OJSC PASHA Bank

Consolidated financial statements

Year ended 31 December 2016
together with independent auditor's report

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Independent auditor's report

To the Shareholders and Board of Directors of OJSC PASHA Bank

Opinion

We have audited the consolidated financial statements of OJSC PASHA Bank and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2016, 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 then ended, and notes to the consolidated financial statements, including summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2016, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Responsibilities of management and the Audit Committee for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

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

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

Ernst & Young Holdings (CIS) B.V.

31 March 2017

Baku, Azerbaijan

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2016

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2016*	*2015*
Assets			
Cash and cash equivalents	6	1,105,769	1,021,306
Trading securities	7	22,669	46,238
Amounts due from credit institutions	8	728,121	137,895
Investment securities			
- available-for-sale	9	173,329	5,696
- loans and receivables	9	61,220	87,903
Derivative financial assets	19	984	324
Loans to customers	10	1,107,274	902,150
Investment property	11	1,654	1,668
Property and equipment	12	12,809	15,851
Goodwill and other intangible assets	13	55,067	56,730
Current income tax assets		–	287
Deferred income tax assets	20	1,647	1,555
Other assets	14	19,302	15,136
Total assets		**3,289,845**	**2,292,739**
Liabilities			
Amounts due to banks and government funds	15	330,294	369,693
Amounts due to customers	16	2,350,687	1,374,113
Other borrowed funds	17	51,473	93,814
Debt securities issued	18	18,705	–
Derivative financial liabilities	19	2,468	991
Current income tax liabilities		12,436	–
Deferred income tax liabilities	20	8,446	9,688
Provision for guarantees and letters of credit	23	6,959	379
Other liabilities	14	21,111	11,572
Total liabilities		**2,802,579**	**1,860,250**
Equity			
Share capital	21	333,000	333,000
Retained earnings		83,152	19,283
Net unrealised loss on investment securities available-for-sale		(1)	(100)
Foreign currency translation reserve		71,046	80,244
Total equity attributable to shareholders of the Bank		**487,197**	**432,427**
Non-controlling interests		69	62
Total equity		**487,266**	**432,489**
Total liabilities and equity		**3,289,845**	**2,292,739**

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

31 March 2017

The accompanying notes on pages 6 to 53 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2016

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2016*	*2015*
Interest income			
Loans to customers		105,063	78,032
Amounts due from credit institutions		35,647	6,799
Investment securities available-for-sale		9,755	6,846
Cash and cash equivalents		2,122	3,382
Securities purchased under agreements to resell		–	61
		152,587	**95,120**
Trading securities		4,915	5,160
		4,915	**5,160**
Interest expense			
Amounts due to customers		(40,530)	(16,700)
Amounts due to banks and government funds		(10,185)	(5,401)
Other borrowed funds		(1,757)	(2,174)
Debt securities issued		(396)	–
Other		(138)	(60)
		(53,006)	**(24,335)**
Net interest income		**104,496**	**75,945**
Provision for impairment of interest earning assets	23	(11,447)	(52,171)
Net interest income after provision for impairment of interest bearing assets		**93,049**	**23,774**
Net fee and commission income	24	12,564	7,686
Net gains/(losses) from trading securities		109	(3,678)
Net gains/(losses) from investment securities available-for-sale		84	(145)
Net gains from foreign currencies:			
- dealing		57,810	17,635
- translation differences		8,699	12,992
- operations with foreign currency derivatives		2,304	5,467
Other income		433	351
Non-interest income		**82,003**	**40,308**
Personnel expenses	25	(35,358)	(21,835)
General and administrative expenses	25	(33,449)	(21,265)
Depreciation and amortisation	12, 13	(6,678)	(4,342)
Goodwill impairment	13	(3,642)	–
Loss on initial recognition of financial assets at fair value		(1,474)	–
(Provision)/reversal of provision for guarantees and letters of credit	23	(6,580)	2,304
Non-interest expenses		**(87,181)**	**(45,138)**
Profit before income tax expense		**87,871**	**18,944**
Income tax expense	20	(18,583)	(4,561)
Net profit for the year		**69,288**	**14,383**
Attributable to:			
- shareholders of the Bank		69,281	14,380
- non-controlling interests		7	3
		69,288	**14,383**

The accompanying notes on pages 6 to 53 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2016*	*2015*
Net profit for the year		**69,288**	**14,383**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Gross unrealised gains/(losses) on investment securities available-for-sale		208	(393)
Realised gains/(losses) on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		(84)	145
Net unrealised gains/(losses) on investment securities available-for-sale	21	**124**	**(248)**
Tax effect of net gains/(losses) on investment securities available-for-sale	20	(25)	50
Foreign currency translation differences	21	(9,198)	83,707
Net other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods		**(9,099)**	**83,509**
Total comprehensive income for the year		**60,189**	**97,892**
Attributable to:			
- shareholders of the Bank		60,182	97,889
- non-controlling interests		7	3
		60,189	**97,892**

The accompanying notes on pages 6 to 53 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

(Figures in tables are in thousands of Azerbaijani manats)

	Attributable to shareholders of the Bank						
	Share capital	Retained earnings (accumulated deficit)	Net unrealised gain/(losses) on investment securities available-for-sale	Foreign currency translation difference	Total	Non-controlling interests	Total equity
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 21)	–	10,832	–	–	10,832	–	10,832
Acquisition of subsidiary (Note 5)	–	–	–	–	–	97	97
Decrease in non-controlling interest	–	–	–	–	–	(38)	(38)
As at 31 December 2015	333,000	19,283	(100)	80,244	432,427	62	432,489
Net profit for the year	–	69,281	–	–	69,281	7	69,288
Other comprehensive loss for the year	–	–	99	(9,198)	(9,099)	–	(9,099)
Total comprehensive income for the year	–	69,281	99	(9,198)	60,182	7	60,189
Dividends to shareholders of the Bank (Note 21)	–	(5,412)	–	–	(5,412)	–	(5,412)
31 December 2016	333,000	83,152	(1)	71,046	487,197	69	487,266

The accompanying notes on pages 6 to 53 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2016*	*2015*
Cash flows from operating activities			
Interest received		130,157	88,989
Interest paid		(38,697)	(22,444)
Fees and commissions received		20,730	12,337
Fees and commissions paid		(8,117)	(4,926)
Net realized losses on sale of investment securities available-for-sale		84	(145)
Net realized gain from trading securities		1,017	178
Realised gains less losses from dealing in foreign currencies and operations with foreign currency derivatives		60,747	23,641
Personnel expenses paid		(26,041)	(18,430)
General and administrative expenses paid		(32,262)	(18,790)
Other operating income received		382	334
Cash flows from operating activities before changes in operating assets and liabilities		**108,000**	**60,744**
Net (increase)/decrease in operating assets			
Trading securities		22,274	(28,098)
Amounts due from credit institutions		(583,565)	63,618
Loans to customers		(179,617)	(202,467)
Other assets		(1,095)	(597)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		(72,062)	19,990
Amounts due to customers		874,709	342,791
Other borrowed funds		(48,120)	(6,976)
Derivative financial liabilities		1,110	–
Other liabilities		(1,497)	1,022
Net cash flows from operating activities before income tax		**120,137**	**250,027**
Income tax paid		(6,252)	(970)
Net cash from operating activities		**113,885**	**249,057**
Cash flows from investing activities			
Acquisition of a subsidiary, net of cash acquired (Note 5)		–	371
Purchase of investment securities available-for-sale		(231,358)	(539,479)
Proceeds from sale and redemption of investment securities available-for-sale		78,569	690,411
Purchase of investment securities – loans and receivables		(27,105)	–
Proceeds from sale and redemption of investment securities – loans and receivables		50,627	–
Purchase and prepayments for property and equipment		(2,356)	(3,999)
Acquisition of intangible assets		(4,526)	(4,406)
Proceeds from sale of property and equipment		34	1,410
Net cash (used in)/from investing activities		**(136,115)**	**144,308**
Cash flows from financing activities			
Proceeds from debt securities issued	18	19,258	–
Dividends paid	21	(5,412)	–
Net cash from financing activities		**13,846**	**–**
Effect of exchange rates changes on cash and cash equivalents		92,847	279,961
Net increase in cash and cash equivalents		**84,463**	**673,326**
Cash and cash equivalents, beginning	6	1,021,306	347,980
Cash and cash equivalents, ending	6	**1,105,769**	**1,021,306**

The accompanying notes on pages 6 to 53 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 four service points and two branches in Azerbaijan as at 31 December 2016 (31 December 2015: 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 2016 and 2015, the following shareholders owned the outstanding shares of the Bank:

Shareholders	*2016 (%)*	*2015 (%)*
PASHA Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

As at 31 December 2016 and 2015, 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 2016 and 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 2016 and 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").

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.

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 2016:

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 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 statements of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016. These amendments do not have any impact on the Group.

Annual improvements 2012-2014 cycle

IFRS 7 Financial Instruments: Disclosures

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Basis of consolidation (continued)

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

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 27.

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

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

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

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

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

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

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.

3. Summary of significant accounting policies (continued)

Financial assets (continued)

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 gain/loss operations with foreign currency derivatives. 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.

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 of 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.

3. Summary of significant accounting policies (continued)

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 due on demand or within 90 days from 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.

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.

3. Summary of significant accounting policies (continued)

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets

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.

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.

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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.

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.

3. Summary of significant accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

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.

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.

3. Summary of significant accounting policies (continued)

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:

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

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.

Repossessed collateral

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

3. Summary of significant accounting policies (continued)

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.

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.

3. Summary of significant accounting policies (continued)

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Foreign currency translation (continued)

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 2016 and 2015 in the preparation of these consolidated financial statements:

	2016	*2015*
1 US dollar	AZN 1.7707	AZN 1.5594
1 euro	AZN 1.8644	AZN 1.7046
1 Georgian lari	AZN 0.6663	AZN 0.6511
1 Turkish lira	AZN 0.5023	AZN 0.5358

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.

From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortised cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as the requirements of IAS 39.

IFRS 9 will also fundamentally change the approach to loan impairment. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Group will be required to record an allowance for expected losses for all loans and other debt financial assets not carried at FVPL, as well as for loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance would be based on the probability of default over the life of the asset.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – 1 January 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to 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. The Group expects a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9, and IFRS 16 *Leases*).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Group does not anticipate early adopting IFRS 15 and is currently evaluating its impact.

IFRS 16 Leases

The IASB issued the new standard for accounting for leases – IFRS 16 *Leases* in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date.

The Group does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

Amendments to IAS 12 Income Taxes

In January 2016, through issuing amendments to IAS 12, the IASB clarified the accounting treatment of deferred tax assets of debt instruments measured at fair value for accounting, but measured at cost for tax purposes. The Group does not anticipate that adopting the amendments would have a material impact on its financial statements.

Amendments to IAS 7 Statement of Cash Flows

In January 2016, the IASB issued amendments to IAS 7 *Statement of Cash Flows* with the intention to improve disclosures of financing activities and help users to better understand the reporting entities' liquidity positions. Under the new requirements, entities will need to disclose changes in their financial liabilities as a result of financing activities such as changes from cash flows and non-cash items (e.g., gains and losses due to foreign currency movements). The amendment is effective from 1 January 2017. The Group is currently evaluating the impact.

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.

4. Significant accounting judgments and estimates (continued)

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.

As at 31 December 2016, the Group applied new methodology for determining the allowance for impairment on loans to customers. The previous applied methodology mainly based on statistical data while new methodology is the combination of statistical data and rating based model. This led to increase in provision for collective loan impairment by AZN 3,889 thousand and reversal of provision for individual loan impairment by AZN 9,056 thousand in the statements of profit or loss (Note 23). In the new methodology, probability of default for individually significant not impaired loans were assessed based on internal rating system. Also, for the purpose of individual assessment, in accordance with the new methodology the Bank used assumptions on realization of collateral based on its own statistics.

Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. If actual results differ from those estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in the consolidated statement of profit or loss (Note 20).

Impairment of goodwill and banking license

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 2016 was AZN 42,228 thousand (2015: AZN 45,045 thousand). 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. under its business expansion strategy. 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 2016 and 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:

	Fair value recognised on acquisition
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
	45,708
Borrowings	2,194
Money markets	366
Deferred income tax liabilities (Note 20)	4,497
Other financial liabilities	45
Other liabilities and provisions	623
	7,725
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 as at 31 December 2015.

Cash outflow on acquisition of the subsidiary

Transaction costs of the acquisition (Note 25)	(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. Cash consideration was prepaid in 2013.

(Figures in tables are in thousands of Azerbaijani manats)

6. Cash and cash equivalents

Cash and cash equivalents comprise:

	2016	*2015*
Cash on hand	114,917	116,763
Current accounts with the CBAR, the NBG and the CBRT	534,087	199,708
Current accounts with other credit institutions	91,145	335,481
Time deposits with credit institutions up to 90 days	365,620	369,354
Cash and cash equivalents	**1,105,769**	**1,021,306**

Current accounts with other credit institutions consist of interest bearing correspondent account balances with resident and non-resident banks in the amount of nil (31 December 2015 – AZN 554 thousand) and AZN 298 thousand (31 December 2015 – AZN 643 thousand), respectively, and non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 27,114 thousand (31 December 2015 – AZN 7,462 thousand) and AZN 63,733 thousand (31 December 2015 – AZN 326,822 thousand), respectively.

As at 31 December 2016, the Group placed AZN 363,994 thousand in time deposits with one resident bank and three non–resident banks maturing through January 2017 with interest rates ranging between 0.4% and 14.30% p.a. (31 December 2015 – AZN 369,354 thousand matured in March 2016 with interest rates ranging between 0.13% and 13.00% p.a.).

7. Trading securities

Trading securities comprise:

	2016		*2015*	
	Annual interest rate	*Carrying value*	*Annual interest rate*	*Carrying value*
Corporate bonds	9.00%	19,431	9.00%	19,770
Bonds of financial institutions	14.00%	3,238	9.75%-14.00%	26,468
Trading securities		**22,669**		**46,238**

As at 31 December 2016, the Bank held securities of two (31 December 2015 – three) local entities amounting to AZN 22,669 thousand (31 December 2015 – AZN 46,238 thousand).

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

8. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2016	*2015*
Time deposit with the CBAR	474,994	–
Loans to banks	93,727	23,386
Time deposits with banks	74,558	92,261
Obligatory reserve with the CBAR, the NBG and the CBRT	47,007	19,196
Restricted deposits	38,742	3,832
	729,028	**138,675**
Less: allowance for impairment (Note 23)	(907)	(780)
Amounts due from credit institutions	**728,121**	**137,895**

(Figures in tables are in thousands of Azerbaijani manats)

8. Amounts due from credit institutions (continued)

As at 31 December 2016, time deposits with the CBAR represents deposit with maturity in September 2017. The deposit was placed from resources of one government entity (Note 16).

As at 31 December 2016, the Group had outstanding amount of AZN 93,727 thousand (31 December 2015 – AZN 23,386 thousand) of unsecured loans issued to six resident commercial banks (31 December 2015 – four resident commercial banks) with contractual maturity through June 2017 (31 December 2015 – May 2017) and with interest rates ranging between 3% and 22% p.a. (31 December 2015 – 7.5% and 16% p.a.).

As at 31 December 2016, time deposits with banks mature between January 2017 and December 2017 (31 December 2015 – between January 2016 and November 2017) with interest rates ranging between 0.5% and 15.00% p.a. (31 December 2015 – between 0.02% and 12.5% p.a.).

As at 31 December 2016, the Group had outstanding amount of AZN 93,727 thousand (31 December 2015 – AZN 23,386 thousand) of unsecured loans issued to six resident commercial banks (31 December 2015 – four resident commercial banks) with contractual maturity through June 2017 (31 December 2015 – May 2017) and with interest rates ranging between 3% and 22% p.a. (31 December 2015 – 7.5% and 16% 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% (2015 – 0.5%) and 1.0% (2015 – 0.5%) of the previous month average of funds attracted from customers by a credit institution in AZN and foreign currencies, respectively. Credit institutions in the Republic of Georgia are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 7% (2015 – 10%) and 20% (2015 – 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 are required to maintain a mandatory interest earning cash deposit with the CBRT at the level of 4%-10.5% for TRY deposits and other liabilities according to their maturities (2015 – 5%-11% for all liabilities) and 4.5%-24.5% for foreign currency deposits and other liabilities according to their maturities (2015 – 5%-25%).

9. Investment securities

Investment securities available-for-sale comprise:

	2016		*2015*	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*
Bonds of the Ministry of Finance of the Republic of Azerbaijan	68,827	72,819	236	235
Notes issued by the Central Bank of Azerbaijan Republic	65,360	65,758	–	–
Corporate bonds	29,028	28,776	–	–
Bonds of financial institutions	7,002	6,988	306	300
Turkey Government Bonds	3,112	3,064	5,154	5,090
Investment securities available-for-sale	**173,329**	**177,405**	**5,696**	**5,625**

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

	2016		*2015*	
	%	*Maturity*	*%*	*Maturity*
Bonds of the Ministry of Finance of the Republic of Azerbaijan	2.49%-20.88%	January 2017 – December 2017	3.59%	May 2016
Notes issued by the Central Bank of Azerbaijan Republic	14.34%-14.39%	January 2017	–	–
Corporate bonds	4.97%-10.38%	October 2021 – December 2021	–	–
Bonds of financial institutions	1.38%-11.84%	January 2017 – September 2017	8.79%	April 2016
Turkey Government Bonds	9.26%-10.64%	March 2017 – June 2017	10.80%	November 2016

(Figures in tables are in thousands of Azerbaijani manats)

9. Investment securities (continued)

Loans and receivables comprise:

	2016	*2015*
Treasury bonds of the Ministry of Finance of Georgia	20,674	25,209
Certificates of deposits of financial institutions	17,686	7,946
Bonds of financial institutions	14,353	23,660
Corporate bonds	8,641	5,790
Treasury bills of the Ministry of Finance of Georgia	–	15,319
Certificates of deposit of the NBG	–	9,979
	61,354	**87,903**
Less: allowance for impairment	(134)	–
Loans and receivables	**61,220**	**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. 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:

	2016	*2015*
Legal entities	1,046,055	823,212
Individuals	123,552	126,636
Loans to customers (gross)	**1,169,607**	**949,848**
Less – allowance for impairment (Note 22)	(62,333)	(47,698)
Loans to customers (net)	**1,107,274**	**902,150**

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

	Corporate lending	*Individual lending*	*Total*
31 December 2016			
Individual impairment	(45,339)	(341)	**(45,680)**
Collective impairment	(12,750)	(3,903)	**(16,653)**
	(58,089)	**(4,244)**	**(62,333)**
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	**93,196**	**3,242**	**96,438**

	Corporate lending	*Individual lending*	*Total*
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**

(Figures in tables are in thousands of Azerbaijani manats)

10. Loans to customers (continued)

Loans are made in the following industry sectors:

	2016	*2015*
Trade and services	469,902	327,626
Non-banking credit organizations	125,530	84,344
Individuals	123,552	126,636
Manufacturing	119,577	167,224
Construction	113,895	101,295
Mining	64,622	30,239
Agriculture and food processing	48,438	48,795
Transport and telecommunication	43,671	26,281
Energy	13,782	16,513
Leasing	6,345	14,994
Other	40,293	5,901
Total loans (gross)	**1,169,607**	**949,848**

As at 31 December 2016, loans granted to top 6 customers (31 December 2015 – 5 customers) which individually exceeded 5% of the Group's equity, amounted to AZN 299,486 thousand (31 December 2015 – AZN 215,005 thousand).

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2016, comprised AZN 5,435 thousand (2015 – AZN 3,718 thousand).

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, cash, securities, 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 2016, the fair value of this investment property amounted to AZN 1,654 thousand (31 December 2015 – AZN 1,668 thousand). The Bank recognized impairment in the amount of AZN 346 thousand as of 31 December 2016 (31 December 2015 – AZN 332 thousand) 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:

	Land	*Buildings*	*Furniture and fixtures*	*Computers and other equipment*	*Vehicles*	*Other equipment*	*Leasehold improvements*	*Construction in progress*	*Total*
Cost									
31 December 2014	**415**	**5,571**	**5,963**	**4,791**	**937**	**482**	**1,491**	**3,851**	**23,501**
Acquisition through business combinations	–	–	97	–	–	–	–	–	97
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	–	1,636
Transfers			2,139	770			942	(3,851)	–
31 December 2015	**415**	**4,107**	**9,178**	**8,031**	**1,127**	**603**	**2,868**	–	**26,329**
Additions	–	–	901	749	127	35	210	–	2,022
Disposals	–	–	(23)	(124)	(119)	–	–	–	(266)
Foreign currency translation difference	–	–	21	3	3	5	27	–	59
31 December 2016	**415**	**4,107**	**10,077**	**8,659**	**1,138**	**643**	**3,105**	–	**28,144**
Accumulated depreciation									
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)	(337)	(1,171)	–	(10,478)
Depreciation charge	–	(206)	(1,889)	(2,100)	(216)	(123)	(544)	–	(5,078)
Disposals	–	–	21	116	108	–	–	–	245
Foreign currency translation difference	–	–	(10)	2	(1)	(1)	(14)	–	(24)
31 December 2016	–	(942)	(6,474)	(4,979)	(750)	(461)	(1,729)	–	(15,335)
Net book value									
31 December 2016	415	3,165	3,603	3,680	388	182	1,376	–	12,809
31 December 2015	415	3,371	4,582	5,034	486	266	1,697	–	15,851
31 December 2014	415	4,975	2,927	2,583	319	283	891	3,851	16,244

(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:

	Goodwill	*Banking license*	*Licenses*	*Computer software*	*Total*
Cost					
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**
Additions	–	–	3,374	3,326	**6,700**
Disposals	–	–	(11)	(394)	**(405)**
Foreign currency translation difference	(243)	(2,817)	4	(23)	**(3,079)**
31 December 2016	**3,642**	**42,228**	**8,842**	**7,489**	**62,201**
Accumulated amortization					
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)**
Amortisation charge	–	–	(1,018)	(582)	**(1,600)**
Disposals	–	–	9	334	**343**
Impairment	(3,642)	–	–	–	**(3,642)**
Foreign currency translation difference	–	–	–	20	**20**
31 December 2016	**(3,642)**	–	**(2,382)**	**(1,110)**	**(7,134)**
Net book value					
31 December 2016	–	**42,228**	**6,460**	**6,379**	**55,067**
31 December 2015	**3,885**	**45,045**	**4,102**	**3,698**	**56,730**
31 December 2014	–	–	**2,018**	**2,108**	**4,126**

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 nil (2015: AZN 3,885 thousand) and AZN 42,228 thousand (2015: 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 fair value calculation

As at 31 December 2016, recoverable amount of cash generating unit have been determined based on fair value less cost to sell calculated through application Income and Market approaches (Level 3) by an independent appraiser for impairment testing purposes. Under the income approach, Warranted Equity Method has been applied. Similar methodology was used for the purpose of valuation of the cash generating unit in prior year.

The calculation of fair value less cost to sell is most sensitive to the following assumptions:

- Price/book multiple calculated on the basis of peer group banks;
- Cost of equity;
- Return on equity of the global banking sector;
- Weights allocated to Market and Income approaches during reconciliation of the results under these approaches and making of the value conclusion;
- Amount of cash contribution required to be made when applying for the banking license in Turkey.

The following rates are used by the Bank for fair value calculation:

Risk free rate	Rf	11.1%
Market premium	Rm-Rf	6.0%
Beta	β	0.88
Company specific risk premium	Rs	1.8%
Cost of equity (discount rate)	**Ke**	**18.2%**
Terminal growth rate		**5.0%**

As a result of the valuation, recoverable amount of cash generating unit amounted to AZN 158,903 thousand. Accordingly goodwill in the amount of AZN 3,642 thousand was determined to be impaired and written-off. The impairment loss was mainly due to decrease in return on equity.

Sensitivity for reasonably possible increase in discount rate by 1% would result in additional impairment of AZN 2,812 thousand.

14. Other assets and liabilities

Other assets comprise:

	2016	*2015*
Other financial assets		
Clearance cheque accounts	2,048	2,263
Settlements on money transfers	5,598	2,071
Accrued commission receivable on guarantees and letters of credit	338	430
Other	101	–
	8,085	**4,764**
Other non-financial assets		
Deferred expenses	3,394	4,848
Prepayments for acquisition of property, equipment and intangible assets	1,362	3,142
Repossessed collateral	5,280	1,537
Other prepayments	1,017	802
Taxes, other than income tax	164	43
	11,217	**10,372**
Other assets	**19,302**	**15,136**

As at 31 December 2016, clearance cheque accounts consist of receivables from other banks for which cheques stand as collateral.

(Figures in tables are in thousands of Azerbaijani manats)

14. Other assets and liabilities (continued)

As at 31 December 2016, deferred expenses of AZN 816 thousand (31 December 2015 – AZN 2,036 thousand), related to the prepayment for the rent of the service points located in Baku and AZN 1,487 thousand (31 December 2015 – AZN 1,101 thousand) related to long term software support.

Other liabilities comprise:

	2016	*2015*
Other financial liabilities		
Settlements on money transfer	3,464	3,310
Clearance cheque accounts	2,048	2,263
Accrued expenses	535	172
Financial lease liabilities	–	596
Other	175	72
	6,222	**6,413**
Other non-financial liabilities		
Payable to employees	13,715	4,415
Deferred income	731	234
Other provision	132	165
Taxes, other than income tax	94	291
Other	217	54
	14,889	**5,159**
Other liabilities	**21,111**	**11,572**

15. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	2016	*2015*
Loans from the National Fund for Support of Entrepreneurship	99,906	67,436
Short-term deposits from banks	90,136	246,210
Long-term deposits from banks	67,287	–
Loans from the CBAR and NBG	41,676	48,383
Amount due to IT Development Fund	5,013	2,400
Amount due to Azerbaijan Mortgage Fund	4,826	4,667
Correspondent accounts with other banks	21,450	597
Amounts due to banks and government funds	**330,294**	**369,693**

As at 31 December 2016, the Group received short-term funds from five non-resident commercial banks (31 December 2015 – six) comprising AZN 90,136 thousand (31 December 2015 – AZN 246,210 thousand) and none from resident commercial banks (31 December 2015 – one) maturing on August 2017 (31 December 2015 – 18 November 2016) and with interest rates ranging between 1.60% and 12.00% p.a. (31 December 2015 – 1%-3% p.a.).

As at 31 December 2016, the Group had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 99,906 thousand (31 December 2015 – AZN 67,436 thousand), maturing through August 2026 (31 December 2015 – through September 2025), 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 2015 – 6% p.a.).

As at 31 December 2016, the Group received long-term funds from one resident commercial bank (31 December 2015 – nil) comprising AZN 67,287 thousand maturing on 2 February 2018 with interest rate 2.00%.

As at 31 December 2016, the Group had loans received from the CBAR and NBG amounting to AZN 41,676 thousand (31 December 2015 – 48,383 thousand), maturing through November 2017 (31 December 2015 – through November 2017) with interest rates ranging between 3.5% and 7% p.a. (31 December 2015 – 3.5% and 9.11% p.a.).

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to banks and government funds (continued)

As at 31 December 2016, the Group had loans refinanced from the IT Development Fund amounting to AZN 5,013 thousand (31 December 2015 – AZN 2,400 thousand), maturing through December 2021 (31 December 2015 – through December 2,021) and bearing interest rate of 1.0% p.a.

As at 31 December 2016, the Group had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 4,826 thousand (31 December 2015 – AZN 4,667 thousand), maturing through December 2040 (31 December 2015 – through May 2040) and bearing interest rate of 4.0% p.a.

16. Amounts due to customers

The amounts due to customers include the following:

	2016	*2015*
Demand deposits	998,925	901,216
Time deposits	1,351,762	472,897
Amounts due to customers	**2,350,687**	**1,374,113**
Held as security against guarantees issued (Note 21)	**8,123**	**8,090**

Included in time deposits is a deposit attracted at market rate from one government entity of AZN 470,006 thousand maturing through September 2017.

An analysis of customer accounts by economic sector follows:

	2016	*2015*
Manufacturing	542,550	56,207
Individuals	532,932	367,234
Investment holding companies	449,016	481,678
Trade and services	372,380	184,048
Construction	166,766	66,385
Transport and communication	90,276	82,876
Insurance	46,254	58,299
Hotel business	42,478	17,904
Public organizations	25,474	17,863
Mining	25,238	11,859
Non banking credit organizations	22,315	18,256
Agriculture	10,454	207
Energy	3,232	844
Other	21,322	10,453
Amounts due to customers	**2,350,687**	**1,374,113**

As at 31 December 2016, customer deposits included balances with five (31 December 2015 – five) largest customers comprised AZN 1,100,919 thousand or 47% of the total customer deposits portfolio (31 December 2015 – AZN 623,366 thousand or 45% of the total customer deposits portfolio).

17. Other borrowed funds

As at 31 December 2016, other borrowed funds included balances with four (31 December 2015 – five) foreign banks amounting to AZN 51,473 thousand (31 December 2015 – AZN 93,814 thousand), maturing through April 2021 (31 December 2015 – through April 2021) and bearing interest rates ranging between 1.48% and 3.75% p.a. (31 December 2015 – between 1.67% and 6.35% p.a.). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Group.

(Figures in tables are in thousands of Azerbaijani manats)

18. Debt securities issued

PASHA Yatirim Bankasi A.S. had issued a fixed rate bond on 26 October 2016, with nominal amount of AZN 18,836 thousand with the term of 90 days maturing at 24 January 2017. The carrying amount of the bond is AZN 18,705 thousand as at 31 December 2016 (31 December 2015 – none).

19. 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.

	2016			*2015*		
	Notional amount	*Fair values*		*Notional amount*	*Fair value*	
		Asset	*Liability*		*Asset*	*Liability*
Interest rate contracts						
Options – domestic	–	–	–	3,350	–	(22)
Foreign exchange contracts						
Forwards and swaps – foreign	26,441	320	(983)	38,158	324	(26)
Forwards and swaps – domestic	37,316	664	(495)	–	–	–
Options – domestic	2,162	–	(990)	3,283	–	(943)
Total derivative assets/ (liabilities)		984	(2,468)		324	(991)

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

As at 31 December 2016 and 2015, 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.

(Figures in tables are in thousands of Azerbaijani manats)

20. Taxation

The corporate income tax expense comprises:

	2016	*2015*
Current tax charge	(19,377)	(2,708)
Deferred tax credit/(charge) – origination and reversal of temporary differences	769	(1,803)
Less: deferred tax recognised in other comprehensive income	25	(50)
Income tax expense	**(18,583)**	**(4,561)**

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

	2016	*2015*
Net (gains)/losses on investment securities available-for-sale	(25)	50
Income tax credited/(charged) to other comprehensive income	**(25)**	**50**

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:

	2016	*2015*
Profit before income tax expense	**87,871**	**18,944**
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	**(17,574)**	**(3,789)**
Tax effect of non-deductible expenses	(1,218)	(1,350)
Change in unrecognized deferred tax assets	–	498
Utilised tax losses carried forward, not recognized previously	–	151
Prior year tax actualization	(302)	–
Tax effect of tax-exempt income	165	199
Effect of difference in tax rate in foreign country	185	15
Other	161	(285)
Income tax expense	**(18,583)**	**(4,561)**

(Figures in tables are in thousands of Azerbaijani manats)

20. Taxation (continued)

Deferred tax assets and liabilities as at 31 December 2016 and 2015 and their movements for the respective years comprise:

		Origination and reversal of temporary differences					*Origination and reversal of temporary differences*			
	2014	*In the statement of profit or loss*	*In other comprehensive income*	*Effect of business combination (Note 5)*	*Translation difference*	*2015*	*In the statement of profit or loss*	*In other comprehensive income*	*Translation difference*	*2016*
Tax effect of deductible temporary differences										
Tax losses carried forward	954	(1,244)	–	1,052	554	1,316	(815)	–	35	536
Trading securities	–	572	–	–	–	572	1	–	–	573
Amounts due from credit institutions	–	–	–	–	–	–	4,024	–	–	4,024
Loans to customers	1,271	(52)	–	–	27	1,246	(841)	–	(10)	395
Investment securities	–	–	–	–	–	–	–	15	–	15
Investment property	–	66	–	–	–	66	3	–	–	69
Property and equipment	55	43	–	–	(50)	48	103	–	–	151
Intangible assets	12	(12)	–	–	–	–	–	–	–	–
Derivative financial liabilities	–	193	–	–	–	193	140	–	–	333
Provision for guarantees and letters of credit	185	(185)	–	–	–	–	318	–	–	318
Other liabilities	211	704	–	50	(63)	902	2,098	–	(85)	2,915
Gross deferred tax assets	**2,688**	**85**	**–**	**1,102**	**468**	**4,343**	**5,031**	**15**	**(60)**	**9,329**
Unrecognised deferred tax asset	(651)	664	–	–	(13)	–	–	–	–	–
Deferred tax asset	**2,037**	**749**	**–**	**1,102**	**455**	**4,343**	**5,031**	**15**	**(60)**	**9,329**
Tax effect of taxable temporary differences										
Trading securities	(47)	47	–	–	–	–	–	–	–	–
Amounts due from credit institutions	(222)	(1,797)	–	–	–	(2,019)	2,019	–	–	–
Derivative financial assets	–	–	–	–	–	–	(169)	–	–	(169)
Investment securities	(24)	–	50	(3)	(36)	(13)	–	(40)	44	(9)
Loans to customers	(711)	286	–	–	168	(257)	146	–	(7)	(118)
Property and equipment	(20)	(394)	–	–	–	(414)	176	–	1	(237)
Intangible assets	–	(72)	–	–	(20)	(92)	25	–	(1)	(68)
Other assets	–	–	–	–	–	–	(350)	–	25	(325)
Amounts due to banks and government funds	–	–	–	–	–	–	(222)	–	–	(222)
Amounts due to customers	–	–	–	–	–	–	(6,534)	–	–	(6,534)
Provision for guarantees and letters of credit	–	(672)	–	–	–	(672)	672	–	–	–
Banking license	–	–	–	(5,596)	(3,413)	(9,009)	–	–	563	(8,446)
Deferred tax liabilities	**(1,024)**	**(2,602)**	**50**	**(5,599)**	**(3,301)**	**(12,476)**	**(4,237)**	**(40)**	**625**	**(16,128)**
Net deferred tax assets/(liabilities)	**1,013**	**(1,853)**	**50**	**(4,497)**	**(2,846)**	**(8,133)**	**794**	**(25)**	**565**	**(6,799)**

The temporary differences associated with investments in subsidiaries arising from consolidation for which a deferred tax liability aggregate to AZN 302 thousand (2015 – AZN 16,186 thousand).

Deferred taxes in the consolidated statement of financial position as at 31 December 2016 and 2015 can be reconciled as follows:

	2016	*2015*
Deferred tax assets	1,647	1,555
Deferred tax liabilities	(8,446)	(9,688)
Net deferred tax liabilities	**(6,799)**	**(8,133)**

21. Equity

As at 31 December 2016 and 2016, the Bank's authorized, issued and fully paid capital amounted to AZN 333,000 thousand 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 25 June 2015, General Shareholders Meeting cancelled its decision to pay dividends dated 25 December 2014 of AZN 10,832 thousand.

On 23 May 2016 Shareholders of the Bank declared dividends totalling AZN 5,412 thousand on ordinary shares (AZN 541 per share) which was paid as at 31 December 2016.

21. Equity (continued)

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. Loss in the amount of AZN 9,198 thousand (2015 – gain in the amount of AZN 83,707 thousand) occurred due to the change of exchange rates 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.

22. 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.

In 2015 as a result of significant drop in crude oil prices, Azerbaijani Manat devalued against the US dollar from AZN 0.7862 to AZN 1.5500 for 1 USD. Following this devaluation, the Central Bank of the Republic of Azerbaijan announced floating exchange rate. During 2016 the exchange rate of Azerbaijani Manat against US dollar continued to fluctuate in the range between AZN 1.4900 and AZN 1.7707.

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 financial position and business prospects.

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 proceeding the year of review.

Management believes that its interpretation of the relevant legislation as at 31 December 2016 is appropriate and that the Group's tax, currency and customs positions will be sustained.

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.

(Figures in tables are in thousands of Azerbaijani manats)

22. Commitments and contingencies (continued)

Compliance with the CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2016 and 2015, the Bank was in compliance with these ratios except for the followings:

a) 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 2016 the Bank's ratio was 18.94% (2015: 22.42%);

b) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 20 percent of the Bank's total capital when the market value of the collateral of credit exposures is more than 100 percent of such credit exposures, or the market value of real estate collateral of loans is above 150% of the loan value. As at 31 December 2016 the Bank's ratio was 24.25% (2015: the Bank was in compliance);

c) Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 31 December 2016 the Bank's ratio was 39.55% (2015: 49.21%);

d) Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 31 December 2016 the Bank's ratio was 58.05% (2015: 72.23%).

Throughout the year the Bank submitted information regarding these breaches to the Financial Markets Supervision Chamber (the "FMSC") on a monthly basis and no sanctions were imposed on the Bank. 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:

	2016	*2015*
Credit-related commitments		
Guarantees issued	239,314	232,587
Unused credit lines	86,545	44,184
Letters of credit	12,940	20,733
	338,799	**297,504**
Operating lease commitments		
Not later than 1 year	4,197	2,593
Later than 1 year but not later than 5 years	16,699	5,936
Later than 5 years	4,780	3,280
	25,676	**11,809**
Less – provisions (Note 23)	(6,959)	(379)
Commitments and contingencies (before deducting collateral)	**357,516**	**308,934**
Less – cash held as security against guarantees issued (Note 16)	(8,123)	(8,090)
Commitments and contingencies	**349,393**	**300,844**

(Figures in tables are in thousands of Azerbaijani manats)

23. 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:

	2016						
	Corporate lending	*Individual lending*	*Total loans to customers*	*Amounts due from credit institutions*	*Investment securities-loans and receivables*	*Total*	*Guarantees and letters of credit*
At 1 January	**(42,127)**	**(5,571)**	**(47,698)**	**(780)**	**–**	**(48,478)**	**(379)**
(Charge)/recovery for the year	(13,036)	1,852	(11,184)	(127)	(136)	(11,447)	(6,580)
Amounts written off	1,362	36	1,398	–	–	1,398	–
Recovery	(4,339)	(561)	(4,900)	–	–	(4,900)	–
Exchange difference	51	–	51	–	2	53	–
At 31 December	**(58,089)**	**(4,244)**	**(62,333)**	**(907)**	**(134)**	**(63,374)**	**(6,959)**

	2015						
	Corporate lending	*Individual lending*	*Total loans to customers*	*Amounts due from credit institutions*	*Investment securities-loans and receivables*	*Total*	*Guarantees and letters of credit*
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)**

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.

24. Net fee and commission income

Net fee and commission income comprise:

	2016	*2015*
Guarantees and letters of credit	5,874	4,686
Settlements operations	5,140	2,857
Servicing plastic card operations	4,569	2,493
Cash operations	3,105	1,609
Securities operations	1,127	645
Other	850	364
Fee and commission income	**20,665**	**12,654**
Servicing plastic card operations	(4,607)	(2,799)
Settlements operations	(1,706)	(778)
Guarantees and letters of credit	(850)	(856)
Cash operations	(495)	(172)
Securities operations	(8)	(145)
Other	(435)	(218)
Fee and commission expense	**(8,101)**	**(4,968)**
Net fee and commission income	**12,564**	**7,686**

(Figures in tables are in thousands of Azerbaijani manats)

25. Personnel, general and administrative expenses

Personnel expenses comprise:

	2016	*2015*
Salaries and bonuses	(27,986)	(16,682)
Social security costs	(5,013)	(2,963)
Other employee related expenses	(2,359)	(2,190)
Total personnel expenses	**(35,358)**	**(21,835)**

General and administrative expenses comprise:

	2016	*2015*
Charity and sponsorship	(8,806)	(719)
Professional services	(7,552)	(3,463)
Operating leases	(6,883)	(4,863)
Software cost	(2,291)	(948)
Advertising costs	(1,943)	(2,006)
Insurance	(896)	(443)
Repair and maintenance	(851)	(411)
Utilities	(641)	(482)
Transportation and business trip expenses	(505)	(378)
Taxes, other than income tax	(505)	(331)
Communications	(486)	(278)
Entertainment	(404)	(443)
Security expenses	(400)	(344)
Membership fees	(290)	(272)
Stationery	(258)	(442)
Printing expenses	(65)	(86)
Impairment of investment property	(14)	(332)
Penalties incurred	–	(168)
Transaction costs of the acquisition (Note 5)	–	(1,610)
Registration fee	–	(1,165)
Loss on disposal of property and equipment	–	(683)
Other expenses	(659)	(1,398)
Total general and administrative expenses	**(33,449)**	**(21,265)**

26. 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.

26. Risk management (continued)

Introduction (continued)

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.

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.

26. Risk management (continued)

Introduction (continued)

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.

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 below 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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group internal credit ratings. 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* High grade	*Neither past due nor impaired* Standard grade	*Neither past due nor impaired* Sub-standard grade	*Past due but not impaired*	*Individually impaired*	*Total*
31 December 2016							
Cash and cash equivalents (excluding cash on hand)	6	534,087	456,765	–	–	–	**990,852**
Trading securities	7	–	22,669	–	–	–	**22,669**
Amounts due from credit institutions	8	73,295	647,954	–	6,872	907	**729,028**
Investment securities – available-for-sale	9	162,975	10,354	–	–	–	**173,329**
Loans and receivables	9	59,334	2,020	–	–	–	**61,354**
Derivative financial assets	19	–	984	–	–	–	**984**
Loans to customers	10						
Corporate lending		–	804,378	133,371	15,110	93,196	**1,046,055**
Individual lending		–	103,282	11,861	5,167	3,242	**123,552**
Other financial assets	14	–	8,085	–	–	–	**8,085**
Total		**829,691**	**2,056,491**	**145,232**	**27,149**	**97,345**	**3,155,908**

	Notes	*Neither past due nor impaired* High grade	*Neither past due nor impaired* Standard grade	*Neither past due nor impaired* Sub-standard grade	*Past due but not impaired*	*Individually impaired*	*Total*
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 – available-for-sale	9	5,390	306	–	–	–	**5,696**
Loans and receivables	9	76,247	11,656	–	–	–	**87,903**
Derivative financial assets	19	–	324	–	–	–	**324**
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**
Other financial assets	14	–	4,764	–	–	–	**4,764**
Total		**300,541**	**1,694,364**	**23,559**	**82,492**	**37,035**	**2,137,991**

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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

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. This also includes all past due collectively assessed loans. 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

31 December 2016	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Amounts due from credit institutions	–	–	–	6,872	**6,872**
Loans to customers					
Corporate lending	3,281	15	1,268	10,546	**15,110**
Individual lending	517	–	–	4,650	**5,167**
Total	**3,798**	**15**	**1,268**	**22,068**	**27,149**

31 December 2015	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
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**

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, restructuring, customer's payment behaviour, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

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 pay-out 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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Credit risk (continued)

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, credit rating of customers, 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:

	2016				*2015*			
	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	692,775	403,189	9,805	**1,105,769**	330,824	671,580	18,902	**1,021,306**
Trading securities	22,669	–	–	**22,669**	46,238	–	–	**46,238**
Amounts due from credit institutions	627,610	48,206	52,305	**728,121**	109,336	14,787	13,772	**137,895**
Investment securities	161,876	10,114	62,559	**234,549**	8,151	5,154	80,294	**93,599**
Derivative financial assets	984	–	–	**984**	–	324	–	**324**
Loans to customers	841,806	202,110	63,358	**1,107,274**	700,911	130,528	70,711	**902,150**
Other financial assets	6,037	2,048	–	**8,085**	2,501	2,263	–	**4,764**
	2,353,757	**665,667**	**188,027**	**3,207,451**	**1,197,961**	**824,636**	**183,679**	**2,206,276**
Financial liabilities								
Amounts due to banks and government funds	251,159	50,782	28,353	**330,294**	309,002	1,785	58,906	**369,693**
Amounts due to customers	2,317,515	2,506	30,666	**2,350,687**	1,360,252	–	13,861	**1,374,113**
Other borrowed funds	–	51,473	–	**51,473**	–	93,814	–	**93,814**
Derivative financial liabilities	1,663	805	–	**2,468**	965	26	–	**991**
Debt securities issued	–	18,705	–	**18,705**	–	–	–	–
Other financial liabilities	4,025	2,048	149	**6,222**	3,454	2,900	59	**6,413**
	2,574,362	**126,319**	**59,168**	**2,759,849**	**1,673,673**	**98,525**	**72,826**	**1,845,024**
Net assets/ (liabilities)	**(220,605)**	**539,348**	**128,859**	**447,602**	**(475,712)**	**726,111**	**110,853**	**361,252**

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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Liquidity risk and funding management (continued)

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Group maintains obligatory reserves with the CBAR, NBG and CBRT, 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 2016 and 2015, these ratios were as follows:

	2016, %	*2015, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	82	63

As at 31 December 2016, liquidity ratio of PASHA Bank Georgia JSC (average volume of liquid assets/average volume of liabilities) based on requirements established by the NBG was 39% (2015 – 34%). Minimum required level of liquidity by NBG is 30%.

As at 31 December 2016, liquidity ratio of PASHA Yatirim Bankasi A.S. based on requirements established by the CBRT was 295% (2015 – 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 2016 and 2015 based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Group expects that many customers will not request repayment on the earliest date the Group could be required to pay and the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

Financial liabilities	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2016*
As at 31 December 2016					
Amounts due to banks and government funds	106,767	60,102	129,782	46,335	**342,986**
Amounts due to customers	1,140,316	801,066	504,349	–	**2,445,731**
Other borrowed funds	3,150	12,381	38,014	–	**53,545**
Gross settled financial liabilities					
- Contractual amounts payable	27,612	25,145	–	–	**52,757**
- Contractual amounts receivable	(27,122)	(24,000)	–	–	**(51,122)**
Net settled derivative financial liabilities	16	974	–	–	**990**
Debt securities issued	18,836	–	–	–	**18,836**
Other financial liabilities	6,222	–	–	–	**6,222**
Total undiscounted financial liabilities	**1,275,797**	**875,668**	**672,145**	**46,335**	**2,869,945**

Financial liabilities	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total 2015*
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**
Gross settled financial liabilities					
- Contractual amounts payable	23,433	–	–	–	**23,433**
- Contractual amounts receivable	(23,786)	–	–	–	**(23,786)**
Net settled derivative financial liabilities	22	–	943	–	**965**
Other financial liabilities	5,967	446	–	–	**6,413**
Total undiscounted financial liabilities	**1,241,913**	**400,935**	**225,068**	**39,331**	**1,907,247**

(Figures in tables are in thousands of Azerbaijani manats)

26. 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.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Maturity undefined*	*Total*
As at 31 December 2016	135,990	123,340	7,651	26,170	45,648	**338,799**
As at 31 December 2015	86,597	57,550	71,717	–	81,640	**297,504**

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 of sensitivity analysis. The Group has no significant concentration of market risk.

Interest rate risk

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

The sensitivity of current year profit is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2016. The Group does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2016 and 2015.

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.

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Currency risk (continued)

As at 31 December 2016, the Group had the following exposure to foreign currency exchange rate risk:

	AZN	*USD*	*EUR*	*GEL*	*TRY*	*Other*	*Total 2016*
Financial assets							
Cash and cash equivalents	161,555	551,692	357,842	2,225	24,668	7,787	**1,105,769**
Trading securities	22,669	–	–	–	–	–	**22,669**
Amounts due from credit institutions	554,056	118,017	56,043	5	–	–	**728,121**
Investment securities	115,981	69,406	–	42,198	6,964	–	**234,549**
Derivative financial assets	842	–	–	–	142	–	**984**
Loans to customers	456,381	318,099	155,210	44,575	133,009	–	**1,107,274**
Other financial assets	4,719	358	959	–	2,048	1	**8,085**
Total financial assets	**1,316,203**	**1,057,572**	**570,054**	**89,003**	**166,831**	**7,788**	**3,207,451**
The effect of derivatives	36,962	1,767	–	–	10,342	–	49,071
Financial liabilities							
Amounts due to banks and government funds	132,731	106,020	34,421	25,681	15,731	15,710	330,294
Amounts due to customers	1,005,650	858,007	474,800	1,805	2,500	7,925	2,350,687
Other borrowed funds	–	9,533	41,940	–	–	–	51,473
Derivative financial liabilities	1,663	–	–	–	805	–	2,468
Debt securities issued	–	–	–	–	18,705	–	18,705
Other financial liabilities	3,452	1,114	137	133	1,332	54	6,222
Total financial liabilities	**1,143,496**	**974,674**	**551,298**	**27,619**	**39,073**	**23,689**	**2,759,849**
The effect of derivatives	–	41,606	7,454	–	1,646	–	50,706
Net position after the effect of derivatives	**209,669**	**43,059**	**11,302**	**61,384**	**136,454**	**(15,901)**	**445,967**

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

	AZN	*USD*	*EUR*	*GEL*	*TRY*	*Other*	*Total 2015*
Financial assets							
Cash and cash equivalents	170,087	486,535	348,590	554	14,379	1,161	**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	–	65,936	5,154	–	**93,599**
Derivative financial assets	–	–	–	–	324	–	**324**
Loans to customers	443,904	182,833	137,516	50,658	86,913	326	**902,150**
Other financial assets	848	660	1,013	–	2,243	–	**4,764**
Total financial assets	**731,820**	**730,986**	**509,223**	**123,747**	**109,013**	**1,487**	**2,206,276**
The effect of derivatives	–	–	4,521	–	19,266	–	23,787
Financial liabilities							
Amounts due to banks and government funds	77,517	236,238	20	55,608	2	308	369,693
Amounts due to customers	492,029	429,583	450,338	1,244	26	893	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	62	2,860	102	6,413
Total financial liabilities	**573,234**	**705,521**	**504,799**	**56,914**	**2,914**	**1,642**	**1,845,024**
The effect of derivatives	–	9,851	9,041	–	4,541	–	23,433
Net position after the effect of derivatives	**158,586**	**15,614**	**(96)**	**66,833**	**120,824**	**(155)**	**361,606**

(Figures in tables are in thousands of Azerbaijani manats)

26. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

The following table details the Group's sensitivity to increase and decrease in the USD, EUR, GEL and TRY 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 2016 and 2015:

	2016		*2015*	
	AZN/USD +20%	*AZN/USD -20%*	*AZN/USD +15%*	*AZN/USD -60%*
Impact on profit before tax	(8,612)	8,612	(2,342)	9,368

	2016		*2015*	
	AZN/EUR +20%	*AZN/EUR -20%*	*AZN/EUR +15%*	*AZN/EUR -60%*
Impact on profit before tax	(2,260)	2,260	14	(58)

	2016		*2015*	
	AZN/GEL +15%	*AZN/GEL -15%*	*AZN/GEL +15%*	*AZN/GEL -15%*
Impact on profit before tax	(9,208)	9,208	(10,025)	10,025

	2016		*2015*	
	AZN/TRY +10%	*AZN/TRY -10%*	*AZN/TRY +10%*	*AZN/TRY -10%*
Impact on profit before tax	(13,645)	13,645	(12,082)	12,082

(Figures in tables are in thousands of Azerbaijani manats)

27. 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:

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Trading securities	31 December 2016	–	22,669	–	**22,669**
Investment securities – available for sale	31 December 2016	35,790	134,187	3,352	**173,329**
Derivative financial assets	31 December 2016	–	984	–	**984**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2016	1,105,769	–	–	**1,105,769**
Amounts due from credit institutions	31 December 2016	–	–	728,121	**728,121**
Investment securities – loans and receivables	31 December 2016	–	2,074	61,027	**63,101**
Loans to customers	31 December 2016	–	–	1,088,091	**1,088,091**
Investment property	31 December 2016	–	–	1,654	**1,654**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2016	–	2,468	–	**2,468**
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2016	–	–	330,294	**330,294**
Amounts due to customers	31 December 2016	–	–	2,354,701	**2,354,701**
Other borrowed funds	31 December 2016	–	–	51,473	**51,473**
Debt securities issued	31 December 2016	–	–	18,690	**18,690**

(Figures in tables are in thousands of Azerbaijani manats)

27. Fair values of financial instruments (continued)

Fair value hierarchy (continued)

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
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	–	4,370	82,348	**86,718**
Loans to customers	31 December 2015	–	–	884,654	**884,654**
Investment property	31 December 2015	–	–	1,668	**1,668**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
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**

(Figures in tables are in thousands of Azerbaijani manats)

27. 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.

	Carrying value 2016	*Fair value 2016*	*Unrecognized gain/(loss) 2016*	*Carrying value 2015*	*Fair value 2015*	*Unrecognized gain/(loss) 2015*
Financial assets						
Cash and cash equivalents	1,105,769	1,105,769	–	1,021,306	1,021,306	–
Amounts due from credit institutions	728,121	728,121	–	137,895	137,895	–
Investment securities – loans and receivables	61,220	63,101	1,881	87,903	86,718	(1,185)
Loans to customers	1,107,274	1,088,091	(19,183)	902,150	884,654	(17,496)
Financial liabilities						
Amounts due to banks and government funds	330,294	330,294	–	369,693	369,693	–
Amounts due to customers	2,350,687	2,354,701	(4,014)	1,374,113	1,373,943	170
Other borrowed funds	51,473	51,473	–	93,814	93,814	–
Debt securities issued	18,705	18,690	15	–	–	–
Total unrecognised change in unrealised fair value			**(21,301)**			**(18,511)**

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.

Movements in level 3 assets and liabilities at fair value

Securities determined as Level 3 assets which are recorded at fair value were purchased closed to reporting period end. Management believes that there were not any movements and their fair value approximates carrying value as of 31 December 2016.

(Figures in tables are in thousands of Azerbaijani manats)

28. 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.

	2016			*2015*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	1,105,769	–	**1,105,769**	1,021,306	–	**1,021,306**
Trading securities	19,479	3,190	**22,669**	23,862	22,376	**46,238**
Amounts due from credit institutions	728,121	–	**728,121**	133,607	4,288	**137,895**
Investment securities	186,387	48,162	**234,549**	53,857	39,742	**93,599**
Derivative financial assets	984	–	**984**	324	–	**324**
Loans to customers	512,518	594,756	**1,107,274**	438,100	464,050	**902,150**
Investment property	–	1,654	**1,654**	–	1,668	**1,668**
Property and equipment	–	12,809	**12,809**	–	15,851	**15,851**
Goodwill and other intangible assets	–	55,067	**55,067**	–	56,730	**56,730**
Current income tax assets	–	–	**–**	287	–	**287**
Deferred income tax assets	–	1,647	**1,647**	–	1,555	**1,555**
Other assets	17,431	1,871	**19,302**	12,056	3,080	**15,136**
Total assets	**2,570,689**	**719,156**	**3,289,845**	**1,683,399**	**609,340**	**2,292,739**
Amounts due to banks and government funds	161,616	168,678	**330,294**	297,897	71,796	**369,693**
Amounts due to customers	1,876,555	474,132	**2,350,687**	1,293,886	80,227	**1,374,113**
Other borrowed funds	14,796	36,677	**51,473**	18,539	75,275	**93,814**
Debt securities issued	18,705	–	**18,705**	–	–	**–**
Derivative financial liabilities	2,468	–	**2,468**	–	991	**991**
Current income tax liability	12,436	–	**12,436**			
Deferred income tax liabilities	–	8,446	**8,446**	–	9,688	**9,688**
Provision for guarantees and letters of credit	6,959	–	**6,959**	379	–	**379**
Other liabilities	18,880	2,231	**21,111**	11,236	336	**11,572**
Total liabilities	**2,112,415**	**690,164**	**2,802,579**	**1,621,937**	**238,313**	**1,860,250**
Net assets	**458,274**	**28,992**	**487,266**	**61,462**	**371,027**	**432,489**

29. 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:

	2016					*2015*				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Cash and cash equivalents	–	18,203	–	–	**18,203**	–	–	–	–	**–**
Amounts due from credit institutions	–	34,487	–	–	**34,487**	–	25,558	–	–	**25,558**

(Figures in tables are in thousands of Azerbaijani manats)

29. Related party disclosures (continued)

	2016					2015				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Loans outstanding at 1 January, gross	–	31,128	2,690	–	33,818	10	19,803	1,644	–	21,457
Loans issued during the year	–	172,952	4,057	291	177,300	–	47,733	6,745	–	54,478
Loan repayments during the year	–	(88,591)	(3,598)	(97)	(92,286)	(10)	(39,067)	(6,555)	–	(45,632)
Interest accrual	–	2,115	63	8	2,186	–	244	28	–	272
Foreign currency translation difference	–	6,908	81	12	7,001	–	2,415	828	–	3,243
Loans outstanding at 31 December, gross	–	124,512	3,293	214	128,019	–	31,128	2,690	–	33,818
Less: allowance for impairment at 31 December	–	(1,097)	(9)	–	(1,106)	–	(945)	(280)	–	(1,225)
Loans outstanding at 31 December, net	–	123,415	3,284	214	126,913	–	30,183	2,410	–	32,593
Interest income on loans	–	6,434	258	13	6,705	–	3,487	137	–	3,624

	2016					2015				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Deposit at 1 January	25,605	135,220	557	85,873	247,255	5,062	26,239	289	57,516	89,106
Deposits received during the year	–	405,758	5,650	81,268	492,676	18,812	123,874	121	58,937	201,744
Deposits repaid during the year	(26,740)	(93,555)	(616)	(114,906)	(235,817)	(4,200)	(15,700)	(99)	(58,726)	(78,725)
Interest accrual	–	136	–	–	136	9	522	6	125	662
Foreign currency translation difference	1,135	6,875	209	6,571	14,790	5,922	285	240	28,021	34,468
Deposits at 31 December	–	454,434	5,800	58,806	519,040	25,605	135,220	557	85,873	247,255
Amounts due to banks and government funds	–	48,317	–	–	48,317	–	289	–	–	289
Current accounts at 31 December	29,564	240,425	1,712	248,151	519,852	10,955	513,550	393	173,911	698,809
Interest expense on deposits	(467)	(12,859)	(123)	(3,176)	(16,625)	(480)	(8,133)	(8)	(3,035)	(11,656)
Guarantees issued	–	12,146	–	–	12,146	–	4,564	–	–	4,564
Letters of credit issued	–	6,465	–	–	6,465	–	2,026	–	–	2,026
Unused credit lines	182	1,787	801	231	3,001	163	558	269	34	1,024
Fee and commission income	55	3,537	8	5	3,605	14	1,426	1	1	1,442
Net gains/(losses) from foreign currencies: dealing	437	14,722	122	3,180	18,461	103	3,585	8	1,584	5,280
Other operating expenses	–	(4,810)	–	–	(4,810)	–	(4,037)	–	–	(4,037)

The Bank has guarantee from its parent received as a collateral in respect of deposits placed in local banks in the amount of AZN 6,872 thousand as at 31 December 2016 (2015 – AZN 21,219 thousand).

(Figures in tables are in thousands of Azerbaijani manats)

29. Related party disclosures (continued)

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

	2016	*2015*
Salaries and other benefits	(6,291)	(3,043)
Social security costs	(550)	(480)
Total key management compensation	**(6,841)**	**(3,523)**

30. 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% (2015: 10%) of risk-weighted assets for regulatory capital. As at 31 December 2016 and 2015 the Bank's capital adequacy ratio on this basis was as follows:

	2016	*2015*
Tier 1 capital	330,438	339,059
Tier 2 capital	75,195	16,206
Less: deductions from capital	(148,987)	(148,987)
Total regulatory capital	**256,646**	**206,278**
Risk-weighted assets	**1,136,889**	**1,199,711**
Capital adequacy ratio	**23%**	**17%**

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 11.4% (2015 – 11.4%) of risk-weighted assets for regulatory capital. As at 31 December 2016, capital adequacy ratio of PASHA Bank Georgia was 34% (31 December 2015 – 44%).

The BRSA requires banks to maintain a minimum total capital adequacy ratio of 8% (2015 – 8%) of risk-weighted assets for regulatory capital. Capital Adequacy Standard Ratio of PASHA Yatirim is calculated in accordance with BRSA. As at 31 December 2016 the bank's capital adequacy ratio was 54% (31 December 2015: 92%).