“Yapi Kredi Bank Azerbaijan” CJSC

Consolidated financial statements

Year ended 31 December 2016
together with independent auditors’ report

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Independent auditors' report
To the Shareholders and Supervisory Board of Yapi Kredi Bank CJSC
Report on the Audit of the consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Yapi Kredi Bank Azerbaijan CJSC ("the Bank"), which comprise the statement of financial position as of December 31, 2016 and for the year then ended, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of Yapi Kredi Bank Azerbaijan CJSC as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

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

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

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

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

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

Auditors' Responsibilities for the Audit of the consolidated 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 consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated 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.

Grant Thornton

Grant Thornton Azerbaijan
Baku, Azerbaijan
Date: 26 April 2017

Consolidated statement of financial position

As at 31 December 2016

(Thousands of Azerbaijani Manats)

	Notes	*2016*	*2015*
Assets			
Cash and cash equivalents	6	219,972	121,648
Amounts due from credit institutions	7	30,755	82,389
Loans to customers	8	185,126	251,752
Investment securities available-for-sale	9	2,647	60
Current income tax assets		–	1,801
Property and equipment	10	7,260	10,211
Intangible assets	11	7,933	5,817
Other assets	13	6,362	3,969
Total assets		**460,055**	**477,647**
Liabilities			
Amounts due to the CBAR	14	20,023	20,014
Amounts due to credit institutions	15	51,966	123,202
Amounts due to customers	16	314,794	212,860
Debt securities issued	17	–	48,759
Deferred income tax liabilities	12	3,077	1,190
Other liabilities	13	5,359	3,665
Total liabilities		**395,219**	**409,690**
Equity			
Share capital	18	46,811	46,811
Retained earnings		18,025	21,146
Total equity		**64,836**	**67,957**
Total liabilities and equity		**460,055**	**477,647**

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

Cenk Yüksel — Chief Executive Officer / General Director

Khalida Hasanova — Chief of Accounting Control Department

Ramin Saftarov — Chief of Financial Reporting Department

26 April 2017

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2016

(Thousands of Azerbaijani Manats)

	Notes	*2016*	*2015*
Interest income			
Loans to customers		33,154	36,151
Amounts due from credit institutions		173	219
Investment securities		25	11
		33,352	**36,381**
Interest expense			
Amounts due to customers		(5,125)	(5,221)
Amounts due to credit institutions		(4,557)	(4,921)
Debt securities issued		(2,947)	(2,973)
		(12,629)	**(13,115)**
Net interest income		**20,723**	**23,266**
Allowance for loan impairment	8	(20,392)	(10,571)
Net interest income after allowance for loan impairment		**331**	**12,695**
Net fee and commission income	20	6,310	6,570
Net gains/(losses) from foreign currency			
- dealing		17,860	12,710
- translation differences		1,543	(1,188)
Other income		20	15
Non-interest income		**25,733**	**18,107**
Personnel expenses	21	(11,859)	(13,363)
General and administrative expenses	22	(10,661)	(10,759)
Depreciation and amortization	10, 11	(4,777)	(5,800)
Provision of other impairment and reversal / (Other impairment and provisions)		(14)	249
Non-interest expense		**(27,311)**	**(29,673)**
(Loss)/Profit before income tax expense		**(1,247)**	**1,129**
Income tax expense	12	(1,874)	(1,091)
(Loss)/Profit for the year		**(3,121)**	**38**
Other comprehensive income for the year		**–**	**–**
Total comprehensive (Loss)/ income for the year		**(3,121)**	**38**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2016

(Thousands of Azerbaijani Manats)

	Share capital	*Retained earnings*	*Total equity*
31 December 2014	**46,811**	**21,108**	**67,919**
Profit for the year	–	38	**38**
Total comprehensive income for the year	**–**	**38**	**38**
31 December 2015	**46,811**	**21,146**	**67,957**
Loss for the year	–	(3,121)	**(3,121)**
Total comprehensive (Loss)/income for the year	**–**	**(3,121)**	**(3,121)**
31 December 2016	**46,811**	**18,025**	**64,836**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2016

(Thousands of Azerbaijani Manats)

	Notes	*2016*	*2015*
Cash flows from operating activities			
Interest received		28,648	34,393
Interest paid		(14,348)	(12,305)
Fees and commissions received		10,139	8,954
Fees and commissions paid		(3,695)	(2,564)
Realized gains less losses from dealing in foreign currencies		17,860	12,710
Other income received		20	15
Personnel expenses paid		(12,184)	(12,904)
Other operating expenses paid		(10,703)	(10,836)
Cash flows from operating activities before changes in operating assets and liabilities		**15,737**	**17,463**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		51,509	(51,704)
Loans to customers		51,036	74,015
Other assets		(2,393)	(451)
Net increase/(decrease) in operating liabilities			
Amounts due to the CBAR		–	20,000
Amounts due to credit institutions		(69,737)	(3,262)
Amounts due to customers		102,053	(26,909)
Other liabilities		2,195	(1,269)
Net cash from operating activities before income tax		**150,400**	**27,883**
Income tax paid		(1,250)	(3,575)
Net cash from operating activities		**149,150**	**24,308**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(2,561)	–
Proceeds from sale and redemption of investment securities available-for-sale		–	8,647
Purchase of property and equipment		(836)	(885)
Purchase of intangible assets	11	(3,797)	(2,615)
Net cash from / (used in) investing activities		**(7,194)**	**5,147**
Cash flows from financing activities			
(Redemption)/proceeds from bonds issued		(48,649)	(12,514)
Net cash used in financing activities		**(48,649)**	**(12,514)**
Effect of exchange rates changes on cash and cash equivalents		5,017	50,295
Net increase / (decrease) in cash and cash equivalents		**98,324**	**67,236**
Cash and cash equivalents, beginning		**121,648**	**54,412**
Cash and cash equivalents, ending	6	**219,972**	**121,648**

The accompanying notes on pages 5 to 39 are an integral part of these consolidated financial statements.

(Thousands of Azerbaijani Manats)

1. Principal activities

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.

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. The Yapi Kredi Bank's registered address is 73G Jalil Mammadguluzadeh street Baku, AZ1078, Azerbaijan.

On 31 July 2007, Yapi Kredi Bank Azerbaijan registered its wholly-owned brokerage subsidiary, Yapi Kredi Invest LLC (the "subsidiary") with the Ministry of Justice of the Republic of Azerbaijan. The Subsidiary commenced its operations in February 2008 and is involved in dealing and brokerage operations. As of 31 December 2016 the total assets size of the subsidiary is 61 AZN, total equity 31 AZN (including retained earnings and current year profit/loss). But during the current year Yapi Kredi Invest has stopped its main operations and is in the liquidation process, therefore comparatives are not fully compareable. The official address of the Subsidiary is 73G Jalil Mammadguluzadeh street Baku, AZ1078, Azerbaijan.

The consolidated financial statements include the financial statements of the Yapi Kredi Bank and its subsidiary (collectively referred to as the "Bank").

The Bank has 13 branches (2015: 16 branches), 1 customer services unit (2015: 1 unit) within the Republic of Azerbaijan. The Bank had 381 employees at 31 December 2016 (2015: 409).

As at 31 December 2016 and 2015 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 2016, 18.20% of the shares of YKB are publicly traded (31 December 2015: 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. Basis of preparation

General

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by International Accounting Standards Board ("IASB").

The Azerbaijani Manat is the reporting and functional currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani Manat. Transactions in other currencies are treated as transactions in foreign currencies. These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN"), except per share amounts and unless otherwise indicated.

The significant accounting policies summarised on the following have been used in the preparation of these financial statements and are consistent with those used in the prior year.

These financial statements have been prepared using the measurement bases specified by IFRS for each type of asset, liability, income and expense, and have been applied consistently. The measurement bases are more fully described in the accounting policies as described below.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies

Standards, interpretations and amendments

The Bank has adopted the following amended IFRS which are effective for annual periods beginning on or after 1 January 2016:

Annual improvements 2012-2014 cycle

These improvements are effective from on or after 1 January 2016. They include:

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

The amendment is applied prospectively and clarifies that:

- Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5.

IFRS 7 Financial Instruments: Disclosures

- The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7.B30 and IFRS 7.42C in order to assess whether the disclosures are required.

- The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendment.

- The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report.

- The amendments must be applied retrospectively.

IAS 19 Employee Benefits

- The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used.

- The amendment must be applied prospectively.

IAS 34 Interim Financial Reporting

- The amendment clarifies that the required interim disclosures must be either in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report).

- The other information within the interim financial report must be available to users on the same terms and at the same time as the interim financial statements.

- The amendment must be applied retrospectively.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Standards, interpretations and amendments (continued)

Basis of consolidation

Subsidiaries are those entities, which are controlled by the Bank and are consolidated. Control is achieved when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Bank controls an investee if, and only if, the Bank has:

- power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee;
- the ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Bank has less than a majority of the voting or similar rights of an investee, the Bank considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- the contractual arrangement(s) with the other vote holders of the investee;
- rights arising from other contractual arrangements;
- the Bank's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Bank and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Bank.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Bank loses control over a subsidiary, it derecognizes the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognizes the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognized in other comprehensive income to profit or loss.

Fair value measurement

The Bank measures financial instruments, such as available-for-sale securities and derivatives at fair value at each balance sheet date. Fair values of financial instruments measured at amortized cost are disclosed in Note 24.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

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

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

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Fair value measurement

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables or available-for-sale financial assets, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category “financial assets at fair value through profit or loss”. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in the profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in consolidated statement of profit or loss and other comprehensive income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

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

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Financial assets (continued)

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity;
- other financial assets may be reclassified to available-for-sale or held to maturity categories only in rare circumstances.

A financial asset classified as available-for-sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category if the Bank has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Cash and cash equivalents

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

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 consolidated 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 consolidated statement of financial position. Securities borrowed are not recorded in the consolidated 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 consolidated statement of profit or loss and other comprehensive income. The obligation to return them is recorded at fair value as a trading liability.

Borrowings

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

If the Bank purchases its own debt, it is removed from the consolidated statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognized in consolidated statement of profit or loss and other comprehensive income.

Leases

Operating − Bank as lessee

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

3. Summary of accounting policies (continued)

Measurement of financial instruments at initial recognition

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- if the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Bank recognizes the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- in all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognizes that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Offsetting of financial instruments

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

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

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

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortized cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets’ carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred based on management risk based matrix). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in in profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the consolidated statement of profit or loss and other comprehensive income.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized 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.

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

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

Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss − measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in profit or loss − is reclassified from other comprehensive income to the consolidated statement of profit or loss and other comprehensive income. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss and other comprehensive income; increases in their fair value after impairment are recognized in consolidated statement of profit or loss and other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the consolidated statement of profit or loss and other comprehensive income.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. The accounting treatment of such restructuring is as follows:

- if the currency of the loan has been changed the old loan is derecognized and the new loan is recognized;
- if the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below;
- if the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

Financial liabilities are classified as either financial liabilities "at FVTPL" or "other financial liabilities".

a) Fair value through profit and loss

Financial liabilities are classified as FVTPL when the financial liability is either held for trading or it is designated as at FVTPL. Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit and loss accounts. The net gain or loss recognized in profit and loss accounts incorporates any interest paid on the financial liability and is included in the "other income/(loss)" line item in the statement of comprehensive income.

b) Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

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

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

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in “Other liabilities”, being the premium received. Subsequent to initial recognition, the Bank’s liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of profit or loss and other comprehensive income. The premium received is recognized in the consolidated statement of profit or loss and other comprehensive income on a straight-line basis over the life of the guarantee.

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.

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 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.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

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.

Repossessed collateral

In certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is measured at the lower of carrying amount or net realizable value and reported within “Other assets”.

Provisions

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

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.

Segment reporting

The Bank’s segmental reporting is based on the following operating segments: Retail banking and corporate banking.

Contingencies

Contingent liabilities are not recognized in the consolidated 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 consolidated statement of financial position but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses

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

Interest and similar income and expense

For all financial instruments measured at amortized cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Fee and commission income

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*

  Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income. 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*

  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 recognized after fulfilling the corresponding criteria.

Dividend income

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

Foreign currency translation

Transactions in foreign currencies are initially recorded in the functional currency converted at the rate of exchange ruling at the date of 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 recognized in the consolidated statement of profit or loss and other comprehensive income as gains less losses from foreign currencies − translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The Bank used the following official exchange rates at 31 December 2016 and 2015 in the preparation of these consolidated financial statements:

	2016	***2015***
1 US dollar	AZN 1.7707	AZN 1.5594
1 EUR	AZN 1.8644	AZN 1.7046

Standards and interpretations issued but not yet effective

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

IFRS 9 Financial Instruments

IFRS 9 *Financial Instruments*, published in July 2014, replaces the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018 and will be applied retrospectively with some exemptions. Early adoption of the standard is permitted. The Group does not intend to adopt this standard early. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 9.

IFRS 12 Disclosure of Interests in Other Entities

- The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10–B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale.

- The amendments are effective from 1 January 2017 and must be applied retrospectively.

(Thousands of Azerbaijani Manats)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers

IFRS 15 *Revenue from Contracts with Customers* establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. The core principle of the new standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group does not intend to adopt this standard early. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 15.

IFRS 16 Leases

IFRS 16 *Leases* replaces the existing lease accounting guidance in IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. It eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, early adoption is permitted if IFRS 15 Revenue from Contracts with Customers is also adopted. The Group does not intend to adopt this standard early. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 16.

The following new or amended standards are not expected to have a significant impact of the Group's consolidated financial statements. They include:

- Disclosure Initiative (Amendments to IAS 7 *Statement of Cash Flows*)
- Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12 *Income Taxes*)
- Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2 *Share-Based Payment*)

IAS 28 Investments in Associates and Joint Ventures

- An entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss.
- If an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.
- The amendments should be applied retrospectively and are effective from 1 January 2018, with earlier application permitted. If an entity applies those amendments for an earlier period, it must disclose that fact.

(Thousands of Azerbaijani Manats)

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has made the following judgments, apart from those involving estimates, which have the most significant effect on the amounts recognized in the consolidated financial statements. Due to the nature of estimates, actual results may significantly differ. The most significant use of judgments and estimates are as follows:

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

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.

Fair value of financial instruments and related classification

Where the fair values of financial assets and financial liabilities recorded on the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques. These techniques are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values. The judgments include considerations of liquidity risk, credit risk and volatility for longer-dated financial assets and liabilities. Changes in assumptions about these factors could affect the reported fair value of financial instruments. Management applies judgement as to the nature and use of financial instruments and classify them accordingly into the relevant category.

Related party transactions

In the normal course of business, the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgment 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 judgment is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

(Thousands of Azerbaijani Manats)

5. Segment information

For management purposes, the Bank is organized into two operating segments based on products and services as follows:

Retail banking	Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities.
Corporate banking	Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements.

Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Bank's total revenue in 2016 or 2015.

The following table presents revenue, expenses and profit information regarding the Bank's operating segments.

2016	*Retail banking*	*Corporate banking*	*Unallocated*	*Total*
Revenue				
Interest income	16,572	16,755	25	**33,352**
Fee and commission income	6,150	3,855	−	**10,005**
Non-interest income	9,651	9,757	15	**19,423**
Total revenue	**32,373**	**30,367**	**40**	**62,780**
Interest expense	(3,110)	(9,519)	−	**(12,629)**
Fee and commission expense	(2,372)	(1,323)	−	**(3,695)**
Impairment charge on interest bearing assets	(8,015)	(12,377)	−	**(20,392)**
Non-interest expense	(13,570)	(13,721)	(20)	**(27,311)**
Segment results	**5,306**	**(6,573)**	**20**	**(1,247)**
Income tax expense	(714)	(1,269)	109	**(1,874)**
Profit/(loss) for the year	**4,592**	**(7,842)**	**129**	**(3,121)**
Other segment information				
Capital expenditure	2,302	2,327	3	**4,633**

2015	*Retail banking*	*Corporate banking*	*Unallocated*	*Total*
Revenue				
Interest income	20,571	15,799	11	**36,381**
Fee and commission income	6,722	2,412	−	**9,134**
Non-interest income	6,523	5,011	3	**11,537**
Total revenue	**33,816**	**23,222**	**14**	**57,052**
Interest expense	(6,238)	(6,877)	−	**(13,115)**
Fee and commission expense	(1,928)	(636)	−	**(2,564)**
Impairment charge on interest bearing assets	(5,625)	(4,946)	−	**(10,571)**
Non-interest expense	(16,670)	(12,994)	(9)	**(29,673)**
Segment results	**3,355**	**(2,231)**	**5**	**1,129**
Income tax expense	(3,233)	2,147	(5)	**(1,091)**
Profit/(loss) for the year	**122**	**(84)**	**−**	**38**
Other segment information				
Capital expenditure	1,023	786	1	**1,810**

Geographic information

The Bank's revenues from third party customers for the years ended 31 December 2016 and 2015 are mainly generated in the Republic of Azerbaijan. IFRS 8 is not applicable on the Bank hence this disclosure does not meet its minimum requirements. This is an additional disclosure for better understanding of profit or loss.

(Thousands of Azerbaijani Manats)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2016	*2015*
Cash on hand	19,758	28,161
Current accounts with the CBAR	38,606	21,397
Accounts with other credit institutions	161,608	72,090
Cash and cash equivalents	**219,972**	**121,648**

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non−resident banks of amounting AZN 26 (2015: AZN 283) and AZN 161,582 (2015: AZN 71,807), respectively.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2016	*2015*
Time deposits	-	50,026
Blocked current account with the CBAR	27,978	31,203
Obligatory reserve with the CBAR	2,777	1,160
Amounts due from credit institutions	**30,755**	**82,389**

As of 31 December 2016, time deposits due from credit institutions were nil. As of 31 December 2015, time deposits due from credit institutions include two deposits placed at non-resident bank denominated in USD, maturing on 14 January 2016 and 29 January 2016 respectively, with the annual effective interest rates of 1.10%-1.35%.

As at 31 December 2016, blocked current account with the CBAR of AZN 27,978 thousand (2015: 31,188) represented funds blocked against borrowings from the CBAR (Note 14).

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.

8. Loans to customers

Loans to customers comprise:

	2016	*2015*
Corporate lending	127,551	156,424
Consumer lending	58,691	73,350
Small business lending	27,228	26,606
Residential mortgages	9,506	12,862
Gross loans to customers	**222,976**	**269,242**
Less: allowance for impairment	(37,850)	(17,490)
Loans to customers	**185,126**	**251,752**

As at 31 December 2016, out of the total amount of loans 41.1% (2015: 49.3%) are denominated in foreign currencies. The decrease in the share of the foreign currency denominated loan portfolio as compared to the previous year is mostly due to the continuing of recession of economy in 2016.

(Thousands of Azerbaijani Manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Corporate lending	*Small business lending*	*Consumer lending*	*Residential mortgages*	*Total*
At 1 January 2016	**7,707**	**1,786**	**7,569**	**428**	**17,490**
Charge for the year	12,379	4,632	2,712	669	**20,392**
Amounts written off	–	–	(32)	–	**(32)**
At 31 December 2016	**20,086**	**6,418**	**10,249**	**1,097**	**37,850**
Individual impairment	18,761	5,510	1,797	991	**27,059**
Collective impairment	1,325	908	8,452	106	**10,791**
	20,086	**6,418**	**10,249**	**1,097**	**37,850**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**44,778**	**10,855**	**3,328**	**1,643**	**60,604**

	Corporate lending	*Small business lending*	*Consumer lending*	*Residential mortgages*	*Total*
At 1 January 2015	**3,013**	**659**	**3,326**	**173**	**7,171**
Charge for the year	4,946	1,127	4,243	255	**10,571**
Amounts written off	(252)	–	–	–	**(252)**
At 31 December 2015	**7,707**	**1,786**	**7,569**	**428**	**17,490**
Individual impairment	7,013	1,544	1,091	342	**9,990**
Collective impairment	694	242	6,478	86	**7,500**
	7,707	**1,786**	**7,569**	**428**	**17,490**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**21,927**	**5,311**	**2,378**	**625**	**30,241**

Individually impaired loans

As at 31 December 2016, loans in the amount of AZN 60,604 thousand (2015: AZN 30,241) were assessed individually. An individual impairment allowance of AZN 27,059 thousand (2015: AZN 9,990) were recognized for such loans. Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2016, comprised AZN 7,567 (2015: AZN 1,725).

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.

Basis of Provision

The provision against Loan and Advances has been provided on bank internal policies in compliance with IFRS requirements of AZN 37.8 million. However, had this provision been made in compliance with the requirements of CBAR then provision against loans and advances would have been AZN 54.6 million. Under the bank internal policies, while carrying out individual impairment, best estimated recoverability percentage was applied to discounted cash flow from each individual loan based on management judgement. Bank believes that this is not a non-compliance of any applicable regulations as the financial statements have been prepared under IFRS.

(Thousands of Azerbaijani Manats)

8. Loans to customers (continued)

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 2016, the Bank had a concentration of loans represented by AZN 63,328 or 28% of gross loan portfolio (2015: AZN 72,332 or 27%) due from the ten (2015: ten) largest third party borrowers.

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

	2016	*2015*
Private companies	127,551	156,424
Individuals	95,425	112,818
Gross loans to customers	**222,976**	**269,242**

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

	2016	*2015*
Individuals	95,425	112,818
Trading enterprises	52,960	96,234
Real estate construction	25,521	30,597
Manufacturing	49,070	29,593
Gross loans to customers	**222,976**	**269,242**

9. Investment securities available-for-sale

Investment securities available-for-sale comprise:

	2016	*2015*
Bonds issued by the State Oil Company of Azerbaijan Republic	2,587	−
Corporate unquoted shares (5% ownership interest at Baku Stock Exchange)	60	60
Available-for-sale securities	**2,647**	**60**

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

	2016		*2015*	
	Annual interest rate	*Maturity*	*Annual interest rate*	*Maturity*
Bonds issued by the State Oil Company of Azerbaijan Republic	5%	October-2021	−	−

(Thousands of Azerbaijani Manats)

10. Property and equipment

The movements in property and equipment were as follows:

	Leasehold improvements	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Total*
Cost					
31 December 2015	**11,449**	**9,257**	**3,048**	**104**	**23,858**
Additions	50	573	192	21	**836**
Disposals	(811)	(112)	(94)	–	**(1,017)**
Transfers	(23)	–	23	–	**–**
31 December 2016	**10,665**	**9,718**	**3,169**	**125**	**23,677**
Accumulated depreciation					
31 December 2015	**(4,893)**	**(6,381)**	**(2,281)**	**(92)**	**(13,647)**
Depreciation charge	(1,305)	(1,419)	(383)	(15)	**(3,122)**
Disposals	243	39	70	–	**352**
Transfers	–	–	–	–	**–**
31 December 2016	**(5,955)**	**(7,761)**	**(2,594)**	**(107)**	**(16,417)**
Net book value					
31 December 2015	**6,556**	**2,876**	**767**	**12**	**10,211**
31 December 2016	**4,710**	**1,957**	**575**	**18**	**7,260**

	Leasehold improvements	*Computers and office equipment*	*Furniture and fixtures*	*Motor vehicles*	*Total*
Cost					
31 December 2014	**11,361**	**9,663**	**2,241**	**111**	**23,376**
Additions	88	316	85	–	**489**
Disposals	–	–	–	(7)	**(7)**
Transfers	–	(722)	722	–	**–**
31 December 2015	**11,449**	**9,257**	**3,048**	**104**	**23,858**
Accumulated depreciation					
31 December 2014	**(3,547)**	**(4,996)**	**(1,399)**	**(99)**	**(10,041)**
Depreciation charge	(1,346)	(1,846)	(421)	–	**(3,613)**
Disposals	–	–	–	7	**7**
Transfers	–	461	(461)	–	**–**
31 December 2015	**(4,893)**	**(6,381)**	**(2,281)**	**(92)**	**(13,647)**
Net book value					
31 December 2014	**7,814**	**4,667**	**842**	**12**	**13,335**
31 December 2015	**6,556**	**2,876**	**767**	**12**	**10,211**

As at 31 December 2016 gross carrying amount of fully depreciated property and equipment was AZN 6,742 (2015: AZN 2,978).

(Thousands of Azerbaijani Manats)

11. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2015	**6,197**	**5,666**	**11,863**
Additions	1,398	2,399	**3,797**
Disposals	(102)	(17)	**(119)**
31 December 2016	**7,493**	**8,048**	**15,541**
Accumulated amortization			
31 December 2015	**(4,755)**	**(1,291)**	**(6,046)**
Amortization charge	(1,088)	(567)	**(1,655)**
Disposals	76	17	**93**
31 December 2016	**(5,767)**	**(1,841)**	**(7,608)**
Net book value			
31 December 2015	**1,442**	**4,375**	**5,817**
31 December 2016	**1,726**	**6,207**	**7,933**

	Licenses	*Computer software*	*Total*
Cost			
31 December 2014	**5,798**	**4,744**	**10,542**
Additions	399	922	**1,321**
31 December 2015	**6,197**	**5,666**	**11,863**
Accumulated amortization			
31 December 2014	**(3,039)**	**(820)**	**(3,859)**
Amortization charge	(1,716)	(471)	**(2,187)**
31 December 2015	**(4,755)**	**(1,291)**	**(6,046)**
Net book value			
31 December 2014	**2,759**	**3,924**	**6,683**
31 December 2015	**1,442**	**4,375**	**5,817**

As at 31 December 2016 gross carrying amount of fully amortized intangible assets was AZN 4,836 (2015: AZN 3,087).

12. Taxation

The corporate income tax expense comprises:

	2016	*2015*
Current tax charge	–	(214)
Prior year tax expense actualization	13	(243)
Deferred tax (charge)/credit − reversal and origination of temporary differences	(1,887)	(634)
Income tax expense	**(1,874)**	**(1,091)**

Standard corporate income tax rate for companies (including banks) comprised 20% for 2016 and 2015. However due tax loss in 2016, no current year charge was recognized. 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:

	2016	*2015*
(Loss)/Profit before income tax expense	**(1,247)**	**1,129**
Statutory tax rate	20%	20%
Income tax expense at the statutory rate	–	**(226)**
Tax effect of items which are not deductible or assessable for taxation purposes		
Impact of Non-deductible expenses	**–**	12
Impact of Prior year tax expense	13	(243)
Impact of temporary difference	(1,887)	(634)
Income tax expense	(1,874)	**(1,091)**

(Thousands of Azerbaijani Manats)

12. Taxation (continued)

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

	2014	*Recognized in the statement of profit or loss and other comprehensive income*	*2015*	*Recognized in the statement of profit or loss and other comprehensive income*	*2016*
Tax effect of temporary differences					
Amounts due from credit institutions	(45)	(190)	(235)	(56)	(291)
Loans to customers	(770)	(840)	(1,610)	(1,608)	(3,218)
Property and equipment	(234)	223	(11)	157	146
Intangible assets	(76)	65	(11)	(48)	(59)
Other liabilities	569	93	662	(125)	537
Other assets	–	15	15	(207)	(192)
Deferred tax liability	**(556)**	**(634)**	**(1,190)**	**(1,887)**	**(3,077)**

The deferred tax liability has been provided in compliance with IFRS requirements of AZN 3.1 million. However, there is AZN 0.4 million deferred tax assets calculated in compliance with the requirements of CBAR.

13. Other assets and liabilities

Other assets comprise:

	2016	*2015*
Amounts in the course of settlement	1,550	894
Other financial assets	**1,550**	**894**
Prepayments	2,159	2,760
Repossessed collateral	2,178	190
Other	475	125
Other non-financial assets	**4,812**	**3,075**
Other assets	**6,362**	**3,969**

As at 31 December 2016, prepayments of AZN 2,159 (2015: AZN 2,760) primarily comprise of advance payments for purchase of property and equipment, advertisement, insurance and rent services.

Other liabilities comprise:

	2016	*2015*
Settlements on plastic cards	741	410
Payables on purchase of property and equipment	-	90
Other	674	154
Other financial liabilities	**1,415**	**654**
Accrued employee costs	1,353	1,660
Deferred income	631	764
Provisions	143	244
Payables to social funds	124	206
Other	1,693	137
Other non-financial liabilities	**3,944**	**3,011**
Other liabilities	**5,359**	**3,665**

Accrued employee costs include bonuses for employees based on the financial performance of the Bank of AZN 563 (2015: AZN 866) and an accrual for unused vacations of AZN 790 (2015: AZN 794).

As at 31 December 2016 and 2015, deferred income represents deferred revenue which was primarily comprised of fee received for issuance of plastic cards, guarantees and letter of credits.

(Thousands of Azerbaijani Manats)

14. Amounts due to the CBAR

As at 31 December 2016, the Bank had loans from the CBAR amounting to AZN 20,000 maturing until 09 June 2017 (2015: AZN 20,000). The Bank pledged USD 15,800 (AZN 27,978) against these loans (Note 7).

15. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2016	*2015*
Loans from banks	36,144	103,584
Time deposits	46	13,001
Demand deposits	13,505	4,406
Amounts due to Azerbaijan Mortgage Fund	2,271	2,211
Amounts due to credit institutions	**51,966**	**123,202**

As at 31 December 2016, the Bank had loans financed by the Azerbaijan Mortgage Fund amounting to AZN 2,271 (2015: AZN 2,211) maturing in 2045 (2015: 2045), with the annual interest rates of 1-4% p.a. (2015: 1-4% p.a.)

16. Amounts due to customers

The amounts due to customers include the following:

	2016	*2015*
Current accounts	143,452	138,426
Time deposits	171,342	74,434
Amounts due to customers	**314,794**	**212,860**
Held as security against guarantees (Note 19)	565	2,899

As at 31 December 2016, amounts due to customers of AZN 136,222 or 43% (2015: AZN 74,768 or 35%) of total amounts due to customers were due to ten (2015: ten) largest customers.

The average annual interest rate on term deposits of individual customers outstanding at 31 December 2016 comprised 4.15% (2015: 7.57%), while the average annual interest rate on term deposits of legal entities outstanding at 31 December 2016 was 4.75% (2015: 10.58%).

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

	2016	*2015*
Private enterprises	207,359	143,048
Individuals	107,415	69,462
Public organizations	20	350
Amounts due to customers	**314,794**	**212,860**

An analysis of customer accounts by economic sector follows:

	2016	*2015*
Trade	166,981	88,907
Individuals	108,260	69,462
Insurance	24,951	29,895
Real estate constructions	6,675	20,982
Transport and communication	7,686	3,264
State and public organizations	241	350
Amounts due to customers	**314,794**	**212,860**

(Thousands of Azerbaijani Manats)

17. Debt securities issued

As at 31 December 2016 the balance of debt securities issued was nil (2015: AZN 48,759).

On 20 June 2014, the Bank issued domestic bonds having a nominal value of AZN 15,000 maturing on 20 June 2016.

On 18 December 2014, the Bank issued on private placement basis bonds having nominal value of USD 30,000 maturing on 19 December 2016. On 6 April 2016, the Bank repurchased debt securities in amount of 5,000 USD. As at 31 December 2016, carrying amount of the placement was nil (2015: AZN 46,753).

18. Equity

As at 31 December 2016 and 2015 number of ordinary shares are 2,340,535,194. 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.

19. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. As a result of significant drop in crude oil prices, Azerbaijani Manat devalued against the US dollar from AZN 1.5594 to AZN 1.7707 for 1 USD year for 31 December 2016. Following the second devaluation, the Central Bank of the Republic of Azerbaijan announced floating exchange rate.

These events resulted in worsening of liquidity in the banking system and much tighter credit conditions. There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Bank's future results and financial position and business prospects in a manner not currently determinable. Such adverse impacts could include deterioration of the quality of the loan portfolio, with increases in non-performing loans and decreases in loan collateral values.

Azerbaijani government announced plans to accelerate reforms and support to banking system in response to current

Economic challenges.

Legal

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

Taxation

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 2016 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.

(Thousands of Azerbaijani Manats)

19. Commitments and contingencies (continued)

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2016, the Bank was in compliance with these ratios except for 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 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 no below 150% of the loan value. As at 31 December 2016, the Bank's ratios were 29.9% and 24.39% respectively (31 December 2015: 22.5% and 18.13% respectively).

The aforementioned breach of the CBAR ratio is related to specific non-government funded project. Throughout the year the Bank submitted information to CBAR regarding this breach on a monthly basis and no sanctions were ever applied to the Bank. Management believes that the Bank will not face any sanctions against the Bank in the future.

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.

Commitments and contingencies

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

	2016	*2015*
Credit related commitments		
Undrawn loan commitments	72,972	76,077
Guarantees issued	35,162	47,496
Letters of credit	2,492	1,938
	110,626	**125,511**
Operating lease commitments		
Not later than 1 year	2,722	3,118
Later than 1 year but not later than 5 years	8,226	11,707
Later than 5 years	2,350	1,770
	13,298	**16,595**
Commitments and contingencies (before deducting collateral)	**123,924**	**142,106**
Less − cash held as security against guarantees (Note 16)	(565)	(2,899)
Commitments and contingencies	**123,359**	**139,207**

Most of the outstanding guarantee letters as at 31 December 2016 and 2015 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.

(Thousands of Azerbaijani Manats)

20. Net fee and commission income

Net fee and commission income comprises:

	2016	*2015*
Plastic card operations	4,463	4,780
Settlements operations	3,253	1,908
Cash operations	1,341	1,318
Guarantees and letters of credit	719	642
Agent activities	104	282
Other	125	204
Fee and commission income	**10,005**	**9,134**
Plastic card operations	(1,718)	(1,323)
Settlements operations	(1,644)	(958)
Guarantees and letters of credit	(37)	(57)
Cash operations	(19)	(26)
Other	(277)	(200)
Fee and commission expense	**(3,695)**	**(2,564)**
Net fee and commission income	**6,310**	**6,570**

21. Personnel expenses

Personnel expenses comprise:

	2016	*2015*
Salaries and bonuses	(9,095)	(10,278)
Social security costs	(1,609)	(1,815)
Other employee benefits	(1,155)	(1,270)
Personnel expenses	**(11,859)**	**(13,363)**

22. General and administrative expenses

General and administrative expenses comprise:

	2016	*2015*
Occupancy and rent	(3,377)	(3,054)
Support expenses	(1,463)	(1,238)
Communications	(983)	(1,009)
Security	(871)	(975)
Repairs and Maintenance	(842)	(1,177)
Losses on disposal of fixed assets and intangible assets	(691)	0
Legal and consultancy	(571)	(699)
Marketing and advertising	(529)	(944)
Utilities	(290)	(309)
Membership	(208)	(100)
Office supplies	(134)	(210)
Entertainment	(71)	(151)
Insurance	(63)	(61)
Operating taxes other than income tax	(61)	(39)
Business travel	(25)	(69)
Fines, penalties, and forfeits	(6)	(220)
Other expenses	(476)	(504)
General and administrative expenses	**(10,661)**	**(10,759)**

(Thousands of Azerbaijani Manats)

23. Risk management

Introduction

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.

(Thousands of Azerbaijani Manats)

23. Risk management (continued)

Introduction (continued)

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.

Credit risk

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

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

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

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

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

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 consolidated statement of financial position, based on the Bank's credit rating system.

As at 31 December 2016 cash and cash equivalents as well as amounts due from credit institutions held at the CBAR, OECD, CIS and other foreign countries investment grade banks are classified as high grade. Cash and cash equivalents held in other banks is included in standard grade.

(Thousands of Azerbaijani Manats)

23. Risk management (continued)

Credit risk (continued)

In the table below financial assets of high grade are those having a minimal level of credit risk, normally with a credit rating on or close to sovereign level or very well collateralized. 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.

		Neither past due nor impaired					
2016	***Notes***	***High grade***	***Standard grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents (excluding cash on hand)	6	200,188	26	–	–	–	**200,214**
Amounts due from credit institutions	7	30,755	-	–	–	–	**30,755**
		230,943	**26**	**–**	**–**	**–**	**230,969**
Loans to customers	8						
Corporate lending		–	50,208	22,319	10,246	44,778	**127,551**
Consumer lending		–	38,356	1,494	15,512	3,328	**58,690**
Small business lending		–	4,901	7,315	4,157	10,855	**27,228**
Residential mortgages		–	6,740	714	410	1,643	**9,507**
		–	**100,205**	**31,842**	**30,325**	**60,604**	**222,976**
Investment securities available-for-sale	9	2,647	–	–	–	–	**2,647**
Other financial assets	13	–	1,550	–	–	–	**1,550**
Total		**233,590**	**101,781**	**31,842**	**30,325**	**60,604**	**458,142**

		Neither past due nor impaired					
2015	***Notes***	***High grade***	***Standard grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents (excluding cash on hand)	6	93,204	283	–	–	–	**93,487**
Amounts due from credit institutions	7	32,348	50,041	–	–	–	**82,389**
		125,552	**50,324**	**–**	**–**	**–**	**175,876**
Loans to customers	8						
Corporate lending		–	115,038	17,556	1,903	21,927	**156,424**
Consumer lending		–	55,386	5,925	9,661	2,378	**73,350**
Small business lending		–	12,879	7,561	855	5,311	**26,606**
Residential mortgages		–	10,738	1,493	6	625	**12,862**
		–	**194,041**	**32,535**	**12,425**	**30,241**	**269,242**
Investment securities available-for-sale	9	60	–	–	–	–	**60**
Other financial assets	13	–	894	–	–	–	**894**
Total		**125,612**	**245,259**	**32,535**	**12,425**	**30,241**	**446,072**

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.

(Thousands of Azerbaijani Manats)

23. Risk management (continued)

Credit risk (continued)

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

2016	***Less than 30 days***	***31 to 60 days***	***61 to 90 days***	***More than 90 days***	***Total***
Loans to customers					
Consumer lending	215	1,411	590	13,296	**15,512**
Corporate lending	58	8,181	1,688	319	**10,246**
Small business lending	62	974	2,596	525	**4,157**
Residential mortgages	1	208	179	22	**410**
Total	**336**	**10,774**	**5,053**	**14,162**	**30,325**

2015	***Less than 30 days***	***31 to 60 days***	***61 to 90 days***	***More than 90 days***	***Total***
Loans to customers					
Consumer lending	377	111	147	9,026	**9,661**
Corporate lending	83	–	–	1820	**1,903**
Small business lending	778	–	–	77	**855**
Residential mortgages	–	–	–	6	**6**
Total	**1,238**	**111**	**147**	**10,929**	**12,425**

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

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 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.

(Thousands of Azerbaijani Manats)

23. Risk management (continued)

Credit risk (continued)

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

	2016				*2015*			
	Azerbaijan	*OECD*	*CIS and other foreign countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	58,389	160,271	1,312	**219,972**	49,841	70,226	1,581	**121,648**
Amounts due from credit institutions	30,755	-	–	**30,755**	32,363	50,026	–	**82,389**
Loans to customers	185,126	–	–	**185,126**	251,752	–	–	**251,752**
Investment securities	2,647	–	–	**2,647**	60	–	–	**60**
Other financial assets	1,550	–	–	**1,550**	894	–	–	**894**
	278,467	**160,271**	**1,312**	**440,050**	**334,910**	**120,252**	**1,581**	**456,743**
Liabilities								
Amounts due to the CBAR	20,023	–	–	**20,023**	20,014	–	–	**20,014**
Amounts due to credit institutions	15,822	36,144	–	**51,966**	19,618	103,584	–	**123,202**
Amounts due to customers	314,794	–	–	**314,794**	212,860	–	–	**212,860**
Debt securities issued	-	-	–	**-**	2,006	46,753	–	**48,759**
Other financial liabilities	1,415	-	–	**1,415**	588	66	–	**654**
	352,054	**36,144**	**–**	**388,198**	**255,086**	**150,403**	**–**	**405,489**
Net assets/(liabilities)	**(73,587)**	**124,127**	**1,312**	**51,852**	**79,824**	**(30,151)**	**1,581**	**51,254**

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:

	2016	*2015*
Instant Liquidity Ratio	107.69%	81.11%

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.

As at 31 December 2016	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to the CBAR	354	20,249	–	–	**20,603**
Amounts due to credit institutions	13,577	36,919	136	3,349	**53,981**
Amounts due to customers	250,530	54,931	5,778	7,969	**319,208**
Debt securities issued	–	-	–	–	**-**
Other financial liabilities	1,415	–	–	–	**1,415**
Total undiscounted financial liabilities	**265,876**	**112,099**	**5,914**	**11,318**	**395,207**

(Thousands of Azerbaijani Manats)

23. Risk management (continued)

Liquidity risk and funding management (continued)

As at 31 December 2015	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to the CBAR	189	20,069	–	–	**20,258**
Amounts due to credit institutions	19,209	104,482	514	2,372	**126,577**
Amounts due to customers	167,044	43,023	800	3,662	**214,529**
Debt securities issued	–	51,992	–	–	**51,992**
Other financial liabilities	654	–	–	–	**654**
Total undiscounted financial liabilities	**187,096**	**219,566**	**1,314**	**6,034**	**414,010**

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*
2016	15,469	21,826	64,498	8,833	**110,626**
2015	90,699	26,805	8,006	–	**125,510**

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.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates 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 2016 and 2015, 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.

(Thousands of Azerbaijani Manats)

23. Risk management (continued)

Market risk (continued)

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 % 2016*	*Effect on profit before tax 2016*	*Increase in currency rate in % 2015*	*Effect on profit before tax 2015*
USD	13.43	1,955	60	4,487
EUR	10.35	101	60	5

Currency	*Decrease in currency rate in % 2016*	*Effect on profit before tax 2016*	*Decrease in currency rate in % 2015*	*Effect on profit before tax 2015*
USD	(4.55)	(662)	(15)	(1,122)
EUR	(1.78)	(17)	(15)	(1)

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.

24. Fair values of financial instruments

Fair value hierarchy

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities available-for-sale	31 December 2016	2,587	–	60	**2,647**
Assets for which fair values are disclosed					
Amounts due from credit institutions	31 December 2016	–	–	30,755	**30,755**
Loans to customers	31 December 2016	–	–	185,126	**185,126**
Liabilities for which fair values are disclosed					
Amounts due to the CBAR	31 December 2016	–	–	20,023	**20,023**
Amounts due to credit institutions	31 December 2016	–	–	51,966	**51,966**
Amounts due to customers	31 December 2016	–	–	314,794	**314,794**
Debt securities issued	31 December 2016	–	–	–	–

(Thousands of Azerbaijani Manats)

24. Fair values of financial instruments (continued)

Fair value hierarchy (continued)

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities available-for-sale	31 December 2015	–	–	60	**60**
Assets for which fair values are disclosed					
Amounts due from credit institutions	31 December 2015	–	–	82,389	**82,389**
Loans to customers	31 December 2015	–	–	251,752	**251,752**
Liabilities for which fair values are disclosed					
Amounts due to the CBAR	31 December 2015	–	–	20,014	**20,014**
Amounts due to credit institutions	31 December 2015	–	–	123,202	**123,202**
Amounts due to customers	31 December 2015	–	–	212,860	**212,860**
Debt securities issued	31 December 2015	–	46,753	2,006	**48,759**

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 consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

2016	*Carrying value*	*Fair value*	*Unrecognized gain/(loss)*
Financial assets			
Cash and cash equivalents	219,972	219,972	–
Amounts due from credit institutions	30,755	30,755	–
Loans to customers	222,976	222,976	–
Other financial assets	1,550	1,550	–
Financial liabilities			
Amounts due to the CBAR	20,023	20,023	–
Amounts due to credit institutions	51,966	51,966	–
Amounts due to customers	314,794	314,794	–
Other financial liabilities	1,415	1,415	–

2015	*Carrying value*	*Fair value*	*Unrecognized gain/(loss)*
Financial assets			
Cash and cash equivalents	121,648	121,648	–
Amounts due from credit institutions	82,389	82,389	–
Loans to customers	269,242	265,435	(3,807)
Other financial assets	894	894	–
Financial liabilities			
Amounts due to the CBAR	20,014	20,014	–
Amounts due to credit institutions	123,202	123,202	–
Amounts due to customers	212,860	212,860	–
Debt securities issued	48,759	48,759	–
Other financial liabilities	654	654	–

24. Fair values of financial instruments (continued)

(Thousands of Azerbaijani Manats)

Fair value hierarchy (continued)

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.

25. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 23 “Risk management” for the Bank’s contractual undiscounted repayment obligations.

	2016			*2015*		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	219,972	–	**219,972**	121,648	–	**121,648**
Amounts due from credit institutions	30,755	-	**30,755**	82,374	15	**82,389**
Loans to customers	159,807	25,319	**185,126**	181,891	69,861	**251,752**
Investment securities available-for-sale	26	2,621	**2,647**	–	60	**60**
Current income tax assets	–	–	–	1,801	–	**1,801**
Property and equipment	–	7,260	**7,260**	–	10,211	**10,211**
Intangible assets	–	7,933	**7,933**	–	5,817	**5,817**
Other assets	6,255	107	**6,362**	3,884	85	**3,969**
Total	**416,815**	**43,240**	**460,055**	**391,598**	**86,049**	**477,647**
Amounts due to the CBAR	20,023	–	**20,023**	20,014	–	**20,014**
Amounts due to credit institutions	49,729	2,237	**51,966**	121,060	2,142	**123,202**
Amounts due to customers	302,391	12,403	**314,794**	208,432	4,428	**212,860**
Debt securities issued	–	–	–	48,759	–	**48,759**
Current income tax liabilities	–	–	**–**	–	–	**–**
Deferred income tax liabilities	–	3,077	**3,077**	–	1,190	**1,190**
Other liabilities	5,203	156	**5,359**	3,665	–	**3,665**
Total	**377,346**	**17,873**	**395,219**	**401,930**	**7,760**	**409,690**
Net	**39,469**	**25,367**	**64,836**	**(10,332)**	**78,289**	**67,957**

The maturity analysis does not exhibit negative gaps in given period. Management expects to the Bank will be able to keep these positive gaps.

26. 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 settlement and foreign exchange transactions.

(Thousands of Azerbaijani Manats)

26. Related party disclosures (continued)

The outstanding balances of related party transactions are as follows:

	2016		*2015*	
	Parent	***Entities under common control***	***Parent***	***Entities under common control***
Loans outstanding at 1 January, gross	–	352	–	–
Loans issued during the year	–	–	–	350
Loan repayments during the year	–	(352)	–	(19)
Other movements	–	–	–	21
Loans outstanding at 31 December, gross	**–**	**–**	**–**	**352**
Less: allowance for impairment at 31 December	–	–	–	–
Loans outstanding at 31 December, net	**–**	**–**	**–**	**352**
Deposits outstanding at 1 January, gross	**50,026**	**–**	**–**	**–**
Deposits placed during the year	80,000	–	63,952	–
Deposit repayments during the year	(130,259)	–	(30,425)	–
Other movements	(125)	–	136	–
Translation gain/loss	358	–	16,363	–
Deposits outstanding at 31 December, gross	–	–	**50,026**	–
Less: allowance for impairment at 31 December	–	–	–	–
Deposits outstanding at 31 December, net		–	**50,026**	–
Deposits at 1 January	**–**	**–**	**–**	**–**
Deposits received during the year	–	–	–	–
Deposits repaid during the year	–	–	–	–
Other movements	–	–	–	–
Deposits at 31 December	**–**	**–**	**–**	**–**
Current accounts at 31 December	**143,801**	**1,500**	**65,442**	**1,711**

Total deposit with parent as at December 31,2016 is 143,001 thousand. During the year 80,000 thousand of deposit placed with parent carrying 0.45% interest rate

	2016		*2015*	
	Parent	***Entities under common control***	***Parent***	***Entities under common control***
Loans borrowed at 1 January	**–**	**103,361**	**–**	**55,901**
Loans borrowed during the year	–	–	5,999	20,970
Loans repaid during the year	–	(70,122)	(6,000)	(20,974)
Other movements	–	2,725	1	2,371
Translation gain/loss	–	107	-	45,093
Loans borrowed at 31 December	**–**	**36,071**	**–**	**103,361**

(Thousands of Azerbaijani Manats)

26. Related party disclosures (continued)

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

	2016		*2015*	
	Parent	***Entities under common control***	***Parent***	***Entities under common control***
Interest income	143	35	202	21
Interest expense	–	(1,848)	–	(2,600)
Fee and commission income	–	29	–	41
Fee and commission expense	(121)	(77)	(138)	(131)
General and administrative expenses	(168)	(693)	(397)	(794)

Compensation of key management personnel of 5 members (2015: 5 members) comprised the following:

	2016	*2015*
Salaries and short term benefits	1,198	1,184
Other accrued employee costs	101	74
Total key management personnel compensation	**1,299**	**1,258**

27. Capital adequacy

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by CBAR, (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 CBAR 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 CBAR requires each bank or banking group to: (a) hold the minimum level of total capital of AZN 50,000 (2015: 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% (2015: 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% (2015: 5%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2015. However, the minimum Capital requirement was breached during 2016. However, the parent company is committed to inject 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 2016, the Bank's capital adequacy ratio based on the CBAR requirements was as follows:

	2016	*2015*
Tier 1 capital	50,925	61,252
Tier 2 capital	3,950	4,209
Less: deductions from capital	(8,465)	(5,817)
Total regulatory capital	**46,410**	**59,644**
Risk-weighted assets	315,967	387,621
Tier 1 capital adequacy ratio	13.47%	14.30%
Total capital adequacy ratio	14.69%	15.38%

28. Events after the reporting period

"Yapi ve Kredi Bankasi A.Ş.", a main shareholder, had already transferred USD 5 million (have already converted manat, which made up AZN 8.6 million) as an additional capital. A due process on capital injection has already been initiated. There are no any material subsequent events or transactions or adjustments (excluding Capital Increasing) have been discovered that should be considered on the consolidated financial statements.