OJSC International Bank of Azerbaijan

Consolidated financial statements

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

Contents

Independent auditor's report

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

Report on the audit of the consolidated financial statements

Opinion

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

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements section* of our report. We are independent of the 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.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter | **How our audit addressed the key audit matter**

Allowance for loans to customers and provision for credit related commitments

Given the significance of the allowance for loans to customers and provision for credit related commitments to the Group's financial position, the complexity and judgments related to the estimation of expected credit losses ("ECL") under newly adopted IFRS 9 *Financial Instruments* ("IFRS 9"), we considered this area as a key audit matter.

The Group exercises significant judgement and estimation techniques to determine probability of default, projected exposure at default and loss arising at default, considering observed historical data, current economic situation and available forward-looking information. The calculation of ECL for financial assets on an individual basis requires scenario analysis of the estimated future cash flows considering current and projected financial performance of the borrowers and value of collateral.

Information on the allowance for expected credit losses on loans to customers and provision for credit related commitments is included in Note 5 – *Significant accounting judgements and estimates*, Note 10 – *Loan to customers*, Note 19 – *Commitments and contingencies*, and Note 23 – *Risk management* to the consolidated financial statements.

Our audit procedures, among others, comprised the following;

- We evaluated expected credit loss methodology developed by the Group in accordance with the requirements of IFRS 9 to calculate allowance for impairment of loans to customers and provision for credit related commitments;
- We considered the appropriateness of the Group's definition of significant credit risk parameters and consistency of their application in accordance with methodology;
- We evaluated underlying statistical models, key inputs and assumptions used and assessed incorporation of forward-looking information in the calculation of ECL on a collective basis;
- We analysed the expected future cash flows from individually significant loans, including the value of collateral. We considered reports of the Group's internal and external appraisers and available market information on the fair value of collateral;
- We evaluated information disclosed in the notes to the consolidated financial statements in regard to allowance for impairment of loans to customers and provision for credit related commitments.

Restructuring of the Group's operations

As described in Note 2 – *Restructuring of the Group's operations* to the consolidated financial statements, the Group's restructure of its assets and liabilities is ongoing. Due to the considerable judgement and possible substantial effect on consolidated statement of financial position, restructuring of assets and liabilities was a key audit matter.

We updated our understanding of the management's current processes related to the restructuring of assets and liabilities.

We evaluated the Group's accounting treatment of the transactions and circumstances arising from the restructuring of the Group's operations, including the classification of the financial results.

We evaluated the information disclosed in the notes to the consolidated financial statements with regard to restructuring of the Group's operations.

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 IFRSs, 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.

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

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

- Identify and assess the risks of material misstatement of the 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 auditor's 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 auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern;

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with 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.

We also provide the Audit committee with a statement that we have complied with relevant ethical requirements regarding independence, and have communicated with it all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Audit committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Turgay Teymurov.

Ernst & Young Holdings (CIS) B.V.

Baku, Azerbaijan

15 May 2019

Consolidated statement of financial position

As at 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2018	2017
Assets			
Cash and cash equivalents	7	1,810,173	2,707,095
Mandatory cash balances with the Central Banks		54,702	55,203
Due from banks and other financial institutions	8	3,249,773	3,317,521
Investment securities	9	90,845	69,628
Loans to customers	10	1,674,153	1,542,910
Receivables from CJSC "Agrarkredit"	2	1,150,401	1,103,964
Current income tax assets		2,102	18,137
Deferred income tax assets	17	900	7,340
Property, equipment and intangible assets	11	200,731	222,915
Other assets	12	40,463	29,999
Total assets		**8,274,243**	**9,074,712**
Liabilities			
Due to banks and other financial institutions	13	45,260	69,289
Customer accounts	14	4,364,649	5,239,613
Payables to CJSC "Agrarkredit"	2	364,596	515,767
Other borrowed funds	15	106,630	175,998
Debt securities issued	16	1,490,698	1,461,701
Current income tax liabilities		1,836	-
Deferred income tax liabilities	17	85,255	554
Other liabilities	12	172,130	232,281
Total liabilities		**6,631,054**	**7,695,203**
Equity	18		
Share capital		1,241,287	1,241,287
Additional paid-in capital		1,909,116	1,900,315
Foreign currency translation reserve		(12,846)	26,201
Revaluation reserve for premises		36,878	35,492
Unrealized gain on investment securities		38,419	32,555
Accumulated deficit		(1,569,665)	(1,860,858)
Total equity attributable to shareholders of the Bank		**1,643,189**	**1,374,992**
Non-controlling interest		-	4,517
Total equity		**1,643,189**	**1,379,509**
Total liabilities and equity		**8,274,243**	**9,074,712**

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

Mr. Abbas Ibrahimov
Chairman of the Management Board

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

Baku, Azerbaijan
15 May 2019

The accompanying notes on pages 6 to 58 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2018	2017
Interest income calculated using effective interest rate			
Loans to customers		195,393	236,818
Due from banks and other financial institutions		161,415	167,174
Cash and cash equivalents		29,381	12,338
Receivables from CJSC "Agrarkredit"		48,266	35,906
Investment securities		2,286	3,761
		436,741	**455,997**
Interest expense			
Customer accounts		(63,451)	(139,374)
Due to banks and other financial institutions		(1,416)	(120,976)
Other borrowed funds		(1,972)	(34,931)
Debt securities issued		(93,915)	(64,753)
		(160,754)	**(360,034)**
Net interest income		**275,987**	**95,963**
Credit loss reversal	20	71,672	5,596
Net interest income after impairment losses for interest bearing assets		**347,659**	**101,559**
Fee and commission income	21	88,851	98,163
Fee and commission expense	21	(17,824)	(15,769)
Net loss arising on initial recognition of financial instruments and loan modification		(19,075)	(6,225)
Gain from debt restructuring	2	–	502,439
Net gains from operations in foreign currencies:			
- dealing		55,355	128,751
- translation differences		21,143	91,247
- operations with foreign currency derivatives		–	13,983
(Impairment)/reversal of impairment of property, equipment and intangible assets	11	(6,736)	11,544
Reversal of provision for credit losses on credit related commitments and other financial assets	20	42,138	7,828
Other impairment reversal	20	8,837	18,791
Operating expenses	22	(127,994)	(149,457)
Other operating income		3,182	9,855
Non-interest income		**47,877**	**711,150**
Profit before income tax expense		**395,536**	**812,709**
Income tax (expense)/benefit	17	(96,860)	13,690
Net profit for the year		**298,676**	**826,399**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Exchange differences on translating foreign operations		(39,047)	488
Net other comprehensive (loss) / gain to be reclassified to profit or loss in subsequent periods		**(39,047)**	**488**
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Unrealised gains on investment securities		7,330	11,841
Change in revaluation reserve for premises		1,733	1,503
Income tax relating to components of other comprehensive income		(1,813)	(2,669)
Net other comprehensive gain not to be reclassified to profit or loss in subsequent periods		**7,250**	**10,675**
Total comprehensive income for the year		**266,879**	**837,562**
Profit attributable to:			
- shareholders of the Bank		298,653	828,112
- non-controlling interest		23	(1,713)
Total comprehensive income attributable to:			
- shareholders of the Bank		266,856	839,243
- non-controlling interest		23	(1,681)
		266,879	**837,562**
Earnings per share, basic and diluted (AZN per share)	18	0.06	0.19

The accompanying notes on pages 6 to 58 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Attributable to shareholders of the Bank								
	Share capital	*Additional paid-in capital*	*Foreign currency translation reserve*	*Revaluation reserve for premises*	*Unrealised gain on investment securities*	*Accumulated deficit*	*Total (deficit)/ equity*	*Non-controlling interest*	*Total (deficit)/ equity*
As at 1 January 2017	**641,287**	**1,556,693**	**25,713**	**34,990**	**23,082**	**(2,689,670)**	**(407,905)**	**6,198**	**(401,707)**
Net profit/(loss) for the year	–	–	–	–	–	828,112	**828,112**	(1,713)	**826,399**
Other comprehensive income for the year	–	–	488	1,202	9,473	–	**11,163**	32	**11,195**
Total comprehensive income/(loss) for the year	**–**	**–**	**488**	**1,202**	**9,473**	**828,112**	**839,275**	**(1,681)**	**837,594**
Transfer to share capital	600,000	(600,000)	–	–	–	–	**–**	–	**–**
Additional paid-in capital	–	943,622	–	–	–	–	**943,622**	–	**943,622**
Transfer to accumulated deficit	–	–	–	(700)	–	700	**–**	–	**–**
As at 31 December 2017	**1,241,287**	**1,900,315**	**26,201**	**35,492**	**32,555**	**(1,860,858)**	**1,374,992**	**4,517**	**1,379,509**
Impact of adopting IFRS 9 (Note 4)	–	–	–	–	–	(8,083)	**(8,083)**	–	**(8,083)**
Restated opening balance under IFRS 9	**1,241,287**	**1,900,315**	**26,201**	**35,492**	**32,555**	**(1,868,941)**	**1,366,909**	**4,517**	**1,371,426**
Net profit for the year	–	–	–	–	–	298,653	**298,653**	23	**298,676**
Other comprehensive (loss) / income for the year	–	–	(39,047)	1,386	5,864	–	**(31,797)**	–	**(31,797)**
Total comprehensive (loss)/income for the year	**–**	**–**	**(39,047)**	**1,386**	**5,864**	**298,653**	**266,856**	**23**	**266,879**
Additional paid-in capital	–	8,801	–	–	–	–	**8,801**	–	**8,801**
Acquisition of non-controlling interest	–	–	–	–	–	623	**623**	(4,540)	**(3,917)**
As at 31 December 2018	**1,241,287**	**1,909,116**	**(12,846)**	**36,878**	**38,419**	**(1,569,665)**	**1,643,189**	**–**	**1,643,189**

The accompanying notes on pages 6 to 58 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2018

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2018*	*2017*
Cash flows from operating activities			
Interest received		262,606	265,424
Interest paid		(133,808)	(346,332)
Fees and commissions received		79,055	98,364
Fees and commissions paid		(17,824)	(11,090)
Gains from operations in foreign currencies		55,355	128,751
Payments on financial derivative instruments		–	(3,497)
Staff costs paid		(53,053)	(54,469)
Other operating expenses paid		(46,110)	(62,380)
Other operating income received		2,687	9,762
Cash flows from operating activities before changes in operating assets and liabilities		**148,908**	**24,533**
Net (increase)/decrease in operating assets			
Mandatory cash balances with Central Banks		501	24,541
Due from banks and other financial institutions		134,065	1,711,951
Loans to customers		(180,657)	660,792
Other assets		(11,999)	16,721
Net (decrease)/increase in operating liabilities			
Due to banks and other financial institutions		(24,378)	(55,853)
Customer accounts		(858,055)	(292,582)
Other liabilities		7,941	(8,742)
Net cash flows (used in) / from operating activities before income tax		**(783,674)**	**2,081,361**
Income tax paid		(337)	(5,307)
Net cash (used in) / from operating activities		**(784,011)**	**2,076,054**
Cash flows (used in) / from investing activities			
Purchase of investment securities		(42,287)	(90,240)
Proceeds from sale and redemption of investment securities		28,396	131,281
Purchase and prepayments for property, equipment and intangible assets		(9,448)	(7,900)
Proceeds from sale of property, equipment and intangible assets		2,284	717
Net cash (used in) / from investing activities		**(21,055)**	**33,858**
Cash flows (used in) / from financing activities			
Repayments of other borrowed funds		(93,773)	(98,058)
Proceeds from other borrowed funds		20,940	17,224
Repayments of subordinated debt		–	(600,000)
Repayments on debt securities issued		(3,307)	(51,321)
Acquisition of non-controlling interests		(3,917)	–
Net cash used in financing activities		**(80,057)**	**(732,155)**
Effect of exchange rate changes on cash and cash equivalents		(9,893)	(31,633)
Effect of change in credit loss allowance		(1,906)	–
Net (decrease)/increase in cash and cash equivalents		**(896,922)**	**1,346,124**
Cash and cash equivalents, beginning of year	7	2,707,095	1,360,971
Cash and cash equivalents, ending of year	7	**1,810,173**	**2,707,095**

The accompanying notes on pages 6 to 58 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows (continued)

(Figures in tables are in thousands of Azerbaijani manats)

Changes in liabilities arising from financing activities comprise:

	Debt securities issued	*Other borrowed funds*	*Subordinated debt*	*Total*
Carrying amount at 31 December 2016	**918,824**	**1,568,307**	**778,755**	**3,265,886**
Proceeds	–	17,224	–	**17,224**
Redemption	(51,321)	(98,058)	(600,000)	**(749,379)**
Non-cash effect of restructuring of liabilities from financing activities	649,069	(1,253,207)	(170,100)	**(774,238)**
Foreign currency translation	(33,031)	(37,694)	(6,970)	**(77,695)**
Other changes	(21,840)	(20,574)	(1,685)	**(44,099)**
Carrying amount at 31 December 2017	**1,461,701**	**175,998**	**–**	**1,637,699**
Cash proceeds	–	20,940	–	**20,940**
Non-cash proceeds	–	2,099	–	**2,099**
Redemption	(3,307)	(93,773)	–	**(97,080)**
Foreign currency translation	(93)	(1)	–	**(94)**
Other changes	32,397	1,367	–	**33,764**
Carrying amount at 31 December 2018	**1,490,698**	**106,630**	**–**	**1,597,328**

The “Other” line includes the effect of accrued but not yet paid interest on debt securities issued, other borrowed funds and subordinated debt. The Group classifies interest paid (including those accrued in prior periods) as cash flows from operating activities.

Apart from non-cash changes presented in the table above, other significant non-cash movement for the year ended 31 December 2018 included transfer of loans to customers and other assets with net carrying value of AZN 88,912 thousand to CJSC “Agrarkredit”, as well as settlement of AZN 52,503 thousand on defaulted guarantees and letters of credit – both in exchange for reduction in Payables to CJSC “Agrarkredit”.

Other significant non-cash movement for the year ended 31 December 2017 included transfer of loans to customers and other assets with total carrying value of AZN 4,013,909 thousand to CJSC “Agrarkredit” in exchange for receivables from CJSC “Agrarkredit” in amount of AZN 1,103,964 thousand as well as transfer of financial liabilities (other than those reflected in the table above) in amount of AZN 1,382,481 thousand to State as part of Group restructuring process (Note 2).

(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 31 December 2018 and 2017 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 (%)* 2018	*Proportion of ownership interest (%)* 2017	*Type of operation*
"The International Bank of Azerbaijan" OJSC	The Republic of Azerbaijan	Parent		Banking
Subsidiaries:				
"IBA-Moscow" LLC	Russian Federation	100.0	100.0	Banking
"International Bank of Azerbaijan-Georgia" OJSC	The Republic of Georgia	100.0	75.0	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
"Biznes Rabita" LLC	The Republic of Azerbaijan	–	100.0	IT infrastructure

During 2018, the Group liquidated "Business Rabita" LLC. Considering that the subsidiary was dormant during 2017 and 2018, the liquidation had no material impact of these consolidated financial statements.

In 2018, the Group acquired 25% of non-controlling interest in "International Bank of Azerbaijan-Georgia" OJSC and started the liquidation process as a result of which the banking licence of the entity was cancelled by the local regulator. The liquidation is under the process as of the date of the issuance of these consolidated financial statements and planned to be completed by the middle of 2019.

In 2019, the decision on continuation of operations "IBA-Moscow" LLC was made.

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

Shareholders	***2018 (%)***	***2017 (%)***
Ministry of Finance of the Republic of Azerbaijan	92.65	77.79
CJSC "Agrarkredit"	0.11	14.86
Other*	7.24	7.35
Total	**100.00**	**100.00**

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

(Figures in tables are in thousands of Azerbaijani manats)

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 2015-2017.

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 and as at 31 December 2018 amounted to AZN 364,596 thousand.

The promissory notes are guaranteed by the MoF. As at the date of signing of these 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 transfer of the remaining part of the problematic assets is expected to be completed by the middle of 2019.

Restructuring of liabilities

During 2016, the Group incurred a loss after tax in the amount of AZN 1,946,407 thousand. As a result of the significant incurred losses the Group breached its debt covenants and regulatory ratios in the 4th quarter of 2016 and the first half of 2017. As a result, as at 31 December 2016 the obligations of the Group in respect of which the covenants were breached have been classified as on demand.

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"). In May and June 2017 the Group obtained protection of its assets in the USA and the UK against claims from its creditors. The proposed Restructuring Plan comprised various options such as swapping the Group's obligations for the obligations of the Republic of Azerbaijan, extending the maturities of the obligations, reducing their interest rates, reducing debt principals for selected liabilities. 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. In August 2017 FMSA and Nasimi District Court of Baku approved the Restructuring Plan of the Group. In September 2017 the Group completed the restructuring of its liabilities under the terms set out in the approved Restructuring Plan. Some creditors initiated legal proceedings against the Group as a result of the debt restructuring, which were ongoing at the date of the authorization of these financial statements (Note 19). Technically the restructuring is expected to be finalized when all issued eurobonds are distributed to the all creditors.

(Figures in tables are in thousands of Azerbaijani manats)

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

Restructuring of liabilities (continued)

The Group recognized AZN 502,439 thousand as a gain from the restructuring in the consolidated profit and loss statement for the period ended 31 December 2017. This amount represents the difference between fair value of newly issued Eurobonds and old liabilities in the amount of AZN 280,880 thousand recognized by the Group and gain in the amount of AZN 221,559 thousand arising from the transfer of liabilities to governments in exchange for promissory notes.

Significant portion of the problematic assets transferred as part of the first stage of the program were denominated in foreign currencies. As the payments made by CJSC "Agrarkredit" to the Group in exchange for the problematic assets included in the first stage of the program were denominated in AZN, this created significant exposure for the Group to foreign currency risk. As at 31 December 2018, the Company's foreign currency short position was approximately AZN 1,031,052 thousand (as at 31 December 2017: AZN 2,816,000 thousand).

To strengthen the capital position of the Group in December 2016 the MoF made a placement for share capital increase of the Group in the amount AZN 600,000 thousand. The share issue was completed in January 2017.

In July 2017 subsequent to the approval of the restructuring plan Moody's upgraded the rating of the Group from Caa1, the rating assigned after announcement of default, to B3. The rating of the Group assigned by Moody's prior to announcement of default was B1. In November 2017, Fitch upgraded the rating of the Group from RD, the rating assigned after announcement of default, to B-. The rating of the Group assigned by Fitch prior to announcement of default was BB. The upgrades of the ratings followed the completion of the Group's debt restructuring and substantial completion of the final part of the problematic assets transfer.

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).

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 2019-2021; and
- Prepare for privatization of the Group in future.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Basis of preparation

General

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

The Azerbaijani manat is presentation currency of the Group and functional currency of OJSC International Bank of Azerbaijan as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Group is required to maintain its records and prepare its financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except when otherwise indicated. The consolidated financial statements have been prepared under the historical cost convention except for premises and debt and equity instruments at fair value through other comprehensive income (FVOCI)

Reclassifications

Following adoption of IFRS 9 (Note 4), the Group updated presentation of consolidated statement of profit or loss and other comprehensive income to present reversals of provision for credit losses on credit related commitments and other financial assets determined in accordance with IFRS 9 in a separate line item. Accordingly, the following reclassifications of reversals of provision and other impairment reversals have been made to 2017 consolidated statement of profit or loss and other comprehensive income to conform to the 2018 presentation:

	As previously reported	*Reclassification*	*As adjusted*
Reversal of provision for credit losses on credit related commitments and other financial assets	–	7,828	7,828
Other impairment reversal	26,619	(7,828)	18,791

4. Summary of significant accounting policies

Changes in accounting policies

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

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

IFRS 9 Financial Instruments

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

(a) Classification and measurement

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

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

(b) Impairment

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

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

(c) Effect of transition to IFRS 9

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

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

		IAS 39 measurement			*Remeasurement*		*IFRS 9*	
Financial assets	***Ref***	***Category***	***Amount***	***Reclas-sification***	***ECL***	***Gross amount***	***Amount***	***Category***
Cash and cash equivalents		L&R	2,707,095				2,707,095	Amortised cost
Mandatory cash balances with the Central Banks		L&R	55,203				55,203	Amortised cost
Due from banks and other financial institutions		L&R	3,317,521		(3,173)		3,314,348	Amortised cost
Investment securities		AFS	69,628				69,628	FVOCI
Loans to customers		L&R	1,542,910		(26,065)	5,365	1,522,210	Amortised cost
Receivables from CJSC "Agrarkredit"		L&R	1,103,964		(1,664)		1,102,300	Amortised cost
Other financial assets		L&R	17,237		350		17,587	Amortised cost
Non-financial assets								
Deferred tax assets			7,340		3,094	(1,073)	9,361	
Total assets			**8,820,898**		**(27,458)**	**4,292**	**8,797,732**	
Non-financial liabilities								
Provision for credit losses on credit related commitments			148,924		(15,083)		133,841	
Total liabilities			**148,924**		**(15,083)**		**133,841**	

The impact of transition to IFRS 9 on reserves and retained earnings is as follows:

	Reserves and retained earnings
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	**(1,860,858)**
Recognition of IFRS 9 ECLs	(15,469)
Remeasurement of gross carrying amount	5,365
Deferred tax in relation to the above	2,021
Restated opening balance under IFRS 9 (1 January 2018)	**(1,868,941)**
Total change in equity due to adopting IFRS 9	**8,083**

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

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

	Loan loss allowance/ provision under IAS 39 / IAS 37 at 31 December 2017	*Re-measurement*	*ECL under IFRS 9 at 1 January 2018*
Impairment allowance for			
Loans and receivables at amortised cost	331,395	26,065	357,460
Due from banks and other financial institutions	2,008	3,173	5,181
Receivables from CJSC "Agrarkredit"	–	1,664	1,664
Other financial assets	20,466	(350)	20,116
Provision for credit losses on credit related commitments	148,924	(15,083)	133,841
	502,793	**15,469**	**518,262**

IFRS 15 Revenue from Contracts with Customers

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

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Considerations

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

Basis of consolidation

Subsidiaries, which are those entities which are controlled by the Bank, are consolidated. Control is achieved when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Bank controls an investee if, and only if, the Bank has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee;
- The ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Bank has less than a majority of the voting or similar rights of an investee, the Bank considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement(s) with the other vote holders of the investee;
- Rights arising from other contractual arrangements;
- The Bank's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Bank and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in full; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Basis of consolidation (continued)

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the acquirer measures the non-controlling interests in the acquiree that are present ownership interests either at fair value or at the proportionate share of the acquiree's identifiable net assets and other components of non-controlling interests at their acquisition date fair value. Acquisition costs incurred are expensed.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IFRS 9 either in profit or loss or as change to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Fair value measurement

The Group measures financial instruments carried at FVOCI and non-financial assets such as premises at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 − quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 − valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 − valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Fair value measurement (continued)

For assets and liabilities that are recognised in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Financial assets and liabilities

Initial recognition

Date of recognition

All regular way purchases and sales of financial assets and liabilities are recognised on the trade date i.e. the date that the Group commits to purchase the asset or liability. Regular way purchases or sales are purchases or sales of financial assets and liabilities that require delivery of assets and liabilities within the period generally established by regulation or convention in the marketplace.

Initial measurement

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

Measurement categories of financial assets and liabilities

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

- Amortised cost;
- FVOCI;
- FVPL.

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

Before 1 January 2018, the Group classified its financial assets as loans to customers (amortised cost), FVPL and available-for-sale.

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

Amounts due from credit institutions, loans to customers

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

The details of these conditions are outlined below.

Business model assessment

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

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

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

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

The SPPI test

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

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

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

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

Debt instruments at FVOCI

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

Equity instruments at FVOCI

From 1 January 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.

Dividends are recognised in profit or loss as other income when the right of the payment has been established, except when the Group benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred directly to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

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

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

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

The Group occasionally issues loan commitments at below market interest rates drawdown. Such commitments are initially recognized at fair value and subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

Performance guarantees

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

Loans and receivables

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

Available-for-sale financial assets

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

Reclassification of financial assets and liabilities

From 1 January 2018, the Group does not reclassify its financial assets subsequent to their initial recognition. Financial liabilities are never reclassified. The Group did not reclassify any of its financial assets and liabilities in 2017.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, current accounts with CBAR, National Bank of Georgia ("NBG") and Central Bank of Russia ("CBR"), excluding obligatory reserves, and amounts due from banks and other financial institutions due on demand or within 90 days from the date of origination and that are free from contractual encumbrances.

Derivative financial instruments

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

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include due to banks and other financial institutions, other borrowed funds, customer accounts, debt securities issued and payables to CJSC "Agrarkredit". After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process.

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into other operating expenses.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- The normal course of business;
- The event of default; and
- The event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Renegotiated loans (continued)

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Group records a modification gain or loss, presented within net loss arising on initial recognition of financial instruments and loan modification in the consolidated statement of profit or loss and other comprehensive income, to the extent that an impairment loss has not already been recorded.

Impairment of financial assets under IAS 39

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

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

If there was an objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred), discounted using original effective interest rate, or, for financial assets available-for-sale, as the difference between cost of investment and its fair value. The carrying amount of the asset was reduced and the amount of the loss was recognised in profit or loss. Interest revenue continued to be accrued on the reduced carrying amount based on the original effective interest rate of the asset, or, for financial assets available-for-sale, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Assets together with the associated allowance were written off when there is no realistic prospect of future recovery and all collateral had been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss decreased because of an event occurring after the impairment had been recognised, the previously recognised impairment loss was reversed in profit or loss, except for equity investments available-for-sale, for which increase in their fair value after impairment were recognised in other comprehensive income.

For the purpose of a collective evaluation of impairment, financial assets were grouped on the basis of the Group's internal credit grading system that considered credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that were collectively evaluated for impairment were estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience was adjusted on the basis of current observable data to reflect the effects of current conditions that had not affected the years on which the historical loss experience was based and to remove the effects of conditions in the historical period that did not exist currently. Estimates of changes in future cash flows reflected, and were directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that were indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows were reviewed regularly to reduce any differences between loss estimates and actual loss experience.

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- The rights to receive cash flows from the asset have expired;
- The Group has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- The Group either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Write-off

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

Financial liabilities

A financial liability is derecognized 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 recognized in profit or loss.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan and of the countries in which the Group has offices and branches and where its subsidiaries are located.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Taxation (continued)

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity, respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property and equipment

Property and equipment other than office premises are stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of property and equipment when that cost is incurred if the recognition criteria are met.

Office premises of the Group are held at revalued amount subject to revaluation to market value on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises being revalued. Increases in the carrying amount arising on revaluation are credited to other comprehensive income unless the increase reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the revaluation gain is recognised in profit or loss to the extent of the amount of reversal. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and decrease the previously recognised revaluation reserve in equity; all other decreases are charged to profit or loss for the year. The revaluation reserve for office premises included in equity is reclassified directly to retained earnings on the retirement or disposal of the asset.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation is recognized so as to write off the cost or valuation of assets (other than freehold land and properties under construction) less their residual values over their useful lives, using the straight-line method. The property and equipment is depreciated over their useful lives on a straight line basis. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis. The following useful lives are used for depreciation purposes:

	Years
Office premises	3-50
Furniture, fixtures, vehicles and other fixed assets	4
Computer and communication equipment	4
Leasehold improvements	10

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

A property, equipment or intangible asset that is no longer used by the Group is written-off from the accounting records.

Repossessed collateral

In certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is measured at the lower of carrying amount and net realizable value and reported within “Other assets”.

Intangible assets

Intangible assets consist of banking license, software and other licenses, and computer software.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 1-10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Banking license is represented by an intangible asset acquired in a business combination and has indefinite useful life.

Intangible assets with indefinite useful lives are not amortised and assessed for impairment at least at each financial year-end whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Retirement and other employee benefit obligations

The Group does not have any pension arrangements separate from the State pension system of the Republic of Azerbaijan which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Group has no post-retirement benefits.

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

Dividends

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

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Expenses are recognized when incurred. The following specific recognition criteria must also be met before revenue and expense is recognised.

Interest and similar income and expense

From 1 January 2018, the Group calculates interest revenue on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets (before 1 January 2018: by applying EIR to the amortized cost of financial assets). EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest revenue or expense.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income and expense

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income includes fee and commission received on plastic cards operations, settlement transactions, servicing contingent liabilities and cash transactions which are recognized as revenue as the services are provided. Fee and commission expense consists of fee and commission paid on plastic cards operations, settlement transactions and cash transactions.

Fee and commission income which forms an integral part of the effective interest rate of a financial instrument is recognized as an adjustment to the effective interest rate and recorded in 'interest income'.

Foreign currency translation

The consolidated financial statements are presented in AZN, which is the Bank's functional currency and presentation currency of the Group. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit as gains less losses from foreign currencies – translation differences.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies.

As at the reporting date, the assets and liabilities of the Bank's subsidiaries whose functional currency is different from the presentation currency of the Bank are translated into AZN at the rate of exchange ruling at the reporting date and, their statements of profit or loss and other comprehensive income are translated at the average exchange rates for the year. The exchange rate differences arising on the translation are recognised in other comprehensive income.

The Group used the following official exchange rates at 31 December 2018 and 2017 in the preparation of these consolidated financial statements:

	2018	*2017*
1 US dollar	AZN 1.7000	AZN 1.7001
1 euro	AZN 1.9468	AZN 2.0307
1 Georgian lari	AZN 0.6367	AZN 0.6514
1 Russian ruble	AZN 0.0245	AZN 0.0295

Standards and interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's consolidated financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

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

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

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

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

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

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

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

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

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

Amendments to IFRS 9 Prepayment Features with Negative Compensation

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

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

Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group will apply these amendments when they become effective.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

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

These improvements include:

IFRS 3 Business Combinations

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. These amendments will apply on future business combinations of the Group.

IFRS 11 Joint Arrangements

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured.

An entity applies those amendments to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after 1 January 2019, with early application permitted. These amendments are currently not applicable to the Bank Group but may apply to future transactions.

IAS 12 Income Taxes

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

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

IAS 23 Borrowing Costs

The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. An entity applies those amendments for annual reporting periods beginning on or after 1 January 2019, with early application permitted. Since the Group's current practice is in line with these amendments, the Group does not expect any effect on its consolidated financial statements.

5. Significant accounting judgments and estimates

In the process of applying the Group's accounting policies, management has made the following judgements and made estimates which have affected the amounts recognised in the consolidated financial statements:

Fair value of financial instruments

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

(Figures in tables are in thousands of Azerbaijani manats)

5. Significant accounting judgments and estimates (continued)

Impairment losses on financial assets

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

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

More details are provided in Notes 10 and 23.

Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. If actual results differ from those estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in the consolidated statement of profit or loss (Note 17).

6. Segment reporting

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. The Group's reportable segments under IFRS 8 are therefore as follows:

- 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.

(Figures in tables are in thousands of Azerbaijani manats)

6. Segment reporting (continued)

	Corporate		*Retail*		*Treasury*		*Unallocated*		*Total*	
Continuing operations	***2018***	***2017***	***2018***	***2017***	***2018***	***2017***	***2018***	***2017***	***2018***	***2017***
Interest income	56,436	96,107	138,957	141,617	241,348	218,273	–	–	**436,741**	**455,997**
Interest expense	(10,881)	(20,449)	(52,570)	(83,670)	(97,303)	(255,915)	–	–	**(160,754)**	**(360,034)**
Net interest income	**45,555**	**75,658**	**86,387**	**57,947**	**144,045**	**(37,642)**	**–**	**–**	**275,987**	**95,963**
Reversal of impairment losses / (impairment losses) for interest bearing assets	42,750	21,632	31,466	(19,156)	(2,544)	3,120	–	–	**71,672**	**5,596**
Net interest income after provision for impairment losses	**88,305**	**97,290**	**117,853**	**38,791**	**141,501**	**(34,522)**	**–**	**–**	**347,659**	**101,559**
Fee and commission income	76,256	69,553	11,008	25,123	1,587	3,487	–	–	**88,851**	**98,163**
Fee and commission expense	(2,623)	(2,546)	(10,668)	(10,114)	(4,533)	(3,109)	–	–	**(17,824)**	**(15,769)**
Reversal of impairment / (impairment) of property, equipment and intangible assets	–	–	–	–	–	–	(6,736)	11,544	**(6,736)**	**11,544**
Other impairment reversal/(charge)	8,837	18,791	–	–	–	–	–	–	**8,837**	**18,791**
Reversal of provision for credit losses on credit related commitments	42,138	7,828	–	–	–	–	–	–	**42,138**	**7,828**
Gain from debt restructuring	–	–	–	–	–	502,439	–	–	**–**	**502,439**
Net gains from operations in foreign currencies:										
- dealing	51,957	127,234	1,992	3,545	1,406	(2,028)	–	–	**55,355**	**128,751**
- translation differences	–	–	–	–	21,143	91,247	–	–	**21,143**	**91,247**
- operations with foreign currency derivatives	–	–	–	–	–	13,983	–	–	**–**	**13,983**
Other operating income	328	2,322	2,854	7,533	–	–	–	–	**3,182**	**9,855**
Non-interest income	**176,893**	**223,182**	**5,186**	**26,087**	**19,603**	**606,019**	**(6,736)**	**11,544**	**194,946**	**866,832**
Operating expenses	–	–	–	–	–	–	(127,994)	(149,457)	**(127,994)**	**(149,457)**
Losses on initial recognition of financial instruments	(19,075)	(6,225)	–	–	–	–	–	–	**(19,075)**	**(6,225)**
Non-interest expenses	**(19,075)**	**(6,225)**	**–**	**–**	**–**	**–**	**(127,994)**	**(149,457)**	**(147,069)**	**(155,682)**
Profit/(loss) before income tax expense	**246,123**	**314,247**	**123,039**	**64,878**	**161,104**	**571,497**	**(134,730)**	**(137,913)**	**395,536**	**812,709**
Income tax expense	–	–	–	–	–	–	(96,860)	13,690	**(96,860)**	**13,690**
Net profit/(loss) for the year	**246,123**	**314,247**	**123,039**	**64,878**	**161,104**	**571,497**	**(231,590)**	**(124,223)**	**298,676**	**826,399**
Segment assets	**894,904**	**759,687**	**800,782**	**807,507**	**6,366,282**	**7,366,764**	**212,275**	**140,754**	**8,274,243**	**9,074,712**
Segment liabilities	**3,334,469**	**3,963,650**	**1,161,008**	**1,595,540**	**2,012,415**	**2,063,871**	**123,162**	**72,142**	**6,631,054**	**7,695,203**

The amount of revenues from entities that are under common control with the Group are disclosed Note 26 “Related party disclosures”.

The geographic information comprises:

	Azerbaijan Republic		*OECD countries*		*Non-OECD countries*		*Total*	
	2018	***2017***	***2018***	***2017***	***2018***	***2017***	***2018***	***2017***
Revenue	549,506	660,240	26,209	14,355	5,232	8,316	**580,947**	**682,911**
Non-current assets	182,356	197,932	–	–	18,375	24,983	**200,731**	**222,915**

Revenue includes operating income excluding interest expense, fee and commission expense and provision for impairment losses.

(Figures in tables are in thousands of Azerbaijani manats)

7. Cash and cash equivalents

Cash and cash equivalents comprise:

	2018	*2017*
Cash on hand	203,940	211,783
Current accounts with Central Banks	129,192	25,839
Correspondent accounts and time deposits with original maturity up to 90 days with credit institutions	1,477,041	2,469,473
Cash and cash equivalents	**1,810,173**	**2,707,095**

As at 31 December 2018, the Group had a concentration of correspondent accounts and time deposits with original maturity up to 90 days with credit institutions represented by AZN 1,446,491 thousand (31 December 2017: AZN 1,989,062 thousand) in seven (31 December 2017: five) largest banks.

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

The following table shows reconciliation from the opening to the closing balance of cash and cash equivalents balance and of the loss allowance of correspondent accounts and time deposits with original maturity up to 90 days with credit institutions by class:

	Stage 1	*Stage 3*	*Total*
Carrying value as at 1 January 2018	**2,707,095**	**–**	**2,707,095**
Transfers to Stage 3	(1,906)	1,906	–
Net cash used in operating, investing and financing activities	(885,123)	–	**(885,123)**
Foreign exchange	(9,893)	–	**(9,893)**
Amounts written off	–	(1,906)	**(1,906)**
At 31 December 2018	**1,810,173**	**–**	**1,810,173**

	Stage 1	*Stage 3*	*Total*
ECL allowance as at 1 January 2018	**–**	**–**	**–**
Changes to inputs used for ECL calculations	(407)	–	**(407)**
Transfers to Stage 3	407	(407)	–
Impact on period end ECL of exposures transferred between stages during the period	–	(1,499)	**(1,499)**
Amounts written off	–	1,906	**1,906**
At 31 December 2018	**–**	**–**	**–**

8. Due from banks and other financial institutions

Due from banks and other financial institutions comprise:

	2018	*2017*
Time deposits with the CBAR	3,027,816	3,273,476
Blocked accounts with non-resident banks	52,447	38,860
Time deposits with resident banks	4,513	6,694
Time deposits with non-resident banks	167,694	–
Loans to credit institutions	3,014	–
Other amounts	–	499
Less: allowance for impairment	(5,711)	(2,008)
Due from banks and other financial institutions	**3,249,773**	**3,317,521**

As at 31 December 2018, the Group had two time deposits (31 December 2017: three) with CBAR maturing in December 2019 (31 December 2017: between November 2018 and December 2018) with interest rate 5% p.a each (31 December 2017: 5% p.a.).

(Figures in tables are in thousands of Azerbaijani manats)

8. Due from banks and other financial institutions (continued)

Movements in allowance on balances due from banks and other financial institutions are presented below:

	Stage 1	*Stage 2*	*Total*
Gross carrying value as at 1 January 2018	**3,313,323**	**6,206**	**3,319,529**
New assets originated or purchased	184,242	–	**184,242**
Assets repaid	(316,617)	(1,690)	**(318,307)**
Change in accrued interest balance	84,327	(3)	**84,324**
Foreign exchange	(14,304)	–	**(14,304)**
At 31 December 2018	**3,250,971**	**4,513**	**3,255,484**

	Stage 1	*Stage 2*	*Total*
ECL allowance as at 1 January 2018	**(4,933)**	**(248)**	**(5,181)**
New assets originated or purchased	(966)	–	**(966)**
Assets repaid	607	90	**697**
Unwind of discount	(126)	–	**(126)**
Net remeasurement of loss allowance	(135)	–	**(135)**
At 31 December 2018	**(5,553)**	**(158)**	**(5,711)**

The movements in allowance for impairment of amounts due from banks and other financial institutions during the year ended 31 December 2017 under IAS 39 were as follows:

	2017
1 January	**(58,069)**
Reversal	3,120
Write-off	52,941
31 December	**(2,008)**

9. Investment securities

Investment securities comprise:

	2018	*2017*
Debt securities at FVOCI		
Government bonds	41,175	X
Corporate bonds	892	X
	42,067	**X**
Equity securities at FVOCI		
Corporate shares	48,778	X
	48,778	**X**
Total investment securities	**90,845**	**X**
Investment securities available-for-sale		
Notes issued by the Central Bank of Azerbaijan Republic	X	22,343
Government bonds	X	6,053
Corporate shares	X	41,232
Total investment securities available-for-sale	**X**	**69,628**

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

As at 31 December 2018, the Government bonds comprise Bonds of the Ministry of Finance of Azerbaijan Republic and Bonds of the Ministry of Finance of Turkey (as at 31 December 2017: Bonds of the Ministry of Finance of the Russian Federation) in amount of AZN 29,503 thousand and AZN 11,672 thousand (as at 31 December 2017: AZN 6,053 thousand), respectively.

(Figures in tables are in thousands of Azerbaijani manats)

9. Investment securities (continued)

As at 31 December 2018, the Corporate shares comprise class 'B' common equity shares of Mastercard Incorporated and class 'C' common equity shares of Visa Incorporated at fair market value of AZN 12,120 thousand and AZN 36,348 thousand, respectively, as well as ordinary shares of Azerbaijan Credit Bureau and Baku Stock Exchange at fair market value of AZN 250 thousand and AZN 60 thousand, respectively (as at 31 December 2017: class 'B' common equity shares of Mastercard Incorporated and class 'C' common equity shares of Visa Incorporated at fair market value of AZN 9,724 thousand and AZN 31,448 thousand, respectively, as well as ordinary shares of Baku Stock Exchange at fair market value of AZN 60 thousand).

The Group made an irrevocable election at initial recognition to present in other comprehensive income subsequent changes in the fair value of corporate equity shares. The basis for this election was that such investments are not held for trading.

10. Loans to customers

Loans to customers comprise:

	2018	*2017*
Loans to individuals	851,626	826,597
Loans to legal entities	925,377	817,915
Loans to be transferred to CJSC "Agrarkredit"	113,025	229,793
Total loans to customers, gross	**1,890,028**	**1,874,305**
Less: allowance for impairment losses	(215,875)	(331,395)
Total loans to customers	**1,674,153**	**1,542,910**

As at 31 December 2018, the Group had a concentration of loans represented by AZN 777,983 thousand or 41% of gross loan portfolio (31 December 2017: AZN 649,901 thousand or 35%) due from ten (31 December 2017: ten) largest borrowers. An allowance of AZN 49,460 thousand (31 December 2017: AZN 108,168 thousand) was recognized against these loans.

Loans to individuals comprise the following products:

	2018	*2017*
Mortgage loans	531,559	571,675
Consumer loans and others	320,067	254,922
Total loans to customers, gross	**851,626**	**826,597**
Less: allowance for impairment losses	(62,598)	(71,709)
Total loans to customers	**789,028**	**754,888**

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

	2018	*2017*
Analysis by sector		
Individuals	851,626	826,597
Trade and Service	545,659	399,023
Railroad, air and other transportation	224,150	229,552
Manufacturing	62,875	96,880
Construction and real estate development	45,245	65,153
Oil and Gas sector, power production and distribution	1,045	13,038
Communication	20,239	11,487
Other	26,164	2,782
Loans to be transferred to CJSC "Agrarkredit"	113,025	229,793
Total loans to customers, gross	**1,890,028**	**1,874,305**
Less: allowance for impairment losses	(215,875)	(331,395)
Total loans to customers	**1,674,153**	**1,542,910**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

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

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**522,578**	**71,036**	**226,455**	**820,069**
New assets originated or purchased	360,563	–	–	**360,563**
Change in accrued balance	9,868	(936)	12,185	**21,117**
Assets repaid	(152,222)	(33,170)	(38,215)	**(223,607)**
Transfer to 12-month ECL	18,358	(15,733)	(2,625)	**–**
Transfer to lifetime ECL not credit-impaired	(90,279)	104,301	(14,022)	**–**
Transfer to lifetime ECL credit-impaired	(5,830)	(2)	5,832	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	1,854	(20,929)	**(19,075)**
Write-offs	–	–	(33,690)	**(33,690)**
At 31 December 2018	**663,036**	**127,350**	**134,991**	**925,377**

Loans to legal entities	*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	(6,346)	–	–	**(6,346)**
Change in accrued balance	(24)	405	–	**381**
Unwind of discount	–	–	(4,827)	**(4,827)**
Assets repaid	10,561	8,748	16,183	35,492
Transfer to 12-month ECL	(5,136)	3,017	2,119	**–**
Transfer to lifetime ECL not credit-impaired	3,718	(6,072)	2,354	**–**
Transfer to lifetime ECL credit-impaired	121	–	(121)	**–**
Net remeasurement of ECL	2,741	6,747	2,754	**12,242**
Changes due to modifications not resulting in derecognition	–	(853)	8,119	**7,266**
Write-offs	–	–	33,690	**33,690**
At 31 December 2018	**(15,839)**	**(9,924)**	**(53,747)**	**(79,510)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

Loans to individuals	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**717,382**	**39,663**	**72,762**	**829,807**
New assets originated or purchased	330,126	–	–	**330,126**
Change in accrued balance	6,444	(50)	3,352	**9,746**
Assets repaid	(271,233)	(16,101)	(26,948)	**(314,282)**
Transfer to 12-month ECL	31,018	(15,844)	(15,174)	**–**
Transfer to lifetime ECL not credit-impaired	(21,119)	23,344	(2,225)	**–**
Transfer to lifetime ECL credit-impaired	(12,256)	(3,917)	16,173	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	**–**
Write-offs	–	–	(3,771)	**(3,771)**
At 31 December 2018	**780,362**	**27,095**	**44,169**	**851,626**

Loans to individuals	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(28,360)**	**(12,209)**	**(57,266)**	**(97,835)**
New assets originated or purchased	(6,220)	–	–	**(6,220)**
Change in accrued balance	(124)	12	–	**(112)**
Unwind of discount	–	–	(2,424)	**(2,424)**
Assets repaid	6,494	3,958	22,857	**33,309**
Transfer to 12-month ECL	(14,752)	5,479	9,273	**–**
Transfer to lifetime ECL not credit-impaired	885	(2,471)	1,586	**–**
Transfer to lifetime ECL credit-impaired	483	1,299	(1,782)	**–**
Net remeasurement of ECL	20,287	(3,900)	(9,474)	**6,913**
Write-offs	–	–	3,771	**3,771**
At 31 December 2018	**(21,307)**	**(7,832)**	**(33,459)**	**(62,598)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

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

Loans to CJSC "Agrarkredit"	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**–**	**–**	**229,794**	**229,794**
Assets transferred to the CJSC Agrarkredit	–	–	(112,314)	**(112,314)**
Change in accrued balance	–	–	10,535	**10,535**
Write-offs	–	–	(14,990)	**(14,990)**
At 31 December 2018	**–**	**–**	**113,025**	**113,025**

Loans to CJSC "Agrarkredit"	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**–**	**–**	**(102,217)**	**(102,217)**
Assets transferred to the CJSC "Agrarkredit"	–	–	28,069	**28,069**
Unwind of discount	–	–	(5,900)	**(5,900)**
Net remeasurement of ECL	–	–	(8,709)	**(8,709)**
Write-offs	–	–	14,990	**14,990**
At 31 December 2018	**–**	**–**	**(73,767)**	**(73,767)**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost (continued)

Movements in the provision for loan impairment during 2017 are as following:

	Legal entities	*Individuals*	*Loans to be transferred To CJSC "Agrarkredit"*	*Total*
As at 1 January 2017	**(335,849)**	**(56,174)**	**(694,151)**	**(1,086,174)**
Reversal/(charge)	21,632	(21,863)	2,707	**2,476**
Write off	35,702	5,003	–	**40,705**
Disposal of provision on sale to CJSC "Agrarkredit"	121,970*	1,829*	589,227	**713,026**
Foreign exchange difference	(924)	(504)	–	**(1,428)**
As at 31 December 2017	**(157,469)**	**(71,709)**	**(102,217)**	**(331,395)**
Individual impairment	(87,412)	(10,675)	(102,217)	**(200,304)**
Collective impairment	(70,057)	(61,034)	–	**(131,091)**
	(157,469)	**(71,709)**	**(102,217)**	**(331,395)**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**206,112**	**29,156**	**229,793**	**465,061**

* *In addition to the list of problematic loans which was approved on 10 February 2017, the loans with the allowance for impairment losses in the amount of AZN 128,274 thousand were transferred to CJSC "Agrarkredit" during the year.*

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

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

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

	2018
Loans modified during the period	
Amortised cost before modification	166,565
Net modification loss	(19,075)

(Figures in tables are in thousands of Azerbaijani manats)

11. Property, equipment and intangible assets

The movements in property and equipment were as follows:

	Office premises	*Leasehold improvements*	*Furniture, fixtures, vehicles, and other fixed assets*	*Computers and communication equipment*	*Construction in progress*	*Total property and equipment*	*Intangible assets*	*Total property, equipment and intangible assets*
Historical cost / revalued amount								
As at 1 January 2017	**173,359**	**6,958**	**81,658**	**94,498**	**10,024**	**366,497**	**44,171**	**410,668**
Transfer	5,946	553	422	704	(7,625)	**–**	–	**–**
Additions	587	229	1,703	2,051	–	**4,570**	5,092	**9,662**
Disposals	(26,991)	(785)	(17,412)	(16,268)	(2,399)	**(63,855)**	(8,484)	**(72,339)**
Reversal of impairment/(Impairment)	17,718	(902)	(163)	(3,185)	–	**13,468**	(1,924)	**11,544**
Revaluation	1,503	–	–	–	–	**1,503**	–	**1,503**
Foreign exchange difference	407	–	(40)	17	–	**384**	(3)	**381**
As at 31 December 2017	**172,529**	**6,053**	**66,168**	**77,817**	**–**	**322,567**	**38,852**	**361,419**
Additions	374	264	2,684	3,356	–	**6,678**	3,385	**10,063**
Disposals and write-offs	–	(2,618)	(1,645)	(8,624)	–	**(12,887)**	(14,968)	**(27,855)**
Reversal of impairment/(Impairment)	(6,041)	–	(695)	–	–	**(6,736)**	–	**(6,736)**
Revaluation	(13,254)	–	–	–	–	**(13,254)**	–	**(13,254)**
Foreign exchange difference	(1,632)	–	(688)	–	–	**(2,320)**	–	**(2,320)**
As at 31 December 2018	**151,976**	**3,699**	**65,824**	**72,549**	**–**	**294,048**	**27,269**	**321,317**
Accumulated depreciation								
As at 1 January 2017	**(12,805)**	**(3,982)**	**(52,981)**	**(61,820)**	**–**	**(131,588)**	**(26,181)**	**(157,769)**
Depreciation charge	(3,010)	(678)	(9,501)	(9,494)	–	**(22,683)**	(3,698)	**(26,381)**
Disposals	4,785	773	16,334	15,195	–	**37,087**	8,497	**45,584**
Foreign exchange differences	(25)	–	17	(7)	–	**(15)**	77	**62**
As at 31 December 2017	**(11,055)**	**(3,887)**	**(46,131)**	**(56,126)**	**–**	**(117,199)**	**(21,305)**	**(138,504)**
Depreciation charge	(4,033)	(748)	(6,870)	(5,906)	–	**(17,557)**	(4,553)	**(22,110)**
Disposals	–	2,279	1,445	6,214	–	**9,938**	14,968	**24,906**
Revaluation	14,987	–	–	–	–	**14,987**	–	**14,987**
Foreign exchange differences	101	–	34	–	–	**135**	–	**135**
As at 31 December 2018	**–**	**(2,356)**	**(51,522)**	**(55,818)**	**–**	**(109,696)**	**(10,890)**	**(120,586)**
Net book value								
As at 1 January 2017	**160,554**	**2,976**	**28,677**	**32,678**	**10,024**	**234,909**	**17,990**	**252,899**
As at 31 December 2017	**161,474**	**2,166**	**20,037**	**21,691**	**–**	**205,368**	**17,547**	**222,915**
As at 31 December 2018	**151,976**	**1,343**	**14,302**	**16,731**	**–**	**184,352**	**16,379**	**200,731**

(Figures in tables are in thousands of Azerbaijani manats)

11. Property, equipment and intangible assets (continued)

As at 31 December 2018 and 2017 included in property, equipment and intangible assets were fully depreciated assets in use in the amount of AZN 53,877 thousand and AZN 65,361 thousand, respectively.

As at 31 December 2018 and 2017 premises owned by the Group were recognized at fair value. The valuation was carried out by an independent firm of appraisers, who hold relevant professional qualification and who had experience in the valuation of assets in similar locations and in a similar category. The fair value is determined by the reference to the market-based evidence. The method of sales comparison (comparative approach) was used by the independent valuators engaged by the Group for the valuation of the premises. As at 31 December 2018 and 2017, the fair value of the Group's premises belonged to Level 3 within the fair value hierarchy.

The following table summarises the sensitivity of the fair value measurement of Group's premises categorised within Level 3 of the fair value hierarchy to changes in unobservable inputs as at 31 December 2018.

Input	*Description of input*	*Description of sensitivity*
Trade discount (difference between bid and ask price)	Local realtors were interviewed, and the resulted discount interval on bargain was found to be between 10% and 15%.	The corrective adjustment on bargain may vary from 10% to 15%. Increase in trade discount input might lead to decrease in the fair value of the Group's premises.

12. Other assets and liabilities

Other assets comprise:

	2018	*2017*
Other financial assets		
Accrued commission and receivables from settlement of off-balance sheet commitments	17,872	24,994
Funds in settlement	15,641	11,689
Pledged funds with non-resident organisations	9,848	1,020
Allowance for impairment of other assets	(12,928)	(20,466)
	30,433	**17,237**
Other non-financial assets		
Repossessed collateral to be transferred to CJSC "Agrarkredit"	2,229	7,644
Prepayments	5,937	3,171
Deferred expenses	1,864	1,947
	10,030	**12,762**
Other assets	**40,463**	**29,999**

Other liabilities comprise:

	2018	*2017*
Other financial liabilities		
Funds in settlement	16,908	12,220
Dividends payable to shareholders	16,411	16,411
	33,319	**28,631**
Other non-financial liabilities		
Credit loss allowance for credit related commitments and provision for other contingencies and commitments	117,727	182,576
Taxes other than income tax	4,094	9,226
Payables to employees	8,914	3,471
Payables to local budget	2,228	1,700
Deferred revenue on plastic cards	5,848	6,677
	138,811	**203,650**
Other liabilities	**172,130**	**232,281**

(Figures in tables are in thousands of Azerbaijani manats)

12. Other assets and liabilities (continued)

The movements in allowances for impairment under IFRS 9 of other financial assets at amortised cost were as follows (comparative amounts for 2017 represent allowance account for credit losses and reflect measurement basis under IAS 39):

	2018				*2017*
	Stage 1	*Stage 2*	*Stage 3*	*Total*	*Total*
ECL as at 1 January	**(69)**	**(10)**	**(20,037)**	**(20,116)**	**(34,202)**
Net remeasurement of ECL	65	(13)	1,861	**1,913**	**(11,215)**
Disposal of provision on assets transferred to CJSC "Agrarkredit"	–	–	–	**–**	**4,961**
Write-offs	–	–	5,275	**5,275**	**19,990**
ECL as at 31 December	**(4)**	**(23)**	**(12,901)**	**(12,928)**	**(20,466)**

The loss allowance for credit related commitments and provision for other contingencies and commitments comprise the following:

	2018	*2017*
Credit related commitments	92,912	148,924
Performance guarantees	19,835	33,652
Legal claims	4,980	–
Credit loss allowance for credit related commitments and provision for other contingencies and commitments	**117,727**	**182,576**

13. Due to banks and other financial institutions

Due to banks and other financial institutions comprise:

	2018	*2017*
Correspondent accounts of non-resident banks	4,625	38,362
Correspondent accounts of resident banks	30,405	20,709
Time deposits of resident banks and other financial institutions	10,230	10,218
Due to banks and other financial institutions	**45,260**	**69,289**

14. Customer accounts

The amounts due to customers include the following:

	2018	*2017*
Legal entities		
Current/settlement accounts	2,937,897	3,056,267
Term deposits	86,481	108,046
Restricted customer deposits	191,635	246,061
Total legal entities	**3,216,013**	**3,410,374**
Individuals		
Current/settlement accounts	394,321	632,150
Term deposits	754,315	1,197,089
Total individuals	**1,148,636**	**1,829,239**
Total customer accounts	**4,364,649**	**5,239,613**

As at 31 December 2018, customer accounts included balances with six (31 December 2017: six) largest customers in the amount of AZN 1,830,184 thousand or 42% of the total customer accounts portfolio (31 December 2017: AZN 2,689,302 thousand or 51% of the total customer accounts portfolio).

(Figures in tables are in thousands of Azerbaijani manats)

14. Customer accounts (continued)

As at 31 December 2018, customer accounts included balances blocked with the Group against letters of credit in the amount of AZN 161,208 thousand (as at 31 December 2017: AZN 227,046 thousand) (Note 19).

An analysis of customer accounts by economic sector follows:

	2018	*2017*
Analysis by economic sector / customer type		
Government related entities	2,154,284	2,679,780
Individuals	1,148,636	1,829,239
Trade and service	729,100	406,591
Manufacturing	99,128	126,909
Energy	63,129	62,843
Public organizations	57,143	53,288
Construction	34,307	27,914
Transportation and communication	37,310	24,486
Other	41,612	28,563
Total customer accounts	**4,364,649**	**5,239,613**

15. Other borrowed funds

Other borrowed funds comprise:

	2018	*2017*
Term borrowings from non-resident financial institutions	19,955	17,254
National Fund for Support of Entrepreneurship and the Mortgage fund (the Republic of Azerbaijan)	86,675	158,744
Total other borrowed funds	**106,630**	**175,998**

16. Debt securities issued

Debt securities issued comprise:

	2018	*2017*
Eurobonds	1,485,136	1,451,787
Certificates of deposit	5,562	9,914
Total debt securities issued	**1,490,698**	**1,461,701**

As at 31 December 2018, 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 consolidated financial statements, the Group was in compliance of these covenants.

17. Taxation

Deferred tax assets and liabilities comprise:

	2018	*2017*
Deferred tax (liabilities) / assets in relation to:		
Due from banks and loans to customers	2,624	(46,110)
Investment securities	(9,693)	(8,227)
Property, equipment and intangible assets	7,164	6,603
Debt securities issued	(46,718)	(53,621)
Other asset	3,308	5,466
Other liabilities	(39,945)	(1,879)
Other	(4,759)	1,252
Tax loss carryforward	5,962	106,117
Unrecognized deferred tax assets	(2,298)	(2,815)
Net deferred tax (liabilities) / assets	**(84,355)**	**6,786**

(Figures in tables are in thousands of Azerbaijani manats)

17. Taxation (continued)

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

	2018	*2017*
Profit before tax	**395,536**	**812,709**
Tax expense at the statutory tax rate (20%)	**(79,107)**	**(162,542)**
Change in deferred tax assets recognized	517	130,047
Utilization of prior year tax losses	–	167,028
Tax effect of permanent differences	(3,031)	(120,522)
Prior year tax actualization	(12,658)	–
Other	(2,581)	(321)
Income tax (expense) / benefit	**(96,860)**	**13,690**
Current income tax expense	(5,511)	(2,652)
Changes in deferred tax	(91,349)	16,342
Income tax (expense) / benefit	**(96,860)**	**13,690**

Deferred income tax assets/(liabilities)	*2018*	*2017*
Deferred tax assets at 1 January	**7,340**	**159**
Deferred tax liabilities at 1 January	**(554)**	**(7,046)**
Change in deferred tax due to IFRS 9 adoption	2,021	–
Change in deferred income tax balances recognized in profit or loss	(91,349)	16,342
Change in deferred income tax recognized in other comprehensive income	(1,813)	(2,669)
Deferred income tax assets at 31 December	**900**	**7,340**
Deferred income tax liabilities at 31 December	**(85,255)**	**(554)**
Net deferred income tax (liabilities)/asset	**(84,355)**	**6,786**

At 31 December 2018, the aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liability have not been recognised was AZN 141,010 thousand (31 December 2017: AZN 151,725 thousand).

18. 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 1 January 2017	**2,375,137**	**641,287**
Registration of additional paid-in capital	2,222,222	600,000
As at 31 December 2017	**4,597,359**	**1,241,287**
As at 31 December 2018	**4,597,359**	**1,241,287**

All ordinary shares have a nominal value of AZN 0.27 per share as at 31 December 2018 and 2017 and rank equally. Each share carries one vote.

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.

(Figures in tables are in thousands of Azerbaijani manats)

18. Equity (continued)

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:

	2018	*2017*
Net profit for the period attributable to shareholders of the Bank	298,653	828,112
Weighted average number of ordinary shares in issue	4,597,359	4,463,836
Earnings per share – basic and diluted (AZN)	**0.06**	**0.19**

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

19. 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.

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

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.

Legal

In the ordinary course of business, the Group is 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. As of the date of issuance of these consolidated financial statements the litigation regarding the entitlement of the Group to a "permanent moratorium" under the Cross Border Insolvency Regulations in support of a voluntary restructuring of the Group in the Republic of Azerbaijan, and ability of the creditors to continue their claims against the Group for recovery of the debt is still in process. The final decision in relation to the moratorium continuation application is due to be taken by the UK Supreme Court. The Group is currently seeking permission from the UK Supreme Court to appeal the decision of the UK Court of Appeal that upheld a first instance decision. Given the currently available information, the Group cannot reasonably estimate the impact of the mentioned above litigation on these consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Legal (continued)

In May 2018 the Moscow Court of Arbitration has imposed arrest on 41.6 percent of the capital of "IBA-Moscow" LLC upon an appeal from Sberbank of Russia with a request to take provisional measures in the form of seizing the Group's property for a total of no more than AZN 36,159 thousand, including a stake (41.6 percent) in the authorized capital of "IBA-Moscow" LLC, in favor of Sberbank PJSC. As a result of negotiations held between the parties the title restriction was imposed to the office building of the Group located in Moscow with the carrying amount of AZN 18,375 thousand and 23 percent of the shares of abovementioned subsidiary.

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 31 December 2018 and 2017 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 CBAR ratios

CBAR and 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 31 December 2018, which is due to significant open currency positions 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;
- Portion of investment in other entity to share capital of the Bank ratio;
- Currency position.

As at the date of signing these 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)

19. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

Financial commitments and contingencies comprise:

Commitments and contingencies	***2018***	***2017***
Guarantees	1,162,430	1,597,966
Letters of credit	143,536	233,011
Undrawn loan commitments	1,729,851	1,769,828
Less: allowance	(112,747)	(182,576)
Commitments and contingencies	**2,923,070**	**3,418,229**
Less: cash held as security against guarantees and letters of credit	(161,208)	(227,046)
Less: cash received from CJSC "Agrarkredit" held as security against guarantees and letters of credit*	(186,282)	(291,660)
Total	**2,575,580**	**2,899,523**

* *Promissory notes in the amount of AZN 186,282 thousand were pledged on behalf of customers to the Group in case of issued letters of credit and guarantees are defaulted.*

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

Financial guarantees	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECLs as at 1 January 2018	**(3,692)**	**(8,113)**	**(110,011)**	**(121,816)**
New exposures originated or purchased	(1,122)	–	–	**(1,122)**
Exposures derecognised or matured (excluding write-offs)	1,497	3,402	14,308	**19,207**
Transfer to 12-month ECL	(281)	–	281	**–**
Transfer to lifetime ECL not credit-impaired	1,239	(1,239)	–	**–**
Transfer to lifetime ECL credit-impaired	–	–	–	**–**
Net remeasurement of ECL	(957)	218	15,358	**14,619**
Foreign currency	–	704	–	**704**
At 31 December 2018	**(3,316)**	**(5,028)**	**(80,064)**	**(88,408)**

Letter of credit	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECLs as at 1 January 2018	**(16)**	**–**	**(1,216)**	**(1,232)**
New exposures originated or purchased	–	–	–	**–**
Exposures derecognised or matured (excluding write-offs)	–	–	810	**810**
Transfer to 12-month ECL	–	–	–	**–**
Transfer to lifetime ECL not credit-impaired	16	(422)	406	**–**
Transfer to lifetime ECL credit-impaired	–	–	–	**–**
Net remeasurement of ECL	(300)	(146)	–	**(446)**
Foreign currency	–	–	–	**–**
At 31 December 2018	**(300)**	**(568)**	**–**	**(868)**

Undrawn commitments	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECLs as at 1 January 2018	**(4,318)**	**(3,230)**	**(3,245)**	**(10,793)**
New exposures originated or purchased	(207)	–	–	**(207)**
Exposures derecognised or matured (excluding write-offs)	1,230	3,230	3,245	**7,705**
Transfer to 12-month ECL	–	–	–	**–**
Transfer to lifetime ECL not credit-impaired	–	–	–	**–**
Transfer to lifetime ECL credit-impaired	–	–	–	**–**
Net remeasurement of ECL	(67)	–	(274)	**(341)**
At 31 December 2018	**(3,362)**	**–**	**(274)**	**(3,636)**

The movements in gross amounts of credit related commitments that most significantly contributed to changes in respective ECLs predominantly consist of exposures derecognised or matured.

An analysis of changes in the provision for performance guarantees and legal claims during the year ended 31 December 2018 is provided in Note 20.

(Figures in tables are in thousands of Azerbaijani manats)

20. Credit loss reversal and other impairment reversal

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans and receivables at amortised cost	10	27,369	15,117	31,730	**74,216**
Cash and cash equivalents	7	–	–	(1,906)	**(1,906)**
Due from banks and other financial institutions	8	(620)	90	–	**(530)**
Receivables from CJSC "Agrarkredit"		(108)	–	–	**(108)**
Credit loss reversal on interest bearing financial assets		**26,641**	**15,207**	**29,824**	**71,672**
Financial guarantees	19	(582)	3,620	29,666	**32,704**
Letters of credit	19	(300)	(146)	810	**364**
Undrawn loan commitments	19	956	3,230	2,971	**7,157**
Credit related commitments		**74**	**6,704**	**33,447**	**40,225**
Other financial assets	12	65	(13)	1,861	**1,913**
Reversal of provision for credit losses on credit related commitments and other financial assets		**139**	**6,691**	**35,308**	**42,138**
Total credit loss reversal		**26,780**	**21,898**	**65,132**	**113,810**

The other impairment reversal affected the balances as follows:

	Legal claims	*Performance guarantees*	*Total*
1 January 2017	**–**	**(52,443)**	**(52,443)**
Reversal	–	18,791	**18,791**
31 December 2017	**–**	**(33,652)**	**(33,652)**
(Charge)/reversal	(4,980)	13,817	**8,837**
31 December 2018	**(4,980)**	**(19,835)**	**(24,815)**

Provision for ECL for credit related commitments and provision on legal claims and performance guarantees are recorded within other non-financial liabilities (Note 12).

21. Fee and commission income and expense

Fee and commission income and expense comprise:

	2018	*2017*
Plastic cards operations	55,912	54,132
Servicing guarantees and letters of credit	14,158	20,194
Settlement transactions	12,236	12,037
Cash transactions	5,190	6,200
Other	1,355	5,600
Fee and commission income	**88,851**	**98,163**
Plastic cards operations	(11,320)	(10,114)
Cash transactions	(3,764)	(3,147)
Settlement transactions	(2,036)	(1,855)
Other	(704)	(653)
Fee and commission expense	**(17,824)**	**(15,769)**
Net fee and commission income	**71,027**	**82,394**

(Figures in tables are in thousands of Azerbaijani manats)

22. Operating expenses

Operating expenses comprise:

	2018	2017
Staff costs	(61,340)	(58,915)
Depreciation of premises and equipment	(17,557)	(22,683)
Consultancy and other professional services	(10,236)	(20,321)
Insurance expense	(1,042)	(7,253)
Software maintenance	(3,944)	(5,679)
Fees paid to deposit insurance fund	(5,876)	(5,102)
Amortization of software and other intangible assets	(4,553)	(3,698)
External labor and guarding	(3,022)	(3,382)
Rent	(2,921)	(3,554)
Customs duties and taxes other than on income	(2,936)	(3,274)
Fines and penalties	(1,135)	(3,030)
Premises, property and maintenance	(1,654)	(2,391)
Communication	(1,654)	(1,391)
Utility	(1,311)	(1,053)
Stationary, books, printing, and other supplies	(991)	(676)
Advertising and marketing services	(1,338)	(482)
Charity and financial aid	(29)	–
Other	(6,455)	(6,573)
Total operating expenses	**(127,994)**	**(149,457)**

23. Risk management

Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. The Group is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Group's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Audit Committee

The Audit Committee has the overall responsibility for the establishment and development of the audit mission and strategy. It is responsible for the fundamental audit issues and monitoring Internal Audit's activities.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Group.

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Risk management structure (continued)

Risk Management

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

Bank Treasury is responsible for managing the Group's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Group.

Internal Audit

Risk management processes throughout the Group are audited annually by the internal audit function, which examines both the adequacy of the procedures and the Group's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities.

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. This information is presented and explained to the Management Board, the Risk Committee, and the head of each business division. The report includes aggregate credit exposure, hold limit exceptions and liquidity ratios. On a monthly basis detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the allowance for credit losses on a quarterly basis. The Board of Directors receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Group.

For all levels throughout the Group, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information.

A daily briefing is given to the Management Board and all other relevant employees of the Group on the utilization of market limits and liquidity, plus any other risk developments.

Risk mitigation

The Group actively uses collateral to reduce its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risks, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit and customer's deposit risks are controlled and managed accordingly.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. The credit quality review process allows the Group to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks

The Group makes available to its customers guarantees which may require that the Group make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Group to similar risks to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

Impairment assessment

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

PD — The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

EAD — The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

The Group has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. Based on the above process, the Group groups its loans into Stage 1, Stage 2, Stage 3 and POCI, as described below:

Stage 1:	When loans are first recognised, the Group recognises an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Group records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
Stage 3:	Loans considered credit-impaired. The Group records an allowance for the LTECL.
POCI:	Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest revenue is subsequently recognised based on a credit-adjusted EIR. ECL are only recognised or released to the extent that there is a subsequent change in the lifetime expected credit losses.

Definition of default and cure

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Group considers amounts due from banks defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

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

- Default and Credit-impaired assets:
  - Loans with principal amount and/or accrued interest and/or any of other payment overdue by more than 90 days from the date specified in the contract.
  - Loans that have been restructured with significant NPV loss.
  - Any loan considered by management as non-performing.
- Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition.
- Default on other financial instruments of the same borrower.
- Default according to external rating.

It is the Group's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

PD estimation process

The Group developed scoring model for collective assessment. Each borrower in credit portfolio is assigned with score based on internal scoring model that creates scores for one-year PD assessment. Lifetime PD is calculated based on migration matrices approach. Scoring model captures different risk levels depending on exposure/client characteristic and total score is assigned to a contract based on weighted sum of point for each characteristic of financial quality of portfolio unit. To consider the impact of macroeconomic factors on probability of default, sensitivity of probabilities to the macroeconomic factors are calculated by statistical regression method. Where practicable, PDs, incorporate forward looking macroeconomic information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Treasury and interbank relationships

The Group's treasury and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Group's credit risk department analyses publicly available information such as financial information and other external data (e.g., the external ratings).

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Consumer lending and residential mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are Oil price, Exchange rate, Real GDP Growth year to year, Unemployment rate, etc.

Corporate and small business lending

The same approach and inputs as for consumer lending applies to corporate and small business lending For significant corporate loans to Group's financial statements, the borrowers are assessed by specialized credit risk employees of the Group.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

Loss given default

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

The Group segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics.

Where appropriate, further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios.

LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

Significant increase in credit risk

The Group continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Group assesses whether there has been a significant increase in credit risk since initial recognition.

The Group also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming restructured due to credit event. In certain cases, the Group may also consider that events explained in "Definition of default" section above are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Group applies the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Group calculates ECLs either on a collective or on an individual basis.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Asset classes where the Group calculates ECL on an individual basis include:

- All significant Stage 3 assets, regardless of the class of financial assets;
- The treasury and interbank relationships (such as amounts due from banks, cash equivalents and debt investment securities at amortised cost and FVOCI).

Asset classes where the Group calculates ECL on a collective basis include:

- The smaller and more generic balances of the Group small business lending;
- Stage 1 and 2 retail mortgages, consumer lending and corporate lending portfolio.

The Group groups these exposures into smaller homogeneous portfolios, based on a combination of internal and external characteristics of the loans, for example overdue bucket, product type.

Forward-looking information and multiple economic scenarios

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

- Oil price;
- Real GDP growth year to year;
- Unemployment rates;
- Foreign exchange rates;
- CPI Growth year to year.

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

Credit quality per class of financial assets

The Group's internal credit rating grades are as follows:

Scoring based on probability of default for loans to customers	***S&P's based on internal/external ratings for Financial Institutions***	***Internal rating description***
0-2.5%	AAA to A-	High
2.5-25%	BBB+ to B-	Standard
25-75%	CCC+ to C	Sub-standard
75-100%	D	Impaired

Probability of default is used as a base for internal rating of corporate customers, and S&P rating is used for financial institutions.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

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

	Note		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	7	Stage 1	1,110,294	495,939	–	–	**1,606,233**
Due from banks and other financial institutions	8	Stage 1	3,064,612	186,359	–	–	**3,250,971**
		Stage 2	–	–	4,513	–	**4,513**
Loans to customers	10						
- Legal entities		Stage 1	491,350	162,197	9,489	–	**663,036**
		Stage 2	55,317	43,082	28,951	–	**127,350**
		Stage 3	–	–	–	134,991	**134,991**
- Individuals		Stage 1	291,996	488,357	9	–	**780,362**
		Stage 2	32	1,440	25,623	–	**27,095**
		Stage 3	–	–	–	44,169	**44,169**
- To be transferred to CJSC "Agrarkredit"		Stage 3	–	–	–	113,025	**113,025**
Debt securities at FVOCI	9	Stage 1	29,503	12,564	–	–	**42,067**
Receivables from CJSC "Agrarkredit"	2	Stage 1	–	1,152,173	–	–	**1,152,173**
Other financial assets	12	Stage 1	–	25,544	–	–	**25,544**
		Stage 2	–	–	281	–	**281**
		Stage 3	–	–	–	17,536	**17,536**
Undrawn loan commitments	19	Stage 1	1,714,214	14,545	622	–	**1,729,381**
		Stage 3	–	–	–	470	**470**
Letters of credit	19	Stage 1	871	138,963	–	–	**139,834**
		Stage 2	–	3,702	–	–	**3,702**
Financial guarantees	19	Stage 1	218,448	11,953	–	–	**230,401**
		Stage 2	125,461	67,706	18,498	–	**211,665**
		Stage 3	–	–	–	424,888	**424,888**
Total			**7,102,098**	**2,804,524**	**87,986**	**735,079**	**10,729,687**

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

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

		Neither past due nor impaired				
31 December 2017	***Notes***	***High grade***	***Standard grade***	***Past due but not impaired***	***Individually impaired***	***Total***
Cash and cash equivalents (excluding cash on hand)	7	25,839	2,469,473	–	–	**2,495,312**
Mandatory cash balances with the Central Banks		55,203	–	–	–	**55,203**
Due from banks and other financial institutions	8	3,273,476	39,359	–	6,694	**3,319,529**
Investments available for sale	9	28,396	41,232	–	–	**69,628**
Loans to customers	10					
Corporate lending		301,531	220,837	89,435	206,112	**817,915**
Individual lending		13,635	589,023	194,783	29,156	**826,597**
Loans to be transferred to CJSC "Agrarkredit"		–	–	–	229,793	**229,793**
Receivables from CJSC "Agrarkredit"	2	–	1,103,964	–	–	**1,103,964**
Other financial assets	12	–	11,235	–	26,468	**37,703**
Total		**3,698,080**	**4,475,123**	**284,218**	**498,223**	**8,955,644**

In the table above cash and cash equivalents, loans to banks and customers of high grade are those having a minimal level of credit risk, normally with a credit rating on or close to sovereign level or very well collateralized. Other borrowers with good financial position and good debt service are included in the standard grade. Sub-standard grade comprises loans below standard grade but not individually impaired. Past due loans to customers include those that are only past due by a few days. An analysis of past due loans as at 31 December 2017, by age, is provided below. The majority of the past due loans are not considered to be impaired.

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

31 December 2017	***Less than 30 days***	***31 to 60 days***	***61 to 90 days***	***More than 90 days***	***Total***
Loans to customers					
Corporate lending	38,771	470	2,275	47,919	**89,435**
Individual lending	127,828	24,188	11,812	30,955	**194,783**
Total	**166,599**	**24,658**	**14,087**	**78,874**	**284,218**

See Note 10 for more detailed information with respect to the allowance for impairment of loans to customers.

Financial guarantees, letters of credit and loan commitments are assessed and a provision for expected credit losses is calculated in similar manner as for loans.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

Geographical concentration information is based on registration of the Group's counterparties. As at 31 December 2018, the geographical concentration of the Group's financial assets and liabilities is set out as below:

	2018				2017			
	The Republic of Azerbaijan	*OECD countries*	*CIS and other non-OECD countries*	*Total*	*The Republic of Azerbaijan*	*OECD countries*	*CIS and other non-OECD countries*	*Total*
Financial assets								
Cash and cash equivalents	302,760	1,457,796	49,617	**1,810,173**	222,560	2,161,436	323,099	**2,707,095**
Mandatory cash balances with the Central Banks	54,574	–	128	**54,702**	48,343	–	6,860	**55,203**
Due from banks and other financial institutions	3,030,628	193,950	25,195	**3,249,773**	3,271,850	32,674	12,997	**3,317,521**
Investment securities	30,646	60,199	–	**90,845**	22,389	41,151	6,088	**69,628**
Loans to customers	1,669,592	–	4,561	**1,674,153**	1,522,499	–	20,411	**1,542,910**
Receivables from CJSC "Agrarkredit"	1,150,401	–	–	**1,150,401**	1,103,964	–	–	**1,103,964**
Other financial assets	15,026	10,005	5,402	**30,433**	15,339	1,020	878	**17,237**
Total	**6,253,627**	**1,721,950**	**84,903**	**8,060,480**	**6,206,944**	**2,236,281**	**370,333**	**8,813,558**
Financial liabilities								
Due to banks and other financial institutions	40,929	597	3,734	**45,260**	30,926	6,208	32,155	**69,289**
Customer accounts	4,150,015	36,727	177,907	**4,364,649**	4,460,037	53,760	725,816	**5,239,613**
Payables to CJSC "Agrarkredit"	364,596	–	–	**364,596**	515,767	–	–	**515,767**
Other borrowed funds	86,675	19,955	–	**106,630**	158,774	17,224	–	**175,998**
Debt securities issued	4,234	1,485,402	1,062	**1,490,698**	6,672	1,453,080	1,949	**1,461,701**
Other financial liabilities	31,619	–	1,700	**33,319**	26,360	–	5,742	**32,102**
Total	4,678,068	1,542,681	184,403	**6,405,152**	**5,198,536**	**1,530,272**	**765,662**	**7,494,470**
Net assets/ (liabilities)	**1,575,559**	**179,269**	**(99,500)**	**1,655,328**	**1,008,408**	**706,009**	**(395,329)**	**1,319,088**

Liquidity risk and funding management

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Group maintains obligatory reserves with the CBAR and CBR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Group based on certain liquidity ratios established by the CBAR. As at 31 December 2018 and 2017, these ratios were as follows:

	2018, %	*2017, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day* / liabilities repayable on demand)	47	44

* *The deposits held in CBAR are not taken into account.*

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2018 and 2017 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities	*Less than 1 month*	*1 to 6 months*	*6 to 12 months*	*Over 12 months*	*Total 2018*
As at 31 December 2018					
Due to banks and other financial institutions	35,166	10,239	–	–	**45,405**
Customer accounts	3,567,041	399,205	320,153	114,430	**4,400,829**
Payables to CJSC "Agrarkredit"	364,596	–	–	–	**364,596**
Other borrowed funds	2,942	9,750	10,856	111,460	**135,008**
Debt securities issued	23	33,308	33,168	2,036,946	**2,103,445**
Other financial liabilities	33,319	–	–	–	**33,319**
Total undiscounted financial liabilities	**4,003,087**	**452,502**	**364,177**	**2,262,836**	**7,082,602**

Financial liabilities	*Less than 1 month*	*1 to 6 months*	*6 to 12 months*	*Over 12 months*	*Total 2017*
As at 31 December 2017					
Due to banks and other financial institutions	59,793	170	204	10,274	**70,441**
Customer accounts	3,990,515	516,400	623,787	173,734	**5,304,436**
Payables to CJSC "Agrarkredit"	21,359	116,049	168,851	209,508	**515,767**
Other borrowed funds	2,484	13,771	20,011	162,802	**199,068**
Debt securities issued	391	30,517	30,234	2,067,547	**2,128,689**
Other financial liabilities	28,631	–	–	–	**28,631**
Total undiscounted financial liabilities	**4,103,173**	**676,907**	**843,087**	**2,623,865**	**8,247,032**

The table below shows the contractual expiry by maturity of the Group's financial commitments and contingencies.

	Up to 1 month	*1 to 6 months*	*6 to 12 months*	*More than 12 months*	*Total*
As at 31 December 2018	1,753,607	669,670	104,731	507,809	**3,035,817**
As at 31 December 2017	1,851,956	638,026	357,473	753,350	**3,600,805**

The Group expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Group's capability to repay its liabilities relies on its ability to realise an equivalent amount of assets within the same period of time. There is a significant concentration of deposits from organizations of related parties in the period of one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Group. Management believes that this level of funding will remain with the Group for the foreseeable future and that in the event of withdrawal of funds, the Group would be given sufficient notice so as to realise its liquid assets to enable repayment.

In addition, the Group has significant amount held in CBAR as disclosed in Note 8, which can be used to mitigate any negative impacts in case of withdrawals.

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices. The Group manages exposures to market risk based of sensitivity analysis. The Group has no significant concentration of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2018. The Group does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2018 and 2017.

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its statement of financial position and statement of cash flows.

The Assets and Liabilities Management Committee controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Group an opportunity to minimize losses from significant currency rates fluctuations toward its national currency The Treasury Department performs daily monitoring of the Group's open currency position with the aim to match the regulatory requirements.

Currency risk sensitivity

The following table details the Group's sensitivity to increase and decrease in the USD and EUR against the AZN. These are the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for specified changes in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

Impact on profit before tax based on assets value as at 31 December 2018:

	31 December 2018		***31 December 2017***	
USD	+14%/-3%	(152,725)/32,727	+11%/-11%	(279,732)/279,732
EUR	+14%/-3%	5,131/(1,099)	+14%/-14%	(38,346)/38,346

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurements

Fair value hierarchy

For the purpose of fair value disclosures, the Group's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy:

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities	31 December 2018	89,703	1,142	–	**90,845**
Office premises	31 December 2018	–	–	151,976	**151,976**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2018	1,810,173	–	–	**1,810,173**
Mandatory cash balances with the Central Banks	31 December 2018	–	–	54,702	**54,702**
Due from banks and other financial institutions	31 December 2018	–	–	3,249,773	**3,249,773**
Loans to customers	31 December 2018	–	81,244	1,620,089	**1,701,333**
Receivables from CJSC "Agrarkredit"	31 December 2018	–	–	1,150,401	**1,150,401**
Other financial assets	31 December 2018	–	–	30,433	**30,433**

		Fair value measurement using			
As at 31 December 2018	*Date of valuation*	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Liabilities for which fair values are disclosed					
Due to banks and other financial institutions	31 December 2018	–	35,030	10,230	**45,260**
Customer accounts	31 December 2018	–	3,332,218	1,037,592	**4,369,810**
Payables to CJSC "Agrarkredit"	31 December 2018	–	–	364,596	**364,596**
Other borrowed funds	31 December 2018	–	86,675	19,955	**106,630**
Debt securities issued	31 December 2018	–	1,497,343	5,732	**1,503,075**
Other financial liabilities	31 December 2018	–	–	33,319	**33,319**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities	31 December 2017	47,285	22,343	–	**69,628**
Office premises	31 December 2017	–	–	161,474	**161,474**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2017	2,707,095	–	–	**2,707,095**
Mandatory cash balances with the Central Banks	31 December 2017	–	–	55,203	**55,203**
Due from banks and other financial institutions	31 December 2017	–	–	3,317,521	**3,317,521**
Loans to customers	31 December 2017	–	82,006	1,440,424	**1,522,430**
Receivables from CJSC "Agrarkredit"	31 December 2017	–	–	1,103,964	**1,103,964**
Other financial assets	31 December 2017	–	–	17,237	**17,237**

(Figures in tables are in thousands of Azerbaijani manats)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

		Fair value measurement using			
As at 31 December 2017	***Date of valuation***	***Quoted prices in active markets (Level 1)***	***Significant observable inputs (Level 2)***	***Significant unobservable inputs (Level 3)***	***Total***
Liabilities for which fair values are disclosed					
Due to banks and other financial institutions	31 December 2017	–	59,071	10,218	**69,289**
Customer accounts	31 December 2017	–	3,688,417	1,565,484	**5,253,901**
Payables to CJSC "Agrarkredit"	31 December 2017	–	–	515,767	**515,767**
Other borrowed funds	31 December 2017	–	158,744	17,254	**175,998**
Debt securities issued	31 December 2017	–	1,482,932	9,914	**1,492,846**
Other financial liabilities	31 December 2017	–	–	28,631	**28,631**

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 2018	***Fair value 2018***	***Carrying value 2017***	***Fair value 2017***
Financial assets				
Cash and cash equivalents	1,810,173	1,810,173	2,707,095	2,707,095
Mandatory cash balances with the Central Banks	54,702	54,702	55,203	55,203
Due from banks and other financial institutions	3,249,773	3,249,773	3,317,521	3,317,521
Loans to customers	1,674,153	1,701,333	1,542,910	1,522,430
Receivables from CJSC "Agrarkredit"	1,150,401	1,150,401	1,103,964	1,103,964
Other financial assets	30,433	30,433	17,237	17,237
Financial liabilities				
Due to banks and other financial institutions	45,260	45,260	69,289	69,289
Customer accounts	4,364,649	4,369,810	5,239,613	5,253,901
Payables to CJSC "Agrarkredit"	364,596	364,596	515,767	515,767
Other borrowed funds	106,630	106,630	175,998	175,998
Debt securities issued	1,490,698	1,503,075	1,461,701	1,492,846
Other financial liabilities	33,319	33,319	28,631	28,631

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

(Figures in tables are in thousands of Azerbaijani manats)

25. Maturity analysis of assets and liabilities

The table below shows assets and liabilities as at 31 December 2018 and 2017 by their remaining contractual maturity (expected maturity match the remaining contractual maturity) by which the Group has right to realise the assets and obligation to settle the liabilities. The Group considers assets and liabilities with remaining contractual maturity of "Within one year" as current, and assets and liabilities with remaining contractual maturity of "More than one year" as non-current. The Group's contractual undiscounted repayment obligations are disclosed in Note 23.

	2018			*2017*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	1,810,173	–	**1,810,173**	2,707,095	–	**2,707,095**
Mandatory cash balances with the Central Banks	54,702	–	**54,702**	55,203	–	**55,203**
Due from banks and other financial institutions	3,240,354	9,419	**3,249,773**	3,284,256	33,265	**3,317,521**
Investment securities	60,483	30,362	**90,845**	69,628	–	**69,628**
Loans to customers	512,068	1,162,085	**1,674,153**	274,143	1,268,767	**1,542,910**
Receivables from CJSC "Agrarkredit"	–	1,150,401	**1,150,401**	–	1,103,964	**1,103,964**
Property, equipment and intangibles	–	200,731	**200,731**	–	222,915	**222,915**
Current income tax assets	2,102	–	**2,102**	18,137	–	**18,137**
Deferred income tax assets	–	900	**900**	–	7,340	**7,340**
Other assets	38,234	2,229	**40,463**	28,719	1,280	**29,999**
Total assets	**5,718,116**	**2,556,127**	**8,274,243**	**6,437,181**	**2,637,531**	**9,074,712**
Due to banks and other financial institutions	45,260	–	**45,260**	59,059	10,230	**69,289**
Customer accounts	4,270,623	94,026	**4,364,649**	5,093,947	145,666	**5,239,613**
Payables to CJSC "Agrarkredit"	364,596	–	**364,596**	306,259	209,508	**515,767**
Other borrowed funds	20,645	85,985	**106,630**	29,315	146,683	**175,998**
Debt securities issued	33,759	1,456,939	**1,490,698**	34,130	1,427,571	**1,461,701**
Current income tax liabilities	1,836	–	**1,836**	–	–	**–**
Deferred income tax liabilities	–	85,255	**85,255**	–	554	**554**
Other liabilities	172,130	–	**172,130**	232,281	–	**232,281**
Total liabilities	**4,908,849**	**1,722,205**	**6,631,054**	**5,754,991**	**1,940,212**	**7,695,203**
Net assets/(liabilities)	**809,267**	**833,922**	**1,643,189**	**682,190**	**697,319**	**1,379,509**

26. 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)

26. Related party disclosures (continued)

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

	2018		2017	
	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		**1,810,173**		**2,707,095**
- Government bodies and state owned entities	100,774		18,329	
Due from banks and other financial institutions		**3,255,484**		**3,317,521**
- Government bodies and state owned entities	3,027,816		3,273,526	
Allowance for impairment losses on due from banks and other financial institutions		**(5,711)**		**–**
- Government bodies and state owned entities	(4,570)		–	
Investment securities		**90,845**		**69,628**
- Government bodies and state owned entities	30,362		22,389	
- Associates	250		–	
Loans to customers, Gross		**1,890,028**		**1,874,305**
- Government bodies and state owned entities	554,277		413,639	
- Key management personnel of the Group	189		–	
- Other related parties	277		2,628	
Allowance for impairment losses on loans to customers		**(215,875)**		**(331,395)**
- Government bodies and state owned entities	(9,881)		(14,178)	
- Key management personnel of the Group	(8)		–	
- Other related parties	(158)		(751)	
Other Assets		**53,391**		**29,999**
- Government bodies and state owned entities	416		448	
Receivables from CJSC “Agrarkredit”		**1,152,173**		**1,103,964**
- Government bodies and state owned entities	1,152,173		1,103,964	
Allowance for impairment on receivables from CJSC “Agrarkredit”		**(1,772)**		**–**
- Government bodies and state owned entities	(1,772)		–	
Customer accounts		**(4,364,649)**		**(5,239,613)**
- Government bodies and state owned entities	(2,477,303)		(2,847,634)	
- Key management personnel of the Group	(257)		(374)	
- Other related parties	(7,691)		(565)	
Payables to CJSC “Agrarkredit”		**(364,596)**		**(515,767)**
- Government bodies and state owned entities	(364,596)		(515,767)	
Due to banks and other financial institutions		**(45,260)**		**(69,289)**
- Government bodies and state owned entities	(5,182)		–	
Other borrowed funds		**(106,630)**		**(175,998)**
- Government bodies and state owned entities	(86,674)		(158,695)	
Undrawn loan commitments		**1,729,851**		**1,769,828**
- Government bodies and state owned entities	1,714,214		1,727,388	
Letters of credit and guarantees		**1,305,966**		**1,830,977**
- Government bodies and state owned entities	512,097		766,504	
Provision for off-balance sheet commitments		**(117,727)**		**(182,576)**
- Government bodies and state owned entities	(7,400)		(18,209)	

(Figures in tables are in thousands of Azerbaijani manats)

26. Related party disclosures (continued)

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

	2018 Related party transactions	*2018* Total category as per the financial statements caption	*2017* Related party transactions	*2017* Total category as per the financial statements caption
Key management personnel compensation:				
- short-term employee benefits	(7,620)	**(61,340)**	(2,399)	**(58,915)**
Total	**(7,620)**		**(2,399)**	

Following further centralization of decision-making and control functions at Group level, the Group revised the composition of key management personnel, as defined by IAS 24 *Related Party Disclosures*. Following the revised composition, key management personnel includes Management Board Members, Executive Directors and head of departments and their aggregate remuneration for the year ended 31 December 2018 amounted to AZN 7,620 thousand.

Included in the consolidated statement of profit or loss and other comprehensive income for the years ended 31 December 2018 and 2017 are the following amounts which were recognized in transactions with related parties:

	2018 Related party transactions	*2018* Total category as per the financial statements caption	*2017* Related party transactions	*2017* Total category as per the financial statements caption
Interest income		**436,741**		**455,997**
- Government bodies and state-owned entities	220,949		234,182	
- Key management personnel of the Group	22		13	
- Other related parties	74		4	
Interest expense		**(160,754)**		**(360,034)**
- Government bodies and state-owned entities	(101,640)		(65,701)	
- Key management personnel of the Group	(3)		(18)	
- Other related parties	(188)		–	
Reversal of impairment losses on interest bearing assets		**71,672**		**5,596**
- Government bodies and state-owned entities	174		16,143	
- Key management personnel of the Group	(2)		56	
- Other related parties	155		(751)	
Reversal of impairment losses on contingent liabilities and credit commitments		**42,138**		**37,834**
- Government bodies and state owned entities	7,414		8,833	
Gains from operations in foreign currencies		**55,355**		**128,751**
- Government bodies and state-owned entities	35,028		87,570	
Fee and commission income		**88,851**		**98,163**
- Government bodies and state-owned entities	14,459		22,288	
- Key management personnel of the Group	11		3	
Fee and commission expense		**(17,824)**		**(15,769)**
- Government bodies and state-owned entities	(3,522)		(2,994)	
Operating expenses		**(127,994)**		**(149,457)**
- Government bodies and state-owned entities	(2,723)		(2,645)	
- Key management personnel of the Group	(7,620)		(2,399)	

(Figures in tables are in thousands of Azerbaijani manats)

27. 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) (Note 19).

CBAR capital adequacy ratio

The CBAR 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 31 December 2018, 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 31 December 2018 and 2017 these ratios exceeded the minimum ratio of 8.0% recommended by the Basel Accord, as disclosed below:

	2018	*2017*
Tier 1 capital	1,564,359	1,267,714
Tier 2 capital	129,700	129,898
Less: deductions from capital	(48,778)	(41,232)
Total capital	**1,645,281**	**1,356,380**
Risk weighted assets	**4,352,272**	**4,948,097**
Tier 1 capital ratio	35.94%	25.62%
Total capital ratio	37.80%	27.41%

28. Events after the reporting period

According to the Decree of the President of Azerbaijan Republic on problematic loans, the government will provide funds for compensation to citizens, whose loans burden increased due to the devaluation of Azerbaijani manat in February and December 2015. The Decree will affect only loans taken after January 2012 in the amount of up to USD 10,000. Currently, estimation of impact is in progress.