Bank BTB OJSC

Consolidated Financial Statements
for the year ended 31 December 2018

Contents

Independent Auditors' Report 3
Consolidated statement of profit or loss and other comprehensive income 6
Consolidated statement of financial position 7
Consolidated statement of cash flows 8
Consolidated statement of changes in equity 9
Notes to the consolidated financial statements 10
1 Background 10
2 Basis of preparation 11
3 Significant accounting policies 14
4 Net interest income 31
5 Fee and commission income 31
6 Fee and commission expense 32
7 Impairment recovery 32
8 Personnel expenses 32
9 Other general administrative expenses 33
10 Income tax expense 33
11 Cash and cash equivalents 34
12 Due from banks and other financial institutions 35
13 Investment securities 35
14 Loans to customers 36
15 Investment property 45
16 Property, equipment and intangible assets 47
17 Other assets 48
18 Deposits and balances from banks 48
19 Current accounts and deposits from customers 48
20 Other borrowed funds 49
21 Share capital 50
22 Risk management, corporate governance and internal control 51
23 Capital management 67
24 Credit related commitments 69
25 Operating leases 69
26 Contingencies 69
27 Related party transactions 70
28 Financial assets and liabilities: fair values and accounting classifications 72
29 Transition to IFRS 9 75
30 Events after reporting period 77

KPMG Audit Azerbaijan LLC
Port Baku South Towers,
12th floor, 153 Neftchilar Avenue, Baku,
AZ1010, Azerbaijan
Telephone +994 (12) 404 8910/11
Fax +994 (12) 404 8914
Internet www.kpmg.az

Independent Auditors' Report

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

Opinion

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

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

Basis for Opinion

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

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

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

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group'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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

— Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

— Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

Andrey Kouznetsov

KPMG Audit Azerbaijan LLC

Baku, the Republic of Azerbaijan

30 April 2019

	Notes	2018 AZN'000	2017* AZN'000
Interest income calculated using the effective interest method	4	19,572	14,449
Interest expense	4	(10,887)	(9,504)
Net interest income		**8,685**	**4,945**
Fee and commission income	5	4,007	2,157
Fee and commission expense	6	(516)	(260)
Net fee and commission income		**3,491**	**1,897**
Net gain on trading in foreign currencies		2,061	2,298
Net foreign exchange loss		(42)	(823)
Other operating income (loss)		520	(9)
Operating income		**14,715**	**8,308**
Impairment recovery	7	1,038	4,262
Personnel expenses	8	(7,504)	(6,304)
Other general administrative expenses	9	(5,749)	(5,796)
Profit before income tax		**2,500**	**470**
Income tax expenses	10	-	-
Total comprehensive income for the year		**2,500**	**470**

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

The consolidated financial statements as set out on pages 6 to 77 were approved by management on 30 April 2019 and were signed on its behalf by:

Mr. Emil Rzayev
Chairman of the Management Board

Mr. Vusal Shahverdiyev
Chief Financial Officer

BANK "BTB" AÇIQ SƏHMDAR CƏMİYYƏTİ
BANK "BTB" OPEN JOINT STOCK COMPANY
BANK BTB

	Notes	2018 AZN'000	2017* AZN'000
ASSETS			
Cash and cash equivalents	11	20,255	25,717
Due from banks and other financial institutions	12	26,674	27,980
Investment securities	13	3,383	2,627
Loans to customers	14	192,467	142,247
Investment property	15	13,376	13,574
Property, equipment and intangible assets	16	51,684	52,019
Other financial assets	17	1,055	935
Other assets	17	961	709
Total assets		**309,855**	**265,808**
LIABILITIES			
Deposits and balances from banks	18	5,835	5,540
Current accounts and deposits from customers	19	128,239	99,154
Other borrowed funds	20	123,303	108,516
Other liabilities		1,093	1,182
Total liabilities		**258,470**	**214,392**
EQUITY			
Share capital	21	66,450	66,450
Accumulated deficits		(15,065)	(15,034)
Total equity		**51,385**	**51,416**
Total liabilities and equity		**309,855**	**265,808**

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

Mr. Emil Rzayev
Chairman of the Management Board

Mr. Vusal Shahverdiyev
Chief Financial Officer

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

	Notes	2018 AZN'000	2017* AZN'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		18,899	14,877
Interest payments		(10,251)	(9,976)
Fee and commission receipts		4,007	2,157
Fee and commission payments		(516)	(260)
Net receipts from foreign exchange		2,061	2,298
Other receipts (payments)		520	(2)
Personnel expenses payments		(7,504)	(6,304)
General administrative expenses payments		(4,014)	(4,389)
(Increase) decrease in operating assets			
Due from banks and other financial institutions		1,338	9,961
Loans to customers		(41,626)	(12,755)
Other assets		(152)	(144)
Increase (decrease) in operating liabilities			
Deposits and balances from banks		290	23
Current accounts and deposits from customers		28,571	20,806
Other liabilities		(135)	1,528
Cash flows (used in) from operations		**(8,512)**	**17,820**
CASH FLOWS FROM INVESTING ACTIVITIES			
Net acquisition of premises, equipment, investment property and intangible assets		(891)	(17,716)
Purchases of investment securities		(850)	(2,606)
Proceeds from sale and repayment of investment securities		103	-
Cash flows used in investing activities		**(1,638)**	**(20,322)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Receipts of other borrowed funds	20	33,278	22,955
Repayment of other borrowed funds	20	(28,486)	(14,880)
Cash flows from financing activities		**4,792**	**8,075**
Net (decrease) increase in cash and cash equivalents		**(5,358)**	**5,573**
Effect of changes in exchange rates on cash and cash equivalents		(104)	(1,086)
Cash and cash equivalents as at the beginning of the year		25,717	21,230
Cash and cash equivalents as at the end of the year	**11**	**20,255**	**25,717**

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

Mr. Emil Rzayev
Chairman of the Management Board

Mr. Vusal Shahverdiyev
Chief Financial Officer

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

	Share capital AZN'000	**Accumulated deficits AZN'000**	**Total equity AZN'000**
Balance as at 1 January 2017	**52,000**	**(15,504)**	**36,496**
Total comprehensive income			
Profit for the year	-	470	470
Total comprehensive income for the year	**-**	**470**	**470**
Issue of ordinary shares (see Note 21)	14,450	-	14,450
Balance as at 31 December 2017	**66,450**	**(15,034)**	**51,416**
Balance as at 1 January 2018*	**66,450**	**(15,034)**	**51,416**
Adjustment on initial application of IFRS 9 (see Note 29)	-	(2,531)	(2,531)
Restated balance as at 1 January 2018	**66,450**	**(17,565)**	**48,885**
Total comprehensive income			
Profit for the year	-	2,500	2,500
Total comprehensive income for the year	-	**2,500**	**2,500**
Balance as at 31 December 2018	**66,450**	**(15,065)**	**51,385**

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

Mr. Emil Rzayev
Chairman of the Management Board

Mr. Vusal Shahverdiyev
Chief Financial Officer

"BANK "BTB" AÇIQ SƏHMDAR CƏMİYYƏTİ • BANK "BTB" OPEN JOINT STOCK COMPANY • BANK BTB

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

1 Background

(a) Organisation and operations

These consolidated financial statements comprise the financial statements of Bank BTB Open Joint-Stock Company (the Bank) and its subsidiary (together, the Group). On 15 February, 2018 the Bank established its fully owned subsidiary named ”BTB Capital” OJSC.

The Bank has started operations under a full banking license No 254 issued by the Central Bank of the Republic of Azerbaijan (the “CBAR”) since March 19, 2010. The Bank’s activities are regulated by the Financial Markets Supervisory Authority (the “FIMSA”) of the Republic of Azerbaijan. The Bank`s primary business consists of banking services: payments and money transfers, trading with foreign currencies, originating loans and other commercial activities. The Bank’s registered office is 27 Yusif Safarov street, Baku, the Republic of Azerbaijan.

The Bank has 12 branches (2017: 10) and 5 divisions (2017: 7). The majority of its assets and liabilities are located in the Republic of Azerbaijan.

The principal subsidiary is as follows:

			Ownership %	
Name	**Country of incorporation**	**Principal activities**	**2018**	**2017**
BTB Capital OJSC	Azerbaijan	Investment	100	-

The Bank is owned by :

	31 December 2018, %	31 December 2017, %
Shareholder		
Mrs. Nigar Mehdiyeva	74.99	74.99
Mr. Rza Sadiq	19.01	19.01
Mrs. Tukazban Mahmudova	6.00	6.00
Total	100.00	100.00

The Group is ultimately controlled by a single individual, Mrs. Nigar Mehdiyeva.

(b) Business environment

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

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

2 Basis of preparation

(a) Statement of compliance

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

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

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis (in 2017:available-for-sale financial instruments were measured at fair value).

(c) Liquidity mismatch

As set out in the contractual maturity table in note 22, as at 31 December 2018 the Group had a negative cumulative liquidity gap of AZN 19,239 thousand in the period up to twelve months.

Management believes that although current accounts balance of AZN 31,852 thousand as at 31 December 2018 is included under on demand category in maturity table, apparently not all of these amounts will be withdrawn in period of one month. Past experience demonstrates that current account average balances have not decreased below AZN 24,000 thousand for the period of last three years. Apart from this, the Group signed overdraft agreement with CBAR in amount of AZN 6,000 thousand with maturity date of 2022 in order to manage liquidity risk.

Subsequent to 31 December 2018, the Bank attracted new term deposits from individuals and corporate customers as well as prolonged term deposits originally maturing during period from January to April 2019 for the total amount of AZN 15,916 thousand and AZN 1,555 thousand for a contractual maturity of one year and more respectively. The Group will be supported with the shareholders' capital injections if it faces liquidity problem.

As a result of management's assessment and the actions being undertaken, the management believes that the Group will be able to cover its liquidity needs over the next twelve months.

(d) Functional and presentation currency

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

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

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

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

(e) Use of estimates and judgments

In preparing these consolidated financial statements, management has made judgement, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.
Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Judgements

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

- Applicable to 2018 only
  - classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding – Note 3(e)(i).
  - establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL – Note 22 (e)(i).

Assumptions and estimations uncertainty

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

- Applicable to 2018 only
  - impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information – Note 22 (e)(i).
- Applicable to 2018 and 2017
  - impairment of financial instruments – Note 3 (e)(iv).
  - estimates of fair values of financial assets and liabilities – Note 28.

(f) Changes in accounting policies and presentation

The Group has initially adopted IFRS 9 and IFRS 15 from 1 January 2018. Also, the Group early adopted *Prepayment Features with Negative Compensation (Amendments to IFRS 9)*, issued in October 2017.

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

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

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Group.

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

- an increase in impairment losses recognised on financial assets (see Note 22(e)(i)); and
- additional disclosures related to IFRS 9 (see Notes 14, 22(e)(i) and 29)

A. IFRS 9 Financial instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Group has adopted consequential amendments to IAS 1 '*Presentation of Financial Statements*', which require separate presentation in the statement of profit or loss and other comprehensive income of interest revenue calculated using the effective

interest method. Previously, the Group disclosed this amount in notes to the financial statements.

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

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

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Group classifies financial assets under IFRS 9, see Note 3(e)(i).

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income; and
- the remaining amount of change in the fair value is presented in profit or loss.

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

Impairment of financial assets

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

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

Transition

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

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings as at 1 January 2018. Accordingly, the information presented as at and for the year ended 31 December 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented as at and for the year ended 31 December 2018 under IFRS 9.

  The Group used the exemption not to restate comparative periods but considering that the amendments made by IFRS 9 to IAS 1 introduced the requirement to present 'interest income calculated using the effective interest rate' as a separate line item in the statement of profit or loss and other comprehensive income, the Group changed the description of the line item from 'interest income' reported in 2017 to 'interest income calculated using the effective interest method'.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
  - The determination of the business model within which a financial asset is held.

- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Group has assumed that credit risk on the asset had not increased significantly since its initial recognition.

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

B. IFRS 15 Revenue from Contracts with Customers

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

The Group initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The timing or amount of the Group's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15.

3 Significant accounting policies

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

(a) Foreign currency

Transactions in foreign currencies are translated to the respective functional currencies of the Group at exchange rates at the dates of the transactions.

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

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

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

(b) Interest

Policy applicable from 1 January 2018

Effective interest rate

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

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

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

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental

costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

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

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

Calculation of interest income and expense

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

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

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

Presentation

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

- interest on financial assets measured at amortised cost;

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

- financial liabilities measured at amortised cost;

Policy applicable before 1 January 2018

Effective interest rate

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

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

Presentation

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

- interest on financial assets measured at amortised cost;

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

- financial liabilities measured at amortised cost;

(c) Fees and commission

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

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

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

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

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

(d) Cash and cash equivalents

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

(e) Financial assets and financial liabilities

i. Classification

Financial assets – Policy applicable from 1 January 2018

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

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

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

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

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

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

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

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

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

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

All other financial assets are classified as measured at FVTPL.

Business model assessment

The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets.

Financial assets – Policy applicable before 1 January 2018

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

- loans and receivables;
- held-to-maturity;
- available-for-sale;

See Note 3(e),(i).

Financial liabilities

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

Financial liabilities (including deposits by financial institutions and customers, term borrowings and other financial liabilities) are initially measured at fair value, net of transaction costs, and subsequently measured at amortized cost using the effective interest method, with interest expense recognised on an effective yield basis.

Reclassification

Financial liabilities are not reclassified subsequent to their initial recognition.

ii. Derecognition

Financial assets

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

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the

consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in other comprehensive income in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities, as explained in Note 3(e)(i). Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

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

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

Financial liabilities

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

iii. Modification of financial assets and financial liabilities

Policy applicable from 1 January 2018

Financial assets

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

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

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

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

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

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

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Group plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases. The Group further performs qualitative evaluation of whether the modification is substantial.

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

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

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

Financial liabilities

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

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

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

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

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is

adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

Policy applicable before 1 January 2018

Financial assets

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

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

Financial liabilities

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

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

iv. Impairment

See also Note 22(e)(i).

Policy applicable from 1 January 2018

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

- financial assets that are debt instruments;
- loan commitments issued.

The Group measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition (see Note 22(e)(i)).

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

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

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised are referred to as 'Stage 2' financial instruments.

Measurement of ECL

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

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

See also Note 22(e)(i).

Restructured financial assets

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

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset (see Note 22(e)(i)).
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI, and finance lease receivables are credit-impaired (referred to as 'Stage 3 financial assets'. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered credit-impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Group considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the consolidated statement of financial position

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

- *financial assets measured at amortised cost*: as a deduction from the gross carrying amount of the assets;
- *loan commitments*: generally, as a provision;
- *where a financial instrument includes both a drawn and an undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component*: the Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- *debt instruments measured at FVOCI*: no loss allowance is recognised in the consolidated statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

Write-offs

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

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

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

Policy applicable before 1 January 2018

Objective evidence of impairment

At each reporting date, the Group assessed whether there was objective evidence that financial assets not carried at FVTPL were impaired. A financial asset or a group of financial assets was 'impaired' when objective evidence demonstrated that a loss event had occurred after the initial recognition of the asset(s) and that the loss event had an impact on the future cash flows of the asset(s) that could be estimated reliably.

In addition, a retail loan that was overdue for 90 days or more was considered impaired.

Objective evidence that financial assets were impaired included:

- significant financial difficulty of a borrower or issuer;

- default or delinquency by a borrower;
- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;
- indications that a borrower or issuer would enter bankruptcy;
- the disappearance of an active market for a security; or
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlated with defaults in the group.

A loan that was renegotiated due to a deterioration in the borrower's condition was usually considered to be impaired unless there was evidence that the risk of not receiving contractual cash flows had reduced significantly and there were no other indicators of impairment.

In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost was objective evidence of impairment. In general, the Group considered a decline of 20% to be 'significant' and a period of nine months to be 'prolonged'. However, in specific circumstances a smaller decline or a shorter period may have been appropriate.

The Group considered evidence of impairment for loans and receivables and held-to-maturity investment securities at both a specific asset and a collective level. All individually significant loans and receivables and held-to-maturity investment securities were assessed for specific impairment. Those found not to be specifically impaired were then collectively assessed for any impairment that had been incurred but not yet identified (IBNR). Loans and receivables and held-to-maturity investment securities that were not individually significant were collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar credit risk characteristics.

In making an assessment of whether an investment in sovereign debt was impaired, the Group considered the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Individual or collective assessment

An individual measurement of impairment was based on management's best estimate of the present value of the cash flows that were expected to be received. In estimating these cash flows, management made judgements about a debtor's financial position and the net realisable value of any underlying collateral. Each impaired asset was assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable were independently approved by the Credit Risk function.

The collective allowance for groups of homogeneous loans was established using statistical methods such as roll rate methodology or, for small portfolios with insufficient information, a formula approach based on historical loss rate experience. The roll rate methodology used statistical analysis of historical data on delinquency to estimate the amount of loss. Management applied judgement to ensure that the estimate of loss arrived at on the basis of historical information was appropriately adjusted to reflect the economic conditions and product mix at the reporting date. Roll rates and loss rates were regularly benchmarked against actual loss experience.

The IBNR allowance covered credit losses inherent in portfolios of loans and receivables, and held-to-maturity investment securities with similar credit risk characteristics when there was objective evidence to suggest that they contained impaired items but the individual impaired items could not yet be identified.

In assessing the need for collective loss allowance, management considered factors such as credit quality, portfolio size, concentrations and economic factors. To estimate the required allowance, assumptions were made to define how inherent losses were modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowance depended on the model assumptions and parameters used in determining the collective allowance.

Loans that were subject to a collective IBNR provision were not considered impaired.

Measurement of impairment

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

Reversal of impairment

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

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

Presentation

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

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

Write-off

The Group wrote off a loan or an investment debt security, either partially or in full, and any related allowance for impairment losses, when the Group determined that there was no realistic prospect of recovery.

(f) Loans to customers

Policy applicable from 1 January 2018

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

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

Policy applicable before 1 January 2018

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

Loans to customers included:

- those classified as loans and receivables;

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

(g) Investment securities

Policy applicable from 1 January 2018

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

- debt investment securities measured at amortised cost (see Note 3(f)(i)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;
- debt securities measured at FVOCI (see Note 3(e)(i));

Policy applicable before 1 January 2018

Investment securities were initially measured at fair value plus, in the case of investment securities not at FVTPL, incremental direct transaction costs, and subsequently accounted for available-for-sale.

Available-for-sale

Available-for-sale investments were non-derivative investments that were designated as available-for-sale or were not classified as another category of financial assets. Available-for-sale investments comprise equity securities and debt securities.

After initial recognition all available-for sale financial assets were measured at fair value with gains or losses being recognized in other comprehensive income until the investment was derecognized 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 profit and loss accounts. Interest income was recognised in profit or loss using the effective interest method.

(h) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

(ii) Depreciation

Depreciation is recognised so as to write off the cost or valuation of assets (other than freehold land and properties under construction) less their residual values over their useful lives, using the straightline method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period. Depreciation commences on the date of ready for use.

The estimated useful lives are as follows:

	Residual value, % of historical cost	Rates used in the year ended 31 December 2018
- buildings	30%	50 years
- furniture and equipment	-	8 years
- computers	-	4 years
- vehicles	-	8 years

(i) Intangible assets

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

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives of intangible assets are 10 years.

(j) Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in normal course of business, or for the use in production or supply of goods or services or for administrative purposes. Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are measured at cost less accumulated depreciation and impairment losses (if any).

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the profit or loss in the period in which the property is derecognised.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

(i) Depreciation

Depreciation is recognised so as to write off the cost or valuation of assets less their residual values over their useful lives, using the straightline method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period. Depreciation commences on the date of ready for use.

The estimated useful lives are as follows:

	Residual value, % of historical cost	Rates used in the year ended 31 December 2018
- buildings	30%	50 years

(k) Provisions

A provision is recognised in the consolidated statement of financial position when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are

determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(l) Financial guarantees and loan commitments

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

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

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

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

For other loan commitments:

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

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

(m) Share capital

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

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

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

(n) Taxation

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

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

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

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

(o) Income and expense recognition

Dividend income is recognised in profit or loss on the date that the dividend is declared.

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

(p) Comparative information

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

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

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

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

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

- “Acquisition of investment securities available-for-sale” was presented as “Purchases of investment securities” line item.

There were no changes in the statement of profit or loss and other comprehensive income for the year ended 31 December 2017, except that “interest income” line item was re-named as interest income calculated using the effective interest method”, and the statement of changes in equity for the year ended 31 December 2017.

(q) Standards issued but not yet effective

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

IFRS 16

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

- the Group has not yet finalised the testing and assessment of controls over its new IT systems; and
- the new accounting policies are subject to change until the Group presents its first financial

statements that include the date of initial application.

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

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

i. Leases in which the Group is a lessee

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

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

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

As at 31 December 2018, the Group does not have any non-cancellable operating leases.

ii. Leases in which the Group is a lessor

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

iii. Transition

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

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

Other standards

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

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

4 Net interest income

	2018 AZN'000	2017 AZN'000
Interest income calculated using the effective interest method		
Loans to customers	19,220	13,928
Investment securities	211	154
Due from banks and other financial institutions	141	367
	19,572	**14,449**
Interest expense		
Current accounts and deposits from customers	7,029	4,754
Other borrowed funds	3,608	3,162
Deposits and balances from banks	250	384
Subordinated borrowings	-	1,204
	10,887	**9,504**
	8,685	**4,945**

5 Fee and commission income

	2018 AZN'000	2017 AZN'000
Settlements	1,801	981
Cash withdrawal	774	420
Plastic card operations	699	535
Guarantees	649	166
Other	84	55
	4,007	**2,157**

Performance obligations and revenue recognition policies

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

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

6 Fee and commission expense

	2018 AZN'000	2017 AZN'000
Settlements	370	165
Cash withdrawal	140	81
Other	6	14
	516	**260**

7 Impairment recovery

	2018 AZN'000	2017 AZN'000
Recovery for impairment of loans to customers	1,384	4,208
(Charge) recovery for impairment of others	(346)	54
	1,038	**4,262**

8 Personnel expenses

	2018 AZN'000	2017 AZN'000
Employee compensation	6,151	5,157
Payments to Social Security Fund	1,353	1,147
	7,504	**6,304**

9 Other general administrative expenses

	2018 AZN'000	2017 AZN'000
Depreciation and amortisation expense	1,348	1,423
Rent expense	866	935
Expenses related to cheques and other valuables	637	370
Professional service fees	427	467
Taxes other than income tax	384	749
Security expense	354	336
Membership fee	351	222
Fees paid to Deposit Insurance Fund	346	188
Communication expense	292	353
Advertising expense	156	140
Utility expense	127	133
Other operating expenses	461	480
	5,749	**5,796**

10 Income tax expense

	2018 AZN'000	2017 AZN'000
Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences	(544)	148
Unrecognized deferred tax assets	544	(148)
Total income tax expense	-	**-**

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

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

	2018 AZN'000	%	2017 AZN'000	%
Profit before income tax	2,500		470	
Income tax at the applicable tax rate	500	20.0	94	20.0
Unrecognised deferred tax assets	(544)	(21.8)	(148)	(31.5)
Non-deductable costs	44	1.8	54	11.5
Total income tax expense	-	-	-	-

Deferred tax assets and liabilities

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax assets as at 31 December 2018 and 2017. These deferred tax assets are not recognised in these consolidated financial statements for the year ended 31 December 2018 and 31 December 2017. Future tax benefits will only be realised if profits will be available against which unused tax losses can be utilised and there are no changes to the law and regulations that adversely affect the Group's ability to claim deductions in future periods. These future tax benefits are not recognised due to uncertainties concerning their realisation. The Group did not recognise income tax expense for the year ended at 31 December 2018 and 2017.

The deductible temporary differences do not expire under current tax legislation. The tax loss carry-forwards expire in 2021.

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

2018 **AZN'000**	**1 January 2018**	**Recognised in profit or loss**	**31 December 2018**
Tax loss carry-forwards	4,509	794	5,303
Loans to customers	28	54	82
Intangible assets	3	2	5
Other liabilities	(17)	-	(17)
Property and equipment	(1,597)	(306)	(1,903)
Unrecognised deferred tax assets	(2,926)	(544)	(3,470)
	-	-	-

2017 **AZN'000**	**1 January 2017**	**Recognised in profit or loss**	**31 December 2017**
Tax loss carry-forwards	4,196	313	4,509
Loans to customers	47	(19)	28
Intangible assets	2	1	3
Other liabilities	(5)	(12)	(17)
Property and equipment	(1,166)	(431)	(1,597)
Unrecognised deferred tax assets	(3,074)	148	(2,926)
	-	-	-

11 Cash and cash equivalents

	2018 **AZN'000**	**2017** **AZN'000**
Cash on hand	13,178	20,681
Nostro accounts with the CBAR	-	1,050
Nostro accounts with other banks		
- rated from BBB- to BBB+	1,030	-
- rated from BB- to BB+	57	3,480
- rated from B- to B+	1,141	114
- rated from CCC- to CCC+	-	134
- not rated	144	258
Total nostro accounts with other banks	2,372	3,986
Term deposits with the CBAR	4,705	-
	20,255	**25,717**

No cash and cash equivalents are credit impaired or past due.

As at 31 December 2018 and 2017 the Group had no bank whose balance exceeded 10% of equity.

All cash and cash equivalent balances are in Stage 1 and their ECL is not material as for 31 December 2018 and 31 December 2017.

12 Due from banks and other financial institutions

	2018 AZN'000	2017 AZN'000
Mandatory reserve with the CBAR	772	601
Correspondent accounts with the CBAR	17,102	27,283
Loans and deposits with other banks		
- rated from BBB- to BBB+	51	51
- rated from B- to B+	4,463	-
- rated from CCC- to CCC+	-	42
- not rated	4,286	3
Total loans and deposits with other banks	**8,800**	**96**
Net due from banks and other financial institutions	**26,674**	**27,980**

As at 31 December 2018, included in due from banks and other financial institutions was blocked correspondent account in the CBAR amounting AZN 17,102 thousand (2017: AZN 26,283 thousand).

All due from banks and other financial institutions balances are in Stage 1 and their ECL is not material as for 31 December 2018 and 31 December 2017.

The Bank has borrowed in foreign currency from CBAR and it blocked balances of the Bank accordingly.

The balance of not rated deposit with other banks belongs to Turkish Government Bank and its rating is close to the rating of the government.

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

As at 31 December 2018 the Group had one bank (2017: one), whose total balances exceeded 10% of equity. The gross value of these balances as at 31 December 2018 is AZN 17,874 thousand (2017: AZN 27,884 thousand).

(b) Mandatory reserve with the CBAR

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

13 Investment securities

	2018 AZN'000	2017 AZN'000
Investment securities measured at amortised cost	3,383	-
Investment securities avaliable-for-sale	-	2,627
Total investment securities	**3,383**	**2,627**

At 31 December 2018, debt securities represented traded bonds of the State Oil Company of Azerbaijan Republic and Invest-AZ LLC in the quantity of 1,445 and 500 respectively and par value of USD 1,008 and 1,000 each. The bonds carry 5% annual interest rate payable quarterly and mature in October 2021.

All investment securities balances are in Stage 1 and their ECL is not material as for 31 December 2018 and 31 December 2017.

Investment securities measured at amortised cost

	2018 AZN'000
Corporate bonds	
- rated from BB- to BB+	2,533
- not rated	850
Total investment securities	**3,383**

Investment securities available-for-sale

	2017 AZN'000
Corporate bonds	
- rated from BB- to BB+	2,627
Total investment securities	**2,627**

14 Loans to customers

	2018 AZN'000	% of total gross loans	2017 AZN'000	% of total gross loans
Loans to corporate customers				
Loans to corporate customers	54,397	26%	41,690	27%
Total loans to corporate customers	**54,397**		**41,690**	
Loans to retail customers				
Mortgage loans	114,019	54%	79,130	50%
Entrepreneurs	20,954	10%	20,352	13%
Consumer loans	15,633	7%	10,688	7%
Auto loans	937	1%	1,960	1%
Credit cards	871	0%	704	0%
Other loans to retail customers	4,914	2%	3,160	2%
Total loans to retail customers	**157,328**		**115,994**	
Gross loans to customers	**211,725**		**157,684**	
Less allowance	(19,258)		(15,437)	
Net loans to customers	**192,467**		**142,247**	

(a) Loss allowance

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

AZN'000	
Balance at 31 December 2017	**15,437**
Remeasurement of loss allowance (Note 29)	2,531
Balance at 1 January 2018	**17,968**

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

AZN'000	2018				2017		
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Individual**	**Collective**	**Total**
Loans to customers at amortised cost*							
Balance at 1 January	740	57	17,171	17,968	1,112	18,533	19,645
Transfer to Stage 1	2,491	(8)	(2,483)	-	-	-	-
Transfer to Stage 2	(452)	1,024	(572)	-	-	-	-
Transfer to Stage 3	-	(454)	454	-	-	-	-
Net remeasurement of loss allowance	(1,710)	(121)	(258)	(2,089)	(469)	(3,739)	(4,208)
New financial assets originated or purchased	705	-	-	705	-	-	-
Write-offs	-	-	(80)	(80)	-	-	-
Unwinding of discount on present value of ECLs	-	-	2,755	2,755	-	-	-
Balance at 31 December	**1,774**	**498**	**16,987**	**19,259**	**643**	**14,794**	**15,437**

AZN'000	2018				2017		
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Individual**	**Collective**	**Total**
Loans to customers at amortised cost-corporate loans*							
Balance at 1 January	480	-	266	746	371	75	446
Transfer to Stage 1	97	-	(97)	-	-	-	-
Transfer to Stage 2	(70)	70	-	-	-	-	-
Transfer to Stage 3	-	(68)	68	-	-	-	-
Net remeasurement of loss allowance	(378)	(1)	904	525	(371)	68	(303)
New financial assets originated or purchased	264	-	-	264	-	-	-
Write-offs	-	-	(80)	(80)	-	-	-
Unwinding of discount on present value of ECLs	-	-	144	144	-	-	-
Balance at 31 December	**393**	**1**	**1,205**	**1,599**	**-**	**143**	**143**

AZN'000	2018				2017	
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Collective**	**Total**
Loans to customers at amortised cost-mortgage loans*						
Balance at 1 January	140	15	3,055	3,210	509	509
Transfer to Stage 1	1,987	(7)	(1,980)	1,987	-	-
Transfer to Stage 2	(31)	603	(572)	(31)	-	-
Transfer to Stage 3	-	(37)	37	-	-	-
Net remeasurement of loss allowance	(1,140)	(90)	775	(455)	490	490
New financial assets originated or purchased	30	-	-	30	-	-
Unwinding of discount on present value of ECLs	-	-	214	214		
Balance at 31 December	**986**	**484**	**1,529**	**2,999**	**999**	**999**

AZN'000	2018				2017		
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Individual**	**Collective**	**Total**
Loans to customers at amortised cost-entrepreneurs*							
Balance at 1 January	76	3	9,498	9,577	504	11,989	12,493
Transfer to Stage 1	35	-	(35)	-	-	-	-
Transfer to Stage 2	(31)	31	-	-	-	-	-
Transfer to Stage 3	-	(34)	34	-	-	-	-
Net remeasurement of loss allowance	(103)	-	(1,397)	(1,500)	(147)	(2,312)	(2,459)
New financial assets originated or purchased	69	-	-	69	-	-	-
Unwinding of discount on present value of ECLs	-	-	1,745	1,745	-	-	-
Balance at 31 December	**46**	**-**	**9,845**	**9,891**	**357**	**9,677**	**10,034**

AZN'000	2018				2017		
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Individual**	**Collective**	**Total**
Loans to customers at amortised cost-consumer loans*							
Balance at 1 January	40	39	2,661	2,740	237	3,409	3,646
Transfer to Stage 1	345	(1)	(344)	345	-	-	-
Transfer to Stage 2	(44)	44	-	(44)	-	-	-
Transfer to Stage 3	-	(39)	39	-	-	-	-
Net remeasurement of loss allowance	(59)	(30)	(190)	(279)	49	(867)	(818)
New financial assets originated or purchased	64	-	-	64	-	-	-
Unwinding of discount on present value of ECLs	-	-	458	458	-	-	-
Balance at 31 December	**346**	**13**	**2,624**	**2,983**	**286**	**2,542**	**2,828**

AZN'000	2018			2017	
	Stage 1	**Stage 3**	**Total**	**Collective**	**Total**
Loans to customers at amortised cost-auto loans*					
Balance at 1 January	3	959	962	1,170	1,170
Transfer to Stage 1	27	(27)	-	-	-
Net remeasurement of loss allowance	(30)	(256)	(286)	(242)	(242)
Unwinding of discount on present value of ECLs	-	89	89		
Balance at 31 December	**-**	**765**	**765**	**928**	**928**

AZN'000	2018			2017	
	Stage 1	**Stage 3**	**Total**	**Collective**	**Total**
Loans to customers at amortised cost-credit cards*					
Balance at 1 January	1	438	439	3	3
Net remeasurement of loss allowance	-	(140)	(140)	298	298
Unwinding of discount on present value of ECLs	-	60	60	-	-
Balance at 31 December	**1**	**358**	**359**	**301**	**301**

AZN'000	2018				2017	
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Collective**	**Total**
Loans to customers at amortised cost-other loans to retail customers*						
Balance at 1 January	-	-	294	294	1,378	1,378
Transfer to Stage 2	(276)	276	-	-		
Transfer to Stage 3	-	(276)	276	-		
Net remeasurement of loss allowance	-	-	46	46	(1,174)	(1,174)
New financial assets originated or purchased	278	-	-	278	-	-
Unwinding of discount on present value of ECLs	-	-	45	45		
Balance at 31 December	**2**	**-**	**661**	**663**	**204**	**204**

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

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

Loans to customers at amortised cost

- the repayment of AZN 7,034 thousand outstanding amount by the borrowers of mortgage loans during the year decreased AZN 1,140 thousand of loss allowance measured on a 12 months basis correspondingly. Moreover, AZN 33,656 thousand increase in mortgage loans by means of new issuance only affected to ECL by AZN 30,0 thousand.
- the repayment of AZN 2,515 thousand outstanding amount by the borrowers of entrepreneur loans during the year decreased AZN 1,397 thousand of loss allowance measured on a lifetime basis correspondingly.
- Repayment of AZN 9,127 thousand outstanding amount by the borrowers of corporate loans during the years decreased AZN 378 thousand of loss allowance measured on a 12 months basis correspondingly. Moreover, AZN 22,027 thousand increase in corpoarte loans by means of new issuance only affected to ECL by AZN 264,0 thousand.

Credit quality analysis

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

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

AZN'000	**31 December 2018**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – corporate customers				
Not overdue	47,749	-	186	47,935
Overdue less than 30 days	838	-	431	1,269
Overdue 30-89 days	-	544	48	592
Overdue 90-179 days	-	-	378	378
Overdue 180-360 days	-	-	1,222	1,222
Overdue more than 360 days	-	-	3,002	3,002
	48,587	**544**	**5,267**	**54,398**
Loss allowance	**(393)**	**(1)**	**(1,205)**	**(1,599)**
Carrying amount	**48,194**	**543**	**4,062**	**52,799**

AZN'000	**31 December 2017**		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – corporate customers			
Not overdue	-	36,392	36,392
Overdue less than 30 days	-	1,307	1,307
Overdue 90-179 days	3,873	-	3,873
Overdue 180-360 days	94	-	94
Overdue more than 360 days	24	-	24
	3,991	**37,699**	**41,690**
Loss allowance	**(75)**	**(68)**	**(143)**
Carrying amount	**3,916**	**37,631**	**41,547**

AZN'000	**31 December 2018**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – Mortgage loans				
Not overdue	103,278	425	1,698	105,401
Overdue less than 30 days	2,299	104	2,782	5,185
Overdue 30-89 days	-	554	332	886
Overdue 90-179 days	-	-	301	301
Overdue 180-360 days	-	-	715	715
Overdue more than 360 days	-	-	1,531	1,531
	105,577	**1,083**	**7,359**	**114,019**
Loss allowance	**(986)**	**(484)**	**(1,529)**	**(2,999)**
Carrying amount	**104,591**	**599**	**5,830**	**111,020**

AZN'000	**31 December 2017**		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – Mortgage loans			
Not overdue	-	75,364	75,364
Overdue less than 30 days	709	-	709
Overdue 30-89 days	1,028	-	1,028
Overdue 90-179 days	102	-	102
Overdue 180-360 days	316	-	316
Overdue more than 360 days	1,611	-	1,611
	3,766	**75,364**	**79,130**
Loss allowance	**(702)**	**(297)**	**(999)**
Carrying amount	**3,064**	**75,067**	**78,131**

AZN'000	**31 December 2018**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – Entrepreneurs				
Not overdue	9,530	-	90	9,620
Overdue less than 30 days	27	-	54	81
Overdue 30-89 days	-	41	200	241
Overdue 90-179 days	-	-	76	76
Overdue 180-360 days	-	-	121	121
Overdue more than 360 days	-	-	10,816	10,816
	9,557	**41**	**11,357**	**20,955**
Loss allowance	**(46)**	**-**	**(9,845)**	**(9,891)**
Carrying amount	**9,511**	**41**	**1,512**	**11,064**

AZN'000	**31 December 2017**		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – Entrepreneurs			
Not overdue	-	7,927	7,927
Overdue less than 30 days	419	-	419
Overdue 30-89 days	153	-	153
Overdue 90-179 days	88	-	88
Overdue 180-360 days	374	-	374
Overdue more than 360 days	11,391	-	11,391
	12,425	**7,927**	**20,352**
Loss allowance	**(9,966)**	**(68)**	**(10,034)**
Carrying amount	**2,459**	**7,859**	**10,318**

AZN'000	**31 December 2018**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – Consumer loans				
Not overdue	12,126	6	30	12,162
Overdue less than 30 days	256	-	5	261
Overdue 30-89 days	1	64	20	85
Overdue 90-179 days	-	-	65	65
Overdue 180-360 days	-	-	341	341
Overdue more than 360 days	-	-	2,717	2,717
	12,383	**70**	**3,178**	**15,631**
Loss allowance	**(346)**	**(13)**	**(2,624)**	**(2,983)**
Carrying amount	**12,037**	**57**	**554**	**12,648**

AZN'000	**31 December 2017**		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – Consumer loans			
Not overdue	506	6,524	7,030
Overdue less than 30 days	554	-	554
Overdue 30-89 days	541	-	541
Overdue 90-179 days	411	-	411
Overdue 180-360 days	522	-	522
Overdue more than 360 days	1,630	-	1,630
	4,164	**6,524**	**10,688**
Loss allowance	**(2,764)**	**(64)**	**(2,828)**
Carrying amount	**1,400**	**6,460**	**7,860**

AZN'000	**31 December 2018**		
	Stage 1	**Stage 3**	**Total**
Loans to customers at amortised cost – Auto loans			
Not overdue	101	-	101
Overdue less than 30 days	53	-	53
Overdue 30-89 days	-	5	5
Overdue 90-179 days	-	11	11
Overdue 180-360 days	-	6	6
Overdue more than 360 days	-	762	762
	154	**784**	**938**
Loss allowance	**-**	**(765)**	**(765)**
Carrying amount	**154**	**19**	**173**

AZN'000	**31 December 2017**		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – Auto loans			
Not overdue	-	637	637
Overdue less than 30 days	329	-	329
Overdue 30-89 days	76	-	76
Overdue 90-179 days	111	-	111
Overdue 180-360 days	64	-	64
Overdue more than 360 days	743	-	743
	1,323	**637**	**1,960**
Loss allowance	**(920)**	**(8)**	**(928)**
Carrying amount	**403**	**629**	**1,032**

AZN'000	**31 December 2018**			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – Credit cards				
Not overdue	445	-	-	445
Overdue less than 30 days	71	-	-	71
Overdue 30-89 days	-	9	-	9
Overdue 90-179 days	-	-	13	13
Overdue more than 360 days	-	-	333	333
	516	**9**	**346**	**871**
Loss allowance	**(1)**	**-**	**(358)**	**(359)**
Carrying amount	**515**	**9**	**(12)**	**512**

AZN'000	**31 December 2017**		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – Credit cards			
Not overdue	-	288	288
Overdue less than 30 days	12	-	12
Overdue 30-89 days	68	-	68
Overdue more than 360 days	336	-	336
	416	**288**	**704**
Loss allowance	**(299)**	**(2)**	**(301)**
Carrying amount	**117**	**286**	**403**

AZN'000	31 December 2018			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Loans to customers at amortised cost – Other loans to retail customers				
Not overdue	2,341	953	1,014	4,308
Overdue less than 30 days	-	-	-	-
Overdue 30-89 days	-	76	-	76
Overdue 180-360 days	-	-	56	56
Overdue more than 360 days	-	-	474	474
	2,341	**1,029**	**1,544**	**4,914**
Loss allowance	**(2)**	**-**	**(661)**	**(663)**
Carrying amount	**2,339**	**1,029**	**883**	**4,251**

AZN'000	31 December 2017		
	Impaired	**Unimpaired**	**Total**
Loans to customers at amortised cost – Other loans to retail customers			
Not overdue	-	733	733
Overdue less than 30 days	1,972	-	1,972
Overdue 30-89 days	45	-	45
Overdue more than 360 days	410	-	410
	2,427	**733**	**3,160**
Loss allowance	**(202)**	**(2)**	**(204)**
Carrying amount	**2,225**	**731**	**2,956**

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

				Fair value of collateral held			
AZN'000	**Gross carrying amount**	**Loss allowance**	**Carrying amount**	**Cash and deposits**	**Real estate**	**Motor vehicles**	**Total**
Loans to corporate customers							
Loans to corporate customers	5,267	(1,205)	4,062	-	4,049	-	4,049
Loans to retail customers							
Mortgage loans	7,359	(1,529)	5,830	-	4,393	-	4,393
Entrepreneurs	11,357	(9,845)	1,512	-	1,049	-	1,049
Consumer loans	3,178	(2,624)	554	23	-	3	26
Auto loans	784	(765)	19	-	-	19	19
Credit cards	346	(358)	(12)	-	-	-	-
Other loans to retail customers	1,544	(661)	883	-	883	-	883
Total credit-impaired loans to customers	**29,835**	**(16,987)**	**12,848**	**23**	**10,374**	**22**	**10,419**

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

				Fair value of collateral held					
AZN'000	**Gross carrying amount**	**Loss allowance**	**Carrying amount**	**Cash and deposits**	**Real estate**	**Precious metals**	**Equip-ment**	**Motor Vehicle**	**Total**
Loans to corporate customers									
Loans to corporate customers	54,397	(1,599)	52,798	14,185	17,404	-	1,358	-	32,947
Loans to retail customers									
Mortgage loans	114,019	(2,999)	111,020	683	100,825	1	-	-	101,509
Entrepreneurs	20,954	(9,891)	11,063	-	6,460	-	126	-	6,586
Consumer loans	15,633	(2,983)	12,650	7,736	288	1,066	-	5	9,095
Auto loans	937	(765)	172	-	51	-	-	121	172
Credit cards	871	(359)	512	153	139	16	-	-	308
Other loans to retail customers	4,914	(662)	4,252	-	2,715	-	-	-	2,715
Total loans to customers	**211,725**	**(19,258)**	**192,467**	**22,757**	**127,882**	**1,083**	**1,484**	**126**	**153,332**

The following table provides information on total amount of loans to customers, net of impairment, by types of collateral as at 31 December 2017:

				Fair value of collateral held					
AZN'000	**Gross carrying amount**	**Loss allowance**	**Carrying amount**	**Cash and deposits**	**Real estate**	**Precious metals**	**Equip-ment**	**Motor Vehicles**	**Total**
Loans to corporate customers									
Loans to corporate customers	41,690	(143)	41,547	10,001	16,284	-	2,782	-	29,067
Loans to retail customers									
Mortgage loans	79,130	(999)	78,131	-	66,764	-	-	-	66,764
Entrepreneurs	20,352	(10,034)	10,318	-	6,446	-	127	-	6,573
Consumer loans	10,688	(2,828)	7,860	1,345	2,922	320	33	-	4,620
Auto loans	1,960	(928)	1,032	-	-	-	-	1,028	1,028
Credit cards	704	(301)	403	165	-	-	-	-	165
Other loans to retail customers	3,160	(204)	2,956	-	2,947	-	-	-	2,947
Total loans to customers	**157,684**	**(15,437)**	**142,247**	**11,511**	**95,363**	**320**	**2,942**	**1,028**	**111,164**

As at 31 December 2018 the Bank held loans (corporate, consumer, mortgage, credit cards) in the amount of AZN 22,757 thousand for which no loss allowance was recognised as they are collateralized by cash. During the reporting period there were no changes in the Bank's collateral policies.

Repossessed collateral

During the year ended 31 December 2018, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 601 thousand (2017: 59 thousand) and recognised them as assets held for sale. The Bank's policy is to sell these as soon as possible. Assets held for sale are comprised of real estates and other assets. See Note 17.

(b) Significant credit exposures

As at 31 December 2018, the Bank had nineteen borrowers or groups of connected borrowers (31 December 2017: fourteen borrowers) with gross loan balances exceeding AZN 1,000 thousand. The gross value of these loans as at 31 December 2018 was AZN 35,915 thousand or 17% of the total loans to customers (31 December 2017: AZN 28,905 thousand or 18%).

(c) Loan maturities

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

(d) Sensitivity analysis

Changes in these estimates could effectthe loan impairment provision. For example, to the extent that the net present value of the estimated cash flow differs by one percent, the impairment allowance on loans to customers as at 31 December 2018 would be AZN 1,925 thousand lower/higher (31 December 2017: AZN 1,422 thousand lower/higher)

15 Investment property

Investment property is comprised of 4 floors covering 2,046 square-meters of Head office of the Group. The Group transferred aforementioned property into investment property to rent out under lease agreements to collect rental income.

The following table provides the reconciliation between the carrying amounts of investment property at the beginning and end of the period:

	Investment property AZN'000
Cost	
Balance at 1 January 2017	13,867
Transfer from property, equipment and intangible assets	189
Balance at 31 December 2017	**14,056**
Depreciation	
Balance at 1 January 2017	(286)
Depreciation charge	(196)
Balance at 31 December 2017	**(482)**
Carrying amount	
At 31 December 2017	**13,574**
Cost	
Balance at 1 January 2018	14,056
Balance at 31 December 2018	**14,056**
Depreciation	
Balance at 1 January 2018	(482)
Depreciation charge	(198)
Balance at 31 December 2018	**(680)**
Carrying amount	
At 31 December 2018	**13,376**

As at 31 December 2018, investment property was carried at cost. Management believes that the fair value of investment property as at 31 December 2018 approximated its carrying amount. The fair value of the Group's investment property is categorised into level 3 of the fair value hierarchy.

Rental income and direct operating expenses arising from investment property were as follows:

	2018 AZN'000	**2017 AZN'000**
Rental income	304	261
Expense arising from lease of property	(51)	(52)
Net gain from investment property	**253**	**209**

16 Property, equipment and intangible assets

AZN'000	Buildings	Computers and communication equipment	Furniture and fixtures	Vehicles	Total property and equipment	Computer software	Total property, equipment and intangible assets
Cost							
Balance at 1 January 2018	50,723	916	3,957	1,422	57,018	483	57,501
Additions	5	125	132	502	764	122	886
Disposals	-	-	(1)	(167)	(168)	-	(168)
Balance at 31 December 2018	**50,728**	**1,041**	**4,088**	**1,757**	**57,614**	**605**	**58,219**
Depreciation and amortisation							
Balance at 1 January 2018	(1,669)	(856)	(1,958)	(831)	(5,314)	(168)	(5,482)d
Depreciation and amortisation for the year	(485)	(54)	(378)	(182)	(1,099)	(51)	(1,150)
Disposals	-	-	-	97	97	-	97
Balance at 31 December 2018	**(2,154)**	**(910)**	**(2,336)**	**(916)**	**(6,316)**	**(219)**	**(6,535)**
Carrying amount							
At 31 December 2018	**48,574**	**131**	**1,752**	**841**	**51,298**	**386**	**51,684**

AZN'000	Buildings and Land	Computers and communication equipment	Furniture and fixtures	Vehicles	Total property and equipment	Computer software	Total property, equipment and intangible assets
Cost							
Balance at 1 January 2017	33,163	871	3,769	1,388	39,191	390	39,581
Additions	17,560	62	258	34	17,914	93	18,007
Disposals	-	(17)	(70)	-	(87)	-	(87)
Balance at 31 December 2017	**50,723**	**916**	**3,957**	**1,422**	**57,018**	**483**	**57,501**
Depreciation and amortisation							
Balance at 1 January 2017	(1,184)	(790)	(1,584)	(654)	(4,212)	(124)	(4,336)
Depreciation and amortisation for the year	(485)	(82)	(439)	(177)	(1,183)	(44)	(1,227)
Disposals	-	16	65	-	81	-	81
Balance at 31 December 2017	**(1,669)**	**(856)**	**(1,958)**	**(831)**	**(5,314)**	**(168)**	**(5,482)**
Carrying amount							
At 31 December 2017	**49,054**	**60**	**1,999**	**591**	**51,704**	**315**	**52,019**

As at 31 December 2018 and 2017 included in property and equipment were fully depreciated assets of AZN 2,174 thousand and AZN 1,519 thousand, respectively.

Buildings and land owned by the Group are carried at cost.

17 Other assets

	2018 AZN'000	2017 AZN'000
Due from payment systems	784	779
Credit and debit cards receivables	239	131
Other receivables	32	25
Total other financial assets	**1,055**	**935**
Assets held for sale	601	59
Prepaid expenses	164	427
Prepayments for property and equipment	126	121
Deferred expenses	20	57
Other	50	45
Total other non-financial assets	**961**	**709**
	2,016	**1,644**

As at 31 December 2018 and 2017, the Group did not have overdue other financial assets. All other financial assets are in Stage 1 and their ECL is not material as for 31 December 2018 and 31 December 2017. All other financial assets are non-rated.

During the year ended 31 December 2018, the Group obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 601 thousand (2017: 59 thousand) and recognised them as assets held for sale

18 Deposits and balances from banks

	2018 AZN'000	2017 AZN'000
Short-term placements of other banks	5,526	5,540
Correspondent accounts and overnight placements of other banks	309	-
	5,835	**5,540**

Deposits and balances from banks comprise term placements of banks.

As at 31 December 2018 the Group has one bank (2017: one bank), whose balance exceeded 10% of equity. The gross value of this balance as at 31 December 2018 is AZN 5,526 thousand (2017: AZN 5,528 thousand).

19 Current accounts and deposits from customers

	2018 AZN'000	2017 AZN'000
Current accounts and demand deposits		
- Retail	11,775	23,036
- Corporate	20,077	11,822
Term deposits		
- Retail	91,676	55,501
- Corporate	4,711	8,795
	128,239	**99,154**

As at 31 December 2018, the Group has 4 customers (2017: 1 customers), whose total balances exceeded 10% of equity. The total amount of these balances as at 31 December 2018 is AZN 31,177 thousand (2017: AZN 13,998 thousand).

As at 31 December 2018, the Group maintained customer deposit balances of AZN 27,116 thousand (2017: AZN 12,116 thousand) that serve as collateral for loans and unrecognised credit instruments granted by the Group.

20 Other borrowed funds

	2018 AZN'000	2017 AZN'000
Other borrowed funds		
Mortgage Fund of the Republic of Azerbaijan	90,272	69,630
Central Bank of the Republic of Azerbaijan	18,004	26,198
National Fund for Entrepreneurship Support	15,027	10,206
Other	-	2,482
Total other borrowed funds	**123,303**	**108,516**

Azerbaijan Mortgage Fund

As at 31 December 2018, AZN 90,272 thousand (2017: AZN 69,630 thousand) out of term borrowings represented funds borrowed from the Azerbaijan Mortgage, a program under the auspices of the CBAR, for granting long-term mortgage loans to individuals. Under this program, funds made available to the Bank at an interest rate of 1-4% p.a. and the Bank further on lends these funds to eligible borrowers at rates not higher than 8% p.a. These borrowings mature between January 2019 and December 2048.

Azerbaijan National Fund for Entrepreneurship Support

As at 31 December 2018, AZN 15,027 thousand (2017: AZN 10,206 thousand) out of term borrowings represented funds borrowed from Azerbaijan National Fund for Entrepreneurship Support, which eatblished for the purpose of improve the support mechanism for entrepreneurship development, create new production and processing enterprises based on innovative technologies in the non-oil sector, ensure the financing of export operations, accelerate investments in the real sector and expand access to financial resources of business units operating in the private sector. Under this program, funds made available to the Bank at an interest rate of 1-5% p.a. and the Bank further on lends these funds to eligible borrowers at rates not higher than 6% p.a. These borrowings mature between June 2022 and March 2025.

Central Bank of the Republic of Azerbaijan

As at 31 December 2018, AZN 18,004 thousand (2017: AZN 26,198 thousand) out of term borrowings represented funds borrowed from Central Bank of the Republic of Azerbaijan. The rate is 3% which is in line with the market rate.

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

'AZN 000	Other borrowed funds	Subordinated borrowings	Total
Balance at 1 January 2017	**100,402**	**15,122**	**115,524**
Changes from financing cash flows			
Receipts of other borrowed funds	22,955	-	22,955
Repayment of other borrowed funds	(14,880)	-	(14,880)
Total changes from financing cash flows	**8,075**	**-**	**8,075**
The effect of changes in foreign exchange rates	-	(601)	(601)
Other changes			
Interest expense	3,162	1,204	4,366
Interest paid	(3,123)	(1,275)	(4,398)
Subordinated debt converted into share capital	-	(14,450)	(14,450)
Balance at 1 December 2018	**108,516**	**-**	**108,516**
Changes from financing cash flows			
Receipts of other borrowed funds	33,278	-	33,278
Repayment of other borrowed funds	(28,486)	-	(28,486)
Total changes from financing cash flows	**4,792**	-	**4,792**
Other changes			
Interest expense	3,608	-	3,608
Interest paid	(3,550)	-	(3,550)
Transfer of mortgage loan portfolio from liquidated bank	9,937	-	9,937
Balance at 31 December 2018	**123,303**	-	**123,303**

During the year 2018, Bank has transferred mortgage loan portfolio from liquidated bank in amount of AZN 9,937 thousand. According to the agreement between Mortgage Fund and the Bank, if the service by the Bank is concluded to be unsatisfactory, the Fund can transfer the "service" to another Bank (by mutually agreeing with other Banks).

21 Share capital

The authorised, issued and outstanding share capital comprises 66,450 ordinary shares (31 December 2017: 66,450). All shares have a nominal value of AZN 1,000 per share. During 2018 there were no any issued shares (2017: 14,450).

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Group.

22 Risk management, corporate governance and internal control

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

(a) Corporate governance framework

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

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

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

As at 31 December 2018 the Supervisory Board includes:

Rza Sadiq **-** Chairman of the Supervisory Board

Alish Tagiyev **-** Member of the Supervisory Board

Samir Gojayev **-** Member of the Supervisory Board

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

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

As at 31 December 2018 the Management Board includes:

Emil Rzayev **-** Chairman of the Management Board

Rufat Abbasov **-** Deputy Chairman of the Management Board

Vusal Shahverdiyev **-** Member of the Management Board

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

(b) Internal control policies and procedures

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

The purpose of internal controls is to ensure:

- proper and comprehensive risk assessment and management
- proper business and accounting and financial reporting functions, including proper authorization, processing and recording of transactions
- completeness, accuracy and timeliness of accounting records, managerial information, regulatory reports, etc.
- reliability of IT-systems, data and systems integrity and protection

- prevention of fraudulent or illegal activities, including misappropriation of assets
- compliance with laws and regulations.

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

The Group developed a system of standards, policies and procedures to ensure effective operations and compliance with relevant legal and regulatory requirements, including the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the recording, reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards and
- risk mitigation, including insurance where this is effective.

There is a hierarchy of requirements for authorization of transactions depending on their size and complexity. A significant portion of operations are automated and the Group put in place a system of automated controls.

The main functions of Internal Audit service include the following:

- audit and efficiency assessment of the system of internal control as a whole, fulfillment of the decisions of key management structures
- audit of efficiency of methodology of assessment of banking risks and risk management procedures, regulated by internal documents in credit organisation (methods, programmes, rules and procedures for banking operations and transactions, and for the management of banking risks)
- audit of reliability of internal control system over automated information systems
- audit and testing of fairness, completeness and timeliness of accounting and reporting function and the reliability (including the trustworthiness, fullness and objectivity) of the collection and submission of financial information
- audit of applicable methods of safekeeping the credit organisation's property
- assessment of economic reasonability and efficiency of operations and other deals
- audit of internal control processes and procedures
- audit of internal control service and risk management service.

Compliance with the Group's standards is supported by a program of periodic reviews undertaken by Internal Audit. The Internal Audit function is independent from management and reports directly to the Audit Committee and the Supervisory Board. The results of Internal Audit reviews are discussed with relevant business process managers, with summaries submitted to the Audit Committee and the Supervisory Board and senior management of the Group.

The internal control system in the Group comprises:

- the Supervisory Board and its committees,

- the Chief Executive officer and the Management Board
- the Chief Accountant
- the risk management function
- the security function, including IT-security
- the human resource function
- the Internal Audit service
- other employees, divisions and functions that are responsible for compliance with the established standards, policies and procedures, including:
  - heads of branches and heads of business-units
  - business processes managers
  - division responsible for compliance with anti-money laundering requirements
  - the legal officer – an employee responsible for compliance with the legal and regulatory requirements
  - other employees with control responsibilities

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

(c) Risk management policies and procedures

The risk management policies aim to identify, analyse and manage the risks faced by the Group, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Supervisory Board has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

The Management Board is responsible for monitoring and implementing risk mitigation measures, and ensuring that the Group operates within established risk parameters.

The Head of the Risk Department is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to the responsible member of the Management Board.

Credit, market and liquidity risks both at the portfolio and transactional levels are managed and controlled through a system of Credit Committees and an Asset and Liability Management Committee (ALCO). In order to facilitate efficient and effective decision-making, the Group established a hierarchy of Credit Committees depending on the type and amount of the exposure.

Both external and internal risk factors are identified and managed throughout the organisation. Particular attention is given to identifying the full range of risk factors and determination of the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Department monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their areas of expertise.

(d) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimizing the return on risk.

Overall authority for market risk is vested in the ALCO, which is chaired by the Chairman of the Management Board. Market risk limits are approved by ALCO based on recommendations of the Risk Department.

The Group manages its market risk by setting open position limits in relation to financial instruments, interest rate maturity and currency positions and stop-loss limits. These are monitored on a regular basis and reviewed and approved by the Supervisory Board.

(i) Interest rate risk

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

Interest rate gap analysis

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

AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Overdue	Non-interest bearing	Carrying amount
31 December 2018								
ASSETS								
Cash and cash equivalents	4,705	-	-	-	-	-	15,550	20,255
Due from banks and other financial institutions	3	-	4,420	4,250	-	-	18,001	26,674
Investment securities	-	-	850	2,494	-	-	39	3,383
Loans to customers	8,192	8,874	30,467	56,881	81,256	4,420	2,377	192,467
Other financial assets	-	-	-	-	-	-	1,055	1,055
	12,900	**8,874**	**35,737**	**63,625**	**81,256**	**4,420**	**37,022**	**243,834**
LIABILITIES								
Deposits and balances from banks	-	-	-	5,815	-	-	20	5,835
Current accounts and deposits from customers	3,996	12,430	44,950	33,897	-	-	32,966	128,239
Other borrowed funds	1,926	3,853	7,702	24,629	84,908	-	285	123,303
	5,922	**16,283**	**52,652**	**64,341**	**84,908**	**-**	**33,271**	**257,377**
	6,978	**(7,409)**	**(16,915)**	**(716)**	**(3,652)**	**4,420**	**3,751**	**(13,543)**

AZN '000	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Overdue	Non-interest bearing	Carrying amount
31 December 2017								
ASSETS								
Cash and cash equivalents	-	-	-	-	-	-	25,717	25,717
Due from banks and other financial institutions	1,002	-	-	-	-	-	26,978	27,980
Investment securities	-	-	-	2,597	-	-	30	2,627
Loans to customers	3,765	5,288	19,039	35,569	65,717	10,304	2,565	142,247
Other financial assets	-	-	-	-	-	-	935	935
	4,767	**5,288**	**19,039**	**38,166**	**65,717**	**10,304**	**56,225**	**199,506**
LIABILITIES								
Deposits and balances from banks	-	-	5,538	-	-	-	2	5,540
Current accounts and deposits from customers	3,378	6,003	36,241	19,958	-	-	33,574	99,154
Other borrowed funds	4,224	3,465	9,741	18,475	72,375	-	236	108,516
	7,602	**9,468**	**51,520**	**38,433**	**72,375**	**-**	**33,812**	**213,210**
	(2,835)	**(4,180)**	**(32,481)**	**(267)**	**(6,658)**	**10,304**	**22,413**	**(13,704)**

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

Average effective interest rates

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

	2018 Average effective interest rate, %			2017 Average effective interest rate, %		
	AZN	**USD**	**EUR**	**AZN**	**USD**	**EUR**
Interest bearing assets						
Due from banks and other financial institutions	8.92%	1.62%	-	12.15%	-	-
Investment securities	-	5.26%	-	-	5.00%	-
Loans to customers	11.27%	12.10%	-	11.22%	14.72%	21.54%
Interest bearing liabilities						
Deposits and balances from banks	6.00%	3.00%	-	-	3.00%	-
Current accounts and deposits from customers	11.96%	4.32%	-	12.77%	5.81%	-
Other borrowed funds	2.98%	-	-	2.96%	3.50%	-

Interest rate sensitivity analysis

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

	2018 AZN'000	2017 AZN'000
100 bp parallel fall	5,908	17,655
100 bp parallel rise	(5,908)	(17,655)

(ii) Currency risk

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

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

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

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
ASSETS					
Cash and cash equivalents	10,395	7,773	1,820	267	20,255
Due from banks and other financial institutions	297	26,377	-	-	26,674
Investment securities	-	3,383	-	-	3,383
Loans to customers	171,616	20,851	-	-	192,467
Other financial assets	615	371	27	42	1,055
Total financial assets	**182,923**	**58,755**	**1,847**	**309**	**243,834**
LIABILITIES					
Deposits and balances from banks	309	5,526	-	-	5,835
Current accounts and deposits from customers	74,192	52,120	1,764	163	128,239
Other borrowed funds	123,303	-	-	-	123,303
Total financial liabilities	**197,804**	**57,646**	**1,764**	**163**	**257,377**
Net position	**(14,881)**	**1,109**	**83**	**146**	

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

	AZN AZN'000	USD AZN'000	EUR AZN'000	Other currencies AZN'000	Total AZN'000
ASSETS					
Cash and cash equivalents	7,145	15,084	3,058	430	25,717
Due from banks and other financial institutions	1,194	26,786	-	-	27,980
Investment securities	-	2,627	-	-	2,627
Loans to customers	122,249	19,929	69	-	142,247
Other financial assets	545	329	24	37	935
Total financial assets	**131,133**	**64,755**	**3,151**	**467**	**199,506**
LIABILITIES					
Deposits and balances from banks	-	5,540	-	-	5,540
Current accounts and deposits from customers	46,501	49,395	3,183	75	99,154
Other borrowed funds	106,043	2,473	-	-	108,516
Total financial liabilities	**152,544**	**57,408**	**3,183**	**75**	**213,210**
Net position	**(21,411)**	**7,347**	**(32)**	**392**	

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

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

	2018 AZN'000	2017 AZN'000
20% appreciation of USD against AZN	177	1,176
20% appreciation of EUR against AZN	13	(5)

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

(e) Credit risk

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

The credit policy establishes:

- procedures for review and approval of loan credit applications;
- methodology for the credit assessment of borrowers (corporate and retail);
- methodology for the credit assessment of counterparties, issuers and insurance companies;
- methodology for the evaluation of collateral;
- credit documentation requirements;
- procedures for the ongoing monitoring of loans and other credit exposures.

Corporate loan credit applications are originated by the relevant client managers and are then passed on to the Loan Department, which is responsible for the corporate loan portfolio. Analysis reports are based on a structured analysis focusing on the customer's business and financial performance. The loan credit application and the report are then independently reviewed by the Risk Management Department and a second opinion is given accompanied by a verification that credit policy requirements are met. The Credit Committee reviews the loan credit application on the basis of submissions by the Loan Department and the Risk Department. Individual transactions are also reviewed by the Credit Supervision Department as well as Legal, Accounting and Tax Departments depending on the specific risks and pending final approval of the Credit Committee.

The Group continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Group. Retail loan credit applications are reviewed by the Sales Department through the use of scoring models and application data verification procedures developed together with the Risk Management Department.

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

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

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

	2018 AZN'000	2017 AZN'000
ASSETS		
Cash and cash equivalents (excluding cash on hand)	7,077	5,036
Due from banks and other financial institutions	26,674	27,980
Investment securities	3,383	2,627
Loans to customers	192,467	142,247
Other financial assets	1,055	935
Commitments on loans and unused credit lines	9,507	8,743
Guarantees issued and similar commitments	14,195	8,588
Total maximum exposure	**254,358**	**196,156**

For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers refer to note 14.

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

In these consolidated financial statements ratings of financial assets and financial liabilities are disclosed in terms of Fitch ratings.

(i) Credit risk - Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

See accounting policy in Note 3(f)(iv).

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Group uses three criteria for determining whether there has been a significant increase in credit risk:

- quantitative test based on movement in probability of default (PD);
- qualitative indicators; and
- backstop of 30 days past due, except for transactions with financial institutions and issuers of securities, for which a backstop of 2-10 days past due is applied.

Generating the term structure of PD

The Group collects performance and default information about its credit risk exposures by type of product as well as borrower's segment. For some portfolios, information purchased from external credit reference agencies is also used.

The Group employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

Determining whether credit risk has increased significantly

The Group assesses whether credit risk has increased significantly since initial recognition at each reporting period. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region. What is considered significant will differ for different types of lending, in particular between corporate and retail.

As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Group's quantitative criteria:

- the presence of the fact of overdue debt for 31-90 days for all segments except transactions with financial institutions and issuers of securities;
- the presence of the fact of debt overdue by 2-10 working days for transactions with financial institutions and issuers of securities;
- deteoriation of external counterparty rating;
- For the retail segment- Default on another financial instrument of the counterparty, the amount of which exceeds 100 AZN ("infecting" assets that do not have overdue debt at the counterparty level);
- For the remaining segments, the criteria of default are applied at the level of the Counterparty, therefore the "contamination" of assets, that do not directly have the criteria of default, transfers them immediately to the 3rd stage;
- Bankruptcy;
- Liquidation of the Counterparty;
- In the case of financial organisations, revocation of the license for the core business;
- Forced restructuring - a change in the terms of the contract, which are the result of the Counterparty's inability to fulfill the obligations stipulated in the contract

If a default event was implemented for a financial instrument according to several criteria, then the minimum (earliest) date of commencement of default is used as the default date.
If a recovery has taken place for the default financial instrument, then the earliest default date after the recovery event is taken as the default date. If after the date of recovery there was no re-entry into default, then the contract for the current date is considered non-default.
Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower; and quantitative criteria (only for financial institutions and issuers of securities):

- the relative change in the external rating at the reporting date compared to the external rating at the recognition date according to the criteria given in Table 1.

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

External rating at the date of initial recognition	Threshold value (the number of steps to downgrade)	The value of the rating (as of the date of the evaluation of the ECL), indicating the transition to Stage 2
AAA	≥ 3	Aa3and below
Aa1	≥ 3	A1 and below
Aa2	≥ 3	A2 and below
Aa3	≥ 3	A3 and below
A1	≥ 3	Baa1 and below
A2	≥ 3	Baa2 and below
A3	≥ 3	Baa3 and below
Baa1	≥ 3	Ba1 and below
Baa2	≥ 3	Ba2 and below
Baa3	≥ 3	Ba3 and below
Ba1	≥ 2	B1 and below
Ba2	≥ 2	B1 and below
Ba3	≥ 2	B2 and below
B1	≥ 1	B3 and below
B2	≥ 1	Caa1 and below
B3	≥ 1	Caa1 and below
Caa1	≥ 1	Caa2 and below
Caa2	≥ 1	Caa3 and below
Caa3	≥ 1	Ca-C

In case of downgrading by the number of steps exceeding the threshold value, the financial instrument moves to Stage 2. The Group can apply expert adjustments when there is a justification that the downgrade, which caused the threshold to be exceeded, was not associated with deterioration of the counterparty credit profile.

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL. Some qualitative indicators of an increase in credit risk, such as delinquency of forbearance, may be indicative of an increased risk of default that persists after the indicator itself has ceased to exist. In these cases the Group determines a probation period during which the financial asset is required to demonstrated good behaviour to provide evidence that its credit risk has declined sufficiently.

A financial instrument returns from 2 to 1 stage if the criteria listed in SICR criteria are missing.

The observation period for Stage 2 does not apply.

For financial instruments entered in Stage 3, the observation period applies. During this period, the financial instrument continues to be in Stage 3, to confirm that the event/impairment does not happen and the improvement in credit quality has taken place and is stable.

Subsequently, if a financial instrument located in Stage 3 does not have impairment criteria, but has one or more criteria for a significant increase in credit risk, it falls into Stage 2 after the observation period.

In the event of the absence / termination of both the impairment criteria and the criteria for a significant increase in credit risk, the Financial Instrument returns to Stage 1, after the observation period. The observation period applies only to Stage 3.

The follow-up / recovery period applies to Financial Instruments in Stage 3, and is 3 months from the disappearance of the default criteria (s) to transfer to Stage 1 or Stage 2.

The Group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that**:**

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month ECL (stage 1) and lifetime ECL measurements (stage 2).

Definition of default

A financial instrument impairment event is determined at the borrower level for all portfolios except for the retail borrowers portfolio. For retail borrowers, the impairment event is determined at the financial instrument level. The Group considers a financial asset to be in default when:

- More than 90 calendar days of overdue debt at the reporting date for all segments except transactions with financial institutions and issuers of securities;
- More than 10 working days of overdue debt at the reporting date for transactions with financial institutions and issuers of securities;
- The counterparty / issuer was declared bankrupt by the court, or the court introduced bankruptcy procedures in relation to the borrower. This criterion applies to all portfolios with the exception of the portfolio of retail borrowers;
- Assignment of a regulatory quality category 4 or 5 to the contract at the reporting date;
- Default / forced restructuring due to the financial difficulties of the borrower (applicable except for transactions with financial institutions and securities). Default / forced restructuring refers to a change in the terms of a contract recognized as a forced restructuring by the Group, which are a consequence of the borrower's inability to perform the obligations specified in the contract, and are caused by a deterioration in the credit quality of the borrower;
- Revocation of the license and the introduction of an interim administration (applicable to financial institutions and issuers of securities).

In assessing whether a borrower is in default, the Group considers indicators that are:

- qualitative – e.g. breaches of covenant;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Group; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Incorporation of forward-looking information

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

The Group formulates one economic scenario: a base case. The base case is aligned with information used by the Group for other purposes such as strategic planning and budgeting. The historical data of defaults use the statistics of CBAR on the share of overdue loans in total loans to individuals in the banking system. The assessment of the impact of macroeconomic information should be made at least on an annual basis.

The Group has identified and documented key drivers of credit risk and credit losses for the entire loan portfolio (including the securities portfolio, requirements for financial institutions), using an

analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

The key driver is Real GDP growth forecast. The economic scenarios used as at 31 December 2018 included the following key indicators for the Republic of Azerbaijan for the years ending 31 December 2019 through 2023.

	2019	**2020**	**2021**	**2022**	**2023**
Real GDP growth	3.60%	3.40%	2.50%	2.00%	2.00%

Predicted relationships between the key indicator and default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 14 years.

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

Modified financial assets

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

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

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

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

The Group renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and interest rate. Both retail and corporate loans are subject to the forbearance policy.

For financial assets modified as part of the Group's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Group's previous experience of similar forbearance action. As part of this process, the Group evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired (see Note 3(e)(iv)). A customer needs to demonstrate consistently good payment behavior over a period of time before the exposure is no longer considered to be credit-impaired/ in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

The methodology of estimating PDs is discussed above under the heading “Generating the term structure of PD”.

The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are recalibrated for different economic scenarios and, for real estate lending, to reflect possible changes in property prices. They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EAD is potential future amounts that may be drawn under the contract, which are estimated based on historical .

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Group measures ECL considering the risk of default over the maximum contractual period (including any borrower’s extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Group considers a longer period. The maximum contractual period extends to the date at which the Group has the right to require repayment of an advance or terminate a loan commitment.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of instrument type.

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the Group has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL are as follows.

		External benchmarks used	
	Exposure	**PD**	**LGD**
Cash and cash equivalents	7,077	Moody’s default study	S&P recovery studies
Due from banks and other financial institutions	26,674	Moody’s default study	S&P recovery studies
Investment securities	3,383	Moody’s default study	S&P recovery studies

(ii) *Liquidity risk*

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The Group maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Supervisory Board.

The Group seeks to actively support a diversified and stable funding base comprising long-term and short-term loans from other banks, core corporate and retail customer deposits, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

The liquidity management policy requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;
- maintaining debt financing plans;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;
- monitoring liquidity ratios against regulatory requirements.

The Treasury Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury Department then provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term liquid trading securities, loans to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

The daily liquidity position is monitored by Treasury Department and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Risk Management Department. Under the normal market conditions, liquidity reports covering the liquidity position are presented to senior management on a weekly basis. Decisions on liquidity management are made by ALCO and implemented by the Treasury Department.

The following tables show the undiscounted cash flows on financial assets, liabilities and credit-related commitments on the basis of their earliest possible contractual maturity. The total gross outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial liability or credit related commitment. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee can be called.

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

AZN'000	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 1 to 5 years**	**More than 5 years**	**Total gross amount outflow**	**Carrying amount**
Non-derivative liabilities							
Deposits and balances from banks	35	31	137	6,368	-	6,571	5,835
Current accounts and deposits from customers	37,608	13,600	48,817	36,212	-	136,237	128,239
Other borrowed funds	2,448	4,325	9,661	33,572	99,675	149,681	123,303
Total financial liabilities	**40,091**	**17,956**	**58,615**	**76,152**	**99,675**	**292,489**	**257,377**
Credit related commitments	**23,702**	**-**	**-**	**-**	**-**	**23,702**	**23,702**

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

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Total gross amount outflow	Carrying amount
Non-derivative liabilities							
Deposits and balances from banks	14	28	5,618	-	-	5,660	5,540
Current accounts and deposits from customers	37,448	6,946	39,049	22,223	-	105,666	99,154
Other borrowed funds	4,654	3,847	11,292	25,417	83,732	128,942	108,516
Total financial liabilities	**42,116**	**10,821**	**55,959**	**47,640**	**83,732**	**240,268**	**213,210**
Credit related commitments	**17,331**	**-**	**-**	**-**	**-**	**17,331**	**17,331**

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, forfeiting in most of the cases the accrued interest. These deposits are classified in accordance with their stated maturity dates. The management of the Group does not expect that individuals and legal entities withdraw their term deposits before their stated maturity dates.

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

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Overdue	Total
Cash and cash equivalents	20,255	-	-	-	-	-	20,255
Due from banks and other financial institutions	899	-	21,522	4,250	-	3	26,674
Investment securities	39	-	850	2,494	-	-	3,383
Loans to customers	5,982	8,592	29,695	54,874	88,904	4,420	192,467
Other financial assets	1,055	-	-	-	-	-	1,055
Total financial assets	**28,230**	**8,592**	**52,067**	**61,618**	**88,904**	**4,423**	**243,834**
Deposits and balances from banks	20	-	-	5,815	-	-	5,835
Current accounts and deposits from customers	36,962	12,430	44,950	33,897	-	-	128,239
Other borrowed funds	2,211	3,853	7,702	24,629	84,908	-	123,303
Total financial liabilities	**39,193**	**16,283**	**52,652**	**64,341**	**84,908**	**-**	**257,377**
Net position	**(10,963)**	**(7,691)**	**(585)**	**(2,723)**	**3,996**	**4,423**	**(13,543)**
Cumulative liquidity gap	**(10,963)**	**(18,654)**	**(19,239)**	**(21,962)**	**(17,966)**	**(13,543)**	

The Group signed overdraft agreement with CBAR in amount AZN 6,000 thousand with maturity date of 2022 in order to manage liquidity risk.

Subsequent to 31 December 2018, the Group prolonged term deposits originally maturing during period from January to April for the total amount of AZN 1,057 thousand for a contractual maturity of one year and more. For reference please see Note 2, Liqudity Mismatch.

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

AZN'000	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	Overdue	Total
Cash and cash equivalents	25,717	-	-	-	-	-	25,717
Due from banks	1,696	-	26,284	-	-	-	27,980
Investment securities	2,627	-	-	-	-	-	2,627
Loans to customers	3,765	5,288	19,039	35,569	68,282	10,304	142,247
Other financial assets	935	-	-	-	-	-	935
Total financial assets	**34,740**	**5,288**	**45,323**	**35,569**	**68,282**	**10,304**	**199,506**
Deposits and balances from banks	2	-	5,538	-	-	-	5,540
Current accounts and deposits from customers	36,952	6,003	36,241	19,958	-	-	99,154
Other borrowed funds	4,457	3,465	9,741	18,475	72,378	-	108,516
Total financial liabilities	**41,411**	**9,468**	**51,520**	**38,433**	**72,378**	**-**	**213,210**
Net position	**(6,671)**	**(4,180)**	**(6,197)**	**(2,864)**	**(4,096)**	**10,304**	**(13,704)**
Cumulative liquidity gap	**(6,671)**	**(10,851)**	**(17,048)**	**(19,912)**	**(24,008)**		

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

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

The Bank was in compliance with these ratios as at 31 December 2018 and 2017. The following table shows the mandatory liquidity ratios calculated as at 31 December 2018 and 2017 *(unaudited)*.

	Requirement	**2018, %**	**2017, %**
Instant liquidity ratio	Not less than 30%	52.72	70.29

(iii) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Group's operations.

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and innovation. In all cases, the Group policy requires compliance with all applicable legal and regulatory requirements.

The Group manages operational risk by establishing internal controls that management determines to be necessary in each area of its operations.

23 Capital management

The FIMSA sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the FIMSA, banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level and maintain a minimum level of total statutory capital of AZN 50,000 thousand (2017: AZN 50,000 thousand). As at 31 December 2018, the statutory capital ratio was 10% (2017: 10%). The Bank was in compliance with the statutory capital requirement of AZN 50,000 thousand and with the statutory capital ratio as at 31 December 2018 and 2017 *(unaudited)*.

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

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

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

The following table shows the composition of the capital position calculated in accordance with the requirements of the Basel Accord, as at 31 December:

	2018 AZN'000	2017 AZN'000
Tier 1 capital		
Share capital	66,450	66,450
Accumulated deficit	(15,065)	(15,034)
Total tier 1 capital	**51,385**	**51,416**
Risk-weighted assets		
On-balance	176,002	152,081
Off-balance	11,851	8,666
Total risk-weighted assets	**187,853**	**160,747**
Total capital expressed as a percentage of risk-weighted assets (total capital ratio)	**27.35%**	**31.99%**
Total tier 1 capital expressed as a percentage of risk-weighted assets (tier 1 capital ratio)	**27.35%**	**31.99%**

Reconciliation of total statutory capital to IFRS equity

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

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

	31 December 2018 AZN'000 (unaudited)	31 December 2017 AZN'000 (unaudited)
Total statutory capital	**54,730**	**53,657**
Reconcilation of total statutory capital and IFRS equity:		
- accumulated deficit	(3,495)	(747)
- current year profit/(loss)	1,796	(218)
- loan loss allowance	1,764	(1,855)
- net interest income	492	690
- other income	26	1,534
- net fee and commission income	(56)	(161)
- personnel expenses	(54)	-
- other general administrative expenses	(376)	(426)
- differences arising from deductions	676	314
- equity investment	350	-
- intangible assets	326	314
- general allowances	(2,322)	(1,590)
Total IFRS equity	**51,385**	**51,416**

24 Credit related commitments

The Group has outstanding credit related commitments to extend loans. These credit related commitments take the form of approved loans and credit card limits and overdraft facilities.

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

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

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

	2018 AZN'000	2017 AZN'000
Contracted amount		
Guarantees	14,195	8,588
Undrawn credit lines	9,507	8,743
	23,702	**17,331**

The total outstanding contractual credit related commitments above do not necessarily represent future cash requirements, as these credit related commitments may expire or terminate without being funded. The majority of loan and credit line commitments do not represent an unconditional credit related commitment by the Group.

25 Operating leases

Leases as lessee

The Group leases a number of premises and equipment under operating leases. The leases typically run for an initial period of five to ten years, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals. The Group does not have any non-cancellable leases.

26 Contingencies

(a) Insurance

The insurance industry in the Republic of Azerbaijan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its premises and equipment, business interruption, or third party liability in respect of property or environmental damage arising from accidents on its property or relating to operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on operations and financial position.

(b) Litigation

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

(c) Taxation contingencies

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

These circumstances may create tax risks in the Azerbaijan Republic that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijani tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial position, if the authorities were successful in enforcing their interpretations, could be significant.

27 Related party transactions

(a) Control relationships

The Bank is controlled by Ms. Nigar Mehdiyeva.

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

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

	2018 AZN'000	2017 AZN'000
Short term employee benefits	437	528
	437	**528**

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

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

	2018 AZN'000	Average effective interest rate, %	2017 AZN'000	Average effective interest rate, %
Statement of financial position				
Loans issued (gross)	62	19.55%	210	16.98%
Loanallowance	-	-	3	-
Current accounts	133	-	170	-

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

	2018 AZN'000	2017 AZN'000
Profit or loss		
Interest income calculated using the effective interest method	8	24
Impairment losses	3	-

(c) Transactions with other related parties

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

	Ultimate controlling party		Shareholders		Other		Total
	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000
Statement of financial position							
ASSETS							
Loans to customers							
Principal balance	21	20.00%	97	4.00%	148	18.67%	266
Impairment allowance	-	-	-	-	(20)	-	(20)
LIABILITIES							
Customer accounts	2	-	1	-	289	-	292
Term deposits	-	-	589	5.96%	4,640	9.07%	5,229
Profit or loss							
Interest income calculated using the effective interest method	4	-	4	-	19	-	27
Interest expense	-	-	35	-	366	-	401

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

	Ultimate controlling party		Shareholders		Other		Total
	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000	Average interest rate, %	AZN'000
Statement of financial position							
ASSETS							
Loans to customers							
Principal balance	8	20.00%	99	4.00%	2,079	18.67%	2,186
Impairment allowance	-	-	-	-	(20)	-	(20)
LIABILITIES							
Customer accounts	-	-	12,143	-	534	-	12,677
Term deposits	-	-	1,849	5.99%	2,679	8.96%	4,528
Profit or loss							
Interest income	2	-	4	-	309	-	315
Interest expense	-	-	111	-	241	-	352
Impairment gains (losses)	-	-	42	-	(20)	-	22

Other related parties include family members of key management personnel and shareholders of the Group.

The majority of balances resulting from transactions with related parties mature within one year. Transactions with related parties are not secured.

28 Financial assets and liabilities: fair values and accounting classifications

(a) Accounting classifications and fair values

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

AZN '000	Amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	20,255	20,255	20,255
Due from banks and other financial institutions	26,674	26,674	26,621
Investment securities	3,383	3,383	3,460
Loans to customers	192,467	192,467	192,089
Other financial assets	1,055	1,055	1,055
	243,834	**243,834**	**243,480**
Deposits and balances from banks	5,835	5,835	5,714
Current accounts and deposits from customers	128,239	128,239	129,736
Other borrowed funds	123,303	123,303	123,303
	257,377	**257,377**	**258,753**

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

AZN '000	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	25,717	-	-	25,717	25,717
Due from banks and other financial institutions	27,980	-	-	27,980	27,980
Investment securities	-	2,627	-	2,627	2,627
Loans to customers	142,247	-	-	142,247	136,144
Other financial assets	935	-	-	935	935
	196,879	**2,627**	**-**	**199,506**	**193,403**
Deposits and balances from banks	-	-	5,540	5,540	5,217
Current accounts and deposits from customers	-	-	99,154	99,154	100,500
Other borrowed funds	-	-	108,516	108,516	103,695
	-	**-**	**213,210**	**213,210**	**209,412**

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using other valuation techniques.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations.

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

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

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

- discount rates of 3.29%-9.46% (2017: 7.15%-8.82%) and 6.13%-17.11% (2017: 6.84%-16.47%) are used for discounting future cash flows from due from banks and other financial institutions and loans to customers, respectively.
- discount rates of 1.43%-10.01% (2017: 3.00%-10.72%) are used for discounting future cash flows from current accounts and deposits from customers.
- discount rate of 3.29%-9.46% (2017: 4.93%-11.80%) and 1.00%-6.00% (2017: 1%-8%) are used for discounting future cash flows from due to banks and other borrowed funds respectively.

(b) Fair value hierarchy

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: inputs other than quotes prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

No financial instruments measured at fair value at 31 December 2018.

The table below analyses financial instruments measured at fair value at 31 December 2017, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

AZN'000	Level 1	Total
Investment securities available-for-sale	2,627	2,627
	2,627	**2,627**

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

AZN'000	Level 1	Level 2	Level 3	Total fair value	Total carrying amount
ASSETS					
Cash and cash equivalents	-	20,255	-	20,255	20,255
Due from banks and other financial institutions	-	26,621	-	26,621	26,674
Investment securities	3,460	-	-	3,460	3,383
Loans to customers	-	-	192,089	192,089	192,467
Other financial assets	-	1,055	-	1,055	1,055
LIABILITIES					
Deposits and balances from banks	-	5,714	-	5,714	5,835
Current accounts and deposits from customers	-	129,736	-	129,736	128,239
Other borrowed funds	-	123,303	-	123,303	123,303

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

AZN'000	Level 2	Level 3	Total fair value	Total carrying amount
ASSETS				
Cash and cash equivalents	25,717	-	25,717	25,717
Due from banks and other financial institutions	27,980	-	27,980	27,980
Loans to customers	-	136,144	136,144	142,247
Other financial assets	935	-	935	935
LIABILITIES				
Deposits and balances from banks	5,217	-	5,217	5,540
Current accounts and deposits from customers	100,500	-	100,500	99,154
Other borrowed funds	103,695	-	103,695	108,516

29 Transition to IFRS 9

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

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

AZN'000	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets					
Cash and cash equivalents	11	Loans and receivables	Amortised cost	25,717	25,717
Due from banks and other financial institutions	12	Loans and receivables	Amortised cost	27,980	27,980
Investment securities – debt [(a)]	13	Available for sale	Amortised cost	2,627	2,627
Loans to customers	14	Loans and receivables	Amortised cost	142,247	139,716
Other financial assets	17	Loans and receivables	Amortised cost	935	935
Total financial assets				**199,506**	**196,975**
Financial liabilities					
Deposits and balances from banks	18	Amortised cost	Amortised cost	5,540	5,540
Current accounts and deposits from customers	19	Amortised cost	Amortised cost	99,154	99,154
Other borrowed funds	20	Amortised cost	Amortised cost	108,516	108,516
Total financial liabilities				**213,210**	**213,210**

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

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

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

AZN'000	IAS 39 carrying amount 31 December 2017	Reclassifica-tion	Remeasure-ment	IFRS 9 carrying amount 1 January 2018
Financial assets				
Amortised cost				
Cash and cash equivalents:				
Opening balance	25,717			
Closing balance				25,717
Due from banks and other financial institutions:				
Opening balance	27,980			
Closing balance				27,980
Loans to customers:				
Opening balance	142,247			
Remeasurement			(2,531)	
Closing balance				139,716
Investment securities:				
Opening balance	-			
From available-for-sale		2,627		
Remeasurement			-	
Closing balance				2,627
Other financial assets	935			935
Total amortised cost	**196,879**	**2,627**	**(2,531)**	**196,975**
Available-for-sale				
Investment securities:				
Opening balance	2,627			
To amortised cost		2,627		
Closing balance				-
Total financial assets	**199,506**	**-**	**(2,531)**	**196,975**

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

A fair value gain or loss that whould have been recognised in other comprehensive income during 2018 would not be material if financial assets were not reclassified from IAS 39 categroy available-for-sale into an amortised cost category under IFRS 9.

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

AZN'000	Impact of adopting IFRS 9 at 1 January 2018
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	(15,034)
Recognition of expected credit losses under IFRS 9 (including loan commitments)	(2,531)
Opening balance under IFRS 9 (1 January 2018)	**(17,565)**

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as at 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2018.

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

	Impairment allowance and provisions		
AZN'000	**31 December 2017 (IAS 39/IAS 37)**	**Remeasurement**	**1 January 2018 (IFRS 9)**
Loans and receivables under IAS 39/financial assets at amortised cost under IFRS 9 (includes loans to customers)	15,437	2,531	17,968
Total measured at amortised cost	**15,437**	**2,531**	**17,968**

30 Events after reporting period

On 28 February 2019, the President of the Republic of Azerbaijan signed a decree "On the additional measures related to the solution of problem loans of individuals in the Republic of Azerbaijan" ("the Decree"). According to the Decree the increase in loan balances denominated in foreign currency resulted from devaluation of the national currency on 21 February 2015 and 21 December 2015 with total exposure up to USD 10,000 in all banks will be compensated by the government.

In addition, according to the Decree the CBAR should provide low interest rate loans to banks under the state guarantee totaling to AZN 682 million for the whole banking sector in order to restructure loans to individuals with overdue days more than 360 as at the date of the Decree and issued starting 1 January 2012 till the date of the Decree with exposure of up to USD 10,000 or AZN 17,000.

In order to prevent deterioration of the currency position of banks as a result of the Decree execution, the CBAR should provide banks with securities totalling to USD 215 million for the whole banking sector with annual interest rate of 0.5%.

Mr. Emil Rzayev
Chairman of the Management Board

Mr. Vusal Shahverdiyev
Chief Financial Officer