financial Position as at 31 December 2018

	Notes	2018 AZN'000	2017* AZN'000
<b>ASSETS</b>			
Cash and cash equivalents	11	17,980	46,494
Amounts due from banks and other financial institutions	12	30,789	68,060
Loans to customers	14	203,155	219,803
Investment securities	13	5,137	39,892
Property, equipment and intangible assets	15	12,634	14,591
Deferred income tax assets	10	10,526	-
Advances to the Ministry of Taxes of the Republic of Azerbaijan		3,178	6,568
Other assets	16	5,962	4,302
<b>Total assets</b>		<b>289,361</b>	<b>399,710</b>
<b>LIABILITIES</b>			
Amounts due to banks and other financial institutions	17	48,690	103,749
Amounts due to customers	18	168,728	244,660
Other liabilities	19	16,855	14,461
Subordinated debt	20	16,762	24,267
<b>Total liabilities</b>		<b>251,035</b>	<b>387,137</b>
<b>EQUITY</b>			
Share capital	21	52,870	52,870
Revaluation reserve for property and equipment		6,398	6,758
Accumulated losses		(20,942)	(47,055)
<b>Total equity</b>		<b>38,326</b>	<b>12,573</b>
<b>Total liabilities and equity</b>		<b>289,361</b>	<b>399,710</b>

\*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 29). As a result of adoption of IFRS 9 the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 3(p)).

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Chairman of the Management Board



Mr. Ali Ibrahimov  
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.

*Bank of Baku Open Joint-Stock Company*  
*Statement of Cash Flows for the year ended 31 December 2018*

	Notes	2018 AZN'000	2017* AZN'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Interest received		45,325	59,707
Interest paid		(16,199)	(35,394)
Fees and commissions received	5	6,016	4,626
Fees and commissions paid	6	(4,473)	(3,593)
Net gain from trading in foreign currencies		1,199	2,374
Other income received		174	120
Personnel expenses paid		(15,820)	(14,276)
Other operating expenses paid		(8,734)	(9,133)
<b>(Increase) decrease in operating assets</b>			
Amounts due from banks and other credit institutions		37,231	69,687
Loans to customers		25,121	15,213
Other assets		(1,571)	(38)
Advances to the Ministry of Taxes of the Republic of Azerbaijan		3,390	-
Financial instruments at fair value through profit or loss		-	1,703
<b>Increase (decrease) in operating liabilities</b>			
Amounts due to banks and other financial institutions		(50,260)	(34,038)
Amounts due to customers		(74,171)	(34,023)
Other liabilities		2,305	3,216
<b>Cash flows (used in)/ from operations</b>		<b>(50,467)</b>	<b>26,151</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property, equipment and intangible assets		(125)	(24)
Proceeds from sale of property, equipment and intangible assets		-	231
Purchases of investment securities		(4,232)	(43,465)
Proceeds from sale and redemption of investment securities		38,644	26,224
<b>Cash flows from/(used in) investing activities</b>		<b>34,287</b>	<b>(17,034)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from loans from other financial institutions	17	187	7,946
Repayment of loans from other financial institutions	17	(4,920)	(43,173)
Repayment of subordinated debt	17	(7,500)	-
<b>Cash flows used in financing activities</b>		<b>(12,233)</b>	<b>(35,227)</b>
<b>Net decrease in cash and cash equivalents</b>			
		<b>(28,413)</b>	<b>(24,293)</b>
Effect of changes in exchange rates on cash and cash equivalents		(75)	(2,053)
Effect of changes in ECL on cash and cash equivalents		(26)	
Cash and cash equivalents as at the beginning of the year		46,494	74,657
<b>Cash and cash equivalents as at the end of the year</b>	<b>11</b>	<b>17,980</b>	<b>46,494</b>

\*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 29). As a result of adoption of IFRS 9 the Bank changed presentation of certain captions, comparative information is re-presented accordingly (see Note 3(p)).

The financial statements as set out on pages 6 to 78 were approved by management on 17 December 2019 and were signed on its behalf by:



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Chairman of the Management Board

Mr. Ali Ibrahimov  
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.

*Bank of Baku Open Joint-Stock Company*  
*Statement of Changes in Equity for the year ended 31 December 2018*

AZN'000	Share capital	Property revaluation reserve	Accumulated losses	Total equity
<b>Balance as at 1 January 2017</b>	52,870	7,118	(54,117)	5,871
<b>Total comprehensive income</b>				
Profit for the year	-	-	6,702	6,702
<b>Other comprehensive income</b>				
<i>Items that will not be reclassified to profit or loss:</i>				
Depreciation of revaluation reserve	-	(360)	360	-
<b>Balance as at 31 December 2017 *</b>	<b>52,870</b>	<b>6,758</b>	<b>(47,055)</b>	<b>12,573</b>
Adjustment on initial application of IFRS 9, net of tax (see Note 29)	-	-	(703)	(703)
<b>Restated balance as at 1 January 2018</b>	<b>52,870</b>	<b>6,758</b>	<b>(47,758)</b>	<b>11,870</b>
<b>Total comprehensive income</b>				
Profit for the year	-	-	26,456	26,456
<b>Other comprehensive income</b>				
<i>Items that will not be reclassified to profit or loss:</i>				
Depreciation of revaluation reserve	-	(360)	360	-
<b>Balance as at 31 December 2018</b>	<b>52,870</b>	<b>6,398</b>	<b>(20,942)</b>	<b>38,326</b>

\*The Bank has initially applied IFRS 9 and IFRS 15 at 1 January 2018. Under the transition methods chosen, comparative information is not restated (see Note 29).

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Mr. Ali Ibrahimov  
Chief Financial Officer

## 1. Background

### (a) Organisation and operations

OJSC Bank of Baku operates under banking license number 247 issued by the Central Bank of the Republic of Azerbaijan (the “CBAR”) on February 18, 2005.

The Bank’s principal activities are deposit taking, customer account maintenance, credit operations, issuance of guarantees, cash and settlement operations, securities and foreign exchange transactons. Its main office is in Baku and it has 17 branches (2017: 17) in Baku and other cities of the Republic of Azerbaijan and 3 servicing outlets as at December 31, 2018 (2017: 2 servicing outlets). The Bank’s registered legal address is 42 Ataturk Avenue, Baku, AZ 1069, Azerbaijan.

The Bank’s activities are regulated by the Financial Markets Supervision Authority (the “FIMSA”) of the Republic of Azerbaijan. In accordance with the presidential decree signed on 28 November, 2019, FIMSA has been abolished, and its powers, including its functions and rights in the field of licensing, regulation and supervision of the financial services market, protection of the rights of investors and consumers of financial services, as well as property have been transferred to the CBAR.

The Bank is a member of the deposit insurance system. The system operates under the Law on Deposit Insurance and other regulations and is governed by the Azerbaijan Deposit Insurance Fund. Until 1 July 2019 insurance covers the Bank’s liabilities to individual depositors with maximum interest rate of up to 15% for each individual for the deposits in local currency (AZN) and up to 3% for deposits held in US dollars (USD), in case of business failure and revocation of the banking license by FIMSA. Since 1 July 2019 these rates have been changed from 15% to 10% and from 3% to 2.5%, respectively.

The Bank is owned by :

	31 December 2018, %	31 December 2017, %
<b>Shareholder</b>		
NAB Holding	35.00	35.00
Mr. Hikmat Ismayilov	31.11	31.11
Azpetrol Neft Shirketi LLC	28.89	28.89
Mr. Elchin Isayev	5.00	5.00
<b>Total</b>	100.00	100.00

NAB Holding is ultimately controlled by Nader Mohaghegh Oromi and Bahram Mohaghegh Oromi. The ultimate shareholder of Azpetrol Neft Shirketi LLC is Mr. Ibrahim Mammadov.

### (b) Business environment

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

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

## **2. Basis of preparation**

### **(a) Statement of compliance**

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

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

### **(b) Basis of measurement**

The financial statements are prepared on the historical cost basis except for buildings stated at revalued amounts, investment securities at FVOCI and investment securities at FVTPL that are measured at fair value (2017: available-for-sale financial assets were measured at fair value).

### **(c) Going concern**

Management has prepared these consolidated financial statements on a going concern basis. In making judgments, management has considered current intentions, the profitability of operations and access to financial resources

As at 31 December 2018 the Bank's total regulatory capital was not in compliance with minimum requirements of AZN 50 mln. set by FIMSA. The Bank had a total accumulated loss in the amount of AZN 20,942 thousand and total equity of AZN 38,326 thousand as at 31 December 2018. The key factors of the negative financial results were an increase of the loan impairment provisions for both cash consumer and business loan portfolios, decrease of interest income due to the decrease of the loan portfolio as a result of temporary stoppage of lending operations during 2015 and 2016. The slowdown of the retail portfolio was caused by the tightening of lending conditions and decrease in the creditworthiness of individuals, following downturn of the economy.

During May 2017, FIMSA conducted inspection at the Bank and based on their assessment, concluded that additional statutory provision in the total amount of AZN 54,900 thousand should be provided on the assets of the Bank as of 30 April 2017. After consideration for additional statutory provision and other adjustments, the Bank's regulatory capital decreased to AZN (41,000) thousand, i.e. AZN 91,000 thousand below the required minimum capital level. Consequently, FIMSA temporarily imposed restrictions over attraction of new deposits from individuals until the Bank increased its total regulatory capital above the minimum required level.

As the Bank's regulatory capital deficiency was not resolved by 27 September 2017, FIMSA imposed additional restrictions on the Bank requiring to cease operation of receiving of insured deposits, including restructure existing deposits received from customers to insured deposit category by Azerbaijan Deposit Insurance Fund

As disclosed in Note 22 (c)(v), the Bank had negative cumulative liquidity gap up to one year as at 31 December 2018 in the amount of AZN 23,951 thousand.

The Bank's capital measurements is disclosed in Note 23.

The management has considered the following events and conditions in its going concern assessment:

- On 28 February 2019, the President of the Republic of Azerbaijan signed a decree "On the additional measures related to the solution of problem loans of individuals in the Republic of Azerbaijan" ("the Decree"). According to the Decree the increase in loan balances denominated in foreign currency resulted from devaluation of the national currency on 21 February 2015 and 21 December 2015 with total exposure up to USD 10,000 in all banks is compensated by the government. In accordance with the Decree, Bank of Baku was entitled to receive funds in the amount of AZN 103.2 million directly from the Ministry of Finance.

Of this, AZN 53.5 million was received and directed to compensation of losses of the Bank for retail loans of 46.2 thousand borrowers that were fully impaired, and AZN 49.7 million was disbursed to customers as compensation from the government as of 30 November 2019.

- In addition to cash compensation, on 1 July, 2019, the Bank signed an agreement of 5 years term loan with 0.1% interest rate and grace period of 1 year with the CBAR in the amount of AZN 117 mln for restructuring the impaired loans. Loan is aimed at helping the Bank to restructure its non-performing loan portfolio.

- Subsequent to 31 December 2018, the Bank attracted new term deposits from individuals and corporate customers as well as prolonged deposits originally maturing during the period from 31 December 2018 to August 2019 for the total amount of AZN 93.4 million.

- As a consequence of all above actions, as of 30 November 2019, the Bank's regulatory capital was AZN 55.6 mln, and total capital adequacy ratio was 22.77% (min. requirement is 10%) which is in compliance with FIMSA's requirement.

- Although current accounts balance of AZN 40,629 thousand is included under on demand category in expected maturity table Note 22 (c)(v), not all of these amounts will be withdrawn in a period of one year as the total current account balances did not decrease below AZN 40 million for the past 2 years, as well as subsequent to the end of the reporting period.

- In June 2019, FIMSA has lifted its restriction on the Bank's right to accept term deposits from individuals.

Taking into account all stated above in relation to the banking facilities for the next twelve months, the Management believes that it is appropriate to prepare the financial statements on going concern basis.

**(d) Functional and presentation currency**

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

At 31 December 2018, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.7 and EUR 1 = AZN 1.9468 (31 December 2017: USD 1 = AZN 1.7001 and EUR 1 = AZN 2.0307).

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

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

**(e) Use of estimates and judgments**

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

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

**Judgements**

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

- Applicable to 2018 only

- classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding – Note 3(e)(i).
- establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL – Note 22(c) (iv).

#### **Assumptions and estimations uncertainty**

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 and 2017 is included in the following notes:

- Applicable to 2018 only
  - impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information – Note 22(c) (iv).
- Applicable to 2018 and 2017
  - impairment of financial assets – Note 22(c) (iv);
  - buildings revaluation estimates - Note 15;
  - recognition of deferred tax assets: availability of future taxable profit which carry-forward tax losses can be utilised – Note 10
  - estimates of fair values of financial assets and liabilities – Note 28

#### **(f) Changes in accounting policies and presentation**

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

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

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

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

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

- an increase in expected credit losses recognised on financial assets (see Note 29);
- additional disclosures related to IFRS 9 (see Notes 22 (d) and 29); and
- additional disclosure related to IFRS 15 (see Note 5).

##### **A. IFRS 9 Financial instruments**

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*.

The requirements of IFRS 9 represent a significant change from IAS 39.

The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Bank has adopted consequential amendments to IAS 1

‘Presentation of Financial Statements’, which require separate presentation in the statement of profit or loss and other comprehensive income of interest revenue calculated using the effective interest method. Previously, the Bank disclosed this amount in notes to the financial statements.

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

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

#### ***Classification of financial assets and financial liabilities***

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. For an explanation of how the Bank classifies financial assets under IFRS 9, see Note 3(e)(i).

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

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

#### ***Impairment of financial assets***

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

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

#### ***Transition***

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings as at 1 January 2018. Accordingly, the information presented as at and for the year ended 31 December 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented as at and for the year ended 31 December 2018 under IFRS 9.  
The Bank used the exemption not to restate comparative periods but considering that the amendments made by IFRS 9 to IAS 1 introduced the requirement to present ‘interest income calculated using the effective interest rate’ as a separate line item in the statement of profit or loss and other comprehensive income, the Bank changed the description of the line item from ‘interest income’ reported in 2017 to ‘interest income calculated using the effective interest method’.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
  - The designation of certain investments in equity instruments not held for trading as at FVOCI
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 29.

### **B. IFRS 15 Revenue from Contracts with Customers**

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

The Bank initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The timing or amount of the Bank's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15. The impact of IFRS 15 was limited to the new disclosure requirements (see Note 5).

## **3. Significant accounting policies**

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

### **(a) Foreign currency**

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

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

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

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on retranslation of investment securities at FVOCI.

### **(b) Interest**

#### ***Policy applicable from 1 January 2018***

#### ***Effective interest rate***

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

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

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

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

### ***Amortised cost and gross carrying amount***

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

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

### ***Calculation of interest income and expense***

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

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

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

### ***Presentation***

Interest income calculated using the effective interest method presented in the statement of profit or loss and other comprehensive income includes:

- interest on financial assets measured at amortised cost;

Interest expense presented in the statement of profit or loss and other comprehensive income includes:

- financial liabilities measured at amortised cost;

### ***Policy applicable before 1 January 2018***

#### ***Effective interest rate***

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

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

### **Presentation**

Interest income calculated using the effective interest method presented in the statement of profit or loss and other comprehensive income includes:

- interest on financial assets measured at amortised cost;

Interest earned on assets at fair value is classified within interest income.

Interest expense presented in the statement of profit or loss and other comprehensive income includes:

- financial liabilities measured at amortised cost;

### **(c) Fees and commission**

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

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

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

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

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

### **(d) Cash and cash equivalents**

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

### **(e) Financial assets and financial liabilities**

#### ***(i) Classification***

#### ***Financial assets – Policy applicable from 1 January 2018***

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

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

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For debt financial assets measured at FVOCI, gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest income using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When a debt financial asset measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss.

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.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss (see Note 3(e)(ii)) unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in other comprehensive income. Cumulative gains and losses recognised in other comprehensive income are transferred to retained earnings on disposal of an investment.

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 Bank'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.

### ***Financial assets – Policy applicable before 1 January 2018***

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

- loans and receivables;
- available-for-sale;

#### *Available-for-sale financial assets*

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

Notes of the CBAR held by the Bank that are traded in an active market are classified as AFS and are stated at fair value. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of other-than-temporary impairment losses, interest calculated using the effective interest method, dividend income and foreign exchange gains and losses, which are recognised in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

AFS equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

### *Loans and receivables*

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market (including balances with the CBAR, amount due from banks and other credit institutions, loans to customers and other financial assets) are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

### **Financial liabilities**

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

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

### **Reclassification**

Financial liabilities are not reclassified subsequent to their initial recognition.

#### *(ii) Derecognition*

### **Financial assets**

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

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

From 1 January 2018 any cumulative gain/loss recognised in other comprehensive income in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities, as explained in Note 3(e)(i).

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

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

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

### **Financial liabilities**

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

***(iii) Modification of financial assets and financial liabilities***

***Policy applicable from 1 January 2018***

**Financial assets**

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

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

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

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

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

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

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy).

This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases. The Bank further performs qualitative evaluation of whether the modification is substantial.

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

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

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

### **Financial liabilities**

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

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

- change the currency of the financial liability;
- change in collateral or other credit enhancement;
- inclusion of conversion option;
- change in the subordination of the financial liability.

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

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

### ***Policy applicable before 1 January 2018***

#### **Financial assets**

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

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

#### **Financial liabilities**

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

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

***(iv) Impairment***

***Policy applicable from 1 January 2018***

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

- financial assets that are debt instruments;
- loan commitments issued;
- lease receivables

No impairment loss is recognised on equity investments.

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 (other than lease receivables) on which credit risk has not increased significantly since their initial recognition (see Note 22(c)(iv)).

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

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

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

***Measurement of ECL***

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

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

See also Note 22(c)(iv).

***Restructured financial assets***

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

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset (see Note 22(c)(iv)).

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

#### ***Credit-impaired financial assets***

At each reporting date, the Bank assesses whether financial assets carried at amortised cost, debt financial assets carried at FVOCI, and finance lease receivables 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 loan that is overdue for 90 days or more is considered credit-impaired.

#### ***Presentation of allowance for ECL in the statement of financial position***

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

- *financial assets measured at amortised cost*: as a deduction from the gross carrying amount of the assets;
- *loan commitments*: 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; and
- *debt instruments measured at FVOCI*: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

#### ***Write-offs***

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

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

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

### **Policy applicable before 1 January 2018**

#### **Objective evidence of impairment**

At each reporting date, the Bank assessed whether there was objective evidence that financial assets not carried at FVTPL were impaired.

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For unlisted equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- It becomes probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

Certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Bank's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income and accumulated under the heading of investments revaluation reserve.

In respect of AFS debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

### **Renegotiated loans**

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

### **Measurement of impairment**

Impairment losses on assets measured at amortised cost were calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Impairment losses on available-for-sale assets were calculated as the difference between the carrying amount and the fair value.

### **Reversal of impairment**

- *For assets measured at amortised cost:* if an event occurring after the impairment was recognised caused the amount of impairment loss to decrease, then the decrease in impairment loss was reversed through profit or loss.
- *For available-for-sale debt security:* if, in a subsequent period, the fair value of an impaired debt security increased and the increase could be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss was reversed through profit or loss; otherwise, any increase in fair value was recognised through other comprehensive income.

Any subsequent recovery in the fair value of an impaired available-for-sale equity security was always recognised in other comprehensive income.

### **Presentation**

Impairment losses were recognised in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on the impaired assets continued to be recognised through the unwinding of the discount.

Impairment losses on available-for-sale investment securities were recognised by reclassifying the losses accumulated in the fair value reserve in equity to profit or loss. The cumulative loss that was reclassified from equity to profit or loss was the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment attributable to the application of the effective interest method were reflected as a component of interest income.

### **Write-off of loans and advances**

Loans and advances are written off against the allowance for impairment losses when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Bank and after the Bank has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the statement of profit or loss in the period of recovery. In accordance with the statutory legislation, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the court.

### **Financial assets carried at cost**

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

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

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

### **Available-for-sale financial assets**

Impairment losses on available-for-sale financial assets were recognised by transferring the cumulative loss that was recognised in other comprehensive income to profit or loss as a reclassification adjustment.

The cumulative loss that was reclassified from other comprehensive income to profit or loss was the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value were reflected as a component of interest income.

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

#### **(v) Fair value measurement principles**

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

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

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

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

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

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

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

**(vi) Offsetting**

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

**(f) Loans to customers**

***Policy applicable from 1 January 2018***

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

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

***Policy applicable before 1 January 2018***

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

Loans to customers included:

- those classified as loans and receivables;
- net investments in finance leases.

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

**(g) Investment securities**

***Policy applicable from 1 January 2018***

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

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

***Policy applicable before 1 January 2018***

Investment securities were initially measured at fair value plus, in the case of investment securities not at FVTPL, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held-to-maturity, FVTPL or available-for-sale.

**Available-for-sale**

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

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

Other fair value changes, other than impairment losses (see Note 3(e)(iv)), were recognised in other comprehensive income and presented in the fair value reserve within equity. When the investment was sold, the gain or loss accumulated in equity was reclassified to profit or loss.

A non-derivative financial asset might be reclassified from the available-for-sale category to the loans and receivables category if it would otherwise have met the definition of loans and receivables and if the Bank had the intention and ability to hold that financial asset for the foreseeable future or until maturity.

**(c) Deposits, debt securities issued and subordinated liabilities**

Deposits, debt securities issued and subordinated liabilities are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except where the Bank designates liabilities at FVTPL (see Note 1(a)(v)).

**(i) 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) Revaluation**

Buildings are subject to revaluation on a regular basis. The frequency of revaluation depends on the movements in the fair values of the buildings being revalued. A revaluation increase on a building is recognised as other comprehensive income except to the extent that it reverses a previous revaluation decrease recognised in profit or loss, in which case it is recognised in profit or loss. A revaluation decrease on a building is recognised in profit or loss except to the extent that it reverses a previous revaluation increase recognised as other comprehensive income directly in equity, in which case it is recognised in other comprehensive income.

**(iii) Depreciation**

Items of property, plant and equipment are depreciated from the date that they are installed and are ready for use, or in respect of internally constructed assets, from the date that the asset is completed and ready for use. Depreciation is based on the cost of an asset less its estimated residual value. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

- Buildings	5%
- furniture and equipment	20%
- computers and communication equipment	25%
- vehicles	20%
- other	20%

**(j) Intangible assets**

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

Acquired computer and 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 of intangible assets are 10 years.

**(k) Provisions**

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

**(l) Financial guarantees and loan commitments**

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

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

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

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

For other loan commitments:

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

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

**(m) Share capital**

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

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

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

**(n) Taxation**

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

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.

Prepayments to Ministry of Taxes of the Republic of Azerbaijan has been made in 2015 and this balance represent cumulative closing balance after recognition of accruedals and payments for all types of taxes.

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

The measurement of deferred tax assets and liabilities 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.

Deferred tax assets and liabilities are 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.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilised. 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.

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.

**(o) Other income and expense recognition**

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

**(p) Comparative information**

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

The effect of main changes in presentation of the statement of financial position is disclosed in Note 29.

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

- “Available-for-sale financial assets” were presented within “Investment securities” line item;

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

- “Acquisition of investment securities available-for-sale” was presented as “Purchases of investment securities”;
- “Proceeds from sale and redemption of investment securities available-for-sale” was presented as “Proceeds from sale and redemption of investment securities” line item.

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

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

**(q) Standards issued but not yet effective**

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 with earlier application permitted; however, the Bank has not early adopted them in preparing these financial statements, with the exception of the amendment to IFRS 9 affecting prepayment features with negative compensation issued in October 2017.

**IFRS 16**

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

- the Bank has not yet finalised the testing and assessment of controls over its new IT systems; and
- the new accounting policies are subject to change until the Bank presents its first financial statements that include the date of initial application.

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

IFRS 16 replaces existing leases guidance, including IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

**i. Leases in which the Bank is a lessee**

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

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

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

**ii. Leases in which the Bank is a lessor**

No significant impact is expected for leases in which the Bank is a lessor.

**iii. Transition**

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

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

**Other standards**

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

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

## 4. Net interest income

	2018 AZN'000	2017 AZN'000
<b>Interest income calculated using the effective interest method</b>		
Loans to customers	37,160	45,564
Investment securities	1,476	1,322
Due from banks and other financial institutions	613	1,809
Cash and cash equivalents	73	1,788
	<b>39,322</b>	<b>50,483</b>
<b>Interest income on finance lease receivables</b>	<b>48</b>	<b>70</b>
<b>Total interest income</b>	<b>39,370</b>	<b>50,553</b>
<b>Interest expense</b>		
Current accounts and deposits from customers	11,583	20,549
Deposits and balances from banks	1,885	6,080
Subordinated debt	1,033	1,103
	<b>14,501</b>	<b>27,732</b>
	<b>24,869</b>	<b>22,821</b>

## 5. Fee and commission income

	<b>2018</b> <b>AZN'000</b>	<b>2017</b> <b>AZN'000</b>
Cash operations	2,260	1,132
Plastic card operations	2,233	2,055
Settlements	769	761
Guarantee letters	252	232
Currency conversion operations	44	144
Other operations	458	302
	<b>6,016</b>	<b>4,626</b>

### *Performance obligations and revenue recognition policies*

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer. The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

<b>Type of service</b>	<b>Nature and timing of satisfaction of performance obligations, including significant payment terms</b>	<b>Revenue recognition under IFRS 15 (applicable from 1 January 2018)</b>
Retail and corporate banking service	The Bank provides banking services to retail and corporate customers, foreign currency transactions, cash operations, settlements and credit card transactions. Transaction-based fees for interchange, foreign currency transactions are charged to the customer's account when transaction takes place.	Revenue related to transactions is recognised at the point in time when the transaction takes place.
	The Bank charges commission fee to the customers for the guarantee letters issued.	Since, the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs, Bank recognized revenue over time.

## 6. Fee and commission expense

	<b>2018</b> <b>AZN'000</b>	<b>2017</b> <b>AZN'000</b>
Plastic card operations	3,269	2,491
Settlements	1,115	882
Letters of credit	64	138
Cash operations	25	82
	<b>4,473</b>	<b>3,593</b>

## 7. Impairment recovery

The following table provides a reconciliation of the impairment losses on debt financial assets in the statement of profit or loss and other comprehensive income per class of financial instrument for the year ended 31 December 2018.

	<b>Loans to customers at amortised cost</b>	<b>Due from banks</b>	<b>Cash and cash equivalents</b>	<b>Total impairment recovery on debt financial instruments</b>
Net remeasurement of loss allowance	16,241	(58)	(26)	16,157
New financial assets originated or purchased	(1,113)	-	-	(1,113)
	<b>22,625</b>	<b>(58)</b>	<b>(26)</b>	<b>15,044</b>
		<b>Investment securities</b>	<b>Other assets</b>	<b>Total other impairment losses</b>
Net remeasurement of loss allowance		10	(316)	(306)
<b>Total</b>		<b>10</b>	<b>(316)</b>	<b>(306)</b>

The following table provides a reconciliation of the impairment losses on debt financial assets in the statement of profit or loss and other comprehensive income per class of financial instrument for the year ended 31 December 2017.

	<b>Loans to customers</b>
Net remeasurement of loss allowance	11,739
<b>Total</b>	<b>11,739</b>

## 8. Personnel expenses

	<b>2018 AZN'000</b>	<b>2017 AZN'000</b>
Employee compensation	14,087	12,410
Payments to Social Security Fund	1,926	1,737
Other employment expenses	42	263
	<b>16,055</b>	<b>14,410</b>

## 9. Other general administrative expenses

	<b>2018</b>	<b>2017</b>
	<b>AZN'000</b>	<b>AZN'000</b>
Depreciation and amortization expenses	2,083	3,090
Occupancy and rent	2,004	2,002
Legal and consultancy	1,412	2,717
Marketing and advertising	1,290	1,015
Deposit insurance fee	702	931
Security	434	390
Communications	318	322
Utilities	315	263
Repair and maintenance of property and equipment	308	246
Taxes other than income tax	240	440
Printing	213	36
Office supplies	212	188
Business travel and related expenses	104	66
Insurance	42	78
Vehicle running costs	34	33
Membership fees	22	19
Other expense	706	521
	<b>10,439</b>	<b>12,357</b>

## 10. Income tax expense

### (a) Amounts recognised in profit or loss

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

	<b>2018</b>	<b>2017</b>
	<b>AZN'000</b>	<b>AZN'000</b>
Current tax expense	-	-
Recognition of previously unrecognized deferred tax assets	9,254	-
Origination and reversal of temporary differences	1,097	-
<b>Total income tax benefit</b>	<b>10,351</b>	<b>-</b>

### Reconciliation of effective tax rate:

	<b>2018</b>		<b>2017</b>	
	<b>AZN'000</b>	<b>%</b>	<b>AZN'000</b>	<b>%</b>
Profit before income tax	16,105		6,702	
Income tax at the applicable tax rate	3,221	20	1,340	20
Income tax overprovided in prior periods	(4,318)	(27)	-	-
Non-deductible costs	-	-	181	3
Change in unrecognized deferred tax asset	(9,254)	(57)	(1,521)	(23)
<b>Total income tax benefit</b>	<b>(10,351)</b>	<b>(64)</b>	<b>-</b>	<b>-</b>

### Deferred tax assets and liabilities

In 2018 the Bank earned taxable profit in the amount of AZN 12,000 thousand, which allowed them to use previously unrecognised tax losses in the amount of AZN 2,407 thousand. Due to the series of events described in Note 2(c), Bank earned additional taxable profit between 1 January 2019 and 30 November 2019, in the amount sufficient to cover major part of unrecognised tax losses. Considering the Bank's actual and forecasted profit for the future 2 years, the tax effect of AZN 9,254 thousand of previously unrecognised tax losses and other deferred tax assets were recognised because management considered it probable that future taxable profits would be available against which such losses can be used.

The tax loss carry-forwards in the amount of AZN 1,936 thousand from tax losses for the year 2015, AZN 3,215 thousand from tax losses for the year 2016, AZN 5,251 thousand from tax losses for the year 2017 expire in 2020, 2021 and 2022 respectively.

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

<b>2018</b> <b>AZN'000</b>	<b>1 January</b> <b>2018</b>	<b>Recognised in</b> <b>profit or loss</b>	<b>impact of</b> <b>adoption</b> <b>IFRS 9 at 1</b> <b>January 2018</b>	<b>31 December</b> <b>2018</b>
Loans to customers	(2,289)	3,888	175	1,774
Property, equipment and intangible assets	(1,644)	41	-	(1,603)
Investment securities	(156)	-	-	(156)
Due from banks	(57)	49	-	(8)
Other liabilities	80	10	-	90
Other assets	511	(484)	-	27
Tax loss carry-forwards	12,809	(2,407)	-	10,402
Deferred tax asset calculated	<b>9,254</b>	<b>1,097</b>	<b>175</b>	<b>10,526</b>
Deferred tax assets not recognized	(9,254)	9,254	-	-
	<b>-</b>	<b>10,351</b>	<b>175</b>	<b>10,526</b>

<b>2017</b> <b>AZN'000</b>	<b>1 January 2017</b>	<b>Recognised in</b> <b>profit or loss</b>	<b>31 December 2017</b>
Loans to customers	4,926	(7,215)	(2,289)
Property, equipment and intangible assets	(2,060)	416	(1,644)
Investment securities available-for-sale	(92)	(64)	(156)
Due from banks	(146)	89	(57)
Other liabilities	58	22	80
Other assets	532	(21)	511
Tax loss carry-forwards	7,557	5,252	12,809
Deferred tax asset calculated	<b>10,775</b>	<b>(1,521)</b>	<b>9,254</b>
Deferred tax asset not recognized	(10,775)	1,521	(9,254)
	<b>-</b>	<b>-</b>	<b>-</b>

## 11. Cash and cash equivalents

	2018 AZN'000	2017 AZN'000
<b>Cash on hand</b>	<b>11,887</b>	<b>13,968</b>
<b>Nostro accounts with the CBAR</b>	<b>3,378</b>	<b>2,146</b>
<b>Nostro accounts with other banks</b>		
- rated from BBB- to BBB+	2,289	9,244
- rated from BB- to BB+	389	28
- rated from B- to B+	-	97
- not rated	62	81
<b>Total nostro accounts with other banks</b>	<b>2,741</b>	<b>9,450</b>
<b>Term deposits with the CBAR</b>	-	<b>3,920</b>
<b>CBAR notes</b>	-	<b>17,010</b>
<b>Expected credit losses</b>	<b>(26)</b>	-
	<b>17,980</b>	<b>46,494</b>

Ratings are based on Fitch rating system.

As at 31 December 2018, the Bank does not have any balances with banks individually exceeding 10% of equity (2017: two banks with total gross value of the balances equal to AZN 32,270 thousand).

All cash and cash equivalent balances are in Stage 1 as at 31 December 2018 and 1 January 2018.

## 12. Due from banks and other financial institutions

	2018 AZN'000	2017 AZN'000
<b>Mandatory reserve with the CBAR</b>	624	2,069
<b>Blocked accounts</b>	27,911	54,753
<b>Loans and deposits with other banks</b>		
- not rated	2,312	11,238
<b>Total loans and deposits with other banks</b>	<b>2,312</b>	<b>11,238</b>
Allowance for loan losses – banks	(58)	-
<b>Net due from banks and other financial institutions</b>	<b>30,789</b>	<b>68,060</b>

As at 31 December 2018, included in due from banks and other financial institutions was blocked correspondent account in the CBAR amounting AZN 22,195 thousand and in Ziraat Bank amounting AZN 5,716 thousand (2017: in CBAR - AZN 23,898 thousand, in Ziraat Bank - AZN 4,562 thousand, in Raiffeisen International AG - AZN 1,340 thousand, in Kapital Bank OJSC - AZN 24,954 thousand).

Balances with CBAR and Kapital Bank OJSC were blocked as collateral for borrowings obtained by the Bank. Balances with other foreign banks were blocked as a guarantee for international operations of customers.

All due from banks and other financial institutions balances are in Stage 1 as for 31 December 2018 and 1 January 2018.

### (a) Concentration of due from banks and other financial institutions

As at 31 December 2018 the Bank has 2 banks (31 December 2017: 6 banks), whose balances individually exceed 10% of equity.

The gross value of these balances as at 31 December 2018 is AZN 28,477 thousand (31 December 2017: AZN 68,060 thousand).

**(b) Mandatory reserve with the CBAR**

The mandatory reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBAR and whose withdrawability is restricted. Reserves are measured in accordance with regulations issued by the CBAR and equal to 0.5% and 1% (2017: 0.5% and 1%) of the average qualifying customer accounts balances denominated in AZN and foreign currency, respectively.

**(c) Credit risk**

The balance of not rated loans to other financial institutions mainly consists of “Premier Credit” non-bank credit organization amounting AZN 2,256 thousand (in 2017: AZN 8,502 thousand belongs to AFB Bank OJSC and AZN 2,736 thousand belongs to “Premier Credit” non-bank credit organization).

There are no impairment indicators in respect of these balances.

### 13. Investment securities

	2018 AZN'000	2017 AZN'000
Investment securities measured at amortised cost	4,949	-
Investment securities designated as at FVTPL - equity instruments	188	128
Available-for-sale investment securities	-	39,774
	5,137	39,902
Allowance for impairment losses	-	(10)
	5,137	39,892

**Investment securities measured at amortized cost**

	2018 AZN'000
Corporate bonds	4,949
<b>Debt securities</b>	<b>4,949</b>

At 31 December 2018, the debt securities included corporate bonds in amount AZN 4,949 thousand of Southern Gas Corridor with rating of BB, carrying an annual interest rate of 6.88% with maturities in March 2026 (2017: AZN 4,125 thousand bonds of Southern Gas Corridor, corporate bonds in the amount of AZN 29,221 thousand with rating of BB-, carrying an annual interest rate of 6.95% with maturities in October 2021 to March, 2030 and notes issued by Ministry of Finance of the Republic of Azerbaijan in amount of AZN 6,428 thousand with rating of BB, with maturities in April-May 2018).

All ratings are based on Fitch rating system.

At 1 January 2018, the Bank designated certain investments shown in the following table as equity securities at FVTPL. In 2017, these investments were classified as available-for-sale and measured at fair value. The FVTPL designation was made because the investments are expected to be held for the long-term for strategic purposes. Management believes it is unlikely that the fair value at the year-end would differ significantly from that carrying amount.

In 2018, the Bank has purchased shares of Baku Stock Exchange in amount of AZN 60 thousand.

**Equity investment securities designated as at FVTPL**

AZN'000	2018 AZN'000
International Bank of Azerbaijan OJSC	88
“MilliKart” LLC	40
Baku Stock Exchange	60
<b>Equity securities</b>	<b>188</b>

## 14. Loans to customers

	2018 AZN'000	% of total gross loans	2017 AZN'000	% of total gross loans
Consumer loans	235,341	59%	157,660	44%
Microloans	66,041	16%	58,298	16%
Cards	52,796	13%	46,614	13%
Business loans	40,012	10%	90,608	25%
Auto loans	6,112	2%	8,974	2%
<b>Total loans to retail customers</b>	<b>400,302</b>		<b>362,154</b>	
Less: Expected credit losses (ECL)	(197,147)		(142,351)	
<b>Net loans to customers</b>	<b>203,155</b>		<b>219,803</b>	

Carrying value of loans to customers analyzed by industry sector:

	2018 AZN'000	2017 AZN'000
Analysis by sector:		
Individuals	345,875	292,075
Agriculture and food processing	34,408	11,510
Trade and services	14,431	58,041
Manufacturing	5,588	528
<b>Total loans to retail customers</b>	<b>400,302</b>	<b>362,154</b>
Less: Expected credit losses	(197,147)	(142,351)
<b>Net loans to customers</b>	<b>203,155</b>	<b>219,803</b>

### Expected credit losses

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

<b>AZN'000</b>	
<b>Balance at 31 December 2017</b>	<b>142,351</b>
Remeasurement of loss allowance (Note 29)	878
Unwinding discount of ECL	46,400
<b>Balance at 1 January 2018</b>	<b>189,629</b>

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

AZN'000	2018				2017		
	Stage 1	Stage 2	Stage 3	Total	Business	Retail	Total
<b>Loans to customers at amortised cost*</b>							
Balance at 1 January	4,813	529	184,287	189,629	7,182	141,417	148,599
Transfer to Stage 1	1,279	(96)	(1,183)	-	-	-	-
Transfer to Stage 2	(294)	309	(15)	-	-	-	-
Transfer to Stage 3	-	(587)	587	-	-	-	-
Net remeasurement of loss allowance	(5,015)	38	(11,264)	(16,241)	2,368	(14,107)	(11,739)
New financial assets originated or purchased	1,113	-	-	1,113	-	-	-
Write-offs	-	-	(6,133)	(6,133)	-	(1,919)	(1,919)
Recoveries of amounts previously written off	-	-	7,796	7,796	-	7,410	7,410
Unwinding of discount on present value of ECLs	-	-	20,983	20,983	-	-	-
<b>Balance at 31 December</b>	<b>1,896</b>	<b>193</b>	<b>195,058</b>	<b>197,147</b>	<b>9,550</b>	<b>132,801</b>	<b>142,351</b>

AZN'000	2018				2017	
	Stage 1	Stage 2	Stage 3	Total	Retail	
<b>Loans to customers at amortised cost-retail loans*</b>						
Balance at 1 January	2,568	447	173,261	176,276	141,417	
Transfer to Stage 1	1,131	(86)	(1,045)	-	-	
Transfer to Stage 2	(266)	281	(15)	-	-	
Transfer to Stage 3	-	(492)	492	-	-	
Net remeasurement of loss allowance	(3,005)	25	(11,368)	(14,348)	(14,107)	
New financial assets originated or purchased	1,087	-	-	1,087	-	
Write-offs	-	-	(6,115)	(6,115)	(1,919)	
Recoveries of amounts previously written off	-	-	7,796	7,796	7,410	
Unwinding of discount on present value of ECLs	-	-	20,161	20,161	-	
<b>Balance at 31 December</b>	<b>1,515</b>	<b>175</b>	<b>183,167</b>	<b>184,857</b>	<b>132,801</b>	

AZN'000	2018				2017	
	Stage 1	Stage 2	Stage 3	Total	Business	
<b>Loans to customers at amortised cost-Business loans*</b>						
Balance at 1 January	2,245	82	11,026	13,353	7,182	
Transfer to Stage 1	148	(10)	(138)	-	-	
Transfer to Stage 2	(28)	28	-	-	-	
Transfer to Stage 3	-	(95)	95	-	-	
Net remeasurement of loss allowance	(2,010)	13	104	(1,893)	2,368	
New financial assets originated or purchased	26	-	-	26	-	
Write-offs	-	-	(18)	(18)	-	
Unwinding of discount on present value of ECLs	-	-	822	822	-	
<b>Balance at 31 December</b>	<b>381</b>	<b>18</b>	<b>11,891</b>	<b>12,290</b>	<b>9,550</b>	

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

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

#### Loans to customers at amortised cost

- the repayment of AZN 34,072 thousand and AZN 20,986 thousand outstanding amounts by the borrowers of consumer loans in Stage 1 and Stage 3 respectively, during the year decreased AZN 2,724 thousand of loss allowance measured on a 12 months basis and AZN 8,102 thousand of loss allowance measured on a lifetime basis.
- AZN 72,241 thousand increase in consumer loans by means of new issuance affected ECL by AZN 850 thousand.
- the repayment of AZN 6,770 thousand outstanding amount by the borrowers of microloans during the year decreased AZN 358 thousand of loss allowance measured on a lifetime basis.
- repayment of AZN 2,423 thousand outstanding amount by the borrowers of card loans during the years decreased AZN 1,223 thousand of loss allowance measured on a lifetime basis.
- the repayment of AZN 52,534 thousand outstanding amount by the borrowers of business loans during the year decreased AZN 2,010 thousand of loss allowance measured on a 12 months basis.
- 6,115 thousand write-offs of retail loans decreased in the same amount the loss allowances.

#### Credit quality analysis

The following table sets out information about the credit quality of loans to customers measured at amortised cost as at 31 December 2018 and as at 31 December 2017. Unless specially indicated, the amounts in the table represent gross carrying amounts.

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

AZN'000	31 December 2018			
	Stage 1	Stage 2	Stage 3	Total
<i>Loans to customers at amortised cost – consumer loans</i>				
Not overdue	102,144	-	-	102,144
Overdue less than 30 days	1,180	-	700	1,880
Overdue 30-89 days	28	699	1,049	1,776
Overdue 90-179 days	-	-	2,850	2,850
Overdue 180-360 days	-	-	6,491	6,491
Overdue more than 360 days	-	-	120,200	120,200
	<b>103,352</b>	<b>699</b>	<b>131,290</b>	<b>235,341</b>
<b>Loss allowance</b>	<b>(1,028)</b>	<b>(124)</b>	<b>(116,299)</b>	<b>(117,451)</b>
<b>Carrying amount</b>	<b>102,324</b>	<b>575</b>	<b>14,991</b>	<b>117,890</b>

AZN'000	31 December 2017			
	Gross loans	Impairment allowance	Net loans	Impairment allowance to gross loans, %
<i>Loans to customers at amortised cost – consumer loans</i>				
Not overdue	73,197	1,707	71,490	2%
Overdue less than 30 days	3,076	625	2,451	20%
Overdue 30-89 days	2,159	912	1,247	42%
Overdue 90-179 days	3,409	1,854	1,555	54%
Overdue 180-360 days	11,661	7,141	4,520	61%
Overdue more than 360 days	64,158	54,877	9,281	86%
<b>Total consumer loans</b>	<b>157,660</b>	<b>67,116</b>	<b>90,544</b>	<b>43%</b>

AZN'000	31 December 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Loans to customers at amortised cost – Card loans</b>				
Not overdue	27,921	-	-	27,921
Overdue less than 30 days	94	-	5	99
Overdue 30-89 days	1	114	16	131
Overdue 90-179 days	-	-	125	125
Overdue 180-360 days	-	-	321	321
Overdue more than 360 days	-	-	24,199	24,199
	<b>28,016</b>	<b>114</b>	<b>24,666</b>	<b>52,796</b>
<b>Loss allowance</b>	<b>(300)</b>	<b>(46)</b>	<b>(23,288)</b>	<b>(23,634)</b>
<b>Carrying amount</b>	<b>27,716</b>	<b>68</b>	<b>1,378</b>	<b>29,162</b>

AZN'000	31 December 2017			
	Gross loans	Impairment allowance	Net loans	Impairment allowance to gross loans, %
<b>Loans to customers at amortised cost – Card loans</b>				
Not overdue	22,863	8	22,855	0%
Overdue less than 30 days	180	14	166	8%
Overdue 30-89 days	143	39	104	27%
Overdue 90-179 days	256	100	156	39%
Overdue 180-360 days	1,427	677	750	47%
Overdue more than 360 days	21,745	20,010	1,735	92%
<b>Total card loans</b>	<b>46,614</b>	<b>20,848</b>	<b>25,766</b>	<b>45%</b>

AZN'000	31 December 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Loans to customers at amortised cost – Micro loans</b>				
Not overdue	21,126	-	-	21,126
Overdue less than 30 days	98	-	185	283
Overdue 30-89 days	-	24	170	194
Overdue 90-179 days	-	-	475	475
Overdue 180-360 days	-	-	1,479	1,479
Overdue more than 360 days	-	-	42,484	42,484
	<b>21,224</b>	<b>24</b>	<b>44,793</b>	<b>66,041</b>
<b>Loss allowance</b>	<b>(176)</b>	<b>(4)</b>	<b>(38,162)</b>	<b>(38,342)</b>
<b>Carrying amount</b>	<b>21,048</b>	<b>20</b>	<b>6,631</b>	<b>27,699</b>

AZN'000	31 December 2017			
	Gross loans	Impairment allowance	Net loans	Impairment allowance to gross loans, %
<b>Loans to customers at amortised cost – Micro loans</b>				
Not overdue	12,390	372	12,018	3%
Overdue less than 30 days	551	137	414	25%
Overdue 30-89 days	754	284	470	38%
Overdue 90-179 days	1,546	672	874	43%
Overdue 180-360 days	4,599	2,394	2,205	52%
Overdue more than 360 days	38,458	34,272	4,186	89%
<b>Total micro loans</b>	<b>58,298</b>	<b>38,131</b>	<b>20,167</b>	<b>65%</b>

AZN'000	31 December 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Loans to customers at amortised cost – auto loans</b>				
Not overdue	90	-	-	90
Overdue less than 30 days	14	-	52	66
Overdue 30-89 days	-	7	58	65
Overdue 90-179 days	-	-	67	67
Overdue 180-360 days	-	-	164	164
Overdue more than 360 days	-	-	5,660	5,660
	<b>104</b>	<b>7</b>	<b>6,001</b>	<b>6,112</b>
<b>Loss allowance</b>	<b>(11)</b>	<b>(1)</b>	<b>(5,418)</b>	<b>(5,430)</b>
<b>Carrying amount</b>	<b>93</b>	<b>6</b>	<b>583</b>	<b>682</b>

AZN'000	31 December 2017			
	Gross loans	Impairment allowance	Net loans	Impairment allowance to gross loans, %
<b>Loans to customers at amortised cost – auto loans</b>				
Not overdue	2,041	231	1,810	11%
Overdue less than 30 days	219	63	156	29%
Overdue 30-89 days	197	111	86	56%
Overdue 90-179 days	194	121	73	62%
Overdue 180-360 days	419	322	97	77%
Overdue more than 360 days	5,904	5,858	46	99%
<b>Total card loans</b>	<b>8,974</b>	<b>6,706</b>	<b>2,268</b>	<b>75%</b>

AZN'000	31 December 2018			
	Stage 1	Stage 2	Stage 3	Total
<b>Loans to customers at amortised cost – Business loans</b>				
Not overdue	22,774	-	885	23,659
Overdue less than 30 days	4,446	-	2	4,448
Overdue 30-89 days	-	44	29	73
Overdue 90-179 days	-	-	114	114
Overdue 180-360 days	-	-	829	829
Overdue more than 360 days	-	-	10,889	10,889
	<b>27,220</b>	<b>44</b>	<b>12,748</b>	<b>40,012</b>
<b>Loss allowance</b>	<b>(381)</b>	<b>(18)</b>	<b>(11,891)</b>	<b>(12,290)</b>
<b>Carrying amount</b>	<b>26,839</b>	<b>26</b>	<b>857</b>	<b>27,722</b>

AZN'000	31 December 2017			
	Gross loans	Impairment allowance	Net loans	Impairment allowance to gross loans, %
<b>Loans to customers at amortised cost – Business loans</b>				
Loans without individual signs of impairment	78,200	63	78,137	0%
Overdue or impaired loans				
Overdue less than 90 days	1,114	89	1,025	8%
Overdue more than 90 days and less than 1 year	3,065	1,858	1,207	61%
Overdue more than 1 year	8,229	7,540	689	92%
<b>Total business loans</b>	<b>90,608</b>	<b>9,550</b>	<b>81,058</b>	<b>11%</b>

The following table sets out information on loans to customers that are credit-impaired and related collateral held in order to mitigate potential losses as at 31 December 2018:

AZN'000	Gross carrying amount	Loss allowance	Carrying amount	Value of collateral held			
				Cash and deposits	Real estate	Motor vehicles	Total
<b>Loans to corporate customers</b>							
Business loans	12,748	(11,891)	857	-	841	-	841
<b>Loans to retail customers</b>							
Consumer loans	131,290	(116,299)	14,991	2	-	-	2
Microloans	44,793	(38,162)	6,631	-	93	-	93
Card loans	24,666	(23,288)	1,378	47	-	-	47
Auto loans	6,001	(5,418)	582	-	-	95	95
<b>Total credit-impaired loans to customers</b>	<b>219,513</b>	<b>(186,821)</b>	<b>32,692</b>	<b>49</b>	<b>934</b>	<b>95</b>	<b>1,078</b>

The following table provides information on collateral securing loans to customers that are credit-impaired, net of impairment, by types of collateral as at 31 December 2017:

AZN'000	Gross carrying amount	Loss allowance	Carrying amount	Value of collateral held			
				Cash and deposits	Real estate	Equipment	Total
<b>Loans to corporate customers</b>							
Business loans	11,294	(9,398)	1,896	1,781	11	-	1,792
<b>Loans to retail customers</b>							
Consumer loans	79,228	(63,872)	15,356	2	4	-	6
Microloans	44,603	(37,338)	7,265	235	17	9	261
Card loans	23,428	(20,787)	2,641	-	-	-	-
Auto loans	6,517	(6,301)	216	-	-	180	180
<b>Total credit-impaired loans to customers</b>	<b>165,070</b>	<b>(137,696)</b>	<b>27,374</b>	<b>2,018</b>	<b>32</b>	<b>189</b>	<b>2,239</b>

### **Repossessed collateral**

During the year ended 31 December 2018, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 38 thousand (2017: 39 thousand) and recognised them as assets held for sale. The Bank's policy is to sell these as soon as possible. Repossessed collateral are comprised of real estates and other assets and disclosure in Note 16.

### **Significant credit exposures**

As at 31 December 2018, the Bank had nine borrowers or groups of connected borrowers (31 December 2017: eleven borrowers) with gross loan balances exceeding AZN 1,000 thousand. The gross value of these loans as at 31 December 2018 was AZN 24,028 thousand or 6% of the total loans to customers (31 December 2017: AZN 70,500 thousand or 17%).

### **Loan maturities**

The maturity of the loan portfolio is presented in Note 22, which shows the remaining period from the reporting date to the contractual maturity of the loans.

### **Key assumptions and judgments for estimating the loan impairment**

The Bank calculates ECL for portfolio of loans as described in Note 22 (c) (iv), on a collective basis. Bank modelled PD, LGD and EAD to calculate 12 month and lifetime expected credit losses.

#### **PD**

For loan portfolio segments, Markov transition matrix is used to estimate PD employing historical monthly data. Using average monthly transitions, annual transition matrix is constructed. PIT PD is computed based on last 12 months data. Through the cycle (TTC) PD was calculated using last 48 months historical overdue information. From the second year on TTC PD was used to calculate life-time ECL.

#### **LGD**

According to the methodology, LGD modelling is based on average rates of historical recoveries that capture cured and non-cured cases. Bank computed recovery rates using SQL script. Outputs of SQL script are used in ECL calculation files as LGD. Recovery period is limited to 60 months and LGD is permanently set to 100% after this period.

#### **EAD**

For loan portfolio, EAD for stage 1 is calculated based on current exposure including projected accrued interest in 3 months time. EAD for stage 2 is calculated based on planned amortization schedule and accrued interest. EAD for stage 3 equals current exposure. CCF is taken as 100% for unused amounts of credit card customers due to lack of historical data for modelling.

### **Sensitivity analysis**

Changes in these estimates could effect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flow differs by one percent, the impairment allowance on loans to customers as at 31 December 2018 would be AZN 189 thousand lower/higher (31 December 2017: AZN 142 thousand lower/higher).

## 15. Property, equipment and intangible assets

AZN'000	Land and buildings	Furniture and equipment	Computers and communication equipment	Vehicles	Other	Licences and computer software	Total
<b>Cost/revalued amount</b>							
Balance at 1 January 2018	13,213	5,342	8,926	646	312	2,366	30,805
Additions	-	20	89	-	5	12	126
Disposals	-	(56)	(1)	(68)	(1)	-	(126)
<b>Balance at 31 December 2018</b>	<b>13,213</b>	<b>5,306</b>	<b>9,014</b>	<b>578</b>	<b>316</b>	<b>2,378</b>	<b>30,805</b>
<b>Depreciation and amortisation</b>							
Balance at 1 January 2018	(1,304)	(4,851)	(7,999)	(537)	(278)	(1,245)	(16,214)
Depreciation and amortisation for the year	(652)	(291)	(867)	(62)	(20)	(191)	(2,083)
Disposals	-	56	1	68	1	-	126
<b>Balance at 31 December 2018</b>	<b>(1,956)</b>	<b>(5,086)</b>	<b>(8,865)</b>	<b>(531)</b>	<b>(297)</b>	<b>(1,436)</b>	<b>(18,171)</b>
<b>Carrying amount At 31 December 2018</b>	<b>11,257</b>	<b>275</b>	<b>94</b>	<b>114</b>	<b>(48)</b>	<b>942</b>	<b>12,634</b>

AZN'000	Land and buildings	Furniture and equipment	Computers and communication equipment	Vehicles	Other	Licences and computer software	Total
<b>Cost/revalued amount</b>							
Balance at 1 January 2017	13,213	5,371	9,003	825	307	2,342	31,061
Additions	-	42	30	-	5	24	101
Disposals	-	(71)	(107)	(179)	-	-	(357)
<b>Balance at 31 December 2017</b>	<b>13,213</b>	<b>5,342</b>	<b>8,926</b>	<b>646</b>	<b>312</b>	<b>2,366</b>	<b>30,805</b>
<b>Depreciation and amortisation</b>							
Balance at 1 January 2017	(652)	(4,362)	(6,524)	(599)	(244)	(1,043)	(13,424)
Depreciation and amortisation for the year	(652)	(559)	(1,557)	(86)	(34)	(202)	(3,090)
Disposals	-	70	82	148	-	-	300
<b>Balance at 31 December 2017</b>	<b>(1,304)</b>	<b>(4,851)</b>	<b>(7,999)</b>	<b>(537)</b>	<b>(278)</b>	<b>(1,245)</b>	<b>(16,214)</b>
<b>Carrying amount At 31 December 2017</b>	<b>11,909</b>	<b>491</b>	<b>927</b>	<b>109</b>	<b>34</b>	<b>1,121</b>	<b>14,591</b>

As at 31 December 2018 and 2017 included in property and equipment were fully depreciated assets of AZN 12,351 thousand and AZN 7,301 thousand, respectively. Buildings and land owned by the Bank are carried at revalued amounts.

### Revalued assets

The fair values of the Bank's buildings and lands are categorised into Level 3 of the fair value hierarchy as at 31 December 2018.

The basis used for the appraisal is the market approach. The market approach is based on an analysis of the results of comparable sales of similar buildings. The key assumption used in applying the market approach is the sell price, in the absence of undue stress and if reasonable time is given.

The carrying value of buildings as at 31 December 2018, if they would not have been revalued, would be AZN 4,304 thousand (31 December 2017: AZN 4,020 thousand).

On 31 December 2018, management analyzed the main factors affecting the change in the value of commercial office real estate from 1 January 2018 to 31 December 2018. Based on the results of the analysis, it was concluded that there have been no significant changes in prices in the office real estate segment. The analysis was conducted based on the comparative sales method. The comparative sales method is based on direct comparison of the revalued object with other objects sold or offered for sale. In this case the fair value of premises is determined based on the price which an independent party would pay for an object similar by its quality and use. The market value of premises was estimated based on information on offers of the comparable items placed in the market, using correction adjustments from -10% to 30% depending on the object analogue. These offers were adjusted for the differences in characteristics of the appraised and similar property. An estimation of value determined using factors mentioned above represents a result of management's analysis of future prospects of running day-to-day operations and is based both on external and internal sources of data.

Changes in these estimates could affect the value of land and premises. For example, to the extent that the market value of comparable items differs by plus/minus three percent, the value of land and premises as at 31 December 2018 would be AZN 338 thousand higher/lower (2017: AZN 360 thousand).

## 16. Other assets

	2018 AZN'000	2017 AZN'000
Plastic cards settlements	7,674	6,107
Receivable from disposed subsidiary	-	60
	7,674	6,168
Less: expected credit losses	(3,697)	(3,574)
<b>Total other financial assets</b>	<b>3,977</b>	<b>2,594</b>
Repossessed collaterals	1,016	1,033
Prepayments for purchase of intangible assets	870	297
Receivables from state and local funds	120	168
Other	568	566
Less: impairment allowances	(589)	(355)
<b>Total other non-financial assets</b>	<b>1,985</b>	<b>1,709</b>
	<b>5,962</b>	<b>4,303</b>

As at 31 December 2018 and 2017, the Bank has overdue receivable from money transfer systems placed in Bank Standard which license was revoked back in 2016 and the Bank has recognized full impairment. All other financial assets are in Stage 1 and their ECL is not material as for 31 December 2018 and 31 December 2017.

During the year ended 31 December 2018, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 38 thousand (2017: 39 thousand) and recognised them as assets held for sale.

## 17. Amounts due to banks and other financial institutions

	2018 AZN'000	2017 AZN'000
<b>Loans from financial institutions</b>	-	8,508
<b>Demand deposits</b>	356	1,521
<b>Time deposits</b>	162	40,815
<b>Other borrowed funds</b>		
Central Bank of the Republic of Azerbaijan	20,000	20,000
National Fund for Entrepreneurship Support of the Republic of Azerbaijan	18,836	23,043
Azerbaijan Mortgage Fund	9,336	9,862
<b>Total other borrowed funds</b>	<b>48,172</b>	<b>52,905</b>
	<b>48,690</b>	<b>103,749</b>

### *Central Bank of the Republic of Azerbaijan*

As at 31 December 2018, AZN 20,000 thousand (2017: AZN 20,000 thousand) out of term borrowings represented funds borrowed from the Central Bank of the Republic of Azerbaijan. The rate is 3.5% which is in line with the market rate.

### *National Fund for Entrepreneurship Support of the Republic of Azerbaijan*

The Bank signed a credit agreement on 14 May 2012 with the Entrepreneurship Development Fund of the Republic of Azerbaijan, 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% per annum and the Bank lends these funds on to eligible borrowers at rates not higher than 7.0%-8.0% per annum. As at 31 December 2018 the Bank has AZN 18,836 thousand (31 December 2017: AZN 23,043 thousand) payable to the fund, repayable up to November 2026. There are no financial covenants with regard to borrowing from the Entrepreneurship Development Fund of the Republic of Azerbaijan that the Bank should comply with.

In estimating the discount rates for term borrowings from the Azerbaijan Mortgage Fund and National Fund for Entrepreneurship Support of Azerbaijan Republic the Bank considers this market as a separate market from other commercial borrowing business as these loans are issued to the whole banking sector of Azerbaijan at the same terms, purposes, conditions and credit risk exposures

### *Azerbaijan Mortgage Fund*

The Bank signed an agreement on 11 July 2007 with the Azerbaijan Mortgage Fund, for the initial financing and refinancing of mortgage loans at an interest rate 1-4% p.a. As at 31 December 2018, the Bank has AZN 9,336 thousand (31 December 2017: AZN 9,862 thousand) payable to the fund, repayable up to May 2045. There are no financial covenants with regard to borrowing from the Azerbaijan Mortgage Fund the Bank should comply with.

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

	Other borrowed funds	Subordinated debt	Total
<b>Balance at 1 January 2018</b>	<b>52,905</b>	<b>24,267</b>	<b>77,172</b>
<b>Changes from financing cash flows</b>			
Proceeds from other borrowed funds	187	-	187
Repayment of other borrowed funds	(4,920)	(7,500)	(12,420)
<b>Total changes from financing cash flows</b>	<b>(4,733)</b>	<b>(7,500)</b>	<b>(12,233)</b>
Interest expense	1,255	1,033	2,288
Interest paid	(1,255)	(1,038)	(2,293)
<b>Balance at 31 December 2018</b>	<b>48,172</b>	<b>16,762</b>	<b>64,934</b>

## 18. Current accounts and deposits from customers

	<b>2018</b> <b>AZN'000</b>	<b>2017</b> <b>AZN'000</b>
<b>Current accounts and demand deposits</b>		
- Retail	29,790	22,774
- Corporate	10,839	18,178
<b>Term deposits</b>		
- Retail	120,595	166,469
- Corporate	7,504	37,239
	<b>168,728</b>	<b>244,660</b>

As at 31 December 2018, the Bank has 2 customers (2017: 13 customers), whose balances exceed 10% of equity. The total amount of these balances as at 31 December 2018 are AZN 15,241 thousand (2017: AZN 24,183 thousand).

As at December 31, 2018 and 2017 amounts due to customers totaling AZN 3,400 thousand and AZN 3,438 thousand, respectively, were held as security against guarantees issued, AZN 10,612 thousand and AZN 66,159 thousand, respectively, as security against loans and AZN 520 thousand and AZN 5,319 thousand as security against undrawn credit facilities. As at December 31, 2018, time deposits were due to customers nominated in AZN, USD and EUR had effective annual interest rates of 5% - 17%, 1% - 17%, 1 - 7.6% respectively (2017: 7.5% - 17%, 1% - 17% and 1% - 7.6%) and maturity in 2019-2023 (2017: mature in 2018-2023).

## 19. Other liabilities

	<b>2018</b> <b>AZN'000</b>	<b>2017</b> <b>AZN'000</b>
Liabilities in the course of settlement	3,468	1,092
Salary and other payables to employees	490	390
Other creditors	416	463
Amounts payable to the State Committee on Property Issues of the Republic of Azerbaijan	12,435	12,435
<b>Total other financial liabilities</b>	<b>16,809</b>	<b>14,380</b>
Other non-financial liabilities	46	81
<b>Total other non-financial liabilities</b>	<b>46</b>	<b>81</b>
<b>Total other liabilities</b>	<b>16,855</b>	<b>14,461</b>

Amounts payable to the State Committee on Property Issues of the Republic of Azerbaijan in amount of AZN 12,345 thousand as at 31 December 2017 and 31 December 2018 is related to seized dividends of one of the bank's shareholder back in 2016. These liabilities were repaid subsequent to reporting date.

## 20. Subordinated debt

	Issue date	Maturity date	Interest Rate	31 December 2018	31 December 2017
Subordinated debt from related parties (AZPETROL NEFT SHIRKETI LLC, USD 14,250 thousand, monthly payment)	January-March, 2016	January-March, 2023	4.5%	16,762	24,267

In the event of bankruptcy or liquidation of the Bank, repayments of these debts are subordinate to the repayments of the Bank's liabilities to all other creditors.

The Bank is not obligated to comply with financial covenants in relation to subordinated debt balances disclosed above.

## 21. Share capital

The authorised, issued and outstanding share capital comprises 3,400,000 ordinary shares (31 December 2017: 3,400,000). All shares have a nominal value of AZN 15.55 per share. During 2018 there were no any issued shares (2017: 0). Each share entitles one vote to the shareholder.

In 2018, the Bank declared no dividends on ordinary shares from its 2017 earnings (2017: no dividends from its 2016 earnings).

## 22. Risk management, corporate governance and internal control

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

### (a) Corporate governance framework

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

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

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

As at 31 December 2018 the Supervisory Board includes:

Elchin Isayev - Chairman of the Supervisory Board

Mogagheh Oromi Shahram - Member of the Supervisory Board

Ilgar Aliyev - Member of the Supervisory Board

Filiz Yunus Emre - Member of the Supervisory Board

Mashallah Taghiyev - Member of the Supervisory Board

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

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

As at 31 December 2018 the Management Board includes:

Eldar Hamidov - Chairman of the Management Board

Hasan Guliyev - Deputy Chairman of the Management Board

Ali Ibrahimov - Deputy Chairman of the Management Board

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

**(b) Internal control policies and procedures**

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

The purpose of internal controls is to ensure:

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

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

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, programmes, 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 the Supervisory Board. The results of Internal Audit reviews are discussed with relevant business process managers, with summaries submitted to the Audit Committee and the Supervisory Board and senior management of the Bank.

The internal control system in the Bank comprises:

- the Supervisory Board and its committees,
- the Chief Executive officer and the Management Board
- the Chief Accountant
- the risk management function
- the security function, including IT-security
- the human resource function
- the Internal Audit service
- other employees, divisions 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
  - the legal officer – an employee responsible for compliance with the legal and regulatory requirements
  - other employees with control responsibilities

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

**(c) Risk management policies and procedures**

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 responsible member of the Management Board.

Credit, market and liquidity risks both at the portfolio and transactional levels are managed and controlled through a system of 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

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.

**(i) 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.

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

**(ii) Interest rate risk**

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

**Interest rate gap analysis**

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

AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non- interest bearing	Carrying amount
<b>31 December 2018</b>							
<b>ASSETS</b>							
Cash and cash equivalents	-	-	-	-	-	17,980	17,980
Due from banks and other financial institutions	-	8	2,304	-	-	28,477	30,789
Investment securities	-	-	-	-	4,949	188	5,137
Loans to customers	24,409	27,032	37,429	74,192	40,093	-	203,155
Other financial assets	-	-	-	-	-	3,977	3,977
	<b>24,409</b>	<b>27,040</b>	<b>39,733</b>	<b>74,192</b>	<b>45,042</b>	<b>50,622</b>	<b>261,038</b>
<b>LIABILITIES</b>							
Amounts due to banks and other financial institutions	851	660	2,852	9,857	34,088	382	48,690
Current accounts and deposits from customers	11,500	28,434	51,687	36,478	-	40,629	168,728
Subordinated debt	37	-	-	-	16,725	-	16,762
Other financial liabilities	-	-	-	-	-	16,809	16,809
	<b>12,388</b>	<b>29,094</b>	<b>54,539</b>	<b>46,335</b>	<b>50,813</b>	<b>57,820</b>	<b>250,989</b>
	<b>12,021</b>	<b>(2,054)</b>	<b>(14,806)</b>	<b>27,857</b>	<b>(5,771)</b>	<b>(7,198)</b>	<b>10,049</b>
<b>31 December 2017</b>							
<b>ASSETS</b>							
Cash and cash equivalents	38,010	-	-	-	-	8,484	46,494
Due from banks and other financial institutions	-	25,095	11,096	-	-	31,869	68,060
Investment securities	-	-	-	25,191	8,155	6,546	39,892
Loans to customers	27,820	19,765	52,341	85,291	34,586	-	219,803
Other financial assets	-	-	-	-	-	2,594	2,594
	<b>65,830</b>	<b>44,860</b>	<b>63,437</b>	<b>110,482</b>	<b>42,741</b>	<b>49,493</b>	<b>376,843</b>
<b>LIABILITIES</b>							
Amounts due to banks and other financial institutions	8,613	-	27,031	44,865	21,719	1,521	103,750
Current accounts and deposits from customers	14,025	45,753	79,144	64,785	1	40,952	244,660
Subordinated debt	41	-	-	-	24,226	-	24,267
Other financial liabilities	-	-	-	-	-	14,380	14,380
	<b>22,679</b>	<b>45,753</b>	<b>106,175</b>	<b>109,650</b>	<b>45,946</b>	<b>56,853</b>	<b>387,056</b>
	<b>43,151</b>	<b>(893)</b>	<b>(42,738)</b>	<b>832</b>	<b>(3,205)</b>	<b>3,182</b>	<b>(10,213)</b>

Interest rate gaps are managed principally through refinancing of interest bearing liabilities maturing in respective maturity bands with liabilities at equal or lower interest rates.

***Average effective interest rates***

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

	2018			2017		
	Average effective interest rate, %			Average effective interest rate, %		
	AZN	USD	EUR	AZN	USD	EUR
<b>Interest bearing assets</b>						
Due from banks and other financial institutions	20.00%	4.12%	-	4.18%	2.45%	-
Investment securities	-	6.88%	-	-	5.43%	-
Loans to customers	17.95%	17.93%	-	15.14%	7.76%	1.52%
<b>Interest bearing liabilities</b>						
Deposits and balances from banks	2.44%	-	-	4.27%	-	-
Current accounts and deposits from customers	11.93%	4.49%	2.72%	13.91%	3.66%	3.02%
Subordinated debt	4.50%	-	-	4.50%	-	-

***Interest rate sensitivity analysis***

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

	2018	2017
	AZN'000	AZN'000
100 bp parallel fall	2,229	(8,046)
100 bp parallel rise	(2,229)	8,046

**(iii) *Currency risk***

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

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

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

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
<b>ASSETS</b>					
Cash and cash equivalents	11,185	4,906	1,758	131	17,980
Due from banks and other financial institutions	398	30,391	-	-	30,789
Loans to customers	176,780	26,375	-	-	203,155
Investment securities	178	4,959	-	-	5,137
Other financial assets	740	2,986	234	17	3,977
<b>Total financial assets</b>	<b>189,281</b>	<b>69,617</b>	<b>1,992</b>	<b>148</b>	<b>261,038</b>
<b>LIABILITIES</b>					
Amounts due to banks and other financial institutions	48,521	168	1	-	48,690
Amounts due to customers	88,222	75,961	4,488	57	168,728
Other financial liabilities	16,339	198	272	-	16,809
Subordinated debt	-	16,672	-	-	16,762
<b>Total financial liabilities</b>	<b>153,082</b>	<b>93,089</b>	<b>4,761</b>	<b>57</b>	<b>250,989</b>
<b>Net position</b>	<b>36,199</b>	<b>(23,472)</b>	<b>(2,769)</b>	<b>91</b>	

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

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
<b>ASSETS</b>					
Cash and cash equivalents	30,713	8,017	7,470	294	46,494
Due from banks and other financial institutions	27,497	39,223	1,340	-	68,060
Loans to customers	149,138	70,657	8	-	219,803
Investment securities	6,546	33,346	-	-	39,892
Other financial assets	1,278	1,222	94	-	2,594
<b>Total financial assets</b>	<b>215,172</b>	<b>152,465</b>	<b>8,912</b>	<b>294</b>	<b>376,843</b>
<b>LIABILITIES</b>					
Amounts due to banks and other financial institutions	92,601	11,036	112	-	103,749
Amounts due to customers	99,813	136,473	8,359	15	244,660
Other financial liabilities	14,062	259	59	-	14,380
Subordinated debt	-	24,267	-	-	24,267
<b>Total financial liabilities</b>	<b>206,476</b>	<b>172,035</b>	<b>8,530</b>	<b>15</b>	<b>387,056</b>
<b>Net position</b>	<b>8,696</b>	<b>(19,570)</b>	<b>382</b>	<b>279</b>	

The Bank manages currency position and reports for compliance purposes based on statutory amounts.

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

	2018 AZN'000	2017 AZN'000
20% appreciation of USD against AZN	(3,756)	(3,131)
20% appreciation of EUR against AZN	(443)	61

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

**(iv) Credit risk**

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

The credit policy establishes:

- procedures for review and approval of loan credit applications;
- methodology for the credit assessment of borrowers (corporate and retail);
- 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 Credit Supervision Department as well as 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 Sales Department through the use of scoring models and application data verification procedures developed together with the Risk Management Department.

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

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

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

	<b>2018</b>	<b>2017</b>
	<b>AZN'000</b>	<b>AZN'000</b>
<b>ASSETS</b>		
Cash and cash equivalents (excluding cash on hand)	6,093	32,526
Due from banks and other financial institutions	30,789	68,060
Investment securities	4,949	39,774
Loans to customers	203,155	219,803
Other financial assets	3,977	2,594
Commitments on loans and unused credit lines	7,863	11,652
Guarantees issued and similar commitments	8,587	10,054
<b>Total maximum exposure</b>	<b>265,413</b>	<b>384,463</b>

The maximum exposure to credit risk from unrecognised contractual commitments at the reporting date is presented in Note 24.

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 (adjusted where relevant for changes in prepayment expectations).

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 2-10 days past due is applied.

#### ***Generating the term structure of PD***

The Bank collects performance and default information about its credit risk exposures by type of product as well as 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***

A financial instrument is transferred from Stage 1 to Stage 2 if there is a significant increase in credit risk when assessed at the reporting date compared to the expected level of credit risk at initial recognition. The presence of a significant increase in credit risk is analyzed on a quarterly basis (at the date the provision was calculated), and the following criteria are considered in the analysis:

- Quality
  - The fact of overdue debt for 31-90 days for all segments except transactions with financial institutions and issuers of securities;
  - The presence of a debt overdue by 1-7 business days for transactions with financial institutions and issuers of securities;
  - Reduction of financial support from the parent company or another affiliate;
  - The receipt by the Bank of reliable negative information about products issued to the borrower.
- Quantitative criteria apply only if there are external ratings:
  - The relative change in the external rating at the reporting date compared to the external rating at the date of recognition according to the criteria given in Table 1.

*Calculation and determination of criteria of materiality of the relative changes in the external rating*

External ratings for corporate borrowers, financial institutions and issuers of securities are determined on the basis of assessments of international rating agencies Moody's, Fitch, S&P.

The relative change in the external rating is defined as the number of rating categories for which the counterparty's external rating at the reporting date is reduced compared to the rating at the transaction date. The criteria for the materiality of changes in the external rating are given in Table 1.

For instruments with low credit risk, the standard assumes the possibility of simplifying and using the assumption that the credit risk of a financial instrument has not increased significantly since initial recognition if it was determined that the financial instrument has low credit risk as at the reporting date. To determine whether the credit risk of a financial instrument is low, the Bank may use external credit risk ratings.

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

Counterparty rating at initial recognition				A significant increase in credit risk is recognized
	Moody's	Fitch	S&P	
1	AAA	AAA	AAA	Low credit risk: category does not change, unless the rating deteriorates by 3 levels
2	Aa1	AA+	AA+	
3	Aa2	AA	AA	
4	Aa3	AA-	AA-	
5	A1	A+	A+	
6	A2	A	A	
7	A3	A-	A-	
8	Baa1	BBB+	BBB+	
9	Baa2	BBB	BBB	
10	Baa3	BBB-	BBB-	
11	Ba1	BB+	BB+	Changes to -2 category
12	Ba2	BB	BB	
13	Ba3	BB-	BB-	
14	B1	B+	B+	Changes to -1 category
15	B2	B	B	
16	B3	B-	B-	
17	Caa1	CCC-C	CCC-C	
18	Caa2			
19	Caa3			
20	Ca-C			
21	D	D	D	

*Criteria for transferring a financial instrument to Stage 3*

A financial instrument is transferred from Stage 1 / Stage 2 to Stage 3 if there is a default. For the purposes of the methodology of the Bank, a default event is assumed to be equivalent to an impairment event.

An impairment event for a financial instrument is determined at the borrower level for all portfolios except for the portfolio of retail borrowers. For retail borrowers, an impairment event is determined at the financial instrument level. Impairment criteria are:

- More than 90 calendar days of arrears on the reporting date for all segments except transactions with financial institutions and issuers of securities;
- More than 7 business days of overdue debts at the reporting date for transactions with financial institutions and issuers of securities;
- The counterparty / issuer was declared bankrupt by the court, or the court introduced bankruptcy proceedings against the Borrower. This criterion applies to all portfolios with the exception of the portfolio of retail borrowers;
- Assignment to the contract of regulatory quality category 5 as of the reporting date;
- Default / forced restructuring due to the financial difficulties of the borrower (applicable except for transactions with financial institutions and securities). Default / forced restructuring is understood as a change in the terms of the contract, recognized as a forced restructuring by the Authorized body of the Bank, which are a result of the borrower's inability to fulfill the obligations stipulated in the contract and are caused by deterioration in the credit quality of the borrower;
- Revocation of the license and introduction of an interim administration (applicable to financial institutions and issuers of securities).

Criteria for recovery and transfer of financial instruments to Stage 1:

- Lack of default criteria described in this section;
- Lack of criteria for a significant increase in credit risk;
- Lack of arrears for three consecutive (including the current reporting month) reporting months;

*Incorporation of forward-looking information*

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

The impact of macroeconomic events is taken into account at the level of the credit risk component PD. The Bank assesses the impact of macroeconomic information on the corporate and retail portfolio. For a portfolio of securities, for requirements to financial institutions, macro adjustments are used according to the corporate portfolio. An assessment of the impact of macroeconomic information should be made at least annually.

*Availability of forward-looking information for future periods.*

Since the analysis requires the calculation of forecast values of the default level, only those factors for which there are forecast values published by open official external sources are included in the list.

*Adequate frequency of data publication*

Since the modeling process requires a sufficient number of observations, then those factors are selected for inclusion in a wide list, the data for which were published more often than once a year.

When analyzing the dependence of the default level on macroeconomic indicators, the list of factors - Real GDP growth, CIP and oil price forecast was used. As a result, real GDP was used as the key driver. The list of indicators can be expanded by adding new factors to it if there are publications on these factors.

The Bank has identified and documented key drivers of credit risk and credit losses for the entire loan portfolio (including the securities portfolio, requirements for financial institutions), using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

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

<b>Key driver</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Real GDP growth	3.90	3.60	2.70
Oil Price (Brent)	63.37	59.93	n/a
Consumer price index	3.80	4.10	3.80

Predicted relationships between the key indicator and default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 4 years.

When building a macroeconomic model, the Bank uses external statistics on defaults (NPL), as there is no sufficient internal statistics on defaults.

#### *Modified financial assets*

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

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

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.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired (see Note 3(e)(iv)). 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.

#### *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).

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.

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 potential future amounts that may be drawn under the contract, which are estimated based on historical .

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.

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.

	Exposure	External benchmarks used	
		PD	LGD
Cash and cash equivalents	6,093	Moody's default study	S&P recovery studies
Due from banks and other financial institutions	2,312	Moody's default study	S&P recovery studies
Investment securities	5,137	Moody's default study	S&P recovery studies

(v) **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 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 by Treasury Department and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Risk Management 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 assets, 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 31 December 2018 is as follows:

AZN'000	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>From 1 to 5 years</b>	<b>More than 5 years</b>	<b>Total gross amount outflow</b>	<b>Carrying amount</b>
<b>Non-derivative liabilities</b>							
Amounts due to banks and other financial institutions	1,269	728	3,144	11,060	36,020	52,221	48,690
Amounts due to customers	52,983	29,934	55,604	39,367	-	177,888	168,728
Other financial liabilities	16,809	-	-	-	-	16,809	16,809
Subordinated debt	99	124	567	19,088	-	19,878	16,762
<b>Total financial liabilities</b>	<b>71,160</b>	<b>30,786</b>	<b>59,315</b>	<b>69,515</b>	<b>36,020</b>	<b>266,796</b>	<b>250,989</b>
<b>Credit related commitments</b>	<b>16,450</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>16,450</b>	<b>16,450</b>

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

AZN'000	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>From 1 to 5 years</b>	<b>More than 5 years</b>	<b>Total gross amount outflow</b>	<b>Carrying amount</b>
<b>Non-derivative liabilities</b>							
Amounts due to banks and other financial institutions	53,840	1,272	9,174	39,873	13,418	117,577	103,749
Amounts due to customers	56,687	47,772	83,453	66,657	1	254,570	244,660
Other financial liabilities	14,380	-	-	-	-	14,380	14,380
Subordinated debt	131	179	821	4,361	24,357	29,849	24,267
<b>Total financial liabilities</b>	<b>125,038</b>	<b>49,223</b>	<b>93,448</b>	<b>110,891</b>	<b>37,776</b>	<b>416,376</b>	<b>387,056</b>
<b>Credit related commitments</b>	<b>21,706</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>21,706</b>	<b>21,706</b>

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. The management of the Bank does not expect that individuals and legal entities withdraw their term deposits before their stated maturity dates.

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

<b>AZN'000</b>	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>From 1 to 5 years</b>	<b>More than 5 years</b>	<b>Overdue</b>	<b>No Maturity</b>	<b>Total</b>
Cash and cash equivalents	17,980	-	-	-	-	-	-	17,980
Due from banks and other financial institutions	6,281	8.00	24,500	-	-	-	-	30,789
Investment securities	-	-	-	-	4,949	-	188	5,137
Loans to customers	12,683	27,032	37,429	74,192	40,093	11,726	-	203,155
Other financial assets	3,977	-	-	-	-	-	-	3,977
<b>Total financial assets</b>	<b>40,921</b>	<b>27,040</b>	<b>61,929</b>	<b>74,192</b>	<b>45,042</b>	<b>11,726</b>	<b>188</b>	<b>261,038</b>
Amounts due to banks and other financial institutions	1,233	660	2,852	9,857	34,088	-	-	48,690
Current accounts and deposits from customers	52,129	28,434	51,687	36,478	-	-	-	168,728
Subordinated debt	37	-	-	-	16,725	-	-	16,762
Other financial liabilities	16,809	-	-	-	-	-	-	16,809
<b>Total financial liabilities</b>	<b>70,208</b>	<b>29,094</b>	<b>54,539</b>	<b>46,335</b>	<b>50,813</b>	<b>-</b>	<b>-</b>	<b>234,180</b>
<b>Net position</b>	<b>(29,287)</b>	<b>(2,054)</b>	<b>7,390</b>	<b>27,857</b>	<b>(5,771)</b>	<b>11,726</b>	<b>188</b>	<b>26,858</b>
<b>Cumulative liquidity gap</b>	<b>(29,287)</b>	<b>(31,341)</b>	<b>(23,951)</b>	<b>3,906</b>	<b>(1,865)</b>	<b>-</b>	<b>-</b>	<b>-</b>

As set out in the contractual maturity table as at 31 December 2018 the Bank had a negative cumulative liquidity gap of AZN 23,951 thousand in the period up to 1 year. Management believes that although current accounts balance of AZN 40,630 thousand as at 31 December 2018 is included under on demand category in maturity table, apparently not all of these amounts will be withdrawn in period of one month. Past experience demonstrates that current account average balances have not decreased below AZN 40,000 thousand for the period of last three years.

Considering the fact that Bank's right to accept term deposits from customers was restricted by FIMSA till the end of April 2019, Bank was not able to improve its liquidity position from 2017. After Bank's regulatory capital became compliant with minimum prudential requirements, FIMSA has lifted its restriction and from April 2019 until August 2019, the Bank has already attracted new deposits in amount of more than AZN 93.4 mln. with maturity of a year and more and is planning to attract more until the end of the year.

In addition, the Bank will be funded by the CBAR in amount of AZN 117 mln for restructuring the impaired loans, which should be repaid within 5 years with 0.1% interest.

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

AZN'000	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>From 1 to 5 years</b>	<b>More than 5 years</b>	<b>Overdue</b>	<b>No Maturity</b>	<b>Total</b>
Cash and cash equivalents	46,494	-	-	-	-	-	-	46,494
Due from banks	27,308	25,095	15,657	-	-	-	-	68,060
Investment securities	-	-	6,428	25,191	8,155	-	118	39,892
Loans to customers	14,971	19,765	52,341	85,291	34,586	12,849	-	219,803
Other financial assets	2,594	-	-	-	-	-	-	2,594
<b>Total financial assets</b>	<b>91,367</b>	<b>44,860</b>	<b>74,426</b>	<b>110,482</b>	<b>42,741</b>	<b>12,849</b>	<b>118</b>	<b>376,843</b>
Amounts due to banks and other financial institutions	10,134	-	27,031	44,865	21,719	-	-	103,749
Current accounts and deposits from customers	54,977	45,753	79,144	64,785	1	-	-	244,660
Subordinated debt	41	-	-	-	24,226	-	-	24,267
Other financial liabilities	14,380	-	-	-	-	-	-	14,380
<b>Total financial liabilities</b>	<b>79,532</b>	<b>45,753</b>	<b>106,175</b>	<b>109,650</b>	<b>45,946</b>	<b>-</b>	<b>-</b>	<b>387,056</b>
<b>Net position</b>	<b>11,835</b>	<b>(893)</b>	<b>(31,749)</b>	<b>832</b>	<b>(3,205)</b>	<b>12,849</b>	<b>118</b>	<b>(10,213)</b>
<b>Cumulative liquidity gap</b>	<b>11,835</b>	<b>10,942</b>	<b>(20,807)</b>	<b>(19,975)</b>	<b>(23,180)</b>	<b>-</b>	<b>-</b>	<b>-</b>

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

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

The Bank was not in compliance with instant liquidity ratio as at 31 December 2018. Please see contractual maturity table and explanations of the Bank's subsequent events to recover the liquidity gap which will also improve the Bank's instant liquidity ratio required to be not less than 30%.

**(vi) 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.

## **23. Capital management**

The FIMSA sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the FIMSA, banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level and maintain a minimum level of total statutory capital of AZN 50,000 thousand (2017: AZN 50,000 thousand). As at 31 December 2018, the statutory capital ratio was 10% (2017: 10%). The Bank was not in compliance with the statutory capital requirement of AZN 50,000 thousand as at 31 December 2018 and 2017.

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

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

As at 31 December 2018 the Bank was in compliance with the requirements for minimum total capital adequacy ratio (2017: was not in compliance with minimum total capital adequacy ratio. See Note 2 in 2017 FS). The calculation of total capital adequacy ratio based on requirements set by the FIMSA as at 31 December was as follows:

	2018 AZN'000 (unaudited)	2017 AZN'000 (unaudited)
<b>Tier 1 capital</b>		
Share capital	52,870	52,870
Accumulated deficit	(26,003)	(26,363)
<b>Total tier 1 capital</b>	<b>26,867</b>	<b>26,507</b>
Deductions from Tier I capital	10,618	12,462
<b>Tier I capital, after deductions (I—2)</b>	<b>16,249</b>	<b>14,045</b>
<b>Tier II capital (not more than Tier I)</b>	<b>15,201</b>	<b>10,778</b>
<b>Total capital</b>	<b>31,450</b>	<b>24,823</b>
Deductions from total capital	(178)	(212)
<b>Total capital after deductions</b>	<b>31,272</b>	<b>24,611</b>
<b>Total risk-weighted assets</b>	<b>283,110</b>	<b>299,670</b>
<b>Tier I adequacy ratio</b>	<b>5.12%</b>	<b>3.86%</b>
<b>Total capital adequacy ratio</b>	<b>10.46%</b>	<b>7.42%</b>

**Reconciliation of total statutory capital to IFRS equity**

The following unaudited supplementary information is intended to provide additional information to users of the financial statements of the Bank for the year ended 31 December 2018 and is not required under International Financial Reporting Standards (IFRS).

	31 December 2018 AZN'000 (unaudited)	31 December 2017 AZN'000 (unaudited)
<b>Total statutory capital (after deductions)</b>	<b>31,272</b>	<b>24,611</b>
Reconciliation of total statutory capital and IFRS equity:		
-IFRS 9 Transition AJE	(703)	-
- retained earnings	(21,070)	(65,610)
- current year profit/(loss)	22,982	44,557
- loan loss allowance	(17,970)	55,258
- net interest income	(1,919)	(7,624)
- other income	6,827	1,500
- net fee and commission income	(617)	(482)
- income tax benefit	11,900	(4,107)
- personnel expenses	35	(183)
- administrative expenses	24,726	195
- differences arising from deductions	10,796	12,674
- equity investment	178	212
- intangible assets	942	1,121
- deferred tax assets	9,676	11,341
- general allowances	(2,822)	(2,936)
- other capital	(8,906)	(7,841)
- revaluation reserve	6,776	7,118
<b>Total IFRS equity</b>	<b>38,326</b>	<b>12,573</b>

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

## 24. Credit related commitments

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 tender and advances guarantees and letters of credit to guarantee the performance of customers to third parties.

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

The contractual amounts of credit related commitments are set out in the following table by category. The amounts reflected in the table for credit related commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees represent the maximum accounting loss that would be recognised at the reporting date if counterparties failed completely to perform as contracted.

	<b>2018</b> <b>AZN'000</b>	<b>2017</b> <b>AZN'000</b>
<b>Contracted amount</b>		
Guarantees	8,587	10,054
Undrawn credit lines	<u>7,863</u>	<u>11,652</u>
	<b><u>16,450</u></b>	<b><u>21,706</u></b>

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.

## 25. Operating leases

### Leases as lessee

The Bank leases a number of premises and equipment under operating leases. The leases typically run for an initial period of one to two years, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

Where the Bank is the lessee, the future minimum lease payments under non-cancelable operating leases of buildings are as follows:

	<b>December 31,</b> <b>2018</b>	<b>December 31,</b> <b>2017</b>
Less than one year	<u>380</u>	<u>421</u>
<b>Total operating lease commitments</b>	<b><u>380</u></b>	<b><u>421</u></b>

## 26. 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.

### (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 position or the results of future operations.

### (c) Taxation contingencies

The taxation system in the Azerbaijan Republic continues to evolve and is characterized by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities who have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Azerbaijan Republic suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

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.

## 27. Related party transactions

### (a) Control relationships

The Bank has no ultimate controlling party.

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

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

	<b>2018</b>	<b>2017</b>
	<b>AZN'000</b>	<b>AZN'000</b>
Short term employee benefits	834	568
	<b>834</b>	<b>568</b>

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

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

	2018 AZN'000	Average effective interest rate, %	2017 AZN'000	Average effective interest rate, %
<b>Statement of financial position</b>				
Loans issued (gross)	101	5.2%	391	11.09%
Loan allowance	(1)	-	-	-
Current accounts	16	-	123	-
Term deposits	13	14%	-	-
Commitments on loans and unused credit lines	64	-	72	8%

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

	2018 AZN'000	2017 AZN'000
<b>Profit or loss</b>		
Interest income calculated using the effective interest method	14	43
Interest expense	(2)	-
Impairment losses	(1)	-

**(c) Transactions with other related parties**

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

	Shareholders		Other		Total
	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000
<b>Statement of financial position</b>					
<b>ASSETS</b>					
Loans to customers					
Principal balance	-	-	29	4%	29
Impairment allowance	-	-	-	-	-
<b>LIABILITIES</b>					
Customer accounts	1,604	-	2,628	-	4,232
Term deposits	-	-	15,000	8.67%	15,000
Subordinated debt	16,762	4.59%	-	-	16,762
<b>Profit or loss</b>					
Interest income calculated using the effective interest method	-	-	-	-	-
Interest expense	1,033	-	1,803	-	2,836

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

	Shareholders		Other		Total
	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000
<b>Statement of financial position</b>					
<b>ASSETS</b>					
Loans to customers					
Principal balance	-	-	41	1.68%	41
<b>LIABILITIES</b>					
Amounts due to banks	-	-	339	0.00%	339
Customer accounts	2,666	-	2,557	-	5,223
Subordinated debt	24,267	4,50%	-	-	24,267
Guarantees issued	-	-	500	1%	500
<b>Profit or loss</b>					
Interest income	-	-	7	-	7
Interest expense	(1,103)	-	-	-	(1,103)

Other related parties include family members of key management personnel, entities under control of shareholders. The majority of balances resulting from transactions with related parties mature within one year. Transactions with related parties are not secured.

## 28. Financial assets and liabilities: fair values and accounting classifications

### (a) Accounting classifications and fair values

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

AZN '000	Amortised cost	FVTPL	Total carrying amount	Fair value
Cash and cash equivalents	17,980		17,980	17,980
Due from banks and other financial institutions	30,789		30,789	30,789
Investment securities	5,019	118	5,137	5,137
Loans to customers	203,155		203,155	205,101
Other financial assets	3,977		3,977	3,977
	<b>260,920</b>	<b>118</b>	<b>261,038</b>	<b>262,984</b>
Deposits and balances from banks	48,690		48,690	48,543
Current accounts and deposits from customers	168,728		168,728	169,894
Other financial liabilities	16,855		16,855	16,809
Subordinated debt	16,762		16,762	16,394
	<b>251,035</b>		<b>251,035</b>	<b>251,640</b>

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

<b>AZN '000</b>	<b>Loans and receivables</b>	<b>Available-for- sale</b>	<b>Other amortised cost</b>	<b>Total carrying amount</b>	<b>Fair value</b>
Cash and cash equivalents	46,494	-	-	46,494	46,493
Due from banks and other financial institutions	68,060	-	-	68,060	68,060
Investment securities	-	39,892	-	39,892	39,892
Loans to customers	219,803	-	-	219,803	218,585
Other financial assets	2,594	-	-	2,594	2,594
	<b>336,951</b>	<b>39,892</b>	<b>-</b>	<b>376,843</b>	<b>375,625</b>
Deposits and balances from banks	-	-	103,749	103,749	103,749
Current accounts and deposits from customers	-	-	244,660	244,660	244,433
Other financial liabilities	-	-	14,380	14,380	14,380
Subordinated debt	-	-	24,267	24,267	24,267
	<b>-</b>	<b>-</b>	<b>387,056</b>	<b>387,056</b>	<b>386,829</b>

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

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

The following assumptions are used by management to estimate the fair values of financial instruments as at 31 December 2018:

- discount rates of 3.29%-9.46% (2017: 4.93%-11.80%) and 6.13%-17.11% (2017: 6.84%-16.47%) are used for discounting future cash flows from due from banks and other financial institutions and loans to customers, respectively.
- discount rates of 1.43%-10.01% (2017: 3.00%-9.48%) are used for discounting future cash flows from current accounts and deposits from customers.
- discount rate of 3.29%-9.46% (2017: 6.06%-7.25%) and 1.00%-4.00% (2017: 1%-8%) are used for discounting future cash flows from due to banks and other borrowed funds respectively.

#### **Loans from government agencies**

Management has assessed the nature of the agreements with the Azerbaijan National Fund for Entrepreneurship Support (“ANFES”) and “Azerbaijan Mortgage Fund” OJSC (“AMF”), and in particular whether the Bank is acting as an agent of the Government agencies, or as a principal with the borrower under this program. Having considered the risks and rewards related to the loans issued under those programs, management have concluded that the Bank is acting as a principal and accordingly the accounting in these financial statements follows this judgment.

The loans issued by the Bank under these programs in accordance with decrees of government agencies do not have similar instruments on the market and form a separate market segment due to their unique nature, specifics of state lending program and borrowers category. Thus the management assumes that contractual interest rates are market rates for such loans and they recognized at fair value which is equal to their nominal value.

Similarly, for the related funds received by the Bank from the government agencies under these programs, the management assumes that contractual interest rates are market rates for such borrowings and recognized at fair value which is equal to their nominal value.

#### **Valuation of financial instruments**

The Bank uses valuation techniques that include inputs that are not based on observable market data to estimate the fair value of certain types of financial instruments.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. When there is no quoted price in an active market, the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

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

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

AZN'000	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total fair value</u>	<u>Total carrying amount</u>
<b>ASSETS</b>					
Cash and cash equivalents	-	17,980	-	17,980	17,980
Due from banks and other financial institutions	-	30,789	-	30,789	30,789
Investment securities	-	4,949	188	5,137	5,137
Loans to customers	-	-	205,101	205,101	203,155
Other financial assets	-	3,977	-	3,977	3,977
<b>LIABILITIES</b>					
Deposits and balances from banks	-	48,543	-	48,543	48,690
Current accounts and deposits from customers	-	169,894	-	169,894	168,728
Other financial liabilities	-	16,809	-	16,809	16,855
Subordinated debt	-	16,394	-	16,394	16,762

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

AZN'000	Level 1	Level 2	Level 3	Total fair value	Total carrying amount
<b>ASSETS</b>					
Cash and cash equivalents	-	46,467	-	46,494	46,494
Due from banks and other financial institutions	-	68,060	-	68,060	68,060
Investment securities available-for-sale	-	39,774	118	39,892	39,892
Loans to customers	-	-	218,585	218,585	219,803
Other financial assets	-	2,594	-	2,594	2,594
<b>LIABILITIES</b>					
Deposits and balances from banks	-	103,749	-	103,749	103,749
Current accounts and deposits from customers	-	244,433	-	244,433	244,660
Other financial liabilities	-	14,380	-	14,380	14,380
Subordinated debt	-	24,267	-	24,267	24,267

## 29. Transition to IFRS 9

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

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

AZN'000	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
<b>Financial assets</b>					
Cash and cash equivalents	11	Loans and receivables	Amortised cost	46,494	46,494
Due from banks and other financial institutions	12	Loans and receivables	Amortised cost	68,060	68,060
Investment securities - debt	13	Available for sale	Financial asset measured at amortised cost	39,774	39,774
Investment securities - equity	13	Available for sale	Investment securities designated as at FVTPL - equity instruments	118	118
Loans to customers	14	Loans and receivables	Amortised cost	219,803	218,925
Other financial assets	16	Loans and receivables	Amortised cost	2,594	2,594
<b>Total financial assets</b>				<b>376,843</b>	<b>375,965</b>
<b>Financial liabilities</b>					
Deposits and balances from banks	17	Amortised cost	Amortised cost	103,749	103,749
Current accounts and deposits from customers	18	Amortised cost	Amortised cost	244,660	244,660
Other financial liabilities	19	Amortised cost	Amortised cost	14,380	14,380
Subordinated debt	20	Amortised cost	Amortised cost	24,267	24,267
<b>Total financial liabilities</b>				<b>387,056</b>	<b>387,056</b>

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

- a. Certain debt securities are held by the Bank Central Treasury in a separate portfolio for long-term yield. These securities may be sold, but such sales are not expected to be more than infrequent. The Bank considers that these securities are held within a business model whose objective is to hold assets to collect the contractual cash flows. These assets are classified as measured at amortised cost under IFRS 9.

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

<b>AZN'000</b>	<b>IAS 39 carrying amount 31 December 2017</b>	<b>Reclassifica- tion</b>	<b>Remeasure- ment</b>	<b>IFRS 9 carrying amount 1 January 2018</b>
<b>Financial assets</b>				
<i>Amortised cost</i>				
Cash and cash equivalents:				
Opening balance	46,494			
Closing balance				46,494
Due from banks and other financial institutions:				
Opening balance	68,060			
Closing balance				68,060
Loans to customers:				
Opening balance	219,803			
Remeasurement			(878)	
Closing balance				218,925
Investment securities:				
Opening balance	-			
From available-for-sale		39,774		
Remeasurement			-	
Closing balance				39,774
Other financial assets	2,594			2,594
<b>Total amortised cost</b>	<b>336,951</b>	<b>39,774</b>	<b>(878)</b>	<b>375,847</b>
<i>FVTPL</i>				
Investment securities:				
Opening balance	-			
From available-for-sale		118		
Closing balance				118
<b>Total FVTPL</b>	<b>-</b>	<b>118</b>	<b>-</b>	<b>118</b>
<i>Available-for-sale</i>				
Investment securities:				
Opening balance	39,892			
To investment securities measured at amortized cost		(39,774)		
To investment securities measured through FVTPL		(118)		
<b>Total financial assets</b>	<b>376,843</b>	<b>-</b>	<b>(878)</b>	<b>375,965</b>

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

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

<b>AZN'000</b>	<b>Impact of adopting IFRS 9 at 1 January 2018</b>
<b>Retained earnings</b>	
Closing balance under IAS 39 (31 December 2017)	12,573
Recognition of expected credit losses under IFRS 9 (including loan commitments)	(878)
Related tax	175
<b>Opening balance under IFRS 9 (1 January 2018)</b>	<b>11,870</b>

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 as at 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

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

<b>AZN'000</b>	<b>Impairment allowance and provisions</b>			
	<b>31 December 2017 (IAS 39)</b>	<b>Unwinding effect of ECL</b>	<b>Remeasurement</b>	<b>1 January 2018 (IFRS 9)</b>
Loans and receivables under IAS 39/financial assets at amortised cost under IFRS 9 (includes loans to customers)	142,351	46,400	878	189,629
<b>Total measured at amortised cost</b>	<b>142,351</b>	<b>46,400</b>	<b>878</b>	<b>189,629</b>

### 30. Events after reporting period

Subsequent to 31 December 2018, as for 30 November 2019, Bank's regulatory capital was AZN 55.7 mln, and capital adequacy ratio was 22.76%, which is in compliance with FIMSA's requirement.

Subsequent to 31 December 2018, during 2019 the Bank has paid the payable balance to the State Committee on Property issues of the Republic of Azerbaijan (see note 19).

On 14 March 2019, approval of Eldar Hamidov as a candidate of Chairman of Management Board has been confirmed. by FIMSA.

In January 2019 the Bank repaid the loan from the Central Bank of the Republic of Azerbaijan in the amount of AZN 20,000 thousand with annual interest rates of 3.5%. In regards with that, the blocked deposit of AZN 22,196 thousand, held as a security against the loan, was released.

\_\_\_\_\_  
Mr. Eldar Hamidov  
Chairman of the Management Board

\_\_\_\_\_  
Mr. Ali Ibrahimov  
Chief Financial Officer

