Access Bank Closed Joint Stock Company

Financial statements

Year ended 31 December 2018
together with independent auditor's report

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Independent auditor's report

To the Shareholders and Management Board of AccessBank CJSC

Opinion

We have audited the financial statements of AccessBank CJSC (the Bank), which comprise the statement of financial position as at 31 December 2018, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

Basis for opinion

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

Responsibilities of management and Audit Committee for the financial statements

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

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

The Audit Committee is responsible for overseeing the Bank's financial reporting process.

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Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Audit Committee 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.

Ernst & Young Holdings (CIS) B.V.

31 May 2019

Baku, Azerbaijan

Statement of financial position

As of 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2018	2017
Assets			
Cash and cash equivalents	5	145,694	123,067
Amounts due from credit institutions	6	4,423	29,660
Derivative financial assets	7	–	1,879
Investment securities	8	1,764	39,175
Loans to customers	9	521,342	541,440
Property and equipment	10	32,596	36,160
Intangible assets	11	18,584	21,487
Deferred income tax assets	12	24,928	18,646
Current income tax assets		–	9
Other assets	14	30,051	13,268
Total assets		**779,382**	**824,791**
Liabilities			
Amounts due to credit institutions	15	8,363	23,094
Derivative financial liabilities	7	10,619	16,890
Amounts due to customers	16	513,449	441,183
Borrowed funds from international lenders	17	204,541	230,544
Other liabilities	14	6,638	6,963
Subordinated loans	18	65,060	65,020
Total liabilities		**808,670**	**783,694**
Equity	19		
Share capital		140,258	140,258
Accumulated deficit		(169,576)	(99,161)
Unrealized gains on investment securities		30	–
(Deficit of equity)/Total equity		**(29,288)**	**41,097**
Total liabilities and equity		**779,382**	**824,791**

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

Anar Hasanov — Chairman of the Management Board

Elshan Hajiyev — Executive Director of Finance Control & Accounting

31 May 2019

The accompanying notes on pages 5 to 50 are an integral part of these financial statements.

Statement of profit or loss and other comprehensive income

For the year ended 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2018	2017
Interest income			
Loans to customers		84,586	93,424
Amounts due from credit institutions		858	3,012
Investment securities		962	724
Cash and cash equivalents		420	70
Interest revenue calculated using effective interest rate		**86,826**	**97,230**
Interest expense			
Borrowed funds from international lenders		(17,515)	(31,440)
Amounts due to customers		(27,942)	(22,185)
Subordinated loans		(6,089)	(6,437)
Amounts due to credit institutions		(123)	(992)
		(51,669)	**(61,054)**
Net interest income		**35,157**	**36,176**
Credit loss reversal/(expense)	13	18,384	(17,558)
Net interest income after credit loss reversal/(expense)		**53,541**	**18,618**
Net fee and commission income	21	6,812	6,052
Net gains/(losses) from foreign currency operations:			
- foreign exchange transactions		3,112	4,276
- translation differences		(9)	(4,639)
- foreign currency derivatives		(21,527)	(38,693)
Other income		325	695
Non-interest expense		**(11,287)**	**(32,309)**
Personnel expenses	22	(33,316)	(37,206)
General and administrative expenses	22	(16,614)	(18,614)
Depreciation and amortization	10, 11	(7,871)	(8,645)
Other impairment reversal/(charge)		454	(525)
Other operating expenses		**(57,347)**	**(64,990)**
Loss before income tax expense		**(15,093)**	**(78,681)**
Income tax credit	12	6,289	6,708
Loss for the year		**(8,804)**	**(71,973)**
Other comprehensive income		37	–
Income tax relating to components of other comprehensive income		(7)	–
Total comprehensive loss for the year		**(8,774)**	**(71,973)**

The accompanying notes on pages 5 to 50 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Share capital	*Accumulated deficit*	*Unrealized gain on investment securities*	*Total Equity (Deficit of equity)*
As at 31 December 2016	85,000	(27,188)	–	57,812
Increase in share capital (Note 19)	55,258	–	–	55,258
Loss for the year	–	(71,973)	–	(71,973)
Other comprehensive income for the year	–	–	–	–
Total comprehensive loss for the year	–	(71,973)	–	(71,973)
As at 31 December 2017	**140,258**	**(99,161)**	–	**41,097**
Impact of adopting IFRS 9 (Note 3)	–	(61,611)	–	(61,611)
Restated opening balance under IFRS 9	140,258	(160,772)	–	(20,514)
Loss for the year		(8,804)	–	(8,804)
Other comprehensive income for the year	–	–	30	30
Total comprehensive loss for the year	–	(8,804)	30	(8,774)
31 December 2018	140,258	(169,576)	30	(29,288)

The accompanying notes on pages 5 to 50 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2018	2017
Cash flows from operating activities			
Interest received		65,610	79,676
Interest paid		(54,809)	(63,055)
Fees and commissions received		11,163	8,532
Fees and commissions paid		(4,231)	(2,480)
Realized losses from transactions with foreign currency derivatives		(25,918)	(6,517)
Realized gains less losses from exchange transactions in foreign currencies		3,112	4,276
Other income received		328	482
Personnel expenses paid		(33,002)	(37,010)
Other operating expenses paid		(17,191)	(18,798)
Cash flows used in operating activities before changes in operating assets and liabilities		**(54,938)**	**(34,894)**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		25,071	16,449
Loans to customers		(20,643)	56,826
Other assets		1,897	(1,656)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		(11,221)	(17,296)
Amounts due to customers		74,844	123,579
Other liabilities		136	3,828
Net cash flows from operating activities before income tax		**15,146**	**146,836**
Income tax paid		–	–
Net cash from operating activities		**15,146**	**146,836**
Cash flows from investing activities			
Purchase of property and equipment		(228)	(94)
Proceeds from sale of property and equipment		–	212
Purchase of Investment securities		–	(37,448)
Proceeds from sale and redemption of Investment securities		37,466	–
Acquisition of intangible assets		(1,133)	(1,407)
Net cash from / (used in) investing activities		**36,105**	**(38,737)**
Cash flows from financing activities			
Repayment of borrowed funds from international lenders	26	(27,055)	(233,228)
Increase in share capital		–	15,627
Net cash used in financing activities		**(27,055)**	**(217,601)**
Effect of expected credit loss on cash and cash equivalents		30	–
Effect of exchange rates changes on cash and cash equivalents		(1,562)	(6,062)
Net increase/(decrease) in cash and cash equivalents		**22,664**	**(115,564)**
Cash and cash equivalents, beginning	5	123,030	238,631
Cash and cash equivalents, ending	5	**145,694**	**123,067**

The accompanying notes on pages 5 to 50 are an integral part of these financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

AccessBank Closed Joint Stock Company (the "Bank") was incorporated in the Republic of Azerbaijan on 5 September 2002. The Bank operates under the license number 245 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR").

The Bank's principal business activity is commercial banking operations within the Republic of Azerbaijan, with a focus on serving micro and small business customers.

The Bank participates in the state deposit insurance scheme, which was introduced by the Azerbaijani Law, *Deposits of Individuals Insurance in Azerbaijan Republic* dated 29 December 2006. Starting 2 March 2016 deposits accepted by the Fund's member banks with the annual interest rate 3% in the foreign currency and 15% in the national currency are fully insured for 3 (three) years.

The Bank has twenty eight branches within the Republic of Azerbaijan as at 31 December 2018 (2017 – twenty eight).

The Bank's registered address is 3 Tbilisi Avenue, Baku, AZ1065, Azerbaijan.

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

Shareholders	*2018* %	*2017* %
IFC (International Finance Corporation)	20.86	20.86
EBRD (European Bank for Reconstruction and Development)	18.54	18.54
KFW (Kreditanstalt für Wiederaufbau)	18.54	18.54
BSTDB (Black Sea Trade and Development Bank)	20.49	20.49
Access Microfinance Holding AG	17.82	17.82
LFS Financial Systems GmbH	3.75	3.75
Total	**100.0**	**100.0**

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Azerbaijani manat ("AZN") is the functional and presentation currency of the Bank. Transactions in other currencies are treated as transactions in foreign currencies. The Bank is required to maintain its records and prepare its financial statements in AZN and in accordance with IFRS. The financial statements are presented in thousands of AZN except when otherwise indicated.

The financial statements have been prepared under the historical cost convention except for investment securities and derivative financial instruments which have been measured at fair value.

3. Summary of accounting policies

Going concern

Following the devaluation of AZN in 2015, the Azerbaijani banking sector has been impacted by a number of adverse economic conditions, including worsening of liquidity and tighter credit conditions. During 2018 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani manat. The Bank started benefitting from improving business prospects, credit worthiness of its clients and lending activity. In order to strengthen the financial performance, the Bank implemented improvements measures which reduced operational expenses and strengthened recovery work. Nevertheless, for the year ended 31 December 2018, the Bank had a deficit of equity and total comprehensive loss in the amounts of AZN 29,288 thousand (2017 – total equity AZN 41,097 thousand) and AZN 8,774 thousand (2017 – AZN 71,973 thousand), respectively. This led to breaches of the Bank's regulatory capital adequacy ratios and financial covenants stipulated by borrowing agreements with the international lenders as at 31 December 2018 and 2017 (Notes 20 and 17).

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Going concern (continued)

In March 2018, the group of international lenders entered into immediate standstill agreement with the Bank according which principal repayments on borrowings were ceased and the Bank became liable for payment of interest only. This decision was made in frame of supporting the Bank on recapitalisation plan.

On 15 November 2018, a group of existing international lenders entered into a debt restructuring agreement to recapitalize the Bank. This recapitalization was completed successfully on 15 March 2019. Related measures included a Tier-1 capital increase by AZN 140,000 thousand, thereof AZN 118,460 thousand by way of debt to equity conversion and AZN 21,540 thousand through debt forgiveness. Furthermore, existing senior debt of AZN 21,994 thousand was converted into Tier-2 eligible subordinated debt and a further AZN 21,994 thousand in senior debt was provided as contingent capital to be converted into either Tier-1 or Tier-2 capital in the event of regulatory non-compliance as of 31 October 2020 (Notes 17 and 18). As a result of these measures, the Bank became compliant with the regulatory capital adequacy ratios as at 31 March 2019 in accordance with the prudential report submitted to Financial Markets Supervision Authority ("FMSA") (Note 20).

In March 2019, in the frame of the restructuring agreement, the Bank made a payment of AZN 59,468 thousand of its senior debt. As a result, carrying amount of borrowing from international lenders exposed to breached covenants comprised AZN 26,559 thousand as of 31 March 2019 (Note 17). The capital increase under restructuring agreement provided further relief to the liquidity situation of the Bank by removing medium and long-term repayment obligations, having also reduced the cash outflow from interest payments. Therefore, management believes that its remaining exposure under breached covenants will not negatively impact the Bank's liquidity in case of repayment on demand.

Management believes that the positive trend in the Bank's core business, strong investor support and adequate liquidity will ensure that the Bank will continue as a going concern. Accordingly, these financial statements have been prepared on the assumption that the Bank will continue as a going concern for the foreseeable future, which implies the realisation of assets and settlement of liabilities in the normal course of business.

Changes in accounting policies

The Bank applied IFRS 15 and IFRS 9 for the first time. The nature and effect of the changes as a result of adoption of these new accounting standards are described below.

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2018. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018.

(a) Classification and measurement

Under IFRS 9, all debt financial assets that do not meet a "solely payment of principal and interest" (SPPI) criterion, are classified at initial recognition as fair value through profit or loss (FVPL). Under this criterion, debt instruments that do not correspond to a "basic lending arrangement", such as instruments containing embedded conversion options or "non-recourse" loans, are measured at FVPL. For debt financial assets that meet the SPPI criterion, classification at initial recognition is determined based on the business model, under which these instruments are managed:

- Instruments that are managed on a "hold to collect" basis are measured at amortised cost;
- Instruments that are managed on a "hold to collect and for sale" basis are measured at fair value through other comprehensive income (FVOCI);
- Instruments that are managed on other basis, including trading financial assets, will be measured at FVPL.

Equity financial assets are required to be classified at initial recognition as FVPL unless an irrevocable designation is made to classify the instrument as FVOCI. For equity investments classified as FVOCI, all realised and unrealised gains and losses, except for dividend income, are recognised in other comprehensive income with no subsequent reclassification to profit and loss.

The classification and measurement of financial liabilities remains largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL. Embedded derivatives are no longer separated from a host financial asset.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

(b) Impairment

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan impairment by replacing IAS 39 incurred loss approach with a forward-looking expected credit loss (ECL) approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset. Details of the Bank's impairment method are disclosed in Note 23. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in section (c) below.

(c) Effect of transition to IFRS 9

The following tables set out the impact of adopting IFRS 9 on the statement of financial position and retained earnings as at 1 January 2018 including the effect of replacing IAS 39 incurred credit loss calculations with IFRS 9 ECL.

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as at 1 January 2018 is as follows:

		IAS 39 measurement		*Reclas-*	*Remeasurement*		*IFRS 9*	
Financial assets	*Ref*	*Category*	*Amount*	*sification*	*ECL*	*Other*	*Amount*	*Category*
Cash and cash equivalents		L&R[1]	123,067	–	(37)	–	123,030	Amortised cost
Amounts due from credit institutions		L&R	29,660	–	(84)	–	29,576	Amortised cost
Derivative financial assets		FVPL	1,879	–	–	–	1,879	FVPL (mandatory)
Loans to customers		L&R	541,440	–	(74,277)	12,866	480,029	Amortised cost
Investment securities equity securities at FVOCI	A	AFS[2]	40	–	–	–	40	FVOCI (equity)
Investment securities – debt securities at FVOCI		AFS[2]	39,175	–	–	–	39,175	FVOCI (debt)
Other financial assets		L&R	6,748	–	–	–	6,748	Amortised cost
Non-financial assets								
Deferred tax assets			18,646	–	–	–	18,646	
Total assets			**760,655**	–	**(74,398)**	**12,866**	**699,123**	
Non-financial liabilities								
Deferred tax liabilities			–	–	–	–	–	
Provisions			38	–	79	–	117	
Total liabilities			**38**	–	**79**	–	**117**	

[1] L&R: Loans and receivables.

[2] AFS: Available-for-sale.

A The Bank has elected the option to irrevocably designate its previous AFS equity instruments as Equity instruments at FVOCI.

The impact of transition to IFRS 9 on accumulated deficit is as follows:

Accumulated deficit	
Closing balance under IAS 39 (31 December 2017)	**(99,161)**
Re-measurement of gross carrying amount of loans to customers under IFRS 9	12,866
Recognition of IFRS 9 ECLs	(74,477)
Deferred tax in relation to the above (Note 12)	–
Restated opening balance under IFRS 9 (1 January 2018)	**(160,772)**
Total change in equity due to adopting IFRS 9	**(61,611)**

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

The following table reconciles the aggregate opening loan loss allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 *Provisions Contingent Liabilities and Contingent Assets* to the ECL allowances under IFRS 9.

	Loan loss allowance / provision under IAS 39 / IAS 37 at 31 December 2017	*Re-measurement*	*ECL under IFRS 9 at 1 January 2018*
Impairment allowance for			
Loans and receivables at amortised cost	(156,680)	(74,277)	(230,957)
Cash and cash equivalents	–	(37)	(37)
Amounts due from credit institutions	–	(84)	(84)
Financial guarantees	(38)	(79)	(117)
	(156,718)	**(74,477)**	**(231,195)**

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the majority of the Bank's revenue including interest revenue, gains/(losses) on operations with securities, lease income which are covered by IFRS 9 *Financial Instruments* and IAS 17 *Leases*. As a result, the majority of the Bank's income are not impacted by the adoption of this standard.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Considerations

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transactions for each payment or receipt of advance consideration. This Interpretation does not have any impact on the Bank's financial statements.

Fair value measurement

The Bank measures debt securities at FVOCI and derivatives at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised 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, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

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:

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

- 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 and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets are recognised 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 marketplace.

Initial measurement

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value and, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

Measurement categories of financial assets and liabilities

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost;
- FVOCI;
- FVPL.

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading, are derivative instruments or the fair value designation is applied.

Amounts due from credit institutions, loans to customers, investments securities at amortised cost

Before 1 January 2018, amounts due from credit institutions and loans to customers included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Bank intended to sell immediately or in the near term;
- That the Bank, upon initial recognition, designated as at FVPL or as available-for-sale;
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

From 1 January 2018, the Bank only measures amounts due from credit institutions, loans to customers, investment debt securities and other financial investments at amortized cost if both of the following conditions are met:

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

The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected);
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of financial asset to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Debt instruments at FVOCI

From 1 January 2018, the Bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets;
- The contractual terms of the financial asset meet the SPPI test.

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest revenue and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the asset.

Equity instruments at FVOCI

From 1 January 2018, upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognised in profit or loss as other income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments.

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss and other comprehensive income, and – under IAS 37 (before 1 January 2018) – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 (from 1 January 2018) – an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, under IAS 39, a provision was made if they were an onerous contract but, from 1 January 2018, these contracts are in the scope of the ECL requirements.

Performance guarantees

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Performance guarantees do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the failure to perform the contractual obligation by another party occurs. Therefore, performance guarantees are not considered financial instruments and thus do not fall in scope of IFRS 9.

Loans and receivables

Before 1 January 2018, loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were not entered into with the intention of immediate or short-term resale and were not classified as trading securities or designated as investment securities available-for-sale. Such assets were carried at amortised cost using the effective interest method. Gains and losses were recognised in profit or loss when the loans and receivables were derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Before 1 January 2018, available-for-sale financial assets were those non-derivative financial assets that were designated as available-for-sale or were not classified in any of the three preceding categories. After initial recognition available-for sale financial assets were measured at fair value with gains or losses being recognised in other comprehensive income until the investment was derecognised or until the investment was determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income was reclassified to the statement of profit or loss and other comprehensive income . However, interest calculated using the effective interest method was recognised in profit or loss.

Reclassification of financial assets and liabilities

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Cash and cash equivalents

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

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the statement of profit or loss and other comprehensive income as net gains/(losses) from financial instruments at fair value through profit or loss or net gains/(losses) from foreign currencies, depending on the nature of the instrument.

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

Under IAS 39, derivatives embedded in financial assets, liabilities and non-financial host contacts, were treated as separate derivatives and recorded at fair value if they met the definition of a derivative (as defined above), their economic characteristics and risks were not closely related to those of the host contract, and the host contract was not itself held for trading or designated at FVPL. The embedded derivatives separated from the host were carried at fair value in the trading portfolio with changes in fair value recognised in the statement of profit or loss and other comprehensive income.

From 1 January 2018, with the introduction of IFRS 9, the Bank accounts in this way for derivatives embedded in financial liabilities and non-financial host contracts. Financial assets are classified based on the business model and SPPI assessments.

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 Central bank, amounts due to credit institutions, amounts due to customers, borrowed funds from international lenders and subordinated loans. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

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

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 other operating expenses.

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:

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Offsetting of financial instruments (continued)

- 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 statement of financial position.

Impairment of financial assets under IAS 39

Before 1 January 2018, the Bank assessed at each reporting date whether there was any objective evidence that a financial asset or a group of financial assets was impaired. A financial asset or a group of financial assets was deemed to be impaired if, and only if, there was objective evidence of impairment as a result of one or more events that had occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that could be reliably estimated. Evidence of impairment may have included indications that the borrower or a group of borrowers was experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they would enter bankruptcy or other financial reorganisation and where observable data indicated that there was a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlated with defaults. For available-for-sale financial instruments, evidence of impairment also included significant or prolonged decline in fair value of investment below its cost.

The Bank assessed whether objective evidence of impairment existed individually for financial assets that were individually significant, or collectively for financial assets that were not individually significant.

If there was an objective evidence that an impairment loss had been incurred, the amount of the loss was 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), discounted using original effective interest rate, or, for financial assets available-for-sale, as the difference between cost of investment and its fair value. The carrying amount of the asset was reduced and the amount of the loss was recognised in profit or loss. Interest income continued to be accrued on the reduced carrying amount based on the original effective interest rate of the asset, or, for financial assets available-for-sale, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Assets together with the associated allowance were written off when there is no realistic prospect of future recovery and all collateral had been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss decreased because of an event occurring after the impairment had been recognised, the previously recognised impairment loss was reversed in statement of profit or loss and other comprehensive income, except for equity investments available-for-sale, for which increase in their fair value after impairment were recognised in other comprehensive income.

For the purpose of a collective evaluation of impairment, financial assets were grouped on the basis of the Bank's internal credit grading system that considered 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 were collectively evaluated for impairment were estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience was adjusted on the basis of current observable data to reflect the effects of current conditions that had not affected the years on which the historical loss experience was based and to remove the effects of conditions in the historical period that did not exist currently. Estimates of changes in future cash flows reflected, and were 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 were indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows were reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Information on impairment assessment under IFRS 9 is presented in Note 23.

Renegotiated loans

The Bank will seek to restructure loans, rather than to take possession of collateral where a client has failed to maintain the agreed repayment schedule due to objective changes in circumstances, but is deemed to be able to repay the loan with a modified repayment schedule. This may involve extending the payment arrangements and the agreement of new loan conditions.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Renegotiated loans (continued)

From 1 January 2018, the Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI. When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- Change in currency of the loan;
- Change in counterparty;
- If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss in the statement of profit or loss and other comprehensive income, to the extent that an impairment loss has not already been recorded.

For modifications not resulting in derecognition, the Bank also reassesses whether here has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. Once an asset has been classified as credit-impaired as the result of modification, it will remain in Stage 3 for a minimum 6-month probation period. In order for the restructured loan to be reclassified out of Stage 3, regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period in accordance with the modified payment schedule.

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 derecognised 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 "pass-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 recognised 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.

Write-off

From 1 January 2018, financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Financial liabilities

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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 recognised in profit or loss.

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 basis 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.

Azerbaijan also has various operating taxes that are assessed on the Bank's activities. These taxes are included as a component of general and administrative expenses.

Current and deferred taxes are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity, respectively.

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
Buildings and leasehold improvements	5-20
Furniture and office equipment	4-5
Computer equipment	4-5
Motor vehicles	4

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

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

Intangible assets

Intangible assets 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 finite. Intangible assets with finite lives are amortized over the useful economic lives of two to twelve years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

3. Summary of significant accounting policies (continued)

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 and net realizable value and reported within 'Other assets'.

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Republic of Azerbaijan, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank does not provide post-retirement benefits to its employees.

Share capital

Share capital

Ordinary shares are classified as equity.

Dividends

Dividends are recognized as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorized for issue.

Contingencies

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

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

From 1 January 2018, the Bank calculates interest revenue on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying EIR to the amortized cost of financial assets). EIR 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 revenue or expense.

When a financial asset becomes credit-impaired, the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Bank reverts to calculating interest revenue on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest revenue by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in "Other interest revenue" in the statement of profit or loss and other comprehensive income.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Fees and commissions

The Bank earns fee and commission income from a diverse range of services it provides to its customers. These fees include commission income for provision of the following services: cash withdrawals, settlement operations, insurance agency activities, fees charged for transactions with plastic cards, etc. 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 and commission expense consists of expenses related to plastic cards, cash settlements with customers and investment securities operations.

Foreign currency translation

The financial statements are presented in Azerbaijani manat, which is the Bank's functional and presentation currency Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the statement of profit or loss and other comprehensive income as net gain/(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 net gain/(losses) from foreign currency transactions.

The official CBAR exchange rates at 31 December 2018 and 31 December 2017 were as follows:

	2018	*2017*
USD/AZN	1.7000	1.7001
EUR/AZN	1.9468	2.0307

Standards 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 financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces 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*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

The Bank plans to adopt IFRS 16 retrospectively with the cumulative effect of initially applying IFRS 16 recognised at the date of initial application. The Bank will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

3. Summary of significant accounting policies (continued)

Standards issued but not yet effective (continued)

The Bank will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. The Bank has not yet determined the effect the standard will have on its financial statements.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 and does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately;
- The assumptions an entity makes about the examination of tax treatments by taxation authorities;
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates;
- How an entity considers changes in facts and circumstances.

An entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Bank will apply the interpretation from its effective date. Although the Bank operates in a complex tax environment, applying the Interpretation is not expected to have any material impact on the financial statements. In addition, the Bank may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

Amendments to IFRS 9: Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the financial statements of the Bank.

Annual improvements 2015-2017 cycle (issued in December 2017)

These improvements include:

IAS 12 Income Taxes

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.

An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognized on or after the beginning of the earliest comparative period. Since the Bank's current practice is in line with these amendments, the Bank does not expect any effect on its financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 24.

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model, which assigns PDs to the individual grades;
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment;
- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various formulae and the choice of inputs;
- Determination of associations between macroeconomic scenarios, economic inputs and the effect on PDs, EADs and LGDs;
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

More details are provided in Notes 9 and 23.

Deferred tax assets

Deferred income tax assets are recorded to the extent that realization of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on medium term business plan prepared by management and extrapolated results thereafter. The business plans are based on management expectations that are believed to be reasonable under the circumstances.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2018	*2017*
Cash on hand	61,744	44,834
Current accounts with the CBAR	28,866	74,886
Current accounts with other banks	24,491	3,347
Time deposits with the credit institutions up to 90 days	30,600	–
	145,701	**123,067**
Less – allowance for impairment	(7)	–
Cash and cash equivalents	**145,694**	**123,067**

(Figures in tables are in thousands of Azerbaijani manats)

5. Cash and cash equivalents (continued)

As at 31 December 2018, Current accounts with other banks consist of correspondent account balances with resident and non-resident banks in the amount of AZN 3,130 thousand (2017 – AZN 371 thousand) and AZN 21,361 thousand (2017 – AZN 2,976 thousand), respectively.

As at 31 December 2018, time deposits with the credit institutions up to 90 days consist of interest bearing overnight deposits placed in two non-resident banks in the amount of AZN 30,600 thousand.

An analysis of changes in gross carrying value and corresponding ECL allowance on cash equivalents during the year ended 31 December 2018 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**78,231**	**2**	**–**	**78,233**
New assets originated or purchased	52,336	–	–	**52,336**
Assets repaid	(46,610)	(2)	–	**(46,612)**
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	(722)	722	–	–
Transfers to Stage 3	–	–	–	–
At 31 December 2018	**83,235**	**722**	**–**	**83,957**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2018	**(37)**	**–**	**–**	**(37)**
New assets originated or purchased	(7)	–	–	**(7)**
Assets repaid	37	–	–	**37**
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	1	(1)	–	–
Transfers to Stage 3	–	–	–	–
At 31 December 2018	**(6)**	**(1)**	**–**	**(7)**

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2018	*2017*
Blocked current account with the CBAR	–	13,397
Obligatory reserve with the CBAR	3,093	2,830
Blocked current accounts with credit institutions	1,324	13,431
Other	8	2
	4,425	29,660
Less- impairment loss allowance	(2)	–
Amounts due from credit institutions	**4,423**	**29,660**

As at 31 December 2017, blocked current accounts represent funds with the CBAR of AZN 13,397 thousand blocked against borrowings from the CBAR (Note 15). As at 31 December 2018, blocked current accounts with credit institutions represent current accounts with two non-resident credit institutions of AZN 1,324 thousand (2017 – 13,431 thousand) blocked against guarantees issued for three customers.

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 0.5% and 1% (2017 – 0.5% and 1%) of the previous month average of attracted funds by the credit institution in foreign and local currencies, respectively. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

(Figures in tables are in thousands of Azerbaijani manats)

6. Amounts due from credit institutions (continued)

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2018 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**29,660**	–	–	**29,660**
New assets originated or purchased	1,593	–	–	**1,593**
Assets repaid	(26,828)	–	–	**(26,828)**
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	(1,032)	1,032	–	–
Transfers to Stage 3	–	–	–	–
At 31 December 2018	**3,393**	**1,032**	–	**4,425**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2018	**(84)**	–	–	**(84)**
New assets originated or purchased	(2)	–	–	**(2)**
Assets repaid	84	–	–	**84**
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	2	(2)	–	–
Transfers to Stage 3	–	–	–	–
At 31 December 2018	–	**(2)**	–	**(2)**

7. Derivative financial assets and liabilities

The Bank enters into derivative financial instruments for trading purposes. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2018			*2017*		
	Notional	*Fair value*		*Notional*	*Fair value*	
	amount	*Asset*	*Liability*	*amount*	*Asset*	*Liability*
Foreign exchange contracts						
Forwards and swaps – foreign	44,690	–	(10,416)	147,702	1,822	(16,890)
Forwards and swaps – domestic	20,375	–	(203)	1,997	57	–
Total derivative assets/ (liabilities)		**–**	**(10,619)**		**1,879**	**(16,890)**

Forwards contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

(Figures in tables are in thousands of Azerbaijani manats)

8. Investment securities

Investment securities comprises:

	2018	*2017*
Debt securities at FVOCI		
Notes issued by the CBAR	–	37,450
Corporate bonds	1,724	1,685
Other	40	40
Investment securities at FVOCI	**1,764**	**39,175**

All balances of investment securities are allocated to Stage 1. The ECL relating to investment securities of the Bank rounds to zero.

9. Loans to customers

Loans to customers comprise:

	2018	*2017*
SME loans	409,276	438,122
Micro loans	234,738	213,065
Retail loans	43,278	22,773
Mortgage loans	13,050	17,762
Staff loans	4,434	6,398
Gross loans to customers	**704,776**	**698,120**
Less: allowance for impairment	(183,434)	(156,680)
Loans to customers	**521,342**	**541,440**

As at 31 December 2018, out of the total amount of loans 50% (2017 – 65.6%) are denominated in foreign currencies.

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers (continued)

Allowance for impairment of loans to customers

An analysis of changes in the gross carrying value and corresponding ECL in relation to SME loans during the year ended 31 December 2018 is as follows:

Loan to customers – SME	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**255,210**	7,620	**183,998**	446,828
New assets originated or purchased	101,350	–	–	101,350
Assets repaid	(98,938)	(2,495)	(27,597)	(129,030)
Transfers to Stage 1	4,679	(3,106)	(1,573)	–
Transfers to Stage 2	(17,433)	17,773	(340)	–
Transfers to Stage 3	(19,340)	(1,692)	21,032	–
Changes to contractual cash flows due to modifications not resulting in derecognition	(5,265)	(316)	(116)	(5,697)
Recoveries	–	–	165	165
Amounts written off	(400)	(12)	(3,928)	(4,340)
At 31 December 2018	**219,863**	**17,772**	**171,641**	**409,276**

Loans to customers – SME	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	(48,422)	(5,107)	(90,328)	(143,857)
New assets originated or purchased	(841)	–	–	(841)
Assets repaid	4,586	803	14,335	19,724
Transfers to Stage 1	(3,068)	2,447	621	–
Transfers to Stage 2	8,756	(8,933)	177	–
Transfers to Stage 3	6,109	907	(7,016)	–
Unwinding of discount (recognised in interest revenue)	–	–	(4,207)	(4,207)
Changes due to modifications not resulting in derecognition	1,204	284	140	1,628
Changes to models and inputs used for ECL calculations	(4,684)	(3,114)	(335)	(8,133)
Recoveries	–	–	(165)	(165)
Amounts written off	400	12	3,928	4,340
At 31 December 2018	**(35,960)**	**(12,701)**	**(82,850)**	**(131,511)**

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers (continued)

Allowance for impairment of loans to customers (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Micro loans during the year ended 31 December 2018 is as follows:

Loan to customers – micro	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**145,924**	**1,284**	**69,924**	**217,132**
New assets originated or purchased	156,778	–	–	**156,778**
Assets repaid	(100,019)	(834)	(7,311)	**(108,164)**
Transfers to Stage 1	296	(59)	(237)	–
Transfers to Stage 2	(3,218)	3,368	(150)	–
Transfers to Stage 3	(8,545)	(340)	8,885	–
Changes to contractual cash flows due to modifications not resulting in derecognition	(517)	(2)	(19)	(538)
Recoveries	–	–	1,416	1,416
Amounts written off	(1,298)	(49)	(30,539)	(31,886)
At 31 December 2018	**189,401**	**3,368**	**41,969**	**234,738**

Loan to customers – micro	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(31,445)**	**(788)**	**(49,354)**	**(81,587)**
New assets originated or purchased	(2,742)	–	–	**(2,742)**
Assets repaid	8,052	444	2,434	**10,930**
Transfers to Stage 1	(175)	46	129	–
Transfers to Stage 2	2,341	(2,424)	83	–
Transfers to Stage 3	6,016	248	(6,264)	–
Unwinding of discount (recognised in interest revenue)	–	–	(2,604)	**(2,604)**
Changes due to modifications not resulting in derecognition	271	22	43	**336**
Changes to models and inputs used for ECL calculations	(675)	364	1,053	**742**
Recoveries	–	–	(1,416)	**(1,416)**
Amounts written off	1,298	49	30,539	**31,886**
At 31 December 2018	**(17,059)**	**(2,039)**	**(25,357)**	**(44,455)**

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers (continued)

Allowance for impairment of loans to customers (continued)

An analysis of changes in the gross carrying value and corresponding ECL in relation to Retail, Mortgage and Staff Loans during the year ended 31 December 2018 is as follows:

Loans to customers – retail, mortgage and staff	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**39,863**	**179**	6,984	47,026
New assets originated or purchased	40,718	–	–	40,718
Assets repaid	(23,331)	(92)	(1,821)	(25,244)
Transfers to Stage 1	96	(37)	(59)	–
Transfers to Stage 2	(165)	182	(17)	–
Transfers to Stage 3	(6,841)	(12)	6,853	–
Changes to contractual cash flows due to modifications not resulting in derecognition	(41)	–	–	(41)
Recoveries	–	–	285	285
Amounts written off	(36)	(3)	(1,943)	(1,982)
At 31 December 2018	**50,263**	**217**	**10,282**	**60,762**

Loans to customers – retail, mortgage and staff	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(1,841)**	**(97)**	**(3,575)**	(5,513)
New assets originated or purchased	(4,092)	–	–	(4,092)
Assets repaid	240	24	959	1,223
Transfers to Stage 1	(37)	27	10	–
Transfers to Stage 2	41	(42)	1	–
Transfers to Stage 3	4,124	3	(4,127)	–
Unwinding of discount (recognised in interest revenue)			(264)	(264)
Changes due to modifications not resulting in derecognition	8	–	–	8
Changes to models and inputs used for ECL calculations	(386)	(41)	(100)	(527)
Recoveries	–	–	(285)	(285)
Amounts written off	36	3	1,943	1,982
At 31 December 2018	**(1,907)**	**(123)**	**(5,438)**	**(7,468)**

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers (continued)

Allowance for impairment of loans to customers (continued)

A reconciliation of the allowance for impairment of loans to customers by class during the year ended 31 December 2017 is as follows:

	Micro loans	*SME loans*	*Retail loans*	*Mortgage loans*	*Staff loans*	*Total*
At 1 January 2017	**49,237**	**88,361**	**2,327**	**1,157**	**647**	**141,729**
Charge/(reversal) for the year	4,552	12,731	409	(324)	190	**17,558**
Recoveries	2,587	1,062	671	–	8	**4,328**
Amounts written off	(2,250)	(3,674)	(847)	–	(164)	**(6,935)**
At 31 December 2017	**54,126**	**98,480**	**2,560**	**833**	**681**	**156,680**
Individual impairment	18,639	68,966	3	421	561	**88,590**
Collective impairment	35,487	29,514	2,557	412	120	**68,090**
Total impairment	**54,126**	**98,480**	**2,560**	**833**	**681**	**156,680**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**32,674**	**161,616**	**41**	**1,133**	**1,729**	**197,193**

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers (continued)

Modified and restructured loans

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

The table below includes Stage 1, 2 and 3 assets that were modified during the period, with the related modification loss suffered by the Bank.

	2018
Loans modified during the period	
Amortised cost before modification	130,410
Modification loss	(6,276)

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 micro loans, cash, charges over real estate properties, inventory, vehicles and third party guarantees;
- For SME loans, cash, charges over real estate properties, inventory and vehicles;
- For retail loans, cash, charges over credited consumer appliances, vehicles, mortgages over residential properties and third party guarantees;
- For mortgage loans, mortgages over residential properties;
- For staff loans, cash, vehicles and mortgages over residential properties.

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.

The Bank calculates LGD rate of individually impaired loans in Stage 3 using discounted value of collaterals. As at 31 December 2018, maximum exposure of such loans amounted to AZN 202,618 thousand for which ECL of AZN 95,585 thousand was created. If these loans were not collateralized, ECL amount for these loans would be AZN 177,243 thousand based on the collective assessment.

Concentration of loans to customers

As at 31 December 2018, the Bank had a concentration of loans represented by AZN 89,841 thousand due from the twenty (2017 – twenty) largest third party borrowers (12.75% of gross loan portfolio) (2017 – AZN 101,535 thousand or 14.5% of gross loan portfolio). An allowance of AZN 40,668 thousand (2017 – AZN 17,424 thousand) was recognized against these loans.

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

	2018	*2017*
Trade	296,505	289,409
Services	237,880	242,115
Agriculture	80,799	76,920
Household	26,838	29,507
Manufacturing	44,823	48,674
Transportation	16,273	11,495
Other	1,658	–
	704,776	**698,120**

(Figures in tables are in thousands of Azerbaijani manats)

10. Property and equipment

The movements in property and equipment were as follows:

	Buildings and leasehold improvements	*Furniture and office equipment*	*Computer equipment*	*Motor vehicles*	*Total*
Cost					
31 December 2017	50,568	11,643	8,164	1,212	71,587
Additions	–	13	192	71	276
Disposals	–	(60)	(120)	(278)	(458)
31 December 2018	50,568	11,596	8,236	1,005	71,405
Accumulated depreciation					
31 December 2017	(16,815)	(10,436)	(7,138)	(1,038)	(35,427)
Depreciation charge	(2,311)	(777)	(621)	(128)	(3,837)
Disposals	–	60	118	277	455
31 December 2018	(19,126)	(11,153)	(7,641)	(889)	(38,809)
Net book value					
31 December 2017	33,753	1,207	1,026	174	36,160
31 December 2018	31,442	443	595	116	32,596

	Buildings and leasehold improvements	*Furniture and office equipment*	*Computer equipment*	*Motor vehicles*	*Total*
Cost					
31 December 2016	50,568	12,407	8,214	1,241	72,430
Additions	–	33	66	–	99
Disposals	–	(797)	(116)	(29)	(942)
31 December 2017	50,568	11,643	8,164	1,212	71,587
Accumulated depreciation					
31 December 2016	(14,329)	(9,924)	(6,451)	(897)	(31,601)
Depreciation charge	(2,486)	(1,285)	(800)	(170)	(4,741)
Disposals	–	773	113	29	915
31 December 2017	(16,815)	(10,436)	(7,138)	(1,038)	(35,427)
Net book value					
31 December 2016	36,239	2,483	1,763	344	40,829
31 December 2017	33,753	1,207	1,026	174	36,160

(Figures in tables are in thousands of Azerbaijani manats)

11. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2017	**26,849**	**8,664**	**35,513**
Additions	654	477	1,131
Disposals	–	–	–
31 December 2018	**27,503**	**9,141**	**36,644**
Accumulated amortization			
31 December 2017	**(7,380)**	**(6,646)**	**(14,026)**
Amortization charge	(2,305)	(1,729)	(4,034)
Disposals	–	–	–
31 December 2018	**(9,685)**	**(8,375)**	**(18,060)**
Net book value			
31 December 2017	**19,469**	**2,018**	**21,487**
31 December 2018	**17,818**	**766**	**18,584**

	Licenses	*Computer software*	*Total*
Cost			
31 December 2016	**25,872**	**8,233**	**34,105**
Additions	977	431	1,408
Disposals	–	–	–
31 December 2017	**26,849**	**8,664**	**35,513**
Accumulated amortization			
31 December 2016	**(4,426)**	**(5,696)**	**(10,122)**
Amortization charge	(2,954)	(950)	(3,904)
Disposals	–	–	–
31 December 2017	**(7,380)**	**(6,646)**	**(14,026)**
Net book value			
31 December 2016	**21,446**	**2,537**	**23,983**
31 December 2017	**19,469**	**2,018**	**21,487**

12. Taxation

The corporate income tax expense comprises:

	2018	*2017*
Current tax charge	–	(398)
Deferred tax credit – origination and reversal of temporary differences	6,282	7,106
Less: deferred tax recognised in other comprehensive income	7	–
Income tax credit	**6,289**	**6,708**

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	2018	*2017*
Net gains on investment securities at fair value through OCI	(7)	X
Income tax charged to other comprehensive income	**(7)**	**–**

(Figures in tables are in thousands of Azerbaijani manats)

12. Taxation (continued)

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2018	*2017*
Loss before tax	**(15,093)**	**(78,681)**
Statutory tax rate	20%	20%
Theoretical income tax benefit at the statutory rate	**3,019**	**15,736**
Prior year tax expense actualisation	–	1,382
Tax effect of non-deductible expenditures	(64)	(73)
Change in unrecognised deferred tax assets	3,186	(10,513)
Other	148	176
Income tax credit	**6,289**	**6,708**

Deferred tax assets and liabilities as of 31 December 2018 and their movements for the respective years comprise:

	2016	*Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income*	*2017*	*Effect of adoption of IFRS 9 (Note 3)*	*In other comprehensive income*	*Origination and reversal of temporary differences in statement of profit or loss and other comprehensive income*	*2018*
Tax effect of deductible temporary differences							
Loans to customers	–	2,642	2,642	12,282	–	2,457	17,381
Intangible assets	342	(342)	–	–	–	–	–
Property and equipment	208	115	323	–	–	70	393
Derivative financial liabilities	–	2,433	2,433	–	–	(883)	1,550
Other assets	(134)	187	53	–	–	(53)	–
Other liabilities	–	–	–	16	–	1	17
Losses available for offset against future taxable income	24,208	9,386	33,594	–	–	1,076	34,670
Gross deferred tax asset	**24,624**	**14,421**	**39,045**	**12,298**	**–**	**2,668**	**54,011**
Unrecognised deferred tax asset	(9,310)	(10,513)	(19,823)	(12,322)	–	3,186	(28,959)
Deferred tax asset	**15,314**	**3,908**	**19,222**	**(24)**	**–**	**5,854**	**25,052**
Tax effect of taxable temporary differences							
Cash and cash equivalents	(71)	35	(36)	7	–	(94)	(123)
Amounts due from credit institutions	–	–	–	17	–	(33)	(16)
Investment securities	–	–	–	–	(7)	–	(7)
Derivative financial assets	(1,905)	1,530	(375)	–	–	375	–
Amounts due to credit institutions	(514)	514	–	–	–	(23)	(23)
Loan to customers	(1,154)	1,154	–	–	–	–	–
Intangible assets	–	(128)	(128)	–	–	(8)	(136)
Other borrowed funds	(63)	63	–	–	–	–	–
Other liabilities	(54)	17	(37)	–	–	37	–
Other assets	–	–	–	–	–	181	181
Subordinated loans	(13)	13	–	–	–	–	–
Deferred tax liability	**(3,774)**	**3,198**	**(576)**	**24**	**(7)**	**435**	**(124)**
Net deferred income tax asset/(liability)	**11,540**	**7,106**	**18,646**	**–**	**(7)**	**6,289**	**24,928**

(Figures in tables are in thousands of Azerbaijani manats)

13. Credit loss reversal/(expense) and other impairment and provisions

The table below shows the ECL charges and reversals on financial instruments recorded in the profit or loss and other comprehensive income for the year ended 31 December 2018:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents	5	31	(1)	–	**30**
Amounts due from credit institutions	6	84	(2)	–	**82**
Loans to customers	9	25,048	(8,935)	2,143	**18,256**
Credit loss reversal/(expense) on financial assets		**25,163**	**(8,938)**	**2,143**	**18,368**
Financial guarantees	20	(25)	41	–	**16**
Credit related commitments		**(25)**	**41**	**–**	**16**
Total credit loss reversal/(expense)		**25,138**	**(8,897)**	**2,143**	**18,384**

As at 31 December 2018, an impairment reversal of other non-financial assets amounted to AZN 454 thousand.

Provision for ECL for credit related commitments are recorded in other liabilities.

14. Other assets and liabilities

Other assets comprise:

	2018	*2017*
Other financial assets		
Settlements through payment terminals	1,734	3,101
Settlements on money transfers and plastic cards	1,315	1,861
Cash blocked by Visa / Master Cards	1,597	1,484
Other	118	302
	4,764	**6,748**
Other non-financial assets		
Deferred expenses	1,012	1,182
Collaterals repossessed in lieu of non-performing loans	23,898	4,668
Prepayments for operating lease agreements	332	528
Prepayments for acquisition of property, equipment and intangible assets	26	69
Other	19	73
	25,287	**6,520**
Other assets	**30,051**	**13,268**

Other liabilities comprise:

	2018	*2017*
Other financial liabilities		
Settlements on money transfer	2,149	1,440
Payables for professional services	752	440
	2,901	**1,880**
Other non-financial liabilities		
Payables to employees	3,108	3,375
Taxes, other than income tax	403	1,659
Other	226	49
	3,737	**5,083**
Other liabilities	**6,638**	**6,963**

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to credit institutions

Amounts due to credit institutions comprise

	2018	*2017*
Loans from the CBAR	–	10,001
Funds received from National Fund for Support of Entrepreneurship	7,877	12,435
Current accounts of credit institutions	486	658
Amounts due to credit institutions	**8,363**	**23,094**

As at 31 December 2018, the Bank had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 7,877 thousand (2017 – AZN 12,435 thousand), maturing through August 2023 (2017 – August 2023), and bearing annual interest rate of 1%. The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at 6%.

16. Amounts due to customers

The amounts due to customers include the following:

	2018	*2017*
Current accounts	177,779	135,452
Term deposits	335,670	305,731
Amounts due to customers	**513,449**	**441,183**
Held as security against guarantees (Note 20)	**229**	**193**

As at 31 December 2018, customer accounts included balances with one hundred (2017 – one hundred) largest customers, which comprised AZN 133,048 thousand or 26% of the amounts due to customers (2017 – AZN 133,247 thousand or 30% of the amounts due to customers). As at 31 December 2018, 48% (2017 – 52%) of amounts to due to customers were denominated in foreign currencies.

Customer accounts by economic sectors are as follows:

	2018	*2017*
Individuals	438,412	349,750
Insurance companies	17,079	61,147
Other	57,958	30,286
Amounts due to customers	**513,449**	**441,183**

17. Borrowed funds from international lenders

Borrowed funds from international lenders consisted of the following:

	2018	*2017*
Syndicated loans	23,041	30,533
Bilateral borrowings	181,500	200,011
Borrowed funds from international lenders	**204,541**	**230,544**

As at 31 December 2018, the Bank's indebtedness under the syndicated loan agreement was outstanding to only one financial institution (2017 – one financial institution) in the aggregate amount of AZN 23,041 thousand (2017 – AZN 30,533 thousand).

As at 31 December 2018, the Bank had senior bilateral borrowings with eight financial institutions (2017 – eight financial institutions) in the aggregate amount of AZN 181,500 thousand (2017 – AZN 200,011 thousand).

17. Borrowed funds from international lenders (continued)

In March 2018, the group of international lenders entered into immediate standstill agreement with the Bank according which principal repayments on borrowings were ceased and the Bank became liable for payment of interest only. This decision was made in frame of supporting the Bank on recapitalisation plan (Note 3).

On 15 November 2018, a group of existing international lenders entered into a debt restructuring agreement to recapitalize the Bank. According to this agreement AZN 7,970 thousand out of syndicated and AZN 46,066 thousand out of bilateral borrowings are subject to conversion into the Bank's equity. In addition, AZN 3,244 thousand out of syndicated and AZN 18,750 thousand out of bilateral borrowings are subject to conversion into the Bank's Tier-2 eligible subordinated debt. As at 31 December 2018, the conversion of the debts to the Bank's equity is to be completed subject to certain conditions including issuance by the Bank, and registration with FMSA, new common non-bearer shares in the total nominal amount of AZN 118,460 thousand. Moreover, 40% of debt from one financial institution in the amount of AZN 21,540 thousand is subject to forgiveness under certain performance obligation. The debt restructuring was completed in March 2019 (Notes 3 and 28).

The Bank is obliged to comply with financial and non-financial covenants stipulated by several of the aforementioned borrowing agreements. As at 31 December 2018 and 2017, the Bank was not in compliance with the financial covenant under all senior loan agreements . In March 2019, in the frame of the restructuring agreement, the Bank made a payment of AZN 59,468 thousand of its senior debt. As a result, carrying amount of borrowing from international lenders exposed to breached covenants comprised AZN 26,559 thousand as of 31 March 2019 (Note 3).

18. Subordinated loans

As at 31 December 2018 and 2017, the Bank had subordinated loans from three financial institutions in the aggregate amount of AZN 65,060 thousand (2017 – AZN 65,020 thousand).

Under the restructuring agreement, AZN 64,424 thousand out of subordinated loans is subject to conversion into the Bank's equity. As at 31 December 2018, the conversion of the debt to the Bank's equity is to be completed subject to certain conditions including issuance by the Bank, and registration with FMSA, new common non-bearer shares in the total nominal amount of AZN 118,460 thousand, to be established from subordinated loans and borrowed funds from international lenders (Notes 3 and 17).

The subordinated loans rank after all other creditors and depositors of the Bank in case of liquidation. The Bank is obliged to comply with certain covenants stipulated by one of the aforementioned loan agreements. As at 31 December 2018, the Bank was not in compliance with the financial covenants.

19. Equity

As at 31 December 2018, the Bank had 33,002 thousand authorized, issued and fully paid ordinary shares (2017 – 33,002 thousand) with a nominal value of AZN 4.25 per share.

During 2017, the shareholders of the Bank increased share capital twice, i.e. in March 2017 and September 2017, in the amounts of AZN 34,850 thousand and AZN 20,408 thousand respectively. These capital increases were partially made by conversion of the Bank's existing senior and subordinated debt into equity (AZN 39,631 thousand out of total AZN 55,258 thousand capital increase). The share capital of the Bank was raised by the shareholders in AZN and they are entitled to dividends and any capital distribution in AZN.

20. Commitments and contingencies

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 their 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.

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies (continued)

Taxation (continued)

Management believes that its interpretation of the relevant legislation as at 31 December 2018 and 2017 is appropriate and the Bank's tax, currency and customs position will be sustained.

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2018 and 2017, the Bank was in compliance with these ratio except for:

- Tier I Capital Adequacy ratio;
- Total Capital Adequacy ratio;
- Minimum Capital requirements;
- The ratio of maximum credit exposure per a single borrower or a group of related borrowers ratio that should not exceed 7 percent of the bank's Tier 1 capital when the market value of the security of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value (2017 – none);
- The ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 20 percent of the bank's Tier 1 capital when the market value of the security of credit exposures is more than 100 percent of such credit exposures, or the market value of real estate collateral of loans is above 150% of the loan value;
- Leverage ratio;
- Aggregate Open Currency Position.

Throughout the year the Bank submitted information regarding these breaches to FMSA on a monthly basis and no sanctions were imposed on the Bank. During 2018, based on request of FMSA the Bank submitted to FMSA the Recapitalization Plan dated 6 July 2018 and Restructuring Agreement dated 15 November 2018 entered into between the Bank, international lenders and existing shareholders of the Bank, envisaging increase of the Bank's capital for the purposes of restoring compliance with Regulatory capital requirements.

In accordance with the prudential report submitted to FMSA, breaches of the abovementioned ratios were subsequently eliminated following the increase of the Bank's capital in March 2019 (Note 3) and the new "Rules on limits for the open currency position in banks" that became effective on 1 March 2019. Consequently, Management believes that the Bank will not face any sanctions against the Bank related to breaches of the prudential ratios as at 31 December 2018 and 31 December 2017 and for the years then ended in the future.

Financial commitments and contingencies

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

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

	2018	*2017*
Credit related commitments		
Undrawn loan commitments	3,507	3,182
Financial Guarantees	5,592	5,599
Less: provision for ECL credit related commitments	(101)	(38)
Commitments and contingencies (before deducting collateral)	**8,998**	**8,743**
Less: deposits held as security against guarantees (Note 16)	(229)	(193)
Commitments and contingencies	**8,769**	**8,550**

(Figures in tables are in thousands of Azerbaijani manats)

20. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

An analysis of changes in the ECLs during the year ended 31 December 2018 is as follows:

Financial guarantees	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2018	**(68)**	**(49)**	–	**(117)**
New exposures	(31)	–	–	(31)
Exposures derecognised or matured (excluding write-offs)	–	(2)	–	(2)
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	–
Changes to inputs used for ECL calculations	6	43	–	49
At 31 December 2018	**(93)**	**(8)**	**–**	**(101)**

21. Net fee and commission income

Net fee and commission income comprises:

	2018	*2017*
Settlement operations	3,547	2,972
Cash operations	3,756	2,808
Plastic cards	3,610	2,374
Documentary operations	55	46
Other	75	332
Fee and commission income	**11,043**	**8,532**
Plastic cards	(3,150)	(1,552)
Cash operations	(57)	(73)
Settlements operations	(107)	(54)
Central Credit Registry fees	(271)	(234)
Other	(646)	(567)
Fee and commission expense	**(4,231)**	**(2,480)**
Net fee and commission income	**6,812**	**6,052**

22. Personnel, general and administrative expenses

Personnel expenses comprise:

	2018	*2017*
Salaries	(28,315)	(31,708)
Social security costs	(4,891)	(5,369)
Other employee related expenses	(110)	(129)
Personnel expenses	**(33,316)**	**(37,206)**

(Figures in tables are in thousands of Azerbaijani manats)

22. Personnel, general and administrative expenses (continued)

General and administrative expenses comprise:

	2018	*2017*
Consultancy and other professional fees	(5,276)	(5,165)
Data processing	(2,401)	(3,825)
Occupancy and rent	(1,516)	(1,648)
Stationery and office supplies	(1,031)	(1,444)
Communications	(1,237)	(1,410)
Repair and maintenance	(821)	(971)
Security services	(601)	(608)
Utilities	(453)	(576)
Advertising and marketing expenses	(687)	(483)
Taxes, other than income tax	(352)	(437)
Business travel expense	(189)	(421)
Entertainment	(44)	(34)
Other	(2,006)	(1,592)
Total general and administrative expenses	**(16,614)**	**(18,614)**

23. Risk management

Introduction

The Bank is exposed to financial and operational risks. Risk exposure is integral to the Bank's business. The Bank's risk management function's aim is to achieve an appropriate balance between risk and return and to minimise potential adverse effects on the Bank's financial performance.

Risk Management Framework

The Management Board is the primary body responsible for the risk management function in the Bank. The risk management function is carried out in respect of financial risks and operational risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function of the Management Board are (i) determining and assessing the specific risks of the Bank's activity, (ii) establishing risk limits and (iii) ensuring that the exposures stay within these limits. The Management Board is also responsible for ensuring an appropriate balance between risk and return, whilst minimizing any potential adverse effects on the Bank's financial performance. The operational risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

The Bank's risk management methodology, policies and assessment procedures are designed to identify, analyse, mitigate and manage the risks faced by the Bank. This is accomplished through setting of appropriate risk limits and controls, whilst ensuring suitable monitoring of risk levels and compliance with the limits and procedures on an on-going basis. The risk management policies and procedures are reviewed regularly to reflect changes in market conditions, and new products and services offered. This is to ensure that "best practices" are implemented in the Bank.

Risk Management Bodies and Governance

Risk management policies and processes around the assessment, approval, monitoring and control of risks are performed by a number of specialized bodies within the Bank, including committees and departments which comply with the requirement of the respective Azerbaijani laws, the CBAR regulations and industry best practices.

The Supervisory Board has overall responsibility for the oversight of the risk management framework. This includes the management of key risks, along with the review and approval of risk management policies and key risk limits such as large exposures, economic and product sector limits. It also delegates certain risk supervision authority levels to the Management Board, the Risk Committee and the Asset and Liability Committee ("ALCO").

Overall roles and responsibilities for the risk management framework are shown below:

Responsibility area	*Supervising body*	*Executive Management*
Strategic and organizational risk	Supervisory Board	Management Board
Credit risk	Management Board / Risk Committee	Business Banking / Risk Department
Market and liquidity risk	Risk Committee, ALCO	Finance/Treasury
Operational risks	Management Board	Internal Audit / Risk Department

23. Risk management (continued)

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties fail to discharge their contractual obligations. The Bank identifies, measures, monitors and controls the risk inherent in individual credits or transactions as well as the risk of the entire portfolio. The Bank sets limits on the amount of risk it is willing to accept for individual counterparties and for sector, region, industry and product 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.

Credit-related commitments risks

The Bank offers guarantees to its customers 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 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.

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 9.

Impairment assessment

From 1 January 2018, the Bank calculates ECL based on several probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are as follows:

PD — The *Probability of Default* is an estimate of the likelihood of default over a given time horizon.

EAD — The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 financial assets, the exposure at default is considered for events over the lifetime of the instruments.

LGD — The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The 12mECL is the portion of LTECL that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both LTECL and 12mECL are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

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, geographic regions 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. The portfolio is divided into 3 stages:

- Loans with less than 30 overdue days refers to Stage 1.
- Loans with 31-90 overdue days are considered as Stage 2.
- Loans with more than 90 overdue days is characterized as Stage 3.

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or whether there are any known difficulties for repayments by counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Defirniton of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.

Such events include:

- Default and Credit-impaired assets:
    - Loans with principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract;
- Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition.
- Default (according to IRB and External Rating).
- Default on other financial instruments of the same borrower.

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present as of reporting date. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the overdue days.

PD estimation process

The client relies on logit regression analysis in order to calculate PD, which represents the relationship between dependent (PD) and one or more independent variables and allows to look at the fit of the model as well as at the significance of the relationships (between dependent and independent variables). The model incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. PDs, incorporating forward looking information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Additionally, financial guarantees, trade receivables, securities, correspondent accounts, and deposits are assessed and provisions are made.

- Average PD rates of the portfolio with 0 overdue days are applied for "ECL of guarantees without loans" calculation. The PD rate of the same client loans is also applied for "ECL of guarantees with loans" calculation.
- PD for receivables and correspondent accounts is taken from external ratings of organizations as of 2018 – end. LGD is considered as 100%.
- Securities part contains only SOCAR bonds. PD is taken from Moody's Average Volume-Weighted Corporate Bond Default Rates. "Rate" for LGD of securities calculation is taken from Moody's Average Unsecured Bond Recovery Rates: LGD = 1 – "rate"

Macro model is used for calculating 1 year PD and 2 years PD rates adjustments. Variables of model are Brent oil price and consumer price index. Applying the macro model shows macroeconomic factor effects to PD rates.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Factors 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 pay-out should bankruptcy ensue, the availability of other financial support and the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

In light of challenging economic conditions, for the purpose of allowance assessment in 2018, the Bank has considered loans for individual assessment when the exposure of a borrower is more than 5 thousand USD equivalent, is overdue for more than 90 days and is covered by hard collateral.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant 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 following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, expected receipts and recoveries once impaired and excess of expected growth in the portfolio. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Loss given default

The credit risk assessment is based on a standardized LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

LGD rates are estimated for the SME, Micro and Retail segment of each asset class. Where appropriate, further recent data is used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, such as:

- NPL average;
- Brent oil price;
- CPI

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The Bank obtains the forward-looking information from third party sources (external rating agencies, governmental bodies e.g. central banks, and international financial institutions). Experts of the Bank's Credit Risk Department determine the weights attributable to the multiple scenarios.

Credit quality per class of financial assets

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

As at 31 December 2018 cash and cash equivalents as well as amounts due from credit institutions held at the CBAR and OECD investment grade banks are classified as high grade. Cash and cash equivalents held in other banks is included in standard grade.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Loans with good debt service are included in the standard grade. Sub-standard grade loans consist of restructured loans with no overdue days.

	Note		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	80,706	3,251	–	–	**83,957**
		Stage 2	–	722	–	–	**722**
Amounts due from credit institutions	6	Stage 1	3,099	294	–	–	**3,393**
		Stage 2	–	1,032	–	–	**1,032**
		Stage 3	–	–	–	–	**–**
Loans to customers	9						
- SME Loans		Stage 1	–	219,863	–	–	**219,863**
		Stage 2	–	–	17,772	–	**17,772**
		Stage 3	–	–	–	171,641	**171,641**
- Micro Loans		Stage 1	–	189,401	–	–	**189,401**
		Stage 2	–	–	3,368	–	**3,368**
		Stage 3	–	–	–	41,969	**41,969**
- Retail, Mortgage and Staff Loans		Stage 1	–	50,263	–	–	**50,263**
		Stage 2	–	–	217	–	**217**
		Stage 3	–	–	–	10,282	**10,282**
Investment securities	8	Stage 1	1,724	–	40	–	**1,764**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	–	**–**
Financial guarantees	20	Stage 1	279	4,171	–	–	**4,450**
		Stage 2	–	–	1,142	–	**1,142**
		Stage 3	–	–	–	–	**–**
Undrawn loan commitment	20	Stage 1	–	3,507	–	–	**3,507**
Total			85,808	472,504	22,539	223,892	**804,743**

The table below shows gross balances under IAS 39 as at 31 December 2017 based on the Bank's internal credit rating system:

		Neither past due nor impaired					
As at 31 December 2017	***Notes***	***High grade***	***Standard grade***	***Sub-standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents (excluding cash on hand)	5	77,750	483	–	–	–	**78,233**
Amounts due from credit institutions	6	16,229	13,431	–	–	–	**29,660**
Derivative financial assets	7	1,822	57	–	–	–	**1,879**
Investment securities	8	39,135	–	40	–	–	**39,175**
Loans to customers	9						
Micro loans		16,146	1,218	126,541	36,486	32,674	**213,065**
SME loans		3,385	1,352	245,612	26,157	161,616	**438,122**
Retail loans		2,091	127	17,355	3,159	41	**22,773**
Mortgage loans		2,126	324	13,581	598	1,133	**17,762**
Staff loans		892	199	3,171	407	1,729	**6,398**
Other financial assets	14	–	6,748	–	–	–	**6,748**
Total		**159,576**	**23,939**	**406,300**	**66,807**	**197,193**	**853,815**

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Aging analysis of past due but not impaired financial assets per classes

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, geographic regions 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.

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

As at 31 December 2017	*Less than 30 days*	*31 to 90 days*	*More than 90 days*	*Total*
Loans to customers				
SME loans	6,926	7,754	11,480	**26,160**
Micro loans	2,692	1,289	32,505	**36,486**
Retail loans	136	73	2,950	**3,159**
Mortgage loans	111	106	381	**598**
Staff loans	45	10	352	**407**
Total	**9,910**	**9,232**	**47,668**	**66,810**

See Note 9 for more detailed information with respect to the allowance for impairment of loans to customers.

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

	2018				*2017*			
	Azerbaijan	*OECD*	*CIS and other countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other countries*	*Total*
Assets								
Cash and cash equivalents	93,548	51,571	575	**145,694**	120,091	2,902	74	**123,067**
Amounts due from credit institutions	4,131	292	–	**4,423**	16,229	13,431	–	**29,660**
Derivative financial assets	–	–	–	**–**	57	1,822	–	**1,879**
Investment securities	1,764	–	–	**1,764**	39,175	–	–	**39,175**
Loans to customers	521,342	–	–	**521,342**	541,440	–	–	**541,440**
Other financial assets	2,382	1,945	437	**4,764**	4,577	1,484	687	**6,748**
	623,167	53,808	1,012	**677,987**	721,569	19,639	761	**741,969**
Liabilities								
Amounts due to credit institutions	8,263	–	100	**8,363**	22,959	–	135	**23,094**
Amounts due to customers	484,673	12,224	16,552	**513,449**	420,652	11,051	9,480	**441,183**
Borrowed funds from international lenders	–	158,172	46,369	**204,541**	–	171,903	58,641	**230,544**
Other financial liabilities	2,882	–	19	**2,901**	1,878	2	–	**1,880**
Derivative financial liabilities	203	10,416	–	**10,619**	–	16,890	–	**16,890**
Subordinated loans	–	65,060	–	**65,060**	–	65,020	–	**65,020**
	496,021	245,872	63,040	**804,933**	445,489	264,866	68,256	**778,611**
Net assets/ (liabilities)	**127,146**	**(192,064)**	**(62,028)**	**(126,946)**	**276,080**	**(245,227)**	**(67,495)**	**(36,642)**

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Bank cannot meet its payment obligations when they fall due under normal or stress circumstances. To limit this risk, management has established a broad range of diversified funding sources in addition to its core deposit base. As part of the asset-liability management the Bank monitors and steers its liquidity position based on the expected future cash in- and outflows on a daily basis.

The Bank pursues a policy of keeping at all times a comfortable level of liquid funds mainly in form of cash on accounts with the CBAR and highly rated international banks in OECD countries. In addition, the Bank maintains with the CBAR a cash deposit (obligatory reserve), the amount of which depends on the level of customer deposits attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis and is monitored against regulatory requirements. A key ratio set up by the CBAR for assessing the liquidity position is the Instant Liquidity Ratio which is defined as the relation of highly liquid assets to liabilities payable on demand. The ratio was 80% as at 31 December 2018 (120.88% as at 31 December 2017), as compared to the minimum percentage required by the CBAR of 30%.

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 subject to notice are treated as if notice were given immediately. In accordance with the Azerbaijan legislation, the Bank is obliged to repay the principal amounts of a term deposit upon demand of a depositor. However, in line with its deposit retention history the Bank expects the average deposit tenors to exceed the contractual maturities of its customer deposits that are displayed below. Term deposits of individuals are included in due to customers at their contractual maturities. The borrowed funds from international lenders are shown in the below table based on the original contractual repayment schedules.

As at 31 December 2018	*Less than 1 month*	*1 to 6 months*	*6 to 12 months*	*1 to 5 years*	*More than 5 years*	*Total*
Financial liabilities						
Amounts due to credit institutions	500	330	1,875	7,372	–	10,077
Gross settled derivative financial instruments						
- contractual amounts payable	–	20,375	–	–	–	20,375
- contractual amounts receivable	–	20,000	–	–	–	20,000
Amounts due to customers	201,211	112,720	168,742	48,631	–	531,304
Borrowed funds from international lenders	204,541	–	–	–	–	204,541
Other financial liabilities	2,901	–	–	–	–	2,901
Subordinated loans	31,171	756	1,609	47,942	–	81,478
Total undiscounted financial liabilities	**440,324**	**154,181**	**172,226**	**103,945**	**–**	**870,676**

As at 31 December 2017	*Less than 1 month*	*1 to 6 months*	*6 to 12 months*	*1 to 5 years*	*More than 5 years*	*Total*
Financial liabilities						
Amounts due to credit institutions	731	611	12,135	14,557	–	28,034
Gross settled derivative financial instruments						
- contractual amounts payable	–	–	1,997	–	–	1,997
- contractual amounts receivable	–	–	2,000	–	–	2,000
Amounts due to customers	154,254	109,328	164,150	31,586	–	459,318
Borrowed funds from international lenders	230,544	–	–	–	–	230,544
Other financial liabilities	1,880	–	–	–	–	1,880
Subordinated loans	31,151	691	1,545	47,912	–	81,299
Total undiscounted financial liabilities	**418,560**	**110,630**	**181,827**	**94,055**	**–**	**805,072**

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Liquidity risk and funding management (continued)

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 1 month	*1 to 6 months*	*6 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2018	1,063	4,440	3,331	265	–	**9,099**
2017	1,366	4,406	2,681	298	30	**8,781**

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 maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than one month in the tables above.

Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay the principal amounts of 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 maintain any trading positions. Non-trading positions are managed and monitored using sensitivity analysis. Except for concentrations in foreign currencies, the Bank has no significant concentrations of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates (e.g. interbank rates such as LIBOR) will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of profit or loss and other comprehensive income.

The sensitivity of the statement of profit or loss and other comprehensive income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate (LIBOR) non-trading financial assets and financial liabilities held at 31 December.

Currency	*Increase in basis points in % 2018*	*Sensitivity of net interest income 2018*	*Increase in basis points in % 2017*	*Sensitivity of net interest income 2017*
USD	0.50	(326)	0.70	(483)

Currency	*Decrease in basis points in % 2018*	*Sensitivity of net interest income 2018*	*Decrease in basis points in % 2017*	*Sensitivity of net interest income 2017*
USD	(0.15)	98	(0.08)	53

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

(Figures in tables are in 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 the manat, 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 and other comprehensive income or equity, while a positive amount reflects a net potential increase.

Currency	*Increase in exchange rate* in % in 2018*	*Effect on profit before tax 2018*	*Increase in exchange rate* in % in 2017*	*Effect on profit before tax 2017*
USD/AZN	14.00	(20,210)	11.30	9,227
EUR/AZN	14.00	–	13.50	(19)

* *This means appreciation of the currencies indicated in the table against AZN.*

Currency	*Decrease in exchange rate** in % in 2018*	*Effect on profit before tax 2018*	*Decrease in exchange rate** in % in 2017*	*Effect on profit before tax 2017*
USD/AZN	(3.00)	4,331	(11.30)	(9,227)
EUR/AZN	(3.00)	–	(13.50)	19

** *This means devaluation of the currencies indicated in the table against AZN.*

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 it has a control framework to manage such risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

The Bank has adopted detailed procedures for managing operational risks which are centred on a strict KYC (Know Your Customer) policy and which serve to protect the Bank, its customers and the laws. The procedures have been prepared in accordance with FATF (Financial Action Task Force) and other international recommendations. The implementation of the T24 banking software further improves operational risk management by allowing up-to-date information on all activities available for management analysis at any time.

The Internal Audit Department (IAD) plays an active role in the risk management process. The IAD focuses on and reviews the major regulatory, financial and operational risks which the Bank is facing to ensure the efficiency of the processes and controls. A risk based audit approach was adopted with the emphasis on processes in areas of higher risk. Internal control mechanisms were tested to assess their adequacy and appropriateness to the Bank's business. In all audited areas, the management establishes relevant controls over activities that correspond to the level of risks inherent to these activities and processes.

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan economy is largely dependent upon these reforms and the effectiveness of economic, financial and monetary measures undertaken by the government as well as crude oil prices and stability of Azerbaijani manat.

The Azerbaijan economy has been negatively impacted by decline of oil prices and devaluation of Azerbaijani manat during 2015. This resulted in reduced access to capital, a higher cost of capital, inflation and uncertainty regarding economic growth.

In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support to financial system. On 6 December 2016 President of the Republic of Azerbaijan approved "Strategic road maps for the national economy and main economic sectors of Azerbaijan". The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond 2025.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Operating environment (continued)

Furthermore, during 2018 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani manat. During 2018, CBAR gradually reduced refinancing rate from 15% to 9.75% with aim of normalising monetary policy.

The Bank's management is monitoring economic developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Bank's business in the foreseeable future.

24. Fair value measurement

Fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

		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					
Derivative financial assets	31 December 2018	–	–	–	**–**
Investment securities	31 December 2018	1,724	–	40	**1,764**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2018	145,694	–	–	**145,694**
Amounts due from credit institutions	31 December 2018	–	4,423	–	**4,423**
Loans to customers	31 December 2018	–	–	529,417	**529,417**
Other financial assets	31 December 2018	–	–	4,764	**4,764**
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2018	–	10,619	–	**10,619**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2018	–	8,363	–	**8,363**
Amounts due to customers	31 December 2018	–	–	512,488	**512,488**
Borrowed funds from international lenders	31 December 2018	–	–	204,541	**204,541**
Subordinated loans	31 December 2018	–	–	65,060	**65,060**

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurement (continued)

Fair value hierarchy (continued)

	Date of valuation	Fair value measurement using: Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets measured at fair value					
Derivative financial assets	31 December 2017	–	1,879	–	**1,879**
Investment securities available-for-sale	31 December 2017	1,685	37,450	40	**39,175**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2017	123,067	–	–	**123,067**
Amounts due from credit institutions	31 December 2017	–	29,660	–	**29,660**
Loans to customers	31 December 2017	–	–	536,806	**536,806**
Other Financial assets	31 December 2017	–	–	7,015	**7,015**
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2017	–	16,890	–	**16,890**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2017	–	23,094	–	**23,094**
Amounts due to customers	31 December 2017	–	–	458,171	**458,171**
Borrowed funds from international lenders	31 December 2017	–	–	230,544	**230,544**
Subordinated loans	31 December 2017	–	–	65,020	**65,020**

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 their fair value.

Fair value of financial assets and liabilities not carried at fair value

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

	Carrying value 2018	*Fair value 2018*	*Unrecognised gain/(loss) 2018*	*Carrying value 2017*	*Fair value 2017*	*Unrecognised gain/(loss) 2017*
Financial assets						
Loans to customers	521,342	529,417	8,075	541,441	536,806	(4,635)
Financial liabilities						
Amounts due to customers	513,449	512,488	961	441,183	458,171	(16,988)
Total unrecognised change in fair value			**9,036**			**(21,623)**

As of 31 December 2018 and 2017, the fair value of cash and cash equivalents, amounts due from credit institutions and other financial current assets and liabilities is estimated to approximate carrying value. As of 31 December 2018 and 2017, the carrying value of amounts due to credit institutions, borrowed funds from international lenders and the subordinated loans approximate their fair values as their interest rates are close to the market indices.

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurement (continued)

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the financial statements and those items that are not measured at fair value in the statement of financial position, but whose fair value is disclosed.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Investment securities.

Investment securities primarily consist of debt securities. These securities are valued using price quotations at the reporting date. Not quoted securities were valued by using similar observable transactions occurred close to reporting date.

Financial assets and financial liabilities carried at amortized cost

The fair value of loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions and borrowed funds from international lenders is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

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.

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 due or settled. See Note 23 "Financial risk management" for the Bank's contractual undiscounted repayment obligations.

	2018			*2017*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	145,694	–	**145,694**	123,067	–	**123,067**
Amounts due from credit institutions	4,423	–	**4,423**	29,660	–	**29,660**
Derivative financial assets	–	–	–	1,879	–	**1,879**
Investment securities	–	1,764	**1,764**	37,450	1,725	**39,175**
Loans to customers	366,629	154,713	**521,342**	351,450	189,990	**541,440**
Property and equipment	–	32,596	**32,596**	–	36,160	**36,160**
Intangible assets	–	18,584	**18,584**	–	21,487	**21,487**
Current income tax assets	–	–	–	9	–	**9**
Deferred income tax assets	–	24,928	**24,928**	–	18,646	**18,646**
Other assets	30,051	–	**30,051**	13,268	–	**13,268**
Total	**546,797**	**232,585**	**779,382**	**556,783**	**268,008**	**824,791**
Amounts due to credit institutions	2,457	5,906	**8,363**	10,013	13,081	**23,094**
Amounts due to customers	471,559	41,890	**513,449**	411,630	29,553	**441,183**
Borrowed funds from international lenders	204,541	–	**204,541**	230,544	–	**230,544**
Other liabilities	6,638	–	**6,638**	6,963	–	**6,963**
Derivative financial liabilities	2,317	8,302	**10,619**	8,119	8,771	**16,890**
Subordinated loans	31,060	34,000	**65,060**	31,018	34,002	**65,020**
Total	**718,572**	**90,098**	**808,670**	**698,287**	**85,407**	**783,694**
Net	**(171,775)**	**142,487**	**(29,288)**	**(141,504)**	**182,601**	**41,097**

Negative gap is caused by borrowings from foreign financial institutions. Refer to Note 17 for further analysis.

(Figures in tables are in thousands of Azerbaijani manats)

26. Changes in liabilities arising from financing activities

	Note	*Other borrowed funds*	*Subordinated loans*	*Total liabilities from financing activities*
Carrying amount at 31 December 2016		**509,185**	**80,039**	**589,224**
Redemption		(233,228)	–	**(233,228)**
Foreign currency translation		(20,288)	(2,765)	**(23,053)**
Conversion into equity		(27,377)	(12,254)	**(39,631)**
Other		2,252	–	**2,252**
Carrying amount at 31 December 2017	17, 18	**230,544**	**65,020**	**295,564**
Redemption		(27,055)	–	**(27,055)**
Foreign currency translation		(10)	–	**(10)**
Other		1,062	40	**1,102**
Carrying amount at 31 December 2018	17, 18	**204,541**	**65,060**	**269,601**

27. 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. The Bank controls transactions with related parties to assure they are carried out at market terms.

(Figures in tables are in thousands of Azerbaijani manats)

27. Related party disclosures (continued)

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	2018				2017		
	Share-holders	*Entities under control of shareholders*	*Key management personnel*	*Other*	*Share-holders*	*Entities under control of shareholders*	*Key management personnel*
Loans outstanding at 1 January, gross	–	–	48	–	–	–	163
Loans issued during the year	–	–	102	153	–	–	595
Loan repayments during the year	–	–	(130)	(123)	–	–	(678)
Foreign currency translation difference	–	–	–	–	–	–	(32)
Other movements	–	–	4	2	–	–	–
Loans outstanding at 31 December, gross	–	–	24	32	–	–	48
Less: allowance for impairment at 31 December	–	–	–	–	–	–	–
Loans outstanding at 31 December, net	–	–	24	32	–	–	48
Derivatives at 1 January	1,822	–	–	–	8,503	–	–
Net (losses)/gains on fair value of derivatives entered into	(1,822)	–	–	–	(6,681)	–	–
Derivatives at 31 December	–	–	–	–	1,822	–	–
Deposits at 1 January	–	–	619	912	–	–	1,239
Deposits received during the year	–	–	844	1,284	–	–	835
Deposits repaid during the year	–	–	(671)		–	–	(543)
Foreign currency translation difference	–	–	–	(1,014)	–	–	–
Other movements	–	–	–	–	–	–	–
Deposits received, at 31 December	–	–	792	1,182	–	–	1,531
Borrowings at 1 January	–	6,396	–	–	60,876	30,039	–
Borrowings received during the year	–	1,570	–	–	–	–	–
Borrowings repaid during the year	–	(1,345)	–	–	(30,137)	(22,651)	–
Foreign currency translation difference	–	–	–	–	(1,756)	(353)	–
Other movements	–	–	–	–	(1,606)	(639)	–
Conversion into capital	–	–	–	–	(27,377)	–	–
Borrowings at 31 December	–	6,621	–	–	–	6,396	–
Current accounts at 31 December	–	–	247	194	–	–	167
Subordinated loans at 1 January	30,263	–	–	–	44,009	–	–
Subordinated loans repaid during the year	–	–	–	–	–	–	–
Foreign currency translation difference	–	–	–	–	(1,589)	–	–
Other movements	15	–	–	–	97	–	–
Conversion into capital	–	–	–	–	(12,254)	–	–
Subordinated loans at 31 December	30,278	–	–	–	30,263	–	–

(Figures in tables are in thousands of Azerbaijani manats)

27. Related party disclosures (continued)

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

	2018				*2017*		
	Share-holders	*Entities under common control*	*Other related parties*	*Key mana-gement personnel*	*Share-holders*	*Entities under common control*	*Key mana-gement personnel*
Interest income on loans	–	–	1	5	–	–	16
Interest expense on deposits	–	–	(84)	(65)	–	–	(21)
Interest expense on borrowings	–	(1,345)	–	–	(1,864)	(4,650)	–
Interest expense on subordinated loans	(2,590)	–	–	–	(3,460)	–	–
Other operating expenses	(167)	–	–	–	(1,209)	–	–

An amount of AZN 131 thousand (2017 – AZN 1,209 thousand) is expensed under a management service agreement with LFS, under which LFS provides management and consulting services to the Bank.

As at 31 December 2018, key management personnel of the Bank consisted of 10 members (2017 – 10 members) and compensation of key management personnel was AZN 3,314 thousand (2016 – AZN 2,750 thousand) which comprises salaries, performance related benefits and other short-term benefits.

28. Events after the reporting period

As described in Notes 3, 17 and 18, in accordance with the restructuring agreement, 27,872,856 new common non-bearer shares in the total amount of AZN 118,460 thousand were issued and registered with FMSA on 22 February 2019. The recapitalization was completed successfully on 15 March 2019.

Further to the recapitalization, the Bank's new shareholder structure became as follows:

Asian Development Bank (ADB)	19.90%
European Investment Bank (EIB)	17.39%
International Finance Corporation (IFC)	16.56%
FMO	9.41%
Austrian Development Bank (OeEB)	9.17%
Swiss Investment Fund for Emerging Markets AG, c/o Obviam DFI AG	8.89%
ResponsAbility Management Company S.A	7.11%
Other shareholders with individually less than 3% ownership	11.57%
Total	**100.00%**