OJSC International Bank of Azerbaijan

Consolidated financial statements

Year ended 31 December 2019
together with independent auditor's report

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Independent auditor's report

To the Shareholders and Supervisory Board 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 2019, and the consolidated statement of profit or loss and other comprehensive income, statement of changes in equity and of cash flows for the year ended 31 December 2019, 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 2019 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 consolidated financial statements section* of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (including International Independence Standards) (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.

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 to communicate with them 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

24 April 2020

Consolidated statement of financial position

As at 31 December 2019

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2019	2018
Assets			
Cash and cash equivalents	7	2,789,673	1,810,173
Mandatory cash balances with the Central Banks		60,059	54,702
Due from banks and other financial institutions	8	3,179,615	3,249,773
Investment securities	9	207,661	90,845
Loans to customers	10	2,165,804	1,674,153
Receivables from CJSC "Agrarkredit"	2	693,281	1,150,401
Current income tax assets		4,387	2,102
Deferred income tax assets	17	1,029	900
Property, equipment and intangible assets	11	192,993	200,731
Other assets	12	47,243	40,463
Total assets		**9,341,745**	**8,274,243**
Liabilities			
Due to banks and other financial institutions	13	31,979	45,260
Customer accounts	14	5,606,673	4,364,649
Payables to CJSC "Agrarkredit"	2	89,055	364,596
Other borrowed funds	15	104,504	106,630
Debt securities issued	16	1,526,354	1,490,698
Current income tax liabilities		74,748	1,836
Deferred income tax liabilities	17	83,498	85,255
Other liabilities	12	141,206	172,130
Total liabilities		**7,658,017**	**6,631,054**
Equity	18		
Share capital		1,241,287	1,241,287
Additional paid-in capital		1,847,437	1,909,116
Foreign currency translation reserve		6,368	(12,846)
Revaluation reserve for premises		38,760	36,878
Unrealized gain on investment securities		58,568	38,419
Accumulated deficit		(1,508,692)	(1,569,665)
Total equity		**1,683,728**	**1,643,189**
Total liabilities and equity		**9,341,745**	**8,274,243**

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

Mr. Abbas Ibrahimov
Chairman of the Management Board

«AZƏRBAYCAN BEYNƏLXALQ BANKI» AÇIQ SƏHMDAR CƏMIYYƏTI
OPEN JOINT STOCK COMPANY «THE INTERNATIONAL BANK OF AZERBAIJAN»

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

Baku, Azerbaijan
24 April 2020

The accompanying notes 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 2019

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2019	2018
Interest income calculated using effective interest rate			
Loans to customers		234,885	195,393
Due from banks and other financial institutions		152,673	161,415
Receivables from CJSC "Agrarkredit"		47,478	48,266
Cash and cash equivalents		35,941	29,381
Investment securities		3,431	2,286
		474,408	**436,741**
Interest expense			
Debt securities issued		(95,891)	(93,915)
Customer accounts		(35,945)	(63,451)
Other borrowed funds		(2,990)	(1,972)
Due to banks and other financial institutions		(685)	(1,416)
Lease liabilities		(377)	–
		(135,888)	**(160,754)**
Net interest income		**338,520**	**275,987**
Credit loss (expense)/reversal	20	(37,765)	71,672
Net interest income after impairment losses for interest bearing assets		**300,755**	**347,659**
Fee and commission income	21	90,163	88,851
Fee and commission expense	21	(24,572)	(17,824)
Net loss arising on initial recognition of financial instruments and loan modification		(23,016)	(19,075)
Net gains from operations in foreign currencies:			
- Dealing		68,248	55,355
- translation differences		(17,957)	21,143
Impairment of property, equipment and intangible assets	11	(4,482)	(6,736)
Reversal of provision for credit losses on credit related commitments and other financial assets	20	14,059	42,138
Other impairment reversal	20	17,707	8,837
Operating expenses	22	(143,619)	(127,994)
Other operating income		7,031	3,182
Non-interest (loss)/income		**(16,438)**	**47,877**
Profit before income tax expense		**284,317**	**395,536**
Income tax expense	17	(68,609)	(96,860)
Net profit for the year		**215,708**	**298,676**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Unrealised gains on debt securities		2,707	–
Exchange differences on translating foreign operations		19,214	(39,047)
Income tax relating to components of other comprehensive income to be reclassified to profit or loss in subsequent periods		(542)	–
Net other comprehensive gain/(loss) to be reclassified to profit or loss in subsequent periods		**21,379**	**(39,047)**
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Unrealised gains on equity securities		22,479	7,330
Change in revaluation reserve for premises	11	2,353	1,733
Income tax relating to components of other comprehensive income not to be reclassified to profit or loss in subsequent periods		(4,966)	(1,813)
Net other comprehensive gain not to be reclassified to profit or loss in subsequent periods		**19,866**	**7,250**
Total comprehensive income for the year		**256,953**	**266,879**
Profit attributable to:			
- shareholders of the Group		215,708	298,653
- non-controlling interest		–	23
Total comprehensive income attributable to:			
- shareholders of the Group		256,953	266,856
- non-controlling interest		–	23
		256,953	**266,879**
Earnings per share, basic and diluted (AZN per share)	18	**0.05**	**0.06**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2019

(Figures in tables are in thousands of Azerbaijani manats)

	Attributable to shareholders of the Group								
	Share capital	*Additional paid-in capital*	*Foreign currency translation reserve*	*Revaluation reserve for premises*	*Unrealised gain on investment securities*	*Accumulated deficit*	*Total equity attributable to shareholders of the Group*	*Non-controlling interest*	*Total equity*
As at 1 January 2018	**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**
Net profit for the year	–	–	–	–	–	215,708	**215,708**	–	**215,708**
Other comprehensive income for the year	–	–	19,214	1,882	20,149	–	**41,245**	–	**41,245**
Total comprehensive income for the year	**–**	**–**	**19,214**	**1,882**	**20,149**	**215,708**	**256,953**	**–**	**256,953**
Additional paid-in capital	–	6,609	–	–	–	–	**6,609**	–	**6,609**
Distribution from additional paid-in capital (Note 18)	–	(68,288)	–	–	–	–	**(68,288)**	–	**(68,288)**
Dividends declared to shareholders	–	–	–	–	–	(150,000)	**(150,000)**	–	**(150,000)**
Other distributions to shareholders	–	–	–	–	–	(4,735)	**(4,735)**	–	**(4,735)**
As at 31 December 2019	**1,241,287**	**1,847,437**	**6,368**	**38,760**	**58,568**	**(1,508,692)**	**1,683,728**	**–**	**1,683,728**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2019

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2019	2018
Cash flows from operating activities			
Interest received		461,306	262,606
Interest paid		(101,267)	(133,808)
Fees and commissions received		92,444	79,055
Fees and commissions paid		(24,625)	(17,824)
Gains from operations in foreign currencies		68,248	55,355
Staff costs paid		(67,140)	(53,053)
Other operating expenses paid		(52,016)	(46,110)
Other operating income received		2,942	2,687
Cash flows from operating activities before changes in operating assets and liabilities		**379,892**	**148,908**
Net (increase)/decrease in operating assets			
Mandatory cash balances with Central Banks		(5,358)	501
Due from banks and other financial institutions		39,777	134,065
Loans to customers		(536,023)	(180,657)
Other assets		(7,230)	(11,999)
Net (decrease)/increase in operating liabilities			
Due to banks and other financial institutions		(13,168)	(24,378)
Customer accounts		1,244,546	(858,055)
Other liabilities		(1,888)	7,941
Net cash flows from / (used in) operating activities before income tax		**1,100,548**	**(783,674)**
Income tax paid		(4,580)	(337)
Net cash from / (used in) operating activities		**1,095,968**	**(784,011)**
Cash flows (used in) / from investing activities			
Purchase of investment securities		(101,008)	(42,287)
Proceeds from redemption of investment securities		11,560	28,396
Purchase and prepayments for property, equipment and intangible assets		(17,924)	(9,448)
Proceeds from sale of property, equipment and intangible assets		52	2,284
Net cash used in investing activities		**(107,320)**	**(21,055)**
Cash flows (used in) / from financing activities			
Repayments of other borrowed funds		(31,481)	(93,773)
Proceeds from other borrowed funds		28,848	20,940
Repayments on debt securities issued		(992)	(3,307)
Acquisition of non-controlling interests		–	(3,917)
Dividend payment (Note 18)		(7,086)	–
Net cash used in financing activities		**(10,711)**	**(80,057)**
Effect of exchange rate changes on cash and cash equivalents		1,563	(9,893)
Effect of change in credit loss allowance		–	(1,906)
Net increase/(decrease) in cash and cash equivalents		**979,500**	**(896,922)**
Cash and cash equivalents, beginning of year	7	1,810,173	2,707,095
Cash and cash equivalents, ending of year	7	**2,789,673**	**1,810,173**

The accompanying notes 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*	*Total*
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**
Cash proceeds	–	28,848	**28,848**
Redemption	(992)	(31,481)	**(32,473)**
Other changes	36,648	507	**37,155**
Carrying amount at 31 December 2019	**1,526,354**	**104,504**	**1,630,858**

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

Non-cash transactions arising from finalization of restructuring of assets is disclosed in Note 2.

The accompanying notes are an integral part of these consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

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

The activities of the Bank are regulated by the 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 2019 and 2018 the Bank had 36 branches operating in the Republic of Azerbaijan.

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

Name	*Country of operation*	*Proportion of ownership interest (%)*		*Type of operation*
		2019	*2018*	
"The International Bank of Azerbaijan" OJSC	The Republic of Azerbaijan	Parent		Banking
Subsidiaries				
"IBA-Moscow" LLC	Russian Federation	100.0	100.0	Banking
"IBA – GEO" JSC	The Republic of Georgia	100.0	100.0	None
"International Insurance Company" OJSC	The Republic of Azerbaijan	100.0	100.0	None
"Azericard" LLC	The Republic of Azerbaijan	100.0	100.0	Plastic cards processing center
"International Leasing Company" LLC	The Republic of Azerbaijan	100.0	100.0	Leasing

As at 31 December 2019 and 2018 shareholders of the Group were as follows:

Shareholders	*2019 (%)*	*2018 (%)*
Ministry of Finance of the Republic of Azerbaijan	91.40	91.40
State Committee on Property Issues of the Republic of Azerbaijan	3.76	3.76
CJSC "Agrarkredit"	0.13	0.11
Other*	4.71	4.73
Total	**100.00**	**100.00**

(*) Other shareholders included minority shareholders holding an interest less than 2% each.

2. Restructuring of the Group's operations

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 the Republic of Azerbaijan (MoF), the President of Azerbaijan Republic signed a decree on 15 July 2015 providing measures to improve the health of the 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).

(Figures in tables are in thousands of Azerbaijani manats)

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

Restructuring of problematic assets (continued)

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 the amount of USD 2,248,000 thousand were then transferred to State along with debt obligations of the Group under the restructuring program. The promissory notes are guaranteed by the MoF.

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.

During 2019, the remaining part of problematic loans in net amount of AZN 37,443 thousand which were planned to be transferred to CJSC "Agrarkredit" was written-off by the Group. As a result of cancellation of transfer by Shareholders, AZN 68,288 thousand was recognized as distribution to shareholders.

On 22 November 2019, the Group signed trilateral agreements with Ministry of Finance of the Republic of Azerbaijan and CJSC "Agrarkredit", to net-off dividends payable to Ministry of Finance of the Republic of Azerbaijan in the amount of AZN 157,652 thousand and CJSC "Agrarkredit" in the amount of AZN 179 thousand and Payables to CJSC "Agrarkredit" in the amount of AZN 334,682 with the promissory notes received from CJSC "Agrarkredit" in the amount of AZN 492,334 thousand.

As a result, as at 31 December 2019 Receivable from CJSC "Agrarkredit" and Payables to CJSC "Agrarkredit" amounted to AZN 693,281 and AZN 89,055 thousand, respectively. As at 31 December 2019, the ECL relating to Receivable from CJSC "Agrarkredit" of the Group is AZN 9,111 thousand (31 December 2018: 1,772 thousand).

Restructuring of liabilities

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

In September 2017 the Group completed the restructuring of its liabilities under the terms set out in the approved Restructuring Plan. The Group was not able to obtain "permanent moratorium" under the Cross Border Insolvency Regulations in support of a voluntary restructuring of the Group in the Republic of Azerbaijan due to objection made by several creditors. As of the date of issuance of these consolidated financial statements there was no legal claim towards the Group in respect of restructuring of liabilities. Technically the restructuring is expected to be finalized when all issued Eurobonds are distributed to the all creditors.

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 2019, the Company's foreign currency short position was approximately AZN 897,099 thousand (as at 31 December 2018: AZN 1,031,052 thousand).

In April 2019, Moody's upgraded the Group'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 the 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.

(Figures in tables are in thousands of Azerbaijani manats)

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

Restructuring of liabilities (continued)

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 2020-2022; 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.

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).

4. Summary of significant accounting policies

Changes in accounting policies

The Group applied for the first-time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2019. 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 16 Leases

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

The effect of adoption IFRS 16 as at 1 January 2019 increase is as follows:

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

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

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

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

<u>Leases previously accounted for as operating leases</u>

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

The Group also applied the available practical expedients wherein it:

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

Based on the foregoing, as at 1 January 2019:

- Right-of-use assets of AZN 2,452 thousand were recognised and included in Other assets;
- Lease liabilities of AZN 2,452 thousand were recognized and included in Other liabilities;

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

(b) Summary of new accounting policies

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

Right-of-use assets

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

Lease liabilities

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

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

Short-term leases and leases of low-value assets

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

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

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

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

Amounts recognised in the consolidated statement of financial position, consolidated income statement and consolidated statement of cash flows

Set out below, are the carrying amounts of the Group's right-of-use assets and lease liabilities and the movements during the period:

	Right-of-use assets Premises	*Lease liabilities*
As at 1 January 2019	**2,452**	**2,452**
Additions	1,857	1,857
Depreciation expense	(1,054)	–
Interest expense	–	377
Payments	–	(1,271)
As at 31 December 2019	**3,255**	**3,415**

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

The Group had total cash outflows for leases of AZN 3,011 in 2019. The Group also had non-cash additions to right-of-use assets and lease liabilities of AZN 1,857 in 2019.

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 *Income Taxes*. It 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.

The Group determines whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments and uses the approach that better predicts the resolution of the uncertainty.

Upon adoption of the Interpretation, the Group considered whether it has any uncertain tax positions, particularly those relating to transfer pricing. The Bank's and the subsidiaries' tax filings in different jurisdictions include deductions related to transfer pricing and the taxation authorities may challenge those tax treatments. The Group determined, based on its tax compliance and transfer pricing study, that it is probable that its tax treatments (including those for the subsidiaries) will be accepted by the taxation authorities. The Interpretation did not have an impact on the consolidated financial statements of the Group.

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 an 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. These amendments had no impact on the consolidated financial statements of the Group.

Annual improvements 2015-2017 cycle

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 had no impact on the consolidated financial statements of the Group as there is no transaction where joint control is obtained.

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 it originally recognised those past transactions or events.

An entity applies the amendments for annual reporting periods beginning on or after 1 January 2019, with early application permitted. When the 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, they had no impact on the consolidated financial statements of the Group.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Basis of consolidation

Subsidiaries, which are those entities which are controlled by the Group, are consolidated. Control is achieved when the Group 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 Group controls an investee if, and only if, the Group 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 Group has less than a majority of the voting or similar rights of an investee, the Group 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 Group's voting rights and potential voting rights.

Subsidiaries are consolidated from the date on which control is transferred to the Group 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.

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Fair value measurement (continued)

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorised 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.

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

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.

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

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).

The details of these conditions are outlined below.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Financial assets and liabilities (continued)

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

The Group measures debt instruments 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

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 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, these contracts are in the scope of the ECL requirements.

The Group's 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.

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.

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 amounts due to banks and other financial institutions, other borrowed funds, amounts due to customers, 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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

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.

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.

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 in the consolidated statement of profit or loss and other comprehensive income, to the extent that an impairment loss has not already been recorded.

For modifications not resulting in derecognition, the Group also reassesses whether here has been a significant increase in credit risk or whether the assets should be classified as credit-impaired. Once an asset has been classified as credit-impaired as the result of modification, it will remain in Stage 3 for a minimum 6-month probation period. In order for the restructured loan to be reclassified out of Stage 3, regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period in accordance with the modified payment schedule.

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 derecognised 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

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.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Financial liabilities

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

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

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 utilised. 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.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

Property and equipment

Property and equipment are carried 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 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 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 reserves a revaluation decrease of the same asset previously recognized in profit or loss, in which case the revaluation gain is recognized in profit or loss to the extent of the amount of reversal. Decreases that offset previous increases of the same asset are recognized in other comprehensive income and decrease the previously recognized 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 of an asset begins when it is available for use. 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. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

Property and equipment (continued)

Costs related to repairs and renewals are charged when incurred and included in other 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

İn 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 include 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 either finite or indefinite. 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.

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.

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

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.

Segment reporting

The Group’s segmental reporting is based on the following operating segments: Retail banking, Corporate banking, Treasury banking.

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 recognised unless an inflow of economic benefit is virtually certain.

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

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 revenue and expense

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. 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.

Fee and commission income

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income include 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 consist of fee and commission paid on plastic card 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 2019 and 2018 in the preparation of these consolidated financial statements:

	2019	***2018***
1 US dollar	AZN 1.7000	AZN 1.7000
1 euro	AZN 1.9035	AZN 1.9468
1 Georgian lari	AZN 0.5936	AZN 0.6367
1 Russian rubl	AZN 0.0274	AZN 0.0245

(Figures in tables are in thousands of Azerbaijani manats)

4. Summary of significant accounting policies (continued)

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 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts* (IFRS 17), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 *Insurance Contracts* (IFRS 4) that was issued in 2005. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features.

A few scope exceptions will apply. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in IFRS 4, which are largely based on grandfathering previous local accounting policies, IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach);
- A simplified approach (the premium allocation approach) mainly for short-duration contracts.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2021, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The amendments are not expected to have a significant impact on the Group's consolidated financial statements.

Amendments to IFRS 3: Definition of a Business

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 *Business Combinations* to help entities determine whether an acquired set of activities and assets is a business or not. They clarify the minimum requirements for a business, remove the assessment of whether market participants are capable of replacing any missing elements, add guidance to help entities assess whether an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test. New illustrative examples were provided along with the amendments.

Since the amendments apply prospectively to transactions or other events that occur on or after the date of first application, the Group will not be affected by these amendments on the date of transition.

Amendments to IAS 1 and IAS 8: Definition of Material

In October 2018, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to align the definition of 'material' across the standards and to clarify certain aspects of the definition. The new definition states that, 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity'.

The amendments to the definition of material is not expected to have a significant impact on the Group's consolidated financial statements.

Interest Rate Benchmark Reform: Amendments to IFRS 9, IAS 39 and IFRS

Interest Rate Benchmark Reform Amendments to IFRS 9, IAS 39 and IFRS 7 includes a number of reliefs, which apply to all hedging relationships that are directly affected by interest rate benchmark reform. A hedging relationship is affected if the reform gives rise to uncertainties about the timing and or amount of benchmark-based cash flows of the hedged item or the hedging instrument. As a result of interest rate benchmark reform, there may be uncertainties about the timing and or amount of benchmark-based cash flows of the hedged item or the hedging instrument during the period before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate (an RFR). This may lead to uncertainty whether a forecast transaction is highly probable and whether prospectively the hedging relationship is expected to be highly effective.

The amendments come into effect from 1 January 2020, but entities may choose to apply them earlier. The amendments are not expected to have a significant impact on the Group's consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

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 (Note 23).

Impairment losses on financial assets

The measurement of impairment losses both under IFRS 9 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.

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. During 2019, The Group changed its segment performance allocation principles to present operating expenses and income taxes for each reportable segment separately.

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	***2019***	***2018***	***2019***	***2018***	***2019***	***2018***	***2019***	***2018***	***2019***	***2018***
Interest income	81,276	56,436	153,609	138,957	239,523	241,348	–	–	474,408	436,741
Interest expense	(8,707)	(10,881)	(29,750)	(52,570)	(97,054)	(97,303)	(377)	–	(135,888)	(160,754)
Net interest income	**72,569**	**45,555**	**123,859**	**86,387**	**142,469**	**144,045**	**(377)**	**–**	**338,520**	**275,987**
Reversal of impairment losses / (impairment losses) for interest bearing assets	(16,615)	42,750	(10,696)	31,466	(10,454)	(2,544)	–	–	(37,765)	71,672
Net interest income after provision for impairment losses	**55,954**	**88,305**	**113,163**	**117,853**	**132,015**	**141,501**	**(377)**	**–**	**300,755**	**347,659**
Fee and commission income	75,576	76,256	14,049	11,008	538	1,587	–	–	90,163	88,851
Fee and commission expense	(5,791)	(2,623)	(16,329)	(10,668)	(2,452)	(4,533)	–	–	(24,572)	(17,824)
Impairment of property, equipment and intangible assets	–	–	–	–	–	–	(4,482)	(6,736)	(4,482)	(6,736)
Other impairment reversal	17,707	8,837	–	–	–	–	–	–	17,707	8,837
Reversal of provision for credit losses on credit related commitments	14,059	42,138	–	–	–	–	–	–	14,059	42,138
Net gains from operations in foreign currencies:										
- dealing	65,430	51,957	2,700	1,992	118	1,406	–	–	68,248	55,355
- translation differences	–	–	–	–	(17,957)	21,143	–	–	(17,957)	21,143
Other operating income	1,032	328	1,910	2,854	–	–	4,089	–	7,031	3,182
Non-interest income	**168,013**	**176,893**	**2,330**	**5,186**	**(19,753)**	**19,603**	**(393)**	**(6,736)**	**150,197**	**194,946**
Operating expenses	(26,426)	(20,406)	(48,412)	(49,084)	(2,476)	(625)	(66,305)	(57,879)	(143,619)	(127,994)
Losses on initial recognition of financial instruments and loan modification	(23,016)	(19,075)	–	–	–	–	–	–	(23,016)	(19,075)
Non-interest expenses	**(49,442)**	**(39,481)**	**(48,412)**	**(49,084)**	**(2,476)**	**(625)**	**(66,305)**	**(57,879)**	**(166,635)**	**(147,069)**
Profit/(loss) before income tax expense	**174,525**	**225,717**	**67,081**	**73,955**	**109,786**	**160,479**	**(67,075)**	**(64,615)**	**284,317**	**395,536**
Income tax expense	(34,076)	(46,913)	(13,098)	(16,593)	(21,435)	(33,354)	–	–	**(68,609)**	**(96,860)**
Net profit/(loss) for the year	**140,449**	**178,804**	**53,983**	**57,362**	**88,351**	**127,125**	**(67,075)**	**(64,615)**	**215,708**	**298,676**
Segment assets	**1,186,730**	**940,663**	**1,121,214**	**854,237**	**6,931,136**	**6,367,163**	**102,665**	**112,180**	**9,341,745**	**8,274,243**
Segment liabilities	**4,467,932**	**3,334,469**	**1,362,213**	**1,161,008**	**1,659,787**	**2,012,415**	**168,085**	**123,162**	**7,658,017**	**6,631,054**

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*	
	2019	***2018***	***2019***	***2018***	***2019***	***2018***	***2019***	***2018***
Revenue	579,718	549,506	42,014	26,209	11,087	5,232	**632,819**	**580,947**
Non-current assets	160,990	164,477	–	–	32,003	36,254	**192,993**	**200,731**

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:

	2019	*2018*
Cash on hand	228,796	203,940
Current accounts with Central Banks	179,090	129,192
Correspondent accounts and time deposits with original maturity up to 90 days with credit institutions	2,381,787	1,477,041
Cash and cash equivalents	**2,789,673**	**1,810,173**

As at 31 December 2019, the Group had a concentration of correspondent accounts and time deposits with original maturity up to 90 days with credit institutions represented by AZN 2,359,322 thousand (31 December 2018: AZN 1,446,491 thousand) in six (31 December 2018: seven) largest banks.

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

8. Due from banks and other financial institutions

Due from banks and other financial institutions comprise:

	2019	*2018*
Time deposits with the CBAR	2,825,550	3,027,816
Time deposits with non-resident banks	339,784	167,694
Blocked accounts with non-resident banks	12,694	52,447
Loans to credit institutions	8,761	3,014
Time deposits with resident banks	1,652	4,513
Less: allowance for impairment	(8,826)	(5,711)
Due from banks and other financial institutions	**3,179,615**	**3,249,773**

As at 31 December 2019, the Group had one time deposit (31 December 2018: two) with CBAR maturing in December 2020 (31 December 2018: in December 2019) with interest rate 3,5% p.a (31 December 2018: 5% p.a. each).

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

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**3,250,971**	**4,513**	–	**3,255,484**
New assets originated or purchased	3,164,328	–	–	**3,164,328**
Assets repaid	(3,204,505)	(2,859)	–	**(3,207,364)**
Change in accrued interest balance	(23,862)	(2)	14	**(23,850)**
Transfer to lifetime ECL credit-impaired	(1,904)	–	1,904	
Foreign exchange	(157)	–	–	**(157)**
At 31 December 2019	**3,184,871**	**1,652**	**1,918**	**3,188,441**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2019	**(5,553)**	**(158)**	–	**(5,711)**
New assets originated or purchased	(4,985)	–	–	**(4,985)**
Assets repaid	5,154	106	–	**5,260**
Unwind of discount	40	(1)	(14)	**25**
Transfer to lifetime ECL credit-impaired	–	–	–	**–**
Net remeasurement of loss allowance	88	(1,599)	(1,904)	**(3,415)**
At 31 December 2019	**(5,256)**	**(1,652)**	**(1,918)**	**(8,826)**

(Figures in tables are in thousands of Azerbaijani manats)

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

	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)**

9. Investment securities

Investment securities comprise:

	2019	*2018*
Debt securities at FVOCI		
Government bonds	63,772	41,175
Corporate bonds	72,632	892
	136,404	**42,067**
Equity securities at FVOCI		
Corporate shares	71,257	48,778
	71,257	**48,778**
Total investment securities	**207,661**	**90,845**

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

As at 31 December 2019, the Government bonds comprise Bonds of the Ministry of Finance of the Republic of Azerbaijan (as at 31 December 2018: Bonds of the Ministry of Finance of the Republic of Azerbaijan and Ministry of Finance of the Republic of Turkey) in the amount of AZN 63,772 thousand (as at 31 December 2018: 29,503 thousand and AZN 11,672 thousand, respectively).

As at 31 December 2019, the corporate bonds comprise of bonds issued in OECD countries and non-OECD countries in the amount of AZN 61,443 thousand and AZN 11,189 thousand respectively (as at 31 December 2018: AZN 892 thousand in non-OECD countries).

As at 31 December 2019, 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 19,182 thousand and AZN 51,765 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 2018: 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).

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers

Loans to customers comprise:

	2019	*2018*
Loans to legal entities	1,193,240	925,377
Loans to individuals	1,095,309	851,626
Loans to be transferred to CJSC "Agrarkredit"	–	113,025
Total loans to customers, gross	**2,288,549**	**1,890,028**
Less: allowance for impairment losses	(122,745)	(215,875)
Total loans to customers	**2,165,804**	**1,674,153**

As at 31 December 2019, the Group had a concentration of loans represented by AZN 969,542 thousand or 42% of gross loan portfolio (31 December 2018: AZN 777,983 thousand or 41%) due from ten (31 December 2018: ten) largest borrowers. An allowance of AZN 39,551 thousand (31 December 2018: AZN 49,460 thousand) was recognized against these loans.

Loans to individuals comprise the following products:

	2019	*2018*
Mortgage loans	576,843	531,559
Consumer loans and others	518,466	320,067
Total loans to customers, gross	**1,095,309**	**851,626**
Less: allowance for impairment losses	(63,398)	(62,598)
Total loans to customers	**1,031,911**	**789,028**

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

	2019	*2018*
Analysis by sector		
Individuals	1,095,309	851,626
Trade and Service	559,361	545,659
Oil and Gas sector, power production and distribution	244,604	1,045
Railroad, air and other transportation	195,091	224,150
Manufacturing	76,625	62,875
Construction and real estate development	50,393	45,245
Communication	40,224	20,239
Other	26,942	26,164
Loans to be transferred to CJSC "Agrarkredit"	–	113,025
Total loans to customers, gross	**2,288,549**	**1,890,028**
Less: allowance for impairment losses	(122,745)	(215,875)
Total loans to customers	**2,165,804**	**1,674,153**

(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 2019 is as follows:

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**663,036**	**127,350**	**134,991**	**925,377**
New assets originated or purchased	472,585	–	–	**472,585**
Change in accrued interest balance	10,174	1,313	8,156	**19,643**
Assets repaid	(137,057)	(46,715)	(24,011)	**(207,783)**
Transfer to 12-month ECL	65,679	(64,520)	(1,159)	**–**
Transfer to lifetime ECL not credit-impaired	(68,376)	68,765	(389)	**–**
Transfer to lifetime ECL credit-impaired	(6,573)	–	6,573	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	(23,016)	**(23,016)**
Write-offs	–	–	(5,809)	**(5,809)**
Transfer from other financial assets	–	–	12,242	**12,242**
At 31 December 2019	**999,468**	**86,193**	**107,578**	**1,193,239**

Loans to legal entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(15,839)**	**(9,924)**	**(53,747)**	**(79,510)**
New assets originated or purchased	(12,832)	–	–	**(12,832)**
Change in accrued interest balance	(37)	(165)	–	**(202)**
Unwind of discount	–	–	(1,696)	**(1,696)**
Assets repaid	2,417	3,248	12,538	**18,203**
Transfer to 12-month ECL	(3,894)	3,691	203	**–**
Transfer to lifetime ECL not credit-impaired	7,831	(7,882)	51	**–**
Transfer to lifetime ECL credit-impaired	6,242	–	(6,242)	**–**
Net remeasurement of ECL	3,885	(4,467)	5,936	**5,354**
Changes due to modifications not resulting in derecognition	–	–	7,486	**7,486**
Write-offs	–	–	5,809	**5,809**
Transfer from other asset	–	–	(1,959)	**(1,959)**
At 31 December 2019	**(12,227)**	**(15,499)**	**(31,621)**	**(59,347)**

(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 individuals during the year ended 31 December 2019 is as follows:

Loans to individuals	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**780,362**	**27,095**	**44,169**	**851,626**
New assets originated or purchased	520,495	–	–	**520,495**
Change in accrued interest balance	3,289	(43)	(1,239)	**2,007**
Assets repaid	(261,576)	(5,441)	(9,571)	**(276,588)**
Transfer to 12-month ECL	17,836	(13,345)	(4,491)	**–**
Transfer to lifetime ECL not credit-impaired	(20,035)	22,211	(2,176)	**–**
Transfer to lifetime ECL credit-impaired	(20,998)	(2,374)	23,372	**–**
Write-offs			(2,229)	**(2,229)**
At 31 December 2019	**1,019,373**	**28,103**	**47,835**	**1,095,311**

Loans to individuals	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(21,307)**	**(7,832)**	**(33,459)**	**(62,598)**
New assets originated or purchased	(10,511)	–	–	**(10,511)**
Change in accrued interest balance	(631)	8	–	**(623)**
Unwind of discount	–	–	33	**33**
Assets repaid	3,631	1,578	7,710	**12,919**
Transfer to 12-month ECL	(7,013)	4,010	3,003	**–**
Transfer to lifetime ECL not credit-impaired	667	(2,144)	1,477	**–**
Transfer to lifetime ECL credit-impaired	481	639	(1,120)	**–**
Net remeasurement of ECL	14,491	(2,347)	(16,991)	**(4,847)**
Write-offs	–	–	2,229	**2,229**
At 31 December 2019	**(20,192)**	**(6,088)**	**(37,118)**	**(63,398)**

(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 be transferred to CJSC "Agrarkredit" during the year ended 31 December 2019 is as follows:

Loans to be transferred to CJSC "Agrarkredit"	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**–**	**–**	**113,025**	**113,025**
Assets transferred to the CJSC "Agrarkredit"	–	–	(4,403)	**(4,403)**
Change in accrued interest balance	–	–	7,901	**7,901**
Write-offs	–	–	(116,523)	**(116,523)**
At 31 December 2019	**–**	**–**	**–**	**–**

Loans to be transferred to CJSC "Agrarkredit"	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**–**	**–**	**(73,767)**	**(73,767)**
Assets transferred to the CJSC "Agrarkredit"	–	–	2,588	**2,588**
Unwind of discount	–	–	(5,045)	**(5,045)**
Net remeasurement of ECL	–	–	(40,299)	**(40,299)**
Write-offs	–	–	116,523	**116,523**
At 31 December 2019	**–**	**–**	**–**	**–**

(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 was 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 interest 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 interest 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

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 interest 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 interest 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

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 be transferred 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 interest balance	–	–	10,535	**10,535**
Write-offs	–	–	(14,990)	**(14,990)**
At 31 December 2018	**–**	**–**	**113,025**	**113,025**

Loans to be transferred 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)**

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 3 assets that were modified during the period, with the related modification loss suffered by the Group.

	2019	*2018*
Loans modified during the period		
Amortised cost before modification	104,376	166,565
Net modification loss	(23,016)	(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:

Historical cost / revalued amount	*Office premises*	*Leasehold improvements*	*Furniture, fixtures, vehicles, and other fixed assets*	*Computers and communication equipment*	*Total property and equipment*	*Intangible assets*	*Total property, equipment and intangible assets*
As at 1 January 2018	**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	–	(2,618)	(1,645)	(8,624)	**(12,887)**	(14,968)	**(27,855)**
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**
Additions	2,919	332	4,176	6,960	**14,387**	3,591	**17,978**
Disposals and write-offs	–	(132)	(2,581)	(469)	**(3,182)**	(2,313)	**(5,495)**
Impairment	(4,482)	–	–		**(4,482)**	–	**(4,482)**
Revaluation	(1,653)	–	–	–	**(1,653)**	–	**(1,653)**
Foreign exchange difference	280	–	1,045	–	**1,325**	–	**1,325**
As at 31 December 2019	**149,040**	**3,899**	**68,464**	**79,040**	**300,443**	**28,547**	**328,990**

Accumulated depreciation	*Office premises*	*Leasehold improvements*	*Furniture, fixtures, vehicles, and other fixed assets*	*Computers and communication equipment*	*Total property and equipment*	*Intangible assets*	*Total property, equipment and intangible assets*
As at 1 January 2018	**(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)**
Depreciation charge	(3,487)	(1,238)	(6,794)	(8,530)	**(20,049)**	(3,835)	**(23,884)**
Disposals	–	–	2,238	469	**2,707**	2,313	**5,020**
Revaluation	3,535	–	–	–	**3,535**	–	**3,535**
Foreign exchange differences	(48)	–	(34)	–	**(82)**	–	**(82)**
As at 31 December 2019	**–**	**(3,594)**	**(56,112)**	**(63,879)**	**(123,585)**	**(12,412)**	**(135,997)**
Net book value							
As at 1 January 2018	**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**
As at 31 December 2019	**149,040**	**305**	**12,352**	**15,161**	**176,858**	**16,135**	**192,993**

(Figures in tables are in thousands of Azerbaijani manats)

11. Property, equipment and intangible assets (continued)

As at 31 December 2019 and 2018 included in property, equipment and intangible assets were fully depreciated assets in use in the amount of AZN 60,604 thousand and AZN 53,877 thousand, respectively.

As at 31 December 2019 and 2018 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 2019 and 2018, 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 the Group's premises categorised within Level 3 of the fair value hierarchy to changes in unobservable inputs as at 31 December 2019.

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.

(Figures in tables are in thousands of Azerbaijani manats)

12. Other assets and liabilities

Other assets comprise:

	2019	*2018*
Other financial assets		
Funds in settlement	23,290	15,641
Pledged funds with non-resident organisations	10,005	9,848
Accrued commission and receivables from settlement of off-balance sheet commitments	8,572	17,872
Allowance for impairment of other assets	(8,887)	(12,928)
	32,980	**30,433**
Other non-financial assets		
Prepayments	5,068	5,937
Right-of-use assets	3,255	–
Deferred expense	3,267	1,864
Repossessed collaterals	2,673	2,229
	14,263	**10,030**
Other assets	**47,243**	**40,463**

Other liabilities comprise:

	2019	*2018*
Other financial liabilities		
Credit loss allowance for credit related commitments	82,894	92,912
Funds in settlement	24,156	16,908
Lease liability	3,415	–
Dividends payable to shareholders	1,494	16,411
	111,959	**126,231**
Other non-financial liabilities		
Provision for other contingencies and commitments	3,928	24,815
Payables to employees	14,345	8,914
Deferred revenue on plastic cards	5,837	5,848
Payables to local budget	3,580	2,228
Taxes other than income tax	1,557	4,094
	29,247	**45,899**
Other liabilities	**141,206**	**172,130**

The movements in allowances for impairment under IFRS 9 of other financial assets at amortised cost during the year ended 31 December 2019 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(4)**	**(23)**	**(12,901)**	**(12,928)**
New assets originated or purchased	(3)	–	–	**(3)**
Assets repaid	3	23	2,679	**2,705**
Transfer to loans to customers	–	–	1,959	**1,959**
Net remeasurement of ECL	(620)	–	–	**(620)**
Write-offs	–	–	–	**–**
ECL as at 31 December 2019	**(624)**	**–**	**(8,263)**	**(8,887)**

The movements in allowances for impairment under IFRS 9 of other financial assets at amortised cost during the year ended 31 December 2018 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(69)**	**(10)**	**(20,037)**	**(20,116)**
Net remeasurement of ECL	65	(13)	1,861	**1,913**
Write-offs	–	–	5,275	**5,275**
ECL as at 31 December 2018	**(4)**	**(23)**	**(12,901)**	**(12,928)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Other assets and liabilities (continued)

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

	2019	*2018*
Credit related commitments	82,894	92,912
Performance guarantees	3,928	19,835
Legal claims	–	4,980
Credit loss allowance for credit related commitments and provision for other contingencies and commitments	**86,822**	**117,727**

13. Due to banks and other financial institutions

Due to banks and other financial institutions comprise:

	2019	*2018*
Correspondent accounts of resident banks	13,884	30,405
Time deposits of resident banks and other financial institutions	10,205	10,230
Correspondent accounts of non-resident banks	7,890	4,625
Due to banks and other financial institutions	**31,979**	**45,260**

14. Customer accounts

The amounts due to customers include the following:

	2019	*2018*
Legal entities		
- Current/settlement accounts	3,978,599	2,937,897
- Term deposits	300,803	86,481
- Restricted customer deposits	120,681	191,635
Total legal entities	**4,400,083**	**3,216,013**
Individuals		
- Current/settlement accounts	524,763	394,321
- Term deposits	681,722	754,315
- Restricted customer deposits	105	–
Total individuals	**1,206,590**	**1,148,636**
Total customer accounts	**5,606,673**	**4,364,649**

As at 31 December 2019, customer accounts included balances with ten (31 December 2018: six) largest customers in the amount of AZN 2,635,656 thousand or 47% of the total customer accounts portfolio (31 December 2018: AZN 1,830,184 thousand or 42% of the total customer accounts portfolio).

As at 31 December 2019, customer accounts included balances blocked with the Group against letters of credit in the amount of AZN 120,776 thousand (as at 31 December 2018: AZN 161,208 thousand) (Note 19).

An analysis of customer accounts by economic sector follows:

	2019	*2018*
Analysis by economic sector / customer type		
Government related entities	3,912,810	2,154,284
Individuals	1,206,590	1,148,636
Trade and service	274,826	729,100
Transportation and communication	49,727	37,310
Public organizations	31,637	57,143
Energy	30,033	63,129
Manufacturing	21,709	99,128
Construction	13,973	34,307
Other	65,368	41,612
Total customer accounts	**5,606,673**	**4,364,649**

(Figures in tables are in thousands of Azerbaijani manats)

15. Other borrowed funds

Other borrowed funds comprise:

	2019	*2018*
Term borrowings from non-resident financial institutions	16,859	19,955
Entrepreneurship Development Fund and the Mortgage fund (the Republic of Azerbaijan)	87,645	86,675
Total other borrowed funds	**104,504**	**106,630**

16. Debt securities issued

Debt securities issued comprise:

	2019	*2018*
Eurobonds	1,521,784	1,485,136
Certificates of deposit	4,570	5,562
Total debt securities issued	**1,526,354**	**1,490,698**

As at 31 December 2019, the Group had one class of Eurobonds issued in September 2017 with coupon rate of 3.5% p.a maturing in September 2024. The Group is obliged to comply with non-financial covenants in relation to these Eurobonds. As of date of issuance of these consolidated financial statements, the Group was in compliance of these covenants.

17. Taxation

Deferred tax assets and liabilities comprise:

	2019	*2018*
Deferred tax (liabilities)/assets in relation to:		
Due from banks and loans to customers	(27,248)	2,624
Investment securities	(14,730)	(9,693)
Property, equipment and intangible assets	6,771	7,164
Debt securities issued	(39,389)	(46,718)
Other assets	4,531	3,308
Other liabilities	(13,600)	(39,945)
Other	(111)	(4,759)
Tax loss carryforward	3,605	5,962
Unrecognized deferred tax assets	(2,298)	(2,298)
Net deferred tax liability	**(82,469)**	**(84,355)**

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:

	2019	*2018*
Profit before tax	**284,317**	**395,536**
Tax expense at the statutory tax rate (20%)	**(56,863)**	**(79,107)**
Change in deferred tax assets recognized	–	517
Tax effect of permanent differences	(2,915)	(3,031)
Prior year tax actualization	–	(12,658)
Other	(8,831)	(2,581)
Income tax expense	**(68,609)**	**(96,860)**
Current income tax expense	(76,189)	(5,511)
Changes in deferred tax	7,580	(91,349)
Income tax expense	**(68,609)**	**(96,860)**

(Figures in tables are in thousands of Azerbaijani manats)

17. Taxation (continued)

Deferred income tax assets/(liabilities)	*2019*	*2018*
Deferred tax assets at 1 January	**900**	**7,340**
Deferred tax liabilities at 1 January	**(85,255)**	**(554)**
Change in deferred tax due to IFRS 9 adoption	–	2,021
Change in deferred income tax balances recognized in profit or loss	7,580	(91,349)
Change in deferred income tax recognized in other comprehensive income	(5,694)	(1,813)
Deferred income tax assets at 31 December	**1,029**	**900**
Deferred income tax liabilities at 31 December	**(83,498)**	**(85,255)**
Net deferred income tax liability	**(82,469)**	**(84,355)**

At 31 December 2019, the aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liability have not been recognised was AZN 129,823 thousand (31 December 2018: AZN 141,010 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 2018	**4,597,359**	**1,241,287**
As at 31 December 2018	**4,597,359**	**1,241,287**
As at 31 December 2019	**4,597,359**	**1,241,287**

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

On 11 October 2019, according to the resolution of Annual General Meeting of Shareholders, the Group declared AZN 150,000 thousand dividend. Dividend earning per share is 0,03 AZN.

Dividend movement comprises:

	2019	*2018*
Dividend payable to Shareholders at 1 January	**16,411**	**16,411**
Dividend declared	150,000	–
Dividend off-setted (Note 2)	(157,831)	–
Dividend paid	(7,086)	–
Dividend payable to Shareholders at 31 December	**1,494**	**16,411**

Revaluation reserve for premises

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

Additional paid-in capital

Additional paid-in capital reflects results from transactions with shareholders acting in their capacity as shareholders. In a turbulent economic condition due to continued decline in the quality of the Group's assets, increase in problematic loans and decline in liquidity position of the Group, the Government of Azerbaijan took 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 2015-2019 to CJSC "Agrarkredit" (Note 2). The transfer of the problematic assets occured 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.

(Figures in tables are in thousands of Azerbaijani manats)

18. Equity (continued)

Additional paid-in capital (continued)

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

	2019	*2018*
Net profit for the period attributable to shareholders of the Group	215,708	298,653
Weighted average number of ordinary shares in issue	4,597,359	4,597,359
Earnings per share – basic and diluted (AZN)	**0.05**	**0.06**

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 2019 the government continued expansionary monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani manat. During 2019, CBAR gradually reduced refinancing rate from 9.75% to 7.50% 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. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Group.

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 2019 and 2018 is appropriate and that the Group's tax, currency and customs positions will be sustained.

Insurance

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

(Figures in tables are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Compliance with CBAR ratios

In accordance with the presidential decree dated 28 November 2019, FMSA has been abolished, and its power, including its functions and rights in the field of licencing, regulation and supervision of the financial services market, protection of the rights of investors and consumers of financial services market, as well as property have been transferred to CBAR. CBAR requires 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 2019, which is due to significant open currency positions. The ratios breached comprise:

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

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 and CBAR on a monthly basis and no sanctions were imposed to the Group. Moreover, Management of the Group provided CBAR 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.

Financial commitments and contingencies comprise:

Commitments and contingencies	*2019*	*2018*
Guarantees	799,042	1,162,430
Letters of credit	108,753	143,536
Undrawn loan commitments	659,953	1,729,851
Less: allowance	(86,822)	(112,747)
Commitments and contingencies	**1,480,926**	**2,923,070**
Less: cash held as security against guarantees and letters of credit	(120,776)	(161,208)
Less: cash received from CJSC “Agrarkredit” held as security against guarantees and letters of credit*	(89,186)	(186,282)
Total	**1,270,964**	**2,575,580**

* *Promissory notes in the amount of AZN 89,186 thousand were pledged on behalf of CJSC “Agrarkredit” 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 2019 is as follows:

Financial guarantees	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(3,316)**	**(5,028)**	**(80,064)**	**(88,408)**
New exposures originated or purchased	(2,709)	–	–	**(2,709)**
Exposures derecognised or matured (excluding write-offs)	1,982	1,523	26,675	**30,180**
Transfer 12-month ECL	(1,275)	1,275	–	**–**
Net remeasurement of ECL	(946)	1,214	(16,599)	**(16,331)**
At 31 December 2019	**(6,264)**	**(1,016)**	**(69,988)**	**(77,268)**

Letter of credit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(300)**	**(568)**	**–**	**(868)**
New exposures originated or purchased	(50)	–	–	**(50)**
Exposures derecognised or matured (excluding write-offs)	300	568	–	**868**
At 31 December 2019	**(50)**	**–**	**–**	**(50)**

(Figures in tables are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

Undrawn commitments	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(3,362)**	**–**	**(274)**	**(3,636)**
New exposures originated or purchased	(3,754)	–	–	**(3,754)**
Exposures derecognised or matured (excluding write-offs)	2,471	–	274	**2,745**
Net remeasurement of ECL	(931)	–	–	**(931)**
At 31 December 2019	**(5,576)**	**–**	**–**	**(5,576)**

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***
ECL 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)	–	**–**
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***
ECL 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)**
At 31 December 2018	**(300)**	**(568)**	**–**	**(868)**

Undrawn commitments	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL 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**
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 2019 is provided in Note 20.

(Figures in tables are in thousands of Azerbaijani manats)

20. Credit loss expense or 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 2019;

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans and receivables at amortised cost	10	413	(2,145)	(25,579)	**(27,311)**
Due from banks and other financial institutions	8	297	(1,494)	(1,918)	**(3,115)**
Receivables from CJSC "Agrarkredit"		(7,339)	–	–	**(7,339)**
Credit loss expense on interest bearing financial assets		**(6,629)**	**(3,639)**	**(27,497)**	**(37,765)**
Financial guarantees	19	(1,673)	2,737	10,076	**11,140**
Letters of credit	19	250	568	–	**818**
Undrawn loan commitments	19	(2,214)	–	274	**(1,940)**
Credit related commitments		**(3,637)**	**3,305**	**10,350**	**10,018**
Other financial assets	12	(620)	23	4,638	**4,041**
Reversal of provision for credit losses on credit related commitments and other financial assets		**(4,257)**	**3,328**	**14,988**	**14,059**
Total credit loss expense		**(10,886)**	**(311)**	**(12,509)**	**(23,706)**

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 2018	**–**	**(33,652)**	**(33,652)**
(Charge)/reversal	(4,980)	13,817	**8,837**
31 December 2018	**(4,980)**	**(19,835)**	**(24,815)**
Reversal	1,800	15,907	**17,707**
Redemption	3,180	–	**3,180**
31 December 2019	**–**	**(3,928)**	**(3,928)**

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

(Figures in tables are in thousands of Azerbaijani manats)

21. Fee and commission income and expense

Fee and commission income and expense comprise:

	2019	***2018***
Plastic cards operations	61,263	55,912
Servicing guarantees and letters of credit	11,608	14,158
Settlement transactions	11,305	12,236
Cash transactions	4,353	5,190
Other	1,634	1,355
Fee and commission income	**90,163**	**88,851**
Plastic cards operations	(17,179)	(11,320)
Cash transactions	(3,834)	(3,764)
Settlement transactions	(2,659)	(2,036)
Other	(900)	(704)
Fee and commission expense	**(24,572)**	**(17,824)**
Net fee and commission income	**65,591**	**71,027**

22. Operating expenses

Operating expenses comprise:

	2019	***2018***
Staff costs	(73,094)	(61,340)
Depreciation of premises and equipment	(20,049)	(17,557)
Consultancy and other professional services	(11,068)	(10,236)
Fees paid to deposit insurance fund	(5,423)	(5,876)
Amortization of software and other intangible assets	(3,835)	(4,553)
Advertising and marketing services	(3,787)	(1,338)
Customs duties and taxes other than on income	(3,553)	(2,936)
Software maintenance	(3,312)	(3,944)
Premises, property and maintenance	(3,136)	(1,654)
External labor and guarding	(3,054)	(3,022)
Communication	(2,038)	(1,654)
Rent	(1,739)	(2,921)
Utility	(1,560)	(1,311)
Stationary, books, printing, and other supplies	(1,540)	(991)
Insurance expense	(1,010)	(1,042)
Charity and financial aid	(150)	(29)
Fines and penalties	(112)	(1,135)
Other	(5,159)	(6,455)
Total operating expenses	**(143,619)**	**(127,994)**

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.

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

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Introduction

Supervisory Board

The Supervisory Board 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.

Risk management structure

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 Supervisory Board 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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Risk management structure (continued)

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

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 and results from default events on a financial instrument which 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.

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 allocates 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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

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).

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 the 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 standardized 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 realized 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 12months ECL 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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

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.

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 amount 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 allocates 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. Financial assets from or guaranteed by Government of Azerbaijan are assigned with "High" internal rating.

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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Risk management (continued)

Credit risk (continued)

The table below shows gross balances as at 31 December 2019 based on the Group's internal 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	1,655,582	905,295	−	−	**2,560,877**
Due from banks and other financial institutions	8	Stage 1	2,905,912	278,959	−	−	**3,184,871**
		Stage 2			1,652		**1,652**
		Stage 3	−	−	−	1,918	**1,918**
Loans to customers	10						
- Legal entities		Stage 1	746,594	252,874	−	−	**999,468**
		Stage 2	68	25,700	60,425	−	**86,193**
		Stage 3	−	−	−	107,578	**107,578**
- Individuals		Stage 1	435,245	584,128	−	−	**1,019,373**
		Stage 2	49	2,388	25,666	−	**28,103**
		Stage 3	−	−	−	47,835	**47,835**
Debt securities at FVOCI	9	Stage 1	84,772	51,632	−	−	**136,404**
Receivables from CJSC "Agrarkredit"	2	Stage 1	702,392	−	−	−	**702,392**
Other financial assets	12						
		Stage 1	10,005	23,290	96	−	**33,391**
		Stage 3	−	−	−	8,476	**8,476**
Undrawn loan commitments	19						
		Stage 1	496,452	163,501	−	−	**659,953**
		Stage 3	−	−	−	−	**−**
Letters of credit	19	Stage 1	106,822	1,676	−	−	**108,498**
		Stage 2	−	−	−	−	**−**
		Stage 3	−	−	−	255	**255**
Financial guarantees	19	Stage 1	136,865	110,498	−	−	**247,363**
		Stage 2	199,000	−	−	−	**199,000**
		Stage 3	−	−	−	352,679	**352,679**
Total			**7,479,758**	**2,399,941**	**87,839**	**518,741**	**10,486,279**

The table below shows gross balances as at 31 December 2018 based on the Group's internal 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	8	Stage 1	3,064,612	186,359	−	−	**3,250,971**
institutions		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			**8,254,271**	**1,652,351**	**87,986**	**735,079**	**10,729,687**

(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 2019, the geographical concentration of the Group's financial assets and liabilities is set out as below:

	2019				*2018*			
	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	349,811	2,381,213	58,649	**2,789,673**	302,760	1,457,796	49,617	**1,810,173**
Mandatory cash balances with the Central Banks	59,199	–	860	**60,059**	54,574	–	128	**54,702**
Due from banks and other financial institutions	2,829,351	327,629	22,635	**3,179,615**	3,030,628	193,950	25,195	**3,249,773**
Investment securities	64,724	132,390	10,547	**207,661**	30,646	60,199	–	**90,845**
Loans to customers	2,160,704	–	5,100	**2,165,804**	1,669,592	–	4,561	**1,674,153**
Receivables from CJSC "Agrarkredit"	693,281	–	–	**693,281**	1,150,401	–	–	**1,150,401**
Other financial assets	18,697	10,018	4,265	**32,980**	15,026	10,005	5,402	**30,433**
Total	**6,175,767**	**2,851,250**	**102,056**	**9,129,073**	**6,253,627**	**1,721,950**	**84,903**	**8,060,480**
Financial liabilities								
Due to banks and other financial institutions	25,550	1,111	5,318	**31,979**	40,929	597	3,734	**45,260**
Customer accounts	5,454,107	39,997	112,569	**5,606,673**	4,150,015	36,727	177,907	**4,364,649**
Payables to CJSC "Agrarkredit"	89,055	–	–	**89,055**	364,596	–	–	**364,596**
Other borrowed funds	87,645	16,859	–	**104,504**	86,675	19,955	–	**106,630**
Debt securities issued	4,234	1,522,075	45	**1,526,354**	4,234	1,485,402	1,062	**1,490,698**
Other financial liabilities	111,649	–	310	**111,959**	124,531	–	1,700	**126,231**
Total	**5,772,240**	**1,580,042**	**118,242**	**7,470,524**	**4,770,980**	**1,542,681**	**184,403**	**6,498,064**
Net assets/ (liabilities)	**403,527**	**1,271,208**	**(16,186)**	**1,658,549**	**1,482,647**	**179,269**	**(99,500)**	**1,562,416**

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 2019 and 2018, these ratios were as follows:

	2019, %	*2018, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day* / liabilities repayable on demand)	51	47

* *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 2019 and 2018 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 2019*
As at 31 December 2019					
Due to banks and other financial institutions	20,928	10,215	1,191	–	**32,334**
Customer accounts	4,774,665	425,095	331,748	113,725	**5,645,233**
Payables to CJSC "Agrarkredit"	89,055	–	–	–	**89,055**
Other borrowed funds	4,402	11,672	10,642	109,523	**136,239**
Debt securities issued	–	33,081	33,107	1,970,098	**2,036,286**
Other financial liabilities	25,066	555	666	3,840	**30,127**
Total undiscounted financial liabilities	**4,914,116**	**480,618**	**377,354**	**2,197,186**	**7,969,274**

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**

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 2019	672,130	368,484	122,259	404,696	**1,567,569**
As at 31 December 2018	1,753,607	669,670	104,731	507,809	**3,035,817**

The Group's financial commitments and contingencies are contractually on demand. However, 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 the 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 2019. The Group does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2019 and 2018.

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 2019 and 2018:

	31 December 2019		***31 December 2018***	
USD	+10% / -3%	(98,454) / 29,536	+14% / -3%	(152,725) / 32,727
EUR	+10% / -6%	2,353 / (1,412)	+14% / -3%	5,131 / (1,099)

(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 2019	204,388	3,273	−	**207,661**
Office premises	31 December 2019	−	−	149,822	**149,822**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2019	2,789,673	−	−	**2,789,673**
Mandatory cash balances with the Central Banks	31 December 2019	−	−	60,059	**60,059**
Due from banks and other financial institutions	31 December 2019	−	−	3,179,615	**3,179,615**
Loans to customers	31 December 2019	−	83,188	2,136,464	**2,219,652**
Receivables from CJSC "Agrarkredit"	31 December 2019	−	−	693,281	**693,281**
Other financial assets	31 December 2019	−	−	32,980	**32,980**

		Fair value measurement using			
As at 31 December 2019	*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 2019	−	−	31,979	**31,979**
Customer accounts	31 December 2019	−	4,503,362	1,103,311	**5,606,673**
Payables to CJSC "Agrarkredit"	31 December 2019	−	−	89,055	**89,055**
Other borrowed funds	31 December 2019	−	87,645	16,859	**104,504**
Debt securities issued	31 December 2019	−	1,476,297	4,704	**1,481,001**
Other financial liabilities	31 December 2019	−	−	111,959	**111,959**

		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**

(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 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	–	–	126,231	**126,231**

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 2019	*Fair value 2019*	*Carrying value 2018*	*Fair value 2018*
Financial assets				
Cash and cash equivalents	2,789,673	2,789,673	1,810,173	1,810,173
Mandatory cash balances with the Central Banks	60,059	60,059	54,702	54,702
Due from banks and other financial institutions	3,179,615	3,179,615	3,249,773	3,249,773
Loans to customers	2,165,804	2,219,652	1,674,153	1,701,333
Receivables from CJSC “Agrarkredit”	693,281	693,281	1,150,401	1,150,401
Other financial assets	32,980	32,980	30,433	30,433
Financial liabilities				
Due to banks and other financial institutions	31,979	31,979	45,260	45,260
Customer accounts	5,606,673	5,606,673	4,364,649	4,369,810
Payables to CJSC “Agrarkredit”	89,055	89,055	364,596	364,596
Other borrowed funds	104,504	104,504	106,630	106,630
Debt securities issued	1,526,354	1,481,001	1,490,698	1,503,075
Other financial liabilities	111,959	111,959	126,231	126,231

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 2019 and 2018 by their remaining contractual maturity, (expected maturity matches the remaining contractual maturity, except for Receivable from CJSC “Agrarkredit”, where decision of Shareholders to prolong contractual maturity is considered) 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.

	2019			***2018***		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	2,789,673	–	**2,789,673**	1,810,173	–	**1,810,173**
Mandatory cash balances with the Central Banks	60,059	–	**60,059**	54,702	–	**54,702**
Due from banks and other financial institutions	3,171,789	7,826	**3,179,615**	3,240,354	9,419	**3,249,773**
Investment securities	71,257	136,404	**207,661**	60,483	30,362	**90,845**
Loans to customers	686,555	1,479,249	**2,165,804**	512,068	1,162,085	**1,674,153**
Receivables from CJSC “Agrarkredit”	–	693,281	**693,281**	–	1,150,401	**1,150,401**
Property, equipment and intangibles	–	192,993	**192,993**	–	200,731	**200,731**
Current income tax assets	4,387	–	**4,387**	2,102	–	**2,102**
Deferred income tax assets	–	1,029	**1,029**	–	900	**900**
Other assets	33,986	13,257	**47,243**	38,234	2,229	**40,463**
Total assets	**6,817,706**	**2,524,039**	**9,341,745**	**5,718,116**	**2,556,127**	**8,274,243**
Due to banks and other financial institutions	31,979	–	**31,979**	45,260	–	**45,260**
Customer accounts	5,511,644	95,029	**5,606,673**	4,270,623	94,026	**4,364,649**
Payables to CJSC “Agrarkredit”	89,055	–	**89,055**	364,596	–	**364,596**
Other borrowed funds	22,859	81,645	**104,504**	20,645	85,985	**106,630**
Debt securities issued	34,282	1,492,072	**1,526,354**	33,759	1,456,939	**1,490,698**
Current income tax liabilities	74,748	–	**74,748**	1,836	–	**1,836**
Deferred income tax liabilities	–	83,498	**83,498**	–	85,255	**85,255**
Other liabilities	138,715	2,491	**141,206**	172,130	–	**172,130**
Total liabilities	**5,903,282**	**1,754,735**	**7,658,017**	**4,908,849**	**1,722,205**	**6,631,054**
Net assets/(liabilities)	**914,424**	**769,304**	**1,683,728**	**809,267**	**833,922**	**1,643,189**

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:

	2019		**2018**	
	Related party balances	***Total category as per the financial statements caption***	***Related party balances***	***Total category as per the financial statements caption***
Cash and cash equivalents		**2,789,673**		**1,810,173**
- Government bodies and state owned entities	126,494		100,774	
Due from banks and other financial institutions		**3,188,441**		**3,255,484**
- Government bodies and state owned entities	2,825,550		3,027,816	
Allowance for impairment losses on due from banks and other financial institutions		**(8,826)**		**(5,711)**
- Government bodies and state owned entities	(4,176)		(4,570)	
Investment securities		**207,661**		**90,845**
- Government bodies and state owned entities	63,722		30,362	
- Associates	250		250	
Loans to customers, Gross		**2,288,549**		**1,890,028**
- Government bodies and state owned entities	745,839		554,277	
- Key management personnel of the Group	391		189	
- Other related parties	1,175		277	
Allowance for impairment losses on loans to customers		**(122,745)**		**(215,875)**
- Government bodies and state owned entities	(8,595)		(9,881)	
- Key management personnel of the Group	(10)		(8)	
- Other related parties	(14)		(158)	
Other Assets		**47,243**		**40,463**
- Government bodies and state owned entities	41		416	
Receivables from CJSC “Agrarkredit”		**702,392**		**1,152,173**
- Government bodies and state owned entities	702,392		1,152,173	
Allowance for impairment on receivables from CJSC “Agrarkredit”		**(9,111)**		**(1,772)**
- Government bodies and state owned entities	(9,111)		(1,772)	
Customer accounts		**(5,606,673)**		**(4,364,649)**
- Government bodies and state owned entities	(3,912,810)		(2,477,303)	
- Key management personnel of the Group	(606)		(257)	
- Other related parties			(7,691)	
Payables to CJSC “Agrarkredit”		**(89,055)**		**(364,596)**
- Government bodies and state owned entities	(89,055)		(364,596)	
Due to banks and other financial institutions		**(31,979)**		**(45,260)**
- Government bodies and state owned entities	(3,732)		(5,182)	
Other borrowed funds		**(104,504)**		**(106,630)**
- Government bodies and state owned entities	(87,645)		(86,675)	
Undrawn loan commitments		**659,953**		**1,729,851**
- Government bodies and state owned entities	490,100		1,714,214	
Letters of credit and guarantees		**907,795**		**1,305,966**
- Government bodies and state owned entities	318,303		512,097	
Provision for off-balance sheet commitments		**(86,822)**		**(117,727)**
- Government bodies and state owned entities	(4,681)		(7,400)	

(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:

	2019		***2018***	
	Related party transactions	***Total category as per the financial statements caption***	***Related party transactions***	***Total category as per the financial statements caption***
Key management personnel compensation:				
- short-term employee benefits	(9,372)	(73,094)	(7,620)	(61,340)
Total	**(9,372)**		**(7,620)**	

Key management personnel include Management Board Members, Executive Directors and head of departments and their aggregate remuneration for the year ended 31 December 2019 amounted to AZN 9,372 thousand.

Included in the consolidated statement of profit or loss and other comprehensive income for the years ended 31 December 2019 and 2018 are the following amounts which were recognized in transactions with related parties:

	2019		**2018**	
	Related party transactions	***Total category as per the financial statements caption***	***Related party transactions***	***Total category as per the financial statements caption***
Interest income		**474,408**		**436,741**
- Government bodies and state-owned entities	224,646		220,949	
- Key management personnel of the Group	37		22	
- Other related parties	90		74	
Interest expense		**(135,888)**		**(160,754)**
- Government bodies and state-owned entities	(96,419)		(101,640)	
- Key management personnel of the Group	–		(3)	
- Other related parties	(128)		(188)	
Impairment losses / reversal of impairment losses on interest bearing assets		**(37,765)**		**71,672**
- Government bodies and state-owned entities	(1,288)		174	
- Key management personnel of the Group	10		(2)	
- Other related parties	14		155	
Reversal of impairment losses / (impairment losses) on contingent liabilities and credit commitments		**14,059**		**42,138**
- Government bodies and state owned entities	(2,719)		7,414	
Gains from operations in foreign currencies		**68,248**		**55,355**
- Government bodies and state-owned entities	38,299		35,028	
Fee and commission income		**90,163**		**88,851**
- Government bodies and state-owned entities	14,565		14,459	
- Key management personnel of the Group	14		11	
Fee and commission expense		**(24,572)**		**(17,824)**
- Government bodies and state-owned entities	(3,686)		(3,522)	
Operating expenses		**(143,619)**		**(127,994)**
- Government bodies and state-owned entities	(4,048)		(2,723)	
- Key management personnel of the Group	(9,372)		(7,620)	

(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).

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum Tier 1 and total capital adequacy ratio of 5.5% and 11% respectively, of risk-weighted assets for regulatory capital. As at 31 December 2019, the Bank was in compliance with these requirements.

Capital adequacy ratio under Basel Capital Accord 1988

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

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

	2019	***2018***
Tier 1 capital	1,580,032	1,564,359
Tier 2 capital	150,690	129,700
Less: deductions from capital	(71,257)	(48,778)
Total capital	**1,659,465**	**1,645,281**
Risk weighted assets	**4,130,704**	**4,352,272**
Tier 1 capital ratio	38.25%	35.94%
Total capital ratio	40.17%	37.80%

28. Events after the reporting period

COVID-19 pandemic is spreading across the world including Azerbaijan. Therefore, economic conditions are subject to tighten in near future. In order to prevent the widespread of COVID-19 pandemic, the government of Azerbaijan keeps taking comprehensive measures in all directions. With respect to reporting period ended on 31 December 2019, the effects of the pandemic on the Group's results after the reporting date do not affect the amounts recognized on the financial statements or operations. The Group considers this pandemic as a non-adjusting event after the reporting period, the quantitative effect of which cannot be estimated reasonably certain at the current date. There has been significant volatility in the stock, currency and commodity markets since March 2020, including declining oil prices. As a response to this development, in March 2020 the President of the Republic of Azerbaijan signed a decree for action plans to minimize the impact of the pandemic. In accordance with this decree, anti-crisis stimulus package of AZN 2.5 billion is being developed to support individuals and various businesses in the country. The Central Bank of the Republic of Azerbaijan continues its monetary policy to ensure stability of AZN exchange rates. For subsequent reporting periods, since the economic effects of this situation are uncertain and cannot be reasonably estimated, the Group assesses possible impacts that may affect the recognition and measurement of assets and liabilities in the financial statements.

In April 2020, Fitch Ratings has revised the Outlook on the Group's Long-Term Issuer Default Rating (IDR) to Stable from Positive on coronavirus uncertainties and lower oil prices. The rating has been affirmed at "B-".

In March 2020, Moody's Investors Service affirmed the Group's long-term local and foreign currency deposit rating at "B1" and Baseline Credit Assessment at "b3". The outlooks on the long-term local and foreign currency deposit ratings were changed to stable from positive.