"Yapi Kredi Bank Azerbaijan" CJSC

International Financial Reporting Standards Financial Statements and Independent Auditor's Report

31 December 2018

Contents

Independent Auditor's Report

To the Shareholders and Board of Directors of the "Yapi Kredi Bank Azerbaijan" CJSC

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of "Yapi Kredi Bank Azerbaijan" CJSC (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).

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2018;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the audit of the financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

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.

Auditor's responsibilities for the audit of the financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional 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 auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with 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.

PricewaterhouseCoopers Audit Azerbaijan LLC

10 May 2019

Baku, the Republic of Azerbaijan

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Yapi Kredi Bank Azerbaijan CJSC
Statement of Financial Position
(Amounts expressed in thousands of Azerbaijani Manats)

	Notes	31 December 2018	31 December 2017
ASSETS			
Cash and cash equivalents	8	163,432	263,695
Notes issued by Central Bank of Azerbaijan Republic and other bonds	11	45,226	32,678
Amounts due from credit institutions	16	62,030	2,380
Loans to customers	10	144,831	118,554
Property and equipment	12	4,573	5,210
Intangible assets	13	7,940	7,952
Other assets	15	7,793	7,993
TOTAL ASSETS		**435,825**	**438,462**
LIABILITIES			
Amounts due to credit institutions	16	7,270	4,317
Amounts due to customers	17	335,050	343,137
Current income tax liabilities		113	1,708
Deferred income tax liabilities	14	2,145	2,370
Other liabilities	15	6,093	5,931
TOTAL LIABILITIES		**350,671**	**357,463**
EQUITY			
Share capital	18	55,381	55,381
Retained earnings		29,773	25,618
TOTAL EQUITY		**85,154**	**80,999**
TOTAL LIABILITIES AND EQUITY		**435,825**	**438,462**

Signed and authorized for release on behalf of the Management Board of the Bank on 10 May 2019:

Closed Joint Stock Company Yapi Kredi Bank Azerbaijan
YAPI KREDİ BANK
AZƏRBAYCAN
Yapı Kredi Bank Azərbaycan Qapalı Səhmdar Cəmiyyəti

Cenk Yüksel
Chief Executive Officer / General Director

Matanat Gasimova
Chief Accountant

Ramin Saftarov
Chief of Financial Reporting Department

(Amounts expressed in thousands of Azerbaijani Manats)

	Notes	**2018**	**2017**
Interest income			
Loans to customers		25,689	24,510
Amounts due from credit institutions		5,245	2,600
Investment securities		3,775	1,664
Interest expense			
Amounts due to customers		(4,767)	(6,631)
Amounts due to credit institutions		(126)	(1,362)
Net interest income		**29,816**	**20,781**
Credit loss allowance		(7,738)	(875)
Net interest income after credit loss allowance		**22,078**	**19,906**
Net fee and commission income	19	5,241	5,619
Gains less losses from trading in foreign currencies		4,984	11,668
Net losses from currency translation differences		(62)	(724)
Other income		52	73
Non-interest income		**10,215**	**16,636**
Personnel expenses	20	(9,787)	(11,840)
General and administrative expenses	21	(10,317)	(11,018)
Depreciation and amortization	11 ,12	(4,068)	(4,827)
Other impairment and provisions		(46)	(7)
Non-interest expenses		**(24,218)**	**(27,692)**
Profit before tax		**8,075**	**8,850**
Income tax expense	13	(2,121)	(1,257)
PROFIT FOR THE YEAR		**5,954**	**7,593**
Other comprehensive income for the year		**5,954**	**7,593**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**5,954**	**7,593**

(Amounts expressed in thousands of Azerbaijani Manats)

	Share Capital	Retained earnings	Total
Balance at 1 January 2017	**46,811**	**18,025**	**64,836**
Profit for the year	-	7,593	**7,593**
Total comprehensive loss for the year	**-**	**7,593**	**7,593**
Share Issue	8,570	-	**8,570**
Balance at 31 December 2017	**55,381**	**25,618**	**80,999**
Adoption of IFRS 9: - remeasurement for expected credit losses, net of tax	-	(1,799)	**(1,799)**
Restated balance at 1 January 2018	**55,381**	**23,819**	**79,200**
Profit for the year	-	5,954	5,954
Total comprehensive income for the year	**-**	**5,954**	**5,954**
Balance at 31 December 2018	**55,381**	**29,773**	**85,154**

(Amounts expressed in thousands of Azerbaijani Manats)

	Notes	2018	2017
Cash flows from operating activities			
Interest received		27,887	28,814
Interest paid		(5,822)	(8,197)
Fees and commissions received		10,931	11,271
Fees and commissions paid		(5,653)	(5,577)
Realized gains less losses from dealing in foreign currencies		4,984	11,668
Other income received		52	66
Personnel expenses paid		(10,339)	(11,531)
Other operating expenses paid		(10,296)	(10,375)
Cash flows from operating activities before changes in operating assets and liabilities		**11,744**	**16,139**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(58,318)	28,375
Loans to customers		(30,840)	65,566
Other assets		200	(1,658)
Net increase/(decrease) in operating liabilities			
Amounts due to the CBAR		–	(20,000)
Amounts due to credit institutions		2,953	(46,919)
Amounts due to customers		(7,158)	27,794
Other liabilities		644	141
Net cash (used)/from in operating activities before income tax		**(80,775)**	**69,438**
Income tax paid		(3,916)	(231)
Net cash (used)/from in operating activities		**(84,691)**	**69,207**
Cash flows from investing activities			
(Purchase)/Disposal of bonds		(10,210)	2,587
Purchase of property and equipment	11	(1,066)	(1,544)
Purchase of intangible assets	12	(2,366)	(1,873)
Net cash used in investing activities		**(13,642)**	**(830)**
Cash flows from financing activities			
Issuance ordinary of shares	17	–	8,570
Net cash from in financing activities		**–**	**8,570**
Effect of exchange rates changes on cash and cash equivalents		(62)	(606)
Net (decrease)/increase in cash and cash equivalents		**(98,395)**	**76,341**
Cash and cash equivalents, beginning		**296,313**	**219,972**
Cash and cash equivalents, ending	7 ,10	**197,918**	**296,313**

As per Company policy cash and cash equivalents includes notes issued by Central Bank of Azerbaijan Republic amounted AZN 34,486 (2017: AZN 32,618)

(Amounts expressed in thousands of Azerbaijani Manats)

1 Introduction

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2018 for Yapi Kredi Bank (the "Bank").

Yapi Kredi Bank Azerbaijan (the "Yapi Kredi Bank") was incorporated and is domiciled in the Republic of Azerbaijan. Yapi Kredi Bank Azerbaijan is a closed joint-stock company limited by shares and was set up in accordance with Azerbaijani regulations.

Principal activity. The Yapi Kredi Bank's principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Yapi Kredi Bank has operated under a full banking licence issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") since 11 January 2000 under registration number 243. The Yapi Kredi Bank participates in the state deposit insurance scheme, which was introduced by the Azeri Law, "Insurance of individual deposits in the Republic of Azerbaijan" dated 29 December 2006. The State Deposit Insurance Fund guarantees full repayment of deposits of individuals, annual interest rate not exceeding 15% for AZN, 3% for foreign currencies.

Registered address and place of business. The Bank's registered address and principal place of business is 73G Jalil Mammadguluzadeh street Baku, AZ1078, Azerbaijan.

The Bank has 7 branches (2017: 7 branches), 1 customer services unit (2017: 1 unit) within the Republic of Azerbaijan. The Bank had 257 employees at 31 December 2018 (2017: 289).

As at 31 December 2018 and 2017 the following shareholders owned the outstanding shares of the Bank:

Shareholder	%
Yapı ve Kredi Bankası A.Ş.	99.8
YK Yatirim Menkul Degerler A.Ş.	0.1
YK Lease A.Ş.	0.1
Total	100.0

Yapı ve Kredi Bankası A.Ş. ("YKB"), an entity established in Turkey, is the ultimate parent of the Bank. YKB's shares have been traded on the Istanbul Stock Exchange ("ISE") since 1987. As at 31 December 2018, 18.20% of the shares of YKB are publicly traded (31 December 2017: 18.20%). The remaining 81.80% is owned by Koç Finansal Hizmetler A.Ş. ("KFS"). The ultimate shareholders of KFS are UniCredito Italiano SPA and Koç Holding, with 50% ownership each.

2 Operating Environment of the Bank

The Republic of Azerbaijan displays certain characteristics of an emerging market. Current and future growth and stability of the economy is largely dependent upon the effective implementation of economic, fiscal and monetary measures undertaken by government as well as crude oil prices and stability of Azerbaijani manat.

Following the negative impact of decline in oil prices and devaluations of national currency against major international currencies, which took place in 2015, operating environment remained highly uncertain.

In addressing these challenges, the government accelerated reforms in support of long term economic stability and sustainability. Furthermore during 2018 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani manat.

In January 2019, Fitch Ratings, international credit rating agency, maintained Azerbaijan's sovereign credit rating at 'BB+' with a stable outlook. At the same time, the agency affirmed the ratings on the long term foreign and local currency sovereign credit ratings of Azerbaijan at 'BB+/BB+'. The agency forecasts that Azerbaijan's economic growth will increase moderately but will still remain dependent on oil industry trends and public investments.

The Bank's Management is monitoring these developments in the current environment and taking precautionary measures as it considers necessary in order to ensure the sustainability and development of the Bank's business in the foreseeable future. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

3 Significant Accounting Policies

Basis of preparation. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value and by the revaluation of premises and equipment, financial instruments categorised at fair value through profit or loss ("FVTPL") and at fair value through other comprehensive income ("FVOCI"). The principal accounting policies applied in the preparation of these financial statements are set out below. Apart from the accounting policy changes resulting from the adoption of IFRS 9 and IFRS 15 effective from 1 January 2018, these policies have been consistently applied to all the periods presented, unless otherwise stated. Refer to Notes 5 and 26 .

Financial instruments – key measurement terms. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees, are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost ("AC") is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any allowance for expected credit losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the gross carrying amount of the financial instrument.

The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount, which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

3 Summary of Accounting Policies (Continued)

Financial instruments – initial recognition. Financial instruments at FVTPL are initially recorded at fair value. All other financial instruments are initially recorded at fair value adjusted for transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets. After the initial recognition, an ECL allowance is recognised for financial assets measured at AC and investments in debt instruments measured at FVOCI, resulting in an immediate accounting loss.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Bank commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

Financial assets – classification and subsequent measurement – measurement categories. The Bank classifies financial assets in the following measurement categories: FVTPL, FVOCI and AC. The classification and subsequent measurement of debt financial assets depends on: (i) the Bank's business model for managing the related assets portfolio and (ii) the cash flow characteristics of the asset.

Financial assets – classification and subsequent measurement – business model. The business model reflects how the Bank manages the assets in order to generate cash flows – whether the Bank's objective is: (i) solely to collect the contractual cash flows from the assets ("hold to collect contractual cash flows",) or (ii) to collect both the contractual cash flows and the cash flows arising from the sale of assets ("hold to collect contractual cash flows and sell") or, if neither of (i) and (ii) is applicable, the financial assets are classified as part of "other" business model and measured at FVTPL.

Business model is determined for a group of assets (on a portfolio level) based on all relevant evidence about the activities that the Bank undertakes to achieve the objective set out for the portfolio available at the date of the assessment. Factors considered by the Bank in determining the business model include the purpose and composition of a portfolio, past experience on how the cash flows for the respective assets were collected, how risks are assessed and managed, how the assets' performance is assessed. Refer to Note 4 for critical judgements applied by the Bank in determining the business models for its financial assets.

Financial assets – classification and subsequent measurement – cash flow characteristics. Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the Bank assesses whether the cash flows represent solely payments of principal and interest ("SPPI"). Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are consistent with the SPPI feature. In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e. interest includes only consideration for credit risk, time value of money, other basic lending risks and profit margin.

Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the financial asset is classified and measured at FVTPL. The SPPI assessment is performed on initial recognition of an asset and it is not subsequently reassessed. Refer to Note 4 for critical judgements applied by the Bank in performing the SPPI test for its financial assets.

Financial assets – reclassification. Financial instruments are reclassified only when the business model for managing the portfolio as a whole changes. The reclassification has a prospective effect and takes place from the beginning of the first reporting period that follows after the change in the business model. The Bank did not change its business model during the current and comparative period and did not make any reclassifications. The entity did not change its business model during the current and comparative period and did not make any reclassifications.

Financial assets impairment – credit loss allowance for ECL. The Bank assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Bank measures ECL and recognises credit loss allowance at each reporting date. The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end

3 Summary of Accounting Policies (Continued)

of each reporting period about past events, current conditions and forecasts of future conditions.

Debt instruments measured at AC are presented in the statement of financial position net of the allowance for ECL. For loan commitments and financial guarantees, a separate provision for ECL is recognised as a liability in the statement of financial position. For debt instruments at FVOCI, changes in amortised cost, net of allowance for ECL, are recognised in profit or loss and other changes in carrying value are recognised in OCI as gains less losses on debt instruments at FVOCI.

The Bank applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter ("12 Months ECL"). If the Bank identifies a significant increase in credit risk ("SICR") since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any ("Lifetime ECL"). Refer to Note 22 for a description of how the Bank determines when a SICR has occurred. If the Bank determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Bank's definition of credit impaired assets and definition of default is explained in Note 22 .

As an exception, for certain financial instruments, such as credit cards, that may include both a loan and an undrawn commitment component, the Bank measures expected credit losses over the period that the Bank is exposed to credit risk, that is, until the expected credit losses would be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. This is because contractual ability to demand repayment and cancel the undrawn commitment does not limit the exposure to credit losses to such contractual notice period.

Financial assets – write-off. Financial assets are written-off, in whole or in part, when the Bank exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a dercognition event. The Bank may write-off financial assets that are still subject to enforcement activity when the Bank seeks to recover amounts that are contractually due, however, there is no reasonable expectation of recovery.

Financial assets – derecognition. The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

Financial assets – modification. The Bank sometimes renegotiates or otherwise modifies the contractual terms of the financial assets. The Bank assesses whether the modification of contractual cash flows is substantial considering, among other, the following factors: any new contractual terms that substantially affect the risk profile of the asset (eg profit share or equity-based return), significant change in interest rate, change in the currency denomination, new collateral or credit enhancement that significantly affects the credit risk associated with the asset or a significant extension of a loan when the borrower is not in financial difficulties.

If the modified terms are substantially different, the rights to cash flows from the original asset expire and the Bank derecognises the original financial asset and recognises a new asset at its fair value. The date of renegotiation is considered to be the date of initial recognition for subsequent impairment calculation purposes, including determining whether a SICR has occurred. The Bank also assesses whether the new loan or debt instrument meets the SPPI criterion. Any difference between the carrying amount of the original asset derecognised and fair value of the new substantially modified asset is recognised in profit or loss, unless the substance of the difference is attributed to a capital transaction with owners.

In a situation where the renegotiation was driven by financial difficulties of the counterparty and inability to make the originally agreed payments, the Bank compares the original and revised expected cash flows to assets whether the risks and rewards of the asset are substantially different as a result of the contractual modification. If the risks and rewards do not change, the modified asset is not substantially different from

3 Summary of Accounting Policies (Continued)

the original asset and the modification does not result in derecognition. The Bank recalculates the gross carrying amount by discounting the modified contractual cash flows by the original effective interest rate, and recognises a modification gain or loss in profit or loss.

Financial liabilities – measurement categories. Financial liabilities are classified as subsequently measured at AC, except for (i) financial liabilities at FVTPL: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in securities), contingent consideration recognised by an acquirer in a business combination and other financial liabilities designated as such at initial recognition and (ii) financial guarantee contracts and loan commitments.

Financial liabilities – derecognition. Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

Modifications of liabilities that do not result in extinguishment are accounted for as a change in estimate using a cumulative catch up method, with any gain or loss recognised in profit or loss, unless the economic substance of the difference in carrying values is attributed to a capital transaction with owners.

Cash and cash equivalents. Cash and cash equivalents are short-term items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash on hand, amounts due from the CBAR, excluding obligatory reserves, and unrestricted balances on correspondent accounts including overnight deposits and deposits with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents, both in the statement of financial position and for the purposes of the statement of cash flows. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL. Notes from CBAR represents per Bank policy represents cash and cash equivalents.

Mandatory cash balances with the CBAR. Mandatory cash balances with the CBAR are carried at AC and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day to day operations, and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows.

Due from other banks. Amounts due from other banks are recorded when the Bank advances money to counterparty banks. Amounts due from other banks are carried at AC when: (i) they are held for the purposes of collecting contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

Investments in debt securities. Based on the business model and the cash flow characteristics, the Bank classifies investments in debt securities as carried at AC, FVOCI or FVTPL. Debt securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI, and if they are not voluntarily designated at FVTPL in order to significantly reduce an accounting mismatch.

Debt securities are carried at FVOCI if they are held for collection of contractual cash flows and for selling, where those cash flows represent SPPI, and if they are not designated at FVTPL. Interest income from these assets is calculated using the effective interest method and recognised in profit or loss. An impairment allowance estimated using the expected credit loss model is recognised in profit or loss for the year. All other changes in the carrying value are recognised in OCI. When the debt security is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from OCI to profit or loss.

Investments in debt securities are carried at FVTPL if they do not meet the criteria for AC or FVOCI. The Bank may also irrevocably designate investments in debt securities at FVTPL on initial recognition if applying this option significantly reduces an accounting mismatch between financial assets and liabilities being recognised or measured on different accounting bases.

Loans and advances to customers. Loans and advances to customers are recorded when the Bank advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Bank classifies loans and advances to customers into one of the following measurement categories: (i) AC: loans that are held for collection of contractual cash flows and those cash

3 Summary of Accounting Policies (Continued)

flows represent SPPI and loans that are not voluntarily designated at FVTPL, and (ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Impairment allowances are determined based on the forward-looking ECL models. Note 22 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Bank incorporates forward-looking information in the ECL models.

Repossessed collateral. Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognised at fair value when acquired and included in premises and equipment, other financial assets, investment properties or inventories within other assets depending on their nature and the Bank's intention in respect of recovery of these assets. The Bank measures a repossessed collateral at the lower of its carrying amount and fair value less costs to sell. The Bank recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Loan commitments. The Bank issues commitments to provide loans. These commitments are irrevocable or revocable only in response to a material adverse change. Such commitments are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at (i) the remaining unamortised balance of the amount at initial recognition, plus (ii) the amount of the loss allowance determined based on the expected credit loss model, unless the commitment is to provide a loan at a below market interest rate, in which case the measurement is at the higher of these two amounts. The carrying amount of the loan commitments represents a liability. For contracts that include both a loan and an undrawn commitment and where the Bank cannot separately distinguish the ECL on the undrawn loan component from the loan component, the ECL on the undrawn commitment is recognised together with the loss allowance for the loan. To the extent that the combined ECLs exceed the gross carrying amount of the loan, they are recognised as a liability.

Financial guarantees. Financial guarantees require the Bank to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantees are initially recognised in "Other liabilities" at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the guarantee. At the end of each reporting period, the guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition. In addition, an ECL loss allowance is recognised for fees receivable that are recognised in the statement of financial position as an asset.

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

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

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

3 Summary of Accounting Policies (Continued)

In addition, there are various operating taxes in Azerbaijan such as VAT, property tax, withholding tax and others which become relevant as a result of the Bank's operations. These taxes are included as a component of general and administrative expenses.

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

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

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

	Years
Leasehold improvements	4-15
Furniture and fixtures	4-5
Computers and office equipment	4
Motor vehicles	4

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

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

Intangible assets. Intangible assets other than goodwill include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Operating leases. Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

Due to other credit institutions. Amounts due to other banks are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at AC.

Amounts due to customers. Amounts due to customers are non-derivative liabilities to individuals, state or corporate customers and are carried at AC.

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

Share Capital. Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity.

Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional paid-in capital.

Presentation of statement of financial position in order of liquidity. The Bank does not have a clearly identifiable operating cycle and therefore does not present current and non-current assets and liabilities separately in the statement of financial position. Instead, assets and liabilities are presented in order of their liquidity. Refer to Note 23 for analysis of financial instruments by expected maturity.

3 Summary of Accounting Policies (Continued)

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

Interest income and expense recognition. Interest income and expense are recorded for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For financial assets that are originated or purchased credit-impaired, the effective interest rate is the rate that discounts the expected cash flows (including the initial expected credit losses) to the fair value on initial recognition (normally represented by the purchase price). As a result, the effective interest is credit-adjusted.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for (i) financial assets that have become credit impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their AC, net of the ECL provision, and (ii) financial assets that are purchased or originated credit impaired, for which the original credit-adjusted effective interest rate is applied to the AC.

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

- *Fee income earned from services that are provided over a certain period of time*

Fee and commission income is recognised over time on a straight line basis as the services are rendered, when the customer simultaneously receives and consumes the benefits provided by the Bank's performance. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

- *Fee income from providing transaction services*

Fee and commission income is recognised at a point in time when the Bank satisfies its performance obligation, usually upon execution of the underlying transaction. The amount of fee or commission received or receivable represents the transaction price for the services identified as distinct performance obligations. Fees arising from negotiating or participating in the negotiation of a transaction for a third party are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Sales and purchases of foreign currencies and currency conversion. The Bank sells and purchases foreign currencies in the cash offices and through the bank accounts, as well as exchanges foreign currencies. The transactions are performed at the exchange rates established by the Bank, which are different from the official spot exchange rates at the particular dates. The differences between the official rates and Bank rates are recognised as gains less losses from trading in foreign currencies at a point in time when a particular performance obligation is satisfied.

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

(Amounts expressed in thousands of Azerbaijani Manats)

3 Summary of Accounting Policies (Continued)

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

The Bank used the following official exchange rates at 31 December 2018 and 2017 in the preparation of these financial statements:

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

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

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

ECL measurement. Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 23 . The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"), as well as models of macro-economic scenarios. The Bank regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience.

A 10% increase or decrease in PD estimates at 31 December 2018 would result in an increase or decrease in total expected credit loss allowances of AZN 109 thousand. A 10% increase or decrease in LGD estimates at 31 December 2018 would result in an increase or decrease in total expected credit loss allowances of AZN 1,285 thousand.

Determination of collateral value. Management monitors market value of collateral on a regular basis. Management uses its experienced judgment or independent opinion to adjust the fair value to reflect the current circumstances. The amount and collateral required depend on the assessment of credit risk of the counterparty.

Initial recognition of related party transactions. In the normal course of business the Bank enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 24 .

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

For such facilities, the Bank measures ECLs over the period that the Bank is exposed to credit risk and ECLs are not mitigated by credit risk management actions. Application of this exception requires judgement. Management applied its judgement in identifying the facilities, both retail and commercial, to which this exception applies. The Bank applied this exception to facilities with the following characteristics:

(a) there is no fixed term or repayment structure, (b) the contractual ability to cancel the contract is not in practice enforced as a result of day-to-day management of the credit exposure and the contract may only

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

be cancelled when the Bank becomes aware of an increase in credit risk at the level of an individual facility, and (c) the exposures are managed on a collective basis. Further, the Bank applied judgement in determining a period for measuring the ECL, including the starting point and the expected end point of the exposures.

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

Significant increase in credit risk ("SICR"). In order to determine whether there has been a significant increase in credit risk, the Bank compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Bank considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioural aspects of particular customer portfolios. The Bank identifies behavioural indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 23 .

Should ECL on all loans and advances to customers be measured at lifetime ECL (that is, including those that are currenty in Stage 1 measured at 12-months ECL), the expected credit loss allowance would be higher by AZN 246 thousand as of 31 December 2018 (1 January 2018: higher by AZN 5,109 thousand).

Modification of financial assets. When financial assets are contractually modified (e.g. renegotiated), the Bank assesses whether the modification is substantial and should result in derecognition of the original asset and recognition of a new asset at fair value. This assessment is based primarily on qualitative factors, described in the relevant accounting policy and it requires significant judgment. In particular, the Bank applies judgment in deciding whether credit impaired renegotiated loans should be derecognised and whether the new recognised loans should be considered as credit impaired on initial recognition. The derecognition assessment depends on whether the risks and rewards, that is, the variability of expected (rather than contractual) cash flows, change as a result of such modifications. Management determined that risks and rewards did not change as a result of modifying such loans and therefore in substantially all such modifications, the loans were neither derecognised nor reclassified out of the credit-impaired stage.

Write-off policy. Financial assets are written-off, in whole or in part, when the Bank exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. Determining the cash flows for which there is no reasonable expectation of recovery requires judgement. Management considered the following indicators that there is no reasonable expectation of recovery: liquidation or bankruptcy proceedings as well as decision of the court. Management also considers, based on past practices, that contractual default interest is not collectible for loans overdue over 360 days. Therefore, the default interest was written-off from the gross carrying amounts of the respective loans.

5 Adoption of New or Revised Standards and Interpretations

Adoption of IFRS 9 "Financial Instruments". The Bank adopted IFRS 9, *Financial Instruments*, from 1 January 2018. The Bank elected not to restate comparative figures and recognised any adjustments to the carrying amounts of financial assets and liabilities in the opening retained earnings as of the date of initial application of the standard, 1 January 2018. Consequently, the revised requirements of the IFRS 7, *Financial Instruments: Disclosures*, have only been applied to the current period. The comparative period disclosures repeat those disclosures made in the prior year.

The significant new accounting policies applied in the current period are described in Note 3. Accounting policies applied prior to 1 January 2018 and applicable to the comparative information are disclosed in Note 26 .

(Amounts expressed in thousands of Azerbaijani Manats)

5 Adoption of New or Revised Standards and Interpretations (Continued)

The following table reconciles the carrying amounts of each class of financial assets as previously measured in accordance with IAS 39 and the new amounts determined upon adoption of IFRS 9 on 1 January 2018.

	Measurement category		Carrying value under IAS 39 - 31 December 2017	Effect of adopting IFRS 9			Carrying value under IFRS 9 - 1 January 2018
				Reclassification		Remeasure-ment	
	IAS 39	IFRS 9		Mandatory	Voluntary	ECL	
Cash and cash equivalents	L&R	AC	263,695	-	-	(1,132)	262,563
Amounts due from credit institutions	L&R	AC	2,380	-	-	(3)	2,377
Loans and advances to customers							
- Corporate lending	L&R	AC	54,727	-	-	1,745	56,472
- Consumer lending	L&R	AC	42,424	-	-	(3,437)	38,987
- Small business lending	L&R	AC	13,774	-	-	570	14,344
- Residential mortgages	L&R	AC	7,629	-	-	105	7,734
Total loans and advances to customers	L&R	AC	**118,554**	-	-	**(1,017)**	**117,537**
Notes issued by Central Bank of Azerbaijan Republic and other bonds	L&R	FVOCI	32,678	-	-	(44)	32,634
Total other financial assets	L&R	AC	3,163	-	-	(52)	3,111
Total financial assets			**420,470**			**(2,248)**	**418,222**

(a) Cash and cash equivalents

All classes of cash and cash equivalents as disclosed in Note 7 were reclassified from loans and receivables ("L&R") measurement category under IAS 39 to AC measurement category under IFRS 9 at the adoption date of the standard. The ECLs for cash and cash equivalents balances were insignificant.

(b) Due from other banks

All classes of due from other banks balances were reclassified from L&R measurement category under IAS 39 to AC measurement category under IFRS 9.

Reconciliation of provision for impairment at 31 December 2017 and credit loss allowance at 1 January 2018. The following table reconciles the prior period's closing provision for impairment measured in accordance with incurred loss model under IAS 39 to the new credit loss allowance measured in accordance with expected loss model under IFRS 9 at 1 January 2018:

(Amounts expressed in thousands of Azerbaijani Manats)

5 Adoption of New or Revised Standards and Interpretations (Continued)

	Provision under IAS 39 or IAS 37 at 31 Dec 2017	Effect Remeasurement from incurred to expected loss	Credit loss allowance under IFRS 9 at 1 January 2018
Cash and cash equivalents	25	1,132	1,157
- Mandatory cash balances with the Central Bank of Azerbaijan Republic	-	3	3
- Investments in debt securities	-	44	44
- Loans and advances to customers	38,048	1,017	39,065
- Other financial assets	-	45	45
Loan commitments	-	-	-
Financial guarantees	-	7	7

At 31 December 2017, all of the Bank's financial liabilities were carried at AC. There were no changes to the classification and measurement of financial liabilities

The following table analyses the impact, net of tax, of transition to IFRS 9 on reserves and retained earnings as of 1 January 2018.

	Share Capital	Retained earnings	Total Equity
Amounts at 31 December 2017 prior to adoption of IFRS 9	**55,381**	**25,618**	**80,999**
Recognition of ECL under IFRS 9 for debt financial assets at amortized cost	-	(1,799)	(1,799)
At 1 January 2018 (under IFRS 9)	**55,381**	**23,819**	**79,200**

Amendments to IFRS 9 - "Prepayment Features with Negative Compensation" (issued on 12 October 2017 and effective at the latest for annual periods beginning on or after 1 January 2019). The amendments were early adopted by the Bank with the date of initial application of 1 January 2018. The amendments enable measurement at amortised cost of certain loans and debt securities that can be prepaid at an amount below amortised cost, for example at fair value or at an amount that includes a reasonable compensation payable to the borrower equal to present value of an effect of increase in market interest rate over the remaining life of the instrument. In addition, the text added to the standard's basis for conclusion reconfirms existing guidance in IFRS 9 that modifications or exchanges of certain financial liabilities measured at amortised cost that do not result in the derecognition will result in an gain or loss in profit or loss. The Bank is therefore not be able to revise effective interest rate for the remaining life of the loan in order to avoid an impact on profit or loss upon a loan modification. The standard did not have a material impact on the Bank

Adoption of IFRS 15 "Revenue from Contracts with Customers" (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018) and Amendments to IFRS 15 "Revenue from Contracts with Customers" (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018). The Bank has adopted IFRS 15, *Revenue from Contracts with Customers*, with the date of initial application of 1 January 2018. The new standard was

5 Adoption of New or Revised Standards and Interpretations (Continued)

applied using the modified retrospective method, with the cumulative effect recognised in retained earnings on 1 January 2018. The standard introduced the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The standard did not have a material impact on the Bank.

The following amended standards became effective for the Bank from 1 January 2018, but did not have any material impact on the Bank:

- Amendments to IFRS 2 "Share-based Payment" (issued on 20 June 2016 and effective for annual periods beginning on or after 1 January 2018).
- Amendments to IFRS 4 - "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts" (issued on 12 September 2016 and effective, depending on the approach, for annual periods beginning on or after 1 January 2018 for entities that choose to apply temporary exemption option, or when the entity first applies IFRS 9 for entities that choose to apply the overlay approach).
- Annual Improvements to IFRSs 2014-2016 cycle – Amendments to IFRS 1 an IAS 28 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- Amendments to IAS 40 – "Transfers of Investment Property" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).

6 New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2019 or later, and which the Bank has not early adopted.

IFRS 16 "Leases" (issued on 13 January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Bank decided that it will apply the standard using the modified retrospective method, without restatement of comparatives.

IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019). IAS 12 specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. An entity should determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. An entity should assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the effect of uncertainty will be reflected in determining the related taxable profit or loss, tax bases, unused tax losses, unused tax credits or tax rates, by using either the most likely amount or the expected value, depending on which method the entity expects to better predict the resolution of the uncertainty. An entity will reflect the effect of a change in facts and circumstances or of new information that affects the judgments or estimates required by the interpretation as a change in accounting estimate. Examples of changes in facts and circumstances or new information that can result in the reassessment of a judgment or estimate include, but are not limited to, examinations or actions by a taxation

6 New Accounting Pronouncements (Continued)

authority, changes in rules established by a taxation authority or the expiry of a taxation authority's right to examine or re-examine a tax treatment. The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgments and estimates required by the Interpretation. The Bank does not expect impact of the amendments on its financial statements.

Annual Improvements to IFRSs 2015-2017 cycle - amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 (issued on 12 December 2017 and effective for annual periods beginning on or after 1 January 2019). The narrow scope amendments impact four standards. IFRS 3 was clarified that an acquirer should remeasure its previously held interest in a joint operation when it obtains control of the business. Conversely, IFRS 11 now explicitly explains that the investor should not remeasure its previously held interest when it obtains joint control of a joint operation, similarly to the existing requirements when an associate becomes a joint venture and vice versa. The amended IAS 12 explains that an entity recognises all income tax consequences of dividends where it has recognised the transactions or events that generated the related distributable profits, eg in profit or loss or in other comprehensive income. It is now clear that this requirement applies in all circumstances as long as payments on financial instruments classified as equity are distributions of profits, and not only in cases when the tax consequences are a result of different tax rates for distributed and undistributed profits. The revised IAS 23 now includes explicit guidance that the borrowings obtained specifically for funding a specified asset are excluded from the pool of general borrowings costs eligible for capitalisation only until the specific asset is substantially complete. The Bank does not expect impact of the amendments on its financial statements.

Amendments to IAS 19 "Plan Amendment, Curtailment or Settlement" (issued on 7 February 2018 and effective for annual periods beginning on or after 1 January 2019). The amendments specify how to determine pension expenses when changes to a defined benefit pension plan occur. When a change to a plan—an amendment, curtailment or settlement—takes place, IAS 19 requires to remeasure net defined benefit liability or asset. The amendments require to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. Before the amendments, IAS 19 did not specify how to determine these expenses for the period after the change to the plan. By requiring the use of updated assumptions, the amendments are expected to provide useful information to users of financial statements. The Bank does not expect impact of the amendments on its financial statements.

Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020). The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

Definition of a business – Amendments to IFRS 3 (issued on 22 October 2018 and effective for acquisitions from the beginning of annual reporting period that starts on or after 1 January 2020). The amendments revise definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if are no outputs. The definition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a 'concentration test'. The assets acquired would not represent a business if substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets). The amendments are prospective and the Bank will apply them and assess their impact from 1 January 2020.

Definition of materiality – Amendments to IAS 1 and IAS 8 (issued on 31 October 2018 and effective for annual periods beginning on or after 1 January 2020). The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions

(Amounts expressed in thousands of Azerbaijani Manats)

6 New Accounting Pronouncements (Continued)

that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The Bank does not expect impact of the amendments on its financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

7 Cash and Cash Equivalents

Cash and cash equivalents comprise:

	2018	2017
Cash on hand	33,323	29,993
Current accounts with the CBAR	34,307	28,449
Short-term deposits placed in the CBAR	7,726	52,517
Accounts with other credit institutions	88,254	152,736
Less credit loss allowance	(178)	-
Cash and cash equivalents	**163,432**	**263,695**

As of 31 December 2018 all cash and cash equivalents were classified as Stage 1. During 2018 year net movement of ECL for cash and cash equivalents was AZN 954 thousans (2017: AZN nil).

As at 31 December 2018, the Bank had short-term deposits placed in the CBAR amounting to AZN 7,694 (2017: AZN 52,517) maturing until 7 January 2019 with the annual interest rates of 7.76-8.92% p.a (2017: 11.80-14.97% p.a).

Current accounts with other credit institutions consist of interest bearing correspondent account balances with resident and non-resident banks of amounting AZN 8,563 (2017: AZN nil) and AZN 69,389 (2017: AZN 62), respectively.

The credit quality of cash and cash equivalents balances may be summarised based on Fitch's ratings as follows at 31 December 2018:

	Cash balances with the CBAR, including mandatory reserves	Accounts with other credit institutions	Total
- Excellent	-	9,653	9,653
- Good	41,931	78,525	120,456
Total cash and cash equivalents, excluding cash on hand	**41,931**	**88,178**	**130,109**

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. Refer to Note 22 for the ECL measurement approach.

(Amounts expressed in thousands of Azerbaijani Manats)

7 Cash and Cash Equivalents (Continued)

The credit quality of cash and cash equivalents balances may be summarised based on Fitch's ratings as follows at 31 December 2017:

Neither past due nor impaired	Cash balances with the CBAR	Amounts with credit institutions	Total
- Central Bank of the Azerbaijan Republic	80,966	–	80,966
- AA- to AA+ rated	–	7,805	7,805
- Lower than A- rated	–	144,931	144,931
Total cash and cash equivalents, excluding cash on hand	**80,966**	**152,736**	**233,702**

As of 31 December 2018, amounts with credit institutions of AZN 67,800 or 77% of total amounts due from credit institutions was due from one largest customer (2017: one).

Information on related party balances is disclosed in Note 24 .

8 Amounts Due from Credit Institutions

Amounts due from credit institutions comprise:

	2018	2017
Short-term deposits placed in banks	59,321	–
Obligatory reserve with the CBAR	2,813	2,380
Amounts due from credit institutions (gross)	**62,134**	**2,380**
Less: allowance for impairment	(104)	–
Amounts due from credit institutions (net)	**62,030**	**2,380**

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

As at 31 December 2018, the Bank had short-term deposits placed in banks amounting to AZN 59,321 (2017: nil) maturing in Feb-May 2019, with the annual interest rates of 3.0-3.8% p.a

.	Stage 1 (12-months ECL)	Total
Placements with credit institutions		
- Excellent	38,370	38,370
- Good	23,764	23,764
Gross carrying amount	**62,134**	**62,134**
Credit loss allowance	(104)	(104)
Total due from credit institutions (carrying amount)	**62,030**	**62,030**

Analysis by credit quality of amounts due from credit institutions outstanding at 31 December 2017, is as follows:

8 Amounts Due from Credit Institutions (Continued)

	Placements with other banks	Total
Neither past due nor impaired		
- Central Bank of the Azerbaijan Republic	2,380	2,380
Total due from credit institutions	**2,380**	**2,380**

9 Loans to Customers

Loans to customers comprise:

	31 December 2018	31 December 2017
Gross carrying amount of loans and advances to customers at AC	191,385	156,602
Less credit loss allowance	(46,554)	(38,048)
Total carrying amount of loans and advances to customers at AC	**144,831**	**118,554**
Total loans and advances to customers	**144,831**	**118,554**

As at 31 December 2018, out of the total amount of loans 35.5% (2017: 29.3%) are denominated in foreign currencies.

Gross carrying amount and credit loss allowance amount for loans and advances to customers at AC by classes at 31 December 2018 and 31 December 2017 are disclosed in the table below:

	31 December 2018			31 December 2017		
In thousands of Azeri Manat	Gross carrying amount	Credit loss allowance	Carrying amount	Gross carrying amount	Provision for loan impairment	Carrying amount
Loans to corporate / commercial customers	106,858	22,667	84,191	73,737	19,010	54,727
Loans to SME	19,447	9,061	10,386	21,774	8,000	13,774
Consumer Loans	55,587	13,224	42,363	52,187	9,763	42,424
Residential Mortgage loans	9,493	1,602	7,891	8,904	1,275	7,629
Total loans and advances to customers at AC	**191,385**	**46,554**	**144,831**	**156,602**	**38,048**	**118,554**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

More detailed explanation of classes of loans to legal entities is provided below:

- Loans to corporate / commercial customers – loans issued to commercial entities;
- Loans to SME – loans issued to small and medium-sized enterprises;
- Consumer Loans – loans issued to individuals for personal needs;
- Residential Mortgage loans - loans issued to individuals for mortgage purposes.

The following table discloses the changes in the credit loss allowance and gross carrying amount for loans and advances to customers carried at amortised cost between the beginning and the end of the reporting period:

	Credit loss allowance				**Gross carrying amount**			
	Stage 1 (12-months ECL)	**Stage 2 (lifetime ECL for SICR)**	**Stage 3 (lifetime ECL for credit im-paired)**	**Total**	**Stage 1 (12-months ECL)**	**Stage 2 (lifetime ECL for SICR)**	**Stage 3 (lifetime ECL for credit im-paired)**	**Total**
Loans to corporate / commercial customers								
At 1 January 2018	**118**	**3,307**	**15,585**	**19,010**	**28,597**	**21,422**	**23,718**	**73,737**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(6)	6	-	-	(1,422)	1,422	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(37)	(1,970)	2,007	-	(80)	(4,650)	4,730	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	3	(3)	-	-	598	(598)	-	-
New originated or purchased	363	309	2,121	2,793	58,213	10,266	4,044	72,523
Derecognised during the period	(112)	(1,546)	(2,015)	(3,673)	(27,970)	(14,465)	(3,441)	(45,876)
Other movements	50	244	4,244	4,538	2,709	(1,935)	5,700	6,474
At 31 December 2018	**379**	**347**	**21,942**	**22,668**	**60,645**	**11,462**	**34,751**	**106,858**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Loans to SME								
At 1 January 2018	**66**	**761**	**7,173**	**8,000**	**5,638**	**5,008**	**11,128**	**21,774**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(17)	17	-	-	(667)	667	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	-	(225)	225	-	-	(618)	618	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	8	(8)	-	-	287	(287)	-	-
New originated or purchased	21	7	1,074	1,102	3,154	282	1,944	5,380
Derecognised during the period	(52)	(308)	(82)	(442)	(4,369)	(3,511)	(89)	(7,969)
Other movements	(6)	(210)	617	401	(806)	(42)	1,110	262
At 31 December 2018	**20**	**34**	**9,007**	**9,061**	**3,237**	**1,499**	**14,711**	**19,447**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Consumer loans								
At 1 January 2018	**4**	**138**	**9,621**	**9,763**	**34,884**	**1,742**	**15,561**	**52,187**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(34)	34	-	-	(2,375)	2,375	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(227)	(209)	436	-	(418)	(362)	780	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	4	(4)	-	-	499	(474)	(25)	-
New originated or purchased	136	16	95	247	18,331	357	162	18,850
Derecognised during the period	(1)	(49)	(769)	(819)	(9,983)	(627)	(1,361)	(11,971)
Other movements	363	125	3,545	4,033	(1,042)	(1,970)	(467)	(3,479)
At 31 December 2018	**245**	**51**	**12,928**	**13,224**	**39,896**	**1,041**	**14,650**	**55,587**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

	Credit loss allowance				Gross carrying amount			
	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Residential mortgage loans								
At 1 January 2018	**22**	**94**	**1,159**	**1,275**	**6,073**	**1,059**	**1,772**	**8,904**
Movements with impact on credit loss allowance charge for the period:								
Transfers:								
- to lifetime (from Stage 1 to Stage 2)	(1)	1	-	-	(362)	362	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(34)	(420)	454	-	(63)	(757)	820	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-	150	(62)	(88)	-
New originated or purchased	4	-	30	34	1,770	19	54	1,843
Derecognised during the period	(2)	(8)	(18)	(28)	(415)	(153)	(33)	(601)
Other movements	24	334	(37)	321	(445)	(239)	31	(653)
At 31 December 2018	**13**	**1**	**1,588**	**1,602**	**6,708**	**229**	**2,556**	**9,493**

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Allowance for impairment of loans to customers

Information about collateral at 31 December 2018 is as follows:

	Corporate lending	Small business lending	Consumer lending	Residential mortgages	Total
Unsecured loans	17,795	2,750	51,386	73	72,004
Loans collateralized by:					
Real estate	81,057	15,705	1,104	9,420	107,286
Cash deposits	7,245	–	1,391	–	8,636
Other assets	761	992	1,706	–	3,459
Less impairment provisions	(22,668)	(9,060)	(13,224)	(1,602)	(46,554)
Total loans to customers	**84,190**	**10,387**	**42,363**	**7,891**	**144,831**

Information about collateral at 31 December 2017 is as follows:

	Corporate lending	Small business lending	Consumer lending	Residential mortgages	Total
Unsecured loans	5,223	819	48,500	65	54,607
Loans collateralized by:					
Real estate	59,802	19,915	1,352	8,839	89,908
Cash deposits	453	–	148	–	601
Other assets	8,259	1,040	2,187	–	11,486
Less impairment provisions	(19,010)	(8,000)	(9,763)	(1,275)	(38,048)
Total loans to customers	**54,727**	**13,774**	**42,424**	**7,629**	**118,554**

Other assets mainly include vehicles and equipment. The disclosure above represents the lower of the carrying value of the loan or collateral taken; the remaining part is disclosed within the unsecured exposures. The carrying value of loans was allocated based on liquidity of the assets taken as collateral.

An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Loans to customers and other financial assets with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade that had changes in the terms and conditions of loan agreements, but not individually impaired.

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Analysis by credit quality of loans outstanding at 31 December 2018 is as follows:

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit im-paired)	Total
Corporate lending				
Less than 30 days	60,645	11,462	137	72,244
30 to 90 days overdue	-	-	66	66
91-180 days overdue	-	-	3,818	3,818
181 to 360 days averdue	-	-	1,413	1,413
Over 360 days overdue	-	-	29,315	29,315
Gross carrying amount	**60,645**	**11,462**	**34,749**	**106,858**
Credit loss allowance	(379)	(347)	(21,942)	(22,667)
Carrying amount	**60,266**	**11,115**	**12,807**	**84,191**
Small business lending				
Less than 30 days	3,237	168	70	3,475
30 to 90 days overdue	-	1,331	-	1,331
91-180 days overdue	-	-	1,872	1,872
181 to 360 days averdue	-	-	207	207
Over 360 days overdue	-	-	12,562	12,562
Gross carrying amount	**3,237**	**1,499**	**14,711**	**19,447**
Credit loss allowance	(21)	(33)	(9,007)	(9,061)
Carrying amount	**3,216**	**1,466**	**5,704**	**10,386**
Consumer lending				
Less than 30 days	39,895	494	142	40,531
30 to 90 days overdue	-	546	32	577
91-180 days overdue	-	-	205	205
181 to 360 days averdue	-	-	355	355
Over 360 days overdue	-	-	13,918	13,918
Gross carrying amount	**39,895**	**1,040**	**14,652**	**55,587**
Credit loss allowance	(245)	(51)	(12,928)	(13,224)
Carrying amount	**39,650**	**989**	**1,724**	**42,363**

(Amounts expressed in thousands of Azerbaijani Manats)

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit impaired)	Total
Residential mortgage loans				
Less than 30 days	6,707	113	116	6,936
30 to 90 days overdue	-	117	-	117
91-180 days overdue	-	-	727	727
181 to 360 days averdue	-	-	41	41
Over 360 days overdue	-	-	1,672	1,672
Gross carrying amount	**6,707**	**230**	**2,556**	**9,493**
Credit loss allowance	**(13)**	**(1)**	**(1,588)**	**(1,602)**
Carrying amount	**6,694**	**229**	**968**	**7,891**

Analysis by credit quality of loans outstanding at 31 December 2017 is as follows:

	Corporate lending	Small business lending	Consumer lending	Residential mortgages	Total
Total neither past due nor impaired	**27,268**	**3,915**	**33,306**	**5,943**	**70,432**
Standard grade	25,657	3,435	32,625	5,823	67,540
Sub-standard grade	1,611	480	681	120	2,892
Past due but not impaired:					
less than 30 days overdue	3,637	2,740	2,431	417	9,225
30 to 90 days overdue	446	702	854	79	2,081
Total past due but not impaired	**4,083**	**3,442**	**3,285**	**496**	**11,306**
Loans individually determined to be impaired (gross):					
less than 30 days overdue	12,577	711	116	–	13,404
30 to 90 days overdue	6,284	2,579	74	734	9,671
91 to 180 days overdue	3,186	1,471	520	234	5,411
181 to 360 days overdue	33	105	927	203	1,268
over 360 days overdue	20,306	9,551	13,959	1,294	45,110
Total individually impaired loans (gross)	**42,386**	**14,417**	**15,596**	**2,465**	**74,864**
Less impairment provisions	(19,010)	(8,000)	(9,763)	(1,275)	(38,048)
Total loans to customers (net)	**54,727**	**13,774**	**42,424**	**7,629**	**118,554**

Impairment assessment. The main considerations for the loan impairment assessment are based on the information provided by the roll-rate model, which measures the movement of the past due amounts balances in various time brackets. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances. The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, the timing of the expected cash flows and expected recoverability of unsecured portion based on management estimates. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances. Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review. The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the roll-rate model assessment. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

The Bank applied the portfolio provisioning methodology prescribed by IAS 39, Financial Instruments: Recognition and Measurement, and created portfolio provisions for impairment losses that were incurred, but have not been specifically identified with any individual loan, by the end of the reporting period. The Bank's policy is to classify each loan as 'neither past due nor impaired' until specific objective evidence of impairment of the loan is identified. The impairment provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realis ability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are individually determined to be impaired.

Past due, but not impaired loans primarily include collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due but not impaired is the whole balance of such loans, not only the individual instalments that are past due.

The financial effect of collateral is presented by disclosing collateral values separately for (i) those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset ("over-collateralised assets") and (ii) those assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets").

The effect of collateral at 31 December 2018:

	Over-collateralized assets		**Under-collateralized assets**	
	Carrying value of the assets	**Fair value of collateral**	**Carrying value of the assets**	**Fair value of collateral**
Corporate lending	56,836	142,256	50,022	21,507
Small business lending	8,486	16,448	10,961	4,617
Consumer lending	1,745	7,015	53,842	1,766
Residential mortgages	8,292	17,051	1,201	791

The effect of collateral at 31 December 2017:

	Over-collateralised assets		**Under-collateralised assets**	
	Carrying value of the assets	**Fair value of collateral**	**Carrying value of the assets**	**Fair value of collateral**
Corporate lending	43,714	115,527	30,023	17,790
Small business lending	11,870	29,521	9,904	5,700
Consumer lending	2,252	8,850	49,935	753
Residential mortgages	7,801	16,815	1,103	801

(Amounts expressed in thousands of Azerbaijani Manats)

9 Loans to Customers (Continued)

Individually impaired loans

As at 31 December 2018, loans in the amount of AZN 66,668 (2017: AZN 74,864) were assessed individually. An individual impairment allowance of AZN 33,698 (2017: AZN 29,223) were recognized for such loans.

In accordance with the CBAR requirements, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the Court.

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- for corporate lending – charges over real estate and trade receivables, third party guarantees;
- for consumer lending – cash, charges over credited consumer appliances and mortgages over residential properties;
- for auto lending – cash and liens over vehicles.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

Concentration of loans to customers

As of 31 December 2018, the Bank had a concentration of loans represented by AZN 45,904 or 24% of gross loan portfolio (2017: AZN 36,090 or 23%) due from the ten (2017: ten) largest third party borrowers.

Loans have been extended to the following types of customers (amounts are presented prior to allowance):

	2018	2017
Private companies	106,858	73,737
Individuals	84,527	82,865
Gross loans to customers	**191,385**	**156,602**

Loans are provided within Azerbaijan in the following industry sectors (amounts are presented prior to allowance):

	2018	2017
Individuals	84,527	82,865
Trading enterprises	64,881	38,471
Real estate construction	23,366	11,380
Manufacturing	18,611	23,886
Gross loans to customers	**191,385**	**156,602**

Refer to Note 23 for the estimated fair value of each class of loans and to customers. Maturity analysis of loans to customers is disclosed in Note 22 . Information on related party balances is disclosed in Note 24 .

(Amounts expressed in thousands of Azerbaijani Manats)

10 Notes Issued by Central Bank of the Republic of Azerbaijan (CBAR) and Other Bonds Issued

	2018	2017
Notes issued by the Central Bank of the Republic of Azerbaijan (CBAR)	34,706	32,618
Bonds issued by the Ministry of Finance of Azerbaijan Republic	10,699	–
Corporate unquoted shares (4.76% ownership interest at Baku Stock Exchange)	60	60
Less credit loss allowance	(239)	-
Total	**45,226**	**32,678**

As of 31 December 2018 all Notes issued by the Central Bank of the Republic of Azerbaijan (CBAR) and Other Bonds Issued were classified as Stage 1.

Nominal interest rates and maturities of debt securities are as follows:

	2018		2017	
	Annual interest rate	**Maturity**	**Annual interest rate**	**Maturity**
Notes issued by the CBAR	7.8%-8.3%	Jan'19	10.01%-14.98%	Jan'18
Bonds issued by the Ministry of Finance of Azerbaijan Republic	7.5%-8.8%	Feb'19-Mar"21	-	-

Notes from CBAR has original maturity of 28 days and as per Bank policy represents cash and cash equivalents. Notes from CBAR are neither past due nor impaired.

Bonds from the Ministry of Finance of Azerbaijan Republic has original maturity of 364 days and 1,092 days. Bonds from Ministry of Finance are neither past due nor impaired.

All security portfolio are measured at amortised cost.

Refer to Note 23 for the estimated fair value of notes issued by Central Bank of the Republic of Azerbaijan and other bonds issued.

(Amounts expressed in thousands of Azerbaijani Manats)

11 Property and Equipment

The movements in intangible assets were as follows:

	Leasehold improvements	Computers and office equipment	Furniture and fixtures	Motor vehicles	Total
Cost					
31 December 2017	**8,722**	**12,111**	**1,948**	**127**	**22,908**
Additions	48	957	61	0	1,066
Disposals	-	(1)	(24)	(17)	(42)
Transfers	-	-	-	–	0
31 December 2018	**8,770**	**13,067**	**1,985**	**110**	**23,932**
Accumulated depreciation					
31 December 2017	**(5,830)**	**(10,035)**	**(1,720)**	**(113)**	**(17,698)**
Depreciation charge	(827)	(786)	(72)	(5)	**(1,690)**
Disposals	–	1	11	17	**29**
Transfers	–	-	-	–	**0**
31 December 2018	**(6,657)**	**(10,820)**	**(1,781)**	**(101)**	**(19,359)**
Net book value					
31 December 2017	**2,892**	**2,076**	**228**	**14**	**5,210**
31 December 2018	**2,113**	**2,247**	**204**	**9**	**4,573**

	Leasehold improvements	Computers and office equipment	Furniture and fixtures	Motor vehicles	Total
Cost					
31 December 2016	**10,665**	**9,718**	**3,169**	**125**	**23,677**
Additions	45	1,422	75	2	1,544
Disposals	(1,952)	(276)	(85)	–	(2,313)
Transfers	(36)	1,247	(1,211)	–	–
31 December 2017	**8,722**	**12,111**	**1,948**	**127**	**22,908**
Accumulated depreciation					
31 December 2016	**(5,955)**	**(7,761)**	**(2,594)**	**(107)**	**(16,417)**
Depreciation charge	(1,235)	(1,581)	(150)	(6)	(2,972)
Disposals	1,360	271	60	–	1,691
Transfers	–	(964)	964	–	–
31 December 2017	**(5,830)**	**(10,035)**	**(1,720)**	**(113)**	**(17,698)**
Net book value					
31 December 2016	**4,710**	**1,957**	**575**	**18**	**7,260**
31 December 2017	**2,892**	**2,076**	**228**	**14**	**5,210**

As at 31 December 2018 gross carrying amount of fully depreciated property and equipment was AZN 10,693 (2017: AZN 8,725).

(Amounts expressed in thousands of Azerbaijani Manats)

12 Intangible Assets

The movements in intangible assets were as follows:

	Licenses	Computer software	Total
Cost			
31 December 2017	**8,485**	**8,929**	**17,414**
Additions	1,083	1,283	2,366
31 December 2018	**9,568**	**10,212**	**19,780**
Accumulated amortization			
31 December 2017	**(6,933)**	**(2,529)**	**(9,462)**
Amortization charge	(1,403)	(975)	(2,378)
31 December 2018	**(8,336)**	**(3,504)**	**(11,840)**
Net book value			
31 December 2017	**1,552**	**6,400**	**7,952**
31 December 2018	**1,232**	**6,708**	**7,940**

	Licenses	Computer software	Total
Cost			
31 December 2016	**7,493**	**8,048**	**15,541**
Additions	992	881	1,873
31 December 2017	**8,485**	**8,929**	**17,414**
Accumulated amortization			
31 December 2016	**(5,767)**	**(1,841)**	**(7,608)**
Amortization charge	(1,166)	(688)	(1,854)
31 December 2017	**(6,933)**	**(2,529)**	**(9,462)**
Net book value			
31 December 2016	**1,726**	**6,207**	**7,933**
31 December 2017	**1,552**	**6,400**	**7,952**

As at 31 December 2018 gross carrying amount of fully amortized intangible assets was AZN 7,646 (2017: AZN 6,191).

(Amounts expressed in thousands of Azerbaijani Manats)

13 Income Taxes

The corporate income tax expense comprises:

	2018	2017
Current tax charge	(1,896)	(1,964)
Deferred income tax credit for the year	(225)	707
Income tax expense	**(2,121)**	**(1,257)**

Standard corporate income tax rate for companies (including banks) comprised 20% for 2018 and 2017. The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2018	2017
Profit before income tax expense	**8,075**	**8,850**
Statutory tax rate	20%	20%
Income tax expense at the statutory rate	(1,615)	(1,770)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Utilization of previously unrecognized tax loss carry forwards	-	1,427
Impact of Non-deductible expenses	(506)	(914)
Income tax expense	**(2,121)**	**(1,257)**

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

	2016	Recognized in the statement of profit or loss and other comprehensive income	2017	Recognized in retained earnings (Adoption of IFRS 9)	Recognized in the statement of profit or loss and other comprehensive income	2018
Tax effect of temporary differences						
Cash and cash equivalents	-	-	-	227	-	227
Amounts due from credit institutions	(291)	-	(291)	-	-	(291)
Loans to customers	(3,218)	390	(2,828)	203	(363)	(2,988)
Property and equipment	146	139	285	-	37	322
Intangible assets	(59)	-	(59)	-	-	(59)
Other liabilities	537	73	610	-	(91)	519
Other assets	(192)	105	(87)	20	192	125
Deferred tax liability	**(3,077)**	**707**	**(2,370)**	**450**	**(225)**	**(2,145)**

(Amounts expressed in thousands of Azerbaijani Manats)

14 Other Assets and Liabilities

Other assets comprise:

	2018	2017
Amounts in the course of settlement	2,957	3,163
Other financial assets	**2,957**	**3,163**
Repossessed collateral	2,803	2,617
Prepayments	2,011	2,204
Other	22	9
Other non-financial assets	**4,836**	**4,830**
Other assets	**7,793**	**7,993**

As at 31 December 2018, prepayments of AZN 2,011 (2017: AZN 2,204) primarily comprise of advance payments for purchase of property and equipment, advertisement, insurance and rent services.

Other liabilities comprise:

	2018	2017
Settlements on plastic cards	3,057	2,252
Other	122	448
Other financial liabilities	**3,179**	**2,700**
Accrued employee costs	1,168	1,596
Payables to social funds	613	557
Deferred income	519	401
Provisions	356	243
Other	258	434
Other non-financial liabilities	**2,914**	**3,231**
Other liabilities	**6,093**	**5,931**

Accrued employee costs include bonuses for employees based on the financial performance of the Bank of AZN 458 (2017: AZN 865) and an accrual for unused vacations of AZN 710 (2017: AZN 731).

As at 31 December 2018 and 2017, deferred income represents deferred revenue which was primarily comprised of fee received for issuance of plastic cards, guarantees and letter of credits.

Analysis by credit quality of other financial assets outstanding at 31 December 2018 is as follows:

Settlements on money transfers	**2018**	**2017**
Neither past due nor impaired		
Other financial assets		
Standard grade	2,957	3,163
Total other financial assets	**2,957**	**3,163**

(Amounts expressed in thousands of Azerbaijani Manats)

15 Amounts Due to Credit Institutions

Amounts due to credit institutions comprise:

	2018	2017
Amounts due to Azerbaijan Mortgage Fund	4,558	3,803
Amounts due to the National Fund for Entrepreneurship Support	2,200	–
Demand deposits	512	514
Amounts due to credit institutions	**7,270**	**4,317**

As at 31 December 2018, the Bank had loans financed by the Azerbaijan Mortgage Fund and National Fund for Entrepreneurship Support amounting to AZN 4,558 (2017: AZN 3,803) and AZN 2,200 (2017: nil) maturing in 2048 (2017: 2047) and 2023, with the annual interest rates of 1-4% p.a. (2017: 1-4% p.a.) and 1% p.a., respectively.

16 Amounts Due to Customers

The amounts due to customers include the following:

	2018	2017
Current accounts	235,334	247,276
Time deposits	99,716	95,861
Amounts due to customers	**335,050**	**343,137**

As at 31 December 2018, amounts due to customers of AZN 136,650 or 41% (2017: AZN 133,950 or 39%) of total amounts due to customers were due to ten (2017: ten) largest customers.

The average annual interest rate on term deposits of individual customers outstanding at 31 December 2018 comprised 2.73% (2017: 5.38%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2018 was 2.16% (2017: 4.80%).

Amounts due to customers include accounts with the following types of customers:

	2018	2017
Private enterprises	227,960	226,283
Individuals	106,931	116,825
Public organizations	159	29
Amounts due to customers	**335,050**	**343,137**

An analysis of customer accounts by economic sector follows:

	2018	2017
Trade	181,521	182,742
Individuals	106,931	116,825
Real estate constructions	18,901	17,958
Insurance and other financial institutions	14,221	14,705
Transport and communication	11,304	9,140
State and public organizations	2,172	1,767
Amounts due to customers	**335,050**	**343,137**

(Amounts expressed in thousands of Azerbaijani Manats)

16 Amounts Due to Customers (Continued)

Refer to Note 23 for the disclosure of the fair value of each class of customer accounts. Information on related party balances is disclosed in Note 24 .

17 Share Capital

As at 31 December 2018 number of ordinary shares are 2,769,035,194 (2017: 2,769,035,194). All ordinary shares have a nominal value of 0.02 per share denominated in Azerbaijani Manats and rank equally. Each share carries one vote.

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

At 31 December 2018 and 2017, the share capital of the Bank was, as follows:

	Number of outstanding ordinary shares	Total nominal value of paid-in and registered ordinary shares
31 December 2016	**2,340,535,194**	**46,811**
New shares issued	428,500,000	8,570
31 December 2017	**2,769,035,194**	**55,381**
New shares issued	-	-
31 December 2018	**2,769,035,194**	**55,381**

Based on the resolution of the shareholders of the Bank dated 18 April 2017, it was decided to increase the share capital amounting to USD 5,000 (AZN 8,501).

On 30 May 2017, the State Committee for Securities of the Republic of Azerbaijan registered the issue of 428,500,000 additional shares each with a nominal value of AZN 0.02 to increase the share capital of the Bank to AZN 55,381 and approved the emission on 18 September 2017. These additional shares had been fully paid-in on 5 April 2017.

18 Commitments and Contingencies

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

Tax contingencies. Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review.

Management believes that as at 31 December 2018 its interpretation of the relevant legislation is appropriate and that the Bank's tax and social contribution position will be sustained.

Insurance. The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

(Amounts expressed in thousands of Azerbaijani Manats)

18 Commitments and Contingencies (Continued)

Compliance with Financial Markets Supervisory Authority ("FIMSA") ratios. FIMSA requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2018, the Bank was in compliance with these ratios which of maximum credit exposure per a single borrower or a group of related borrowers ratio that should not exceed 7 percent of the bank's Tier 1 capital when the market value of the security of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is not below 150% of the loan value and maximum credit exposure per a single borrower or a group of related borrowers ratio that should not exceed 20 percent of the bank's Tier 1 capital when the market value of the security of credit exposures is no less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is not below 150% of the loan value. As at 31 December 2018, the Bank's ratios were 19.62% and 6.94% respectively (31 December 2017: 16.08% and 18.72% respectively).

As of 31 March 2019 the Bank was in breach of covenant set for the maximum credit exposure per a single borrower or a group of related borrowers ratio that should not exceed 20 percent of credit requirement of non-resident bank with minimum investment rating given by bank operating in the Republic of Azerbaijan, as well as international rating agencies (taken as percentage), and actual ratio was amounted to 23.07 percent. Subsequent to the year-end the Bank submitted information to the FIMSA regarding this breach on a monthly basis. Management believes that the Bank will not face any sanctions against the Bank due to this breach in the future and the breach will be mitigated by the end of May 2019.

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

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

	2018	2017
Credit related commitments		
Undrawn loan commitments	73,939	85,914
Guarantees issued	21,666	24,928
Letters of credit	7,489	8,632
Total	**103,094**	**119,474**
Operating lease commitments		
Not later than 1 year	2,067	1,842
Later than 1 year but not later than 5 years	3,577	3,816
Later than 5 years	2,067	2,924
Total	**7,711**	**8,582**
Commitments and contingencies (before deducting collateral)	**110,805**	**128,056**
Less – cash held as security against guarantees	(881)	(523)
Commitments and contingencies	**109,924**	**127,533**

Most of the outstanding guarantee letters as at 31 December 2018 and 2017 represent guarantees issued to clients for the letters' performance on delivering goods and services, and tender guarantees issued to clients as a pledge of their intent to participate in a bidding tender, announced by various institutions.

(Amounts expressed in thousands of Azerbaijani Manats)

19 Net Fee and Commission Income

Net fee and commission income comprises:

	2018	2017
Plastic card operations	4,628	4,807
Settlements operations	3,709	3,933
Cash operations	1,455	1,472
Guarantees and letters of credit	800	721
Agent activities	266	178
Other	36	85
Fee and commission income	**10,894**	**11,196**
Plastic card operations	(3,658)	(3,440)
Settlements operations	(1,425)	(1,699)
Agent activities	(234)	(127)
Guarantees and letters of credit	(16)	(9)
Cash operations	-	(6)
Other	(320)	(296)
Fee and commission expense	**(5,653)**	**(5,577)**
Net fee and commission income	**5,241**	**5,619**

20 Personnel Expenses

	2018	2017
Salaries and bonuses	(7,395)	(8,563)
Social security costs	(1,457)	(1,780)
Other employee benefits	(935)	(1,497)
Personnel expenses	**(9,787)**	**(11,840)**

21 General and Administrative Expenses

	2018	2017
Occupancy and rent	(2,569)	(2,928)
Support expenses	(1,723)	(1,641)
Communications	(961)	(1,022)
Legal and consultancy	(882)	(779)
Security	(758)	(722)
Repairs and Maintenance	(763)	(664)
Marketing and advertising	(640)	(728)
Membership	(362)	(238)
Utilities	(300)	(331)
Fines, penalties, and forfeits	(276)	-
Entertainment	(115)	(144)
Office supplies	(114)	(116)
Insurance	(83)	(96)
Operating taxes other than income tax	(79)	(77)
Business travel	(49)	(56)
Losses on disposal of fixed assets and intangible assets	(13)	(622)
Other expenses	(630)	(854)
General and administrative expenses	**(10,317)**	**(11,018)**

22 Financial Risk Management

Risk is inherent in the Bank's activities and managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's sustainability and profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk, market risk and operating risks.

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

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

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

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

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

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

Risk Controlling Unit. The Risk Controlling Unit is responsible for monitoring compliance with risk principles, policies and limits, across the Bank. Each business group has a decentralized unit which is responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems.

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

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

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

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

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. On a regular basis detailed reporting of industry and customer risks takes place.

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

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

22 Financial Risk Management (Continued)

Credit risk. The Bank exposes itself to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to meet an obligation.

Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties, giving rise to financial assets and off-balance sheet credit-related commitments.

The Bank's maximum exposure to credit risk is reflected in the carrying amounts of financial assets in the statement of financial position. For financial guarantees issued, commitments to extend credit, undrawn credit lines and export/import letters of credit, the maximum exposure to credit risk is the amount of the commitment.

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

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

Credit quality per class of financial assets. The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Bank's credit rating system.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating at initiation. The Bank actively uses collateral to reduce its credit risks.

Expected credit loss (ECL) is a probability-weighted estimate of the present value of future cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of default occurring in a given time period used as weights). An ECL measurement is unbiased and is determined by adjusting risk of default to the expectations on development of macroeconomic situation in future. ECL measurement is based on four components used by the Bank: Probability of Default ("PD"), Exposure at Default ("EAD"), Loss Given Default ("LGD") and Discount Rate.

Default definition. The Bank defines default as a situation when the exposure meets one or more of the following criteria:

- The loan was 90+ days overdue at any point within the considered time horizon

Expected credit losses are modelled over instrument's *lifetime period*. The *lifetime period* is equal to the remaining contractual period to maturity of debt instruments, adjusted for expected prepayments, if any. For loan commitments and financial guarantee contracts, it is the contractual period over which an entity has a present contractual obligation to extend credit. As a matter of exception from determining the lifetime exposure based on contractual maturity, for credit cards issued to individuals, the lifetime exposure is measured over a period that is based on expected life of the credit card contracts, based on internal statistics, and it is equal on average to 1 to 5 years.

Management models *Lifetime ECL,* that is, losses that result from all possible default events over the remaining lifetime period of the financial instrument. The *12-month ECL,* represents a portion of lifetime ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting period, or remaining *lifetime period* of the financial instrument if it is less than a year.

The Bank has three approaches for ECL measurement: (i) assessment on an individual basis; (ii) assessment on a portfolio basis: internal ratings are estimated on an individual basis but the same credit risk parameters (e.g. PD, LGD) will be applied during the process of ECL calculations for the same credit

22 Risk Management (Continued)

risk ratings and homogeneous segments of the loan portfolio; and (iii) assessment based on external ratings

The level of ECL that is recognised in these financial statements depends on whether the credit risk of the borrower has increased significantly since initial recognition. This is a three-stage model for ECL measurement. A financial instrument that is not credit-impaired on initial recognition and its credit risk has not increased significantly since initial recognition has a credit loss allowance based on 12-month ECLs (Stage 1). If a SICR since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired and the loss allowance is based on lifetime ECLs. If a financial instrument is credit-impaired, the financial instrument is moved to Stage 3 and loss allowance is based on lifetime ECLs. The consequence of an asset being in Stage 3 is that the entity ceases to recognise interest income based on gross carrying value and applies the asset's effective interest rate to the carrying amount, net of ECL, when calculating interest income.

If there is evidence that the SICR criteria are no longer met, the instrument is transferred back to Stage 1. If an exposure has been transferred to Stage 2 based on a qualitative indicator, the Bank monitors whether that indicator continues to exist or has changed.

Leaving default status depends on which defaulted triggers exposure experienced during its default. Number of scenarios can be limited to two:

- if exposure experienced only more than 90 days past due then it's no longer considered as default when it reaches 30 days delinquency;
- if exposure experienced also other default triggers then it leaves default status when it no longer meets any of the default criteria for a consecutive period of twelve months;

This logic has been determined based on an analysis that considers the likelihood of a financial instrument returning to default status after curing by using different possible definitions of cures

ECL measurement for financial guarantees and loan commitments. The ECL measurement for these instruments includes the same steps as described above for on-balance sheet exposures and differs with respect to EAD calculation. The EAD is a product of credit conversion factor ("CCF") and amount of the commitment ("$ExOff$"). CCF for undrawn credit lines of corporate customers, credit cards issued to individuals and for financial guarantees is defined based on statistical analysis of past exposures at default. CCF for overdrafts is defined as 100% since the limits can be used by the customers at any time.

Internal ratings. For purpose of PD modelling were created simplified behavioural scoring models that were developed to differentiate the risk profile of an individual exposure.

Credit scoring is an instrument widely used by companies for the internal processes of portfolio risk measurement and management. Scoring can be defined in general as a statistical technique to predict, at a specific point in time with the available information, the probability of a future event. More specifically it allows banks to estimate the probability of default of a person requesting credit (then application scoring model is usually used) or a customer already in the portfolio (behavioural scoring model).

The main assumption for scoring model development is that the past behaviour is a good predictor for the future, thus models are developed based on historical data. In particular, behavioural models are leveraging the information regarding past delinquency, historical credit utilization, history of payments or collection actions. In practice, credit scoring results in the definition of a table listing the characteristics that provide the most predictive information together with the associated attributes and weightings. A total score is obtained as the sum of the points for each characteristic.
Credit granting authorization levels are also determined in accordance with the rating of Corporate, Commercial and SME customers. By using this methodology; it is aimed to establish risk based optimization of credit processes through assigning the lower rated customer to higher authority levels whereas assigning higher rated customer to lower authority levels.

(Amounts expressed in thousands of Azerbaijani Manats)

22 Risk Management (Continued)

The Bank takes following criterias into consideration for the identification of default:

- The loan is overdue more than 90 days.
- The borrower is not able to pay at least one of the loans he received from the Bank (cross default)
- Having a negative intelligence and bad-record for the borrower in the market.
- Deterioration of the creditworthiness of the borrower

Ratings, which were created base on score values, gather exposures with similar risk profile. Therefore PDs are estimated on homogenies risk groups (i.e. per segment and rating).

External ratings. External ratings are assigned to counterparties by independent international rating agencies, such as S&P, Moody's and Fitch. These ratings are publicly available. Such ratings and the corresponding range of PD are applied for the following financial instruments: amounts due from the CBAR, balances on correspondent accounts including overnight deposits and deposits.

Master scale credit risk grade	Corresponding ratings of external international rating agencies (S&P)	Corresponding PD interval
Excellent	AAA to BB+	0,01% - 0,5%
Good	BB to B+	0,51% - 3%
Satisfactory	B, B-	3% - 10%
Special monitoring	CCC+ to CC-	10% - 99,9%
Default	C, D-I, D-II	100%

Each master scale credit risk grade is assigned a specific degree of creditworthiness:

- *Excellent* – strong credit quality with low expected credit risk;
- *Good* – adequate credit quality with a moderate credit risk;e
- *Satisfactory* – moderate credit quality with a satisfactory credit risk;
- *Special monitoring* – facilities that require closer monitoring and remedial management; and
- *Default* – facilities in which a default has occurred.

External ratings are assigned to counterparties by independent international rating agencies, such as S&P, Moody's and Fitch. These ratings are publicly available.

Probability of default (PD). PD is an estimate of the likelihood of default to occur over a given time period. For every exposure is estimated lifetime PD curve which is dependant from time, credit risk rating and segment. 12-month PD is calculated as part of lifetime PD curve. The Bank uses different statistical approaches depending on the segment and product type to calculated lifetime PDs, such as Bayesian Scalar approach, Weibull and Adjusted Weibull distribution.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for supportable forward-looking information when appropriate. Lifetime PDs represent the estimated probability of a default occurring over the remaining life of the financial instrument and it is a sum of the 12 months PDs over the life of the instrument. The Bank uses different statistical approaches depending on the segment and product type to calculated lifetime PDs, such as the extrapolation of 12-month PDs based on migration matrixes, developing lifetime PD curves based on the historical default data, hazard rate approach or other.

Macro-economic factors. Internal bank forecasts provide the best estimate of the expected macro-economic development over the next 3 years. After 3 years, no macro economic impact is used. The impact of the relevant economic variables on the PD has been determined by performing statistical regression analysis to understand the impact that the changes in these variables historically had on the

22 Risk Management (Continued)

default rates.

As with any economic forecast, the projections are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes.

Loss given default (LGD). LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive. It is usually expressed as a percentage of the gross book value. The expected losses are discounted to present value at the end of the reporting period.

LGD varies by the type of counterparty and product type. The LGDs are determined based on the factors that impact the expected recoveries after a default event. The calculation of LGD is based on recovery statistics.

LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by the type of counterparty, type and seniority of the claim, and the availability of collateral or other credit support.

The 12-month and lifetime LGDs are determined based on the factors that impact the expected recoveries after a default event. The approach to LGD measurement can be divided into three possible approaches:

- measurement of LGD based on the specific characteristics of the collateral;
- calculation of LGD on a portfolio basis based on recovery statistics; or
- individually defined LGD depending on different factors and scenarios.

The Bank calculates LGD based on specific characteristics of the collateral, such as projected collateral values, historical discounts on sales and other factors for loans secured by real estate, cash and liquid securities. LGD is calculated on a collective basis based on the latest available recovery statistics for the remainder of the corporate loan portfolio and for retail secured and unsecured products.

Exposure at default (EAD). EAD is an estimate of exposure at a future default date, taking into account expected changes in the exposure after the reporting period, including repayments of principal and interest, and expected drawdowns on committed facilities.

For revolving products EAD is estimated using Credit Conversion Factor ("CCF"). CCF is a coefficient that shows the probability of conversion of the off-balance amounts to an on-balance sheet exposure within a defined period. CCF for financial guarantees is defined based on globally accepted Basel 3 standard.

The EADs are determined based on the expected payment profile that varies by product type. EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis for amortising products and bullet repayment loans. This will also be adjusted for any expected overpayments made by a borrower. Early repayment or refinancing assumptions are also incorporated into the calculation. For revolving products, the EAD is predicted by taking the current drawn balance and adding a "credit conversion factor" that accounts for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type, current limit utilisation and other borrower-specific behavioural characteristics.

Staging

The level of ECL that is recognised in these financial statements depends on which stage was assigned to exposure from a three stage model. A financial instrument that is not credit-impaired on initial recognition and its credit risk has not deteriorated significantly since initial recognition has a credit loss allowance based on 12-month ECLs (Stage 1). If a stage 2 since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired and the loss allowance is based on lifetime ECLs. If a financial instrument is credit-impaired, the financial instrument is moved to Stage 3 and loss allowance is based on lifetime ECLs. The consequence of an asset being in Stage 3 is that the entity ceases to recognise interest income based on gross carrying value and applies the asset's nominal interest rate to the carrying amount, net of ECL, when calculating interest income.

22 Risk Management (Continued)

- *Significant deterioration in credit risk (Stage 2)*

The assessment whether or not there has been a significant deterioration in credit risk (stage 2) since initial recognition is performed on whole portfolio. The criteria used to identify stage 2 are monitored and reviewed periodically for appropriateness by the Bank's Risk Management Department. The presumption, being that there have been significant deterioration in credit risk since initial recognition when financial assets are more than 30 days past due, has not been rebutted.

The Bank considers a financial instrument to have experienced a stage 2 when one or more of the following quantitative, qualitative or backstop criteria have been met:

- 31-90 days overdue
- Restructured overdue loans
- Clients with specific monitoring status
- Any other relevant management information on financial situation deterioration on the customer.

If there is evidence that the stage 2 criteria are no longer met, the instrument is transferred back to Stage 1. If an exposure has been transferred to Stage 2 based on a qualitative indicator, the Bank monitors whether that indicator continues to apply or it is no longer valid.

Forward-looking information incorporated in the ECL models. The assessment of SICR and the calculation of ECLs both incorporate supportable forward-looking information. The Bank identified certain key economic variables that correlate with developments in credit risk and ECLs. Forecasts of economic variables (the "base economic scenario") are provided by the Bank's and provide the best estimate of the expected macro-economic development over the next three years. The impact of the relevant economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact that the changes in these variables historically had on the default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Bank's Risk Department also provides other possible scenarios along with scenario weightings. The number of other scenarios used is set based on the analysis of each major product type to ensure that non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking into account the range of possible outcomes of which each chosen scenario is representative. The assessment of SICR is performed using the Lifetime PD under each of the bases and the other scenarios, multiplied by the associated scenario weighting, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether a 12-month or lifetime ECL should be recorded. Following this assessment, the Bank measures ECL as either a probability-weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecast, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Bank's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

The Bank regularly reviews its methodology and assumptions to reduce any difference between the estimates and the actual loss of credit. Such backtesting is performed at least once a year.

The results of backtesting the ECL measurement methodology are communicated to Bank Management and further steps for tuning models and assumptions are defined after discussions between authorised persons.

(Amounts expressed in thousands of Azerbaijani Manats)

22 Risk Management (Continued)

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

	2018				2017			
	Azerbaijan	**OECD**	**CIS and other foreign countries**	**Total**	**Azerbaijan**	**OECD**	**CIS and other foreign countries**	**Total**
Assets								
Cash and cash equivalents	83,833	79,384	215	**163,432**	111,193	152,482	20	**263,695**
Amounts due from credit institutions	2,807	42,579	16,644	**62,030**	2,380	–	–	**2,380**
Loans to customers	144,831	–	–	**144,831**	118,554	–	–	**118,554**
Notes issued by CBAR and other bonds issued	45,226	–	–	**45,226**	32,678	–	–	**32,678**
Other financial assets	2,957	–	–	**2,957**	3,163	–	–	**3,163**
Total	**279,654**	**121,963**	**16,859**	**418,476**	**267,968**	**152,482**	**20**	**420,470**
Liabilities								
Amounts due to credit institutions	7,237	–	33	**7,270**	4,284	–	33	**4,317**
Amounts due to customers	335,050	–	–	**335,050**	343,137	–	–	**343,137**
Other financial liabilities	3,179	–	–	**3,179**	2,700	–	–	**2,700**
	345,466	**-**	**33**	**345,499**	**350,121**	**–**	**33**	**350,154**
Net assets/(liabilities)	**(65,812)**	**121,963**	**16,826**	**72,977**	**(82,153)**	**152,482**	**(13)**	**70,316**

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has developed a sophisticated system for comprehensive assessment of expected cash flows. The methodology of the liquidity management tools and reports is approved by the Supervisory Board of the Bank, prepared by the Assets and Liabilities Management department and reviewed on the monthly basis by Asset Liabilities Committee.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. Additionally, the Bank maintains obligatory reserve with the CBAR and utilizes a highly effective cash management system across all its branches, ATMs and balances of the correspondent accounts.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on minimum liquidity ratio of 30% established by the CBAR. As at 31 December, these ratios were as follows:

	2018	**2017**
Instant Liquidity Ratio	45.27%	47.11%

Analysis of financial liabilities by remaining contractual maturities. The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subjected to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

(Amounts expressed in thousands of Azerbaijani Manats)

22 Risk Management (Continued)

As at 31 December 2018	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	550	210	3,677	5,441	**9,878**
Amounts due to customers	393,308	32,439	10,729	–	**436,476**
Other financial liabilities	3,179	–	–	–	**3,179**
Total undiscounted financial liabilities	**397,037**	**32,649**	**14,406**	**5,441**	**449,533**

As at 31 December 2017	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
Financial liabilities					
Amounts due to credit institutions	547	184	1,152	4,398	6,281
Amounts due to customers	286,078	48,819	11,195	–	346,092
Other financial liabilities	2,700	–	–	–	2,700
Total undiscounted financial liabilities	**289,325**	**49,003**	**12,347**	**4,398**	**355,073**

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

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
2018	12,624	16,656	56,221	17,593	**103,094**
2017	13,390	26,669	69,275	10,140	**119,474**

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

The Bank's capability to repay its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time.

The Bank does not receive any significant funds from any one organization or private individual.

Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 16 .

The Bank does not use the above maturity analysis based on undiscounted contractual maturities of liabilities to manage liquidity. Instead, the Bank monitors expected maturities and the resulting expected liquidity gap as follows:

(Amounts expressed in thousands of Azerbaijani Manats)

22 Risk Management (Continued)

The maturity analysis of financial instruments at 31 December 2018 is as follows:

	Less than 3 months	3 to 12 months	1 to 5 years	Over 5 years	Total
At 31 December 2018					
Financial assets	286,830	78,809	45,382	4,498	415,519
Financial liabilities	296,796	32,011	11,281	8,326	348,414
Net liquidity gap based on expected maturities	**(9,966)**	**46,798**	**34,101**	**(3,828)**	**67,105**
At 31 December 2017					
Financial assets	340,621	38,132	34,861	3,693	417,307
Financial liabilities	309,192	30,620	10,279	3,294	353,385
Net liquidity gap based on expected maturities	**31,428**	**7,512**	**24,582**	**399**	**63,922**

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

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

As at 31 December 2018 and 2017, the Bank did not have any instruments with floating interest rates.

Currency risk. Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

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

Currency	Increase in currency rate in % 2018	Effect on profit before tax 2018	Increase in currency rate in % 2017	Effect on profit before tax 2017
USD	0.00	-	8.43	1,630
EUR	5.06	40	11.13	(39)

Currency	Decrease in currency rate in % 2018	Effect on profit before tax 2018	Decrease in currency rate in % 2017	Effect on profit before tax 2017
USD	(0.01)	(1)	(3.99)	(772)
EUR	(5.86)	(47)	(3.30)	12

(Amounts expressed in thousands of Azerbaijani Manats)

22 Risk Management (Continued)

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

23 Fair Values of Financial Instruments

	Date of valuation	Fair value measurement using: Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets measured at fair value					
Notes issued by CBAR and other bonds issued	31 December 2018	45,166	-	60	**45,226**
Assets for which fair values are disclosed					
Amounts due from credit institutions	31 December 2018	–	–	62,030	**62,030**
Loans to customers	31 December 2018	–	–	144,831	**144,831**
Liabilities for which fair values are disclosed					
Amounts due to the CBAR	31 December 2018	–	–	–	-
Amounts due to credit institutions	31 December 2018	–	–	7,270	**7,270**
Amounts due to customers	31 December 2018	–	–	335,050	**335,050**

	Date of valuation	Fair value measurement using: Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets measured at fair value					
Notes issued by CBAR and other bonds issued	31 December 2017	32,618	–	60	32,678
Assets for which fair values are disclosed					
Amounts due from credit institutions	31 December 2017	–	–	2,380	2,380
Loans to customers	31 December 2017	–	–	118,554	118,554
Liabilities for which fair values are disclosed					
Amounts due to the CBAR	31 December 2017	–	–	–	–
Amounts due to credit institutions	31 December 2017	–	–	4,317	4,317
Amounts due to customers	31 December 2017	–	–	343,137	343,137

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

(Amounts expressed in thousands of Azerbaijani Manats)

23 Fair Values of Financial Instruments (Continued)

2018	Carrying value	Fair value	Unrecognized gain/(loss)
Financial assets			
Cash and cash equivalents	163,432	163,432	–
Amounts due from credit institutions	62,030	62,030	–
Loans to customers	191,385	191,385	–
Other financial assets	2,957	2,957	–
Financial liabilities			
Amounts due to credit institutions	7,270	7,270	–
Amounts due to customers	335,050	335,050	–
Other financial liabilities	3,179	3,179	–

2017	Carrying value	Fair value	Unrecognized gain/(loss)
Financial assets			
Cash and cash equivalents	263,695	263,695	–
Amounts due from credit institutions	2,380	2,380	–
Loans to customers	156,602	156,602	–
Other financial assets	3,163	3,163	–
Financial liabilities			
Amounts due to credit institutions	4,317	4,317	–
Amounts due to customers	343,137	343,137	–
Other financial liabilities	2,700	2,700	–

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

Financial assets and financial liabilities carried at amortized cost. Fair value of the quoted notes is based on price quotations at the reporting date. The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities. Short term instruments are ignored for this working.

24 Related Party Disclosures

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

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

YKB and KFS directly and indirectly control and have significant influence over a significant number of entities. The Bank enters into banking transactions with these entities including but not limited to lending, deposit taking, cash.

(Amounts expressed in thousands of Azerbaijani Manats)

24 Related Party Disclosures (Continued)

The outstanding balances of related party transactions are as follows:

	2018		2017	
	Parent	Entities under common control	Parent	Entities under common control
Loans outstanding at 1 January, gross	-	**504**	–	–
Loans issued during the year	–	1,464	–	502
Loan repayments during the year	-	(504)	–	–
Other movements	–	2	–	2
Loans outstanding at 31 December, gross	-	**1,466**	–	**504**
Less: allowance for impairment at 31 December	-	(9)	–	(2)
Loans outstanding at 31 December, net	-	**1,457**	–	**502**
Deposits outstanding at 1 January, gross	–	–	–	–
Deposits placed during the year	103,627	5,780	57,803	–
Deposit repayments during the year	(102,290)	–	(57,803)	–
Other movements	418	163	–	–
Translation gain/loss	(78)	–	–	–
Deposits outstanding at 31 December, gross	**1,677**	**5,943**	–	–
Less: allowance for impairment at 31 December	(22)	–	–	–
Deposits outstanding at 31 December, net	**1,655**	**5,943**	–	–
Deposits at 1 January	–	–	–	–
Deposits received during the year	–	–	–	961
Deposits repaid during the year	–	–	–	(961)
Deposits at 31 December	–	–	–	–
Current accounts at 31 December	**1,681**	**6,229**	**144,593**	**85**

Total current accounts with the parent as at December 31,2018 is AZN 1,681 (2017: AZN 144,593). During the year AZN 103,627 (2017: AZN 57,803) of deposit placed with parent carrying 0.32% (2017: 1.15%) and AZN 5,780 (2017: nil) with entities under common control carrying 3.25% interest rate.

	2018		2017	
	Parent	Entities under common control	Parent	Entities under common control
Loans borrowed at 1 January	–	–	–	**36,071**
Loans borrowed during the year	–	–	–	–
Loans repaid during the year	–	–	–	(34,042)
Other movements	–	–	–	(632)
Translation gain/loss	–	–	–	(1,397)
Loans borrowed at 31 December	–	–	–	–

(Amounts expressed in thousands of Azerbaijani Manats)

24 Related Party Disclosures (Continued)

The income and expense arising from related party transactions are as follows:

	2018		2017	
	Parent	**Entities under common control**	**Parent**	**Entities under common control**
Interest income	423	298	780	2
Interest expense	-	(36)	–	(685)
Fee and commission income	-	34	–	27
Fee and commission expense	(112)	(13)	(117)	(18)
General and administrative expenses	(78)	(623)	(138)	(643)

Compensation of key management personnel of 6 members (2017: 5 members) comprised the following:

	2018	2017
Salaries and short term benefits	1,331	1,533
Other accrued employee costs	100	(1)
Total key management personnel compensation	**1,431**	**1,532**

25 Capital Adequacy

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by FIMSA, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. Compliance with capital adequacy ratios set by the FIMSA is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Executive Officer and Chief Accountant. The other objectives of capital management are evaluated annually.

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

The FIMSA requires each bank or banking group to: (a) hold the minimum level of total capital of AZN 50,000 (2017: AZN 50,000); (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the "total capital ratio") at or above the prescribed minimum of 10% (2017: 10%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the "Tier 1 capital ratio") at or above the prescribed minimum of 5% (2017: 5%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2018. The parent company injected additional capital to enable the bank to be complaint with the requirements on Minimum Capital as per regulator during the year 2017.

As at 31 December 2018, the Bank's capital adequacy ratio based on the FIMSA requirements was as follows:

	2018	2017
Tier 1 capital	69,605	59,494
Tier 2 capital	9,071	13,125
Less: deductions from capital	(8,449)	(8,543)
Total regulatory capital	**70,227**	**64,076**
Risk-weighted assets	294,648	312,251
Tier 1 capital adequacy ratio	20.73%	16.30%
Total capital adequacy ratio	23.79%	20.48%

26 Accounting Policies Applicable before 1 January 2018

Accounting policies applicable to the comparative period ended 31 December 2017 that were amended by IFRS 9, are as follows.

Financial instruments – key measurement terms. Depending on their classification financial instruments are carried at fair value or AC as described below. Refer to Note 3 for the definition of fair value and AC as well as for description of valuation techniques.

Loans and advances to customers. Loans and advances to customers were carried at AC and impairment losses were recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which had an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated. If the Bank determined that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it included the asset in a group of financial assets with similar credit risk characteristics, and collectively assessed them for impairment.

The primary factors that the Bank considered in determining whether a financial asset was impaired were its overdue status and realisability of related collateral, if any. The following other principal criteria were also used to determine whether there was objective evidence that a credit loss has occurred:

- any instalment was overdue and the late payment could not be attributed to a delay caused by the settlement systems;
- the borrower experienced a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtained;
- the borrower considered bankruptcy or a financial reorganisation;
- there was an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impacted the borrower; or
- the value of collateral significantly decreased as a result of deteriorating market conditions.

For the purposes of a collective evaluation of credit loss, financial assets were grouped on the basis of similar credit risk characteristics. Those characteristics were relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that were collectively evaluated for credit loss, were estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts would become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience was adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently.

Credit loss was always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which excluded future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflected the cash flows that might result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure was probable.

If the terms of an impaired financial asset held at AC were renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment were measured using the original effective interest rate before the modification of terms. The renegotiated asset were then derecognised and a new asset were recognised at its fair value only if the risks and rewards of the asset substantially changed. This were normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present

26 Accounting Policies Applicable before 1 January 2018 (Continued)

valueof the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the credit loss decreases and the decrease could be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss was reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets were written off against the related credit loss allowance after all the necessary procedures to recover the asset had been completed and the amount of the loss had been determined. Subsequent recoveries of amounts previously written off were credited to credit loss account in profit or loss for the year.

Repurchase and reverse repurchase agreements and securities lending. Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the statement of financial position and, in case the transferee has the right by contract or custom to sell or repledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as amounts due from credit institutions or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

Securities lent to counterparties are retained in the statement of financial position. Securities borrowed are not recorded in the statement of financial position, unless these are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the statement of profit or loss and other comprehensive income. The obligation to return them is recorded at fair value as a trading liability.