“UNIBANK COMMERCIAL BANK” OPEN JOINT STOCK COMPANY

The International Financial Reporting Standards Consolidated Financial Statements and Independent Auditors’ Report

For the Year Ended December 31, 2017

"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2017

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the consolidated financial statements of "Unibank Commercial Bank" OJSC (the "Bank") and its subsidiaries (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the consolidated financial position of the Group as at December 31, 2017, the consolidated results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Detecting and preventing fraud, errors and other irregularities.

The consolidated financial statements for the year ended December 31, 2017 were authorized for issue on May 4, 2018 by the Management Board of the Group.

On behalf of the Executive Board:

Mr. Faig Huseynov

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 4, 2018

KOMMERSIYA BANKI UNIBANK COMMERCIAL BANK

Mrs. Vafa Kalantarova

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 4, 2018

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Independent Auditors' Report

To the Shareholders and Executive Board of "Unibank Commercial Bank" Open Joint Stock Company.

Opinion

We have audited the consolidated financial statements of "Unibank Commercial Bank" Open Joint Stock Company (the "Bank") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at December 31, 2017, 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 December 31, 2017, 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), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter - Comparative Information

We draw attention to Note 4 to the consolidated financial statements which indicates that the comparative information presented for the year ended December 31, 2016 has been restated and reclassified. Our opinion is not modified in respect of this matter.

Other Matter - Comparative Information

The consolidated financial statements of the Group as at and for the year ended December 31, 2016 were audited by another auditor who expressed an unmodified opinion on those financial statements on June 15, 2017.

As part of our audit of the consolidated financial statements as at and for the year ended December 31, 2017, we audited the adjustments described in Note 4 that were applied to restate the comparative information presented as at and for the year ended December 31, 2016. We were not engaged to audit, review, or apply any procedures to the consolidated financial statements for the year ended December 31, 2016 other than with respect to the adjustments described in Note 4 to the consolidated financial statements. Accordingly, we do not express an opinion or any other form of assurance on those respective financial statements taken as a whole. However, in our opinion, the adjustments described in Note 4 are appropriate and have been properly applied.

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.

The Audit Committee is 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 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 financial statements, including the disclosures, and whether the 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.

Baker Tilly Azerbaijan

May 4, 2018
Baku, the Republic of Azerbaijan

"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2017
(in thousands of Azerbaijan Manats)

	Notes	December 31, 2017	December 31, 2016
ASSETS			
Cash and cash equivalents	7	83,343	53,192
Mandatory cash balances with the Central Bank of the Republic of Azerbaijan		2,914	3,397
Due from other banks	8	94,826	141,214
Loans and advances to customers	9, 32	319,451	350,146
Investment securities available-for-sale	10, 32	6,379	498
Advances to the Ministry of Taxes of the Republic of Azerbaijan		-	4,713
Deferred income tax asset	26	7,778	6,412
Premises and equipment	11	45,249	44,922
Intangible assets	11	8,852	6,665
Other financial assets	12	9,332	8,849
Other assets	13	14,585	8,714
TOTAL ASSETS		**592,709**	**628,722**
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks and other financial institutions	14	3,286	19,426
Customer accounts	15, 32	366,026	373,334
Debt securities in issue	16, 32	-	12,309
Term borrowings	17, 32	143,977	258,431
Other financial liabilities	18	9,662	6,651
Other liabilities		414	216
Subordinated debt	19, 32	18,858	31,642
Preference shares	20, 32	-	14,000
TOTAL LIABILITIES		**542,223**	**716,009**
EQUITY:			
Equity attributable to owners of the Bank:			
Share capital	21	125,686	56,565
Share premium	21	484	484
Accumulated deficit		(75,684)	(121,823)
TOTAL EQUITY ATTRIBUTABLE TO OWNERS OF THE BANK		**50,486**	**(64,774)**
Non-controlling interest		-	(22,513)
TOTAL EQUITY		**50,486**	**(87,287)**
TOTAL LIABILITIES AND EQUITY		**592,709**	**628,722**

On behalf of the Executive Board:

Mr. Faig Huseynov
Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 4, 2018

KOMMERSIYA BANKI UNIBANK

Mrs. Vafa Kalantarova
Chief Financial Officer
Baku, the Republic of Azerbaijan

May 4, 2018

The notes on pages 10-80 form an integral part of these consolidated financial statements.

"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2017

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	Notes	Year ended December 31, 2017	Year ended December 31, 2016 (Reclassified)
Continuing operations:			
Interest income	22, 32	71,724	123,032
Interest expense	22, 32	(26,371)	(43,294)
Net interest income before recovery of provision for impairment loss/(provision for impairment loss)	22	**45,353**	**79,738**
Recovery of provision for impairment loss/(Provision for impairment loss) on interest bearing assets	23, 32	41,256	(157,315)
Net interest income/(loss)		**86,609**	**(77,577)**
Fee and commission income	24, 32	10,899	9,847
Fee and commission expense	24	(6,121)	(5,623)
Gains less losses from trading in foreign currencies		7,675	10,675
Net foreign exchange translation (loss)/gain		(10,908)	22,550
Impairment loss on other assets	23	(226)	-
Recovery of provision for credit related commitments	23	-	365
Fair value loss on interest-free loans to customers at initial measurement		(2,230)	-
Other operating (loss)/income, net		1,920	(3,638)
Administrative and other operating expenses	25, 32	(43,040)	(42,796)
Profit/(loss) before income tax		**44,578**	**(86,197)**
Income tax expense	26	(141)	(1,483)
Income/(loss) from continuing operations		**44,437**	**(87,680)**
Discontinued operations:			
Gain/(loss) from discontinued operations	6	1,836	(29,452)
Total comprehensive income/(loss) for the year		**46,273**	**(117,132)**
Total comprehensive income/(loss) attributable to:			
Owners of the Bank from continuing operations		44,437	(87,680)
Owners of the Bank from discontinued operations		1,702	(19,249)
Non-controlling interest		134	(10,203)
Total comprehensive income/(loss) for the year		**46,273**	**(117,132)**
Earnings/(loss) per share for profit/(loss) attributable to the owners of the Bank, basic and diluted (AZN)	27	**1.46**	**(5.14)**
From continuing operations		1.41	(4.22)
From discontinued operations		0.05	(0.92)

On behalf of the Executive Board:

Mr. Faig Huseynov

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 4, 2018

Mrs. Vafa Kalantarova

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 4, 2018

UNIBANK KOMMERSIYA BANKI COMMERCIAL BANK

The notes on pages 10-80 form an integral part of these consolidated financial statements.

"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2017
(in thousands of Azerbaijan Manats)

	Share capital	Share premium	Accumulated deficit	Total equity attributable to owners of the Group	Non-controlling interest	Total equity
January 1, 2016	**56,565**	**484**	**(14,894)**	**42,155**	**(12,310)**	**29,845**
Total comprehensive loss for the year	-	-	(106,929)	(106,929)	(10,203)	(117,132)
December 31, 2016	**56,565**	**484**	**(121,823)**	**(64,774)**	**(22,513)**	**(87,287)**
Total comprehensive income for the year	-	-	46,139	46,139	134	46,273
Increase of share capital	69,121	-	-	69,121	-	69,121
Disposal of subsidiary (Note 6)	-	-	-	-	22,379	22,379
December 31, 2017	**125,686**	**484**	**(75,684)**	**50,486**	**-**	**50,486**

On behalf of the Executive Board:

Mr. Faig Huseynov

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 4, 2018

Mrs. Vafa Kalantarova

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 4, 2018

The notes on pages 10-80 form an integral part of these consolidated financial statements.

"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017
(in thousands of Azerbaijan Manats)

	Notes	Year ended December 31, 2017	Year ended December 31, 2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		62,079	92,015
Interest paid		(26,748)	(58,959)
Fees and commissions received		11,051	9,873
Fees and commissions paid		(6,245)	(5,815)
Income received from trading in foreign currencies		7,675	10,675
Other operating income received/(expenses paid)		1,573	(3,702)
Administrative and other operating expenses paid		(36,770)	(36,923)
Income tax paid		(671)	(89)
Cash flows from operating activities before changes in operating assets and liabilities		**11,944**	**7,075**
Change in operating assets and liabilities:			
Net decrease /(increase) in mandatory cash balances with the CBAR		483	(704)
Net (increase)/decrease in due from other banks		12,681	22,427
Net decrease in loans and advances to customers		59,124	213,938
Net (increase)/decrease in other financial assets		(568)	592
Net increase in other assets		(1,458)	(2,166)
Net (decrease)/increase in due to banks and other financial institutions		(16,143)	11,648
Net increase/(decrease) in customer accounts		12,776	(230,106)
Net (decrease)/increase in other financial liabilities		(5,126)	2,007
Net increase/(decrease) in other liabilities		40	(599)
Net cash from operating activities		**73,753**	**24,112**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Disposal of a subsidiary, net of cash disposed of		235	-
Acquisition of investment securities available-for-sale, net		(5,881)	-
Acquisition of premises, equipment and intangible assets		(9,977)	(2,828)
Proceeds on disposal of premises and equipment		160	201
Net cash used in investing activities		**(15,463)**	**(2,627)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from term borrowings		8,861	57,005
Repayment of term borrowings		(48,601)	(96,078)
Proceeds from subordinated debt		17,001	-
Repayment of subordinated debt		(4,875)	(121)
Proceeds from debt securities in issue		-	-
Redemption of debt securities in issue		(91)	(48,973)
Issuance of ordinary shares		2,500	-
Net cash used in financing activities		**(25,205)**	**(88,167)**
Effect of exchange rate changes on cash and cash equivalents		(2,934)	(906)
Net increase/(decrease) in cash and cash equivalents		30,151	(67,588)
Cash and cash equivalents at the beginning of the year	7	53,192	120,780
Cash and cash equivalents at the end of the year	7	**83,343**	**53,192**

On behalf of the Executive Board:

Mr. Faig Huseynov

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 4, 2018

Mrs. Vafa Kalantarova

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 4, 2018

The notes on pages 10-80 form an integral part of these consolidated financial statements.

1. ORGANIZATION

These consolidated financial statements of the "Unibank Commercial Bank" OJSC (the "Bank") and its subsidiaries (together referred to as the "Group") for the year ended December 31, 2017, have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is a joint stock company limited by shares and was set up in accordance with Azerbaijani regulations. As at December 31, 2017 the Bank is ultimately controlled by Mr. Eldar Garibov (December 31, 2016: Mr. Eldar Garibov) (See Note 21).

On June 17, 2004, the Bank registered Closed Joint Stock Company Unileasing ("Unileasing") with the Ministry of Justice of the Republic of Azerbaijan. Unileasing commenced its operations in August 2004 and 66.7% of share capital were owned by the Bank at December 31, 2016. On March 31, 2017 the Bank sold its ownership in Unileasing to a third party individual. See Note 5.

On January 23, 2008, the Bank registered its fully owned subsidiary, Open Joint Stock Company Unicapital ("Unicapital"), with the Ministry of Justice of the Republic of Azerbaijan. Unicapital commenced its operations in February 2008. Major activities of Unicapital are trust management of stock portfolios and dealing in the stock market of the Republic of Azerbaijan.

Principal activity of the Bank. The principal business activity of the Bank is commercial and retail banking operations within the Republic of Azerbaijan. The Bank has been operating under a full banking license issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") since 1992.

The Bank participates in the state deposit insurance scheme, which was introduced by the "Law on Deposit Insurance" dated December 29, 2006. The Azerbaijan Deposit Insurance Fund guarantees repayment of 100% of individual deposits meeting the following criteria:

- placed between August 1, 2013 and May 19, 2014 in local or foreign currency for an equivalent of up to AZN 30,000 and bearing annual interest rate not higher than 10%;
- placed between May 19, 2014 and February 24, 2015 in local or foreign currency for an equivalent of up to AZN 30,000 and bearing annual interest rate not higher than 9%;
- placed between February 24, 2015 and March 1, 2016 in local or foreign currency for an equivalent of up to AZN 30,000 and bearning annual interest rate not higher than 12%;
- placed after March 2, 2016 for any amount for up to 3 years at annual interest rate not higher than 15% for local currency and 3% for foreign currency deposits.

As at December 31, 2017 the Bank has 31 branches (December 31, 2016: 32 branches) within the Republic of Azerbaijan.

The Bank's registered address is:
55 Rashid Behbudov Street
AZ1014, Baku, the Republic of Azerbaijan

Business environment

The Group's operations are conducted in the Republic of Azerbaijan. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Azerbaijani economy contracted by 1.3% growth (year-on-year) in the first half of 2017, driven by a decline in oil GDP (7.2%) as oil revenues were decreased due to production volumes and oil prices. On the upside, and despite continued banking sector distress, the non-oil economy expanded by 1.7% for the first time in over a year, supported by the strong performance of the agriculture and manufacturing sectors. Annual inflation remained high at 13-14% during 2017, driven mainly by an increase in government-controlled tariffs for electricity, water, and gas, and in domestic food prices. Citing inflationary pressures, the Central Bank of the Republic of Azerbaijan continued to tighten the monetary policy stance during 2017 by scaling up liquidity absorption operations. The manat has appreciated by 4.4% against the U.S. dollar since end of 2016, reflecting its stronger external position and increased liquidity absorption operations. The troubled financial sector continues to exert a negative impact on the economy. Credit contracted by 15.6% in the first half of 2017, and the quality of assets continued to deteriorate. Per official statistics, the nonperforming loan ratio reached 13% in June 2017 compared to 9% at end-2016. Although manat deposits grew in the second quarter of 2017, the customer deposits (corporate and household) shrank by 4.4% during the first seven months of 2017.

Starting from February 2016 the Central Bank of the Republic of Azerbaijan has gradually increased refinancing rate from 5% to 15% during 2017 and the minimum capital adequacy ratio was lowered from 12% to 10%.

In February 2018, Standard & Poor's, international credit agency, affirmed long and short-term sovereign credit rating of Azerbaijan in foreign and local currency at 'BB+/B' upgrading rating outlook from negative to stable.

The Azerbaijani economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. While the Government has introduced a range of stabilization measures and plans to expedite reforms and support to banking system in response to current economic challenges. The Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in manner not currently determinable.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Group's operations and consequently what effect, if any, they could have on the financial position of the Group.

Amidst the ongoing crisis, the government of Azerbaijan shifted its oil-oriented economic policy, dominated for two decades, to the diversification of the economy. For that purpose, a "national strategic roadmap" was adopted to formulate a correct development strategy covering 11 sectors. The implementation of the "national strategic roadmap" was assigned to the newly formed "Center for Analysis of Economic Reforms and Communications," the aim of which is analyzing the effectiveness of conducted reforms and making new proposals.

Significant measures have been taken in custom services and taxation as well. As of August 1, 2016, new regulations to ensure more operative and transparent custom clearance (a "green corridor" and other access systems) were implemented. The new simplified procedures are intended to stimulate imports and provide favorable conditions for business and external trade. As a continuation of reforms in customs, the reception of e-declarations is introduced minimize the contact of citizens with government officials. In order to amend the existing tax system, the decree approving the "Directions of Reforms in Taxation for 2016" was signed. The presidential decree requires the Ministry of Taxes to ensure that on-site and off-tax audits are performed within short periods of time and extend the coverage of electronic tax audits to limit face-to-face contacts with taxpayers. Another important amendment on monopolistic actions was made to the Criminal Code. Besides, the latest changes in December 2016 to Taxes Code "transfer pricing" will be applied against artificially exaggerated expenses and "voluntary tax disclosure" notion included in the Code which is highly practicable in greatest economies. Furthermore, in order to prevent additional exposure to financial sanctions by the tax authority because of tax liability miscalculation, the mechanism of "determination of tax liability in advance" principle will be in force. Along with them, implementation of electronic invoices will play an important role in prevention of tax evasion and will impact positively on tax system optimization.

Azerbaijan is also trying to benefit from regional connectivity initiatives to boost transit and trade. In particular, the country is one of the sponsors of the East-West and North-South transport corridors. Construction of the Baku-Tbilisi-Kars railway line, connecting the Caspian region with Turkey, was completed in 2017. The Trans-Anatolian Natural Gas Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP) will deliver natural gas from Azerbaijan's Shah Deniz gas field to Turkey and Europe. The economy is expected to expand from 2018 onward, supported by an acceleration of oil GDP as the Shah Deniz gas field-one of the largest gas fields in the world-begins production. Non-oil output will continue to grow at a slow pace due to limited credit growth and the weak business environment.

2. BASIS OF PREPARATION

Statement of compliance

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

These consolidated financial statements have been prepared based on the assumption that the Group will continue as a going concern for the foreseeable future.

Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that available-for-sale financial assets are stated at fair value.

Functional currency

The functional currency of the Bank and its subsidiaries is the Azerbaijan 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. The AZN is also the presentation currency for the purposes of these consolidated financial statements. All values are rounded to the nearest thousand AZN's, except when otherwise indicated.

Use of estimates and judgments

In the application of the Group's accounting policies, which are described in Note 3, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Impairment of loans and receivables

The Group regularly reviews its loans and receivables to assess for impairment. The Group's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses and actual losses would require the Group to record provisions which could have a material impact on its financial statements in future periods.

The Group uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans. The Group uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.

The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group is not in a position to predict what changes in conditions will take place in the Republic of Azerbaijan and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

As at December 31, 2017 and 2016 the gross loans and advances to customers totaled AZN 580,686 thousand and AZN 680,397 thousand, respectively, and provision for loan impairment amounted to AZN 261,235 thousand and AZN 330,251 thousand, respectively.

Useful life of premises and equipment

The Group assesses the remaining useful lives of items of premises and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of premises and equipment and on depreciation recognized in profit or loss.

In previous years the Group has been using the depreciation rates formed in accordance with the mid-term plans and initial estimations of the useful lives. However, during 2017 the Group's management realized that depreciation rate and residual values for certain assets differ from practical use of the assets as well as asset consumption rates used by similar size commercial banks operating in the Republic of Azerbaijan. Considering this situation the management of the Group has adopted new depreciation rate for buildings upon investigating set of adequate information. Application of new depreciation rates has been effective prospectively starting from January 1, 2017.

Fair value of repossessed assets

Repossessed assets represents the assets acquired following the foreclosure of loans that are in default. The Group measures these assets at the lower of its carrying amount and fair value less costs to sell. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Group did not recognized fair value gain/(loss) on repossessed assets during the year ended December 31, 2017 and 2016.

Valuation of financial instruments

As described in Note 31, the Group uses valuation techniques that include inputs that are not based on observable market date to estimate the fair value of certain types of financial instruments. Note 31 provides detailed information about the key assumptions used in the determination of the fair value of financial instruments, as well as the detailed sensitivity analysis for these assumptions. The directors believe that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

Tax legislation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations. Refer to Note 30.

Recoverability of deferred tax assets

The management of the Group reviews deferred tax assets at the end of each reporting period and reduces it to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. The carrying value of deferred tax assets amounted to AZN 7,778 thousand and AZN 6,412 thousand as at December 31, 2017 and 2016, respectively.

The recoverability of the deferred tax asset has been determined using profitability forecasts used in the long-term business strategy of the Group, including the assumption of planned business changes within the Group. These assumptions were tested for sensitivity to confirm that the estimates used are not overestimated or aggressive. The time horizon of the forecasts used was limited to 5 years – the period when the tax loss carry forward can be utilized in accordance with Azerbaijan tax rules.

Initial recognition of related party transactions

In the normal course of business the Group enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgment is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgment is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. The management concluded that interest rates for transactions with related parties do not significantly differ from those applied to transactions with third parties. Terms and conditions of related party balances are disclosed in Note 32.

Disposal of subsidiary

If a parent loses control of a subsidiary, the parent derecognizes the assets and liabilities of the former subsidiary from the consolidated statement of financial position. A loss of control means that a parent no longer has control over its subsidiary, i.e. does not control an investee when it is exposed, or does not have rights to variable returns from its involvement with the investee and does not have the ability to affect those returns through its power over the investee.

During the year ended December 31, 2017 the Group sold its 66.67% ownership in Unileasing, to a third party resident individual as a result of which the Group lost control over Unileasing. The details of this transaction are disclosed in detail in Note 6.

Capital adequacy ratio

Capital adequacy ratio is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (July 1988, updated in November 2005) or Basel Capital Accord requirements. Such requirements are subject to interpretation and accordingly the appropriateness of the inclusion, exclusion, and/or classification of amounts included in the calculation of the capital adequacy ratio requires management judgment, for example, whether the off-balance sheet commitments covered by blocked customer accounts would carry no risk for the purposes of calculating total risk-weighted assets. Currently, management believes that such off-balance sheet commitments carry no risk for the capital adequacy calculation purposes.

Term borrowings and loans to customers with below market rate

Management has considered whether gains or losses should arise on initial recognition of loans from governmental and international financial institutions and related lending. The Group obtains long term financing from government and international financial institutions with interest rates at which such institutions ordinarily lend in emerging markets and which may be lower than rates at which the Group could source the funds from local lenders. As the transactions are with unrelated parties, management's judgment is that these funds and the related lending are at the market interest rates and no initial recognition gains or losses should arise. In making this judgment management also considered that these instruments are a separate market segment. In other cases, where applicable the management recognizes gain or loss on initial recognition of below market rate loans and borrowings. During the year ended December 31, 2017 fair value loss on interest free loans to customers at initial measurement amounted to AZN 2,230 thousand (2016: nil).

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below are applied consistently to all periods presented in these consolidated financial statements, and are applied consistently by Group entities.

Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries. Control is achieved when the Bank:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Bank reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Bank has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally.

The Bank considers all relevant facts and circumstances in assessing whether or not the Bank's voting rights in an investee are sufficient to give it power, including:

- the size of the Bank's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Bank, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Bank has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Bank gains control until the date when the Bank ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the owners of the Bank and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Bank and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions and balances are eliminated in full on consolidation.

If the Group loses control over a subsidiary, it derecognizes the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognized in profit or loss.

Non-controlling interests

Non-controlling interests represent the portion of profit or loss and net assets of subsidiaries not owned, directly or indirectly, by the Bank.

Non-controlling interests are presented separately in the consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Group entities 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 amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized 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 recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments unless the difference is due to impairment in which case foreign currency differences that have been recognized in other comprehensive income are reclassified to profit or loss; a financial liability designated as a hedge of the net investment in a foreign operation to the extent that the hedge is effective; or qualifying cash flow hedges to the extent that the hedge is effective, which are recognized in other comprehensive income.

The exchange rates used by the Group in the preparation of the consolidated financial statements as at year-end are as follows:

	December 31, 2017	December 31, 2016
AZN/1 USD	1.7001	1.7707
AZN/1 EUR	2.0307	1.8644

In December 2016, the Central Bank of the Republic of Azerbaijan announced floating exchange rate policy.

Recognition of interest income

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Group and the amount of income can be measured reliably. Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.
Interest earned on assets at fair value is classified within interest income.

Recognition of fee and commission income

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment.

Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided. Loan syndication fees are recognized in profit or loss when the syndication has been completed. All other commissions are recognized when services are provided.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, unrestricted balances on corresponded and term deposits with the Central Bank of the Republic of Azerbaijan (the “CBAR”) with original maturity of less or equal to 90 days, notes issued by the Central Bank of the Republic of Azerbaijan (the “CBAR”) up to 90 days and amounts due from credit institutions with original maturity of less or equal to 90 days and are free from contractual encumbrances.

Mandatory cash balance held with the CBAR

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

Financial instruments

The Group recognizes financial assets and liabilities in its consolidated statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

Financial assets are classified into the following specified categories: ‘held-to-maturity’ investments, ‘available-for-sale’ (AFS) financial assets and ‘loans and receivables’. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated as available-for-sale or are not classified as (a) loans and receivables or (b) held-to-maturity investments or (c) FVTPL.

Listed shares and listed redeemable notes held by the Group that are traded in an active market are classified as AFS and are stated at fair value. The Group also has investments in unlisted shares that are not traded in an active market but that are also classified as AFS financial assets and stated at fair value (because the Group management considers that fair value can be reliably measured). Fair value is determined in the manner described (See Note 30). Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of other-than-temporary impairment losses, interest calculated using the effective interest method, dividend income and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period. The foreign exchange gains and losses that are recognized in profit or loss are determined based on the amortized cost of the monetary asset. Other foreign exchange gains and losses are recognized in other comprehensive income.

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

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as ‘loans and receivables’. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

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

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

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

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

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

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

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

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

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

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

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

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

Renegotiated loans

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

Write-off of loans and advances

Loans and advances are written off against the provision for loan impairment when deemed uncollectible. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Group and after the Group has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the consolidated statement of comprehensive income in the period of recovery.

In accordance with the statutory legislation, loans may only be written off with the approval of the Supervisory Board and, in certain cases, with the respective decision of the court.

Derecognition of financial assets

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another party. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay.

If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset’s carrying amount and the sum of the consideration received and receivable and the cumulative gain of loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Group retains an option to repurchase part of a transferred asset), the Group allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit or loss. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Financial liabilities and equity instruments issued

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognized at the proceeds received, net of direct issue costs.

Repurchase of the Bank’s own equity instruments is recognized and deducted directly in equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Bank’s own equity instruments.

Other financial liabilities

Other financial liabilities, including depository instruments with the Central Bank of the Republic of Azerbaijan, due to other banks and customer accounts, debt securities in issue, term borrowings, subordinated debt and other liabilities are initially measured at fair value, net of transaction costs.

Preference shares represent shares that are non-redeemable and carry mandatory dividends, and are classified as financial liabilities.

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

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by the Group are initially measured at their fair values and, if not designated as at FVTPL, are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Derecognition of financial liabilities

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liability simultaneously. Income and expense is not offset in the consolidated statement of comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

The principal accounting policies are set out below.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recognized as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Repossessed assets

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed assets are measured at the lower of carrying amount and fair value less costs to sell.

Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation and provision for impairment, where required.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalized and the replaced part is retired.

Depreciation

Land and construction in progress are not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. During the year ended December 31, 2017 the Group revised the residual values and useful lives of certain classes of assets based on benchmark assessment.

2017	Residual values	Useful lives in years
Buildings	40%	50 years
Office and computer equipment	20%	5 - 6 years
Furniture, fixtures and other equipment	30%	5 - 8 years
Leasehold improvements	-	over the term of the underlying lease

2016	Residual values	Useful lives in years
Buildings	-	40 years
Office and computer equipment	10%	5 years
Furniture, fixtures and other equipment	10%	5 - 7 years
Leasehold improvements	-	over the term of the underlying lease

Construction in progress is carried at cost, less any recognized impairment loss. Cost includes professional fees. Such construction in progress is classified to the appropriate categories of property and equipment when completed and ready for intended use.

Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets’ residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.
Gains and losses on disposals determined by comparing proceeds with carrying amount are recognized in profit or loss for the year (within other operating income or expenses).

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

Intangible assets

Intangible assets acquired separately

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. The estimated useful lives of intangible assets are 10 years. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Derecognition of intangible assets

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

Impairment of tangible and intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Non-current assets held for sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are remeasured in accordance with the Group's accounting policies. Thereafter generally, the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell.

Discontinued operations

Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as profit or loss after tax from discontinued operations in the statement of profit or loss. Additional disclosures are provided in Note 6. All other notes to the financial statements include amounts for continuing operations, unless indicated otherwise.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax expense.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from 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.

Current and deferred tax for the year

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

Operating taxes

Azerbaijan also has various other taxes, which are assessed on the Group’s activities. These taxes are included as a component of operating expenses in the consolidated statement of comprehensive income.

Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Contingencies

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

Repossessed collateral

The Group obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Group a claim on these assets for both existing and future customer liabilities.

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed collateral is initially recognized at an amount equal to the carrying amount of a loan for which it was pledged. Repossessed assets are measured at the lower of carrying amount and fair value less costs to sell.

Credit related commitments

The Group enters into credit related commitments, including letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognized at their fair value, which is normally evidenced by the amount of fees received. This amount is amortized on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at the higher of (i) the remaining unamortized balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the end of each reporting period.

Equity reserves

The reserves recorded in equity (other comprehensive income) on the Group's consolidated statement of financial position include 'Available-for-sale' reserve which comprises changes in fair value of investment securities available-for-sale.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

New standards and interpretations not yet adopted

At the date of authorization of these consolidated financial statements, other than the Standards and Interpretations adopted by the Group in advance of their effective dates, the following Interpretations were in issue but not yet effective.

Annual Improvements to IFRS Standards 2014-2016 Cycle contains amendments to IFRS 1 and IAS 28 which are not yet mandatorily effective for the Group.

Standard	Subject of amendment
IFRS 1 "First-time Adoption of International Financial Reporting Standards"	Deletion of short-term exemptions for the first-time adopters: The amendments delete the short-term exemptions in IFRS 1 that relate to IFRS 7, IAS 19, IFRS 12 and IAS 27.
IAS 28 "Investments in Associates and Joint Ventures"	Measuring an associate or joint venture at fair value: The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

The amendments to IFRS 1 and IAS 28 are effective for annual periods begin on or after January 1, 2018.

The IASB and FASB have issued their joint revenue recognition standard, IFRS 15 "Revenue from Contracts with Customers", which replaces all existing IFRS and US GAAP revenue requirements. IFRS 15 specifies how and when an IFRS reporter will recognize revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 was issued in May 2014 and applies to an annual reporting period beginning on or after January 1, 2018. An earlier application is permitted.

Amendments to IAS 40 "**Transfers of Investment Property"** are intended to clarify that an entity can only reclassify a property to/from investment property when, and only when, there is evidence that a change in the use of the property occurred. The amendments are effective for periods beginning on or after January 1, 2018. Earlier application is permitted. An entity applies the amendments to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is also permitted if that is possible without the use of hindsight.

IFRIC 22 "Foreign Currency Transactions and Advance Consideration" addresses foreign currency transactions or parts of transactions where:

- there is consideration that is denominated or priced in a foreign currency;
- the entity recognizes a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and
- the prepayment asset or deferred income liability is non-monetary.

The Interpretations Committee came to the following conclusion that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The interpretation applies to annual reporting periods beginning or after January 1, 2018. An earlier adoption is permitted.

IFRS 9 "Financial Instruments" – in July 2014, IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

- From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives to be assessed based on a combination of the entity`s business model for managing the assets and the instruments` contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortized cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortized cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as requirements of IAS 39;
- IFRS 9 will also fundamentally change the approach to loan impairment. The standard will replace IAS 39`s incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Bank will be required to record an allowance for expected losses for all loans and other debt financial assets not carried at FVPL, as well as for loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance would be based on the probability of default over the life of asset.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the Group plans to adopt new standard by recognizing the cumulative transitional effect in opening retained earnings on January 1, 2018 and will not restate comparative information. The Group expects an impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward looking elements to determine the extent of the impact. The Group is in the process of quantifying the effect of adoption of IFRS 9, however no reasonable estimate of this effect is yet available.

Amendments to IFRS 2 "Share-Based Payment" – The IASB have published final amendments to IFRS 2 "Share-based Payment" that clarify the classification and measurement of share-based payment transactions. Classification and Measurement of Share-based Payment Transactions contains the following clarifications and amendments:

Accounting for cash-settled share-based payment transactions that include a performance condition

Until issue of these amendments, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

Classification of share-based payment transactions with net settlement features

The IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

Accounting for modifications of share-based payment transactions from cash-settled to equity-settled

Until issue of these amendments, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognized in respect of the cash-settled share-based payment is derecognized and the equity-settled share-based payment is recognized at the modification date fair value to the extent services have been rendered up to the modification date;

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- Any difference between the carrying amount of the liability as at the modification date and the amount recognized in equity at the same date would be recognized in profit and loss immediately.

The amendments are effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

IFRS 16 "Leases", which specifies how and IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 16 was issued on January 13, 2016 and applies to an annual reporting period beginning on or after January 1, 2019.

IFRS 17 "Insurance contracts" was issued in May 2017 and replaced IFRS 4 "Insurance contracts". The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 "Insurance Contracts" to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

IFRIC 23 "Uncertainty over Income Tax Treatments" addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- whether tax treatments should be considered collectively;
- assumptions for taxation authorities' examinations;
- the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- the effect of changes in facts and circumstances.

The interpretation applies to annual reporting periods beginning or after January 1, 2019.

Annual Improvements to IFRS Standards 2015-2017 Cycle contains amendments to four International Financial Reporting Standards (IFRSs) as result of the IASB's annual improvements project.

Standard	Subject of amendment
IFRS 3 "Business Combinations" and IFRS 11 "Joint Arrangements"	The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
IAS 12 "Income Taxes"	The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises.
IAS 23 "Borrowing Costs"	The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

The amendments are all effective for annual periods beginning on or after January 1, 2019.

Amendments to IAS 28 "Investments in Associations and Joint Ventures" – The IASB has published amendments to IAS 28 regarding the long-term interest in associates and joint Ventures. According to the amendment the entity should apply IFRS 9 to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendment is effective for annual periods beginning on or after January 1, 2019.

Amendments to IFRS 9 "Financial Instruments" – The IASB has published amendments to IFRS 9 regarding prepayment features with negative compensation and modifications of financial liabilities.

Prepayment Features with Negative Compensation amends the existing requirement of IFRS 9 regarding termination rights in order to allow measurement at amortized cost even in the case of negative compensation payments. The IASB also clarifies that the entity recognizes any adjustment to the amortized cost of the financial liability arising from a modification or exchange in profit or loss at the date of modification or exchange.

The amendment is effective for annual periods beginning on or after January 1, 2019.

The Management is considering the implications of these standards, their impact on the financial statements and the timing of its adoption by the Group.

4. PRIOR PERIOD RECLASSIFICATIONS AND RESTATEMENTS

During the year ended December 31, 2017, the Management detected certain errors in the financial statements for the year ended December 31, 2016. These errors were corrected as disclosed below.

	Notes	As previously reported December 31, 2016	Effect of restatements	Effect of reclassification of discontinued operations	As restated December 31, 2016
Statement of comprehensive income:					
Provision for impairment losses on interest bearing assets	a	148,498	28,079	(19,262)	157,315
Net foreign exchange translation loss/(gain)	a	11,602	(28,079)	(6,073)	(22,550)

a) Correction of wrongly reported foreign exchange loss amount.

The Group also represented the profit and loss statement and disclosed notes related to discontinued operations for the year ended December 31, 2016 as required under IFRS 5 "Non-current assets held for sale and discontinued operations" (see relevant notes).

5. MANAGEMENT OF CAPITAL

The objectives of management when managing the Bank's and Group's capital are (i) to comply with the capital requirements set by the FIMSA, (ii) to safeguard the Group's ability to continue as a going concern and (iii) to maintain a sufficient capital base to achieve a capital adequacy ratio based on Basel Capital Accord of at least 8%.

Under the current prudential capital requirements set by the FIMSA banks have to: (a) hold the minimum level of total statutory capital of AZN 50,000 thousand (December 31, 2016: AZN 50,000 thousand); (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 10% (December 31, 2016: 10%) and (c) maintain a ratio of Tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 5% (December 31, 2016: 5%).

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Management considers that the Bank was in compliance with the statutory capital ratio as at December 31, 2017 (December 31, 2016: in compliance). The calculation of capital adequacy based on the prudential reports prepared by the Bank in accordance with the prudential regulations set by the FIMSA was as follows:

	December 31, 2017	December 31, 2016
Total capital	67,488	64,918
Risk-weighted assets	521,836	551,291
Capital adequacy ratio (%)	**12.93%**	**11.78%**

The regulatory guidelines on capital adequacy are mostly based on Basel Capital Accord requirements with some differences related to inclusion of additional components into total capital as well as to calculation of allowance for impairment losses on loans to customers, which is determined per the prudential rules on loan loss provisioning.

The Group is also subject to minimum capital requirements established by covenants stated in loan agreements, including capital adequacy levels calculated in accordance with the requirements of the Basel Capital Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998) and Amendment to the Capital Accord to incorporate market risks (updated November 2005), commonly known as Basel I. The composition of the Group's capital calculated in accordance with Basel Capital Accord is as follows:

	December 31, 2017	December 31, 2016
Tier 1 capital		
Share capital	125,686	56,565
Share premium	484	484
Accumulated losses	(75,684)	(144,336)
Preference shares	-	14,000
Total tier 1 capital	**50,486**	**(73,287)**
Tier 2 capital		
Subordinated debt (unamortized part)	18,701	-
Total tier 2 capital	**18,701**	**-**
Less: Investments in equity shares	(502)	(498)
Total capital	**68,685**	**(73,785)**
Risk-weighted assets:		
On-balance sheet	389,380	399,059
Off-balance sheet	29,598	34,174
Total risk weighted assets	**418,978**	**433,233**
Total capital expressed as a percentage of risk-weighted assets (total capital ratio)	**16.39%**	**(17.03%)**
Total tier 1 capital expressed as a percentage of risk-weighted assets (tier 1 capital ratio)	**12.05%**	**(16.92%)**

The table below provides an overview of the differences in composition of the net assets as at December 31, 2017 presented in the Group`s consolidated financial statements prepared under IFRS and total statutory capital determined under the rules and regulations of the FIMSA.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	December 31, 2017 (unaudited)	December 31, 2016 (unaudited)
Total statutory capital	**67,488**	**64,918**
Differences between statutory capital and IFRS equity:		
- non-cumulative preference shares	-	(14,000)
- accumulated losses	(7,858)	(65,672)
- loan loss allowance	1,229	(65,565)
- provision for potential losses	(8,846)	-
- income tax	3,075	1,864
- others	(3,316)	(1,971)
- differences on deduction	13,793	13,067
- intangible assets	8,850	6,581
- deferred tax assets	4,703	4,548
- investments	240	1,938
- general allowances	(5,537)	(5,731)
- other capital	(18361)	(11,624)
IFRS (net liabilities)/equity of the Bank	**49,525**	**(19,042)**
IFRS net liabilities of subsidiaries	**961**	**(45,732)**
Total equity attributable to owners of the Bank	**50,486**	**(64,774)**

6. DISPOSAL OF SUBSIDIARY – DISCONTINUED OPERATIONS

On March 31, 2017, the Group fully disposed of its 66.67% ownership in Unileasing through a sale of 600,000 ordinary shares with nominal value of AZN 2 per share for AZN 600 thousand to a third party resident individual. As the Company disposed of its subsidiary, it should be disclosed under discontinued operations.

The results of the discontinued operations of the disposal group are as follows:

	December 31, 2017	December 31, 2016
Interest income	492	2,427
Interest expense	(1,493)	(6,140)
Elimination of inter-group interest expense	206	1,162
Net interest expense	**(795)**	**(2,551)**
Recovery of impairment losses/(Impairment losses) on interest bearing assets (Notes 8 and 9)	347	(19,262)
Net interest loss after impairment losses	**(448)**	**(21,813)**
Fee and commission income	168	68
Fee and commission expense	(129)	(191)
Other operating income	1	19
Impairment loss	(357)	(874)
Net foreign exchange translation loss gain/(loss)	1,444	(6,073)
Administrative and other operating expenses	(70)	(588)
Net non-interest income/(loss)	**1,057**	**(7,639)**
Results from operating activities	**609**	**(29,452)**
Gain on sale of discontinued operations	**1,227**	**-**
Profit/(loss) from discontinued operations	**1,836**	**(29,452)**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Cash flows from discontinued operations	**December 31, 2017**	**December 31, 2016**
Net cash from/(used in) operating activities	1,913	(4,012)
Net cash from investing activities	-	3
Net cash (used in)/from financing activities	(1,784)	3,627
Effect of exchange rate changes on cash and cash equivalents	-	57
Net cash flow for the period	**129**	**(325)**

Effect of disposal on the financial position of the Group	**December 31, 2017**
Cash and cash equivalents	(365)
Loans and advances to customers	(18,446)
Provision for impairment loss against loans to customers (Note 9)	5,806
Due from other banks	(9,348)
Provision for impairment loss against due from other banks (Note 8)	9,348
Advances to the Ministry of Taxes of the Republic of Azerbaijan	(88)
Premises and equipment (Note 11)	(657)
Intangible assets (Note 11)	(78)
Other assets	(1,917)
Term borrowings	75,051
Provision for impairment losses on due from banks (Note 8)	(29,057)
Provision for potential losses (Note 18)	(8,846)
Deferred income tax asset	1,366
Other liabilities	237
Non-controlling interest	(22,379)
Net liabilities disposed	**627**
Consideration received	600
Gain on sales of discontinued operations	**1,227**
Consideration received	600
Cash and cash equivalents disposed of	(365)
Net cash inflows	**235**

7. CASH AND CASH EQUIVALENTS

	December 31, 2017	**December 31, 2016**
Cash on hand	31,579	35,044
Cash balances with the CBAR (other than mandatory cash balances)	28,410	7,895
Notes issued by CBAR with original maturity up to 90 days	9,593	-
Correspondent accounts with other banks:		
- *rated AA- to AA+ (Fitch Ratings)*	-	6,573
- *rated A- to A+ (Fitch Ratings)*	28	1,307
- *rated BBB- to BBB+ (Fitch Ratings)*	11,899	1,649
- *rated below BBB- (Fitch Ratings)*	923	482
- *not rated*	911	242
Total correspondent accounts with other banks	13,761	10,253
Total cash and cash equivalents	**83,343**	**53,192**

No past due or impaired balance existed in cash and cash equivalents as at December 31, 2017 and December 31, 2016.

As at December 31, 2017 the Group had two banks (December 31, 2016: two banks), with balances exceeding 10% of total cash and cash equivalents. The gross value of these balances as at December 31, 2017 was AZN 49,291 thousand (December 31, 2016: AZN 14,318 thousand).

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The most recently published international rating for the Republic of Azerbaijan is BB+ (Fitch Ratings) (2016: BB+/Fitch Ratings).

Currency, interest rate, geographical and liquidity analysis of cash and cash equivalents are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of cash and cash equivalents.

8. DUE FROM OTHER BANKS

	December 31, 2017	**December 31, 2016**
Restricted balances with the CBAR	67,007	107,942
Term placements with resident banks	43,093	39,018
Term placements with non-resident banks	13,783	3,602
	123,883	**150,562**
Less: Provision for impairment	(29,057)	(9,348)
Net due from other banks	**94,826**	**141,214**

As at December 31, 2017 term placements with local banks included term placements with five local banks with principal balance amounting to the equivalent of AZN 37,493 thousand and bearing annual interest rates ranging between 3% and 4% (December 31, 2016: placements with seven local banks amounting to the equivalent of AZN 29,649 thousand and bearing annual interest rates ranging between 4% and 7%). Loans with the same amount (AZN 37,493 thousand) have subsequently been granted by these local banks to Unileasing under separate loan agreement bearing annual interest rates ranging between 4% and 5% (December 31, 2016: AZN 29,649 thousand of this amount have subsequently been granted by these local banks to Unileasing under separate loan agreement bearing annual interest rates ranging between 5% and 11%). These term placements of the Bank and the loans obtained by Unileasing are not netted-off since based on the legal contract they represent separate assets placed with and liabilities due from third parties. As a part of sale of Unileasing transaction, the Group derecognized term placements with resident banks in the amount of AZN 9,348 thousand before provision of AZN 9,348 thousand and recognized provision for impairment losses in the amount of AZN 29,057 against due from other banks that were pledged as a collateral against the loans to Unileasing.

As at December 31, 2017 and 2016 the restricted balances with the CBAR represented funds blocked by the CBAR as collateral for the loans issued to the Bank.

Amounts due from other banks are not collateralized. An analysis by credit quality of amounts due from other banks is as follows:

	December 31, 2017	**December 31, 2016**
Current and not impaired		
- Central Bank of the Republic of Azerbaijan	67,007	107,942
A+ (Fitch Ratings)	-	3,602
>BBB (Fitch Ratings)	5,041	-
<BBB (Fitch Ratings)	16,605	11,510
- not rated	6,173	18,160
Total due from other banks	**94,826**	**141,214**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Movements in provision for impairment during the year ended December 31, 2017 are as follows:

	Balance at January 1, 2017	Write off of assets as a result of sale of subsidiary	Net increase in provision for impairment included in gain from sale of subsidiary	Balance at December 31, 2017
Due from other banks	9,348	(9,348)	29,057	29,057
Total	**9,348**	**(9,348)**	**29,057**	**29,057**

As at December 31, 2017 the Group has one bank (December 31, 2016: one bank) with an outstanding balance exceeding 10% of total due from other banks. The gross value of these balances as at December 31, 2017 is AZN 67,007 thousand (December 31, 2016: AZN 107,942 thousand).

Currency, interest rate, geographical and liquidity analysis of due from other banks are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of due from other banks.

9. LOANS AND ADVANCES TO CUSTOMERS

	December 31, 2017	December 31, 2016
Business loans	211,747	230,749
Cash consumer loans	177,373	218,916
Credit cards	90,294	130,515
Purchase of apartments and mortgages	53,301	47,138
Micro loans	43,949	45,667
Purchase of motor vehicles	4,022	7,412
Gross loans and advances to customers	**580,686**	**680,397**
Less: Provision for loan impairment	(261,235)	(330,251)
Net loans and advances to customers	**319,451**	**350,146**

Movements in the provision for loan impairment during the year ended December 31, 2017 are as follows:

	Balance at January 1, 2017	Loans written off during the year	Recovery of loans written off	Decrease in provision for impairment (discontinued operations)	Eliminated as a result of disposal of subsidiary	Increase/ (decrease) in provision for impairment	Balance December 31, 2017
Business loans	108,425	(10,067)	1,161	(347)	(2,774)	3,181	99,579
Cash consumer loans	137,492	(9,425)	703	-	-	(24,092)	104,678
Credit cards	40,522	(4,502)	360	-	-	(9,328)	27,052
Purchase of apartments and mortgages	2,385	(1)	78	-	(1,457)	(731)	274
Micro loans	36,685	(1)	19	-	-	(8,100)	28,603
Purchase of motor vehicles	4,742	(1)	69	-	(1,575)	(2,186)	1,049
Total	**330,251**	**(23,997)**	**2,390**	**(347)**	**(5,806)**	**(41,256)**	**261,235**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Movements in the provision for loan impairment during the year ended December 31, 2016 are as follows:

	Balance at January 1, 2016	Loans written off during the year	Recovery of loans written off	Increase in provision for impairment (discontinued operation)	Increase in provision for impairment	Balance at December 31, 2016
Business loans	46,847	(6,709)	733	9,914	57,640	108,425
Cash consumer loans	82,940	(492)	559	-	54,485	137,492
Credit cards	19,839	(228)	151	-	20,760	40,522
Purchase of apartments and mortgages	703	-	16	-	1,666	2,385
Micro loans	15,660	-	9	-	21,016	36,685
Purchase of motor vehicles	2,962	(52)	84	-	1,748	4,742
Total	**168,951**	**(7,481)**	**1,552**	**9,914**	**157,315**	**330,251**

Economic sector risk concentrations within the customer loan portfolio are as follows:

	December 31, 2017		December 31, 2016	
	Amount	%	Amount	%
Retail loans				
Cash consumer loans	177,377	30.5	218,916	32.2
Credit cards	90,297	15.5	130,515	19.2
Purchase of apartments and mortgages	53,300	9.2	47,138	6.9
Micro loans	43,950	7.6	45,667	6.7
Purchase of motor vehicles	4,022	0.7	7,412	1.1
Total retail loans	**368,946**	**63.5**	**449,648**	**66.1**
Business loans				
Trade and services	134,511	23.2	131,109	19.3
Construction	37,029	6.4	59,997	8.8
Agriculture	17,141	3.0	16,625	2.4
Manufacturing	15,899	2.7	14,821	2.2
Transportation	-	-	2,066	0.3
Other	7,160	1.2	6,131	0.9
Total business loans	**211,740**	**36.5**	**230,749**	**33.9**
Gross loans and advances to customers	**580,686**	**100.0**	**680,397**	**100.0**

As at December 31, 2017 the Group had 47 borrowers (December 31, 2016: 42 borrowers) with the outstanding loan amount above AZN 1,000 thousand. The aggregate balance of these borrowers was AZN 131,546 thousand (December 31, 2016: AZN 128,863 thousand) or 23% (December 31, 2016: 19%) of the gross loan portfolio.

As at December 31, 2017 mortgage loans included AZN 39,094 thousand (December 31, 2016: AZN 38,449 thousand) under the program covered by the borrowing agreement with the Azerbaijan Mortgage Fund. In addition, a further AZN 3,578 thousand (December 31, 2016: AZN 3,782 thousand) of these loans are awaiting the approval of the Azerbaijan Mortgage Fund to be included as part of this program and therefore for further funding under the borrowing agreement to be provided to the Group.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

As at December 31, 2016 loans and advances to customers included finance lease receivables of the Group’s leasing subsidiary in the amount of AZN 6,220 thousand recorded net of provision for uncollectible finance lease receivables of AZN 13,878 thousand. As at December 31, 2016 finance lease receivables are represented by 292 lease contracts primarily related to the lease of various types of vehicles, construction and medical equipment. These finance lease contracts usually expire over three to five years. Lease payments are made on a monthly basis. The leasing subsidiary holds title to property subject to the lease during the lease term. During the year ended December 31, 2017 the lease receivable balances were disposed of as a result of sale of Unileasing.

Risks related to the leased property such as damage caused by various reasons, theft and other are generally insured in the finance lease agreements. This insurance arrangement is entered into by the lessee and an insurance company to insure the leased property against damages caused by the reasons listed above. The management of the leasing subsidiary periodically assesses the financial performance of the lessees by monitoring debts outstanding and analyzing their financial reports.

Management have assessed whether finance leases represent a separate class and therefore should be separately shown within the analysis within this note. However, management have determined that as their approach to the assessment of risk is based on the classes as set out within this note and not based on a consideration of finance leases as a separate class, no separate class for such leases is required.

Finance lease payments receivable (gross investment in the leases) and their present values are as follows:

	Due in 1 year	**Due between 1 and 5 years**	**Due after 5 years**	**Total**
Finance lease payments receivable at December 31, 2016	4,632	3,106	102	7,840
Unearned finance income	(327)	(1,232)	(61)	(1,620)
Present value of lease payments receivable at December 31, 2016	**4,305**	**1,874**	**41**	**6,220**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

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

	Business loans	**Cash consumer loans**	**Credit cards**	**Purchase of apartments and mortgages**	**Micro loans**	**Purchase of motor vehicles**	**Total**
Current and not impaired							
Unsecured loans	37,679	25,982	55,153	106	1,058	62	120,040
Loans collateralised by:							
- real estate	45,523	504	2	51,556	767	-	98,352
- personal transport	154	25	-	-		232	411
- bank deposits	2,461	5,093	298	-		-	7,852
- moveable property	4,387	-	-	-	6,799	-	11,186
- other assets	-	-	-	-		-	-
Loans renegotiated	17,141	24,711	534	22	615	93	43,116
Total current and not impaired	**107,345**	**56,315**	**55,987**	**51,684**	**9,239**	**387**	**280,957**
Less: Provision for impairment	(19,135)	(2,099)	(882)	(3)	(202)	(2)	(22,323)
Past due but not impaired							
- 30 to 90 days overdue	2,089	1,914	594	407	172	10	5,186
Total past due but not impaired	**2,089**	**1,914**	**594**	**407**	**172**	**10**	**5,186**
Less: Provision for impairment	(586)	(1,107)	(278)	-	(96)	-	(2,067)
Loans determined to be impaired							
- 90 to 180 days overdue	857	2,773	851	225	170	10	4,886
- 180 to 360 days overdue	10,677	8,522	2,671	222	1,092	58	23,242
- over 360 days overdue	90,779	107,849	30,191	763	33,276	3,557	266,415
Total impaired loans	**102,313**	**119,144**	**33,713**	**1,210**	**34,538**	**3,625**	**294,543**
Less: Provision for impairment	(79,858)	(101,472)	(25,892)	(271)	(28,305)	(1,047)	(236,845)
Net loans and advances to customers	**112,168**	**72,695**	**63,242**	**53,027**	**15,346**	**2,973**	**319,451**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Analysis by credit quality of loans outstanding at December 31, 2016 is as follows:

	Business loans	Cash consumer loans	Credit cards	Purchase of apartments and mortgages	Micro loans	Purchase of motor vehicles	Total
Current and not impaired							
Unsecured loans	20,669	31,180	79,819	77	2,121	17	133,883
Loans collateralised by:							
- real estate	50,774	263	-	43,457	242	-	94,736
- personal transport	378	152	-	-	-	1,079	1,609
- bank deposits	4,764	2,628	613	-	-	-	8,005
- moveable property	4,877	4	-	-	3,051	-	7,932
- other assets	552	-	-	-	2	-	554
Loans renegotiated	27,072	32,326	1,983	58	2,142	92	63,673
Total current and not impaired	**109,086**	**66,553**	**82,415**	**43,592**	**7,558**	**1,188**	**310,392**
Less: provision for impairment	(8,510)	(4,471)	(1,942)	(244)	(491)	(230)	(15,888)
Past due but not impaired							
- 30 to 90 days overdue	11,434	6,919	3,245	578	1,073	251	23,500
Total past due but not impaired	**11,434**	**6,919**	**3,245**	**578**	**1,073**	**251**	**23,500**
Less: provision for impairment	(3,803)	(4,599)	(1,724)	(172)	(824)	(155)	(11,277)
Loans determined to be impaired							
- 90 to 180 days overdue	9,638	10,850	4,537	246	2,078	300	27,649
- 180 to 360 days overdue	33,565	53,895	17,799	591	14,538	900	121,288
- over 360 days overdue	67,026	80,699	22,519	2,131	20,420	4,773	197,568
Total impaired loans	**110,229**	**145,444**	**44,855**	**2,968**	**37,036**	**5,973**	**346,505**
Less: Provision for impairment	(96,112)	(128,422)	(36,856)	(1,969)	(35,370)	(4,357)	(303,086)
Net loans and advances to customers	**122,324**	**81,424**	**89,993**	**44,753**	**8,982**	**2,670**	**350,146**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

The Group applied the portfolio provisioning methodology prescribed by IAS 39, Financial Instruments: Recognition and Measurement, and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the end of the reporting period. The Group’s policy is to classify each loan as ‘current and not impaired’ until a specific objective evidence of impairment of the loan is identified. The impairment provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

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

Past due, but not impaired loans presented in above table represent collateralized loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due, but not impaired is the whole balance of such loans, not only the individual installments that are past due.

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at December 31, 2017 was as follows:

	Business loans	Cash consumer loans	Purchase of apartments and mortgages	Micro loans	Purchase of motor vehicles	Total
Fair value of collateral - loans past due but not impaired						
- real estate	1,091	-	407	7	-	1,505
- personal transport	-	-	-	-	10	10
- bank deposits	-	35	-	-	-	35
- moveable property	-	-	-	104	-	104
Fair value of collateral loans individually determined to be impaired						
- real estate	33,103	620	875	439	-	35,037
- personal transport	201	12	-	7	1,836	2,056
- moveable property	141	293	-	22,842	-	23,276
- other assets	105	-	-	26	-	131
Total	**34,641**	**960**	**1,282**	**23,425**	**1,846**	**62,154**

The Group considers fair value of realized collaterals for loss given default rate determination during collective impairment assessment of loan portfolio.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at December 31, 2016 was as follows:

	Business loans	Cash consumer loans	Purchase of apartments and mortgages	Micro loans	Purchase of motor vehicles	Total
Fair value of collateral - loans past due but not impaired						
- real estate	7,542	83	578	30	-	8,233
- personal transport	-	-	-	-	238	238
- bank deposits	-	177	-	-	-	177
- moveable property	242	-	-	670	-	912
Fair value of collateral loans individually determined to be impaired						
- real estate	38,962	598	2,353	621	-	42,534
- personal transport	254	13	-	7	4,338	4,612
- moveable property	5,622	408	-	24,402	-	30,432
- other assets	3,591	-	-	29	-	3,620
Total	**56,213**	**1,279**	**2,931**	**25,759**	**4,576**	**90,758**

Currency, interest rate, geographical and liquidity analysis of loans and advances to customers are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of loans and advances to customers. Information on related party balances is disclosed in Note 32.

10. INVESTMENT SECURITIES AVAILABLE-FOR-SALE

	December 31, 2017	December 31, 2016
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	5,877	-
Corporate shares – unquoted	502	498
Total investment securities available-for-sale	**6,379**	**498**

As disclosed in Note 31, information about fair value of corporate unquoted shares was not disclosed because their fair value cannot be measured reliably.

Details of corporate unquoted shares available for sale are:

Name	Nature of business	Country of registration	% of ownership	December 31, 2017	December 31, 2016
"Milli Kart" LLC	Card processing	The Republic of Azerbaijan	8.0	400	400
Baku Stock Exchange	Stock exchange	The Republic of Azerbaijan	6.0	60	60
S.W.I.F.T SCRL	Telecommunication	The Republic of Azerbaijan	0.5	42	38
Total investment securities available-for-sale				**502**	**498**

Currency, interest rate, geographical and liquidity analysis of investment securities available-for-sale are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of investment securities available-for-sale. Information on related party balances is disclosed in Note 32.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

11. PREMISES, EQUIPMENT AND INTANGIBLE ASSETS

	Leasehold improvements	Land and buildings	Office and computer equipment	Furniture, fixture and other equipment	Construction in progress	Total premises and equipment	Intangible assets	Total
Net book value as at January 1, 2016	**3,911**	**34,076**	**2,695**	**6,839**	**1,137**	**48,658**	**4,671**	**53,329**
Additions	197	-	31	123	104	455	2,792	3,247
Transfers	-	725	-	-	(725)	-	-	-
Disposals	(1,101)	(3)	(133)	(381)	(25)	(1,643)	-	(1,643)
Accumulated depreciation of disposals	1,101	-	122	303	-	1,526	-	1,526
Depreciation and amortization charge from continuing operations	(1,063)	(962)	(704)	(1,267)	-	(3,996)	(789)	(4,785)
Depreciation and amortization charge from discontinued operations	-	(45)	(6)	(27)	-	(78)	(9)	(87)
Cost as at December 31, 2016	6,907	39,890	8,512	15,093	491	70,893	9,639	80,532
Accumulated depreciation/amortization as at December 31, 2016	(3,862)	(6,099)	(6,507)	(9,503)	-	(25,971)	(2,974)	(28,945)
Net book value as at December 31, 2016	**3,045**	**33,791**	**2,005**	**5,590**	**491**	**44,922**	**6,665**	**51,587**
Additions	49	691	2,387	370	7	3,504	3,445	6,949
Disposal of subsidiary (Note 6)	-	(519)	(12)	(126)	-	(657)	(78)	(735)
Disposals	(839)	-	(218)	(406)	-	(1,463)	-	(1,463)
Accumulated depreciation of disposals	839	-	184	270	-	1,293	-	1,293
Depreciation and amortization charge from continuing operations	(445)	(463)	(632)	(791)	-	(2,331)	(1,178)	(3,509)
Depreciation and amortization charge from discontinued operations	-	(15)	-	(4)	-	(19)	(2)	(21)
Cost as at December 31, 2017	6,117	39,786	10,577	14,581	498	71,559	12,931	84,490
Accumulated depreciation/amortization as at December 31, 2017	(3,468)	(6,301)	(6,863)	(9,678)	-	(26,310)	(4,079)	(30,389)
Net book value as at December 31, 2017	**2,649**	**33,485**	**3,714**	**4,903**	**498**	**45,249**	**8,852**	**54,101**

Construction in progress consists of construction and refurbishment of branch premises. Upon completion, assets are transferred to land and buildings.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Intangible assets include software and licenses. Additions to intangible assets during the year ended December 31, 2017 include security software in the amount of AZN 2,421 thousand, corporate internet banking software in the amount of AZN 204 thousand, banking software modules and other licenses.

As at December 31, 2017 included in the closing balance of premises and equipment were fully depreciated assets still in use with the total initial cost of AZN 1,985 thousand (December 31, 2016: AZN 1,487 thousand).

12. OTHER FINANCIAL ASSETS

	December 31, 2017	December 31, 2016
Receivable from National Depository Center	6,000	-
Brokerage operations	-	5,366
Receivables from online payments	1,584	1,006
Settlements on money transfer operations	-	383
Receivables for credit and debit card transactions	1,519	331
Other financial assets	229	1,763
	9,332	**8,849**

Receivables for credit and debit card transactions represent net funds receivable from other local banks for cash withdrawn from the Bank's ATMs by customers of other banks.

There were neither past due nor impaired other financial assets as at December 31, 2017 and 2016.

Currency, interest rate, geographical and liquidity analysis of other financial assets are disclosed in Note 28. Refer to Note 31 for the estimated fair value of each class of amounts other financial assets.

13. OTHER ASSETS

	December 31, 2017	December 31, 2016
Repossessed collateral	8,550	8,327
Equipment purchased for transfer to finance lease	-	1,404
Prepaid expenses	1,405	418
Prepayment for equipment	3,134	194
Other	1,496	493
	14,585	**10,836**
Less: Provision for impairment	-	(2,122)
Total other assets	**14,585**	**8,714**

Movements in provision for impairment of other assets during the years ended December 31, 2017 and 2016 are as follows:

	2017	2016
Balance at January 1,	2,122	4,116
Recognized through subsequent lease	-	(2,868)
Increase in provision for impairment losses from discontinued operations	357	874
Derecognized as a result of sale of subsidiary	(2,479)	-
Increase in provision for impairment losses	226	-
Derecognized as a result of write-off of assets	(226)	-
Balance at December 31,	-	**2,122**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

As at December 31, 2017 and 2016 repossessed collateral mainly represents equipment confiscated by the Group for loans and lease receivables individually determined to be impaired. The management believes that as at December 31, 2017 and 2016 net realizable value of these collaterals did not significantly differ from their carrying value disclosed in these consolidated financial statements.

The information on related party balances is disclosed in Note 32.

14. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2017	December 31, 2016
Correspondent accounts and overnight placement of other banks	226	135
Short-term placements of other banks and financial institutions	3,060	19,291
Total due to other banks	**3,286**	**19,426**

As at December 31, 2017 short-term placements of other banks and financial institutions included several placements of resident banks, bearing interest rates of 3-4% per annum with maturities from July to December 2018 (December 31, 2016: resident banks, bearing interest rate of 4-18% per annum with maturities in February and December 2017).

As at December 31, 2017 the Group has one bank (December 31, 2016: three banks and one financial institution) with outstanding balance exceeding 10% of total due to banks and other financial institutions. The gross value of this balance as at December 31, 2017 is AZN 3,102 thousand (December 31, 2016: AZN 18,887 thousand).

Currency, interest rate, geographical and liquidity analysis of due to banks and other financial institutions are disclosed in Note 28. Refer to Note 30 for the estimated fair value of each class of amounts of due to banks and other financial institutions.

15. CUSTOMER ACCOUNTS

	December 31, 2017	December 31, 2016
State and public organizations		
- Current/settlement accounts	2,004	1,837
Other legal entities		
- Current/settlement accounts	74,764	34,217
- Term deposits	6,125	9,857
Individuals		
- Current/demand accounts	49,689	34,107
- Term deposits	233,444	293,316
Total customer accounts	**366,026**	**373,334**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Economic sector concentrations within customer accounts are as follows:

	December 31, 2017		December 31, 2016	
	Amount	**%**	**Amount**	**%**
Individuals	283,133	77.4	327,423	87.7
Trade and services	58,582	16.0	22,035	5.9
Finance	9,213	2.5	11,110	3.0
Energy and mining	6,688	1.8	4,379	1.2
Manufacturing	3,612	1.0	6,478	1.7
Construction	3,009	0.8	705	0.2
Communication and transport	200	0.1	236	0.1
Agriculture	40	0.0	14	0.0
Other	1,549	0.4	954	0.2
Total customer accounts	**366,026**	**100.0**	**373,334**	**100.0**

As at December 31, 2017 the Group had 41 customers (December 31, 2016: 37 customers) with balances above AZN 1,000 thousand. The aggregate balance of these customers was AZN 120,833 thousand (December 31, 2016: AZN 114,696 thousand) or 33% (December 31, 2016: 31%) of total customer accounts.

Currency, interest rate, geographical and liquidity analysis of customer accounts are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of customer accounts. Information on related party balances is disclosed in Note 32.

16. DEBT SECURITIES IN ISSUE

	December 31, 2017	December 31, 2016
Corporate bonds denominated in foreign currency	-	12,309
Total debt securities in issue	**-**	**12,309**

On June 9, 2017 the Bank signed share subscription agreement with EBRD and DEG on converting debt securities in issue in the amounts of AZN 8,212 and AZN 3,519 respectively, into share capital.

Currency, interest rate, geographical and liquidity analysis of debt securities in issue are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of debt securities in issue. Information on related party balances is disclosed in Note 32.

A reconciliation of the opening and closing amounts of debt securities in issue with relevant cash and non-cash changes from financing activities is stated below:

	Amount
January 1, 2017	12,309
Cash flows	
Proceeds	-
Repayment	(91)
Interest paid	(1)
Non-cash changes	
Interest expense	-
Converted to share capital	(11,731)
Foreign exchange gain	(486)
December 31, 2017	-

(in thousands of Azerbaijan Manats, unless otherwise indicated)

17. TERM BORROWINGS

	December 31, 2017	December 31, 2016
Funds borrowed from resident banks and government organizations	138,130	213,166
Funds borrowed from non-resident banks and organizations	5,847	45,265
Total term borrowings	**143,977**	**258,431**

As at December 31, 2017 term borrowings included AZN 84,992 thousand due to the CBAR with interest rates of 3.5% and maturing in August, September and October 2018 (2016: AZN 124,937 thousand at the CBAR refinancing rates between 3% and 7% per annum with maturities in January, February and May 2017).

On June 9, 2017 the Bank signed share subscription agreement with EBRD on converting term borrowings in the amount of AZN 7,089 into share capital.

As at December 31, 2016 term borrowings included borrowings of Unileasing from seven local banks in the total amount of AZN 29,649 thousand at annual interest rates ranging between 5% and 11%. These placements have been granted by the Bank to these banks under separate loan agreement bearing annual interest rates ranging between 4 and 8.5% with maturity from March to December 2017. During 2017, the Group derecognized term borrowings in the amount of AZN 75,051 thousand as a result of sale of Unileasing.

Term placements of the Bank and the loans obtained by Unileasing are not netted off since based on the legal contracts they represent separate assets placed at and liabilities due from third parties.

The Group is obliged to comply with certain financial covenants stipulated in its term borrowing agreements. The Group's non-compliance with certain financial covenants is described in Note 30.

Currency, interest rate, geographical and liquidity analysis of term borrowings are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of term borrowings. Information on related party balances is disclosed in Note 32.

A reconciliation of the opening and closing amounts of term borrowings with relevant cash and non-cash changes from financing activities is stated below:

	Amount
January 1, 2017	258,431
Cash flows	
Proceeds	8,861
Repayment	(48,601)
Interest paid	(6,458)
Non-cash changes	
Interest expense	7,872
Converted to share capital	(7,089)
Intra-group elimination	7,631
Disposed on sale of subsidiary	(75,051)
Foreign exchange gain	(1,619)
December 31, 2017	**143,977**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

18. OTHER FINANCIAL LIABILITIES

	December 31, 2017	December 31, 2016
Provision for potential losses (Note 6)	8,846	-
Items in course of settlement	202	6,229
Other	614	422
Total other financial liabilities	**9,662**	**6,651**

Currency, interest rate, geographical and liquidity analysis of other financial liabilities are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of other financial liabilities.

19. SUBORDINATED DEBT

	December 31, 2017	December 31, 2016
Subordinated debt from Deutsche Investitions-und Entwiklungsgesellschaft mbH	1,700	26,560
Subordinated debt securities issued	17,158	5,082
Total subordinated debt	**18,858**	**31,642**

On April 10, 2008 the Bank signed subordinated debt agreement with Deutsche Investitions-und Entwicklungsgesellschaft mbH ("DEG") in the amount of USD 15,000 thousand with original maturity date of September 30, 2019 and an annual interest rate of 10.5%.

On June 9, 2017 the Bank signed share subscription agreements with DEG converting debt amount into share capital in the amount of AZN 23,801 thousand.

On May 29, 2013 the Bank issued subordinated debt securities in the amount of AZN 5,000 thousand. The debt bears an annual interest rate of 14% with original maturity date of May 3, 2018. AZN 4,875 thousand of this amount was settled during 2017 before maturity date.

On December 28, 2017, the Bank issued subordinated debt securities in the amount of USD 10,000 thousand. The debt bears an annual interest rate of 6% and matures on December 28, 2023. EBRD holds USD 5,800 thousand of total issued debt securities. The remaining part of these securities are hold by individuals.

The repayment of Bank's subordinated debt ranks after all other creditors in case of liquidation of the Bank.

Currency, interest rate, geographical and liquidity analysis of subordinated debt are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of subordinated debt. Information on related party balances is disclosed in Note 32.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

A reconciliation of the opening and closing amounts of subordinated debt with relevant cash and non-cash changes from financing activities is stated below:

	Amount
January 1, 2017	31,642
Cash flows	
Proceeds	17,001
Repayment	(4,875)
Interest paid	(310)
Non-cash changes	
Interest expense	260
Converted to share capital	(23,801)
Foreign exchange gain	(1,059)
December 31, 2017	**18,858**

20. PREFERENCE SHARES

	December 31, 2017	**December 31, 2016**
Preference shares	-	14,000
Total preference shares	-	**14,000**

On February 27, 2013 as per decision of the Extraordinary General Meeting of Shareholders Bank issued 3,308,850 irredeemable preference shares in total amount of AZN 9,000 thousand. The preference shares bear an annual yield of 16.67%.

On December 29, 2012 as per decision of the General Meeting of Shareholders the Bank issued 1,838,250 irredeemable preference shares in total amount of AZN 5,000 thousand. The preference shares bear an annual yield of 16.67%.

According to the legislation of the Azerbaijan Republic banks are not allowed to pay dividends if net assets are less than share capital. Therefore, no dividends were declared by the Bank on preference shares during the year ended December 31, 2017 (2016: AZN nil). As set out in Basel Capital Accord Standards, perpetual preference shares carrying a non-cumulative charge are considered a constituent of Tier-1 capital. The Group holds preference shares of same nature and included the amount of these shares in calculating Tier-1 capital ratio. Refer to Note 4.

On July 25, 2017 holders of preference shares agreed on converting their preference shares to ordinary share capital.

Currency, interest rate, geographical and liquidity analysis of preference shares are disclosed in Note 29. Refer to Note 31 for the estimated fair value of each class of amounts of preference shares. Information on related party balances is disclosed in Note 32.

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21. SHARE CAPITAL

	Number of outstanding ordinary shares	Ordinary shares	Share premium	Total
As at December 31, 2016	**20,796,000**	**56,565**	**484**	**57,049**
As at December 31, 2017	**46,208,219**	**125,686**	**484**	**126,170**

The nominal value of the registered amount of the Bank's issued share capital as at December 31, 2017 is AZN 125,686 thousand (December 31, 2016: AZN 56,565 thousand).
The shareholders of the Bank as at December 31, 2017 and 2016 were as follows:

No	Shareholders	December 31, 2017, % (rounded up to one hundred decimal)	December 31, 2016, % (rounded up to one hundred decimal)
1	Mr.Eldar Garibov	41.91	68.34
2	Deutsche Investitions-und Entwiklungsgesellschaft mbH	25.99	8.33
3	European Bank for Reconstruction and Development	18.49	15.15
4	Other minor shareholders	13.61	8.18

Share premium represents the excess of contributions received over the nominal value of shares issued.

During the year ended December 31, 2017 the share capital of the Bank increased via converting customer accounts in the amount of AZN 10,000 thousand, debt securities in issue in the amount of AZN 11,731 thousand, term borrowings in the amount of AZN 7,089 thousand, subordinated debt in the amount of AZN 23,801, preference shares in the amount of AZN 14,000 and cash injection of AZN 2,500 thousand.

As at December 31, 2017 all ordinary shares have a nominal value of AZN 2.72 per share (December 31, 2016: AZN 2.72 per share) and rank equally. Each share carries one vote. During the year ended December 31, 2017, no dividends were declared and paid (December 31, 2016: nil).

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22. INTEREST INCOME AND EXPENSE

	Year ended December 31, 2017	Year ended December 31, 2016 (Reclassified)
Interest income comprises:		
Interest income on financial assets recorded at amortized cost:		
- interest income on unimpaired financial assets	59,438	93,366
- interest income on impaired financial assets	12,984	33,255
Total interest income	**72,422**	**126,621**
Less: Elimination of inter-group interest income	(206)	(1,162)
Less: Amounts attributable to discontinued operations (Note 6)	(492)	(2,427)
Amount attributable to continuing operations	**71,724**	**123,032**
Interest income on financial assets recorded at amortized cost comprises:		
- Loans and advances to customers	68,485	122,660
- Finance leases	509	2,441
- Due from other banks and correspondent accounts	2,330	1,490
- Investment securities available-for-sale	1,098	30
Total interest income	**72,422**	**126,621**
Less: Elimination of inter-group interest income	(206)	(1,162)
Less: Amounts attributable to discontinued operations (Note 6)	(492)	(2,427)
Amount attributable to continuing operations	**71,724**	**123,032**
Interest expense on financial liabilities recorded at amortized cost comprises:		
- Term deposits of individuals	18,329	21,134
- Term borrowings, due to banks and other financial institutions	7,872	16,312
- Debt securities in issue	-	7,904
- Subordinated debt	260	2,789
- Term deposits of legal entities	1,403	1,295
Total interest expense	**27,864**	**49,434**
Less: Elimination of inter-group interest expense	(206)	(1,162)
Less: Amounts attributable to discontinued operations (Note 6)	(1,287)	(4,978)
Amount attributable to continuing operations	**26,371**	**43,294**
Net interest income	**45,353**	**79,738**

Information on related party transactions is disclosed in Note 32.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

23. RECOVERY OF IMPAIRMENT LOSSES/(IMPAIRMENT LOSSES)

	Note	Year ended December 31, 2017	Year ended December 31, 2016 (reclassified/restated)
Interest bearing assets			
- Due from other banks	6, 8	(29,057)	(9,348)
- Loans and advances to customers	9	41,603	(167,229)
		12,546	**(176,577)**
Less: Amounts attributable to discontinued operations	6	(347)	19,262
Less: Amounts included in gain from sales of discontinued operations	**6**	29,057	
Amount attributable to continuing operations		**41,256**	**(157,315)**
Non-interest bearing assets			
- Other assets	13	(583)	(874)
- Credit related commitments	18	-	365
		(583)	**(509)**
Less: Amounts attributable to discontinued operations	6	357	874
Amount attributable to continuing operations		**(226)**	**365**
Total impairment losses		**41,030**	**(156,950)**

24. FEE AND COMMISSION INCOME AND EXPENSE

	Year ended December 31, 2017	Year ended December 31, 2016 (reclassified)
Fee and commission income:		
Plastic cards operations	4,937	4,590
Settlement transactions	2,981	1,840
Brokerage operations	1,205	1,021
Cash transactions	1,149	1,076
Guarantees and letters of credit issued	81	423
Leasing operations	-	68
Other	714	897
Total fee and commission income	**11,067**	**9,915**
Less: Amounts attributable to discontinued operations (Note 6)	(168)	(68)
Amount attributable to continuing operations	**10,899**	**9,847**
Fee and commission expense:		
Plastic cards operations	4,366	3,660
Settlement transactions	529	330
Cash transactions	367	497
Brokerage operations	139	673
Guarantees and letters of credit	79	185
Centralized credit registry	78	40
Other	692	429
Total fee and commission expense	**6,250**	**5,814**
Less: Amounts attributable to discontinued operations (Note 6)	(129)	(191)
Amount attributable to continuing operations	**6,121**	**5,623**
Net fee and commission income	**4,778**	**4,224**

Information on related party transactions is disclosed in Note 32.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

25. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	Year ended December 31, 2017	Year ended December 31, 2016 (reclassified)
Staff costs	24,065	23,016
Depreciation expenses	2,350	4,074
Professional fees	2,037	3,008
Rent expenses	2,270	2,462
Computer software costs	1,764	687
Communication expenses	1,324	1,591
Insurance of customer deposits	1,250	1,601
Amortization expenses	1,180	798
Repair and maintenance expenses	1,039	1,064
Security expenses	968	880
Utility expenses	857	678
Representation expenses	776	802
Advertising expenses	737	648
Other insurance expenses	521	505
Taxes other than on income	503	499
Payments to the Financial Markets Supervisory Authority	366	-
Publishing and stationary	204	282
Penalties for unpaid taxes for prior years	78	361
Other expenses	821	427
Total administrative and other operating expenses	**43,110**	**43,383**
Less: Amounts attributable to discontinued operations (Note 6)	(70)	(587)
Amount attributable to continuing operations	**43,040**	**42,796**

Included in staff costs for the year ended December 31, 2017 are obligatory payments to the State Social Protection Fund of the Republic of Azerbaijan in the amount of AZN 3,751 thousand (2016: AZN 3,624 thousand).

Rental expenses are related to the lease of the Group's branch buildings in Baku and in the regions of the Republic of Azerbaijan, exchange offices and costs associated with ATMs installed in department stores and in other areas.

Information on related party transactions is disclosed in Note 32.

26. INCOME TAXES

(a) Components of income tax benefit

Income tax expense comprises the following:

	Year ended December 31, 2017	Year ended December 31, 2016
From continuing operations:		
Current income tax	141	90
Deferred income tax	-	1,393
Income tax expense/(benefit) for the year	**141**	**1,483**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate

The income tax rate applicable to the majority of the Group's income is 20%. A reconciliation between the expected and the actual taxation charge is provided below.

	Year ended December 31, 2017	Year ended December 31, 2016
Loss before income tax	**46,414**	**(115,649)**
Theoretical tax benefit at statutory rate (20%)	9,283	(23,130)
Non-deductible expenses	209	511
Current income tax withheld at source for dividends received	35	-
Change in unrecognized deferred tax asset	(9,386)	24,102
Income tax expense for the year	**141**	**1,483**

(c) Deferred taxes analyzed by type of temporary difference

Differences between IFRS and Azerbaijan statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases.

The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 20%.

	January 1, 2017	Charged to profit or loss	December 31, 2017
Tax effect of deductible/(taxable) temporary differences			
Customer accounts	-	331	331
Other liabilities	-	1,769	1,769
Due from other banks	-	5,811	5,811
Loan loss provision	17,913	(23,104)	(5,191)
Depreciation and amortization	(708)	(93)	(801)
Other assets	2,427	(3,139)	(712)
Tax loss carried forward	18,139	5,531	23,670
Interest accrued on impaired loans	134	(134)	-
Other temporary differences	867	(867)	-
Recognized deferred tax asset	38,772	(13,895)	24,877
Deferred tax asset not recognized	(32,360)	15,261	(17,099)
Net deferred tax asset	**6,412**	**1,366**	**7,778**

In the context of the Group's current structure and Azerbaijan tax legislation, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	January 1, 2016	Charged to profit or loss	December 31, 2016
Tax effect of deductible/(taxable) temporary differences			
Loan loss provision	3,060	14,853	17,913
Depreciation and amortization	(498)	(210)	(708)
Accrual of payables to employees	251	(251)	-
Other assets	2,317	110	2,427
Tax loss carried forward	9,998	8,141	18,139
Interest accrued on impaired loans	134	-	134
Other temporary differences	801	66	867
Recognized deferred tax asset	16,063	22,709	38,772
Deferred tax asset not recognized	(8,258)	(24,102)	(32,360)
Net deferred tax asset	**7,805**	**(1,393)**	**6,412**

The composition of the total net deferred tax asset of the Group after offsetting within the individual entities comprising the Group is, as follows:

	December 31, 2017	December 31, 2016
Deferred income tax asset	7,778	6,412
Total net deferred tax asset	**7,778**	**6,412**

Movement in valuation allowance of deferred income tax is as follows:

	December 31, 2017	December 31, 2016
Opening balance as at January 1,	(32,360)	(8,258)
Eliminated on disposal of subsidiary	13,616	-
Charged to profit or loss	9,386	(24,102)
Valuation allowance included in gain from disposal of subsidiary	(7,741)	-
Total deferred income tax asset not recognized	**(17,099)**	**(32,360)**

27. EARNINGS PER SHARE

Basic earnings per share are calculated by dividing the profit attributable to equity holders of the Group by the weighted average number of ordinary shares in issue during the period, excluding treasury shares.

The Group has no dilutive potential ordinary shares, therefore, the diluted earnings per share equal the basic earnings per share.

	Note	Year ended December 31, 2017	Year ended December 31, 2016
Profit/(loss) for the year attributable to ordinary shareholders		46,139	(106,929)
Weighted average number of ordinary shares in issue (thousands)	21	31,703	20,796
Basic and diluted loss per ordinary share (expressed in AZN per share)		**1.46**	**(5.14)**
From continuing operations		1.41	(4.22)
From discontinued operations		0.05	(0.92)

28. SEGMENT ANALYSIS

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance for the entity. The functions of CODM are performed by the Board of Directors of the Group.

(a) Description of products and services from which each reportable segment derives its revenue

The Group is organized on the basis of three main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages.
- Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products.
- Leasing – representing finance leasing performed by Unileasing (disposed in 2017).

(b) Factors that management used to identify the reportable segments

The Group's segments are strategic business units that focus on different customers. They are managed separately because each business unit requires different marketing strategies and service level.

Segment financial information reviewed by the CODM includes the results and the statement of financial position of the Group's subsidiaries. Ongoing review of these subsidiary entities is delegated to the local management teams, but the CODM performs regular review on a consolidated basis. The CODM obtains financial statements of the Group's subsidiaries. Such financial information overlaps with segment analysis provided internally to the CODM.

Management therefore applied the core principle of IFRS 8, *Operating Segments*, in determining which of the overlapping financial information sets should form the basis of operating segments. Management considered that information on subsidiary entities is available when required in concluding that segments include details of the subsidiaries.

(c) Measurement of operating segment profit or loss, assets and liabilities

The CODM reviews financial information prepared based on Azerbaijani accounting standards adjusted to meet the requirements of internal reporting. Such financial information differs in certain aspects from International Financial Reporting Standards:

(i) funds are not reallocated between segments;
(ii) income taxes are not allocated to segments;

The CODM evaluates performance of each segment based on profit before tax.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

(d) Information about reportable segment profit or loss, assets and liabilities

Segment information for the main reportable business segments of the Group for the years ended December 31, 2017 and 2016 is set out below:

	Retail banking	Corporate banking	Leasing (discontinued operations)	Eliminations	Total Group
Year ended December 31, 2017					
Interest income	58,014	13,907	492	(197)	72,216
Fee and commission income	5,719	3,852	168	1,328	11,067
Total revenues	63,733	17,759	660	1,131	83,283
Interest expense	(16,751)	(9,817)	(1,287)	197	(27,658)
Fee and commission expense	(3,383)	(1,410)	(129)	(1,328)	(6,250)
Impairment loss on repossessed collateral	-	(226)	(357)	-	(583)
Provision for impairment losses on interest bearing assets	36,253	5,003	347	-	41,603
Fair value loss on interest-free loans to customers at initial measurement	-	(2,230)	-	-	(2,230)
Gain on sale of discontinued operations	-	-	1,227	-	1,227
Foreign exchange translation gains less losses	(6,931)	(3,977)	1,444	-	(9,464)
Administrative and other operating expenses	(33,008)	(6,443)	(50)	-	(39,501)
Segment results	**39,913**	**(1,341)**	**1,855**	**-**	**40,427**
Year ended December 31, 2016					
Interest income	100,184	24,016	2,427	(1,168)	125,459
Fee and commission income	5,147	3,707	68	993	9,915
Total revenues	105,331	27,723	2,495	(175)	135,374
Interest expense	(28,452)	(14,848)	(6,140)	1,168	(48,272)
Fee and commission expense	(3,237)	(1,394)	(191)	(993)	(5,815)
Impairment loss on repossessed collateral	-	-	(874)	-	(874)
Provision for impairment losses on interest bearing assets	(78,659)	(78,656)	(19,262)	-	(176,577)
Foreign exchange translation gains less losses	14,766	7,784	(6,073)	-	16,477
Administrative and other operating expenses	(31,502)	(6,148)	(500)	-	(38,150)
Segment results	**(21,753)**	**(65,539)**	**(30,545)**	**-**	**(117,837)**

Total reportable segment assets and liabilities as at December 31, 2017 and 2016 are presented in the following table:

	Retail banking	Corporate banking	Leasing (discontinued operations)	Eliminations	Total Group as at December 31, 2017
Total reportable segment assets	322,226	184,927	-	(240)	506,913
Total reportable segment liabilities	(338,606)	(194,327)	-	785	(532,148)
Capital expenditure paid	6,341	3,639	-	-	9,980

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	Retail banking	Corporate banking	Leasing	Eliminations	Total Group as at December 31, 2016
Total reportable segment assets	368,338	189,028	6,455	(15,374)	548,447
Total reportable segment liabilities	(428,303)	(219,801)	(76,835)	15,797	(709,142)
Capital expenditure paid	1,869	959	-	-	2,828

(e) Reconciliation of reportable segment revenues, profit or loss, assets and liabilities

A reconciliation of adjusted profit before tax to total profit before income tax is provided as follows:

	2017	2016
Adjusted profit/(loss) before income tax for reportable segments	**40,427**	**(117,837)**
Gains less losses from trading in foreign currencies	7,675	10,675
Provision for credit related commitments	-	365
Other operating income, net	1,920	(3,619)
Depreciation of premises and equipment	(2,350)	(4,074)
Amortization of intangible assets	(1,180)	(798)
Penalties for unpaid taxes for prior years	(78)	(361)
Loss before income tax	**46,414**	**(115,649)**

The adjustments are attributable to the following:

- Gains/(losses) arising from trading in foreign currencies are not allocated to the segments.
- The Group does not allocate depreciation and amortization to the segments.
- The Group does not allocate other operating loss and other non-operating income to segments.
- The Group does not allocate penalties for unpaid taxes for prior years.

Reportable segments’ assets are reconciled to total assets as follows:

	December 31, 2017	December 31, 2016
Total reportable segment assets	**506,913**	**548,447**
Advances to the Ministry of Taxes of the Republic of Azerbaijan	-	4,713
Deferred income tax asset	7,778	6,412
Premises, equipment and intangible assets	54,101	51,587
Other financial assets	9,332	8,849
Other assets	14,585	8,714
Total consolidated assets	**592,709**	**628,722**

The adjustments are attributable to the following:

- Advances to the Ministry of Taxes of the Republic of Azerbaijan, income taxes, other assets and other financial assets are not allocated between the reporting segments for internal management reporting.
- Premises, equipment and intangible assets are not allocated between the reporting segments for internal management reporting.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Reportable segments' liabilities are reconciled to total liabilities as follows:

	December 31, 2017	December 31, 2016
Total reportable segment liabilities	**532,148**	**709,142**
Other financial liabilities	9,662	6,651
Other liabilities	413	216
Total consolidated liabilities	**542,223**	**716,009**

The adjustments are attributable to the following:

- Current income tax liability, other financial liabilities and other liabilities are not allocated between the reportable segments for internal management reporting.
- Deferred income tax liability is not calculated for the purpose of internal management reporting.

The Group does not report the geographical segment based on the fact that the substantially all of its operating are carries out in the Republic of Azerbaijan.

(f) Analysis of revenues by products and services

The Group's revenues are analyzed by products and services in Note 22 (interest income) and Note 24 (fee and commission income).

29. FINANCIAL RISK MANAGEMENT

The risk management function within the Group is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks.

The Group has exposure to financial risks which include credit, liquidity, market and operational risks. The taking of risk is integral to the Group's business.

The Group's risk management function's aim is to achieve an appropriate balance between risk and return and to minimize potential adverse effects on the Group's financial performance.

Risk management framework

The risk management function is an integral part of the Group's internal control system and is centralized. The Group's risk management policies and approaches aim to identify, analyze, mitigate and manage the risks faced by the Group. This is accomplished through setting appropriate risk limits and controls, continuously monitoring risk levels and the adherence to limits and procedures and ensuring that business processes are correctly formulated and maintained.

Risk Management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and to ensure that "best practices" are implemented. The Group, as part of its risk culture, emphasizes integrity, management and employee standards in order to maintain and continuously improve upon a conservative control environment.

Risk management bodies and governance

Risk management policy, assessment, approval, monitoring and controls are conducted by a number of specialized bodies within the Group. These bodies also oversee the risk management policies and controls at the Bank's leasing subsidiary. The Group has established executive bodies, committees and departments which conform to Azerbaijani law, FIMSA and the Central Bank of the Republic of Azerbaijan regulations and the best industry practices.

The Supervisory Board of the Group has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing and approving risk management policies as well as several key risk limit approval authorities, including significantly large exposures, economic and product sector limits. It also delegates certain authority levels to the Executive Board and the Credit Committee.

Established by, appointed by and reporting directly to the Supervisory Board are the Executive Board, the Executive Committee, the Risk Management Committee, the Audit Committee ("AC"), the Internal Audit Department, the Credit Committee and the Asset and Liability Committee ("ALCO").

The Executive Board is responsible for the implementation and monitoring of risk mitigation measures and ensuring that the Group operates within the established risk parameters. The Member of the Executive Board responsible for risk management along with the Risk Management Department which reports to him are responsible for the overall risk management functions, ensuring the implementation of common principles and methods for identifying, measuring, mitigating, managing and reporting both financial and non-financial risks.

The Risk Management Committee is chaired by the Member of the Executive Board responsible for risk management. This Committee is responsible for establishing risk management methodologies and ensuring that the risk appetite of the Group is correctly reflected in the strategic and business plans of the Group. It is the main forum for discussing and recommending changes in all risk approaches and procedures to the Executive and Supervisory Boards. It ensures that the Risk Management Department, the Credit Committee and ALCO, as well as the Executive Board, address all potential risks facing the Group and report on these issues to the Supervisory Board.

The Audit Committee is responsible for overseeing and monitoring the internal control framework of the Group and for assessing the adequacy of risk management policies and procedures, as an integral part of the internal control system of the Group. The Chairman of the AC, an independent professional auditor, and the other two Committee members are representatives of two of the shareholders. The AC members cannot be employees or part of the management structure of the Group. They provide recommendations to the Executive Board, the Risk Management Committee and the Supervisory Board on development of the framework, as well as their views on, the quality of risk management and compliance with established policies, procedures and limits. The AC supervises the work of the Internal Audit, which reports directly to the AC. The Internal Audit's working plans, schedule of audits and its reports, including non-planned audits, are closely reviewed and approved by the AC.

Implementation plans based on Internal Audit's and the AC's recommendations, including status reports, are approved by the Executive Board and reported to the Executive Board, the Supervisory Board and the General Meeting of the Shareholders.

The Credit Committee consists of five members. They are nominated by the Risk Management Committee and the Executive Board and elected by the Supervisory Board. The Credit Committee manages and approves, or recommends for approval counterparty credit risk exposures within its credit approval authority for corporate, retail and financial sector entities. It also continuously reviews and makes recommendations as to analysis methodology and portfolio quality, including overall structure, diversification and pricing. The Credit Committee is one of the bodies which ensures adherence to all approval and authority limits and high standards for risk analysis and assessments.

ALCO is responsible for the management and optimization of the Group's asset and liability structure. It is an integral part of the risk management process that focuses on various market risks, including liquidity, foreign currency and interest rate risks. ALCO's functions include making recommendations for approval of strategies, policies and limits associated with the aforementioned risks. It is responsible for providing timely and reliable information and reports regarding these risk areas. ALCO assists in setting pricing policies and funding strategies. It is also responsible, along with other risk management and controlling units of the Group, for ensuring that Treasury and other relevant units work with the parameters set by ALCO, the Risk Management Committee, the Executive Board and the Supervisory Board.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Group's loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk. Normally, the only credit risk arising from market operations is Azerbaijani government bonds and the notes issued by the Central Bank of the Republic of Azerbaijan. These securities are used exclusively to help manage the liquidity position of the Group.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organizations, is as follows:

For secured business loans:

- The Supervisory Board reviews and approves limits up to a maximum limit of 20% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board together with The Credit Committee reviews and approves limits up to a maximum limit of 10% of Tier1 capital and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 400 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves up to a maximum limit of AZN 150 thousand and meets on a regular basis;
- The Risk Management and Director of the Corporate Banking Services Department reviews and approves limits up to a maximum limit of AZN 30 thousand.

For secured retail loans:

- The Supervisory Board reviews and approves up to a maximum limit of 20% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board reviews and approves limits up to a maximum limit of 10% of the Tier1 capital and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 1,000 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves limits up to a maximum limit of AZN 400 thousand and meets on a regular basis;
- The Supervisory Director reviews and approves limits up to a maximum limit of AZN 250 thousand;
- The loans below the limits stipulated above are reviewed and approved by the Head of the branch.

For unsecured business loans:

- The Supervisory Board reviews and approves limits up to a maximum limit of 7% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board together with The Credit Committee reviews and approves limits up to a maximum limit of 6% of Tier1 capital and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 30 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves up to a maximum limit of AZN 15 thousand and meets on a regular basis;
- The Risk Management and Director of the Corporate Banking Services Department reviews and approves limits up to a maximum limit of AZN 5 thousand.

For unsecured retail loans:

- The Supervisory Board reviews and approves up to a maximum limit of 7% of the Tier1 capital and meets on a regular basis;
- The Chairman of the Supervisory Board reviews and approves limits up to a maximum limit of AZN 250 thousand and meets on a regular basis;
- The Credit Committee reviews and approves limits up to a maximum limit of AZN 100 thousand and meets on a regular basis;
- The Junior Credit Committee reviews and approves limits up to a maximum limit of AZN 50 thousand and meets on a regular basis;
- The Supervisory Director reviews and approves limits up to a maximum limit of AZN 10 thousand;
- The loans below the limits stipulated above are reviewed and approved by the Head of the branch.

The Supervisory Board also approves general limits so as to control and manage risk diversification:

- Portfolio limits: corporate loans, retail loans and interbank exposures as percentages of the total portfolio;
- Portfolio limits: secured facilities and unsecured facilities as percentages of the total portfolios and as a percentage of the retail portfolio; and
- Economic sector and product exposures: as a percentage of the corporate and retail portfolios.

The Executive Board also approves limits and authority levels for exposures, as follows:

- By branch;
- By collateral type and loan to value ratios;
- By individual authority.

As at December 31, 2017 and 2016 the breakdown of the loan portfolio by economic and product sectors is provided in Note 9.

Credit risk management

Credit risk policy is developed by the Risk Management Committee and Executive Board in line with the risk profile and strategic plans of the Group. It is approved by the Supervisory Board.

This policy establishes:

- Procedures for generating, analyzing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;

- The methodology for the credit rating of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures;
- Environmental policy; and
- Loan loss provisioning policy.

Loan/credit requests are originated and generated by client managers and credit inspectors. Credit applications within approved authority limits are approved by the branches or relevant business generating units. The copies of the approved requests are submitted to the Risk Management Department for prior - control, including being assigned a rating and input into a monitoring schedule. Risk exposure requests above these limits are sent to the Credit Group of the Risk Management Department. The Credit Group performs a secondary analysis and issues a report, rating and opinion. If the credit request is below a certain authorized limit and receives a positive opinion from Risk Management, and is signed off by the appropriate individuals, then the request is considered approved. If the opinion of risk management is negative then the request is sent to the Credit Committee for adjudication. If approved and the transaction is in an amount higher than the competence of the Credit Committee then it is sent to the Executive Board for approval. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval.

The Group uses a rating system for SME loans based on a 100-point scale. For large corporate loans the Group uses a rating system based on a 100-point scale. A customer rating is generated based on an analysis of four basic criteria: creditworthiness, financial performance, credit history and other risks.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of a party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in entering into conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target groups, types of product, default statistics, loan/value ratios (if applicable), and pricing.

Collateral and other credit enhancements.

Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Group has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Group are as follows:

- Commercial real estate
- Residential real estate
- Corporate capital assets
- Corporate liquid assets
- Transport vehicles
- Term deposits
- Other, including precious metals

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collaterals. Loan to values ratios are approved by the Executive Board and controlled by the Risk Management Department. The loan to value limits as of December 31, 2017 and December 31, 2016 are as follows:

Type of collateral	Ratio of loan amount to liquid value of collateral
Real estate	up to 70%
Precious metals	up to 80%
Machinery, equipment	up to 50%
Inventory	up to 60%
Vehicles, transport	up to 70%
Term deposit	up to 90%

As supplement collateral the Bank may accept personal guarantees.

An exclusion from the collateral guidelines requires high level authorization of the Executive Board.

The Monitoring Group is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Monitoring Group physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

The Statistical Group of the Risk Management Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

Related party lending

The Central Bank of the Republic of Azerbaijan has strict definitions regarding the category of “related parties”. Mainly, these are corporate entities owned/controlled by the shareholders or the private individuals themselves or immediate family members. Also included are individuals with senior management/authority positions in the Group. The largest loan per related party private individual may not be more than 3% of the consolidated capital of the Group. Per related corporate entity, the limit is 10%. The overall limit for related party risk exposure is 20%. Pricing and other terms and conditions must be done on an arms-length basis.

Past due, non-performing loans

The Group has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Unsecured retail loans over 10 days past-due are automatically transferred to the Problematic Loans Department. The department classifies loans under following categories based on their characteristics:

SOFT10 status – Represents loans with, depending on the loan type, 10-20 days overdue and which have never had 60 days overdue during the loan period.

HARD status - Represents loans with, depending on the loan type, 21-59 days overdue and which have never had 60 days overdue during the loan period.

PROBLEM status - Represents loans which at least once have had 60 days overdue and more than 1 day overdue loans during the loan period.

Corporate loans over 60-days past-due are also transferred to this department. All loans are placed on non-accrual after 90 days past due. If the Problematic Loans Department is unsuccessful in collecting on these obligations, then legal proceedings are initiated. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board.

All past-due statistics are reported to the Credit Committee on at least a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee.

Allowance for loan losses – provisioning policy

The Group establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

The Central Bank of the Republic of Azerbaijan also has a provisioning policy which is a minimum standard for banks. The categories with reserve requirements are as follows:

Satisfactory	1%
Watch	1%
Controllable assets	2%
Unsatisfactory assets	25%
Assets-at-risk	50%
Hopeless assets	100%

For loans issued after May 5, 2016:

	AZN		FCCY	
Category	**Retail**	**Business**	**Retail**	**Business**
Satisfactory	1%	1%	2%	2%
Watch	5%	1%	10%	5%

These categories are strictly defined.

In its IFRS reporting, the Group utilizes the methodology which complies with IAS 39.

Maximum exposure to credit risk

The Group's maximum exposure to on balance sheet credit risk is generally reflected in the carrying amounts of financial assets on the consolidated statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

The maximum credit risk for off-balance items, mainly letters of credit and guarantees, represents the gross amount of the commitment. The Group's maximum exposure to off-balance credit risk is disclosed in Note 30.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Group uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Maximum exposure of credit risk

The Groups maximum exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Group’s maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

Currency risk

The Group is exposed to effects of fluctuation in the prevailing local/foreign currency exchange rates on its financial position. Currency risk is the risk that movements in foreign exchange rates will affect the Group’s income or the value of its portfolios of financial instruments.

The main element in the Group’s risk policy regarding foreign currency risk is that there is no conscious effort to take a trading position in any currency. Limited open positions occur as a natural consequence of business operations only. The Group uses every effort to match its assets and liabilities by currency.

Exposure to foreign exchange risk faced by the Bank is also limited by the Central Bank of the Republic of Azerbaijan statutory requirements.

The foreign exchange exposures are managed by the Risk Management Department, who issue daily reports, reviewed and controlled by ALCO and the Treasury Department. The table below summarizes the Group’s exposure to foreign currency exchange rate risk at the end of the reporting period:

	December 31, 2017			December 31, 2016		
	Monetary financial assets	Monetary financial liabilities	Net position	Monetary financial assets	Monetary financial liabilities	Net position
AZN	261,624	280,561	(18,937)	232,443	308,519	(76,076)
USD	238,921	244,696	(5,775)	310,289	392,132	(81,843)
EUR	12,903	16,054	(3,151)	13,130	13,974	(844)
Other	2,797	498	2,299	1,434	1,168	266
Total	**516,245**	**541,809**	**(25,564)**	**557,296**	**715,793**	**(158,497)**

The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream and cost structure of the borrower, the possible appreciation of the currencies in which loans and advances have been extended against the Azerbaijani Manat may adversely affect the borrower’s repayment ability and therefore increase the potential of future loan losses.

The following table presents sensitivities of profit and loss to reasonably possible changes in exchange rates applied at the end of the reporting period, with all other variables held constant:

	December 31, 2017	December 31, 2016
US Dollars strengthening by 50% (2016: 50%)	2,888	(40,922)
US Dollars weakening by 50% (2016: 50%)	(2,888)	40,922
Euro strengthening by 50% (2016: 50%)	(1,576)	(422)
Euro weakening by 50% (2016: 50%)	1,576	422
Other currency strengthening by 50% (2016: 50%)	1,150	133
Other currency weakening by 50% (2016: 50%)	(1,150)	(133)

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Other than as a result of any impact on the Group’s profit or loss, there is no other impact on the Group’s equity as a result of such changes in exchange rates.

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Group.

The Group’s exposure to currency risk at the end of the reporting period is not representative of the typical exposure during the year. The following table presents sensitivities of profit and loss and equity to reasonably possible changes in exchange rates applied to average exposure to currency risk during the year, with all other variables held constant:

	Average exposure during 2017	Average exposure during 2016
US Dollars strengthening by 50% (2016: 50%)	(23,543)	(44,926)
US Dollars weakening by 50% (2016: 50%)	23,543	44,926
Euro strengthening by 50% (2016: 50%)	(493)	(287)
Euro weakening by 50% (2016: 50%)	493	287
Other currency strengthening by 50% (2016: 50%)	294	(18)
Other currency weakening by 50% (2016: 50%)	(294)	18

Other than as a result of any impact on the Group’s profit or loss, there is no other impact on the Group’s equity as a result of such changes in exchange rates.

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:

	Less than 1 month	1-6 months	6-12 months	Over 1 year	Non-interest bearing	Carrying amount
December 31, 2017						
ASSETS						
Cash and cash equivalents	9,593	-	-	-	73,750	83,343
Mandatory cash balances with the CBAR	-	-	-	-	2,914	2,914
Due from other banks	-	7,104	14,831	-	72,891	94,826
Loans and advances to customers	3,746	45,438	48,774	204,104	17,389	319,451
Investment securities available-for-sale	5,877	-	-	-	502	6,379
Other financial assets	-	-	-	-	9,332	9,332
Total financial assets	**19,216**	**52,542**	**63,605**	**204,104**	**176,778**	**516,245**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	Less than 1 month	1-6 months	6-12 months	Over 1 year	Non-interest bearing	Carrying amount
LIABILITIES						
Due to banks and other financial institutions	-	-	3,060	-	226	3,286
Customer accounts	25,741	112,976	81,747	16,363	129,199	366,026
Term borrowings	31,100	3,337	60,470	48,805	265	143,977
Debt securities in issue	-	-	-	-	-	-
Other financial liabilities	-	-	-	-	9,662	9,662
Subordinated debt	-	125	-	18,702	31	18,858
Total financial liabilities:	**56,841**	**116,438**	**145,277**	**83,870**	**139,383**	**541,809**
Net liquidity gap:	**(37,625)**	**(63,896)**	**(81,672)**	**120,234**	**37,395**	**(25,564)**

	Less than 1 month	1-6 months	6-12 months	Over 1 year	Non-interest bearing	Carrying amount
December 31, 2016						
ASSETS						
Cash and cash equivalents	-	-	-	-	53,192	53,192
Mandatory cash balances with the CBAR	-	-	-	-	3,397	3,397
Due from other banks	-	2,656	26,993	-	111,565	141,214
Loans and advances to customers	6,751	50,769	41,493	238,604	12,529	350,146
Investment securities available-for-sale	-	-	-	-	498	498
Other financial assets	-	-	-	-	8,849	8,849
Total financial assets:	**6,751**	**53,425**	**68,486**	**238,604**	**190,030**	**557,296**
LIABILITIES						
Due to banks and other financial institutions	2,000	8,000	9,269	-	157	19,426
Customer accounts	22,269	139,032	106,349	30,914	74,770	373,334
Term borrowings	9,670	45,382	48,393	115,968	39,018	258,431
Debt securities in issue	-	-	-	90	12,219	12,309
Other financial liabilities	-	-	-	-	6,651	6,651
Subordinated debt	-	-	-	5,000	26,642	31,642
Preference shares	-	-	-	-	14,000	14,000
Total financial liabilities:	**33,939**	**192,414**	**164,011**	**151,972**	**173,457**	**715,793**
Net liquidity gap:	**(27,188)**	**(138,989)**	**(95,525)**	**86,632**	**16,573**	**(158,497)**

The Group takes on exposure 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 reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At present, the Group manages its interest rate risk by matching, where possible, its maturity and/or repricing positions. In addition, the Group’s monthly interest margins are continually reviewed in order to reprice its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin at a minimum of 10%. ALCO and the Risk Management Department constantly monitor the maintenance of this margin. ALCO is also responsible for presenting interest rate movement reports and forecasts. At present, through the Group’s matching policies and high interest rate margins, potential interest rate risk is not considered to be significant.

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ALCO and Treasury are responsible for managing interest rate risk, the Risk Management Department for controlling and the Executive Board must approve all guidelines and asset/liability repricing.

As at December 31, 2017 if interest rates at that date had been 100 basis points lower with all other variables held constant, profit for the year would have been AZN 494 thousand (December 31, 2016: AZN 1,401 thousand) higher, mainly as a result of lower interest expense on variable interest liabilities. If interest rates had been 100 basis points higher, with all other variables held constant, profit would have been AZN 494 thousand (December 31, 2016: AZN 1,401 thousand) lower, mainly as a result of higher interest expense on variable interest liabilities. The Group’s profit is not exposed to AZN market interest rate changes because the bank does not have variable interest assets or liabilities denominated in AZN. The impact of a reasonably possible shift in market interest rates on other components of equity, including as a result of an increase in the fair value of fixed rate financial assets classified as available for sale, would not be significant.

The Group monitors interest rates for its financial instruments. The table below summarizes interest rates based on reports reviewed by key management personnel:

	December 31, 2017				December 31, 2016			
	USD	**AZN**	**EUR**	**Other**	**USD**	**AZN**	**EUR**	**Other**
Assets								
Cash and cash equivalents	0.6	11.1	-	-				
Due from other banks	3.5	-	-	-	4.9	7.0	-	-
Loans and advances to customers	15.6	19.2	9.3	16.9	17.3	20.6	10.9	21.6
Investment securities available-for-sale	-	9.0	-	-	-	-	-	-
Liabilities								
Due to other banks and financial institutions	3.3	-	-	-	5.1	14.2	-	-
Customer accounts	3.6	13.0	0.8	-	5.6	13.1	3.3	-
Debt securities in issue	-	-	-	-	0.1	-	-	-
Term borrowings	8.1	2.6	-	-	8.2	3.5	-	-
Subordinated debt	5.9	14.0	-	-	12.5	14.0	-	-
Preference shares	-	-	-	-	-	16.7	-	-

The sign “-“ in the table above means that the Group does not have the respective assets or liabilities in corresponding currency.

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Geographical risk concentrations

The geographical concentration of the Group's financial assets and liabilities at December 31, 2017 is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	Total
FINANCIAL ASSETS:				
Cash and cash equivalents	69,437	12,787	1,119	83,343
Mandatory cash balances with the CBAR	2,914	-	-	2,914
Due from other banks	81,044	13,782	-	94,826
Loans and advances to customers	319,451	-	-	319,451
Investment securities available-for-sale	6,379	-	-	6,379
Other financial assets	9,332	-	-	9,332
TOTAL FINANCIAL ASSETS	**488,557**	**26,569**	**1,119**	**516,245**
FINANCIAL LIABILITIES:				
Due to banks and other financial institutions	3,279	-	7	3,286
Customer accounts	344,344	6,224	15,458	366,026
Term borrowings	138,130	5,847	-	143,977
Other financial liabilities	9,662	-	-	9,662
Subordinated debt	7,294	11,564	-	18,858
TOTAL FINANCIAL LIABILITIES	**502,709**	**23,635**	**15,465**	**541,809**
NET POSITION	**(14,152)**	**2,934**	**(14,346)**	**(25,564)**
CREDIT RELATED COMMITMENTS	**57,218**	**-**	**-**	**57,218**

Assets, liabilities and credit related commitments have generally been based on the country in which the counterparty is located. Balances with the Republic of Azerbaijan counterparties actually outstanding to/from off-shore companies of these the Republic of Azerbaijan counterparties are allocated to the caption "the Republic of Azerbaijan". Cash on hand and premises and equipment have been allocated based on the country in which they are physically held.

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The geographical concentration of the Group's financial assets and liabilities at December 31, 2016 is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	Total
FINANCIAL ASSETS:				
Cash and cash equivalents	43,376	9,311	505	53,192
Mandatory cash balances with the CBAR	3,397	-	-	3,397
Due from other banks	137,612	3,602	-	141,214
Loans and advances to customers	350,146	-	-	350,146
Investment securities available-for-sale	498	-	-	498
Other financial assets	8,849	-	-	8,849
TOTAL FINANCIAL ASSETS	**543,878**	**12,913**	**505**	**557,296**
FINANCIAL LIABILITIES:				
Due to banks and other financial institutions	19,426	-	-	19,426
Customer accounts	347,787	5,075	20,472	373,334
Debt securities in issue	91	12,218	-	12,309
Term borrowings	213,283	25,721	19,427	258,431
Other financial liabilities	6,651	-	-	6,651
Subordinated debt	5,082	26,560	-	31,642
Preference shares	1,700	12,300	-	14,000
TOTAL FINANCIAL LIABILITIES	**594,020**	**81,874**	**39,899**	**715,793**
NET POSITION	**(50,142)**	**(68,961)**	**(39,394)**	**(158,497)**
CREDIT RELATED COMMITMENTS	**65,610**	**-**	**-**	**65,610**

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations arising from its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. 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 the management of financial institutions.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Executive Board and Supervisory Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The Central Bank of the Republic of Azerbaijan has in place minimum levels of liquidity required. The loan agreements with international financial institutions also have minimum liquidity covenants in their agreements with the Group. As of December 31, 2017 the Bank was not in compliance with some of these covenants. Accordingly, the Group classified those borrowings on demand category in liquidity disclosures.

The Group's liquidity policy is comprised of the following:

- Projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;

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- Maintaining a funding plan commensurate with the Group's strategic goals;
- Maintaining a diverse range of funding sources thereby increasing the Group's borrowing capacity, domestically as well as from foreign sources;
- Maintaining highly liquid and high-quality assets;
- Adjusting its product base by time bands against available funding sources;
- Daily monitoring of liquidity ratios against regulatory requirements; and
- Constant monitoring of asset and liability structures by time-bands.

The treasury function within the Group is charged with the following responsibilities:

- Compliance with the liquidity requirements of the Central Bank of the Republic of Azerbaijan as well as with the liquidity requirement covenants contained in the agreements with foreign lending sources;
- Daily reports to management, including reporting to management on the forecast levels of cash flows in the main currencies (AZN, USD, EUR), cash positions, changes in the consolidated statement of financial position;
- Constantly controlling/monitoring the level of liquid assets;
- Monitoring of deposit and other liability concentrations; and
- Maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

ALCO is responsible for ensuring that Treasury properly manages the Group's liquidity position. The Risk Management Department is responsible for controlling these activities. Decisions on liquidity positions and management are made by the Executive Board. Funding plans are approved by the Supervisory Board.

The table below shows liabilities at December 31, 2017 by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows, including gross loan commitments and financial guarantees. Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in the statement of financial position is based on discounted cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The undiscounted maturity analysis of financial assets and liabilities by contractual maturities at December 31, 2017 is as follows:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
Assets							
Cash and cash equivalents	83,343	-	-	-	-	-	83,343
Mandatory cash balances with the CBAR	-	-	-	-	-	2,914	2,914
Due from other banks	133	20,331	69,583	-	-	5,841	95,888
Loans and advances to customers	27,028	72,013	73,700	180,262	100,282	-	453,285
Investment securities available-for-sale	5,877	-	-	-	-	502	6,379
Other financial assets	9,332	-	-	-	-	-	9,332
Total financial assets	**125,713**	**92,344**	**143,283**	**180,262**	**100,282**	**9,257**	**651,141**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
Liabilities							
Due to banks and other financial institutions	(229)	(48)	(3,096)	-	-	-	(3,373)
Customer accounts	(154,015)	(119,739)	(84,978)	(18,193)	-	-	(376,925)
Term borrowings	(31,507)	(5,086)	(61,416)	(10,195)	(59,397)	-	(167,601)
Other financial liabilities	(9,662)	-	-	-	-	-	(9,662)
Subordinated debt	-	(694)	(516)	(5,780)	(18,021)	-	(25,011)
Total financial liabilities	**(195,413)**	**(125,567)**	**(150,006)**	**(34,168)**	**(77,418)**	**-**	**(582,572)**
Net liquidity gap on recognized financial assets and liabilities	**(69,700)**	**(33,223)**	**(6,723)**	**146,094**	**22,864**	**9,257**	**68,569**
Cumulative liquidity gap on recognized financial assets and liabilities	**(69,700)**	**(102,923)**	**(109,646)**	**36,448**	**59,312**	**68,569**	
Credit related commitments	**(57,218)**	**-**	**-**	**-**	**-**	**-**	**(57,218)**

The undiscounted maturity analysis of financial assets and liabilities by contractual maturities at December 31, 2016 is as follows:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
Assets							
Cash and cash equivalents	53,192	-	-	-	-	-	53,192
Mandatory cash balances with the CBAR	-	-	-	-	-	3,397	3,397
Due from other banks	127	31,572	38,909	71,778	-	-	142,386
Loans and advances to customers	25,485	89,335	78,971	283,675	96,242	-	573,708
Investment securities available-for-sale	-	-	-	-	-	498	498
Other financial assets	8,849	-	-	-	-	-	8,849
Total financial assets	**87,653**	**120,907**	**117,880**	**355,453**	**96,242**	**3,895**	**782,030**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	No maturity	Total
Liabilities							
Due to banks and other financial institutions	(2,346)	(8,502)	(9,508)	-	-	-	(20,356)
Customer accounts	(94,855)	(149,917)	(112,046)	(33,294)	-	-	(390,112)
Term borrowings	(49,970)	(50,023)	(51,329)	(84,745)	(53,953)	-	(290,020)
Debt securities in issue	(2)	(12,413)	(5)	(94)	-	-	(12,514)
Other financial liabilities	(6,651)	-	-	-	-	-	(6,651)
Subordinated debt	-	(432)	(1,318)	(31,932)	-	-	(33,682)
Preference shares	-	-	-	-	-	(14,000)	(14,000)
Total financial liabilities	**(153,824)**	**(221,287)**	**(174,206)**	**(150,065)**	**(53,953)**	**(14,000)**	**(767,335)**
Net liquidity gap on recognized financial assets and liabilities	**(66,171)**	**(100,380)**	**(56,326)**	**205,388**	**42,289**	**(10,105)**	**14,695**
Cumulative liquidity gap on recognized financial assets and liabilities	**(66,171)**	**(166,551)**	**(222,877)**	**(17,489)**	**24,800**	**14,695**	
Credit related commitments	**(65,610)**	**-**	**-**	**-**	**-**	**-**	**(65,610)**

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Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with Azerbaijan Civil Code, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to accrued interest.

The table presents an analysis of liquidity position of the Group's financial assets and liabilities by expected maturities as at December 31, 2017:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 1 year	No maturity	Total
Assets						
Cash and cash equivalents	83,343	-	-	-	-	83,343
Mandatory cash balances with the CBAR	-	-	-	-	2,914	2,914
Due from other banks	47	7,105	81,838	5,235	601	94,826
Loans and advances to customers	21,188	45,438	48,774	204,051	-	319,451
Investment securities available-for-sale	5,877	-	-	-	502	6,379
Other financial assets	9,332	-	-	-	-	9,332
Total financial assets	**119,787**	**52,543**	**130,612**	**209,286**	**4,017**	**516,245**
Liabilities						
Due to banks and other financial institutions	226	-	3,060	-	-	3,286
Customer accounts	23,646	32,161	15,623	294,596	-	366,026
Term borrowings	31,366	3,337	60,470	48,804	-	143,977
Other financial liabilities	9,662	-	-	-	-	9,662
Subordinated debt	31	125	-	18,702	-	18,858
Preference shares	-	-	-	-	-	-
Total financial liabilities	**64,931**	**35,623**	**79,153**	**362,102**	**-**	**541,809**
Net liquidity gap December 31, 2017	**54,856**	**16,920**	**51,459**	**(152,816)**	**4,017**	**(25,564)**
Cumulative liquidity gap December 31, 2017	**54,856**	**71,776**	**123,235**	**(29,581)**	**(25,564)**	

(in thousands of Azerbaijan Manats, unless otherwise indicated)

The table presents an analysis of liquidity position of the Group's financial assets and liabilities as at December 31, 2016:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	Over 1 year	Not defined	Total
Assets						
Cash and cash equivalents	53,192	-	-	-	-	53,192
Mandatory cash balances with the CBAR	-	-	-	-	3,397	3,397
Due from other banks	21	31,063	38,353	71,777	-	141,214
Loans and advances to customers	17,096	50,769	41,493	240,788	-	350,146
Investment securities available-for-sale	-	-	-	-	498	498
Other financial assets	8,849	-	-	-	-	8,849
Total financial assets	**79,158**	**81,832**	**79,846**	**312,565**	**3,895**	**557,296**
Liabilities						
Due to banks and other financial institutions	2,157	8,000	9,269	-	-	19,426
Customer accounts	3,115	65,174	6,324	289,373	9,348	373,334
Term borrowings	47,196	45,382	46,917	111,542	7,394	258,431
Debt securities in issue	-	-	-	3,757	8,552	12,309
Other financial liabilities	6,651	-	-	-	-	6,651
Subordinated debt	82	-	-	5,000	26,560	31,642
Preference shares	-	-	-	-	14,000	14,000
Total financial liabilities	**59,201**	**118,556**	**62,510**	**409,672**	**65,854**	**715,793**
Net liquidity gap December 31, 2016	**19,957**	**(36,724)**	**17,336**	**(97,107)**	**(61,959)**	**(158,497)**
Cumulative liquidity gap December 31, 2016	**19,957**	**(16,767)**	**569**	**(96,538)**	**(158,497)**	

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of customer accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. Refer to Note 29 for liquidity mismatch of the Group.

Operational risk

The Group is exposed to operational risk. Operational risk is defined as the risk of loss, whether direct or indirect, resulting from inadequate or failed internal processes, people or systems or due to external factors other than credit, market and liquidity risks. Inadequate or inappropriately designed business process systems, management failures, technology failures, faulty control structures, human error, fraud and non-conformance to generally accepted standards of corporate behavior can cause losses for an organization.

The Group's objective in managing operational risk is to balance the avoidance of financial losses and damage to the Group's reputation with overall operational efficiencies and cost effectiveness.

Operational risk arises in the unit that generates an operation, and so the primary responsibility for addressing operational risk lies within each business unit. This responsibility is supported by the development of overall standards within the general internal control system of the Group. The approach of the Group's internal control system covers the following areas:

- requirements for the appropriate segregation of duties, including avoidance of conflicts of interest, independent authorization of transactions and strict delineations of system access rights;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls, procedures and instructions and their approval across business and risk management lines;
- constant control and monitoring of adherence to controls, procedures and instructions, including a strong internal audit function;
- continuous evaluation of present and potential operational risks;
- continuous evaluation of the adequacy of controls and procedures in addressing the risks identified;
- development of contingency plans;
- continual evaluation of IT security issues;
- requirements for the reporting of operational errors and losses and proposed remedial actions;
- appropriate recruitment, training and professional development;
- ensuring adherence to the Group's out-sourcing policy;
- ethical and code of conduct standards; and
- implementation of risk mitigation measures, including insurance.

The Operational Risk Group of the Risk Management Department and Internal Audit have primary responsibility for monitoring, reporting and making recommendations to improve the Group's operational risk management.

30. CONTINGENCIES AND COMMITMENTS

Legal proceedings – From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in this consolidated financial statements.

Taxation – Commercial legislation of the Republic of Azerbaijan, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Group believes that it has accrued all tax amounts due and therefore no allowance has been made in the consolidated financial statements.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. In the case of criminal investigation statute of limitation may be extended up to seven years based on the court decision.

Compliance with covenants – The Bank is subject to certain covenants related primarily to its term borrowings and subordinated debts. Non-compliance with such covenants may result in negative consequences for the Group including, growth in the cost of borrowings and timing of repayment of existing facilities.

As at December 31, 2017 the Bank was in breach of certain covenants with two financing arrangements with outstanding balances amounting to AZN 5,847 thousand (2016: five financing arrangements with outstanding balances amounting to AZN 21,036 thousand). The Bank has classified these agreements as on demand liabilities.

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

Commitments to extend credit represent unused portions of authorizations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Outstanding amount of credit related commitments are, as follows:

	December 31, 2017	**December 31, 2016**
Cancellable undrawn credit lines	54,796	62,074
Letters of guarantee	2,422	3,536
Total credit related commitments	**57,218**	**65,610**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Credit related commitments are denominated in currencies as follows:

	December 31, 2017	December 31, 2016
Azerbaijani Manats	35,240	32,920
US Dollars	19,247	28,469
Euro	2,731	4,092
Other	-	129
Total	**57,218**	**65,610**

Liquidity and currency analysis of contingencies and commitments are disclosed in Note 28. Information on related party balances is disclosed in Note 31.

31. FAIR VALUE OF FINANCIAL INSTRUMENTS

IFRS defines fair value as 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.

Fair value hierarchy

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

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

The table below analyses financial instruments measured at fair value at 31 December 2017 and 2016, by the level in the fair value hierarchy into which the fair value measurement is categorized. The amounts are based on the values recognized in the statement of financial position:

	December 31, 2017	December 31, 2016
	Level 3	Level 3
Available-for-sale financial assets	502	498
	502	**498**

(in thousands of Azerbaijan Manats, unless otherwise indicated)

Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)

Except as detailed in the following table, the directors consider that the carrying amounts of financial assets and financial liabilities recognized in the consolidated financial statements approximate their fair values.

	December 31, 2017		December 31, 2016	
	Carrying value	Fair value Level 2	Carrying value	Fair value Level 2
Cash and cash equivalents	83,343	83,343	53,192	53,192
Mandatory cash balances with the CBAR	2,914	2,914	3,397	3,397
Investment securities available-for-sale	6,379	6,379	-	-
Due from other banks	94,826	94,826	141,214	141,214
Loans and advances to customers	319,451	319,451	350,146	350,146
Other financial assets	9,332	9,332	8,849	8,849
Total financial assets:	**516,245**	**516,245**	**556,798**	**556,798**
Due to other banks and financial institutions	3,286	3,286	19,426	19,426
Customer accounts	366,026	366,026	373,334	373,334
Debt securities in issue	-	-	12,309	12,309
Term borrowings	143,977	143,977	258,431	258,431
Other financial liabilities	9,662	9,662	6,651	6,651
Subordinated debt	18,858	18,858	31,642	31,642
Preference shares	-	-	14,000	14,000
Total financial liabilities:	**541,809**	**541,809**	**715,793**	**715,793**

The fair values of the financial assets and financial liabilities included in the Level 2 and Level 3 categories above have been determined in accordance with generally accepted pricing models based on a discounted cash flow analysis, with the most significant inputs being the discount rate that reflects the credit risk of counterparties.

32. RELATED PARTY TRANSACTIONS

Parties are generally considered to be related if the parties are under common control or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

As at December 31, 2017 and 2016, the outstanding balances with related parties were as follows:

	December 31, 2017				December 31, 2016			
	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties
Gross amount of loans and advances to customers (contractual interest rate: 2017: 14% - 26% p.a.; 2016: 14% - 26% p.a.)	580	258	-	-	433	1,596	-	7
Impairment provisions for loans and advances to customers	(11)	(4)	-	-	(7)	(31)	-	-
Investment securities available-for-sale	-	-	-	400				400
Current/settlements accounts	131	73	-	541	190	278	-	330
Term deposits (contractual interest rate: 2017: 2.4% - 15.5% p.a.; 2016: 2.4%-15.5% p.a.)	1,476	-	-	2,890	1,508	9,425	-	3,847
Debt securities in issue (contractual interest rate: 2017: 0% - 0% p.a.; 2016: 0% p.a.)	-	-	-	-	-	-	12,218	-
Term borrowings (contractual interest rate: 2017: 0% - 0% p.a.; 2016: 6.7%-7.3% p.a.)	-	-	-	-	-	-	13,346	-
Subordinated debt (contractual interest rate: 2017: 5% - 6% p.a.; 2016: 12.5% p.a.)	-	-	11,564	-	-	-	27,529	-
Preference shares	-	-	-	-	-	1,500	200	-

As at December 31, 2017 and 2016 fair value of collaterals pledged in respect to loans issued to key management personnel amounted to AZN 929 thousand and AZN 726 thousand, respectively.

(in thousands of Azerbaijan Manats, unless otherwise indicated)

The income and expense items with related parties for the years ended December 31, 2017 and 2016 were as follows:

	Year ended December 31, 2017				Year ended December 31, 2016			
	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties
Interest income	66	185	-	-	53	106	-	1
Interest expense	(122)	(130)	(77)	(131)	(56)	(83)	(2,393)	(112)
Provision for loan impairment/(Recovery of provision for loan impairment)	(3)	26	-	-	59	(17)	-	-
Fee and commission income	15	10	-	29	5	7	1	16
Other income	-	-	54	-	-	-	2	5
Administrative and other operating expense	2,315	253	-	-	1,771	223	-	1,216

During the year ended December 31, 2017, the remuneration of key management personnel comprised salaries and bonuses totaling to AZN 2,568 thousand (December 31, 2016: AZN 1,994 thousand).

Other rights and obligations with related parties were as follows:

	December 31, 2017				December 31, 2016			
	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties
Letters of guarantee	-	-	-	-	-	-	-	561

33. EVENTS AFTER THE REPORTING PERIOD

On February 12, 2018 the Central Bank of the Republic of Azerbaijan decided to reduce the refinancing rate from 15% to 13%, the ceiling of the interest rate corridor from 18% to 16% and the floor from 10% to 8%.

On April 10, 2018 the Central Bank of the Republic of Azerbaijan decided to reduce the refinancing rate from 13% to 11%, while the ceiling and the floor of the interest rate corridor was set at a ± 3% symmetric range to the refinancing rate.