

OJSC International Bank of Azerbaijan

Interim condensed consolidated financial statements

30 June 2019

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Report on review of interim financial information

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Report on Review of Interim Financial Information

To the Shareholders and Board of Directors of OJSC International Bank of Azerbaijan

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of OJSC International Bank of Azerbaijan and its subsidiaries (the "Group"), which comprise the interim consolidated statement of financial position as at 30 June 2019 and the related interim consolidated statements of profit or loss and comprehensive income, changes in equity and cash flows for the six-month period then ended, and selected explanatory notes (interim financial information). Management is responsible for the preparation and presentation of this interim financial information in accordance with IAS 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Other matter

The interim condensed consolidated financial statements as of 30 June 2018 and for the six-month period then ended were not reviewed.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with IAS 34, *Interim Financial Reporting*.

Ernst & Young Holdings (CIS) B.V.

Baku, Azerbaijan

14 October 2019

Interim consolidated statement of financial position**As at 30 June 2019***(Figures in tables are in thousands of Azerbaijani manats)*

	Notes	30 June 2019 (unaudited)	31 December 2018
Assets			
Cash and cash equivalents	5	2,204,813	1,810,173
Mandatory cash balances with the Central Banks		54,567	54,702
Due from banks and other financial institutions	6	2,990,142	3,249,773
Investment securities	8	140,075	90,845
Loans to customers	7	1,760,785	1,674,153
Receivables from CJSC "Agrarkredit"	2	1,175,103	1,150,401
Current income tax assets		-	2,102
Deferred income tax assets		900	900
Property, equipment and intangible assets		197,617	200,731
Other assets	9	49,035	40,463
Total assets		8,573,037	8,274,243
Liabilities			
Due to banks and other financial institutions	13	39,301	45,260
Customer accounts	14	4,490,069	4,364,649
Payables to CJSC "Agrarkredit"	2	365,261	364,596
Other borrowed funds	16	105,075	106,630
Debt securities issued	15	1,508,920	1,490,698
Current income tax liabilities		43,879	1,836
Deferred income tax liabilities		81,785	85,255
Other liabilities	9	138,348	172,130
Total liabilities		6,772,638	6,631,054
Equity			
Share capital	17	1,241,287	1,241,287
Additional paid-in capital		1,909,116	1,909,116
Foreign currency translation reserve		3,055	(12,846)
Revaluation reserve for premises		37,923	36,878
Unrealized gain on investment securities		52,785	38,419
Accumulated deficit		(1,443,767)	(1,569,665)
Total equity attributable to shareholders of the Bank		1,800,399	1,643,189
Total liabilities and equity		8,573,037	8,274,243

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

Mr. Abbas Ibrahimov
Chairman of the Management Board

Baku, Azerbaijan

14 October 2019



Mr. Nabi Aliyev
Deputy Chairman of the Management Board, CFO

The accompanying selected explanatory notes on pages 5 to 27 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of profit or loss and other comprehensive income**For the six months ended 30 June 2019***(Figures in tables are in thousands of Azerbaijani manats)*

		<i>For the six months ended 30 June (unaudited)</i>	<i>For the six months ended 30 June (unaudited, not reviewed)</i>
	<i>Notes</i>	<i>2019</i>	<i>2018</i>
Interest income calculated using effective interest rate			
Loans to customers		110,639	108,182
Due from banks and other financial institutions		76,084	87,562
Cash and cash equivalents		19,273	7,315
Receivables from CJSC "Agrarkredit"		24,711	22,292
Investment securities		1,426	335
		232,133	225,686
Interest expense			
Customer accounts		(18,000)	(32,703)
Due to banks and other financial institutions		(361)	(941)
Other borrowed funds		(1,332)	(950)
Debt securities issued		(47,832)	(48,044)
Lease liabilities		(629)	-
		(68,154)	(82,638)
Net interest income		163,979	143,048
Credit loss (expense)/reversal	11	(20,324)	48,414
Net interest income after impairment losses for interest bearing accounts		143,655	191,462
Fee and commission income	12	42,984	42,418
Fee and commission expense	12	(10,745)	(7,796)
Net gains/(losses) from foreign currencies:			
- dealing		32,179	24,073
- translation differences		(15,798)	7,943
Reversal of provision for credit losses on credit related commitments and other financial assets	11	16,298	5,823
Other impairment reversal	11	18,938	2,991
Operating expenses	19	(67,082)	(71,211)
Other operating income		4,837	2,060
Non-interest income		21,611	6,301
Profit before income tax expense		165,266	197,763
Income tax expense	10	(39,368)	(46,346)
Profit for the period		125,898	151,417
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i>			
Exchange differences on translating foreign operations		15,901	(39,047)
Net other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods		15,901	(39,047)
<i>Other comprehensive income that will not be reclassified to profit or loss in subsequent periods</i>			
Unrealized gains on investment securities		17,958	7,330
Change in revaluation reserve for premises		1,306	1,733
Income tax relating to components of other comprehensive income		(3,853)	(1,813)
Total other comprehensive income not be reclassified to profit or loss in subsequent periods		15,411	7,250
Total comprehensive income for the period		157,210	119,620
Profit attributable to:			
- shareholders of the Bank		125,898	151,408
- non-controlling interests		-	9
		125,898	151,417
Total comprehensive income attributable to:			
- shareholders of the Bank		157,210	119,611
- non-controlling interests		-	9
		157,210	119,620
Earnings per share, basic and diluted (AZN per share)	17	0.03	0.03

The accompanying selected explanatory notes on pages 5 to 27 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of changes in equity**For the six months ended 30 June 2019***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Attributable to shareholders of the Bank</i>						<i>Total (equity)</i>	<i>Non-controlling interest</i>	<i>Total (equity)</i>
	<i>Share capital</i>	<i>Additional paid-in capital</i>	<i>Accumulated deficit</i>	<i>Unrealized gain on investment securities</i>	<i>Revaluation reserve on premises</i>	<i>Foreign currency translation</i>			
As at 1 January 2018	1,241,287	1,900,315	(1,868,941)	32,555	35,492	26,201	1,366,909	4,517	1,371,426
Net profit/(loss) for the period	-	-	151,408	-	-	-	151,408	9	151,417
Other comprehensive income for the period	-	-	-	5,864	1,386	(39,047)	(31,797)	-	(31,797)
Total comprehensive income/(loss) for the period	-	-	151,408	5,864	1,386	(39,047)	119,611	9	119,620
Additional paid-in capital	-	8,801	-	-	-	-	8,801	-	8,801
At 30 June 2018 (unaudited, not reviewed)	1,241,287	1,909,116	(1,717,533)	38,419	36,878	(12,846)	1,495,321	4,526	1,499,847
As at 1 January 2019	1,241,287	1,909,116	(1,569,665)	38,419	36,878	(12,846)	1,643,189	-	1,643,189
Net profit for the period	-	-	125,898	-	-	-	125,898	-	125,898
Other comprehensive income/(loss) for the period	-	-	-	14,366	1,045	15,901	31,312	-	31,312
Total comprehensive income for the period	-	-	125,898	14,366	1,045	15,901	157,210	-	157,210
Additional paid-in capital	-	-	-	-	-	-	-	-	-
At 30 June 2019 (unaudited)	1,241,287	1,909,116	(1,443,767)	52,785	37,923	3,055	1,800,399	-	1,800,399

The accompanying selected explanatory notes on pages 5 to 27 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of cash flows**For the six months ended 30 June 2019***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>For the six months ended 30 June (unaudited)</i>	<i>For the six months ended 30 June (unaudited, not reviewed)</i>
<i>Notes</i>	2019	2018
Cash flows from operating activities		
Interest received	117,874	136,482
Interest paid	(52,186)	(64,395)
Fees and commissions received	42,097	38,979
Fees and commissions paid	(10,115)	(10,925)
Gains from operations in foreign currencies	32,179	24,073
Staff costs paid	(33,393)	(17,497)
Other operating expenses paid	(22,692)	(20,639)
Other operating income received	4,835	4,232
Cash flows from operating activities before changes in operating assets and liabilities	78,599	90,310
<i>Net (increase)/decrease in operating assets</i>		
Mandatory cash balances with Central Banks	135	501
Due from banks and other financial institutions	335,621	(29,558)
Loans to customers	(90,801)	72,282
Other assets	(6,201)	(45,632)
<i>Net (decrease)/increase in operating liabilities</i>		
Due to banks and other financial institutions	(9,993)	(76,847)
Customer accounts	125,983	(1,111,835)
Other liabilities	(31,662)	(52,459)
Net cash flows from / (used in) operating activities before income tax	401,681	(1,153,238)
Income tax paid	(2,546)	-
Net cash from / (used in) operating activities	399,135	(1,153,238)
Cash flows (used in) / from investing activities		
Proceeds from sale and redemption of investment securities	-	26,288
Purchase and prepayments for property, equipment and intangible assets	(5,117)	(1,748)
Proceeds from sale of property, equipment and intangible assets	-	-
Net cash (used in) / from investing activities	(5,117)	24,540
Cash flows (used in) / from financing activities		
Repayments of other borrowed funds	(11,219)	(9,320)
Repayments of subordinated debt	-	-
Proceeds from other borrowed funds	11,138	10,470
Repayments on debt securities issued	-	(1,654)
Acquisition of non-controlling interests	-	(5,107)
Net cash used in financing activities	(81)	(5,611)
Effect of exchange rate changes on cash and cash equivalents	703	(2,399)
Effect of change in credit loss allowance	-	-
Net increase/(decrease)in cash and cash equivalents	394,640	(1,136,708)
Cash and cash equivalents, beginning of year	5 1,810,173	1,814,298
Cash and cash equivalents, ending of year	5 2,204,813	677,590

During the period ended 30 June 2019, the Group received debt securities from Government in amount of AZN 31,272 thousand within the Restructuring Plan of liabilities.

The accompanying selected explanatory notes on pages 5 to 27 are an integral part of these interim condensed consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

The International Bank of Azerbaijan (“the Bank”) was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan.

The activities of the Bank are regulated by the Financial Markets Supervision Authority (“FMSA”) and the Central Bank of the Republic of Azerbaijan (“CBAR”). The Bank conducts its business under a general full banking license issued on 30 December 1992. The Bank’s primary business consists of commercial activities, trading with securities, foreign currencies and derivative instruments, originating loans and guarantees.

The registered office of the Bank is located at 67, Nizami Street, AZ1005, Baku, the Republic of Azerbaijan.

As at 30 June 2019 and 31 December 2018 the Bank had 36 branches operating in the Republic of Azerbaijan.

The accompanying consolidated financial statements comprise the accounts of the Bank and its subsidiaries (hereinafter, together name as the “Group”). The consolidated financial statements include the following subsidiaries:

Name	Country of operation	Proportion of ownership interest (%)		Type of operation
		2019	2018	
“The International Bank of Azerbaijan” OJSC	The Republic of Azerbaijan	Parent		Banking
Subsidiaries:				
“IBA-Moscow” LLC	Russian Federation	100.0	100.0	Banking
JSC “IBA GEO”	The Republic of Georgia	100.0	100.0	Banking
“International Insurance Company” OJSC	The Republic of Azerbaijan	100.0	100.0	Insurance
“Azericard” LLC	The Republic of Azerbaijan	100.0	100.0	Plastic cards processing center
“International Leasing Company” LLC	The Republic of Azerbaijan	100.0	100.0	Leasing

As at 30 June 2019 and 31 December 2018 shareholders of the Bank were as follows:

Shareholder	At 30 June 2019 (unaudited) %	At 31 December 2018 %
Ministry of Finance of the Republic of Azerbaijan	92.65	92.65
CJSC “Agrarkredit”	0.13	0.11
Other*	7.22	7.24
Total	100.0	100.0

(*) Other shareholders included minority shareholders holding an interest less than 5% each.

2. Restructuring of the Group’s operations

During 2015-2016 Azerbaijan has been impacted by a number of adverse economic conditions as a result of the continued decline in the global oil prices. In order to support the diversification of the economy, strengthen its international compatibility and export potential, as well as to provide balance of payments sustainability, during 2015 and 2016 the CBAR devalued Azerbaijani manat against the US dollar from AZN 0.7862 to AZN 1.5500 for 1 USD. Following this devaluation, the CBAR announced floating exchange rate. During 2016 the exchange rate of AZN against USD continued to fluctuate in the range between AZN 1.4900 and AZN 1.7707 for 1 USD. This led to decline in most sectors of economy and significantly increased the amounts of non-performing loans in the banking sector.

Restructuring of problematic assets

In the turbulent economic conditions due to continued decline in the quality of the Group’s assets, increase in problematic loans and decline in liquidity position of the Group, the Government of Azerbaijan was taking a number of steps during 2015-2016 to strengthen the Group’s capital position and the quality of its assets. Following an in-depth review of the asset quality and liquidity position of the Group by the CBAR and the Ministry of Finance of Azerbaijan Republic (MoF), the President of Azerbaijan Republic signed a decree on 15 July 2015 providing measures to improve the health of Group’s assets. On 28 July 2015, Ministry of Finance, the Central Bank of Azerbaijan and the Group confirmed the list of problematic assets, which were included to the restructuring plan of the Group. The problematic assets include bad or overdue loans to customers and banks, as well as certain guarantees and other off-balance sheet commitments. According to the President’s decree and other documents signed between parties involved, certain problematic assets of the Group were transferred to the government owned company – CJSC “Agrarkredit” with several tranches during 2015-2019.

(Figures in tables are in thousands of Azerbaijani manats)

2. Restructuring of the Group's operations (continued)

Restructuring of problematic assets (continued)

The first part of the problematic assets transfer program was successfully completed in 2016. The assets transferred as part of the program amounted to AZN 9,930,957 thousand representing gross carrying value of the assets at the date of transfer (before provisions).

During 2016, the MoF, CBAR, FMSA and the Group further worked together to identify remaining problematic assets to be transferred to CJSC "Agrarkredit" as the final part of the program. On 10 February 2017, the list of such problematic assets was approved by the parties involved and the Cabinet of Ministers of the Republic of Azerbaijan. These assets amounted to AZN 4,013,909 thousand. The transfer was agreed to be made at full gross value of respective transactions as at 1 January 2017, including all on and off-balance sheet exposures. In April 2017 the Group and CJSC "Agrarkredit" signed an agreement and initiated the transfer of the problematic assets. During the year 2017, the Group received promissory notes in the total amount of USD 2,900,000 thousand with 4% coupon rate payable at maturity in exchange for the problematic assets transferred. The promissory notes in amount of USD 2,248,000 thousand were then transferred to State along with debt obligations of the Group under the restructuring program.

The value of promissory notes received from CJSC "Agrarkredit" in 2017 exceeded the value of corresponding problematic assets transferred by AZN 515,767 thousand, for which the Payables to CJSC "Agrarkredit" was recognized in the consolidated statement of financial position as at 31 December 2017. Due to further transfers of problematic assets and off-balance sheet commitments the payable amount decreased in 2018. As at 30 June 2019 it was amounted to AZN 365,261 thousand (2018: AZN 364,596 thousand).

The promissory notes are guaranteed by the MoF. As at the date of signing of these interim condensed consolidated financial statements the Group transferred to CJSC "Agrarkredit" more than 95% of the problematic assets included in the final part of the program. The program is expected to be completed by the end of 2019.

Restructuring of liabilities

Due to the financial difficulties on 11 May 2017, the Group defaulted on certain of its liabilities and announced their restructuring.

On 23 May 2017, the Group announced to the creditors the proposed terms of the debt restructuring ("Restructuring Plan"). The Restructuring Plan was approved by FMSA, Nasimi District Court and the creditors holding 93.9% of the principal amount of liabilities subject to the restructuring. In September 2017 the Group completed the restructuring of its liabilities under the terms set out in the approved Restructuring Plan. The Group was subject to legal actions and complaints (Note 18) and technically the restructuring is expected to be finalized when all issued eurobonds are distributed to the all creditors.

Although the restructuring deteriorated Group's credit ratings, during the subsequent years Bank was able to improve the ratings significantly. Thus, in June 2018 Fitch Ratings has affirmed Group's Long-Term Issuer-Default Rating at 'B-' with a Stable Outlook. The agency has also resolved the Rating Watch Evolving (RWE) on Group's Viability Rating (VR) and upgraded the VR to 'b' from 'ccc'. In April 2019 Moody's upgraded the Bank's ratings in the following way: Baseline Credit Assessment (upgraded to b3 from caa2, adjusted Baseline Credit Assessment (upgraded to b3 from caa2), Long-term Bank Deposits (upgraded to B1 from B3), Long-term Counterparty Risk Assessment (upgraded to Ba3(cr) from B2(cr)), Long-term Counterparty Risk Rating (upgraded to Ba3 from B2). In May 2019 Fitch Ratings has revised the Outlook on Bank's Long Term Issuer Default Rating (IDR) to Positive from Stable and affirmed the ratings in the following way: Long-Term IDR B-, Short-Term IDR B, Viability rating b-.

The upgrade of Group's external ratings reflects improved profitability and reduced pressure from a large short foreign currency position. It is also supported by the Group's currently low-risk asset structure and liquidity position.

To ensure future operational profitability and maintain financial stability the Group's management and shareholders intend to develop the Group's business both in corporate and in retail segments and have developed a plan that includes, but not limited to, the following steps:

- ▶ Improve cost efficiency of the existing operations;
- ▶ Abandon the investments with low return;
- ▶ Hedge or close the final short open currency position;
- ▶ Attract funding in functional currency;
- ▶ Start implementation of the development strategy for 2019-2022; and
- ▶ Prepare for privatization of the Group in future.

(Figures in tables are in thousands of Azerbaijani manats)

2. Restructuring of the Group's operations (continued)

Restructuring of liabilities (continued)

Management believes that the above-mentioned measures and continued financial support of the controlling shareholder will ensure that the Group will continue as a going concern and, accordingly, these consolidated financial statements have been prepared on the assumption that the Group will continue in operation for the foreseeable future.

3. Basis of preparation

General

The interim condensed consolidated financial statements for the six months ended 30 June 2019 have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting*.

The interim consolidated financial statements do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Group's annual financial statements as at 31 December 2018.

Changes in accounting policies

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2018, except for the adoption of new Standards effective as of 1 January 2019. The nature and the effect of these changes are disclosed below. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Several other amendments and interpretations apply for the first time in 2019, but do not have an impact on the interim consolidated financial statements of the Group.

IFRS 16 Leases

IFRS 16 supersedes IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC 15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on-balance sheet model.

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact for leases where the Group is the lessor.

The Group adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 January 2019. Under this method, the standard is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application. The Group elected to use the transition practical expedient allowing the standard to be applied only to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 at the date of initial application. The Group also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option ('short-term leases'), and lease contracts for which the underlying asset is of low value 'low-value assets'.

The effect of adoption IFRS 16 as at 1 January 2019 (increase/(decrease)) is as follows:

Assets	
Other assets	2,452
Total assets	2,452
Liabilities	
Other liabilities	2,452
Total liabilities	2,452

(Figures in tables are in thousands of Azerbaijani manats)

3. Basis of preparation (continued)

Changes in accounting policies (continued)

(a) Nature of the effect of adoption of IFRS 16

The Group has lease contracts for premises. Before the adoption of IFRS 16, the Group classified each of its leases (as lessee) at the inception date as either a finance lease or an operating lease. A lease was classified as a finance lease if it transferred substantially all of the risks and rewards incidental to ownership of the leased asset to the Group; otherwise it was classified as an operating lease. Finance leases were capitalised at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments were apportioned between interest and reduction of the lease liability. In an operating lease, the leased property was not capitalised and the lease payments were recognised as rent expense in profit or loss on a straight-line basis over the lease term. Any prepaid rent and accrued rent were recognised under Other assets and Other liabilities, respectively.

Upon adoption of IFRS 16, the Group applied a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The standard provides specific transition requirements and practical expedients, which has been applied by the Group.

Leases previously accounted for as operating leases

The Group recognised right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and leases of low-value assets. The right-of-use assets for leases were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised. Lease liabilities were recognised based on the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application.

The Group also applied the available practical expedients wherein it:

- ▶ Used a single discount rate to a portfolio of leases with reasonably similar characteristics;
- ▶ Relied on its assessment of whether leases are onerous immediately before the date of initial application;
- ▶ Applied the short-term leases exemptions to leases with lease term that ends within 12 months at the date of initial application;
- ▶ Excluded the initial direct costs from the measurement of the right-of-use asset at the date of initial application;
- ▶ Used hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

Based on the foregoing, as at 1 January 2019:

- ▶ Right-of-use assets of AZN 2,452 thousand were recognised and included in Other assets.
- ▶ Lease liabilities in the amount of AZN 2,452 thousand were recognized and included in Other liabilities.

(b) Summary of new accounting policies

Set out below are the new accounting policies of the Group upon adoption of IFRS 16, which have been applied from the date of initial application:

Right-of-use assets

The Group recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Group is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognised right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right-of-use assets are subject to impairment.

(Figures in tables are in thousands of Azerbaijani manats)

3. Basis of preparation (continued)

Changes in accounting policies (continued)

Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating a lease, if the lease term reflects the Group exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Short-term leases and leases of low-value assets

The Group applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 10,000). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

Significant judgement in determining the lease term of contracts with renewal options

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Group has the option, under some of its leases to lease the assets for additional terms of three to five years. The Group applies judgement in evaluating whether it is reasonably certain to exercise the option to renew. That is, it considers all relevant factors that create an economic incentive for it to exercise the renewal. After the commencement date, the Group reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew (e.g., a change in business strategy).

4. Segment information

The Group discloses information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. This matter is regulated by IFRS 8 *Operating Segments* and other standards that require special disclosures in the form of segmental reporting.

Information reported to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance focuses on types of services delivered or provided. For managerial purposes, the Group is organised into three operating segments:

- ▶ Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products.
- ▶ Retail banking – representing private banking services, private customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages.
- ▶ Treasury – comprises interbank lending and borrowings, securities trading swaps, foreign exchange services, issuance of bonds and promissory notes and other treasury functions.

No operating segments have been aggregated to form the above reportable operating segments.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects, as explained in the table below, is measured differently from operating profit or loss in the consolidated financial statements. Income taxes are managed on a group basis and are not allocated to operating segments.

(Figures in tables are in thousands of Azerbaijani manats)

4. Segment information (continued)

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

The following tables present income and profit information regarding the Group's operating segments for the six months ended 30 June 2019 and 2018, respectively:

Six months ended 30 June 2019 (unaudited)	Retail banking	Corporate banking	Treasury	Unallocated	Total
Interest income	72,237	38,402	121,494	–	232,133
Interest expense	(16,283)	(2,346)	(49,525)	–	(68,154)
Net interest income	55,954	36,056	71,969	–	163,979
Reversal of provision for credit losses on credit related commitments	–	16,298	–	–	16,298
Credit loss expense	(16,501)	(4,248)	425	–	(20,324)
Fee and commission income	5,325	36,891	768	–	42,984
Fee and commission expense	(6,481)	(1,581)	(2,683)	–	(10,745)
Other non-interest income	5,370	48,021	(13,235)	–	40,156
Operating expense	–	–	–	(67,082)	(67,082)
Segment profit/(loss)	43,667	131,437	57,244	(67,082)	165,266
Income tax expense	–	–	–	(39,368)	(39,368)
Profit for the period	43,667	131,437	57,244	(106,450)	125,898

Six months ended 30 June 2018 (unaudited, not reviewed)	Retail banking	Corporate banking	Treasury	Unallocated	Total
Interest income	70,633	37,549	117,504	–	225,686
Interest expense	(29,584)	(3,120)	(49,934)	–	(82,638)
Net interest income	41,049	34,429	67,570	–	143,048
Reversal of provision for credit losses on credit related commitments	–	5,823	–	–	5,823
Credit loss expense	8,689	38,215	1,510	–	48,414
Fee and commission income	5,255	36,405	758	–	42,418
Fee and commission expense	(4,666)	(1,147)	(1,983)	–	(7,796)
Other non-interest income	3,314	24,720	9,033	–	37,067
Operating expense	–	–	–	(71,211)	(71,211)
Segment profit/(loss)	53,641	138,445	76,888	(71,211)	197,763
Income tax expense	–	–	–	(46,346)	(46,346)
Profit for the period	53,641	138,445	76,888	(117,557)	151,417

The following table presents segment assets of the Group's operating segments:

Segment assets	Retail banking	Corporate banking	Treasury	Unallocated	Total
At 30 June 2019 (unaudited)	909,151	883,395	6,574,704	205,787	8,573,037
At 31 December 2018	800,782	894,904	6,366,282	212,275	8,274,243

Segment liabilities	Retail banking	Corporate banking	Treasury	Unallocated	Total
At 30 June 2019 (unaudited)	1,104,157	3,488,846	2,015,284	164,351	6,772,638
At 31 December 2018	1,161,008	3,334,469	2,012,415	123,162	6,631,054

(Figures in tables are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	30 June 2019 (unaudited)	31 December 2018
Cash on hand	286,014	203,940
Current accounts with the Central Bank	54,888	129,192
Correspondent accounts and time deposits credit institutions up to 90 days	1,863,911	1,477,041
Cash and cash equivalents	2,204,813	1,810,173

All balances of cash equivalents are allocated to Stage 1. The ECL relating to cash equivalents of the Group rounds to zero.

6. Amounts due from banks and other financial institutions

Amounts due from credit institutions comprise:

	30 June 2019 (unaudited)	31 December 2018
Time deposits with the CBAR	2,937,785	3,027,816
Blocked accounts with non-resident banks	19,979	52,447
Time deposits with resident banks	2,294	4,513
Time deposits with non-resident banks	32,347	167,694
Loans to credit institutions	3,023	3,014
Less – allowance for impairment	(5,286)	(5,711)
Amounts due from credit institutions	2,990,142	3,249,773

An analysis of changes in the ECL allowances during the period ended 30 June 2019 is as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at 1 January 2019	(5,553)	(158)	–	(5,711)
New assets originated or purchased	(607)	–	–	(607)
Assets repaid	868	158	–	1,026
Net remeasurement of loss allowance	6	–	–	6
At 30 June 2019 (unaudited)	(5,286)	–	–	(5,286)

An analysis of changes in the ECL allowances during the period ended 30 June 2018 is as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at 1 January 2018	(4,933)	(248)	–	(5,181)
New assets originated or purchased	(201)	–	–	(201)
Assets repaid	1,636	158	–	1,794
Change in accrued balance	(32)	–	–	(32)
Net remeasurement of loss allowance	(51)	–	–	(51)
At 30 June 2018 (unaudited, not reviewed)	(3,581)	(90)	–	(3,671)

7. Loans to customers

Loans to customers comprise:

	30 June 2019 (unaudited)	2018
Loans to individuals	937,378	851,626
Loans to legal entities	948,350	925,377
Loans to be transferred to CJSC "Agrarkredit"	112,074	113,025
Total loans to customers, gross	1,997,802	1,890,028
Less: allowance for impairment losses	(237,017)	(215,875)
Total loans to customers	1,760,785	1,674,153

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the ECL in relation to Loans to legal entities and loans to individuals during the period ended 30 June 2019 is, as follows:

<i>Loans to legal entities</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2019	(15,839)	(9,924)	(53,747)	(79,510)
New assets originated or purchased	(4,453)	–	–	(4,453)
Change in accrued balance	27	106	–	133
Unwind of discount	–	–	(1,463)	(1,463)
Assets repaid	1,521	1,160	3,800	6,481
Transfer to 12-month ECL	(3,113)	2,857	256	–
Transfer to lifetime ECL not credit- impaired	1,143	(1,761)	618	–
Transfer to lifetime ECL credit- impaired	–	–	–	–
Net remeasurement of ECL	1,134	(4,995)	(2,548)	(6,409)
At 30 June 2019 (unaudited)	(19,580)	(12,557)	(53,084)	(85,221)
<i>Loans to individuals</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2019	(21,307)	(7,832)	(33,459)	(62,598)
New assets originated or purchased	(4,950)	–	–	(4,950)
Change in accrued balance	(17)	(4)	–	(21)
Unwind of discount	–	–	(917)	(917)
Assets repaid	1,944	963	2,790	5,697
Transfer to 12-month ECL	(6,849)	3,855	2,994	–
Transfer to lifetime ECL not credit- impaired	944	(2,559)	1,615	–
Transfer to lifetime ECL credit- impaired	480	694	(1,174)	–
Net remeasurement of ECL	13,290	(692)	(12,165)	433
At 30 June 2019 (unaudited)	(16,465)	(5,575)	(40,316)	(62,356)

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the ECL in relation to Loans to CJSC Agrarkredit during the period ended 30 June 2019 is, as follows:

<i>Loans to CJSC "Agrarkredit"</i>	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2019	-	-	(73,767)	(73,767)
Assets transferred to the CJSC "Agrarkredit"	-	-	-	-
Unwind of discount	-	-	(2,605)	(2,605)
Net remeasurement of ECL	-	-	(17,660)	(17,660)
Write-offs	-	-	4,592	4,592
At 30 June 2019 (unaudited)	-	-	(89,440)	(89,440)

An analysis of changes in the ECL in relation to Loans to CJSC Agrarkredit during the period ended 30 June 2018 is, as follows:

<i>Loans to legal entities</i>	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2018	(21,474)	(21,916)	(114,018)	(157,408)
New assets originated or purchased	(3,571)	-	-	(3,571)
Change in accrued balance	(31)	201	-	170
Unwind of discount	-	-	(2,827)	(2,827)
Assets repaid	6,014	6,357	12,139	24,510
Transfer to 12-month ECL	(2,568)	1,508	1,060	-
Transfer to lifetime ECL not credit-impaired	1,859	(3,036)	1,177	-
Transfer to lifetime ECL credit-impaired	60	1	(61)	-
Net remeasurement of ECL	1,985	6,367	8,754	17,106
Write-offs	-	-	34,168	34,168
At 30 June 2018 (unaudited, not reviewed)	(17,726)	(10,518)	(59,608)	(87,852)

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the ECL in relation to Loans to CJSC Agrarkredit during the period ended 30 June 2018 is, as follows:

<i>Loans to individuals</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	(28,360)	(12,209)	(57,266)	(97,835)
New assets originated or purchased	(3,275)	-	-	(3,275)
Change in accrued balance	(215)	(256)	-	(471)
Unwind of discount	-	-	(1,424)	(1,424)
Assets repaid	2,494	3,198	11,649	17,341
Transfer to 12-month ECL	(7,377)	2,740	4,637	-
Transfer to lifetime ECL not credit-impaired	443	(1,236)	793	-
Transfer to lifetime ECL credit-impaired	242	649	(891)	-
Net remeasurement of ECL	12,287	(2,235)	(7,474)	2,578
Write- offs	-	-	3,767	3,767
At 30 June 2018 (unaudited, not reviewed)	(23,761)	(9,349)	(46,209)	(79,319)
<i>Loans to CJSC "Agrarkredit"</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECL as at 1 January 2018	-	-	(102,217)	(102,217)
Assets transferred to the CJSC "Agrarkredit"	-	-	(3,459)	(3,459)
Unwind of discount	-	-	1,002	1,002
Net remeasurement of ECL	-	-	(5,578)	(5,578)
Write- offs	-	-	14,997	14,997
At 30 June 2018 (unaudited, not reviewed)	-	-	(95,255)	(95,255)

(Figures in tables are in thousands of Azerbaijani manats)

8. Investment securities

Investment securities including those pledged under repurchase agreements comprise:

	30 June 2019 (unaudited)	31 December 2018
Government Bonds	74,039	41,175
Corporate bonds	921	892
Debt securities at FVOCI	74,960	42,067
Corporate shares	65,115	48,778
Equity securities at FVOCI	65,115	48,778
Total investment securities	140,075	90,845

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

9. Other assets and liabilities

	30 June 2019 (unaudited)	31 December 2018
Other financial assets		
Accrued commission and receivables from settlement of off-balance sheet commitments	19,275	17,872
Funds in settlement	16,913	15,641
Pledged funds with non-resident organisations	10,006	9,848
Right-of-use asset	1,701	-
Allowance for impairment of other assets	(12,139)	(12,928)
	35,756	30,433
Other non-financial assets		
Repossessed collateral to be transferred to CJSC "Agrarkredit"	1,969	2,229
Prepayments	8,921	5,937
Deferred expenses	2,389	1,864
	13,279	10,030
Other assets	49,035	40,463

Other liabilities comprise:

	30 June 2019 (unaudited)	31 December 2018
Other financial liabilities		
Funds in settlement	14,779	16,908
Dividends payable to shareholders	16,411	16,411
Lease liabilities	2,687	-
	33,877	33,319
Other non-financial liabilities		
Credit loss allowance for credit related commitments and provision for other contingencies and commitments	79,928	117,727
Taxes other than income tax	3,317	4,094
Payables to employees	10,161	8,914
Payables to local budget	4,107	2,228
Deferred revenue on plastic cards	6,958	5,848
	104,471	138,811
Other liabilities	138,348	172,130

(Figures in tables are in thousands of Azerbaijani manats)

10. Taxation

The corporate income tax expense comprises:

	<i>For the six months ended</i>	
	30 June 2019 <i>(unaudited)</i>	30 June 2018 <i>(unaudited, not reviewed)</i>
Current tax charge/(credit)	(46,691)	–
Changes in deferred tax	3,470	(48,159)
Less: deferred tax recognized directly in other comprehensive income	3,853	1,813
Income tax expense	(39,368)	(46,346)

11. Credit loss expense and other impairment and provisions

The table below shows the ECL charges on financial instruments recorded in the interim condensed consolidated statement of profit or loss and other comprehensive income for the period ended 30 June 2019:

	<i>Note</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Loans to customers	7	8,496	(3,462)	(25,783)	(20,749)
Cash and cash equivalents		–	–	–	–
Due from banks and other financial institutions	6	267	158	–	425
Receivables from CJSC “Agrarkredit”		–	–	–	–
Credit loss charge on interest bearing financial assets (unaudited)		8,763	(3,304)	(25,783)	(20,324)
Financial guarantees	18	(97)	(72)	14,034	13,865
Letters of credit	18	300	568	–	868
Undrawn loan commitments	18	776	–	–	776
Credit related commitments (unaudited)		979	496	14,034	15,509
Other financial assets		(22)	3	808	789
Reversal of provision for credit losses on credit related commitments and other financial assets (unaudited)		957	499	14,842	16,298
Total credit loss charge (unaudited)		9,720	(2,805)	(10,941)	(4,026)

The table below shows the ECL charges on financial instruments recorded in the interim consolidated statement of profit or loss and other comprehensive income for the period ended 30 June 2018 (unaudited, not reviewed):

	<i>Note</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
Loans to customers	7	15,688	13,632	19,490	48,810
Cash and cash equivalents		–	–	(1,906)	(1,906)
Due from banks and other financial institutions	6	1,352	158	–	1,510
Receivables from CJSC “Agrarkredit”		–	–	–	–
Credit loss charge on interest bearing assets (unaudited, not reviewed)		17,040	13,790	17,584	48,414
Financial guarantees	18	(291)	1,357	2,970	4,036
Letters of credit	18	(150)	(73)	405	182
Undrawn loan commitments	18	912	567	126	1,605
Credit related commitments (unaudited, not reviewed)		471	1,851	3,501	5,823
Other financial assets		(45)	(12)	57	–
Reversal of provision for credit losses on credit related commitments and other financial assets (unaudited, not reviewed)		426	1,839	3,558	5,823
Total credit loss charge (unaudited, not reviewed)		17,466	15,629	21,142	54,237

(Figures in tables are in thousands of Azerbaijani manats)

11. Credit loss expense and other impairment and provisions (continued)

Provision for ECL for credit related commitments and provision on legal claims and performance guarantees are recorded within other non-financial liabilities for the period ended 30 June 2019 (Note 9).

	<i>Legal claims</i>	<i>Performance guarantees</i>	<i>Total</i>
31 December 2017	–	(33,652)	(33,652)
(Charge)/reversal	(4,980)	13,817	8,837
31 December 2018	(4,980)	(19,835)	(24,815)
Reversal	1,628	17,310	18,938
Redemption	3,352	–	3,352
30 June 2019 (unaudited)	–	(2,525)	(2,525)

Provision for ECL for credit related commitments and provision on legal claims and performance guarantees are recorded within other non-financial liabilities for the period ended 30 June 2018 (Note 9).

	<i>Legal claims</i>	<i>Performance guarantees</i>	<i>Total</i>
31 December 2016	–	(52,443)	(52,443)
Reversal	–	18,791	18,791
31 December 2017	–	(33,652)	(33,652)
(Charge)/reversal	(4,980)	1,989	(2,991)
30 June 2018 (unaudited, not reviewed)	(4,980)	(31,663)	(36,643)

12. Net fee and commission income

Net fee and commission income comprises:

	30 June 2019 (unaudited)	30 June 2018 (unaudited, not reviewed)
Plastic cards operations	29,170	25,473
Servicing guarantees and letters of credit	6,248	6,957
Settlement transactions	5,106	5,744
Cash transactions	1,960	2,945
Other	500	1,299
Fee and commission income	42,984	42,418
Plastic cards operations	(7,430)	(5,189)
Cash transactions	(1,781)	(1,401)
Settlement transactions	(1,146)	(901)
Other	(388)	(305)
Fee and commission expense	(10,745)	(7,796)
Net fee and commission income	32,239	34,622

13. Due to banks and other financial institutions

Due to banks and other financial institutions comprise:

	30 June 2019 (unaudited)	31 December 2018
Correspondent accounts of non-resident banks	6,762	4,625
Correspondent accounts of resident banks	22,335	30,405
Time deposits of resident banks and other financial institutions	10,204	10,230
Due to banks and other financial institutions	39,301	45,260

(Figures in tables are in thousands of Azerbaijani manats)

14. Customer accounts

The amounts due to customers comprise:

	30 June 2019 (unaudited)	31 December 2018
Legal entities		
- Current/settlement accounts	3,089,456	2,937,897
- Term deposits	180,408	86,481
- Restricted customer deposits	131,534	191,635
Total legal entities	3,401,398	3,216,013
Individuals		
- Current/settlement accounts	505,781	394,321
- Term deposits	582,890	754,315
Total individuals	1,088,671	1,148,636
Total customer accounts	4,490,069	4,364,649

15. Debt securities issued

Debt securities issued comprise:

	30 June 2019 (unaudited)	31 December 2018
Eurobonds	1,503,656	1,485,136
Certificates of deposit	5,264	5,562
Total debt securities issued	1,508,920	1,490,698

As at 30 June 2019, the Group had one class of Eurobonds issued in September 2017 with coupon rate of 3.5% p.a maturing in September 2024. The Group is obliged to comply with non-financial covenants in relation to these Eurobonds. As of date of issuance of these interim condensed consolidated financial statements, the Group was in compliance of these covenants.

16. Other borrowed funds

Other borrowed funds consisted of the following:

	30 June 2019 (unaudited)	31 December 2018
Term borrowings from non-resident financial institutions	18,428	19,955
National Fund for Support of Entrepreneurship and the Mortgage fund (the Republic of Azerbaijan)	86,647	86,675
Total other borrowed funds	105,075	106,630

17. Equity

The Group's share capital comprises of the following number of shares:

Ordinary shares (par value of 0.27 AZN)	Number of paid-in shares (in thousands)	Share capital
As at 31 December 2017	4,597,359	1,241,287
As at 31 December 2018	4,597,359	1,241,287
As at 30 June 2019 (unaudited)	4,597,359	1,241,287

All ordinary shares have a nominal value of AZN 0.27 per share as at 30 June 2019, 31 December 2018 and rank equally. Each share carries one vote.

(Figures in tables are in thousands of Azerbaijani manats)

17. Equity (continued)

Revaluation reserve for premises

The revaluation reserve for property and equipment is used to record increases in the fair value of premises and decreases to the extent that such decrease relates to an increase on the same asset previously recognised in equity through other comprehensive income.

Additional paid-in capital

Additional paid-in capital reflects results from transactions with shareholders acting in their capacity as shareholders. In a turbulent economic condition due to continued decline in the quality of the Group's assets, increase in problematic loans and decline in liquidity position of the Group, the Government of Azerbaijan has been taking a number of steps to strengthen the Group's capital position and the quality of its assets. As part of these measures, certain of the problematic assets of the Group were transferred in several tranches during 2015-2018 to CJSC "Agrarkredit" (Note 2). The transfer of the problematic assets occurs at an agreed amount at the time of transfer. Since CJSC "Agrarkredit" is also ultimately controlled by the Ministry of Finance any amounts received from CJSC "Agrarkredit" in excess of the net carrying amounts of transferred assets have been recognized as additional paid-in capital of the Group.

The gain/loss and weighted average number of shares used in calculation of basis and diluted loss per share are as follows:

	30 June 2019 <i>(unaudited)</i>	30 June 2018 <i>(unaudited, not reviewed)</i>
Net profit for the period attributable to shareholders of the Bank	125,898	151,408
Weighted average number of ordinary shares in issue	4,597,359	4,597,359
Earnings per share – basic and diluted (AZN)	0.03	0.03

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

18. Commitments and contingencies

Operating environment

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

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

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

During 2018 CBAR maintained monetary policy aimed at macroeconomic stability, including low one-digit inflation and steady AZN rate. At the same time the CBAR gradually reduced refinancing rate from 15% to 9.75%.

Furthermore, over first six months of 2019 the CBAR continued easing monetary conditions while maintaining stability of Azerbaijani manat. As a result, CBAR refinancing rate further declined from 9.75% to 8.5% and AZN rate remained unchanged.

Finally, on 28 February 2019 according to the Decree of the President of Azerbaijan Republic on problematic loans, the government provided funds for compensation to citizens, whose loans burden increased due to the devaluation of Azerbaijani manat in 2015. This measure reduced amounts of non-performing loans as well as supported capital and liquidity in the banking system. The effect of decree was not material for the Group.

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

(Figures in tables are in thousands of Azerbaijani manats)

18. Commitments and contingencies (continued)

Legal

In the ordinary course of business, the Group was subject to legal actions and complaints. On 23 May 2017 the Group announced to some of its creditors the proposed terms of the debt restructuring ("Restructuring Plan"). In May and June 2017 the Group obtained temporary protection of its assets in USA and UK against claims from its creditors. On 18 July 2017 the Group announced that the Restructuring Plan was approved by the creditors holding 93.9% of the principal amount of liabilities subject to the restructuring. Some creditors initiated legal proceedings against the Group as a result of the debt restructuring. On 26 June 2019 the UK Supreme Court refused the moratorium continuation application of the Group. Currently the Group is not subject to any legal actions and complaints in relation to the foreign debt restructuring and given the currently available information, cannot reasonably estimate the impact of the potential litigations by minority bondholders on these interim condensed consolidated financial statements.

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities. Recent events within the Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review.

Management believes that its interpretation of the relevant legislation as at 30 June 2019 and 31 December 2018 is appropriate and that the Group's tax, currency and customs positions will be sustained.

Insurance

The Group has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Compliance with FMSA ratios

FMSA require banks to maintain certain prudential ratios computed based on statutory financial statements.

The Bank did not achieve full compliance with certain statutory ratios as at 30 June 2019, which is due to significant open currency positions (as a result of restructuring of Group's operations – Note 2) and significant volume of operations with related parties. The ratios breached comprise:

- ▶ Ratio of maximum credit exposure of the bank per single borrower or group of borrowers;
- ▶ Currency position.

As at the date of signing these interim condensed consolidated financial statements the ratio of portion of investment in other entity to share capital of the Bank was no longer breached.

Consequences of the breach of the prudential ratios include withdrawal of banking license by the regulating body. Throughout the year the Group submitted information regarding these breaches to the FMSA on a monthly basis and no sanctions were imposed to the Group. Moreover, Management of the Group provided FMSA with action plan for improvement of remaining ratios in future.

Considering all above mentioned facts, Management believes that the Group will not face any sanctions in the future.

Financial commitments and contingencies

The Group provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the 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.

(Figures in tables are in thousands of Azerbaijani manats)

18. Commitments and contingencies (continued)**Credit related and other commitments**

The Group's commitments and contingencies comprised the following:

	30 June 2019 (unaudited)	31 December 2018
Credit related commitments		
Guarantees	848,476	1,162,430
Letters of credit	121,088	143,536
Undrawn loan commitments	1,785,346	1,729,851
Less: allowance	(79,928)	(112,747)
Commitments and contingencies	2,674,982	2,923,070
Less: cash held as security against guarantees and letters of credit	(131,154)	(161,208)
Less: cash received from CJSC "Agrarkredit" held as security against guarantees and letters of credit	(130,410)	(186,282)
	2,413,418	2,575,580

An analysis of changes in the ECLs during the six months 2019 are, as follows:

Financial guarantees	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2019	(3,316)	(5,028)	(80,064)	(88,408)
New exposures originated or purchased	(541)			(541)
Exposures derecognised or matured (excluding write-offs)	65	-	15,233	15,298
Transfer to 12- month ECL	-	-	-	-
Transfer to lifetime ECL not credit- impaired	-	-	-	-
Transfer to lifetime ECL credit- impaired	-	-	-	-
Net remeasurement of ECL	379	(72)	(1,199)	(892)
Foreign currency	-	-	-	-
At 30 June 2019 (unaudited)	(3,413)	(5,100)	(66,030)	(74,543)

Letter of credit	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2019	(300)	(568)	-	(868)
New exposures originated or purchased	-			-
Exposures derecognised or matured (excluding write-offs)	300	568	-	868
Transfer to 12- month ECL	-	-	-	-
Transfer to lifetime ECL not credit- impaired	-	-	-	-
Transfer to lifetime ECL credit- impaired	-	-	-	-
Net remeasurement of ECL	-	-	-	-
Foreign currency	-	-	-	-
At 30 June 2019 (unaudited)	-	-	-	-

Undrawn commitments	Stage 1	Stage 2	Stage 3	Total
ECLs as at 1 January 2018	(3,362)	-	(274)	(3,636)
New exposures originated or purchased	(1,263)	-	-	(1,263)
Exposures derecognised or matured (excluding write-offs)	164	-	-	164
Transfer to 12- month ECL	(274)	-	274	-
Transfer to lifetime ECL not credit- impaired	555	(555)	-	-
Transfer to lifetime ECL credit- impaired	-	-	-	-
Net remeasurement of ECL	1,875	-	-	1,875
At 30 June 2019 (unaudited)	(2,305)	(555)	-	(2,860)

(Figures in tables are in thousands of Azerbaijani manats)

18. Commitments and contingencies (continued)**Credit related and other commitments (continued)**

An analysis of changes in the ECLs during the six months of 2018 (unaudited, not reviewed) are, as follows:

<i>Financial guarantees</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2018	(3,692)	(8,113)	(110,011)	(121,816)
New exposures originated or purchased	(562)	-	-	(562)
Exposures derecognised or matured (excluding write-offs)	749	896	1,391	3,036
Transfer to 12- month ECL	(127)	-	127	-
Transfer to lifetime ECL not credit- impaired	620	(620)	-	-
Transfer to lifetime ECL credit- impaired	-	-	-	-
Net remeasurement of ECL	(478)	109	1,579	1,210
Foreign currency	-	352	-	352
At 30 June 2018 (unaudited, not reviewed)	(3,490)	(7,376)	(106,914)	(117,780)

<i>Letter of credit</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2018	(16)	-	(1,216)	(1,232)
New exposures originated or purchased	-	-	-	-
Exposures derecognised or matured (excluding write-offs)	-	-	405	405
Transfer to 12- month ECL	-	-	-	-
Transfer to lifetime ECL not credit- impaired	-	-	-	-
Transfer to lifetime ECL credit- impaired	8	(211)	203	-
Net remeasurement of ECL	(150)	(73)	-	(223)
Foreign currency	-	-	-	-
At 30 June 2018 (unaudited, not reviewed)	(158)	(284)	(608)	(1,050)

<i>Undrawn commitments</i>	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
ECLs as at 1 January 2018	(4,318)	(3,230)	(3,245)	(10,793)
New exposures originated or purchased	(414)	-	-	(414)
Exposures derecognised or matured (excluding write-offs)	1,460	567	674	2,701
Transfer to 12- month ECL	-	-	-	-
Transfer to lifetime ECL not credit- impaired	-	-	-	-
Transfer to lifetime ECL credit- impaired	-	-	-	-
Net remeasurement of ECL	(134)	-	(548)	(682)
At 30 June 2018 (unaudited, not reviewed)	(3,406)	(2,663)	(3,119)	(9,188)

(Figures in tables are in thousands of Azerbaijani manats)

19. Operating expenses

Operating expenses comprise:

	30 June 2019 (unaudited)	30 June 2018 (unaudited, not reviewed)
Staff costs	(31,505)	(40,776)
Depreciation of premises and equipment	(8,006)	(10,973)
Consultancy and other professional services	(7,084)	(287)
Insurance expense	(64)	(9)
Software maintenance	(2,543)	(57)
Fees paid to deposit insurance fund	(2,716)	(2,939)
Amortization of software and other intangible assets	(1,942)	(2,519)
External labor and guarding	(1,701)	(440)
Rent	(1,887)	(480)
Customs duties and taxes other than on income	(1,972)	(640)
Fines and penalties	(17)	(1,280)
Premises, property and maintenance	(1,281)	(1,817)
Communication	(438)	(4,636)
Utility	(679)	(937)
Stationary, books, printing, and other supplies	(710)	(887)
Advertising and marketing services	(2,827)	(1,475)
Charity and financial aid	(109)	(486)
Other	(1,601)	(573)
Total operating expenses	(67,082)	(71,211)

20. Fair values of financial instruments

Fair value hierarchy

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

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

The following table shows an analysis of financial instruments recorded at fair value measurement at the end of reporting period by level of the fair value hierarchy:

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Assets measured at fair value					
Investment securities	30 June 2019	139,164	911	-	140,075

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Assets measured at fair value					
Investment securities	31 December 2018	89,703	1,142	-	90,845

(Figures in tables are in thousands of Azerbaijani manats)

20. Fair values of financial instruments (continued)

Fair value hierarchy (continued)

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

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

	Carrying value 30 June 2019 (unaudited)	Fair value 30 June 2019 (unaudited)	Carrying value 31 December 2018	Fair value 31 December 2018
Financial assets				
Cash and cash equivalents	2,204,813	2,204,813	1,810,173	1,810,173
Mandatory cash balances with the Central Banks	54,567	54,567	54,702	54,702
Due from banks and other financial institutions	2,990,142	2,990,142	3,249,773	3,249,773
Loans to customers	1,760,785	1,772,122	1,674,153	1,701,333
Receivables from CJSC "Agrarkredit"	1,175,103	1,175,103	1,150,401	1,150,401
Other financial assets	35,756	35,216	30,433	30,433
Financial liabilities				
Due to banks and other financial institutions	39,301	39,301	45,260	45,260
Customer accounts	4,490,069	4,496,564	4,364,649	4,369,810
Payables to CJSC "Agrarkredit"	365,261	365,261	364,596	364,596
Other borrowed funds	105,075	105,075	106,630	106,630
Debt securities issued	1,508,920	1,451,409	1,490,698	1,503,075
Other financial liabilities	33,877	33,877	33,319	33,319

21. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

(Figures in tables are in thousands of Azerbaijani manats)

21. Related party disclosures (continued)

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

	30 June 2019 (unaudited)		31 December 2018	
	Related party balances	Total category as per the financial statements caption	Related party balances	Total category as per the financial statements caption
Cash and cash equivalents		2,204,813		1,810,173
- Government bodies and state owned entities	44,432		100,774	
Due from banks and other financial institutions		2,995,428		3,255,484
- Government bodies and state owned entities	2,937,783		3,027,816	
Allowance for impairment losses on due from banks and other financial institutions		(5,286)		(5,711)
- Government bodies and state owned entities	(4,342)		(4,570)	
Investment securities		140,075		90,845
- Government bodies and state owned entities	63,117		30,362	
- Associates	-		250	
Loans to customers, Gross		1,997,802		1,890,028
- Government bodies and state owned entities	525,958		554,277	
- Key management personnel of the Group	168		189	
- Other related parties	874		277	
Allowance for impairment losses on loans to customers		(237,017)		(215,875)
- Government bodies and state owned entities	(9,393)		(9,881)	
- Key management personnel of the Group	(6)		(8)	
- Other related parties	(202)		(158)	
Other Assets		49,035		40,463
- Government bodies and state owned entities	230		416	
Receivables from CJSC "Agrarkredit"		1,176,875		1,152,173
- Government bodies and state owned entities	1,176,875		1,152,173	
Allowance for impairment on receivables from CJSC "Agrarkredit"		(1,772)		(1,772)
- Government bodies and state owned entities	(1,772)		(1,772)	
Customer accounts		(4,490,069)		(4,364,649)
- Government bodies and state owned entities	(2,554,299)		(2,477,303)	
- Key management personnel of the Group	(596)		(257)	
- Other related parties	(9,006)		(7,691)	
Payables to CJSC "Agrarkredit"		(365,261)		(364,596)
- Government bodies and state owned entities	(365,261)		(364,596)	
Due to banks and other financial institutions		(39,301)		(45,260)
- Government bodies and state owned entities	-		(5,182)	
Other borrowed funds		(105,075)		(106,630)
- Government bodies and state owned entities	(86,647)		(86,674)	
Undrawn loan commitments		1,785,346		1,729,851
- Government bodies and state owned entities	1,727,780		1,714,214	
Letters of credit and guarantees		969,564		1,305,966
- Government bodies and state owned entities	362,340		512,097	
Provision for off-balance sheet commitments		(79,928)		(117,747)
- Government bodies and state owned entities	(4,820)		(7,400)	

During the period ended 30 June 2019, The Group received promissory notes from Government in amount of AZN 31,272 thousand within the Restructuring Plan of liabilities, which was considered as related party transaction.

(Figures in tables are in thousands of Azerbaijani manats)

21. Related party disclosures (continued)

Transactions with entities other than government-related

Compensation to members of key management personnel of the Group comprised the following:

	30 June 2019 (unaudited)		30 June 2018 (unaudited, not reviewed)	
	Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
Key management personnel compensation:				
- short-term employee benefits	(4,666)	(31,505)	(2,561)	(40,776)
Total	(4,666)		(2,561)	

Included in the consolidated statement of profit or loss and other comprehensive income for the years ended 30 June 2019 and 30 June 2018 are the following amounts which were recognized in transactions with related parties:

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

	30 June 2019 (unaudited)		30 June 2018 (unaudited, not reviewed)	
	Related party transactions	Total category as per the financial statements caption	Related party transactions	Total category as per the financial statements caption
Interest income		232,133		225,686
- Government bodies and state-owned entities	111,402		92,016	
- Key management personnel of the Group	8		9	
- Other related parties	25		14	
Interest expense		(68,154)		(82,638)
- Government bodies and state-owned entities	(49,553)		(53,511)	
- Key management personnel of the Group	(1)		(9)	
- Other related parties	(69)		(26)	
(Charge)/reversal of impairment losses / (impairment losses) on interest bearing assets		(20,234)		48,414
- Government bodies and state-owned entities	505		6,145	
- Key management personnel of the Group	2		(14)	
- Other related parties	(58)		(125)	
Reversal of impairment losses / (impairment losses) on contingent liabilities and credit commitments		16,298		5,823
- Government bodies and state owned entities	(1,899)		(1,357)	
Gains from operations in foreign currencies		32,179		24,073
- Government bodies and state-owned entities	14,399		10,271	
Fee and commission income		42,984		42,418
- Government bodies and state-owned entities	7,558		6,521	
- Key management personnel of the Group	2		1	
- Other related parties	13		-	
Fee and commission expense		(10,745)		(7,796)
- Government bodies and state-owned entities	(1,694)		(1,321)	
Operating expenses		(67,082)		(71,211)
- Government bodies and state-owned entities	(1,423)		(1,145)	
- Key management personnel of the Group	(4,666)		(2,561)	

(Figures in tables are in thousands of Azerbaijani manats)

22. Capital adequacy

The Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Group's capital is managed by the ratios established by Basel Capital Accord 1988 and monitored using the ratios established by the regulator.

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Compliance with capital adequacy ratios set by regulator is monitored monthly with reports outlining their calculation reviewed and signed by the Group's Chief Financial Officer (CFO).

FMSA capital adequacy ratio

The FMSA requires banks to maintain a minimum Tier 1 and total capital adequacy ratio of 5% and 10% respectively, of risk-weighted assets for regulatory capital. As at 30 June 2019, the Bank was in compliance with these requirements.

Capital adequacy ratio under Basel Capital Accord 1988

The Group's international risk based capital adequacy ratio is computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks.

As at 30 June 2019 and 31 December 2018 these ratios exceeded the minimum ratio of 8.0% recommended by the Basel Accord, as disclosed below:

	30 June 2019 (unaudited)	31 December 2018
Tier 1 capital	1,665,074	1,564,359
Tier 2 capital	87,704	129,700
Less: deductions from capital	(61,647)	(48,778)
Total capital	1,691,131	1,645,281
Risk weighted assets	4,066,098	4,352,272
Tier 1 capital ratio	40.95%	35.94%
Total capital ratio	41.59%	37.80%

23. Events after the end of the interim period

On 11 October 2019, according to the resolution of Annual General Meeting of Shareholders, the Group declared the dividend in the total amount of AZN 150,000 thousand.

On 11 October 2019, according to the resolution of Annual General Meeting of Shareholders, the Group announced the decision to establish new investment company.