“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, 2018

“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, 2018

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, 2018, 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, 2018 were authorized for issue on May 29, 2019 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 29, 2019

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

May 29, 2019

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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, 2018, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

Basis for Opinion

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

Responsibilities of Management and the Audit Committee 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 responsible for overseeing the Group's financial reporting process.

Baker Tilly Audit Azerbaijan CJSC trading as Baker Tilly is a member of the global network of Baker Tilly International Ltd., the members of which are separate and independent legal entities.

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Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

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

Baker Tilly Azerbaijan

May 29, 2019
Baku, the Republic of Azerbaijan

"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2018
(in thousands of Azerbaijan Manats)

	Notes	December 31, 2018	December 31, 2017
ASSETS			
Cash and cash equivalents	9	109,988	83,343
Mandatory cash balances with the Central Bank of the Republic of Azerbaijan		3,128	2,914
Due from other banks	10	90,605	94,826
Loans and advances to customers	11, 32	388,821	319,451
Investment securities	12, 32	6,640	6,379
Deferred income tax asset	26	7,778	7,778
Premises and equipment	13	49,937	45,249
Intangible assets	13	12,548	8,852
Other financial assets	14	7,781	9,332
Other assets	15	17,503	14,585
TOTAL ASSETS		**694,729**	**592,709**
LIABILITIES AND EQUITY			
LIABILITIES:			
Due to banks and other financial institutions	16	16,208	3,286
Customer accounts	17, 32	467,149	366,026
Term borrowings	18, 32	129,689	143,977
Subordinated debt	20, 32	18,725	18,858
Other liabilities	19	6,928	10,076
TOTAL LIABILITIES		**638,699**	**542,223**
EQUITY:			
Equity attributable to owners of the Bank:			
Share capital	21	125,686	125,686
Share premium	21	484	484
Accumulated deficit		(70,140)	(75,684)
TOTAL EQUITY		**56,030**	**50,486**
TOTAL LIABILITIES AND EQUITY		**694,729**	**592,709**

On behalf of the Executive Board:

Mr. Faig Huseynov
Chairman of the Executive Board
Baku, the Republic of Azerbaijan
May 29, 2019

Mrs. Vafa Kalantarova
Chief Financial Officer
Baku, the Republic of Azerbaijan
May 29, 2019

The notes on pages 9-91 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, 2018

(in thousands of Azerbaijan Manats, unless otherwise indicated)

	Notes	Year ended December 31, 2018	Year ended December 31, 2017
Continuing operations:			
Interest income	22, 32	59,344	71,724
Interest expense	22, 32	(23,198)	(26,371)
Net interest income before expected credit losses	22	**36,146**	**45,353**
Recovery of expected credit losses	23, 32	34,532	41,256
Net interest income		**70,678**	**86,609**
Fee and commission income	24, 32	13,113	10,899
Fee and commission expense	24	(7,452)	(6,121)
Gains less losses from trading in foreign currencies		5,062	7,675
Net foreign exchange translation loss		(392)	(10,908)
Impairment loss on other assets		(2,020)	(226)
Recovery of expected credit losses for guarantees and credit related commitments	23	4,246	-
Administrative and other operating expenses	25, 32	(53,309)	(43,040)
Fair value loss on interest-free loans to customers at initial measurement		-	(2,230)
Other operating income, net		1,019	1,920
Profit before income tax		**30,945**	**44,578**
Income tax expense	26	(82)	(141)
Income from continuing operations		**30,863**	**44,437**
Discontinued operations:			
Gain from discontinued operations		-	1,836
Total comprehensive income for the year		**30,863**	**46,273**
Total comprehensive income attributable to:			
Owners of the Bank from continuing operations		30,863	44,437
Owners of the Bank from discontinued operations		-	1,702
Non-controlling interest		-	134
Total comprehensive income for the year		**30,863**	**46,273**
Earnings per share for profit attributable to the owners of the Bank, basic and diluted (AZN)	27	**0.67**	**1.46**
From continuing operations		0.67	1.41
From discontinued operations		-	0.05

On behalf of the Executive Board:

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Chairman of the Executive Board
Baku, the Republic of Azerbaijan
May 29, 2019

Mrs. Vafa Kalantarova
Chief Financial Officer
Baku, the Republic of Azerbaijan
May 29, 2019

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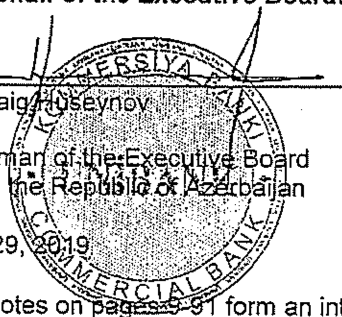
"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2018
(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, 2017	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 8)	-	-	-	-	22,379	22,379
December 31, 2017	125,686	484	(75,684)	50,486	-	50,486
Impact of adopting IFRS 9 as at January 1, 2018	-	-	(25,319)	(25,319)	-	(25,319)
Restated balance as at January 1, 2018	125,686	484	(101,003)	25,167	-	25,167
Total comprehensive income for the year	-	-	30,863	30,863	-	30,863
December 31, 2018	125,686	484	(70,140)	56,030	-	56,030

On behalf of the Executive Board:



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

May 29, 2019

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

May 29, 2019

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"UNIBANK COMMERCIAL BANK" OPEN JOINT STOCK COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018
(in thousands of Azerbaijan Manats)

	Notes	Year ended December 31, 2018	Year ended December 31, 2017
CASH FLOWS FROM OPERATING ACTIVITIES:			
Interest received		63,627	62,079
Interest paid		(22,093)	(26,748)
Fees and commissions received		13,168	11,051
Fees and commissions paid		(7,432)	(6,245)
Income received from trading in foreign currencies		5,062	7,675
Other operating income received, net		417	1,573
Administrative and other operating expenses paid		(49,197)	(36,770)
Income tax paid		(82)	(671)
Cash flows from operating activities before changes in operating assets and liabilities		**3,470**	**11,944**
(Increase)/decrease in operating assets:			
Mandatory cash balances with the CBAR		(214)	483
Due from other banks		2,436	12,681
Loans and advances to customers		(67,208)	59,124
Other financial assets		1,520	(568)
Other assets		(494)	(1,458)
Increase/(decrease) in operating liabilities:			
Due to banks and other financial institutions		12,915	(16,143)
Customer accounts		100,348	12,776
Other liabilities		757	(5,086)
Net cash provided from operating activities		**53,530**	**73,753**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of investment securities		(578)	(5,881)
Acquisition of premises, equipment and intangible assets		(11,900)	(9,977)
Proceeds on disposal of premises and equipment		367	160
Disposal of a subsidiary, net of cash disposed of		-	235
Net cash used in investing activities		**(12,111)**	**(15,463)**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from term borrowings	18	20,156	8,861
Repayment of term borrowings	18	(34,399)	(48,601)
Proceeds from subordinated debt		-	17,001
Repayment of subordinated debt	20	(125)	(4,875)
Redemption of debt securities in issue		-	(91)
Issuance of ordinary shares		-	2,500
Net cash used in financing activities		**(14,368)**	**(25,205)**
Effect of exchange rate changes on cash and cash equivalents		(406)	(2,934)
Net increase in cash and cash equivalents		26,645	30,151
Cash and cash equivalents at the beginning of the year	9	83,343	53,192
Cash and cash equivalents at the end of the year	9	**109,988**	**83,343**

On behalf of the Executive Board:

Mr. Faig Huseynov

Chairman of the Executive Board
Baku, the Republic of Azerbaijan

May 29, 2019

Mrs. Vafa Kalantarova

Chief Financial Officer
Baku, the Republic of Azerbaijan

May 29, 2019

The notes on pages 9-91 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, 2018, 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, 2018 the Bank is ultimately controlled by Mr. Eldar Garibov (December 31, 2017: 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 8.

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 4 years at annual interest rate not higher than 15% for local currency and 3% for foreign currency deposits.

As at December 31, 2018 the Bank has 31 branches (December 31, 2017: 31 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-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.

According to Moody’s, real GDP growth accelerated further after growing 0.1% in 2017 over the first five months of 2018 by 1.6% compared with the year-earlier period, and expects the economy to grow by 2% in 2018 and 3% in 2019. Growth will be aided by higher oil prices and increased gas exports.

Moody’s Investors Service says that the credit profile of Azerbaijan (Ba2 stable) reflects its relatively high levels of gross government debt and guarantees, and fragile banking sector. These features reflect the legacy impact of the fall in oil prices and steep depreciation in the manat over 2014-2016. Conversely, the country’s large financial assets provide significant support to the credit profile. Moody's conclusions are contained in its annual credit analysis, “Government of Azerbaijan - Ba2 stable”. This credit analysis elaborates on Azerbaijan’s credit profile in terms of economic strength, low (+); institutional strength, low (-); fiscal strength, high; and susceptibility to event risk, moderate. These are the four main analytic factors in Moody’s Sovereign Bond Rating methodology.

Manat has remained stable during 2018. However, uncertainty over the exchange rate in the future and the ongoing fragility of the banking system hinder policy transmission into the real economy.

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 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. The management is currently performing sensitivity analyses under different oil prices scenarios and elaborating relevant action plans for mainlining sustainability of the business.

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.

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, financial instruments categorised at fair value through profit or loss (“FVPL”) and at fair value through other comprehensive income (“FVOCI”). These consolidated financial statements have been prepared assuming that the Group is a going concern and will continue in operation for the foreseeable future. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. Apart from the accounting policy changes resulting from the adoption of IFRS 9 and IFRS 15 effective from January 1, 2018, these policies have been consistently applied to all the periods presented, unless otherwise stated.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

This is the first set of the Group’s annual consolidated financial statements in which IFRS 9 “Financial Instruments” and IFRS 15 “Revenue from Contracts with Customers” have been applied. Changes to significant accounting policies are described in Note 2 and Note 5.

Financial instruments - key measurement terms. Depending on their classification financial instruments are carried at fair value or amortized cost as described below.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is the price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the number of instruments held by the entity. This is the case even if a market’s normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm’s length transactions or consideration of financial data of the investees are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note 31.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents

(including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortized cost is the amount at which the financial instrument was recognized at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortization of transaction costs deferred at initial recognition and of any premium or discount to the maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortized discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of the related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortized over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Initial recognition of financial instruments. Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

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

Classification of financial instruments. From January 1, 2018 on initial recognition, a financial asset is classified as measured at: amortized cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVPL").

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at FVPL:

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

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

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

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

All other financial assets are classified as measured at FVPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI at FVPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

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

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

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

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

In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money - e.g. periodical reset of interest rates, which is not consistent with the interest payment period.

Reclassification of financial assets. Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets. The reclassification has a prospective effect.

Financial assets impairment – credit loss allowance for ECL. The Group assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Group measures ECL and recognises credit loss allowance at each reporting date. The measurement of ECL reflects:

(i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

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

The Group applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter (“12 months ECL”). If the Bank identifies SICR since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any (“Lifetime ECL”). Refer to Note 29 for a description of how the Group determines when a SICR has occurred. If the Group determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Group’s definition of credit impaired assets and definition of default is explained in Note 29. For financial assets that are purchased or originated credit-impaired (“POCI Assets”), the ECL is always measured as a Lifetime ECL. POCI assets are financial assets that are credit-impaired upon initial recognition, such as impaired loans acquired. Note 29 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Group incorporates forward-looking information in the ECL models.

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

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

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

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

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. Funds restricted for a period of more than 1 business day on origination are excluded from cash and cash equivalents, both in the consolidated statement of financial position and for the purposes of the consolidated statement of cash flows. Cash and cash equivalents are carried at amortized cost because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVPL.

Mandatory cash balances with the Central Bank of the Republic of Azerbaijan. Mandatory cash balances with the Central Bank of the Republic of Azerbaijan represent the amount of obligatory reserves deposited with the Central Bank of the Republic of Azerbaijan in accordance with requirements established by the Central Bank of the Republic of Azerbaijan, which subject to restrictions on their availability. In view of the above the amount of the minimum reserve deposit required by the Central Bank of the Republic of Azerbaijan is not included as a cash equivalent in the consolidated statement of cash flows.

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

Loans and advances to customers. Loans and advances to customers are recorded when the Group advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Group classifies loans and advances to customers into one of the following measurement categories:

(i) AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and

(ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Impairment allowances are determined based on the forward-looking ECL models. Note 2 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Group incorporates forward-looking information in the ECL models.

Credit related commitments. Financial guarantee contracts are contracts that require 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. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.
Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognized in accordance with the principles of IFRS 15.

Loan commitments provided by the Group are measured as the amount of the loss allowance. The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognized as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognized together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognized as a provision.

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

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

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

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

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

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.

2018	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

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

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.

Investment property. Investment property is property held by the Group to earn rental income or for capital appreciation, or both and which is not occupied by the Group. Investment property includes building for future use as property and equipment.

Investment property is stated at cost less accumulated depreciation and provision for impairment, where required.

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment. Depreciation on items of investment property is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Estimated useful lives of investment property are 50 years. At each end of each reporting period management assesses whether there is any indication of impairment of investment properties. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. However, since it is not possible to measure fair value less costs to sell because there is no basis for making reliable estimate of the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions, the entity uses the asset's value in use as its recoverable amount. The carrying amount is reduced to the recoverable amount and the impairment loss is recognized in profit or loss for the year. An impairment loss recognized for an asset in prior years is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognized in profit or loss for the year.

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.

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.

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.

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

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

Operating leases. Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease. Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

Due to banks. Amounts due to banks are recorded when money or other assets are advanced to the Group by counterparty banks. The non-derivative liability is carried at amortized cost. If the Group purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from retirement of debt.

Customer accounts. Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortized cost.

Derecognition of financial liabilities. The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss accounts.

Offset of financial assets and liabilities. Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts, and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge/credit comprises current tax and deferred tax and is recognized in profit or loss for the year, except if it is recognized in other comprehensive income or directly in equity because it relates to transactions that are also recognized, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if the consolidated financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within administrative and other operating expenses.

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

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

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.

Income and expense recognition. Interest income and expense are recorded for debt instruments measured at amortized cost or at FVOCI on an accrual basis using the effective interest method.

This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate 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. The Group does not designate loan commitments as financial liabilities at FVPL.

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

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- Financial assets that have become credit-impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their amortized cost (net of the expected credit loss ("ECL") provision); and
- Financial assets that are purchased or originated credit-impaired, for which the original credit-adjusted effective interest rate is applied to the amortized cost.

Fee and commission income and expense. All other fees, commissions and other income and expense items are generally recorded on an accrual basis over the period in which the services are rendered as the customer simultaneously receives and consumes the benefits as the Group performs, usually on a straight-line basis.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, and which are earned when the Group satisfies the performance obligation are recorded upon the completion of the transaction. Portfolio and other management advisory and service fees are recognized based on the applicable service contracts, over the period in which the services are rendered as the customer simultaneously receives and consumes the benefits as the Group performs, usually on a straight-line basis. Asset management fees relating to investment funds are recognized over the period in which services are rendered as the customer simultaneously receives and consumes the benefits as the Group performs, usually on a straight-line basis. The same principle is applied for wealth management, financial planning and custody services that are continually provided over an extended period of time.

Foreign currency translation. The functional currency of the Group is the currency of the primary economic environment in which the Group operates. The functional and the presentation currency of the Group, is the national currency of the Republic of Azerbaijan, Azerbaijani Manats ("AZN").

Monetary assets and liabilities are translated into the Group's functional currency at the official exchange rate of the CBAR at the end of the respective reporting period. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into the Group's functional currency at year-end official exchange rates of the CBAR, are recognized in profit or loss for the year (as foreign exchange translation gains less losses). Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency, including equity investments, are translated using the exchange rates at the date when the fair value was determined.

Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

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

	December 31, 2018	December 31, 2017
AZN/US Dollar 1	1.7000	1.7001
AZN/Euro 1	1.9468	2.0307

Offsetting. Financial assets and 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 either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

Earnings per share. Earnings per share are determined by dividing the profit or loss attributable to owners of the Group by the weighted average number of participating shares outstanding during the reporting year.

Staff costs and related contributions. Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Group. The Group has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme.

3. SIGNIFICANT ACCOUNTING POLICIES APPLICABLE BEFORE JANUARY 1, 2018

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

Financial instruments – key measurement terms. Depending on their classification financial instruments are carried at fair value or AC as described below.

Due from other banks. Amounts due from other banks are recorded when the Group advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortized cost.

Loans and advances to customers. Loans and advances to customers are recorded when the Group advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates and has no intention of trading the receivable. Loans and advances to customers are carried at amortized cost.

Impairment of financial assets carried at amortized cost. Impairment losses are recognized in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment.

The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Group obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

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

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

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

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

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

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

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

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Group to originate loans at market interest rates are integral to the effective interest rate 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. The Group does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful for collection, the base for calculation of interest income is reduced to present value of expected cash inflows and interest income is thereafter recorded based on the asset's original effective interest rate which was used before impairment recognition.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, which are earned on execution of the underlying transaction are recorded on its completion. Portfolio and other management advisory and service fees are recognized based on the

applicable service contracts, usually on a time-proportion basis. Trust and custody services fees related to investment funds are recorded proportionally over the period the service is provided.

All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

4. CRITICAL ACCOUNTING ESTIMATES, AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Measurement of ECL allowance (from January 1, 2018). Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 29. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"), as well as models of macro-economic scenarios. The Group regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience. For details of ECL measurement including incorporation of forward-looking information refer to Note 29.

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

For such facilities, the Group measures ECLs over the period that the Group is exposed to credit risk and ECLs are not mitigated by credit risk management actions. Application of this exception requires judgement. Management applied its judgement in identifying the facilities, both retail and commercial, to which this exception applies. The Group applied this exception to facilities with the following characteristics: (a) there is no fixed term or repayment structure, (b) the contractual ability to cancel the contract is not in practice enforced as a result of day-to-day management of the credit exposure and the contract may only be cancelled when the Group becomes aware of an increase in credit risk at the level of an individual facility, and (c) the exposures are managed on a collective basis. Further, the Group applied judgement in determining a period for measuring the ECL, including the starting point and the expected end point of the exposures.

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

Significant increase in credit risk ("SICR"). In order to determine whether there has been a significant increase in credit risk, the Group compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial

recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Group considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioural aspects of particular customer portfolios. The Group identifies behavioural indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 29.

Business model assessment. The business model drives classification of financial assets. Management applied judgement in determining the level of aggregation and portfolios of financial instruments when performing the business model assessment. When assessing sales transactions, the Group considers their historical frequency, timing and value, reasons for the sales and expectations about future sales activity. Sales transactions aimed at minimizing potential losses due to credit deterioration are considered consistent with the "hold to collect" business model. Other sales before maturity, not related to credit risk management activities, are also consistent with the "hold to collect" business model, provided that they are infrequent or insignificant in value, both individually and in aggregate. The Group assesses significance of sales transactions by comparing the value of the sales to the value of the portfolio subject to the business model assessment over the average life of the portfolio. In addition, sales of financial asset expected only in stress case scenario, or in response to an isolated event that is beyond the Group's control, is not recurring and could not have been anticipated by the Group, are regarded as incidental to the business model objective and do not impact the classification of the respective financial assets.

The "hold to collect and sell" business model means that assets are held to collect the cash flows, but selling is also integral to achieving the business model's objective, such as, managing liquidity needs, achieving a particular yield, or matching the duration of the financial assets to the duration of the liabilities that fund those assets.

The residual category includes those portfolios of financial assets, which are managed with the objective of realizing cash flows primarily through sale, such as where a pattern of trading exists. Collecting contractual cash flow is often incidental for this business model.

Assessment whether cash flows are solely payments of principal and interest ("SPPI"). Determining whether a financial asset's cash flows are solely payments of principal and interest required judgement. The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument's underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument's cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument's cash flows are not SPPI and the instrument is then carried at FVTPL.

The Group identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset's principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual paramount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (ii) the fair value of the prepayment feature is immaterial at initial recognition.

The Group's loan agreements allow adjusting interest rates in response to certain macro-economic or regulatory changes. Management applied judgement and assessed that competition in the banking sector and the practical ability of the borrowers to refinance the loans would prevent it from resetting the interest rates at an above-market level and hence cash flows were assessed as being SPPI.

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

5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

IFRS 9 "Financial Instruments". The Group has adopted IFRS 9 "Financial Instruments" issued in July 2014 with a date of initial application of January 1, 2018. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

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

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortized cost, those to be measured subsequently at FVOCI and those to be measured subsequently at FVTPL.
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest ("SPPI"). If a debt instrument is held to collect contractual cash flows, it may be carried at amortized cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets is classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVTPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition. For an explanation of how the Group classifies financial assets under IFRS 9, see further in this Note.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

- IFRS 9 replaces the incurred loss model in IAS 39 with the ECL (Expected credit loss) model. There is a "three stage" approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that the Group has to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. For an explanation of how the Group applies the impairment requirements of IFRS 9, see in Note 3.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging. The Group has elected to continue to apply the hedge accounting requirements of IAS 39.

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

- Amounts for the previous periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in accumulated deficit and reserves as at January 1, 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application:
  - the determination of the business model within which a financial asset is held,
  - the designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL,
  - the designation of certain investments in equity instruments not held for trading at FVOCI,
  - for financial liabilities designated at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Group has assumed that credit risk on the asset had not increased significantly since its initial recognition. The financial instrument has a low risk of default if the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily; reduce the ability of the borrower to fulfil its contractual cash flow obligations.

For the purposes of measurement as at December 31, 2017, IAS 39 "Financial Instruments: Recognition and Measurement", classified financial assets into the following categories: (a) Loans and Receivables ("L&R"); (b) Available for sale ("AFS") financial assets; (c) financial assets held to maturity ("HTM") and (d) financial assets at FVTPL. There was no change in classification of financial liabilities when transition to IFRS 9.

The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 into their new measurement categories upon transition to IFRS 9 on January 1, 2018:

	Measurement category		**Carrying value per IAS 39 as at December 31, 2017**	**Effect**		**Carrying value per IFRS 9 as at January 1, 2018**
	IAS 39	IFRS 9		Re-measurement	Reclass-ification	
Financial assets						
Cash and cash equivalents	L&R	AC	83,343	-	-	83,343
Mandatory cash balances with the Central Bank of the Republic of Azerbaijan	L&R	AC	2,914	-	-	2,914
Due from other banks and credit institutions	L&R	AC	94,826	(1,632)	-	93,194
Loans and advances to customers	L&R	AC	319,451	(23,431)	-	296,020
Investment securities	AFS	FVOCI	6,379	(31)	-	6,348
Other financial assets	L&R	AC	9,332	-	-	9,332
Non-financial assets						
Deferred income tax asset			7,778	-	-	7,778
Financial liabilities						
Due to banks and other financial institutions	Other FL	AC	(3,286)	-	-	(3,286)
Customer accounts	Other FL	AC	(366,026)	-	-	(366,026)
Term borrowings	Other FL	AC	(143,977)	-	-	(143,977)
Subordinated debt	Other FL	AC	(18,858)	-	-	(18,858)
Other financial liabilities	Other FL	AC	(816)	-	-	(816)
Non-financial liabilities						
Provision for guarantees and similar commitments			(8,846)	(225)	-	(9,071)

The following table reconciles the closing loss allowance for financial assets in accordance with IAS 39 as at December 31, 2017 to the credit loss allowance determined in accordance with IFRS 9 as at January 1, 2018.

	Loan loss allowance/ Provision under IAS 39/IAS 37 at December 31, 2017	**Re-measurement on profit or loss items**	**Re-measurement on balance items**	**Credit loss allowance under IFRS 9 as at January 1, 2018**
Due from banks and other financial institutions	(29,057)	(1,632)	-	(30,689)
Loans and advances to customers	(261,235)	(23,431)	49,838	(234,828)
Investment securities	-	(31)	-	(31)
Unused credit lines and guarantees	(8,846)	(225)	-	(9,071)
Total credit loss allowance	**(299,138)**	**(25,319)**	**49,838**	**(274,619)**

The following table analyses the impact of transition to IFRS 9 on reserves and accumulated deficit:

	Accumulated deficit
Closing balance under IAS 39 (December 31, 2017)	**(75,684)**
Recognition of IFRS 9 ECLs	(25,319)
Restated opening balance under IFRS 9 (January 1, 2018)	**(101,003)**
Total change in equity due to adopting IFRS 9	**(25,319)**

As at January 1, 2018 the management also eliminated accrued interest in the amount of AZN 49,838 thousand and respective provision of the same amount for the Stage 3 loans.

IFRS 15 "Revenue from Contracts with Customers". IFRS 15 "Revenue from Contracts with Customers", issued in May 2014, and amended in April 2016, establishes a five-step model to account for revenue arising from contracts with customers. The Group has adopted IFRS 15 on date of initial application January 1, 2018. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the majority of the Group's revenue including interest income, gains/(losses) on operations with securities, lease income which are covered by IFRS 9 Financial Instruments and IAS 17 Leases. As a result, the majority of the Group's income is not impacted by the adoption of this standard.

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 further clarify that the situations listed in IAS 40 are not exhaustive and that a change in use is possible for properties under construction (i.e. a change in use is not limited to completed properties).

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.

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;

- 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 Group has adopted **Annual Improvements to IFRS Standards 2014-2016 Cycle** containing amendments below to IFRS 1 and IAS 28:

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.

6. STANDARD AND INTERPRETATIONS ISSUED BUT 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.

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.

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

Amendments to IAS 19 "Employee Benefits Plan Amendment, Curtailment or Settlement" – The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognized in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied.

The amendments to IAS 19 must be applied to annual periods beginning on or after January 1, 2019, but they can be applied earlier if an entity elects to do so.

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 consolidated financial statements and the timing of its adoption by the Group.

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.

The Group has chosen the application of IFRS 16 in accordance with IFRS 16:C5(b), i.e, retrospectively, with the cumulative effect of initially applying the Standard recognized at the date of initial application. Consequently, the Group will not restate the comparative information, instead will recognize the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings at the date of initial application.

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. The Bank might be effected by application of new standard as a Lessee.

IFRS 16 may change how the Group accounts for leases previously classified as operating leases under IAS 17, which were off‑balance sheet. On initial application of IFRS 16, for all leases (except as noted below), the Group will:

a) Recognize right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments;
b) Recognize depreciation of right-of-use assets and interest on lease liabilities in the statement of profit or loss;
c) Separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the cash flow statement.

Lease incentives (e.g. rent-free period) will be recognized as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease liability incentive, amortized as a reduction of rental expenses on a straight-line basis.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 *Impairment of Assets*. This will replace the previous requirement to recognize a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as personal computers and office furniture), the Group will opt to recognize a lease expense on a straight-line basis as permitted by IFRS 16.

The Group has not yet evaluated the effects of application if this standard on its consolidated financial statements.

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.

IFRS 3 *Business Combinations. Amendment of the definition of "Business"* – The amendments will help companies determine whether an acquisition made is of a business or a Bank of assets.

The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. Distinguishing between a business and a group of assets is important because an acquirer recognizes goodwill only when acquiring a business. According to the amendment new definition a "business" is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing *goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities*.

Companies are required to apply the amended definition of a business to acquisitions that occur on or after January 1, 2020. Earlier application is permitted.

New definition of "Material" – The IASB has issued amendments to its definition of material to make it easier for companies to make materiality judgements. The updated definition amends IAS 1 ***Presentation of Financial Statements*** and IAS 8 ***Accounting Policies, Changes in Accounting*** *Estimates and Errors.*

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. According to the new definition, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The changes are effective from January 1, 2020. Earlier application is permitted.

IFRS 10 "Consolidated Financial Statements" and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognized in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the re-measurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

7. 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, 2017: 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, 2017: 10%) and (c) maintain a ratio of Tier-1 capital to the risk-weighted assets (the 'Tier-1 capital ratio') at or above the prescribed minimum of 5% (December 31, 2017: 5%).

Management considers that the Bank was in compliance with the statutory capital ratio as at December 31, 2018 and 2017. 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, 2018	December 31, 2017
Total capital	63,450	67,488
Risk-weighted assets	568,171	521,836
Capital adequacy ratio (%)	**11.17%**	**12.93%**

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, 2018	December 31, 2017
Tier 1 capital		
Share capital	125,686	125,686
Share premium	484	484
Accumulated losses	(70,140)	(75,684)
Preference shares	-	-
Total tier 1 capital	**56,030**	**50,486**
Tier 2 capital		
Subordinated debt (unamortized part)	18,360	18,701
Total tier 2 capital	**18,360**	**18,701**
Less: Investments in equity shares	(750)	(502)
Total capital	**73,640**	**68,685**
Risk-weighted assets:		
On-balance sheet	496,534	389,380
Off-balance sheet	43,114	29,598
Total risk weighted assets	**539,648**	**418,978**
Total capital expressed as a percentage of risk-weighted assets (total capital ratio)	**13.65%**	**16.39%**
Total tier 1 capital expressed as a percentage of risk-weighted assets (tier 1 capital ratio)	**10.38%**	**12.05%**

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

	December 31, 2018 (unaudited)	December 31, 2017 (unaudited)
Total statutory capital	**63,450**	**67,488**
Differences between statutory capital and IFRS equity:		
- accumulated losses	(6,697)	(7,858)
- loan loss allowance	6,236	1,229
- provision for potential losses	(4,825)	(8,846)
- income tax	3,075	3,075
- others	(11,183)	(3,316)
- differences on deduction	18,225	14,295
- intangible assets	12,531	8,850
- deferred tax assets	4,703	4,703
- investments	991	742
- general allowances	(5,060)	(5,537)
- other capital	(14,620)	(18,361)
IFRS equity of the Bank	**55,298**	**50,027**
IFRS equity of subsidiaries	**732**	**459**
Total equity attributable to owners of the Bank	**56,030**	**50,486**

8. 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
Interest income	492
Interest expense	(1,493)
Elimination of inter-group interest expense	206
Net interest expense	**(795)**
Recovery of impairment losses/(Impairment losses) on interest bearing assets (Notes 10 and 11)	347
Net interest loss after impairment losses	**(448)**
Fee and commission income	168
Fee and commission expense	(129)
Other operating income	1
Impairment loss	(357)
Net foreign exchange translation gain	1,444
Administrative and other operating expenses	(70)
Net non-interest income	**1,057**
Results from operating activities	**609**
Gain on sale of discontinued operations	**1,227**
Profit from discontinued operations	**1,836**

Cash flows from discontinued operations	**December 31, 2017**
Net cash provided from operating activities	1,913
Net cash used in financing activities	(1,784)
Effect of exchange rate changes on cash and cash equivalents	-
Net cash flow for the period/year	**129**

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 11)	5,806
Due from other banks	(9,348)
Provision for impairment loss against due from other banks (Note 10)	9,348
Advances to the Ministry of Taxes of the Republic of Azerbaijan	(88)
Premises and equipment (Note 13)	(657)
Intangible assets (Note 13)	(78)
Other assets	(1,917)
Term borrowings	75,051
Provision for impairment losses on due from other banks (Note 10)	(29,057)
Provision for potential losses (Note 19)	(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**

9. CASH AND CASH EQUIVALENTS

	December 31, 2018	**December 31, 2017**
Cash on hand	40,182	31,579
Cash balances with the CBAR (other than mandatory cash balances)	21,081	28,410
Notes issued by CBAR with original maturity up to 90 days	9,914	9,593
Correspondent accounts with other banks:		
- rated A- to A+ (Fitch Ratings)	10,352	28
- rated BBB- to BBB+ (Fitch Ratings)	21,899	11,899
- rated below BBB- (Fitch Ratings)	963	923
- not rated	5,597	911
Total correspondent accounts with other banks	38,811	13,761
Total cash and cash equivalents	**109,988**	**83,343**

As at December 31, 2018 the Group had two banks (December 31, 2017: two banks), with balances exceeding 10% of total cash and cash equivalents. The gross value of these balances as at December 31, 2018 was AZN 42,756 thousand (December 31, 2017: AZN 49,291 thousand).

The most recently published international rating for the Republic of Azerbaijan is BB+ (Fitch Ratings) (2017: BB+/Fitch Ratings).

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Group did not recognize any credit loss allowance for cash and cash equivalents. Refer to Note 2 for the ECL measurement approach.

10. DUE FROM OTHER BANKS

	December 31, 2018	January 1, 2018	December 31, 2017
Restricted balances with the CBAR	50,367	67,007	67,007
Term placements with resident banks	66,068	43,093	43,093
Term placements with non-resident banks	4,964	13,783	13,783
	121,399	**123,883**	**123,883**
Less: Allowance for expected credit loss	(30,794)	(30,689)	(29,057)
Net due from other banks	**90,605**	**93,194**	**94,826**

As at December 31, 2018 term placements with local banks included term placements with five local banks with principal balance amounting to the equivalent of AZN 36,125 thousand and bearing 3% annual interest rate (December 31, 2017: placements with five local banks amounting to the equivalent of AZN 37,493 thousand and bearing annual interest rates ranging between 3% and 4%). As at December 31, 2018 the Group recognized credit loss allowance in the amount of AZN 28,941 thousand against due from other banks that were pledged as collateral against the loans to “Direkt Kredi” LLC (previously “Unileasing” CJSC) (December 31, 2017: AZN 29,057 thousand). 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.

As at December 31, 2018 and 2017 the restricted balances with the CBAR represented funds blocked by the CBAR as collateral for the loans issued to the Group.

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

	December 31, 2018	December 31, 2017
Current and not impaired		
- Central Bank of the Republic of Azerbaijan	50,367	67,007
A+ (Fitch Ratings)		-
>BBB (Fitch Ratings)	4,963	5,041
<BBB (Fitch Ratings)	33,734	16,605
- not rated	1,541	6,173
Total due from other banks	**90,605**	**94,826**

Movements in provision for impairment during the year ended December 31, 2018 are as follows:

	Balance at December 31, 2017	Impact of adopting IFRS 9 as at January 1, 2018	Balance at January 1, 2018	Net increase in credit loss allowance	Balance at December 31, 2018
Due from banks and other financial institutions	(29,057)	(1,632)	(30,689)	(105)	(30,794)
Total	**(29,057)**	**(1,632)**	**(30,689)**	**(105)**	**(30,794)**

As at December 31, 2018 the Group has two banks (December 31, 2017: one bank) with an outstanding balance exceeding 10% of total due from other banks. The gross value of these balances as at December 31, 2018 is AZN 90,289 thousand (December 31, 2017: AZN 67,007 thousand).

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

	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at January 1, 2018	**86,395**	-	**37,488**	**123,883**
Net change in carrying value	(1,121)	-	(1,363)	(2,484)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Foreign exchange and other movements	-	-	-	-
As at December 31, 2018	**85,274**	-	**36,125**	**121,399**

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at January 1, 2018	**-**	**-**	**(30,689)**	**(30,689)**
Net change in ECL value	(1,853)	-	1,748	(105)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
As at December 31, 2018	**(1,853)**	-	**(28,941)**	**(30,794)**

11. LOANS AND ADVANCES TO CUSTOMERS

	December 31, 2018	December 31, 2017
Business loans	154,859	211,747
Cash consumer loans	140,159	177,373
Credit cards	75,456	90,294
Purchase of apartments and mortgages	54,176	53,301
Micro loans	41,659	43,949
Purchase of motor vehicles	1,139	4,022
Gross loans and advances to customers	**467,448**	**580,686**
Less: Allowance for expected credit loss	(78,627)	(261,235)
Net loans and advances to customers	**388,821**	**319,451**

Movements in the expected credit allowance against loans and advances to customers during the year ended December 31, 2018 are as follows:

	Balance at December 31, 2017	Impact of adopting IFRS 9 on accumulated deficit as at January 1, 2018	Impact of IFRS 9 on balance items as at January 1, 2018	Balance at January 1, 2018	Loans written off during the period	Recovery of loans written off	Recovery of credit loss allowance	Balance at December 31, 2018
Business loans	99,579	2,962	(33,318)	69,223	(17,803)	101	(16,455)	35,066
Cash consumer loans	104,678	8,100	(5,868)	106,910	(82,275)	5,038	(8,902)	20,771
Credit cards	27,052	5,052	(3,377)	28,727	(14,661)	1,392	(6,834)	8,624
Purchase of apartments and mortgages	274	244	(63)	455	-	18	(60)	413
Micro loans	28,603	4,711	(6,469)	26,845	(11,809)	72	(1,885)	13,223
Purchase of motor vehicles	1,049	2,362	(743)	2,668	(1,570)	67	(635)	530
Total	**261,235**	**23,431**	**(49,838)**	**234,828**	**(128,118)**	**6,688**	**(34,771)**	**78,627**

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**

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

	December 31, 2018		December 31, 2017	
	Amount	**%**	**Amount**	**%**
Retail loans				
Cash consumer loans	140,159	30.0	177,377	30.5
Credit cards	75,456	16.2	90,297	15.5
Purchase of apartments and mortgages	54,176	11.6	53,300	9.2
Micro loans	41,659	8.9	43,950	7.6
Purchase of motor vehicles	1,139	0.2	4,022	0.7
Total retail loans	**312,589**	**66.9**	**368,946**	**63.5**
Business loans				
Trade and services	104,656	22.4	134,511	23.2
Manufacturing	24,342	5.2	15,899	2.7
Agriculture	10,748	2.3	17,141	3.0
Construction	10,446	2.2	37,029	6.4
Other	4,667	1.0	7,160	1.2
Total business loans	**154,859**	**33.1**	**211,740**	**36.5**
Gross loans and advances to customers	**467,448**	**100.0**	**580,686**	**100.0**

As at December 31, 2018 the Group had 33 borrowers (December 31, 2017: 47 borrowers) with the outstanding loan amount above AZN 1,000 thousand. The aggregate balance of these borrowers was AZN 93,509 thousand (December 31, 2017: AZN 131,546 thousand) or 20% (December 31, 2017: 23%) of the gross loan portfolio.

As at December 31, 2018 mortgage loans included AZN 42,484 thousand (December 31, 2017: AZN 39,094 thousand) under the program covered by the borrowing agreement with the Azerbaijan Mortgage Fund. In addition, a further AZN 2,775 thousand (December 31, 2017: AZN 3,578 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.

The following tables show the summary of reconciliations from the opening to the closing balances of gross loans and the loss allowance of loans to customers:

	2018			
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**174,686**	**81,207**	**274,466**	**530,359**
Transfer to Stage 1	8,395	(8,381)	(14)	-
Transfer to Stage 2	(4,970)	5,978	(1,008)	-
Transfer to Stage 3	(2,208)	(8,030)	10,238	-
New assets originated or purchased	245,597	5,474	8,419	259,490
Loans repaid	(109,866)	(36,159)	(47,882)	(193,907)
Amounts written off	(1)	(529)	(127,588)	(128,118)
Foreign exchange and other movements	(15)	(301)	(60)	(376)
At December 31, 2018	**311,618**	**39,259**	**116,571**	**467,448**

	2018			
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	**(3,079)**	**(5,529)**	**(226,220)**	**(234,828)**
Transfer to Stage 1	(225)	215	10	-
Transfer to Stage 2	38	(726)	688	-
Transfer to Stage 3	55	773	(828)	-
Net remeasurement	1,569	2,393	40,680	44,642
New assets originated or purchased	(3,101)	(1,171)	(5,599)	(9,871)
Recovery of loans written off	-	-	(6,688)	(6,688)
Amounts written off	1	529	127,588	128,118
At December 31, 2018	**(4,742)**	**(3,516)**	**(70,369)**	**(78,627)**

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

	2018			
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**57,316**	**27,584**	**98,702**	**183,602**
Transfer to Stage 1	27	(27)	-	-
Transfer to Stage 2	(3,855)	4,551	(696)	-
Transfer to Stage 3	(782)	(2,057)	2,839	-
New assets originated or purchased	56,899	1,117	1,878	59,894
Loans repaid	(38,509)	(12,216)	(19,757)	(70,482)
Amounts written off	-	-	(17,803)	(17,803)
Foreign exchange and other movements	(15)	(295)	(42)	(352)
At December 31, 2018	**71,081**	**18,657**	**65,121**	**154,859**

	2018			
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	**(2,111)**	**(2,846)**	**(64,266)**	**(69,223)**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	24	(578)	554	-
Transfer to Stage 3	38	177	(215)	-
Net remeasurement	990	1,499	16,710	19,199
New assets originated or purchased	(1,751)	(231)	(762)	(2,744)
Recovery of loans written off	-	-	(101)	(101)
Amounts written off	-	-	17,803	17,803
At December 31, 2018	**(2,810)**	**(1,979)**	**(30,277)**	**(35,066)**

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

	2018			
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**10,954**	**43,526**	**111,445**	**165,925**
Transfer to Stage 1	6,627	(6,627)	-	-
Transfer to Stage 2	(34)	189	(155)	-
Transfer to Stage 3	(265)	(5,068)	5,333	-
New assets originated or purchased	125,602	4,209	6,314	136,125
Loans repaid	(44,766)	(19,430)	(15,410)	(79,606)
Amounts written off	(1)	(468)	(81,806)	(82,275)
Foreign exchange and other movements	-	(1)	(9)	(10)
At December 31, 2018	**98,117**	**16,330**	**25,712**	**140,159**

	2018			
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	**(23)**	**(2,044)**	**(104,843)**	**(106,910)**
Transfer to Stage 1	(136)	136	-	-
Transfer to Stage 2	-	(85)	85	-
Transfer to Stage 3	1	522	(523)	-
Net remeasurement	128	541	14,333	15,002
New assets originated or purchased	(525)	(912)	(4,663)	(6,100)
Recovery of loans written off	-	-	(5,038)	(5,038)
Amounts written off	1	468	81,806	82,275
At December 31, 2018	**(554)**	**(1,374)**	**(18,843)**	**(20,771)**

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

	2018			
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**46,981**	**8,257**	**31,402**	**86,640**
Transfer to Stage 1	1,701	(1,687)	(14)	-
Transfer to Stage 2	(418)	467	(49)	-
Transfer to Stage 3	(687)	(578)	1,265	-
New assets originated or purchased	18,223	1	215	18,439
Loans repaid	(2,511)	(3,840)	(8,598)	(14,949)
Amounts written off	-	(60)	(14,601)	(14,661)
Foreign exchange and other movements	-	(5)	(8)	(13)
At December 31, 2018	**63,289**	**2,555**	**9,612**	**75,456**

	2018			
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	**(503)**	**(494)**	**(27,730)**	**(28,727)**
Transfer to Stage 1	(87)	77	10	-
Transfer to Stage 2	9	(43)	34	-
Transfer to Stage 3	8	38	(46)	-
Net remeasurement	90	259	6,688	7,037
New assets originated or purchased	(41)	(6)	(156)	(203)
Recovery of loans written off	-	-	(1,392)	(1,392)
Amounts written off	-	60	14,601	14,661
At December 31, 2018	**(524)**	**(109)**	**(7,991)**	**(8,624)**

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

	2018			
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**50,486**	**1,197**	**1,553**	**53,236**
Transfer to Stage 1	37	(37)	-	-
Transfer to Stage 2	(607)	710	(103)	-
Transfer to Stage 3	(376)	(207)	583	-
New assets originated or purchased	5,125	124	-	5,249
Loans repaid	(3,758)	(274)	(277)	(4,309)
Amounts written off	-	-	-	-
Foreign exchange and other movements	-	-	-	-
At December 31, 2018	**50,907**	**1,513**	**1,756**	**54,176**

	2018			
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	-	-	**(455)**	**(455)**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	(12)	12	-
Transfer to Stage 3	-	-	-	-
Net remeasurement	-	12	78	90
New assets originated or purchased	(2)	(19)	(9)	(30)
Recovery of loans written off	-	-	(18)	(18)
Amounts written off	-	-	-	-
At December 31, 2018	**(2)**	**(19)**	**(392)**	**(413)**

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

		2018		
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**8,747**	**486**	**28,435**	**37,668**
Transfer to Stage 1	3	(3)	-	-
Transfer to Stage 2	(56)	61	(5)	-
Transfer to Stage 3	(98)	(103)	201	-
New assets originated or purchased	39,748	23	12	39,783
Loans repaid	(20,241)	(305)	(3,436)	(23,982)
Amounts written off	-	(1)	(11,808)	(11,809)
Foreign exchange and other movements	-	-	(1)	(1)
At December 31, 2018	**28,103**	**158**	**13,398**	**41,659**

		2018		
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	**(442)**	**(131)**	**(26,272)**	**(26,845)**
Transfer to Stage 1	(2)	2	-	-
Transfer to Stage 2	5	(8)	3	-
Transfer to Stage 3	8	36	(44)	-
Net remeasurement	361	68	2,250	2,679
New assets originated or purchased	(782)	(3)	(9)	(794)
Recovery of loans written off	-	-	(72)	(72)
Amounts written off	-	1	11,808	11,809
At December 31, 2018	**(852)**	**(35)**	**(12,336)**	**(13,223)**

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

	2018			
Gross carrying value	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
As at January 1, 2018	**202**	**157**	**2,929**	**3,288**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	(17)	17	-
New assets originated or purchased	-	-	-	-
Loans repaid	(81)	(94)	(404)	(579)
Amounts written off	-	-	(1,570)	(1,570)
Foreign exchange and other movements	-	-	-	-
At December 31, 2018	**121**	**46**	**972**	**1,139**

	2018			
Allowance for ECL of loans to customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
At January 1, 2018	-	**(14)**	**(2,654)**	**(2,668)**
Transfer to Stage 1	-	-	-	-
Transfer to Stage 2	-	-	-	-
Transfer to Stage 3	-	-	-	-
Net remeasurement	-	14	621	635
New assets originated or purchased	-	-	-	-
Recovery of loans written off	-	-	(67)	(67)
Amounts written off	-	-	1,570	1,570
At December 31, 2018	-	-	**(530)**	**(530)**

Analysis by credit quality of loans and advances to customers outstanding as at December 31, 2018 is as follows:

	Business loans	**Cash consumer loans**	**Credit cards**	**Purchase of apartments and mortgages**	**Micro loans**	**Purchase of motor vehicles**	**Total**
Stage 1 (12-months ECL)	71,081	98,117	63,289	50,907	28,103	121	311,618
Stage 2 (lifetime ECL)	18,657	16,330	2,555	1,513	158	46	39,259
- not past due	18,089	14,109	332	975	111	20	33,636
- less than 30 days overdue	384	2,048	2,048	538	26	26	5,070
- 30 to 90 days overdue	184	173	175	-	21	-	553
Stage 3 (lifetime ECL):	65,121	25,712	9,612	1,756	13,398	972	116,571
- not past due	9,167	4,421	569	594	56	1	14,808
- less than 30 days overdue	8,291	2,373	417	190	12	-	11,283
- 30 to 90 days overdue	734	1,793	220	153	16	-	2,916
- over 90 days overdue	46,929	17,125	8,406	819	13,314	971	87,564
Total gross loans and advances to customers	**154,859**	**140,159**	**75,456**	**54,176**	**41,659**	**1,139**	**467,448**
Less: Credit loss allowance	(35,066)	(20,771)	(8,624)	(413)	(13,223)	(530)	(78,627)
Total net loans and advances to customers	**119,793**	**119,388**	**66,832**	**53,763**	**28,436**	**609**	**388,821**

Analysis by credit quality of loans outstanding as at January 1, 2018 is as follows:

	Business loans	Cash consumer loans	Credit cards	Purchase of apartments and mortgages	Micro loans	Purchase of motor vehicles	Total
Stage 1 (12-months ECL)	57,316	10,954	46,981	50,486	8,747	202	174,686
Stage 2 (lifetime ECL)	27,584	43,526	8,257	1,197	486	157	81,207
- not past due	26,711	42,554	7,553	524	409	130	77,881
- less than 30 days overdue	643	808	447	673	30	27	2,628
- 30 to 90 days overdue	230	164	257	-	47	-	698
Stage 3 (lifetime ECL):	98,702	111,445	31,402	1,553	28,435	2,929	274,466
- not past due	20,796	-	21	-	-	-	20,817
- less than 30 days overdue	523	1,902	475	-	34	28	2,962
- 30 to 90 days overdue	1,749	1,697	330	406	106	10	4,298
- over 90 days overdue	75,634	107,846	30,576	1,147	28,295	2,891	246,389
Total gross loans and advances to customers	**183,602**	**165,925**	**86,640**	**53,236**	**37,668**	**3,288**	**530,359**
Less: Credit loss allowance	(69,223)	(106,910)	(28,727)	(455)	(26,845)	(2,668)	(234,828)
Total net loans and advances to customers	**114,379**	**59,015**	**57,913**	**52,781**	**10,823**	**620**	**295,531**

Analysis by credit quality of loans outstanding 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**

Provision methodology as at December 31, 2017

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 was 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 considered in determining whether a loan was impaired were 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 and advances to customers at December 31, 2018 was as follows:

	Business loans	Cash consumer loans	Purchase of apartments and mortgages	Micro loans	Purchase of motor vehicles	Total
- real estate	33,985	346	680	264	-	35,275
- personal transport	143	21	-	-	785	949
- moveable property	154	56	-	10,860	-	11,070
- bank deposits	-	44	-	-	-	44
- other assets	135	-	-	16	-	151
Total	**34,417**	**467**	**680**	**11,140**	**785**	**47,489**

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

Fair value of collateral in respect of loans and advances to customers at December 31, 2017 was as follows:

	Business loans	Cash consumer loans	Purchase of apartments and mortgages	Micro loans	Purchase of motor vehicles	Total
- real estate	34,194	620	1,282	446	-	36,542
- personal transport	201	12	-	7	1,846	2,066
- moveable property	141	293	-	22,946	-	23,380
- bank deposits	-	35	-	-	-	35
- other assets	105	-	-	26	-	131
Total	**34,641**	**960**	**1,282**	**23,425**	**1,846**	**62,154**

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.

12. INVESTMENT SECURITIES

	December 31, 2018	December 31, 2017
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	2,087	5,877
Corporate debt securities	3,968	-
Corporate shares – unquoted	750	502
Less: Allowance for expected credit loss	(165)	-
Total investment securities	**6,640**	**6,379**

Details of corporate unquoted shares designated as FVOCI (as available for sale as at December 31, 2017) are:

Name	Nature of business	Country of registration	% of ownership	December 31, 2018	December 31, 2017
"Milli Kart" LLC	Card processing	The Republic of Azerbaijan	8.0	400	400
Azerbaijan Credit Bureau	Data processing	The Republic of Azerbaijan	12.50	250	-
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	40	42
Total investment securities				**750**	**502**

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

	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at January 1, 2018	**5,877**	-	-	**5,877**
Net change in carrying value	178	-	-	178
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Foreign exchange and other movements	-	-	-	-
As at December 31, 2018	**6,055**	-	-	**6,055**

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at January 1, 2018	**(31)**	**-**	**-**	**(31)**
Net change in ECL value	(134)	-	-	(134)
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
As at December 31, 2018	**(165)**	-	-	**(165)**

13. PREMISES, EQUIPMENT AND INTANGIBLE ASSETS

	Land and buildings	Office and computer equipment	Furniture, fixture and other equipment	Construction in progress	Leasehold improvements	Total premises and equipment	Intangible assets	Total
Net book value as at January 1, 2017	**33,791**	**2,005**	**5,590**	**491**	**3,045**	**44,922**	**6,665**	**51,587**
Additions	691	2,387	370	7	49	3,504	3,445	6,949
Disposal of subsidiary (Note 8)	(519)	(12)	(126)	-	-	(657)	(78)	(735)
Disposals	-	(218)	(406)	-	(839)	(1,463)	-	(1,463)
Accumulated depreciation of disposals	-	184	270	-	839	1,293	-	1,293
Depreciation and amortization charge from continuing operations	(463)	(632)	(791)	-	(445)	(2,331)	(1,178)	(3,509)
Depreciation and amortization charge from discontinued operations	(15)	-	(4)	-	-	(19)	(2)	(21)
Cost as at December 31, 2017	39,786	10,577	14,581	498	6,117	71,559	12,931	84,490
Accumulated depreciation/amortization as at December 31, 2017	(6,301)	(6,863)	(9,678)	-	(3,468)	(26,310)	(4,079)	(30,389)
Net book value as at December 31, 2017	**33,485**	**3,714**	**4,903**	**498**	**2,649**	**45,249**	**8,852**	**54,101**
Additions	-	2,313	2,448	2,319	229	7,309	5,275	12,584
Transfers	2,412	-	-	(2,412)	-	-	-	-
Disposals	(378)	-	(204)	-	(213)	(795)	-	(795)
Accumulated depreciation of disposals	90	-	154	-	213	457	-	457
Depreciation and amortization charge	(472)	(761)	(723)	-	(327)	(2,283)	(1,579)	(3,862)
Cost as at December 31, 2018	41,820	12,890	16,825	405	6,134	78,074	18,205	96,279
Accumulated depreciation/amortization as at December 31, 2018	(6,683)	(7,624)	(10,247)	-	(3,583)	(28,137)	(5,657)	(33,794)
Net book value as at December 31, 2018	**35,137**	**5,266**	**6,578**	**405**	**2,551**	**49,937**	**12,548**	**62,485**

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

Intangible assets include software and licenses. Additions to intangible assets during the year ended December 31, 2018 included security software, corporate internet banking software, bank accounting software modules and other licenses in the amount of AZN 5,275 thousand. (2017: 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, 2018 included in the closing balance of premises and equipment were fully depreciated assets still in use with the total initial cost of AZN 2,247 thousand (December 31, 2017: AZN 1,985 thousand).

14. OTHER FINANCIAL ASSETS

	December 31, 2018	December 31, 2017
Receivables from online payments	3,568	1,584
Receivables for credit and debit card transactions	1,945	1,519
Brokerage operations	1,907	-
Receivable from National Depository Center	-	6,000
Others	361	229
	7,781	**9,332**

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.

15. OTHER ASSETS

	December 31, 2018	December 31, 2017
Repossessed collaterals	13,912	8,550
Prepayment for equipment	2,450	3,134
Prepaid expenses	1,182	1,405
Others	1,743	1,496
	19,287	**14,585**
Less: Provision for impairment of repossessed collaterals	(1,784)	-
Total other assets	**17,503**	**14,585**

Movements in provision for impairment of repossessed collaterals during the years ended December 31, 2018 and 2017 are as follows:

	2018	2017
Balance at January 1,	-	2,122
Increase in provision for impairment losses	2,020	226
Derecognized as a result of write-off of assets	(236)	(226)
Derecognized as a result of sale of subsidiary	-	(2,479)
Increase in provision for impairment losses from discontinued operations	-	357
Balance at December 31,	**1,784**	-

As at December 31, 2018 and 2017 repossessed collaterals mainly represent immovable properties confiscated by the Group for loans and lease receivables determined to be credit impaired. During the year ended December 31, 2018 the Group recognized impairment loss on repossessed collaterals in the amount of AZN 2,020 thousand (2017: AZN 226 thousand)

16. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2018	December 31, 2017
Short-term placements of other banks and financial institutions	16,008	3,060
Correspondent accounts and overnight placement of other banks	200	226
Total due to other banks	**16,208**	**3,286**

As at December 31, 2018 short-term placements of other banks and financial institutions included several placements of one resident bank, bearing interest rates of 8-8.8% per annum with maturities from June to December 2019 (December 31, 2017: resident banks, bearing interest rate of 3-4% per annum with maturities from July to December 2018).

As at December 31, 2018 the Group has one bank (December 31, 2017: one bank) with outstanding balance exceeding 10% of total due to banks and other financial institutions. The gross value of this balance as at December 31, 2018 is AZN 16,008 thousand (December 31, 2017: AZN 3,102 thousand).

17. CUSTOMER ACCOUNTS

	December 31, 2018	December 31, 2017
Individuals		
- Term deposits	293,588	233,444
- Current/demand accounts	68,734	49,689
Other legal entities		
- Term deposits	12,473	6,125
- Current/settlement accounts	91,489	74,764
State and public organizations		
- Current/settlement accounts	865	2,004
Total customer accounts	**467,149**	**366,026**

Economic sector concentrations within customer accounts are as follows:

	December 31, 2018		December 31, 2017	
	Amount	%	Amount	%
Individuals	362,322	77.5	283,133	77.4
Trade and services	79,253	17.0	58,582	16.0
Finance	15,206	3.3	9,213	2.5
Manufacturing	3,566	0.8	3,612	1.0
Energy and mining	3,197	0.7	6,688	1.8
Agriculture	1,304	0.3	40	0.0
Communication and transport	940	0.2	200	0.1
Construction	560	0.1	3,009	0.8
Other	801	0.1	1,549	0.4
Total customer accounts	**467,149**	**100.0**	**366,026**	**100.0**

As at December 31, 2018 the Group had 46 customers (December 31, 2017: 41 customers) with balances above AZN 1,000 thousand. The aggregate balance of these customers was AZN 146,468 thousand (December 31, 2017: AZN 120,833 thousand) or 31% (December 31, 2017: 33%) of total customer accounts.

Included in customer accounts in the amount of AZN 3,891 thousand and AZN 2,742 thousand as at December 31, 2018 and 2017, respectively is accrued interest payable.

Included in customer accounts in the amount of AZN 40,287 thousand and AZN 29,769 thousand as at December 31, 2018 and 2017, respectively are deposits blocked as collateral for loans issued.

Included in customer accounts in the amount of AZN 330,056 thousand and AZN 249,018 thousand as at December 31, 2018 and 2017, respectively are deposits secured by the Azerbaijan Deposit Insurance Fund.

18. TERM BORROWINGS

	December 31, 2018	December 31, 2017
Funds borrowed from resident banks and government organizations	129,689	138,130
Funds borrowed from non-resident banks and organizations	-	5,847
Total term borrowings	**129,689**	**143,977**

As at December 31, 2018 term borrowings included AZN 62,000 thousand due to the CBAR with interest rates of 3-3.5% and maturing in April and March 2019 (2017: AZN 84,992 thousand at the CBAR refinancing rate of 3.5% per annum with maturities in August, September and October 2018).

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.

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

	2018	2017
January 1	**143,977**	**258,431**
Cash flows		
Proceeds	20,156	8,861
Repayment	(34,399)	(48,601)
Interest paid	(4,906)	(6,458)
Non-cash changes		
Interest expense	4,861	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	**129,689**	**143,977**

19. OTHER LIABILITIES

	December 31, 2018	December 31, 2017
Other financial liabilities:		
Items in course of settlement	253	202
Others	930	614
Total other financial liabilities	**1,183**	**816**
Other non-financial liabilities:		
Provision for guarantees and similar commitments	4,825	8,846
Others	920	414
Total other liabilities	**6,928**	**10,076**

An analysis of changes in ECL allowance on guarantees and similar commitments during the year ended December 31, 2018 is as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at January 1, 2018	**(225)**	-	**(8,846)**	**(9,071)**
(Charge)/recovery of expected credit losses	(403)	-	4,649	4,246
As at December 31, 2018	**(628)**	-	**(4,197)**	**(4,825)**

20. SUBORDINATED DEBT

	December 31, 2018	December 31, 2017
Subordinated debt securities issued	17,025	17,158
Subordinated debt from Deutsche Investitions-und Entwiklungsgesellschaft mbH	1,700	1,700
Total subordinated debt	**18,725**	**18,858**

On April 10, 2008 the Group 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 Group signed share subscription agreements with DEG converting debt amount into share capital in the amount of AZN 23,801 thousand.

On December 28, 2017, the Group 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 Group's subordinated debt ranks after all other creditors in case of liquidation of the Group.

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

	2018	2017
January 1,	**18,858**	**31,642**
Cash flows		
Proceeds	-	17,001
Repayment	(125)	(4,875)
Interest paid	(1,030)	(310)
Non-cash changes		
Interest expense	1022	260
Converted to share capital	-	(23,801)
Foreign exchange gain	-	(1,059)
December 31,	**18,725**	**18,858**

21. SHARE CAPITAL

	Number of outstanding ordinary shares	Ordinary shares	Share premium	Total
As at December 31, 2017	**46,208,219**	**125,686**	**484**	**126,170**
As at December 31, 2018	**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, 2018 is AZN 125,686 thousand (December 31, 2017: AZN 125,686 thousand).

The shareholders of the Bank as at December 31, 2018 and 2017 were as follows:

No	Shareholders	December 31, 2018, % (rounded up to one hundred decimal)	December 31, 2017, % (rounded up to one hundred decimal)
1	European Bank for Reconstruction and Development	44.48	18.49
2	Mr. Eldar Garibov	41.91	41.91
3	Deutsche Investitions-und Entwiklungsgesellschaft mbH	-	25.99
4	Other minor legal shareholders	7.60	7.60
5	Other minor individual shareholders	6.01	6.01

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

On July 3, 2018, the European Bank for Reconstruction and Development purchased 12,008 thousand shares in the amount of AZN 32,667 thousand from Deutsche Investitions-und Entwiklungsgesellschaft mbH while becoming the largest shareholder of the Group. However, Mr. Eldar Garibov remains to be ultimate controlling party of the Group.

As at December 31, 2018 share capital amount of the Bank did not change. 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, 2018 all ordinary shares have a nominal value of AZN 2.72 per share (December 31, 2017: AZN 2.72 per share) and rank equally. Each share carries one vote. During the year ended December 31, 2018, no dividends were declared and paid (December 31, 2017: nil).

22. INTEREST INCOME AND EXPENSE

	Year ended December 31, 2018	Year ended December 31, 2017
Interest income on financial assets recorded at amortized cost comprises:		
- Loans and advances to customers	55,628	68,485
- Due from other banks and correspondent accounts	2,172	2,330
- Investment securities	1,529	1,098
- Finance leases	15	509
Total interest income	**59,344**	**72,422**
Less: Elimination of inter-group interest income	-	(206)
Less: Amounts attributable to discontinued operations (Note 8)	-	(492)
Amount attributable to continuing operations	**59,344**	**71,724**
Interest expense on financial liabilities recorded at amortized cost comprises:		
- Term deposits of individuals	(16,014)	(18,329)
- Term borrowings, due to banks and other financial institutions	(5,331)	(7,872)
- Subordinated debt	(1,022)	(260)
- Term deposits of legal entities	(831)	(1,403)
Total interest expense	**(23,198)**	**(27,864)**
Less: Elimination of inter-group interest expense	-	206
Less: Amounts attributable to discontinued operations (Note 8)	-	1,287
Amount attributable to continuing operations	**(23,198)**	**(26,371)**
Net interest income	**36,146**	**45,353**

23. RECOVERY OF EXPECTED CREDIT LOSSES/(ALLOWANCE FOR EXPECTED CREDIT LOSS)

The table below shows the ECL (charge)/recovery on financial instruments recorded in the statement of profit or loss and other comprehensive income for the year ended December 31, 2018:

	Note	Stage 1	Stage 2	Stage 3	Total
- Due from banks and other financial institutions		(1,853)	-	1,748	(105)
- Loans and advances to customers		(1,532)	1,222	35,081	34,771
- Investment securities		(134)	-	-	(134)
Credit loss allowance (charge)/recovery on financial assets		**(3,519)**	**1,222**	**36,829**	**34,532**
- Unused credit lines and guarantees		(403)	-	4,649	4,246
Total credit loss allowance (charge)/recovery		**(3,922)**	**1,222**	**41,478**	**38,778**

Recovery of impairment losses/(impairment losses) for the year ended December 31, 2017 were as follows:

	Note	Year ended December 31, 2017
Interest bearing assets		
- Due from other banks	8, 10	(29,057)
- Loans and advances to customers	11	41,603
		12,546
Less: Amounts attributable to discontinued operations	8	(347)
Less: Amounts included in gain from sales of discontinued operations	**8**	29,057
Amount attributable to continuing operations		**41,256**
Non-interest bearing assets		
- Other assets	15	(583)
		(583)
Less: Amounts attributable to discontinued operations	8	357
Amount attributable to continuing operations		**(226)**
Total impairment losses		**41,030**

24. FEE AND COMMISSION INCOME AND EXPENSE

	Year ended December 31, 2018	Year ended December 31, 2017
Fee and commission income:		
Plastic cards operations	6,729	4,937
Settlement transactions	2,477	2,981
Cash transactions	1,668	1,149
Brokerage operations	876	1,205
Guarantees and letters of credit issued	141	81
Others	1,222	714
Total fee and commission income	**13,113**	**11,067**
Less: Amounts attributable to discontinued operations (Note 8)	-	(168)
Amount attributable to continuing operations	**13,113**	**10,899**
Fee and commission expense:		
Plastic cards operations	5,424	4,366
Cash transactions	943	367
Settlement transactions	513	529
Centralized credit registry	393	78
Guarantees and letters of credit	25	79
Brokerage operations	-	139
Others	154	692
Total fee and commission expense	**7,452**	**6,250**
Less: Amounts attributable to discontinued operations (Note 8)	-	(129)
Amount attributable to continuing operations	**7,452**	**6,121**
Net fee and commission income	**5,661**	**4,778**

25. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	Year ended December 31, 2018	Year ended December 31, 2017
Staff costs	31,998	24,065
Professional fees	3,421	2,037
Rent expenses	2,331	2,270
Depreciation expenses	2,283	2,350
Amortization expenses	1,579	1,180
Communication expenses	1,319	1,324
Insurance of customer deposits	1,318	1,250
Computer software costs	1,210	1,764
Utility expenses	1,127	857
Repair and maintenance expenses	1,055	1,039
Advertising expenses	1,022	737
Security expenses	976	968
Representation expenses	817	776
Taxes other than income tax	576	503
Payments to the Financial Markets Supervisory Authority	565	366
Other insurance expenses	463	521
Publishing and stationary	234	204
Other expenses	1,015	899
Total administrative and other operating expenses	**53,309**	**43,110**
Less: Amounts attributable to discontinued operations (Note 8)	-	(70)
Amount attributable to continuing operations	**53,309**	**43,040**

Included in staff costs for the year ended December 31, 2018 are obligatory payments to the State Social Protection Fund of the Republic of Azerbaijan in the amount of AZN 4,911 thousand (2017: AZN 3,751 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.

26. INCOME TAXES

(a) Components of income tax benefit

Income tax expense comprises the following:

	Year ended December 31, 2018	Year ended December 31, 2017
From continuing operations:		
Current income tax	(82)	(141)
Income tax expense for the year	**(82)**	**(141)**

(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, 2018	Year ended December 31, 2017
Profit before income tax	**30,945**	**46,414**
Theoretical tax benefit at statutory rate (20%)	(6,189)	(9,283)
Non-deductible expenses	(308)	(209)
Current income tax withheld at source for dividends received	(13)	(35)
Change in unrecognized deferred income tax asset	6,428	9,386
Income tax expense for the year	**(82)**	**(141)**

(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%.

Tax effect of deductible/(taxable) temporary differences	December 31, 2017	Impact of adopting IFRS 9 as at January 1, 2018	January 1, 2018	Charged to profit or loss	December 31, 2018
Customer accounts	331	-	331	117	448
Other liabilities	1,769	45	1,814	(843)	971
Due from other banks	5,811	326	6,137	-	6,137
Loan loss provision	(5,191)	4,686	(505)	(6,279)	(6,784)
Depreciation and amortization	(801)	-	(801)	(402)	(1,203)
Other assets	(712)	-	(712)	239	(473)
Other temporary differences	-	6	6	1,540	1,546
Tax loss carried forward	23,670	-	23,670	(800)	22,870
Deferred income tax asset before valuation allowance	24,877	5,063	29,940	(6,428)	23,512
Deferred tax asset not recognized	(17,099)	(5,063)	(22,162)	6,428	(15,734)
Net deferred income tax asset	**7,778**	**-**	**7,778**	**-**	**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.

	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 income tax asset	38,772	(13,895)	24,877
Deferred income tax asset not recognized	(32,360)	15,261	(17,099)
Net deferred income tax asset	**6,412**	**1,366**	**7,778**

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, 2018	December 31, 2017
Deferred income tax asset	7,778	7,778
Total net deferred income tax asset	**7,778**	**7,778**

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

	December 31, 2018	December 31, 2017
Closing balance as at December 31,	(17,099)	(32,360)
Impact of adopting IFRS 9 as at January 1, 2018	(5,063)	-
Opening balance as at January 1, 2018	(22,162)	(32,360)
Charged to profit or loss	6,428	9,386
Eliminated on disposal of subsidiary	-	13,616
Valuation allowance included in gain from disposal of subsidiary	-	(7,741)
Total deferred income tax asset not recognized	**(15,734)**	**(17,099)**

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, 2018	Year ended December 31, 2017
Profit/(loss) for the year attributable to ordinary shareholders		30,863	46,139
Weighted average number of ordinary shares in issue (thousands)	21	46,208	31,703
Basic and diluted loss per ordinary share (expressed in AZN per share)		**0.67**	**1.46**
From continuing operations		0.67	1.41
From discontinued operations		-	0.05

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.

(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, 2018 and 2017 is set out below:

	Retail banking	Corporate banking	Leasing (discontinued operations)	Eliminations	Total Group
Year ended December 31, 2018					
Interest income	51,305	8,016	-	23	59,344
Fee and commission income	8,219	4,548	-	346	13,113
Total revenues	59,524	12,564	-	369	72,457
Interest expense	(15,671)	(7,504)	-	(23)	(23,198)
Fee and commission expense	(4,924)	(2,182)	-	(346)	(7,452)
Impairment loss on repossessed collateral	-	(2,020)	-	-	(2,020)
Recovery of expected credit loss	10,884	23,648	-	-	34,532
Recovery of expected credit losses for credit related commitments	-	4,246	-	-	4,246
Foreign exchange translation gains less losses	(262)	(130)	-	-	(392)
Administrative and other operating expenses	(38,070)	(11,372)	-	-	(49,442)
Segment results	**11,481**	**17,250**	**-**	**-**	**28,731**
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**

Total reportable segment assets and liabilities as at December 31, 2018 and 2017 are presented in the following table:

	Retail banking	Corporate banking	Leasing (discontinued operations)	Eliminations	Total Group as at December 31, 2018
Total reportable segment assets	400,561	198,440	-	180	599,181
Total reportable segment liabilities	(421,621)	(208,873)	-	(1,277)	(631,771)
Capital expenditure paid	7,958	3,942	-	-	11,900

	Retail banking	Corporate banking	Leasing	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)	(194,326)	-	785	(532,147)
Capital expenditure paid	6,341	3,639	-	-	9,980

(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:

	2018	2017
Adjusted profit before income tax for reportable segments	**28,731**	**40,427**
Gains less losses from trading in foreign currencies	5,062	7,675
Other operating income, net	1,019	1,920
Depreciation of premises and equipment	(2,283)	(2,350)
Amortization of intangible assets	(1,579)	(1,180)
Penalties for unpaid taxes for prior years	(5)	(78)
Profit before income tax	**30,945**	**46,414**

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.
- The Group does not allocate recovery of expected credit losses for credit related commitments.

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

	December 31, 2018	December 31, 2017
Total reportable segment assets	**599,181**	**506,913**
Deferred income tax asset	7,778	7,778
Premises, equipment and intangible assets	62,485	54,101
Other financial assets	7,781	9,332
Other assets	17,503	14,585
Total consolidated assets	**694,728**	**592,709**

The adjustments are attributable to the following:

- 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.

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

	December 31, 2018	December 31, 2017
Total reportable segment liabilities	**631,771**	**532,147**
Other financial liabilities	1,183	816
Other non-financial liabilities	5,745	9,260
Total consolidated liabilities	**638,699**	**542,223**

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 (“RMC”), the Audit Committee (“AC”), the Internal Audit Department and the Credit Committee.

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, 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.

RMC 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. RMC'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. RMC 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 RMC, 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.

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, 2018 and 2017 the breakdown of the loan portfolio by economic and product sectors is provided in Note 11.

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.

Consumer lending is built based on the scoring model. The model is empirical, which is created according to the statistic information. The model consists of 7 score groups, where the first level is the lowest value of PD, and the last level is the highest one. Depending on the level, the credit amount and the interest rates are provided for the consumer lending.

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.

Expected credit loss (ECL) measurement – definitions

ECL is a probability-weighted estimate of the present value of future cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of default occurring in a given time period used as weights). An ECL measurement is unbiased and determined by evaluating a range of possible outcomes.

Discount Rate – a tool to discount an expected loss to the present value at the reporting date. The discount rate represents the effective interest rate (EIR) for the financial instrument or an approximation thereof.

Lifetime period – the maximum period over which ECL should be measured. For loans with fixed maturity, the lifetime period is equal to the remaining contractual period. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit. For credit cards issued to individuals, it is the period that is based on internal statistics, and it is equal to 3 years.

Lifetime ECL – losses that result from all possible default events over the remaining lifetime period of the financial instrument.

12-month ECL – the portion of lifetime ECLs that represent the ECLs resulting from default events on a financial instrument that are possible within 12 months after the reporting date that are limited by the remaining contractual life of the financial instrument.

Forward looking information – the information that includes the key macroeconomic variables impacting credit risk and expected credit losses for each portfolio segment. A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.

Credit Conversion Factor (CCF) – a coefficient that shows that the probability of conversion of an off-balance sheet amounts to exposure on the balance within a defined period. It can be calculated for a 12-month or lifetime period. Based on the analysis performed, the Group considers that 12-month and lifetime CCFs are the same.

Purchased or originated credit impaired (POCI) financial assets – financial assets that are credit-impaired upon initial recognition.

Low credit risk financial assets – assets that have an investment grade defined by external rating agencies or corresponding internal rating, debt instruments issued by Azerbaijan Republic and nominated in AZN, loans to companies owned by Azerbaijan Republic and nominated in AZN. The presumption, being that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has not been rebutted.

Default and credit-impaired asset – a loan is in default, meaning fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- the borrower is more than 90 days past due on its contractual payments;
- the loan is restructured less than 6 months ago and is 31-90 days past due on its contractual payments;
- the borrower has the external rating below Caa2;
- the Group consider to sell the borrower's debt with significant losses (more than 5% of the debt principal balance and accrued interest);
- other information available on borrower bankruptcy or default.

The Credit Committee decides on recognition of the borrower as credit-impaired one based on the unlikeliness-to-pay criteria listed below:

- the borrower is insolvent;
- it is becoming likely that the borrower will enter bankruptcy;
- Other criteria reflecting difficulties with successful fulfilling of obligations by the borrower.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months.

Significant increase in credit risk (SICR) – the SICR assessment is performed on an individual basis and on a portfolio basis. For loans issued to legal entities and individuals, interbank loans and debt securities accounted for at AC or at FVOCI, SICR is assessed on an individual basis by monitoring the triggers stated below. The criteria used to identify a SICR are monitored and reviewed periodically for appropriateness by the Group's Risk Management Committee.

The Group considers a financial instrument to have experienced a SICR when one or more of the following quantitative, qualitative or backstop criteria have been met.

For loans issued to legal entities and bonds issued by the legal entities, interbank operations and bonds issued by the banks:

- 31-90 days past due;
- Restructured and 6-30 days past due;
- Monitoring suggests borrower has financial difficulties.

For loans to Individuals:

- 31-60 days past due;
- Restructured and 6-30 days past due;

If there is evidence that the SICR criteria are no longer met and this has lasted at least 6 month, the instrument will be transferred back to Stage 1. If an exposure has been transferred to Stage 2 Based on a qualitative indicator, the Group monitors whether that indicator continues to exist or has changed.

ECL measurement – description of estimation techniques

General principle

For non-POCI financial assets, ECLs are generally measured based on the risk of default over one of two different time periods, depending on whether the credit risk of the borrower has increased significantly since initial recognition. This approach can be summarized in a three-stage model for ECL measurement:

Stage 1: a financial instrument that is not credit-impaired on initial recognition and its credit risk has not increased significantly since initial recognition; loss allowance is based on 12-month ECLs.
Stage 2: if a SICR since initial recognition is identified, the financial instrument is moved to Stage 2 but not yet deemed to be credit-impaired; loss allowance is based on lifetime ECLs.
Stage 3: if the financial instrument is credit-impaired, the financial instrument is then moved to Stage 3 and loss allowance is based on lifetime ECLs.

ECL for POCI financial assets is always measured on a lifetime basis (Stage 3), so at the reporting date, the Bank only recognizes the cumulative changes in lifetime expected credit losses.

The Group can carry out three separate approaches for ECL measurement:

- assessment on an individual basis;
- assessment on a portfolio basis;
- assessment based on external ratings.

The Group performs an assessment on an individual basis for the following types of loans issued to legal entities: loans with unique credit risk characteristics, individually significant loans and credit-impaired loans.

The Group performs an assessment on a portfolio basis for the following types of assets: loans and credit-related commitments issued to legal entities (standard lending, specialized lending, loans to leasing companies, etc.), interbank loans, retail loans and loans issued to SMEs. This approach incorporates aggregating the portfolio into homogeneous segments based on borrower-specific information.

The Group performs assessments on external ratings for the following types of loans: interbank loans, debt securities issued by the banks, legal entities and sovereigns, loans issued to sovereigns.

Principles of assessment on individual basis – ECL assessments on an individual basis are done by weighting the estimates of credit losses for different possible outcomes against the probabilities of each outcome. The Group defines at least two possible outcomes for each loan, one of which leads to credit loss in spite of the probability of such a scenario. Individual assessment is mainly based on the expert judgement of the Problem Loans Collection Department. Expert judgements are regularly tested in order to decrease the difference between estimates and actual losses.

Principles of assessment on portfolio basis – to assess the staging of exposure and to measure a loss allowance on a collective basis, the Group combines its exposures into segments on the basis of shared credit risk characteristics, such as that exposures to risk within a group are homogeneous.

Examples of shared characteristics include: type of customer (such as income producing real estate or leasing companies), product type (such as credit cards or cash loans), credit risk rating and date of initial recognition.

The different segments reflect differences in credit risk parameters such as PD and LGD. The appropriateness of groupings is monitored and reviewed on a periodic basis by the Risk Management Committee.

In general, ECL is the multiplication of the following credit risk parameters: EAD, PD and LGD (definitions of the parameters are provided above). The general approach used for ECL calculation is stated below. It could be applied for products assessed on a portfolio basis and for products for which the bank has credit risk ratings assessment based on borrower-specific information.

The ECL is determined by predicting credit risk parameters (EAD, PD and LGD) for the next 12 months or instrument lifetime. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has been repaid or defaulted in an earlier period).

The brief principles of calculating the credit risk parameters are as following.

The EADs are determined based on the expected payment profile, which varies by product type:

- for amortizing products and bullet repayment loans, EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis.
- for revolving products, the EAD is predicted by taking the current drawn balance and adding a credit conversion factor that accounts for the expected drawdown of the remaining limit by the time of default.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD:

- 12-month PDs – the estimated probability of a default occurring within the next 12 months (or over the remaining life of the financial instrument if less than 12 months). This parameter is used to calculate 12- month ECLs. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for forward-looking information when appropriate.
- Lifetime PDs – the estimated probability of a default occurring over the remaining life of the financial instrument. This parameter is used to calculate lifetime ECLs for Stage 2 exposures. An assessment of a Lifetime PD is based on the latest available historic default data and adjusted for forward looking information when appropriate.

To calculate Lifetime PD, the Group uses different statistical approaches depending on the segment and product type, such as the extrapolation of 12-month PDs based on migration matrixes and developing lifetime PD curves based on the historical default data. For lifetime PD calculations, the Group uses historical default data and the extrapolation of trends for longer periods during which default data was not available.

LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by the product, overdue days and the availability of collateral or other credit support.

The 12-month and lifetime LGDs are determined based on the factors that impact the expected recoveries after a default event.

The approach to LGD measurement can be divided into three possible approaches:

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

For loans secured by real estate the Bank calculates LGD based on specific characteristics of the collateral, such as projected collateral values, historical discounts on sales and other factors.

For particular segments of the corporate, retail, interbank loan portfolio and corporate bonds LGD is calculated on a collective basis based on the latest available recovery statistics.

ECL measurement for off-balance sheet financial instruments

CCF for undrawn credit lines of legal entities, credit cards issued to individuals and financial guarantees is defined based on statistical analysis of exposure at default.

CCF for overdrafts is defined as 100% since the limits can be used by the clients at any time.

Principles of assessment based on external ratings – the principles of ECL calculations based on external ratings are the same as for their assessment on a portfolio basis. Since the clients have defined the external credit rating, credit risk parameters (PD) could be taken from the default and recovery statistics published by international rating agencies.

Forward-looking information incorporated in the ECL models. The assessment of the SICR and the calculation of ECLs both incorporate forward-looking information. The Group has performed historical analyses and identified the key economic variables impacting credit risk and ECLs for each portfolio.

These economic variables and their associated impact on the PD vary by financial instrument. These economic variables, such as consumer price index changes, nominal and real GDP growth, nominal and real effective exchange rates, USD exchange rate changes, changes in the budget expenditures have been tested by performing statistical regression analysis to understand the impact of changes in these variables has historically had on default rates.

Based on them the Group's Risk Management Committee makes the forecast of future macroeconomic conditions, which is considered by the management of the Group to define the next coming stage of economic cycle using not only statistical approach but also expert judgement of the management.

The assessment of SICR is performed using the Lifetime PD for retail borrowers and 12-month PD for other financial assets, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether a 12-month or lifetime ECL should be recorded. Following this assessment, the Bank measures ECL as either a probability-weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running the relevant ECL model.

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

Validation

The Group regularly reviews its methodology and assumptions to reduce any difference between the estimates and the actual loss of credit. Such validation is performed at least once a year. The results of validation the ECL measurement methodology are communicated to the Group management and further steps for tuning models and assumptions are defined after discussions between authorized persons.

Assessment of loss allowance for credit related commitments

Assessment of loss allowance for credit related commitments is performed on a similar basis with balance sheet exposures by application of credit conversion factor (CCF) if the counterparty has current balance sheet exposure. Statistical information and Basel Committee values are used for calculation of CCF. If the counterparty does not have balance sheet exposure the assessment of expected credit loss allowance is performed on an individual or collective basis depending on the amount of exposure by applying CCF.

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

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, 2018 and December 31, 2017 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. 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.

In its IFRS reporting, the Group utilizes the methodology which complies with IFRS 9.

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-off 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.

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 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, 2018			December 31, 2017		
	Monetary assets	Monetary liabilities	Net position	Monetary assets	Monetary liabilities	Net position
AZN	371,175	398,521	(27,346)	261,624	280,561	(18,937)
USD	203,607	207,024	(3,417)	238,921	244,696	(5,775)
EUR	29,947	31,442	(1,495)	12,903	16,054	(3,151)
Other	2,234	792	1,442	2,797	498	2,299
Total	**606,963**	**637,779**	**(30,816)**	**516,245**	**541,809**	**(25,564)**

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, 2018	December 31, 2017
US Dollars strengthening by 50% (2017: 50%)	(1,709)	(2,888)
US Dollars weakening by 50% (2017: 50%)	1,709	2,888
Euro strengthening by 50% (2017: 50%)	(748)	(1,576)
Euro weakening by 50% (2017: 50%)	748	1,576
Other currency strengthening by 50% (2017: 50%)	721	1,150
Other currency weakening by 50% (2017: 50%)	(721)	(1,150)

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 2018	Average exposure during 2017
US Dollars strengthening by 50% (2017: 50%)	(2,298)	(23,543)
US Dollars weakening by 50% (2017: 50%)	2,298	23,543
Euro strengthening by 50% (2017: 50%)	(1,250)	(493)
Euro weakening by 50% (2017: 50%)	1,250	493
Other currency strengthening by 50% (2017: 50%)	935	294
Other currency weakening by 50% (2017: 50%)	(935)	(294)

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, 2018						
ASSETS						
Cash and cash equivalents	9,914	-	-	-	100,074	109,988
Mandatory cash balances with the CBAR	-	-	-	-	3,128	3,128
Due from other banks	-	6,469	13,975	14,558	55,603	90,605
Loans and advances to customers	8,194	51,623	69,085	236,097	23,822	388,821
Investment securities	5,890	-	-	-	750	6,640
Other financial assets	-	-	-	-	7,781	7,781
Total financial assets	**23,998**	**58,092**	**83,060**	**250,655**	**191,158**	**606,963**
LIABILITIES						
Due to banks and other financial institutions	-	6,000	10,000	-	208	16,208
Customer accounts	16,751	129,951	122,957	32,511	164,979	467,149
Term borrowings	435	64,562	5,317	59,154	221	129,689
Subordinated debt	-	-	-	18,700	25	18,725
Other financial liabilities	-	-	-	-	1,183	1,183
Total financial liabilities:	**17,186**	**200,513**	**138,274**	**110,365**	**166,616**	**632,954**
Net liquidity gap:	**6,812**	**(142,421)**	**(55,214)**	**140,290**	**24,542**	**(25,991)**

	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	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**
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
Subordinated debt	-	125	-	18,702	31	18,858
Other financial liabilities	-	-	-	-	816	816
Total financial liabilities:	**56,841**	**116,438**	**145,277**	**83,870**	**130,537**	**532,963**
Net liquidity gap:	**(37,625)**	**(63,896)**	**(81,672)**	**120,234**	**46,241**	**(16,718)**

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%. The Risk Management Department constantly monitors the maintenance of this margin. RMC 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.

RMC 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, 2018 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 540 thousand (December 31, 2017: AZN 497 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 540 thousand (December 31, 2017: AZN 497 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, 2018				December 31, 2017			
	USD	**AZN**	**EUR**	**Other**	**USD**	**AZN**	**EUR**	**Other**
Assets								
Cash and cash equivalents	0.3	1.47	-	-	0.6	1.23	-	-
Due from other banks	1.65	-	-	-	3.5	-	-	-
Loans and advances to customers	11.6	20.3	5.5	27.1	15.6	19.2	9.3	16.9
Investment securities	-	10.35	-	-	-	9.0	-	-
Liabilities								
Due to other banks and financial institutions	-	8.5	-	-	3.3	-	-	-
Customer accounts	2.3	11.1	0.6	-	3.6	13.0	0.8	-
Debt securities in issue	-	-	-	-	-	-	-	-
Term borrowings	-	3.6	-	-	8.1	2.6	-	-
Subordinated debt	5.5	-	-	-	5.9	14.0	-	-

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

Geographical risk concentrations

The geographical concentration of the Group's financial assets and liabilities at December 31, 2018 is set out below:

	The Republic of Azerbaijan	OECD countries	Other non-OECD countries	Total
FINANCIAL ASSETS:				
Cash and cash equivalents	75,845	10,602	23,541	109,988
Mandatory cash balances with the CBAR	3,128	-	-	3,128
Due from other banks	90,605	-	-	90,605
Loans and advances to customers	388,821	-	-	388,821
Investment securities	6,640	-	-	6,640
Other financial assets	7,781	-	-	7,781
TOTAL FINANCIAL ASSETS	**572,820**	**10,602**	**23,541**	**606,963**
FINANCIAL LIABILITIES:				
Due to banks and other financial institutions	16,208	-	-	16,208
Customer accounts	448,642	2,241	16,266	467,149
Term borrowings	129,689	-	-	129,689
Subordinated debt	7,151	11,574	-	18,725
Other financial liabilities	1,183	-	-	1,183
TOTAL FINANCIAL LIABILITIES	**602,873**	**13,815**	**16,266**	**632,954**
NET POSITION	**(30,053)**	**(3,213)**	**7,275**	**(25,991)**
CREDIT RELATED COMMITMENTS	**78,048**	-	-	**78,048**

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.

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	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
Subordinated debt	7,294	11,564	-	18,858
Other financial liabilities	816	-	-	816
TOTAL FINANCIAL LIABILITIES	**493,863**	**23,635**	**15,465**	**532,963**
NET POSITION	**(5,306)**	**2,934**	**(14,346)**	**(16,718)**
CREDIT RELATED COMMITMENTS	**57,218**	**-**	**-**	**57,218**

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. As of December 31, 2018 the Bank was in compliance with these covenants.

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;

- 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.

RMC 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, 2018 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, 2018 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	109,988	-	-	-	-	-	109,988
Mandatory cash balances with the CBAR	-	-	-	-	-	3,128	3,128
Due from other banks	90	58,362	14,466	21,027	-	221	94,166
Loans and advances to customers	37,704	78,098	94,030	205,240	96,150	-	511,222
Investment securities	6,054	-	-	-	-	750	6,804
Other financial assets	7,781	-	-	-	-	-	7,781
Total financial assets	**161,617**	**136,460**	**108,496**	**226,267**	**96,150**	**4,099**	**733,089**

	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	(321)	(6,568)	(10,433)	-	-	-	(17,322)
Customer accounts	(180,361)	(139,696)	(129,787)	(37,000)	-	-	(486,844)
Term borrowings	(845)	(66,235)	(6,536)	(18,006)	(63,707)	-	(155,329)
Subordinated debt	-	(510)	(535)	(22,800)	-	-	(23,845)
Other financial liabilities	(1,183)	-	-	-	-	-	(1,183)
Total financial liabilities	**(182,710)**	**(213,009)**	**(147,291)**	**(77,806)**	**(63,707)**	**-**	**(684,523)**
Net liquidity gap on recognized financial assets and liabilities	**(21,093)**	**(76,549)**	**(38,795)**	**148,461**	**32,443**	**4,099**	**48,566**
Cumulative liquidity gap on recognized financial assets and liabilities	**(21,093)**	**(97,642)**	**(136,437)**	**12,024**	**44,467**	**48,566**	
Credit related commitments	**(78,048)**	**-**	**-**	**-**	**-**	**-**	**(78,048)**

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	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**

	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)
Subordinated debt	-	(694)	(516)	(5,780)	(18,021)	-	(25,011)
Other financial liabilities	(816)	-	-	-	-	-	(816)
Total financial liabilities	**(186,567)**	**(125,567)**	**(150,006)**	**(34,168)**	**(77,418)**	**-**	**(573,726)**
Net liquidity gap on recognized financial assets and liabilities	**(60,854)**	**(33,223)**	**(6,723)**	**146,094**	**22,864**	**9,257**	**77,415**
Cumulative liquidity gap on recognized financial assets and liabilities	**(60,854)**	**(94,077)**	**(100,800)**	**45,294**	**68,158**	**77,415**	
Credit related commitments	**(57,218)**	-	-	-	-	-	**(57,218)**

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, 2018:

	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	109,988	-	-	-	-	109,988
Mandatory cash balances with the CBAR	-	-	-	-	3,128	3,128
Due from other banks	52	56,836	13,975	19,522	220	90,605
Loans and advances to customers	31,892	51,623	69,085	236,221	-	388,821
Investment securities	5,890	-	-	-	750	6,640
Other financial assets	7,781	-	-	-	-	7,781
Total financial assets	**155,603**	**108,459**	**83,060**	**255,743**	**4,098**	**606,963**
Liabilities						
Due to banks and other financial institutions	208	6,000	10,000	-	-	16,208
Customer accounts	1,140	1,858	6,073	458,078	-	467,149
Term borrowings	656	64,562	5,317	59,154	-	129,689
Subordinated debt	25	-	-	18,700	-	18,725
Other financial liabilities	1,183	-	-	-	-	1,183
Total financial liabilities	**3,212**	**72,420**	**21,390**	**535,932**	**-**	**632,954**
Net liquidity gap December 31, 2018	**152,391**	**36,039**	**61,670**	**(280,189)**	**4,098**	**(25,991)**
Cumulative liquidity gap December 31, 2018	**152,391**	**188,430**	**250,100**	**(30,089)**	**(25,991)**	

The table presents an analysis of liquidity position of the Group's financial assets and liabilities 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	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
Subordinated debt	31	125	-	18,702	-	18,858
Other financial liabilities	816	-	-	-	-	816
Total financial liabilities	**56,085**	**35,623**	**79,153**	**362,102**	**-**	**532,963**
Net liquidity gap December 31, 2017	**63,702**	**16,920**	**51,459**	**(152,816)**	**4,017**	**(16,718)**
Cumulative liquidity gap December 31, 2017	**63,702**	**80,622**	**132,081**	**(20,735)**	**(16,718)**	

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.

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.

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, 2018	**January 1, 2018**	**December 31, 2017**
Cancellable undrawn credit lines	70,186	54,796	54,796
Letters of guarantee and similar commitments	12,687	11,268	11,268
Less: Expected credit losses for credit related commitments	(4,825)	(9,071)	(8,846)
Total credit related commitments	**78,048**	**56,993**	**57,218**

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, 2018	**December 31, 2017**
Azerbaijani Manats	63,740	35,240
US Dollars	13,440	19,247
Euro	868	2,731
Other	-	-
Total	**78,048**	**57,218**

Liquidity and currency analysis of contingencies and commitments are disclosed in Note 29. Information on related party balances is disclosed in Note 32.

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 December 31, 2018 and 2017, 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 consolidated statement of financial position:

	December 31, 2018	December 31, 2017
Investment securities at level 1	2,086	5,877
Investment securities at level 3	4,554	502
	6,640	**6,379**

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, 2018		December 31, 2017	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	109,988	109,988	83,343	83,343
Mandatory cash balances with the CBAR	3,128	3,128	2,914	2,914
Due from other banks	90,605	90,605	94,826	94,826
Loans and advances to customers	388,821	388,821	319,451	319,451
Other financial assets	7,781	7,781	9,332	9,332
Total financial assets:	**600,323**	**600,323**	**509,866**	**509,866**
Due to other banks and financial institutions	16,208	16,208	3,286	3,286
Customer accounts	467,149	467,149	366,026	366,026
Term borrowings	129,689	129,689	143,977	143,977
Subordinated debt	18,725	18,725	18,858	18,858
Other financial liabilities	1,183	1,183	816	816
Total financial liabilities:	**632,954**	**632,954**	**532,963**	**532,963**

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.

As at December 31, 2018 and 2017, the outstanding balances with related parties were as follows:

	December 31, 2018				December 31, 2017			
	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: 2018: 8% - 28% p.a.; 2017: 14% - 26% p.a.)	343	146	-	-	580	258	-	-
Allowance for expected credit losses	(3)	(5)	-	-	(11)	(4)	-	-
Investment securities	-	-	-	400	-	-	-	400
Current/settlements accounts	49	223	-	177	131	73	-	541
Term deposits (contractual interest rate: 2018: 1.5% - 12% p.a.; 2017: 2.4%-15.5% p.a.)	113	-	-	8,429	1,476	-	-	2,890
Debt securities in issue (contractual interest rate: 2018: 0% - 0% p.a.; 2017: 0% p.a.)	-	-	-	-	-	-	-	-
Term borrowings (contractual interest rate: 2018: 0% - 0% p.a.; 2017: 0% p.a.)	-	-	-	-	-	-	-	-
Subordinated debt (contractual interest rate: 2018: 6% p.a.; 2017: 5% - 6% p.a.)	-	-	9,875	-	-	-	11,564	-
Preference shares	-	-	-	-	-	-	-	-

As at December 31, 2018 and 2017 fair value of collaterals pledged in respect to loans issued to key management personnel amounted to AZN 268 thousand and AZN 929 thousand, respectively.

The income and expense items with related parties for the years ended December 31, 2018 and 2017 were as follows:

	Year ended December 31, 2018				Year ended December 31, 2017			
	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties	Key management personnel	Ultimate controlling party	Other shareholders	Other related parties
Interest income	30	57	-	-	66	185	-	-
Interest expense	(16)	-	(605)	(658)	(122)	(130)	(77)	(131)
Provision for/(recovery of) expected credit loss	8	(1)	-	-	(3)	26	-	-
Fee and commission income	4	20	-	55	15	10	-	29
Other income	-	-	-	13	-	-	54	-
Administrative and other operating expense	2,402	404	-	462	2,315	253	-	-

During the year ended December 31, 2018, the remuneration of key management personnel comprised salaries and bonuses totaling to AZN 2,806 thousand (December 31, 2017: AZN 2,568 thousand).

Other rights and obligations with related parties were as follows:

	December 31, 2018				December 31, 2017			
	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	-	-	-	19	-	-	-	-

33. EVENTS AFTER THE REPORTING PERIOD

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

In addition, according to the Decree the CBAR will provide loans to the banks with 0.1% interest rate and for 5 years under the state guarantee totaling to AZN 682 million in order to restructure loans to individuals with overdue days more than 360 as at the date of the Decree and issued starting January 1, 2012 till the date of the Decree with exposure of up to USD 10 thousand or AZN 17 thousand.

In order to prevent deterioration of the currency position of banks as a result of the Decree execution, the CBAR will provide banks with securities totaling to USD 215 million with annual interest rate of 0.5% upon the request of the banks.

The Group expects improvement of quality of its non-performing loan portfolio as a result of the Decree. The minimum effect of recovery has expected to be around AZN 36,500 thousand.