

OJSC PASHA Bank
Consolidated financial statements

Year ended 31 December 2015
together with independent auditors' report



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Independent auditors' report

To the Shareholders and Board of Directors of OJSC PASHA Bank

We have audited the accompanying consolidated financial statements of OJSC PASHA Bank and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2015, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year 2015, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC PASHA Bank and its subsidiaries as at 31 December 2015, and their financial performance and cash flows for the year 2015 in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

5 May 2016

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CONSOLIDATED STATEMENT OF FINANCIAL POSITION**As at 31 December 2015***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	<i>31 December 2015</i>	<i>31 December 2014</i>
Assets			
Cash and cash equivalents	6	1,021,306	347,980
Trading securities	7	46,238	28,599
Amounts due from credit institutions	8	137,895	72,691
Investment securities			
- available-for-sale	9	5,696	209,467
- loans and receivables	9	87,903	-
Derivative financial assets	18	324	-
Loans to customers	10	902,150	538,875
Investment property	11	1,668	2,000
Property and equipment	12	15,851	16,244
Goodwill and other intangible assets	13	56,730	4,126
Current income tax assets		287	1,367
Deferred income tax assets	19	1,555	1,013
Prepayment for equity investment		-	41,971
Other assets	14	15,136	8,925
Total assets		2,292,739	1,273,258
Liabilities			
Amounts due to banks and government funds	15	369,693	174,377
Amounts due to customers	16	1,374,113	703,058
Other borrowed funds	17	93,814	55,451
Derivative financial liabilities	18	991	87
Deferred income tax liabilities	19	9,688	-
Provision for guarantees and letters of credit	22	379	2,683
Dividends payable to shareholders	20	-	10,832
Other liabilities	14	11,572	3,064
Total liabilities		1,860,250	949,552
Equity			
Share capital	20	333,000	333,000
Retained earnings/(accumulated deficit)		19,283	(5,929)
Net unrealised (loss)/gain on investment securities available-for-sale		(100)	98
Foreign currency translation reserve		80,244	(3,463)
Total equity attributable to shareholders of the Bank		432,427	323,706
Non-controlling interests		62	-
Total equity		432,489	323,706
Total liabilities and equity		2,292,739	1,273,258

Signed and authorised for release on behalf of the Executive Board of the Bank:

Taleh Kazimov

Chairman of the Executive Board

Hayala Nagiyeva

Chief Financial Officer

5 May 2016

*The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.*

CONSOLIDATED STATEMENT OF PROFIT OR LOSS**For the year ended 31 December 2015***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Interest income			
Loans to customers		78,032	46,606
Investment securities available-for-sale		6,846	9,772
Amounts due from credit institutions		6,799	3,392
Trading securities		5,160	3,954
Cash and cash equivalents		3,382	541
Securities purchased under agreements to resell		61	70
		<u>100,280</u>	<u>64,335</u>
Interest expense			
Amounts due to customers		(16,700)	(9,220)
Amounts due to banks and government funds		(5,401)	(4,500)
Other borrowed funds		(2,174)	(1,666)
Other		(60)	(7)
		<u>(24,335)</u>	<u>(15,393)</u>
Net interest income		<u>75,945</u>	<u>48,942</u>
Provision for impairment of interest earning assets	22	<u>(52,171)</u>	<u>(31,092)</u>
Net interest income after provision for impairment of interest bearing assets		<u>23,774</u>	<u>17,850</u>
Net fee and commission income	23	7,686	4,203
Net (losses)/gains from trading securities		(3,678)	47
Net losses from investment securities available-for-sale		(145)	(160)
Net gains/(losses) from foreign currencies:			
- dealing		17,635	7,019
- translation differences		12,992	(159)
- operations with foreign currency derivatives		5,467	-
Other income		351	313
Non-interest income		<u>40,308</u>	<u>11,263</u>
Personnel expenses	24	(21,835)	(11,006)
General and administrative expenses	24	(21,265)	(14,620)
Depreciation and amortisation	12, 13	(4,342)	(3,705)
Reversal of provision/(provision) for guarantees and letters of credit	22	2,304	(2,534)
Non-interest expenses		<u>(45,138)</u>	<u>(31,865)</u>
Profit/(loss) before income tax expense		<u>18,944</u>	<u>(2,752)</u>
Income tax expense	19	(4,561)	(44)
Net profit/(loss) for the year		<u>14,383</u>	<u>(2,796)</u>
Attributable to:			
- shareholders of the Bank		14,380	(2,796)
- non-controlling interests		3	-
		<u>14,383</u>	<u>(2,796)</u>

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**For the year ended 31 December 2015***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Net profit/(loss) for the year		14,383	(2,796)
Other comprehensive income			
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods:</i>			
Gross unrealised (losses)/gains on investment securities available-for-sale		(393)	18
Realised losses on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		145	160
Net unrealised (losses)/gains on investment securities available-for-sale	20	(248)	178
Tax effect of net (losses)/gains on investment securities available-for-sale	19	50	(36)
Foreign currency translation difference net of tax	20	83,707	(2,731)
Net other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods		83,509	(2,589)
Total comprehensive income/(loss) for the year		97,892	(5,385)
Attributable to:			
- shareholders of the Bank		97,889	(5,385)
- non-controlling interests		3	-
		97,892	(5,385)

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**For the year ended 31 December 2015***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Attributable to shareholders of the Bank</i>				<i>Total</i>	<i>Non-controlling interests</i>	<i>Total equity</i>
	<i>Share capital</i>	<i>Retained earnings (accumulated deficit)</i>	<i>Net unrealised gain/(losses) on investment securities available-for-sale</i>	<i>Foreign currency translation difference</i>			
As at 31 December 2013	228,000	7,699	(44)	(732)	234,923	-	234,923
Net loss for the year	-	(2,796)	-	-	(2,796)	-	(2,796)
Other comprehensive loss for the year	-	-	142	(2,731)	(2,589)	-	(2,589)
Total comprehensive loss for the year	-	(2,796)	142	(2,731)	(5,385)	-	(5,385)
Dividends declared (Note 20)	-	(10,832)	-	-	(10,832)	-	(10,832)
Cash contribution for share capital increase (Note 20)	105,000	-	-	-	105,000	-	105,000
As at 31 December 2014	333,000	(5,929)	98	(3,463)	323,706	-	323,706
Net profit for the year	-	14,380	-	-	14,380	3	14,383
Other comprehensive income for the year	-	-	(198)	83,707	83,509	-	83,509
Total comprehensive income for the year	-	14,380	(198)	83,707	97,889	3	97,892
Cancellation of dividends declared in 2014 (Note 20)	-	10,832	-	-	10,832	-	10,832
Acquisition of subsidiary (Note 5)	-	-	-	-	-	97	97
Decrease in non-controlling interest	-	-	-	-	-	(38)	(38)
31 December 2015	333,000	19,283	(100)	80,244	432,427	62	432,489

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS**For the year ended 31 December 2015***(Figures in tables are in thousands of Azerbaijani manats)*

	<i>Notes</i>	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Cash flows from operating activities			
Interest received		88,989	59,195
Interest paid		(22,444)	(15,072)
Fees and commissions received		12,337	7,706
Fees and commissions paid		(4,926)	(3,188)
Net realized losses on sale of investment securities available-for-sale		(145)	(160)
Net realized gain/(loss) from trading securities		178	(71)
Realised gains less losses from dealing in foreign currencies and operations with foreign currency derivatives		23,641	7,019
Personnel expenses paid		(18,430)	(12,494)
General and administrative expenses paid		(18,790)	(13,653)
Other operating income received		334	168
Cash flows from operating activities before changes in operating assets and liabilities		60,744	29,450
<i>Net (increase)/decrease in operating assets</i>			
Trading securities		(28,098)	22,732
Amounts due from credit institutions		63,618	(23,356)
Loans to customers		(202,467)	(239,755)
Other assets		(597)	(3)
<i>Net increase/(decrease) in operating liabilities</i>			
Amounts due to banks and government funds		19,990	65,659
Amounts due to customers		342,791	418,704
Other borrowed funds		(6,976)	17,968
Other liabilities		1,022	1,267
Net cash from operating activities before income tax		250,027	292,666
Income tax paid		(970)	(4,960)
Net cash from operating activities		249,057	287,706
Cash flows from investing activities			
Acquisition of a subsidiary, net of cash acquired (Note 5)		371	-
Purchase of investment securities available-for-sale		(539,479)	(296,820)
Proceeds from sale and redemption of investment securities available-for-sale		690,411	242,048
Purchase and prepayments for property and equipment		(3,999)	(5,758)
Acquisition of intangible assets		(4,406)	(1,667)
Proceeds from sale of property and equipment		1,410	1,646
Net cash from/(used in) investing activities		144,308	(60,551)
Cash flows from financing activities			
Share capital contribution	20	-	105,000
Dividends paid	20	-	(14,992)
Net cash from financing activities		-	90,008
Effect of exchange rates changes on cash and cash equivalents		279,961	(17,239)
Net increase in cash and cash equivalents		673,326	299,924
Cash and cash equivalents, beginning	6	347,980	48,056
Cash and cash equivalents, ending	6	1,021,306	347,980

The accompanying notes on pages 6 to 55 are an integral part of these consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

OJSC PASHA Bank (“the Bank”) was established on 18 June 2007, as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence No. 250 issued by the Central Bank of the Republic of Azerbaijan (the “CBAR”) on 28 November 2007.

The Bank and its subsidiaries (together – “the Group”) accept deposits from the public and extend credit, transfer payments, exchange currencies and provide other banking services to its commercial and private customers.

The Bank has three service points and two branches in Azerbaijan as at 31 December 2015 (31 December 2014: three service points and two branches) and two subsidiaries, JSC PASHA Bank Georgia located in the Republic of Georgia and PASHA Yatirim Bankasi A.Ş. (the “Subsidiaries”) located in the Republic of Turkey.

The Bank’s registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As at 31 December 2015 and 2014, the following shareholders owned the outstanding shares of the Bank:

<i>Shareholders</i>	<i>31 December 2015 (%)</i>	<i>31 December 2014 (%)</i>
PASHA Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	100	100

As at 31 December 2015 and 2014, the Group is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Group.

PASHA Bank Georgia JSC, a wholly – owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand as of 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 thousand as at 31 December 2015. PASHA Bank Georgia JSC operates under a banking licence issued by the National Bank of Georgia (the “NBG”) on 17 January 2013.

Legal address of the PASHA Bank Georgia JSC is 15 Rustaveli Street, Tbilisi, GE 0108, Georgia.

TAIB Yatirim Bank A.Ş. was incorporated in 1987 as an investment bank in Turkey with the permission of the Council of Ministers decision no. 6224 which allows the transfer of the banks’ net profit after statutory liabilities and in case of liquidation the transfer of capital to foreign shareholders. On 27 January 2015, the Bank acquired 79.47% of the voting common shares of TAIB Yatirim Bank A.Ş. (Note 5). TAIB Yatirim Bank A.Ş. was renamed to Pasha Yatirim Bankasi A.Ş. at the registration of the Bank as shareholder. In March 2015, investment in share capital of the subsidiary was increased by TRY 175,000 thousand to TRY 255,000 thousand. As at 31 December 2015, the Bank holds 99.92% voting common shares of PASHA Yatirim Bankasi A.Ş. with its head office located in Istanbul. The activities of the bank are regulated by the Central Bank of the Republic of Turkey (the “CBRT”).

OJSC PASHA Bank and its Subsidiaries were consolidated in these financial statements.

2. Basis of preparation

General

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

(Figures in tables are in thousands of Azerbaijani manats)

2. Basis of preparation (continued)

The Azerbaijani manat is the functional and presentation currency of OJSC PASHA Bank 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 trading and available for sale securities and derivative financial instruments which have been measured at fair value.

Reclassifications

The following reclassifications have been made to 2014 balances to conform to the 2015 presentation:

	<i>As previously reported</i>	<i>Reclassification</i>	<i>As adjusted</i>
Consolidated statement of financial position			
Loans to banks	21,621	(21,621)	–
Amounts due from credit institutions	51,070	21,621	72,691
Amounts due to credit institutions	55,451	(55,451)	–
Other borrowed funds	–	55,451	55,451
Consolidated statement of profit or loss			
Interest income on:			
Loans to banks	1,097	(1,097)	–
Amounts due from credit institutions	2,836	556	3,392
Cash and cash equivalents	–	541	541
Interest expense on:			
Amounts due to credit institutions	1,666	(1,666)	–
Other borrowed funds	–	1,666	1,666
Consolidated statement of cash flows			
Loans to banks	(3,776)	3,776	–
Amounts due from credit institutions	(19,580)	(3,776)	(23,356)
Amounts due to credit institutions	17,968	(17,968)	–
Other borrowed funds	–	17,968	17,968

3. Summary of significant accounting policies

Changes in accounting policies

The Group has adopted the following amended IFRS which are effective for annual periods beginning on or after 1 January 2015:

Annual improvements 2010-2012 Cycle

These improvements are effective from 1 July 2014 and the Group has applied these amendments for the first time in these consolidated financial statements. They include:

IFRS 3 Business Combinations

The amendment is applied prospectively and clarifies that all contingent consideration arrangements classified as liabilities (or assets) arising from a business combination should be subsequently measured at fair value through profit or loss whether or not they fall within the scope of IFRS 9 (or IAS 39, as applicable). This is consistent with the Group's current accounting policy, and thus this amendment does not impact the Group's accounting policy.

IFRS 13 Short-term Receivables and Payables – Amendments to IFRS 13

This amendment to IFRS 13 clarifies in the Basis for Conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This is consistent with the Group's current accounting policy, and thus this amendment does not impact the Group's accounting policy.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Changes in accounting policies (continued)

Annual improvements 2011-2013 Cycle

These improvements are effective from 1 July 2014 and the Group has applied these amendments for the first time in these in consolidated financial statements. They include:

IFRS 13 Fair Value Measurement

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable). The Group does not apply the portfolio exception in IFRS 13.

IAS 40 Investment Property

The description of ancillary services in IAS 40 differentiates between investment property and owner-occupied property (i.e., property, plant and equipment). The amendment is applied prospectively and clarifies that IFRS 3, and not the description of ancillary services in IAS 40, is used to determine if the transaction is the purchase of an asset or business combination. In previous periods, the Group has relied on IFRS 3, not IAS 40, in determining whether an acquisition is of an asset or is a business acquisition. Thus, this amendment does not impact the accounting policy of the Group.

Meaning of effective IFRSs – Amendments to IFRS 1

The amendment clarifies in the Basis for Conclusions that an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but permits early application, provided either standard is applied consistently throughout the periods presented in the entity's first IFRS financial statements. This amendment to IFRS 1 had no impact on the Group, since the Group is an existing IFRS preparer.

Basis of consolidation

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

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

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

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

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

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 Bank 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Business combinations

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

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

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

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognised in accordance with IAS 39 either in profit or loss or as change to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the consideration transferred over the acquiree's net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Fair value measurement

The Group measures financial instruments, such as trading and available-for-sale securities and derivative financial instruments at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 26.

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)

3. 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 categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

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

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

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available-for-sale financial assets, as appropriate. The Group determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

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

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category “financial assets at fair value through profit or loss”. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in Net trading income. In a currency swap, the Group pays a specified amount in one currency and receives a specified amount in another currency. Currency swaps are mostly gross-settled.

Held to maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity when the Group has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held to maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in profit or loss when the investments are impaired, as well as through the amortization process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

The Group places deposits with banks as well as issues loans to banks. According to the terms of deposit agreements the Group is allowed to withdraw deposits before maturity while as per terms of loan agreements the Group is not allowed to do so and loans can be demanded by the Group at maturity.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated statement of profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- ▶ a financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity;
- ▶ other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gain or loss already recognized in profit or loss is not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBAR, NBG and CBRT, excluding obligatory reserves, and amounts due from credit institutions with no maturity and less than 90 days of the date of origination and that are free from contractual encumbrances.

Repurchase and reverse repurchase agreements

Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and, in case the transferee has the right by contract or custom to sell or re-pledge them, reclassified as securities pledged under sale and repurchase agreements. The corresponding liability is presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as separate account on the consolidated statement of financial position if material or as cash and cash equivalents or loans to customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derivative financial instruments

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

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading portfolio with changes in fair value recognised in profit or loss.

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 government funds, other borrowed funds and amounts due to customers. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortisation process.

Leases

Operating – Bank as lessee

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

Measurement of financial instruments at initial recognition

When financial instruments are recognised initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Group determines that the fair value at initial recognition differs from the transaction price, then:

- ▶ if the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Group recognises the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- ▶ in all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Group recognises that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

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.

Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortized cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in current year profit. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the consolidated statement of profit or loss.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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

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

Available-for-sale financial investments

For available-for-sale financial investments, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the other comprehensive income is reclassified from other comprehensive income to the consolidated statement of profit or loss. Impairment losses on equity investments are not reversed through the consolidated statement of profit or loss; increases in their fair value after impairment are recognized in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recognized in the consolidated statement of profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of profit or loss, the impairment loss is reversed through the consolidated statement of profit or loss.

Held to maturity financial investments

For held to maturity investments the Group assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognized in the consolidated statement of profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to the consolidated statement of comprehensive income.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets (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 accounting treatment of such restructuring is as follows:

- ▶ If the currency of the loan has been changed the old loan is derecognised and the new loan is recognised.
- ▶ If the loan restructuring is not caused by the financial difficulties of the borrower the Group uses the same approach as for financial liabilities described below.
- ▶ If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Group recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Group recalculates the effective interest rate.

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

Derecognition of financial assets and liabilities

Financial assets

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

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

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

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

Financial liabilities

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of profit or loss. The premium received is recognized in profit or loss on a straight-line basis over the life of the guarantee.

The interest rate is applied to amount of guarantees without consideration of effective interest rate method.

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.

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

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

Property and equipment

Property and equipment 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 property and equipment when that cost is incurred if the recognition criteria are met.

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, including construction in progress, begins when it is ready and available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Buildings	20
Furniture and fixtures	4
Computers and other equipment	4
Vehicles	4
Other equipment	5
Leasehold improvements	6

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Property and equipment (continued)

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

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

Investment property

Investment property is land or building or a part of building held to earn rental income or for capital appreciation and which is not used by the Group or held for the sale in the ordinary course of business. Property that is being constructed or developed or redeveloped for future use as investment property is also classified as investment property.

Investment property is initially recognized at cost, including transaction costs, and subsequently is stated at cost less accumulated depreciation and any accumulated impairment losses. For disclosure purposes investment property is re-measured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment property is determined on the base of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Earned rental income is recorded in the income statement within income arising from non-banking activities. Gains and losses resulting from changes in the fair value of investment property are recorded in the consolidated statement of profit or loss and presented within income or expense arising from non-banking activities.

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Group and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to premises and equipment, and its carrying amount at the date of reclassification becomes its deemed cost.

Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the consideration transferred over the investee's net identifiable assets acquired and liabilities assumed. Goodwill on an acquisition of a subsidiary is included in goodwill and other intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- ▶ represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- ▶ is not larger than the operating segment as defined in IFRS 8 Operating Segments before aggregation.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Intangible assets other than goodwill

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

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

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

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

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.

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 in the consolidated statement of financial position but disclosed when an inflow of economic benefits is probable.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which 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 income or expense. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income and expense

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee and commission income includes cash collection and withdrawal fees and customer services fees, which are recognized as revenue as the services are provided. Fee and commission expense consists of documentary operations (letters of credit and guarantees), customer, brokerage, custodian and foreign currency purchase/sale fees.

Foreign currency translation

The consolidated financial statements are presented in AZN, which is the Bank's functional and presentation currency. 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 statement of profit or loss are translated at the weighted average exchange rates for the year. The exchange rate differences arising on the translation are taken to consolidated statement of comprehensive income.

The Group used the following official exchange rates at 31 December 2015 and 2014 in the preparation of these consolidated financial statements:

	<i>31 December 2015</i>	<i>31 December 2014</i>
1 US Dollar	AZN 1.5594	AZN 0.7844
1 Euro	AZN 1.7046	AZN 0.9522
1 Georgian Lari	AZN 0.6511	AZN 0.4244
1 Turkish Lira	AZN 0.5358	AZN 0.3381

(Figures in tables are in thousands of Azerbaijani manats)

3. 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 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Revenue arising from lease contracts within the scope of IAS 17 *Leases*, insurance contracts within the scope of IFRS 4 *Insurance Contracts* and financial instruments and other contractual rights and obligations within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (or IFRS 9 *Financial Instruments*, if early adopted) is out of IFRS 15 scope and is dealt by respective standards.

Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Group.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Group given that the Group has not used a revenue-based method to depreciate its non-current assets.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Amendments to IAS 27: Equity Method in Separate Financial Statements

The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively. For first-time adopters of IFRS electing to use the equity method in its separate financial statements, they will be required to apply this method from the date of transition to IFRS. The amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. The Group currently considers whether to apply these amendments for preparation of its separate financial statements. These amendments will not have any impact on the Group's consolidated financial statements.

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

The amendments address the acknowledged inconsistency between the requirements in IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is contributed to an associate or a joint venture. The amendments clarify that an investor recognises a full gain or loss on the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture. The gain or loss resulting from the re-measurement at fair value of an investment retained in a former subsidiary is recognised only to the extent of unrelated investors' interests in that former subsidiary. The amendments are applied prospectively to transactions occurring in annual periods beginning on or after 1 January 2016. Earlier application is permitted.

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 Presentation of Financial Statements clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- ▶ The materiality requirements in IAS 1
- ▶ That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated
- ▶ That entities have flexibility as to the order in which they present the notes to financial statements
- ▶ That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact on the Group.

IFRS 16 Leases

In January 2016, the IASB issued IFRS 16 Leases with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 Leases. Lessees will recognise a "right of use" asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. The Group is currently assessing the impact of IFRS 16 on its financial statements.

IAS 12 Income Taxes

In January 2016, the IASB issued amendments to IAS 12 Income Taxes. The amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value and clarify recognition of deferred tax assets for unrealised losses, to address diversity in practice. Entities are required to apply the amendments for annual periods beginning on or after 1 January 2017. Earlier application is permitted. These amendments are not expected to have any impact on the Group.

(Figures in tables are in thousands of Azerbaijani manats)

4. 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.

Allowance for loan impairment

The Group regularly reviews its loans and receivables to assess impairment. The Group uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Group uses its experienced judgement to adjust observable data for a group of loans or receivables to reflect current circumstances.

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.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment. The valuations of collaterals are performed based on review of similar collaterals available on the market.

Deferred tax assets

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

Impairment of goodwill and banking license

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating unit to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2015 was AZN 3,885 thousand (2014: nil). More details are provided in Note 13.

The recoverable amount of banking license is measured annually, irrespective of whether there is any indication that it may be impaired. This requires an estimation of the value in use of the cash-generating unit. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The Group reviews and validates at the end of each reporting period its decision to classify the useful life of an intangible asset as indefinite. If events and circumstances no longer support an indefinite useful life, the change from indefinite to finite life is accounted for as a change in accounting estimate under IAS 8, which requires such changes to be recognised prospectively. Furthermore, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. The carrying amount of banking license at 31 December 2015 was AZN 45,045 thousand (2014: nil). More details are provided in Note 13.

(Figures in tables are in thousands of Azerbaijani manats)

5. Business combination

Acquisition of TAIB Yatirim Bank

On 27 January 2015, the Bank completed acquisition of 79.92% of the voting common shares of TAIB Yatirim Bank A.Ş. The Bank also acquired a call option for purchase of 20.00% of voting shares that were held by one shareholder. This minority shareholder also acquired put option over these 20.00% voting shares. The option was exercised on 30 October 2015. The transaction was registered by the Banking Regulation and Supervision Agency ("the BRSA") of the Republic of Turkey on 23 December 2015. As at 31 December 2015, the Bank holds 99.92% of voting common shares of PASHA Yatirim Bankasi A.Ş.

As at 31 December 2015, accounting for the business combination was completed. While making a purchase price allocation the Bank identified a banking license (the "License"), an intangible asset with indefinite useful life, for which respective fair value exercise was made which amounted to AZN 27,978 thousand (Note 13). The License is not accounted in the separate financial statements of PASHA Yatirim Bankasi A.Ş.

The fair value of the identifiable assets and liabilities acquired and goodwill arising as at the date of acquisition was:

	<i>Fair value recognised on acquisition</i>
Cash and cash equivalents	371
Loans to customers	15,570
Investment securities available-for-sale	587
Property and equipment (Note 12)	97
Intangible assets (Note 13)	28,042
Other assets	1,041
	<u>45,708</u>
Borrowings	2,194
Money markets	366
Deferred income tax liabilities (Note 19)	4,497
Other financial liabilities	45
Other liabilities and provisions	623
	<u>7,725</u>
Total identifiable net assets	37,983
Non-controlling interests	97
Goodwill arising on acquisition (Note 13)	2,413
Purchase consideration transferred	40,299

The goodwill of AZN 2,413 thousand comprises the value of expected synergies arising from the acquisition. None of the goodwill recognized is expected to be deductible for income tax purposes.

From the date of acquisition, PASHA Yatirim Bankasi A.Ş. has contributed AZN 9,855 thousand of interest income, AZN 582 thousand of non-interest income and AZN 4,517 thousand to the net profit before tax of the Bank.

Cash outflow on acquisition of the subsidiary

Transaction costs of the acquisition (Note 24)	(1,610)
Net cash acquired with the subsidiary (included in cash flows from investing activities)	371
Cash paid	(40,299)
Net cash outflow	(41,538)

The transaction costs of AZN 1,610 have been expensed and are included in other operating expenses.

(Figures in tables are in thousands of Azerbaijani manats)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	<u>31 December 2015</u>	<u>31 December 2014</u>
Cash on hand	116,763	69,993
Current accounts with the CBAR, the NBG and the CBRT	199,708	16,321
Current accounts with other credit institutions	335,481	222,734
Time deposits with credit institutions up to 90 days	369,354	38,932
Cash and cash equivalents	<u>1,021,306</u>	<u>347,980</u>

Current accounts with other credit institutions consist of interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 554 thousands (31 December 2014 – AZN 2,603 thousands) and AZN 643 thousands, respectively, and non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 7,462 thousands (31 December 2014 – AZN 972 thousands) and AZN 326,822 thousands (31 December 2014 – AZN 219,159 thousands), respectively.

As at 31 December 2015, the Group placed AZN 369,354 thousands in time deposits with two resident banks and seven non-resident banks maturing through March 2016 with interest rates ranging between 0.13% and 13.00% p.a (31 December 2014 – AZN 38,932 matured in March 2015 with interest rates ranging between 0.04% and 11.00% p.a.).

7. Trading securities

Trading securities comprise:

	<u>31 December 2015</u>		<u>31 December 2014</u>	
	<i>Annual interest rate</i>	<i>Carrying value</i>	<i>Annual interest rate</i>	<i>Carrying value</i>
Bonds of financial institutions	9.75%-14.00%	26,468	9%-14%	14,626
Corporate bonds	9.00%	19,770	9%-11%	13,973
Trading securities		<u>46,238</u>		<u>28,599</u>

As at 31 December 2015, the Bank carried market maker service activities and acquired securities of three (31 December 2014 – seven) local entities amounting to AZN 46,238 thousand (31 December 2014 – AZN 28,599 thousand).

In December 2015, the Bank's management decided to reclassify trading securities with fair value of AZN 7,609 thousand into category loans and receivables of investment securities due to deterioration of issuer's financial standing.

8. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	<u>31 December 2015</u>	<u>31 December 2014</u>
Time deposits with banks	92,261	39,277
Loans to banks	23,386	21,621
Obligatory reserve with the CBAR, the NBG and the CBRT	19,196	5,620
Restricted deposits	3,832	6,173
	<u>138,675</u>	<u>72,691</u>
Less: allowance for impairment (Note 22)	(780)	-
Amounts due from credit institutions	<u>137,895</u>	<u>72,691</u>

(Figures in tables are in thousands of Azerbaijani manats)

8. Amounts due from credit institutions (continued)

As at 31 December 2015, time deposits with banks mature between January 2016 and November 2017 (31 December 2014 – between February 2015 and June 2015) with interest rates ranging between 0.02% and 12.5% p.a. (31 December 2014 – between 3% and 10% p.a.).

As at 31 December 2015, the Group had outstanding amount of AZN 23,386 thousands (31 December 2014 – AZN 21,621 thousands) of unsecured loans issued to four resident commercial banks (31 December 2014 – six resident commercial banks) with contractual maturity through May 2017 (31 December 2014 – November 2015) and with interest rates ranging between 7.5% and 16% p.a. (31 December 2014 – 7.5%-12% p.a.).

Credit institutions in the Republic of Azerbaijan are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at the level of 0.5% (2014 – 2%) of the previous month average of funds attracted from customers by a credit institution in local and foreign currency. Credit institutions in the Republic of Georgia are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 10% and 15% of the average of funds attracted from customers by the credit institution for the appropriate two-week period in GEL and foreign currencies, respectively. Credit institutions in the Republic of Turkey keep TRY, USD, EUR and Gold reserve deposits for its TRY and foreign currency liabilities at the CBRT in accordance with the Decree issued by the CBRT no. 2005/1, "Regarding Reserve Deposits" which are interest earning.

9. Investment securities

Investment securities available-for-sale comprise:

	31 December 2015		31 December 2014	
	Carrying value	Nominal value	Carrying value	Nominal value
Turkey Government Bonds	5,154	5,090	–	–
Bonds of financial institutions	306	300	7,179	7,151
Bonds of the Ministry of Finance of the Republic of Azerbaijan	236	235	18,163	18,000
Notes issued by the Azerbaijan Mortgage Fund	–	–	155,210	154,585
Treasury bonds of the Ministry of Finance of Georgia	–	–	3,464	3,454
Treasury bills of the Ministry of Finance of Georgia	–	–	22,660	22,566
Certificates of Deposits of financial institutions	–	–	1,619	1,619
Corporate bonds	–	–	1,172	1,139
Investment securities available-for-sale	5,696	5,625	209,467	208,514

Nominal interest rates per annum and maturities of these securities are as follows:

	31 December 2015		31 December 2014	
	%	Maturity	%	Maturity
Turkey Government Bonds	10.80%	November 2016	–	–
Bonds of financial institutions	8.79%	April 2016	9.00%-14.00%	January 2015 – May 2018
Bonds of the Ministry of Finance of the Republic of Azerbaijan	3.59%	May 2016	3.25%-5.00%	May 2015 – May 2017
Notes issued by the Azerbaijan Mortgage Fund	–	–	3.00%	May 2016 – December 2023
Treasury bills of the Ministry of Finance of Georgia	–	–	4.34%-7.10%	January 2015 – August 2015
Treasury bonds of the Ministry of Finance of Georgia	–	–	7.43%-8.00%	March 2016 – August 2016
Certificates of Deposits of financial institutions	–	–	5.25%	August 2016 – January 2015
Corporate bonds	–	–	9.00%	January 2015 – December 2017

(Figures in tables are in thousands of Azerbaijani manats)

9. Investment securities (continued)

Loans and receivables comprise:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Treasury bonds of the Ministry of Finance of Georgia	25,209	-
Bonds of financial institutions	23,660	-
Treasury bills of the Ministry of Finance of Georgia	15,319	-
Certificates of deposit of the NBG	9,979	-
Certificates of deposits of financial institutions	7,946	-
Corporate bonds	5,790	-
Loans and receivables	87,903	-

On 1 July 2015, Asset and Liability Committee of PASHA Bank Georgia JSC decided to reclassify certain of PASHA Bank Georgia JSC's investment securities from the available-for-sale category into category of loans and receivables because of absence of active market in 2015 in Georgia. The bank has no history of sale of any of its securities before maturity. The bank assessed that based on the changing market conditions it is not intending to sell the securities in future and will hold them till their contractual maturities. The fair value of available-for-sale securities at the date of reclassification was AZN 43,912 thousand.

10. Loans to customers

Loans to customers comprise:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Legal entities	823,212	506,551
Individuals	126,636	67,091
Loans to customers (gross)	949,848	573,642
Less – allowance for impairment (Note 22)	(47,698)	(34,767)
Loans to customers (net)	902,150	538,875

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	<i>Corporate lending</i>	<i>Individual lending</i>	<i>Total</i>
31 December 2015			
Individual impairment	(23,313)	(1,893)	(25,206)
Collective impairment	(18,814)	(3,678)	(22,492)
	(42,127)	(5,571)	(47,698)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	31,673	4,582	36,255
31 December 2014			
Individual impairment	(27,971)	(164)	(28,135)
Collective impairment	(6,431)	(201)	(6,632)
	(34,402)	(365)	(34,767)
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	60,936	767	61,703

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Loans are made in the following industry sectors:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Trade and services	327,626	268,315
Manufacturing	167,224	63,395
Individuals	126,636	67,091
Construction	101,295	72,094
Non banking credit organizations	84,344	21,420
Agriculture and food processing	48,795	35,504
Mining	30,239	16,110
Transport and telecommunication	26,281	15,695
Energy	16,513	7,511
Leasing	14,994	5,288
Other	5,901	1,219
Total loans (gross)	949,848	573,642

As at 31 December 2015, loans granted to top 5 customers (31 December 2014 – 5 customers) amounted to AZN 215,005 thousand (31 December 2014 – AZN 155,677 thousand), which individually exceeded 5% of the Group's equity.

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2015, comprised AZN 3,718 thousands (2014 – AZN 7,629 thousands).

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For commercial lending, charges over real estate properties, inventory and trade receivables;
- ▶ For retail lending, mortgages over residential properties.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

11. Investment property

In 2011, the Bank acquired land for the amount of AZN 2,000 thousand as investment property which is held for long-term appreciation in value. As at 31 December 2015, the fair value of this investment property amounted to AZN 1,668 thousand (31 December 2014 – AZN 2,342 thousand). The Bank recognized impairment in the amount of AZN 332 thousand as of 31 December 2015 (31 December 2014 – nil) due to decrease in recoverable amount.

(Figures in tables are in thousands of Azerbaijani manats)

12. Property and equipment

The movements in property and equipment were as follows:

	<i>Land</i>	<i>Buildings</i>	<i>Furniture and fixtures</i>	<i>Computers and other equipment</i>	<i>Vehicles</i>	<i>Other equipment</i>	<i>Leasehold improvements</i>	<i>Construction in progress</i>	<i>Total</i>
Cost									
31 December 2013	–	6,774	5,135	4,081	1,120	471	1,549	–	19,130
Additions	415	328	877	874	103	23	–	3,851	6,471
Disposals	–	(1,531)	(27)	(137)	(268)	(6)	–	–	(1,969)
Foreign currency translation difference	–	–	(22)	(27)	(18)	(6)	(58)	–	(131)
31 December 2014	415	5,571	5,963	4,791	937	482	1,491	3,851	23,501
Acquisition through business combinations	–	–	97	–	–	–	–	–	99
Additions	–	–	634	2,861	311	28	2	–	3,836
Disposals	–	(1,464)	(164)	(930)	(174)	(9)	–	–	(2,741)
Foreign currency translation difference	–	–	509	539	53	102	433	–	1,634
Transfers	–	–	2,139	770	–	–	942	(3,851)	–
31 December 2015	415	4,107	9,178	8,031	1,127	603	2,868	–	26,329
Accumulated depreciation									
31 December 2013	–	(326)	(1,920)	(1,432)	(637)	(110)	(316)	–	(4,741)
Depreciation charge	–	(332)	(1,165)	(942)	(235)	(95)	(307)	–	(3,076)
Disposals	–	62	26	137	235	2	–	–	462
Foreign currency translation difference	–	–	23	29	19	4	23	–	98
31 December 2014	–	(596)	(3,036)	(2,208)	(618)	(199)	(600)	–	(7,257)
Depreciation charge	–	(253)	(1,461)	(1,148)	(175)	(97)	(311)	–	(3,445)
Disposals	–	113	155	671	174	7	–	–	1,120
Foreign currency translation difference	–	–	(254)	(312)	(22)	(48)	(260)	–	(896)
31 December 2015	–	(736)	(4,596)	(2,997)	(641)	(336)	(1,172)	–	(10,478)
Net book value									
31 December 2015	415	3,371	4,582	5,034	486	267	1,696	–	15,851
31 December 2014	415	4,975	2,927	2,583	319	284	890	3,851	16,244
31 December 2013	–	6,448	3,215	2,649	483	361	1,233	–	14,389

(Figures in tables are in thousands of Azerbaijani manats)

13. Goodwill and other intangible assets

The movements in goodwill and other intangible assets were as follows:

	<i>Goodwill</i>	<i>Banking license</i>	<i>Licenses</i>	<i>Computer software</i>	<i>Total</i>
Cost					
31 December 2013	-	-	2,337	2,692	5,029
Additions	-	-	631	407	1,038
Disposals	-	-	(267)	(98)	(365)
Foreign currency translation difference	-	-	(23)	(7)	(30)
31 December 2014	-	-	2,678	2,994	5,672
Acquisition through business combination (Note 5)	2,413	27,978	-	64	30,455
Additions	-	-	2,085	2,302	4,387
Disposals	-	-	(389)	(429)	(818)
Transfers	-	-	990	(990)	-
Foreign currency translation difference	1,472	17,067	111	639	19,289
31 December 2015	3,885	45,045	5,475	4,580	58,985
Accumulated amortization					
31 December 2013	-	-	(257)	(783)	(1,040)
Amortisation charge	-	-	(465)	(164)	(629)
Disposals	-	-	57	59	116
Foreign currency translation difference	-	-	5	2	7
31 December 2014	-	-	(660)	(886)	(1,546)
Amortisation charge	-	-	(457)	(440)	(897)
Disposals	-	-	222	198	420
Transfers	-	-	(455)	455	-
Foreign currency translation difference	-	-	(23)	(209)	(232)
31 December 2015	-	-	(1,373)	(882)	(2,255)
Net book value					
31 December 2015	3,885	45,045	4,102	3,698	56,730
31 December 2014	-	-	2,018	2,108	4,126
31 December 2013	-	-	2,080	1,909	3,989

Impairment testing of goodwill and other intangible assets with indefinite lives

Goodwill and banking license acquired through business combination with indefinite lives have been allocated to one individual cash-generating unit for impairment testing which is PASHA Yatirim Bankasi A.Ş.

The carrying amount of goodwill and value of the banking license acquired allocated to the cash-generating units is AZN 3,885 thousand and AZN 45,045 thousand respectively.

(Figures in tables are in thousands of Azerbaijani manats)

13. Goodwill and other intangible assets (continued)

Key assumptions used in value in use calculations

The recoverable amount of the subsidiary in Turkey have been determined based on a value in use method, applied dividend discount model calculation, based on equity estimations in financial budgets approved by senior management covering a three-year period. Since the investor does not have intention to collect dividends during the foreseeable future, the expected cash inflow from the investment was determined based on equity value considering the market multiple. The following rates are used by the Bank.

	<u>2015</u>
Discount rate	23%
Equity multiple	1.5
Expected growth rate of net income, average for the period	40%

The calculation of value in use is most sensitive to the following assumptions:

- Interest margins;
- Corporate and commercial loan portfolio volumes projected;
- Discount rates; and
- Local inflation rates.

Interest margins

Interest margins are based on average values achieved in the three years preceding the start of the budget period. These are increased over the budget period for anticipated market conditions. The interest rates range between 11.8% and 13.3% for corporate loans and 12.5% and 14% for commercial loans in TL. In foreign currency denominated loans the interest rates are forecasted as 4.5% per annum for total loan portfolio.

Corporate and commercial loan portfolio volumes projected

Macro-economic assumptions are based on published researches. The corporate loan portfolio growth in local Turkish currency was estimated in average 34% per year during the forecast period. The portfolio in foreign currency was forecasted with comparatively aggressive growth rate in average with the range between 40% and 62% growth rate per annum. Toward the end of the forecast period the growth rates are more stable and declining. The same trend is applicable for the commercial portfolio with much higher growth rate estimations.

Discount rates

Discount rates reflect management's estimate of return of capital employed (ROCE) required in each business. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. Discount rates are calculated by using the Weighted Average Cost of Capital (WACC) method.

Local inflation rates

The inflation rate considered for the forecasted period is 6.7%, with stable average USD/TL exchange rates.

Sensitivity to changes in assumptions

Management believes that reasonable possible changes in key assumptions used to determine the recoverable amount segments will not result in an impairment of goodwill.

(Figures in tables are in thousands of Azerbaijani manats)

14. Other assets and liabilities

Other assets comprise:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Other financial assets		
Clearance cheque accounts	2,263	–
Settlements on money transfers	2,071	850
Accrued interest receivable on guarantees and letters of credit	430	419
	<u>4,764</u>	<u>1,269</u>
Other non-financial assets		
Deferred expenses	4,848	4,205
Prepayments for acquisition of property, equipment and intangible assets	3,142	2,912
Repossessed collateral	1,537	–
Other prepayments	802	–
Taxes, other than income tax	43	539
	<u>10,372</u>	<u>7,656</u>
Other assets	<u>15,136</u>	<u>8,925</u>

As at 31 December 2015, clearance cheque accounts consist of receivables from other banks for which cheques stand as collateral.

As at 31 December 2015, deferred expenses of AZN 2,036 thousand (31 December 2014 – AZN 3,013 thousand), related to the long term prepayment for the rent of the service points located in Baku and AZN 1,101 thousand (31 December 2014 – nil) related to long term software support.

As at 31 December 2015, included in prepayments for the purchase of property, equipment and intangible assets are prepayments for new software in the amount of AZN 2,442 thousand (31 December 2014 – AZN 1,561 thousand).

Other liabilities comprise:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Other financial liabilities		
Settlements on money transfer	3,310	1,431
Clearance cheque accounts	2,263	–
Financial lease liabilities	596	–
Accrued expenses	172	146
Payables for professional services	–	96
Other	72	27
	<u>6,413</u>	<u>1,700</u>
Other non-financial liabilities		
Payable to employees	4,415	564
Deferred income	234	778
Other provision	165	–
Taxes, other than income tax	291	22
Other	54	–
	<u>5,159</u>	<u>1,364</u>
Other liabilities	<u>11,572</u>	<u>3,064</u>

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Short-term deposits from banks	246,210	81,424
Loans from the National Fund for Support of Entrepreneurship	67,436	44,767
Loans from the CBAR and NBG	48,383	-
Amount due to Azerbaijan Mortgage Fund	4,667	1,643
Amount due to IT Development Fund	2,400	2,000
Correspondent accounts with other banks	597	4,139
Long-term deposits from banks	-	40,404
Amounts due to banks and government funds	369,693	174,377

As at 31 December 2015, the Group received short-term funds from one resident commercial bank (31 December 2014 – five) and six non-resident commercial bank (31 December 2014 – one) comprising AZN 246,210 thousands (31 December 2014 – AZN 81,424 thousands) maturing on 18 November 2016 (31 December 2014 – 19 November 2015) and with interest rates ranging between 1% and 3% p.a. (31 December 2014 – 3%-5% p.a.).

As at 31 December 2015, the Group had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 67,436 thousand (31 December 2014 – AZN 44,767 thousand), maturing through September 2025 (31 December 2014 – through May 2023), and bearing interest rate of 1.0% p.a. The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at interest rate of 6% p.a. (31 December 2014 – 6% p.a.).

As at 31 December 2015, the Group had loans received from the CBAR and NBG amounting to AZN 48,383 thousand (31 December 2014 – nil), maturing through November 2017 with interest rates ranging between 3.5% and 9.11% p.a.

As at 31 December 2015, the Group had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 4,667 thousand (31 December 2014 – AZN 1,643 thousand), maturing through May 2040 (31 December 2014 – through November 2037) and bearing interest rate of 4.0% p.a..

16. Amounts due to customers

The amounts due to customers include the following:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Demand deposits	901,216	558,229
Time deposits	472,897	144,829
Amounts due to customers	1,374,113	703,058
Held as security against guarantees issued (Note 21)	8,090	2,500

(Figures in tables are in thousands of Azerbaijani manats)

16. Amounts due to customers (continued)

An analysis of customer accounts by economic sector follows:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Investment holding companies	481,678	289,970
Individuals	367,234	194,757
Trade and services	184,048	125,256
Transport and communication	82,876	15,110
Construction	66,385	10,463
Insurance	58,299	27,154
Manufacturing	56,207	1,864
Non banking credit organizations	18,256	8,407
Hotel business	17,904	13,696
Public organizations	17,863	10,925
Mining	11,859	329
Energy	844	37
Agriculture	207	198
Other	10,453	4,892
Amounts due to customers	1,374,113	703,058

As at 31 December 2015, customer deposits included balances with five (31 December 2014 – five) largest customers comprised AZN 623,366 thousand or 45% of the total customer deposits portfolio (31 December 2014 – AZN 370,629 thousand or 53% of the total customer deposits portfolio).

17. Other borrowed funds

As at 31 December 2015, other borrowed funds included balances with five (31 December 2014 – six) foreign banks amounting to AZN 93,814 thousand (31 December 2014 – AZN 55,451 thousand), maturing through April 2021 (31 December 2014 – through April 2021) and bearing interest rates ranging between 1.67% and 6.35% p.a. (31 December 2014 – between 1.45% and 10.13% p.a.). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Group.

18. Derivative financial instruments

The Group enters into derivative financial instruments for trading purposes. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	<i>31 December 2015</i>			<i>31 December 2014</i>		
	<i>Notional amount</i>	<i>Fair values</i>		<i>Notional amount</i>	<i>Fair value</i>	
		<i>Asset</i>	<i>Liability</i>		<i>Asset</i>	<i>Liability</i>
Interest rate contracts						
Options – domestic	3,350	–	(22)	–	–	–
Foreign exchange contracts						
Forwards and swaps – foreign	38,158	324	(26)	9,730	–	(87)
Options – domestic	3,283	–	(943)	–	–	–
Total derivative assets/(liabilities)		324	(991)		–	(87)

Foreign and domestic in the table above stand for counterparties where foreign means non-Azerbaijani entities and domestic means Azerbaijani entities.

(Figures in tables are in thousands of Azerbaijani manats)

18. Derivative financial instruments (continued)

As at 31 December 2015 and 2014, the Group has positions in the following types of derivatives:

Forwards

Forwards and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

Swaps

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

Options

Options are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

19. Taxation

The corporate income tax expense comprises:

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Current tax charge	(2,708)	(3,062)
Deferred tax charge/(credit) – origination and reversal of temporary differences	(1,803)	2,982
Less: deferred tax recognised in other comprehensive income	(50)	36
Income tax expense	(4,561)	(44)

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Net losses/(gains) on investment securities available-for-sale	50	(36)
Income tax credited/(charged) to other comprehensive income	50	(36)

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

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

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Profit/(loss) before income tax expense	18,944	(2,752)
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	(3,789)	550
Tax effect of non-deductible expenses	(1,350)	(394)
Change in unrecognized deferred tax assets	498	(386)
Utilised tax losses carried forward, not recognized previously	151	-
Tax effect of tax-exempt income	199	192
Effect of difference in tax rate in foreign country	15	-
Other	(285)	(6)
Income tax expense	(4,561)	(44)

Deferred tax assets and liabilities as at 31 December and their movements for the respective years comprise:

	<i>Origination and reversal of temporary differences</i>			<i>Origination and reversal of temporary differences</i>			<i>Effect of business combination (Note 5)</i>	<i>Translation difference</i>	<i>2015</i>
	<i>2013</i>	<i>In the statement of profit or loss</i>	<i>In other compre- hensive income</i>	<i>2014</i>	<i>In the statement of profit or loss</i>	<i>In other compre- hensive income</i>			
Tax effect of deductible temporary differences									
Tax losses carried forward	265	689	-	954	(1,244)	-	1,052	554	1,316
Trading securities	-	-	-	-	572	-	-	-	572
Loans to customers	177	1,094	-	1,271	(52)	-	-	27	1,246
Investment securities	11	-	(11)	-	-	-	-	-	-
Investment property	-	-	-	-	66	-	-	-	66
Property and equipment	-	55	-	55	43	-	-	(50)	48
Intangible assets	-	15	(3)	12	(12)	-	-	-	-
Derivative financial liabilities	-	-	-	-	193	-	-	-	193
Provision for guarantees and letters of credit	-	185	-	185	(185)	-	-	-	-
Other liabilities	540	(329)	-	211	704	-	50	(63)	902
Gross deferred tax assets	993	1,709	(14)	2,688	85	-	1,102	468	4,343
Unrecognised deferred tax asset	(265)	(386)	-	(651)	664	-	-	(13)	-
Deferred tax asset	728	1,323	(14)	2,037	749	-	1,102	455	4,343
Tax effect of taxable temporary differences									
Trading securities	(119)	72	-	(47)	47	-	-	-	-
Amounts due from credit institutions	(124)	(98)	-	(222)	(1,797)	-	-	-	(2,019)
Investment securities	-	(2)	(22)	(24)	-	50	(3)	(36)	(13)
Loans to customers	(1,796)	1,085	-	(711)	286	-	-	168	(257)
Property and equipment	(303)	283	-	(20)	(394)	-	-	-	(414)
Intangible assets	(46)	46	-	-	(72)	-	-	(20)	(92)
Provision for guarantees and letters of credit	(309)	309	-	-	(672)	-	-	-	(672)
Deferred tax arisen at acquisition	-	-	-	-	-	-	(5,596)	(3,413)	(9,009)
Deferred tax liabilities	(2,697)	1,695	(22)	(1,024)	(2,602)	50	(5,599)	(3,301)	(12,476)
Net deferred tax assets/(liabilities)	(1,969)	3,018	(36)	1,013	(1,853)	50	(4,497)	(2,846)	(8,133)

The temporary differences associated with investments in subsidiaries arising from consolidation for which a deferred tax liability (2014 – deferred tax assets) has not been recognised, aggregate to AZN 16,186 (2014 – AZN 546).

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

Deferred taxes in the consolidated statement of financial position as at 31 December 2015 and 2014 can be reconciled as follows:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Deferred tax assets	1,555	1,013
Deferred tax liabilities	(9,688)	–
Net deferred tax (liabilities)/assets	(8,133)	1,013

20. Equity

As at 31 December 2015 and 2014, the Bank's authorized, issued and fully paid capital amounted to AZN 333,000 thousands comprising of 10,000 ordinary shares with a par value of AZN 33,300.00 per ordinary share. Each ordinary share entitles one vote to the shareholder.

On 14 February 2014, the shareholders of the Bank decided to increase share capital of the Bank by additional cash contribution amounting to AZN 105,000 thousands. Increase of share capital has been finalized on 22 April 2014. The increase was carried out by converting 10,000 shares with a par value of AZN 22,800.00 per ordinary share into an equal number of shares with a par value of AZN 33,300.00 per share.

On 7 May 2014, the Bank paid dividends to shareholders totalling AZN 14,992 thousands. On 25 December 2014, the shareholders of the Bank declared dividends totalling AZN 10,832 thousands which is payable as at 31 December 2014.

On 25 June 2015, General Shareholders Meeting cancelled its decision to pay dividends dated 25 December 2014 of AZN 10,832 thousand.

Foreign currency translation reserve

Foreign currency translation reserve is used to record exchange difference arising from the translation of the financial statements of foreign subsidiaries. Gain in the amount of AZN 83,707 (2014 – loss in the amount AZN 2,731 thousand) occurred due to two devaluations of AZN (2014 – appreciation of AZN) throughout the year (Note 3).

Unrealised gains (losses) on investment securities available-for-sale

This reserve records fair value changes on available-for-sale investments.

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

As a result of significant drop in crude oil prices, Azerbaijani manat devalued against the US dollar from AZN 0.7862 to AZN 1.0500 for 1 USD on 21 February 2015 and further to AZN 1.5500 for 1 USD on 21 December 2015. Following the second devaluation, the Central Bank of the Republic of Azerbaijan announced floating exchange rate.

These events resulted in worsening of liquidity in the banking system and much tighter credit conditions. There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Group's future results and financial position and business prospects in a manner not currently determinable. Such adverse impacts could include deterioration of the quality of the loan portfolio, with increases in non-performing loans and decreases in loan collateral values, and losses on investment securities.

Azerbaijani government announced plans to accelerate reforms and support to banking system in response to current economic challenges.

The Group's Management is monitoring these 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 2015 is appropriate and that the Group's tax, currency and customs positions will be sustained.

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Insurance

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

Compliance with the CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2015, the Bank was in compliance with these ratios except for the followings:

- Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 7 percent of the bank's total capital when the market value of the collateral of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value. As at 31 December 2015 the Bank's ratio was 22.42%;
- Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 31 December 2015 the Bank's ratio was 49.21%;
- Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 31 December 2015 the Bank's ratio was 72.23%.

Throughout the year the Bank submitted information to CBAR regarding these breaches on a monthly basis and no sanctions were ever applied to the Bank. In previous years, the Bank received a letter from CBAR that currently no sanctions were considered against the Bank for the first breach mentioned above. Also in November 2015 the Bank received a clearance letters from CBAR regarding acceptance of the action plans and non-application of sanctions against the Bank for the aforementioned breaches. Management believes that the Bank will not face any sanctions against the Bank 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:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Credit-related commitments		
Guarantees issued	232,587	66,994
Unused credit lines	44,184	28,912
Letters of credit	20,733	24,604
	<u>297,504</u>	<u>120,510</u>
Operating lease commitments		
Not later than 1 year	2,593	2,072
Later than 1 year but not later than 5 years	5,936	6,500
Later than 5 years	3,280	4,597
	<u>11,809</u>	<u>13,169</u>
Less – provisions (Note 22)	(379)	(2,683)
Commitments and contingencies (before deducting collateral)	<u>308,934</u>	<u>130,996</u>
Less – cash held as security against guarantees issued (Note 16)	(8,090)	(2,500)
Commitments and contingencies	<u>300,844</u>	<u>128,496</u>

(Figures in tables are in thousands of Azerbaijani manats)

22. Impairment losses on interest bearing assets, and provision for guarantees and letters of credit

The movements in allowance for impairment losses on interest bearing assets, and provision for guarantees and letters of credit were as follows:

	<i>Year ended 31 December 2015</i>					
	<i>Corporate lending</i>	<i>Individual lending</i>	<i>Total loans to customers</i>	<i>Amounts due from credit institutions</i>	<i>Total</i>	<i>Guarantees and letters of credit</i>
At 1 January	(34,401)	(366)	(34,767)	–	(34,767)	(2,683)
(Charge)/recovery for the year	(45,337)	(6,054)	(51,391)	(780)	(52,171)	2,304
Amounts written off	37,038	849	37,887	–	37,887	–
Acquisition of subsidiary	(181)	–	(181)	–	(181)	–
Exchange difference	754	–	754	–	754	–
At 31 December	(42,127)	(5,571)	(47,698)	(780)	(48,478)	(379)

	<i>Year ended 31 December 2014</i>					
	<i>Corporate lending</i>	<i>Individual lending</i>	<i>Total loans to customers</i>	<i>Amounts due from credit institutions</i>	<i>Total</i>	<i>Guarantees and letters of credit</i>
At 1 January	(21,486)	(252)	(21,738)	–	(21,738)	(150)
Charge for the year	(30,818)	(274)	(31,092)	–	(31,092)	(2,534)
Amounts written off	17,902	161	18,063	–	18,063	1
At 31 December	(34,402)	(365)	(34,767)	–	(34,767)	(2,683)

Allowance for impairment of assets is deducted from the carrying amount of the related assets. Provision for guarantees and letters of credit is recorded in liabilities.

23. Net fee and commission income

Net fee and commission income comprise:

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Guarantees and letters of credit	4,686	2,615
Settlements operations	2,857	1,482
Servicing plastic card operations	2,493	1,499
Cash operations	1,609	981
Securities operations	645	785
Other	364	37
Fee and commission income	12,654	7,399
Servicing plastic card operations	(2,799)	(1,604)
Guarantees and letters of credit	(856)	(749)
Settlements operations	(778)	(556)
Cash operations	(172)	(59)
Securities operations	(145)	(134)
Other	(218)	(94)
Fee and commission expense	(4,968)	(3,196)
Net fee and commission income	7,686	4,203

(Figures in tables are in thousands of Azerbaijani manats)

24. Personnel, general and administrative expenses

Personnel expenses comprise:

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Salaries and bonuses	(16,682)	(7,517)
Social security costs	(2,963)	(1,513)
Other employee related expenses	(2,190)	(1,976)
Total personnel expenses	(21,835)	(11,006)

General and administrative expenses comprise:

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Operating leases	(4,863)	(4,009)
Professional services	(3,463)	(3,150)
Advertising costs	(2,006)	(1,672)
Transaction costs of the acquisition	(1,610)	-
Registration fee	(1,165)	-
Software cost	(948)	(953)
Charity and sponsorship	(719)	(1,873)
Loss on disposal of property and equipment	(683)	(46)
Utilities	(482)	(357)
Insurance	(443)	(296)
Entertainment	(443)	-
Stationery	(442)	(114)
Repair and maintenance	(411)	(274)
Transportation and business trip expenses	(378)	(453)
Security expenses	(344)	(215)
Impairment of investment property	(332)	-
Taxes, other than income tax	(331)	(35)
Communications	(278)	(251)
Membership fees	(272)	(61)
Penalties incurred	(168)	(1)
Printing expenses	(86)	(46)
Other expenses	(1,398)	(814)
Total general and administrative expenses	(21,265)	(14,620)

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management

Introduction

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

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

Risk management structure

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

Board of Directors

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

Audit Committee

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

Management Board

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

Risk Committee

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

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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Introduction (continued)

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

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

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

Risk mitigation

Bank 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. 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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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 amounts shown above represent 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 details on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes.

Credit quality per class of financial assets

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

	Notes	Neither past due nor impaired			Past due but not impaired	Individually impaired	Total
		High grade	Standard grade	Sub-standard grade			
31 December 2015							
Cash and cash equivalents (excluding cash on hand)	6	199,708	704,835	–	–	–	904,543
Trading securities	7	–	46,238	–	–	–	46,238
Amounts due from credit institutions	8	19,196	113,092	–	5,607	780	138,675
Investment securities	9	81,943	11,656	–	–	–	93,599
Loans to customers	10						
Corporate lending		–	693,412	21,942	76,185	31,673	823,212
Individual lending		–	119,737	1,617	700	4,582	126,636
Total		300,847	1,688,970	23,559	82,492	37,035	2,132,903

	Notes	Neither past due nor impaired			Past due but not impaired	Individually impaired	Total
		High grade	Standard grade	Sub-standard grade			
31 December 2014							
Cash and cash equivalents (excluding cash on hand)	6	16,321	261,666	–	–	–	277,987
Trading securities	7	–	28,599	–	–	–	28,599
Amounts due from credit institutions	8	5,620	67,071	–	–	–	72,691
Investment securities available-for-sale	9	209,467	–	–	–	–	209,467
Loans to customers	10						
Corporate lending		–	366,295	47,199	32,121	60,936	506,551
Individual lending		–	64,166	1,079	1,079	767	67,091
Total		231,408	787,797	48,278	33,200	61,703	1,162,386

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

The Group classifies its loan related assets as follows:

High grade – counterparties with excellent financial performance or sovereign risk, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Standard grade – counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and overdue in principal and interest up to 30 days.

Sub-Standard grade – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Past due but not impaired – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

Individually impaired – counterparties with satisfactory and unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Group's rating policy. The attributable risk ratings are assessed and updated regularly.

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

<i>31 December 2015</i>	<i>Less than 30 days</i>	<i>31 to 60 days</i>	<i>61 to 90 days</i>	<i>More than 90 days</i>	<i>Total</i>
Amounts due from credit institutions	-	-	-	5,607	5,607
Loans to customers					
Corporate lending	-	32,496	17,785	25,904	76,185
Individual lending	-	-	-	700	700
Total	-	32,496	17,785	32,211	82,492

<i>31 December 2014</i>	<i>Less than 30 days</i>	<i>31 to 60 days</i>	<i>61 to 90 days</i>	<i>More than 90 days</i>	<i>Total</i>
Loans to customers					
Corporate lending	-	-	-	32,121	32,121
Individual mortgages	-	-	-	1,079	1,079
Total	-	-	-	33,200	33,200

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans to customers that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Group's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

The geographical concentration of the Group's monetary assets and liabilities is set out below:

	31 December 2015				31 December 2014			
	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	330,824	671,580	18,902	1,021,306	89,584	253,478	4,918	347,980
Trading securities	46,238	-	-	46,238	28,599	-	-	28,599
Amounts due from credit institutions	109,336	14,787	13,772	137,895	60,271	6,609	5,811	72,691
Investment securities	8,151	5,154	80,294	93,599	177,120	-	32,347	209,467
Derivative financial assets	-	324	-	324	-	-	-	-
Loans to customers	700,911	130,528	70,711	902,150	516,876	-	21,999	538,875
Other financial assets	2,501	2,263	-	4,764	1,269	-	-	1,269
	<u>1,197,961</u>	<u>824,636</u>	<u>183,679</u>	<u>2,206,276</u>	<u>873,719</u>	<u>260,087</u>	<u>65,075</u>	<u>1,198,881</u>
Financial liabilities								
Amounts due to banks and government funds	309,002	1,785	58,906	369,693	165,486	4,723	4,168	174,377
Amounts due to customers	1,360,252	-	13,861	1,374,113	700,853	-	2,205	703,058
Other borrowed funds	-	93,814	-	93,814	-	55,451	-	55,451
Derivative financial liabilities	965	26	-	991	-	-	87	87
Other financial liabilities	3,454	2,900	59	6,413	1,636	37	27	1,700
	<u>1,673,673</u>	<u>98,525</u>	<u>72,826</u>	<u>1,845,024</u>	<u>867,975</u>	<u>60,211</u>	<u>6,487</u>	<u>934,673</u>
Net assets/(liabilities)	<u>(475,712)</u>	<u>726,111</u>	<u>110,853</u>	<u>361,252</u>	<u>5,744</u>	<u>199,876</u>	<u>58,588</u>	<u>264,208</u>

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Liquidity risk and funding management

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

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 Bank maintains obligatory reserves with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. As at 31 December 2015 and 2014, these ratios were as follows:

	<i>31 December 2015, %</i>	<i>31 December 2014, %</i>
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	63	101

As at 31 December 2015, liquidity ratio of PASHA Bank Georgia JSC (average volume of liquid assets/average volume of liabilities) based on requirements established by the NBG was 34% (2014 – 102.66%). Minimum required level of liquidity by NBG is 30%.

As at 31 December 2015, liquidity ratio of PASHA Yatirim Bankasi A.S. based on requirements established by the CBRT was 322%. Minimum required level of liquidity by CBRT is 100%.

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2015 and 2014 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.

<i>Financial liabilities</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total 2015</i>
As at 31 December 2015					
Amounts due to banks and government funds	199,791	105,121	52,716	37,127	394,755
Amounts due to customers	1,030,542	278,887	90,475	–	1,399,904
Other borrowed funds	5,944	16,481	80,934	2,204	105,563
Derivative financial liabilities	26	–	965	–	991
Other financial liabilities	5,967	446	–	–	6,413
Total undiscounted financial liabilities	1,242,270	400,935	225,090	39,331	1,907,626
<i>Financial liabilities</i>	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total 2014</i>
As at 31 December 2014					
Amounts due to banks and government funds	40,883	95,302	26,494	16,181	178,860
Amounts due to customers	607,406	68,611	39,521	–	715,538
Other borrowed funds	8,273	20,225	27,019	3,329	58,846
Derivative financial liabilities	87	–	–	–	87
Dividends payable to shareholders	10,832	–	–	–	10,832
Other financial liabilities	1,700	–	–	–	1,700
Total undiscounted financial liabilities	669,181	184,138	93,034	19,510	965,863

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Liquidity risk and funding management (continued)

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

	<i>Less than 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Maturity undefined</i>	<i>Total</i>
As at 31 December 2015	86,597	57,550	71,717	81,640	297,504
As at 31 December 2014	44,843	47,727	27,630	310	120,510

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.

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

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 on 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 following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's current year profit.

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 2015. The sensitivity of equity is calculated by revaluing fixed rate available-for-sale financial assets at 31 December 2015 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve. However, as interest rate of available-for-sale securities in the local market is based on the carried accrued discount or premiums on these securities at the time of purchase or sale (as included in actual price of purchased or sold securities), thus, any change in the rates to be applied to the fixed-rate available-for-sale financial assets does not have any impact or effect on equity.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

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 requirements of the CBAR.

As at 31 December 2015, the Group had the following exposure to foreign currency exchange rate risk:

	<i>AZN</i>	<i>USD</i>	<i>EUR</i>	<i>Other</i>	<i>Total 2015</i>
Financial assets					
Cash and cash equivalents	170,087	486,535	348,590	16,094	1,021,306
Trading securities	46,238	–	–	–	46,238
Amounts due from credit institutions	58,545	50,647	22,104	6,599	137,895
Investment securities	12,198	10,311	–	71,090	93,599
Derivative financial assets	–	–	–	324	324
Loans to customers	443,904	182,833	137,516	137,897	902,150
Other financial assets	848	660	1,013	2,243	4,764
Total financial assets	731,820	730,986	509,223	234,247	2,206,276
Financial liabilities					
Amounts due to banks and government funds	77,517	236,238	20	55,918	369,693
Amounts due to customers	492,029	429,583	450,338	2,163	1,374,113
Other borrowed funds	–	39,451	54,024	339	93,814
Derivative financial liabilities	965	–	–	26	991
Other financial liabilities	2,723	249	417	3,024	6,413
Total financial liabilities	573,234	705,521	504,799	61,470	1,845,024
Net financial position	158,586	25,465	4,424	172,777	361,252

As at 31 December 2014 the Group had the following exposure to foreign currency exchange rate risk:

	<i>AZN</i>	<i>USD</i>	<i>EUR</i>	<i>Other</i>	<i>Total 2014</i>
Financial assets					
Cash and cash equivalents	43,004	48,412	251,427	5,137	347,980
Trading securities	28,599	–	–	–	28,599
Amounts due from credit institutions	42,055	15,475	10,448	4,713	72,691
Investment securities available-for-sale	177,120	1,619	–	30,728	209,467
Loans to customers	423,444	63,470	42,392	9,569	538,875
Other financial assets	482	213	574	–	1,269
Total financial assets	714,704	129,189	304,841	50,147	1,198,881
Financial liabilities					
Amounts due to banks and government funds	112,687	61,567	47	76	174,377
Amounts due to customers	366,241	61,348	274,829	640	703,058
Other borrowed funds	–	19,890	35,386	175	55,451
Derivative financial liabilities	–	–	–	87	87
Other financial liabilities	1,430	36	182	52	1,700
Total financial liabilities	480,358	142,841	310,444	1,030	934,673
Net financial position	234,346	(13,652)	(5,603)	49,117	264,208

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

The following table details the Group's sensitivity to a 60% increase and 15% 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 2015 and 2014:

	31 December 2015		31 December 2014	
	AZN/USD +15%	AZN/USD -60%	AZN/USD +8.74%	AZN/USD -35%
Impact on profit before tax	(3,820)	15,279	1,193	(4,778)

	31 December 2015		31 December 2014	
	AZN/EUR +15%	AZN/EUR -60%	AZN/EUR +10.7%	AZN/EUR -35%
Impact on profit before tax	(664)	2,654	600	(1,961)

26. Fair values of financial instruments

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:

	Date of valuation	Fair value measurement using			Total
		Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Assets measured at fair value					
Trading securities	31 December 2015	-	46,238	-	46,238
Investment securities – available for sale	31 December 2015	5,390	306	-	5,696
Derivative financial assets	31 December 2015	-	324	-	324
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2015	1,021,306	-	-	1,021,306
Amounts due from credit institutions	31 December 2015	-	-	137,895	137,895
Investment securities – loans and receivables	31 December 2015	-	-	86,718	86,718
Loans to customers	31 December 2015	-	-	884,654	884,654
Investment property	31 December 2015	-	-	1,668	1,668

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values of financial instruments (continued)**Fair value hierarchy (continued)**

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2015	–	991	–	991
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2015	–	–	369,693	369,693
Amounts due to customers	31 December 2015	–	–	1,373,943	1,373,943
Other borrowed funds	31 December 2015	–	–	93,814	93,814

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Assets measured at fair value					
Trading securities	31 December 2014	28,599	–	–	28,599
Investment securities available-for-sale	31 December 2014	160,120	21,604	27,743	209,467
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2014	347,980	–	–	347,980
Amounts due from credit institutions	31 December 2014	–	–	72,691	72,691
Loans to customers	31 December 2014	–	–	538,500	538,500
Investment property	31 December 2014	–	–	2,342	2,342

	<i>Date of valuation</i>	<i>Fair value measurement using</i>			<i>Total</i>
		<i>Quoted prices in active markets (Level 1)</i>	<i>Significant observable inputs (Level 2)</i>	<i>Significant unobservable inputs (Level 3)</i>	
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2014	–	87	–	87
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2014	–	–	174,377	174,377
Amounts due to customers	31 December 2014	–	–	703,058	703,058
Other borrowed funds	31 December 2014	–	–	55,451	55,451

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values of financial instruments (continued)

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

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

	<i>Carrying value 2015</i>	<i>Fair value 2015</i>	<i>Unrecognized gain/(loss) 2015</i>	<i>Carrying value 2014</i>	<i>Fair value 2014</i>	<i>Unrecognized gain/(loss) 2014</i>
Financial assets						
Cash and cash equivalents	1,021,306	1,021,306	–	347,980	347,980	–
Amounts due from credit institutions	137,895	137,895	–	72,691	72,691	–
Investment securities – loans and receivables	87,903	86,718	(1,185)	–	–	–
Loans to customers	902,150	884,654	(17,496)	538,875	538,500	(375)
Financial liabilities						
Amounts due to banks and government funds	369,693	369,693	–	174,377	174,377	–
Amounts due to customers	1,374,113	1,373,943	170	703,058	703,058	–
Other borrowed funds	93,814	93,814	–	55,451	55,451	–
Total unrecognized change in unrealised fair value			(18,511)			(375)

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.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, without a specific maturity and variable rate financial instruments.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values of financial instruments (continued)

Movements in level 3 assets and liabilities at fair value

The following table shows a reconciliation of the opening and closing amount of Level 3 assets which are recorded at fair value:

	<i>At 1 January 2015</i>	<i>Purchases</i>	<i>Interest income</i>	<i>(Loss) recorded in OCI</i>	<i>Settlements</i>	<i>Reclassifica- tions</i>	<i>Currency translation difference</i>	<i>At 31 December 2015</i>
Assets								
Investment securities available-for-sale	27,743	35,003	1,401	(352)	(27,335)	(38,232)	1,772	-
	<u>27,743</u>	<u>35,003</u>	<u>1,401</u>	<u>(352)</u>	<u>(27,335)</u>	<u>(38,232)</u>	<u>1,772</u>	<u>-</u>

	<i>At 1 January 2014</i>	<i>Purchases</i>	<i>Interest income</i>	<i>Gain recorded in OCI</i>	<i>Settlements</i>	<i>Reclassifica- tions</i>	<i>Currency translation difference</i>	<i>At 31 December 2014</i>
Assets								
Investment securities available-for-sale	5,525	32,345	1,498	109	(10,296)	-	1,438	27,743
	<u>5,525</u>	<u>32,345</u>	<u>1,498</u>	<u>109</u>	<u>(10,296)</u>	<u>-</u>	<u>1,438</u>	<u>27,743</u>

The following table shows the quantitative information about significant unobservable inputs used in the fair value measurement categorized within level 3 of the fair value hierarchy:

31 December 2014	<i>Carrying amount</i>	<i>Valuation techniques</i>	<i>Unobservable input</i>	<i>Range of discount rate</i>
Investment securities available-for-sale				
Treasury bills of the Ministry of Finance of Georgia	22,660	Discounted cash flow	Discount rate	4.59%-5.34%
Government coupon bonds of the Ministry of Finance of Georgia	3,464	Discounted cash flow	Discount rate	6.47%
Corporate deposit certificates	1,619	Discounted cash flow	Discount rate	5.25%

(Figures in tables are in thousands of Azerbaijani manats)

27. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled See Note 25 "Risk management" for the Group's contractual undiscounted repayment obligations.

	31 December 2015			31 December 2014		
	Within one year	More than one year	Total	Within one year	More than one year	Total
Cash and cash equivalents	1,021,306	–	1,021,306	347,980	–	347,980
Trading securities	23,862	22,376	46,238	10,047	18,552	28,599
Amounts due from credit institutions	133,607	4,288	137,895	72,691	–	72,691
Investment securities	53,857	39,742	93,599	37,198	172,269	209,467
Derivative financial assets	324	–	324	–	–	–
Loans to customers	438,100	464,050	902,150	268,048	270,827	538,875
Investment property	–	1,668	1,668	–	2,000	2,000
Property and equipment	–	15,851	15,851	–	16,244	16,244
Goodwill and other intangible assets	–	56,730	56,730	–	4,126	4,126
Current income tax assets	287	–	287	1,367	–	1,367
Deferred income tax assets	–	1,555	1,555	–	1,013	1,013
Prepayment for equity investment	–	–	–	–	41,971	41,971
Other assets	12,056	3,080	15,136	4,317	4,608	8,925
Total assets	1,683,399	609,340	2,292,739	741,648	531,610	1,273,258
Amounts due to banks and government funds	297,897	71,796	369,693	133,005	41,372	174,377
Amounts due to customers	1,293,886	80,227	1,374,113	670,890	32,168	703,058
Other borrowed funds	18,539	75,275	93,814	27,807	27,644	55,451
Derivative financial liabilities	–	991	991	87	–	87
Deferred income tax liabilities	–	9,688	9,688	–	–	–
Provision for guarantees and letters of credit	379	–	379	2,666	17	2,683
Dividends payable to shareholders	–	–	–	10,832	–	10,832
Other liabilities	11,236	336	11,572	2,430	634	3,064
Total liabilities	1,621,937	238,313	1,860,250	847,717	101,835	949,552
Net assets/(liabilities)	61,462	371,027	432,489	(106,069)	429,775	323,706

28. 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.

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

	31 December 2015				31 December 2014					
	Parent	Entities under common control	Key management personnel	Other	Total	Parent	Entities under common control	Key management personnel	Other	Total
Amounts due from credit institutions	–	25,558	–	–	25,558	–	22,070	–	–	22,070

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

	31 December 2015					31 December 2014				
	Parent	Entities	Key	Other	Total	Parent	Entities	Key	Other	Total
		under common control	management personnel				under common control	management personnel		
Loans outstanding at 1 January, gross	10	19,803	1,644	–	21,457	25	13,467	1,003	–	14,495
Loans issued during the year	–	47,733	6,745	–	54,478	40	32,964	2,367	3	35,374
Loan repayments during the year	(10)	(39,067)	(6,555)	–	(45,632)	(55)	(26,628)	(1,735)	(3)	(28,421)
Interest accrual	–	244	28	–	272	–	–	9	–	9
Foreign currency translation difference	–	2,415	828	–	3,243	–	–	–	–	–
Loans outstanding at 31 December, gross	–	31,128	2,690	–	33,818	10	19,803	1,644	–	21,457
Less: allowance for impairment at 31 December	–	(945)	(280)	–	(1,225)	–	(364)	(30)	–	(394)
Loans outstanding at 31 December, net	–	30,183	2,410	–	32,593	10	19,439	1,614	–	21,063
Interest income on loans	–	3,487	137	–	3,624	1	2,405	123	–	2,529

	31 December 2015					31 December 2014				
	Parent	Entities	Key	Other	Total	Parent	Entities	Key	Other	Total
		under common control	management personnel				under common control	management personnel		
Deposit at 1 January	5,062	26,239	289	57,516	89,106	988	12,044	272	68,196	81,500
Deposits received during the year	18,812	123,874	121	58,937	201,744	24,200	20,766	96	87,813	132,875
Deposits repaid during the year	(4,200)	(15,700)	(99)	(58,726)	(78,725)	(20,143)	(6,744)	(79)	(98,493)	(125,459)
Interest accrual	9	522	6	125	662	17	173	–	–	190
Foreign currency translation difference	5,922	285	240	28,021	34,468	–	–	–	–	–
Deposits at 31 December	25,605	135,220	557	85,873	247,255	5,062	26,239	289	57,516	89,106
Current accounts at 31 December	10,955	513,550	393	173,911	698,809	11,701	332,746	104	93,125	437,676
Interest expense on deposits	(480)	(8,133)	(8)	(3,035)	(11,656)	(1,144)	(2,400)	(29)	(2,950)	(6,523)
Guarantees issued	–	4,564	–	–	4,564	–	19,500	–	–	19,500
Letters of credit issued	–	2,026	–	–	2,026	–	1,609	–	–	1,609
Unused credit lines	163	558	269	34	1,024	153	4,369	516	44	5,082
Fee and commission income	14	1,426	1	1	1,442	15	558	12	1	586
Net gains/(losses) from foreign currencies: dealing	103	3,585	8	1,584	5,280	8	306	8	1,737	2,059
Other operating expenses	–	(4,037)	–	–	(4,037)	(17)	(4,003)	–	30	(3,990)

The Bank has guarantee from its parent received as a collateral in respect of deposits placed in local banks in the amount of AZN 21,219 thousand as at 31 December 2015 (2014 – nil).

During the period the Bank sold property in net book value amount of AZN 1,351 thousand to one entity under common control.

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

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

	<i>Year ended 31 December 2015</i>	<i>Year ended 31 December 2014</i>
Salaries and other benefits	(3,043)	(1,966)
Social security costs	(480)	(277)
Total key management compensation	(3,523)	(2,243)

29. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the CBAR.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

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

The Bank 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 Bank 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.

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 10% (2014: 12%) of risk-weighted assets for regulatory capital. As at 31 December 2015 and 2014 the bank's capital adequacy ratio on this basis was as follows:

	<i>31 December 2015</i>	<i>31 December 2014</i>
Tier 1 capital	339,059	333,000
Tier 2 capital	16,206	10,793
Less: Deductions from capital	(148,987)	(51,141)
Total regulatory capital	206,278	292,652
Risk-weighted assets	1,199,711	883,623
Capital adequacy ratio	17%	33%

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 11.4% (2014 - 12%) of risk-weighted assets for regulatory capital. As at 31 December 2015, capital adequacy ratio of PASHA Bank Georgia was 44% (31 December 2014 – 65%).

Capital Adequacy Standard Ratio of PASHA Yatirim is calculated in accordance with BRSA. As at 31 December 2015 the bank's capital adequacy ratio was 91.75% (31 December 2014: 135.43%).