OJSC PASHA Bank

Consolidated financial statements

Year ended 31 December 2017
together with independent auditor's report

CONTENTS

Building a better working world

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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 2017, 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 a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISA). 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 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.

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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.

9 March 2018

Baku, Azerbaijan

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2017*	*2016*
Assets			
Cash and cash equivalents	5	1,465,771	1,105,769
Trading securities	6	2,224	22,669
Amounts due from credit institutions	7	592,029	728,121
Investment securities			
- available-for-sale	8	405,530	173,329
- loans and receivables	8	40,408	61,220
Derivative financial assets	18	1,665	984
Loans to customers	9	1,350,668	1,107,274
Investment property	10	1,668	1,654
Property and equipment	11	12,808	12,809
Intangible assets	12	48,954	55,067
Current income tax assets		2,154	–
Deferred income tax assets	19	640	1,647
Other assets	13	33,896	19,302
Total assets		**3,958,415**	**3,289,845**
Liabilities			
Amounts due to banks and government funds	14	399,973	330,294
Amounts due to customers	15	2,889,961	2,350,687
Other borrowed funds	16	39,105	51,473
Debt securities issued	17	81,765	18,705
Derivative financial liabilities	18	2,058	2,468
Current income tax liabilities		1,136	12,436
Deferred income tax liabilities	19	10,056	8,446
Provision for guarantees and letters of credit	21, 22	3,112	6,959
Other liabilities	13	32,100	21,111
Total liabilities		**3,459,266**	**2,802,579**
Equity			
Share capital	20	333,000	333,000
Retained earnings		113,601	83,152
Net unrealised loss on investment securities available-for-sale		(24)	(1)
Foreign currency translation reserve		52,496	71,046
Total equity attributable to shareholders of the Bank		**499,073**	**487,197**
Non-controlling interests		76	69
Total equity		**499,149**	**487,266**
Total liabilities and equity		**3,958,415**	**3,289,845**

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

9 March 2018

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 2017

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2017*	*2016*
Interest income			
Loans to customers		126,613	105,063
Amounts due from credit institutions		59,096	35,647
Investment securities available-for-sale		25,488	9,755
Cash and cash equivalents		16,740	2,122
		227,937	**152,587**
Trading securities		2,142	4,915
Finance lease receivables		1,032	–
		3,174	**4,915**
Interest expense			
Amounts due to customers		(71,534)	(40,530)
Amounts due to banks and government funds		(12,066)	(10,185)
Other borrowed funds		(1,057)	(1,757)
Debt securities issued		(4,715)	(396)
Other		–	(138)
		(89,372)	**(53,006)**
Net interest income		**141,739**	**104,496**
Reversal of provision/(provision) for impairment of interest earning assets	22	3,111	(11,447)
Net interest income after provision for impairment of interest bearing assets		**144,850**	**93,049**
Net fee and commission income	23	11,191	12,564
Net gains from trading securities		3,065	109
Net (losses)/gains from investment securities available-for-sale		(102)	84
Net gains from foreign currencies:			
- dealing		33,380	57,810
- translation differences		2,910	8,699
- operations with foreign currency derivatives		1,624	2,304
Other income		533	433
Non-interest income		**52,601**	**82,003**
Personnel expenses	24	(43,891)	(35,358)
General and administrative expenses	24	(30,927)	(33,449)
Depreciation and amortisation	11, 12	(7,451)	(6,678)
License and goodwill impairment	12	(6,236)	(3,642)
Loss on initial recognition of financial assets at fair value		–	(1,474)
Reversal of provision/(provision) for guarantees and letters of credit	22	3,844	(6,580)
Non-interest expenses		**(84,661)**	**(87,181)**
Profit before income tax expense		**112,790**	**87,871**
Income tax expense	19	(23,698)	(18,583)
Net profit for the year		**89,092**	**69,288**
Attributable to:			
- shareholders of the Bank		89,085	69,281
- non-controlling interests		7	7
		89,092	**69,288**

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 2017

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2017*	*2016*
Net profit for the year		**89,092**	**69,288**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Gross unrealised (losses)/gains on investment securities available-for-sale		(131)	208
Realised losses/(gains) on investment securities available-for-sale reclassified to the consolidated statement of profit or loss		102	(84)
Net unrealised (losses)/gains on investment securities available-for-sale	20	**(29)**	**124**
Tax effect of net (losses)/gains on investment securities available-for-sale	19	6	(25)
Foreign currency translation differences	20	(18,550)	(9,198)
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		**(18,573)**	**(9,099)**
Total comprehensive income for the year		**70,519**	**60,189**
Attributable to:			
- shareholders of the Bank		70,512	60,182
- non-controlling interests		7	7
		70,519	**60,189**

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 2017

(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 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 income/(loss) for the year	–	–	99	(9,198)	(9,099)	–	(9,099)
Total comprehensive income/(loss) for the year	–	69,281	99	(9,198)	60,182	7	60,189
Dividends to shareholders of the Bank (Note 20)	–	(5,412)	–	–	(5,412)	–	(5,412)
As at 31 December 2016	333,000	83,152	(1)	71,046	487,197	69	487,266
Net profit for the year	–	89,085	–	–	89,085	7	89,092
Other comprehensive loss for the year	–	–	(23)	(18,550)	(18,573)	–	(18,573)
Total comprehensive income/(loss) for the year	–	89,085	(23)	(18,550)	70,512	7	70,519
Dividends to shareholders of the Bank (Note 20)	–	(58,636)	–	–	(58,636)	–	(58,636)
As at 31 December 2017	333,000	113,601	(24)	52,496	499,073	76	499,149

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 2017

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2017*	*2016*
Cash flows from operating activities			
Interest received		195,836	130,157
Interest paid		(53,321)	(38,697)
Fees and commissions received		24,545	20,730
Fees and commissions paid		(13,722)	(8,117)
Net realized (losses)/gains on sale of investment securities available-for-sale		(102)	84
Net realized gain from trading securities		2,849	1,017
Realised gains less losses from dealing in foreign currencies and operations with foreign currency derivatives		35,811	60,747
Personnel expenses paid		(40,869)	(26,041)
General and administrative expenses paid		(29,839)	(32,262)
Other operating income received		1,794	382
Cash flows from operating activities before changes in operating assets and liabilities		**122,982**	**108,000**
Net (increase)/decrease in operating assets			
Trading securities		20,428	22,274
Amounts due from credit institutions		138,964	(583,565)
Loans to customers		(270,754)	(179,617)
Other assets		(4,074)	(1,095)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		96,099	(72,062)
Amounts due to customers		506,475	874,709
Other borrowed funds		(15,112)	(48,120)
Derivative financial liabilities		–	1,110
Other liabilities		5,388	(1,497)
Net cash flows from operating activities before income tax		**600,396**	**120,137**
Income tax paid		(31,552)	(6,252)
Net cash from operating activities		**568,844**	**113,885**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		(1,849,253)	(231,358)
Proceeds from sale and redemption of investment securities available-for-sale		1,619,165	78,569
Purchase of investment securities – loans and receivables		(32,888)	(27,105)
Proceeds from sale and redemption of investment securities – loans and receivables		52,841	50,627
Purchase and prepayments for property and equipment		(5,685)	(2,356)
Acquisition of intangible assets		(6,562)	(4,526)
Proceeds from sale of property and equipment		42	34
Net cash used in investing activities		**(222,340)**	**(136,115)**
Cash flows from financing activities			
Proceeds from bonds issued	29	165,216	19,258
Redemption of bonds issued	29	(101,321)	–
Dividends paid	20	(58,636)	(5,412)
Net cash from financing activities		**5,259**	**13,846**
Effect of exchange rates changes on cash and cash equivalents		8,239	92,847
Net increase in cash and cash equivalents		**360,002**	**84,463**
Cash and cash equivalents, beginning	5	1,105,769	1,021,306
Cash and cash equivalents, ending	5	**1,465,771**	**1,105,769**

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

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 2017 and 2016 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 2017 and 2016, the following shareholders owned the outstanding shares of the Bank:

Shareholders	*2017 (%)*	*2016 (%)*
PASHA Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

As at 31 December 2017 and 2016, 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 at 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 thousand as at 31 December 2017 and 2016. 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. and it 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 2017 and 2016, 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.

(Figures in tables are in thousands of Azerbaijani manats)

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 2017:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Group has provided the information for both the current and the comparative period in Note 29.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealized Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. This amendment have no effect on the Group.

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the Scope of Disclosure Requirements

The amendments clarify that certain disclosure requirements in IFRS 12 apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified as held for sale or included in a disposal group. These amendments did not affect the Group's financial statements.

Basis of consolidation

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

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

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

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Business combinations

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

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

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

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

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

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

Fair value measurement

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

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

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

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

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

3. Summary of significant accounting policies (continued)

Fair value measurement (continued)

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

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

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

Financial assets

Initial recognition

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

Date of recognition

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

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in Net 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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Financial assets (continued)

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Derivative financial instruments (continued)

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

Borrowings

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

Leases

Operating – Bank as lessee

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

Measurement of financial instruments at initial recognition

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

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

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

Offsetting of financial instruments

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Impairment of financial assets

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

Amounts due from credit institutions and loans to customers

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

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

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

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.

3. Summary of significant accounting policies (continued)

Impairment of financial assets (continued)

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.

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)

Intangible assets

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

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

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

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

Provisions

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

Retirement and other employee benefit obligations

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

Share capital

Share capital

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

Dividends

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

Contingencies

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

Recognition of income and expenses

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Recognition of income and expenses (continued)

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense. Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Fee and commission income and expense

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

Foreign currency translation

The consolidated financial statements are presented in AZN, which is the Group's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit as gains less losses from foreign currencies – translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

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

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

The Group used the following official exchange rates at 31 December 2017 and 2016 in the preparation of these consolidated financial statements:

	2017	*2016*
1 US dollar	AZN 1.7001	AZN 1.7707
1 euro	AZN 2.0307	AZN 1.8644
1 Georgian lari	AZN 0.6514	AZN 0.6663
1 Turkish lira	AZN 0.4499	AZN 0.5023

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective

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

IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 addresses classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required but restating comparative information is not compulsory.

The Group plans to adopt the new standard by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018 and will not restate comparative information. The Group is in the process of quantifying the effect of adoption of IFRS 9, however no reasonable estimate of this effect is yet available.

(a) Classification and measurement

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

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

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

The classification and measurement of financial liabilities remain largely unchanged from the current IAS 39 requirements. Derivatives will continue to be measured at FVPL.

The Group expects to continue measuring at fair value all financial assets currently held at fair value. Most quoted equity shares currently held as available-for-sale with gains and losses recorded in other comprehensive income will, instead, be measured at fair value through profit or loss, which will increase volatility in recorded profit or loss. The revaluation reserve related to those securities will be reclassified to retained earnings. The Group expects to designate some shares in non-listed companies as FVOCI.

Trading debt and equity securities will continue to be classified as FVPL. Debt securities currently classified as available-for-sale are expected to be measured at FVOCI under IFRS 9 as the Group expects not only to hold these assets to collect contractual cash flows, but also to sell a significant amount on a relatively frequent basis. The vast majority of loans are expected to satisfy the SPPI criterion and will continue to be measured at amortised cost, however some of the loans will be reclassified as FVPL.

(b) Impairment

IFRS 9 requires the Group to record an allowance for expected credit losses (ECL) on all of its debt financial assets at amortised cost or FVOCI, as well as loan commitments and financial guarantees. The allowance is based on the ECL 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 is based on the ECL over the life of the asset. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the lifetime ECL.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

The Group has established a methodology for assigning rating to customer in following segments of portfolio: Corporate customers, SME customers, Financial Institutions and Retail/Individual customers. Assigned rating is returning PD on "customer by customer" base.

The Group has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition. The Group groups its loans into Stage 1, Stage2, Stage 3 and POCI. The Group calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. In its ECL models, the Group relies on a broad range of forward looking information as economic inputs, integrated in estimates of credit risk components (PD, LGD and EAD). Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The Group considers that there has been a significant increase in credit risk when the credit rating has deteriorated significantly since initial recognition. Level of significant deterioration differs from segment to segment and varies from 2 to 3 notches or defined score threshold. The Group also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations when the borrower becomes 90 days past due on its contractual payments depending on segment. The Group considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements. As a part of a qualitative assessment of whether a customer is in default, the Group also considers a variety of instances that may indicate unlikeliness to pay.

The Group calculates ECLs on an individual basis for POCI assets, significant assets with factors of credit impairment and certain assets with factors of significant increase of credit risk. The Group calculates ECL on a collective basis for all other classes of assets which it groups into homogeneous borrowers.

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014, and amended in April 2016, will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. The Group plans to adopt the new standard using the modified retrospective method by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018, without restating comparative information.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, interest and fee income integral to financial instruments and leases will fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (IFRS 9 and IFRS 16 *Leases*). As a result, the majority of the Group's income will not be impacted by the adoption of this standard. The Group currently does not expect a material effect from initial application of IFRS 15.

IFRS 16 Leases

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

3. Summary of significant accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

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

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

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. In 2018, the Group will continue to assess the potential effect of IFRS 16 on its financial statements.

Transfers of Investment Property – Amendments to IAS 40

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if it is possible without the use of hindsight. Effective for annual periods beginning on or after 1 January 2018. The Group does not expect a material effect from application of these amendments.

Annual improvements 2014-2016 cycle (issued in December 2016)

These improvements include:

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the advance consideration. The Interpretation is effective for annual periods beginning on or after 1 January 2018. Since the Group's current practice is in line with the Interpretation, the Group does not expect any effect on its financial statements.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

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

An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The Interpretation also addresses the assumptions an entity makes about the examination of tax treatments by taxation authorities, as well as how it considers changes in facts and circumstances.

The interpretation is effective for annual reporting periods beginning on or after 1 January 2019, but certain transition reliefs are available. The Group will apply interpretation from its effective date. Since the Group operates in a complex tax environment, applying the Interpretation may affect its financial statements and the required disclosures. In addition, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

4. Significant accounting judgments and estimates

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

Fair value of financial instruments

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

Allowance for loan impairment

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

The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions.

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

Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. If actual results differ from those estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in the consolidated statement of profit or loss (Note 19).

Impairment of 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 2017 was AZN 31,587 thousand (31 December 2016 – AZN 42,228 thousand). More details are provided in Note 12.

(Figures in tables are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	*2016*
Cash on hand	71,250	114,917
Current accounts with the CBAR, the NBG and the CBRT	388,733	534,087
Current accounts with other credit institutions	58,594	91,145
Time deposits with credit institutions up to 90 days	947,194	365,620
Cash and cash equivalents	**1,465,771**	**1,105,769**

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 3,199 thousand (31 December 2016 – AZN 27,114 thousand) and AZN 55,395 thousand (31 December 2016 – AZN 64,031 thousand), respectively.

As at 31 December 2017, the Group placed AZN 947,194 thousand in time deposits with one resident bank and eight non-resident banks maturing through February 2018 with interest rates ranging between 0.9% and 14.99% p.a. (31 December 2016 – AZN 365,620 thousand matured in January 2017 with interest rates ranging between 0.4% and 14.3% p.a.).

6. Trading securities

Trading securities comprise:

	2017	*2016*
Corporate bonds	2,224	19,431
Bonds of financial institutions	–	3,238
Trading securities	**2,224**	**22,669**

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2017	*2016*
Time deposits with banks	466,370	74,558
Loans to banks	22,789	93,727
Obligatory reserve with the CBAR, the NBG and the CBRT	72,540	47,007
Restricted deposits	31,201	38,742
Time deposit with the CBAR	–	474,994
	592,900	**729,028**
Less: allowance for impairment (Note 22)	(871)	(907)
Amounts due from credit institutions	**592,029**	**728,121**

As at 31 December 2017, time deposits with banks mature between January 2018 and December 2018 (31 December 2016 – between January 2017 and December 2017) with interest rates ranging between 0% and 2.2% p.a. (31 December 2016 – between 0.5% and 15.00% p.a.).

As at 31 December 2017, the Group had outstanding amount of AZN 21,918 thousand (31 December 2016 – AZN 45,876 thousand) of secured loan issued to one resident commercial bank (31 December 2016 – two resident commercial banks) and AZN 871 thousand (31 December 2016 – AZN 47,851 thousand) of unesecured loans issued to one resident commercial bank (31 December 2016 – six resident commercial banks) with contractual maturity through December 2018 (31 December 2016 – December 2017) and with interest rates ranging between 11.5% and 15% p.a. (31 December 2016 – 3% and 22% p.a.).

(Figures in tables are in thousands of Azerbaijani manats)

7. Amounts due from credit institutions (continued)

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% (2016 – 0.5%) and 1.0% (2016 – 1.0%) 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% (2016 – 7%) and 20% (2016 – 20%) 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 (2016 – 4%-10.5%) and 4%-24% for foreign currency deposits and other liabilities according to their maturities (2016 – 4.5%-24.5%).

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 15).

8. Investment securities

Investment securities available-for-sale comprise:

	2017		*2016*	
	Carrying value	*Nominal value*	*Carrying value*	*Nominal value*
Notes issued by the Central Bank of Azerbaijan Republic	282,237	283,781	65,360	65,758
Bonds of the Ministry of Finance of the Republic of Azerbaijan	103,614	107,050	68,827	72,819
Corporate bonds	9,146	9,009	29,028	28,776
US treasury bonds	4,233	4,250	–	–
Bonds of financial institutions	4,015	4,089	7,002	6,988
Turkey Government Bonds	2,285	2,250	3,112	3,064
Investment securities available-for-sale	**405,530**	**410,429**	**173,329**	**177,405**

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

	2017		*2016*	
	%	*Maturity*	*%*	*Maturity*
Notes issued by the Central Bank of Azerbaijan Republic	9.54%-14.56%	January 2018	14.34%-14.39%	January 2017
Bonds of the Ministry of Finance of the Republic of Azerbaijan	7.22%-16.46%	February 2018 – November 2019	2.49%-20.88%	January 2017 – December 2017
Corporate bonds	2.43%-18.28%	February 2020 – December 2021	4.97%-10.38%	October 2021 – December 2021
US treasury bonds	1.80%-1.88%	July 2022 – December 2022	–	–
Bonds of financial institutions	2.01%-17.21%	July 2018 – October 2027	1.38%-11.84%	January 2017 – September 2017
Turkey Government Bonds	11.37%	July 2018	9.26%-10.64%	March 2017 – June 2017

Loans and receivables comprise:

	2017	*2016*
Certificates of deposits of financial institutions	17,489	17,686
Bonds of financial institutions	14,382	14,353
Corporate bonds	7,932	8,641
Treasury bonds of the Ministry of Finance of Georgia	765	20,674
	40,568	**61,354**
Less: allowance for impairment (Note 22)	(160)	(134)
Loans and receivables	**40,408**	**61,220**

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers

Loans to customers comprise:

	2017	*2016*
Legal entities	1,258,722	1,046,055
Individuals	155,270	123,552
Loans to customers (gross)	**1,413,992**	**1,169,607**
Less – allowance for impairment (Note 22)	(63,324)	(62,333)
Loans to customers (net)	**1,350,668**	**1,107,274**

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

	Corporate lending	*Individual lending*	*Total*
31 December 2017			
Individual impairment	(44,401)	(2,026)	**(46,427)**
Collective impairment	(13,613)	(3,284)	**(16,897)**
	(58,014)	**(5,310)**	**(63,324)**
Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance	**99,105**	**3,079**	**102,184**

	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**

Loans are made in the following industry sectors:

	2017	*2016*
Trade and services	485,670	469,902
Individuals	155,270	123,552
Non-banking credit organizations	155,257	125,530
Manufacturing	141,134	119,577
Construction	135,712	113,895
Agriculture and food processing	82,943	48,438
Mining	69,175	64,622
Energy	53,627	13,782
Transport and telecommunication	46,346	43,671
Leasing	32,044	6,345
Other	56,814	40,293
Total loans (gross)	**1,413,992**	**1,169,607**

As at 31 December 2017, loans granted to top 7 customers (31 December 2016 – 6 customers) which individually exceeded 5% of the Group's equity, amounted to AZN 335,080 thousand (31 December 2016 – AZN 299,486 thousand).

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2017, comprised AZN 5,595 thousand (2016 – AZN 5,435 thousand).

(Figures in tables are in thousands of Azerbaijani manats)

9. Loans to customers (continued)

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;
- The Group also obtains guarantees from parent company for loans to their customers.

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.

Finance lease receivables

Included in corporate lending portfolio are finance lease receivables. The analysis of finance lease receivables at 31 December 2017 (31 December 2016 – nil) is as follows:

	Not later than 1 year	*Later than 1 year and not later than 5 years*	*Later than 5 years*
Gross investment in finance leases	10,984	6,808	–
Unearned future finance income on finance leases	(75)	(2,029)	–
Net investment in finance leases	**10,909**	**4,779**	**–**

10. 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 2017, the fair value of this investment property amounted to AZN 1,668 thousand (31 December 2016 – AZN 1,654 thousand). The Bank recognized impairment in the amount of AZN 332 thousand as at 31 December 2017 (31 December 2016 – AZN 346 thousand) due to decrease in recoverable amount.

(Figures in tables are in thousands of Azerbaijani manats)

11. 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 improve-ments*	*Total*
Cost								
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**
Additions	–	–	3,050	1,377	203	28	89	**4,747**
Disposals	–	–	(482)	(251)	(47)	(17)	–	**(797)**
Foreign currency translation difference	–	–	(39)	(109)	(7)	(12)	(33)	**(200)**
31 December 2017	**415**	**4,107**	**12,606**	**9,676**	**1,287**	**642**	**3,161**	**31,894**
Accumulated depreciation								
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)**
Depreciation charge	–	(205)	(1,836)	(1,917)	(183)	(115)	(432)	**(4,688)**
Disposals	–	–	482	214	47	14	1	**758**
Foreign currency translation difference	–	–	31	102	2	10	34	**179**
31 December 2017	**–**	**(1,147)**	**(7,797)**	**(6,580)**	**(884)**	**(552)**	**(2,126)**	**(19,086)**
Net book value								
31 December 2017	**415**	**2,960**	**4,809**	**3,096**	**403**	**90**	**1,035**	**12,808**
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**

(Figures in tables are in thousands of Azerbaijani manats)

12. Intangible assets

The movements in intangible assets were as follows:

	Goodwill	*Banking license*	*Licenses*	*Computer software*	*Total*
Cost					
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**
Additions	–	–	2,906	4,468	**7,374**
Disposals	–	–	(281)	(1)	**(282)**
Foreign currency translation difference	–	(4,405)	(17)	(126)	**(4,548)**
31 December 2017	**3,642**	**37,823**	**11,450**	**11,830**	**64,745**
Accumulated amortization					
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)**
Amortisation charge	–	–	(1,494)	(1,269)	**(2,763)**
Disposals	–	–	281	1	**282**
Impairment	–	(6,236)	–	–	**(6,236)**
Foreign currency translation difference	–	–	5	55	**60**
31 December 2017	**(3,642)**	**(6,236)**	**(3,590)**	**(2,323)**	**(15,791)**
Net book value					
31 December 2017	–	**31,587**	**7,860**	**9,507**	**48,954**
31 December 2016	–	**42,228**	**6,460**	**6,379**	**55,067**
31 December 2015	**3,885**	**45,045**	**4,102**	**3,698**	**56,730**

Impairment testing of intangible assets with indefinite lives as at 31 December 2017

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

The carrying amount of the banking license acquired allocated to the cash-generating units is AZN 31,587 thousand (31 December 2016 – AZN 42,228 thousand).

Key assumptions used in fair value calculation

As at 31 December 2017, recoverable amount of cash generating unit have been determined based on value in use method. Absence of the market transactions for comparison purposes has lead the Bank to change the method of valuation from fair value to value in use approach. The current valuation is based on the information about historical and prospective financials and strategic initiatives of the Bank, and other third party information available on the market.

(Figures in tables are in thousands of Azerbaijani manats)

12. Intangible assets (continued)

Key assumptions used in fair value calculation (continued)

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

- Financial performance (including current and forecasted results)
- Cost of equity
- ROE (including current and forecasted results)
- Growth rate of loan portfolio
- GDP growth rate in Turkey
- Leverage ratio
- Period of discounted cash flow of 8 years
- Long term inflation growth rate of 3%

The following rates are used by the Bank for calculation of Cost of Equity:

	2017
Cost of equity calculation	
US Risk-Free Rate	2.7%
US Equity Market risk premium	5.1%
Country risk premium	3.1%
Beta	0.82
Cost of equity USD	**9.9%**
USA inflation rate	**2.3%**
Turkey inflation rate	**5.5%**
Cost of equity TRY	**13.3%**

As a result of the valuation, recoverable amount of cash generating unit amounted to AZN 151,359 thousand. Accordingly, the license was partially impaired by amount of AZN 6,236 thousand. The impairment loss was mainly due to decrease in return on equity (2016 – 18.2%).

Sensitivity for reasonably possible increase in discount rate by 1% (from 13.3% to 14.3%) would result in additional impairment of AZN 24,379 thousand under the same assumption of the long-term Return on Equity.

Impairment testing of goodwill and intangible assets with indefinite lives as at 31 December 2016

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

12. Intangible assets (continued)

Key assumptions used in fair value calculation (continued)

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

		2016
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.

13. Other assets and liabilities

Other assets comprise:

	2017	*2016*
Other financial assets		
Settlements on money transfers	11,267	5,598
Clearance cheque accounts	1,443	2,048
Accrued commission receivable on guarantees and letters of credit	466	338
Other	55	101
	13,231	**8,085**
Other non-financial assets		
Repossessed collateral	15,287	5,280
Deferred expenses	2,308	3,394
Prepayments for acquisition of property, equipment and intangible assets	1,771	1,362
Other prepayments	1,299	1,017
Taxes, other than income tax	–	164
	20,665	**11,217**
Other assets	**33,896**	**19,302**

As at 31 December 2017, clearance cheque accounts consist of receivables from other banks for which cheques stand as collateral.

As at 31 December 2017 deferred expenses of AZN 1,297 thousand (31 December 2016 – AZN 1,487 thousand) related to long term software support.

(Figures in tables are in thousands of Azerbaijani manats)

13. Other assets and liabilities (continued)

Other liabilities comprise:

	2017	*2016*
Other financial liabilities		
Settlements on money transfer	11,804	3,464
Clearance cheque accounts	1,443	2,048
Accrued expenses	626	535
Other	720	175
	14,593	**6,222**
Other non-financial liabilities		
Payable to employees	16,064	13,715
Deferred income	965	731
Taxes, other than income tax	139	94
Other provision	118	132
Other	221	217
	17,507	**14,889**
Other liabilities	**32,100**	**21,111**

14. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	2017	*2016*
Loans from the National Fund for Support of Entrepreneurship	138,747	99,906
Long-term deposits from banks	131,540	67,287
Short-term deposits from banks	107,160	90,136
Amount due to Azerbaijan Mortgage Fund	11,201	4,826
Amount due to IT Development Fund	5,251	5,013
Loans from the CBAR and NBG	1,956	41,676
Correspondent accounts with other banks	4,118	21,450
Amounts due to banks and government funds	**399,973**	**330,294**

As at 31 December 2017, the Group had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 138,747 thousand (31 December 2016 – AZN 99,906 thousand), maturing through December 2027 (31 December 2016 – through August 2026), 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 2016 – 6% p.a.).

As at 31 December 2017, the Group received long-term funds from one non-resident commercial bank (31 December 2016 – none) and one resident commercial bank (31 December 2016 – one) comprising AZN 131,540 thousand maturing through January 2019 with interest rates ranging between 1.00% and 2.50% p.a. (31 December 2016 – February 2018 with interest rate 2.00% p.a.).

As at 31 December 2017, the Group received short-term funds from fifteen non-resident commercial banks (31 December 2016 – five) and one resident commercial bank (31 December 2016 – none) comprising AZN 107,160 thousand (31 December 2016 – AZN 90,136 thousand) maturing through August 2018 (31 December 2016 – August 2017) and with interest rates ranging between 0.10% and 15.20% p.a. (31 December 2016 – 1.60% and 12.00% p.a.).

As at 31 December 2017, the Group had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 11,201 thousand (31 December 2016 – AZN 4,826 thousand), maturing through October 2047 (31 December 2016 – through December 2040) and bearing interest rate of 4.0% p.a.

As at 31 December 2017, the Group had loans refinanced from the IT Development Fund amounting to AZN 5,251 thousand (31 December 2016 – AZN 5,013 thousand), maturing through December 2021 (31 December 2016 – through December 2021) and bearing interest rate of 1.0% p.a.

(Figures in tables are in thousands of Azerbaijani manats)

15. Amounts due to customers

The amounts due to customers include the following:

	2017	*2016*
Demand deposits	1,856,582	998,925
Time deposits	1,033,379	1,351,762
Amounts due to customers	**2,889,961**	**2,350,687**
Held as security against guarantees issued (Note 21)	**38,481**	**8,123**

As at 31 December 2016, 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:

	2017	*2016*
Individuals	775,936	532,932
Investment holding companies	517,692	449,016
Trade and services	491,191	372,380
Manufacturing	455,919	542,550
Transport and communication	218,090	90,276
Construction	128,187	166,766
Insurance	87,244	46,254
Mining	75,542	25,238
Hotel business	48,395	42,478
Agriculture	26,096	10,454
Public organizations	18,758	25,474
Non banking credit organizations	9,218	22,315
Energy	8,946	3,232
Other	28,747	21,322
Amounts due to customers	**2,889,961**	**2,350,687**

As at 31 December 2017, customer deposits included balances with five (31 December 2016 – five) largest customers comprised AZN 1,298,632 thousand or 45% of the total customer deposits portfolio (31 December 2016 – AZN 1,100,919 thousand or 47% of the total customer deposits portfolio).

16. Other borrowed funds

As at 31 December 2017, other borrowed funds included balances with three (31 December 2016 – four) foreign banks amounting to AZN 39,105 thousand (31 December 2016 – AZN 51,473 thousand), maturing through April 2021 (31 December 2016 – through April 2021) and bearing interest rates ranging between 1.47% and 3.72% p.a. (31 December 2016 – between 1.48% and 3.75% p.a.). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Group.

17. Debt securities issued

As at 31 December 2017, PASHA Yatirim Bankasi A.S. had issued interest-bearing bonds with carrying amount of AZN 81,765 thousand (31 December 2016 – AZN 18,705 thousand) maturing in December 2022 (31 December 2016 – matured in January 2017). Bonds issued by the bank as at 31 December 2017, bear annual interest rates ranging from 5% to 12.1% (31 December 2016 – 12.1%).

(Figures in tables are in thousands of Azerbaijani manats)

18. Derivative financial instruments

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

	2017			*2016*		
	Notional amount	*Fair values*		*Notional amount*	*Fair value*	
		Asset	*Liability*		*Asset*	*Liability*
Foreign exchange contracts						
Forwards and swaps – foreign	59,389	40	(2,058)	26,441	320	(983)
Forwards and swaps – domestic	8,501	1,625	–	37,316	664	(495)
Options – domestic	–	–	–	2,162	–	(990)
Total derivative assets/ (liabilities)		**1,665**	**(2,058)**		**984**	**(2,468)**

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 2017 and 2016, the Group has positions in the following types of derivatives:

Forwards

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

Swaps

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

Options

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

19. Taxation

The corporate income tax expense comprises:

	2017	*2016*
Current tax charge	(20,219)	(19,377)
Deferred tax (charge)/credit – origination and reversal of temporary differences	(3,473)	769
Less: deferred tax recognised in other comprehensive income	(6)	25
Income tax expense	**(23,698)**	**(18,583)**

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

	2017	*2016*
Net losses/(gains) on investment securities available-for-sale	6	(25)
Income tax credited/(charged) to other comprehensive income	**6**	**(25)**

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

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

	2017	*2016*
Profit before income tax expense	**112,790**	**87,871**
Statutory tax rate	20%	20%
Theoretical tax expense at the statutory rate	**(22,558)**	**(17,574)**
Tax effect of non-deductible expenses	(951)	(1,218)
Effect from change in tax legislation	(271)	–
Prior year tax actualization	–	(302)
Tax effect of tax-exempt income	89	165
Effect of difference in tax rate in foreign country	151	185
Other	(158)	161
Income tax expense	**(23,698)**	**(18,583)**

Deferred tax assets and liabilities as at 31 December 2017 and 2016 and their movements for the respective years comprise:

		Origination and reversal of temporary differences				*Origination and reversal of temporary differences*			
	2015	*In the statement of profit or loss*	*In other compre-hensive income*	*Transla-tion difference*	*2016*	*In the statement of profit or loss*	*In other compre-hensive income*	*Transla-tion difference*	*2017*
Tax effect of deductible temporary differences									
Tax losses carried forward	1,316	(815)	–	35	536	(552)	–	16	–
Trading securities	572	1	–	–	573	(573)	–	–	–
Amounts due from credit institutions	–	4,024	–	–	4,024	(4,024)	–	–	–
Loans to customers	1,246	(841)	–	(10)	395	(139)	–	(21)	235
Investment securities	–	–	15	–	15	–	6	–	21
Investment property	66	3	–	–	69	(3)	–	–	66
Property and equipment	48	103	–	–	151	(155)	–	4	–
Derivative financial liabilities	193	140	–	–	333	(18)	–	–	315
Provision for guarantees and letters of credit	–	318	–	–	318	(318)	–	–	–
Other liabilities	902	2,098	–	(85)	2,915	458	–	(26)	3,347
Deferred tax asset	**4,343**	**5,031**	**15**	**(60)**	**9,329**	**(5,324)**	**6**	**(27)**	**3,984**
Tax effect of taxable temporary differences									
Amounts due from credit institutions	(2,019)	2,019	–	–	–	(2,618)	–	–	(2,618)
Derivative financial assets	–	(169)	–	–	(169)	(156)	–	–	(325)
Investment securities	(13)	–	(40)	44	(9)	8	–	–	(1)
Loans to customers	(257)	146	–	(7)	(118)	(2,677)		(3)	(2,798)
Property and equipment	(414)	176	–	1	(237)	132	–	5	(100)
Intangible assets	(92)	25	–	(1)	(68)	44	–	(1)	(25)
Other assets	–	(350)	–	25	(325)	(561)	–	–	(886)
Amounts due to banks and government funds	–	(222)	–	–	(222)	222	–	–	–
Amounts due to customers	–	(6,534)	–	–	(6,534)	6,534	–	–	–
Provision for guarantees and letters of credit	(672)	672	–	–	–	(330)	–	–	(330)
Banking license	(9,009)	–	–	563	(8,446)	1,247	–	882	(6,317)
Deferred tax liabilities	**(12,476)**	**(4,237)**	**(40)**	**625**	**(16,128)**	**1,845**	**–**	**883**	**(13,400)**
Net deferred tax assets/(liabilities)	**(8,133)**	**794**	**(25)**	**565**	**(6,799)**	**(3,479)**	**6**	**856**	**(9,416)**

(Figures in tables are in thousands of Azerbaijani manats)

19. Taxation (continued)

Deferred taxes in the consolidated statement of financial position as at 31 December 2017 and 2016 can be reconciled as follows:

	2017	*2016*
Deferred tax assets	640	1,647
Deferred tax liabilities	(10,056)	(8,446)
Net deferred tax liabilities	**(9,416)**	**(6,799)**

20. Equity

As at 31 December 2017 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 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.

On 25 April 2017 Shareholders of the Bank declared dividends totalling AZN 58,636 thousand on ordinary shares (AZN 5,864 per share) which was paid as at 31 December 2017.

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 18,550 thousand (2016 – AZN 9,198 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.

21. Commitments and contingencies

Operating environment

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

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

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

Furthermore, during 2017 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani manat. This policy is expected to continue in 2018 with the aim of maintaining macroeconomic stability.

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

21. Commitments and contingencies (continued)

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 2017 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.

Compliance with the CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2017 and 2016, 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 2017 the Bank's ratio was 25.27% (31 December 2016 – 18.94%);

b) Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 31 December 2017 the Bank's ratio was 39.41% (31 December 2016 – 39.55%);

c) Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 31 December 2017 the Bank's ratio was 57.85% (31 December 2016 – 58.05%).

Throughout the year the Bank submitted information regarding these breaches to the Financial Markets Supervision Authority (the "FMSA") 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.

(Figures in tables are in thousands of Azerbaijani manats)

21. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

Financial commitments and contingencies comprise:

	2017	*2016*
Credit-related commitments		
Guarantees issued	390,089	239,314
Unused credit lines	153,616	86,545
Letters of credit	6,441	12,940
	550,146	338,799
Operating lease commitments		
Not later than 1 year	4,565	4,197
Later than 1 year but not later than 5 years	16,487	16,699
Later than 5 years	1,377	4,780
	22,429	25,676
Less – provisions (Note 22)	(3,112)	(6,959)
Commitments and contingencies (before deducting collateral)	569,463	357,516
Less – cash held as security against guarantees issued (Note 15)	(38,481)	(8,123)
Commitments and contingencies	530,982	349,393

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

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

	2017						
	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	(58,089)	(4,244)	(62,333)	(907)	(134)	(63,374)	(6,959)
(Charge)/reversal for the yea	6,376	(3,275)	3,101	36	(26)	3,111	3,844
Amounts written off	1,765	2,363	4,128	–	–	4,128	–
Recovery	(8,234)	(154)	(8,388)	–	–	(8,388)	–
Exchange difference	168	–	168	–	–	168	3
At 31 December	(58,014)	(5,310)	(63,324)	(871)	(160)	(64,355)	(3,112)

	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)/reversal 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)

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.

(Figures in tables are in thousands of Azerbaijani manats)

23. Net fee and commission income

Net fee and commission income comprise:

	2017	*2016*
Servicing plastic card operations	8,224	4,569
Settlements operations	8,103	5,140
Guarantees and letters of credit	6,313	5,874
Cash operations	1,681	3,105
Securities operations	225	1,127
Other	285	850
Fee and commission income	**24,831**	**20,665**
Servicing plastic card operations	(7,828)	(4,607)
Settlements operations	(2,810)	(1,706)
Guarantees and letters of credit	(1,238)	(850)
Cash operations	(1,123)	(495)
Securities operations	(14)	(8)
Other	(627)	(435)
Fee and commission expense	**(13,640)**	**(8,101)**
Net fee and commission income	**11,191**	**12,564**

24. Personnel, general and administrative expenses

Personnel expenses comprise:

	2017	*2016*
Salaries and bonuses	(33,107)	(27,986)
Social security costs	(6,369)	(5,013)
Other employee related expenses	(4,415)	(2,359)
Total personnel expenses	**(43,891)**	**(35,358)**

General and administrative expenses comprise:

	2017	*2016*
Professional services	(8,502)	(7,552)
Operating leases	(6,987)	(6,883)
Software cost	(3,298)	(2,291)
Advertising costs	(2,237)	(1,943)
Charity and sponsorship	(1,997)	(8,806)
Insurance	(1,330)	(896)
Membership fees	(910)	(290)
Repair and maintenance	(840)	(851)
Utilities	(780)	(641)
Transportation and business trip expenses	(613)	(505)
Entertainment	(611)	(404)
Communications	(606)	(486)
Security expenses	(595)	(400)
Taxes, other than income tax	(430)	(505)
Impairment of investment property	(338)	(14)
Stationery	(282)	(258)
Printing expenses	(28)	(65)
Other expenses	(543)	(659)
Total general and administrative expenses	**(30,927)**	**(33,449)**

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management

Introduction

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

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

Risk management structure

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

Board of Directors

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

Audit Committee

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

Management Board

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

Risk Committee

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

Risk Management

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

Bank Treasury

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

Internal Audit

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

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.

25. Risk management (continued)

Introduction (continued)

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

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

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

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

Risk mitigation

Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

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

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

Credit risk

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

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

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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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.

Credit quality per class of financial assets

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

	Notes	*Neither past due nor impaired*			*Past due but not impaired*	*Individually impaired*	*Total*
		High grade	*Standard grade*	*Sub-standard grade*			
31 December 2017							
Cash and cash equivalents (excluding cash on hand)	5	388,733	1,005,788	–	–	–	**1,394,521**
Trading securities	6	–	2,224	–	–	–	**2,224**
Amounts due from credit institutions	7	72,540	519,489	–	–	871	**592,900**
Investment securities – available-for-sale	8	392,369	13,161	–	–	–	**405,530**
Loans and receivables	8	40,568	–	–	–	–	**40,568**
Derivative financial assets	18	–	1,665	–	–	–	**1,665**
Loans to customers	9						
Corporate lending		–	1,024,510	23,716	111,391	99,105	**1,258,722**
Individual lending		–	143,037	4,455	4,699	3,079	**155,270**
Other financial assets	13	–	13,231	–	–	–	**13,231**
Total		**894,210**	**2,723,105**	**28,171**	**116,090**	**103,055**	**3,864,631**

	Notes	*Neither past due nor impaired*			*Past due but not impaired*	*Individually impaired*	*Total*
		High grade	*Standard grade*	*Sub-standard grade*			
31 December 2016							
Cash and cash equivalents (excluding cash on hand)	5	534,087	456,765	–	–	–	**990,852**
Trading securities	6	–	22,669	–	–	–	**22,669**
Amounts due from credit institutions	7	73,295	647,954	–	6,872	907	**729,028**
Investment securities – available-for-sale	8	162,975	10,354	–	–	–	**173,329**
Loans and receivables	8	59,334	2,020	–	–	–	**61,354**
Derivative financial assets	18	–	984	–	–	–	**984**
Loans to customers	9						
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	13	–	8,085	–	–	–	**8,085**
Total		**829,691**	**2,056,491**	**145,232**	**27,149**	**97,345**	**3,155,908**

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)

25. 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 2017	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans to customers:					
Corporate lending	10,477	8,499	7,708	84,707	**111,391**
Individual lending	278	4	–	4,417	**4,699**
Total	**10,755**	**8,503**	**7,708**	**89,124**	**116,090**

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**

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.

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.

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Credit risk (continued)

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:

	2017				*2016*			
	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	608,263	714,111	143,397	**1,465,771**	692,775	403,189	9,805	**1,105,769**
Trading securities	–	2,224	–	**2,224**	22,669	–	–	**22,669**
Amounts due from credit institutions	45,250	491,312	55,467	**592,029**	627,610	48,206	52,305	**728,121**
Investment securities	389,907	12,344	43,687	**445,938**	161,876	10,114	62,559	**234,549**
Derivative financial assets	1,625	–	40	**1,665**	984	–	–	**984**
Loans to customers	958,190	319,730	72,748	**1,350,668**	841,806	202,110	63,358	**1,107,274**
Other financial assets	11,788	1,443	–	**13,231**	6,037	2,048	–	**8,085**
	2,015,023	**1,541,164**	**315,339**	**3,871,526**	**2,353,757**	**665,667**	**188,027**	**3,207,451**
Financial liabilities								
Amounts due to banks and government funds	324,582	48,941	26,450	**399,973**	251,159	50,782	28,353	**330,294**
Amounts due to customers	2,848,654	14,415	26,892	**2,889,961**	2,317,515	2,506	30,666	**2,350,687**
Other borrowed funds	–	39,105	–	**39,105**	–	51,473	–	**51,473**
Derivative financial liabilities	–	2,058	–	**2,058**	1,663	805	–	**2,468**
Debt securities issued	42,476	39,289	–	**81,765**	–	18,705	–	**18,705**
Other financial liabilities	13,052	1,456	85	**14,593**	4,025	2,048	149	**6,222**
	3,228,764	**145,264**	**53,427**	**3,427,455**	**2,574,362**	**126,319**	**59,168**	**2,759,849**
Net assets/ (liabilities)	**(1,213,741)**	**1,395,900**	**261,912**	**444,071**	**(220,605)**	**539,348**	**128,859**	**447,602**

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)

25. 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 2017 and 2016, these ratios were as follows:

	2017, %	*2016, %*
Instant Liquidity Ratio (30% is the minimum required by the CBAR) (assets receivable or realisable within one day/liabilities repayable on demand)	53	82

As at 31 December 2017, liquidity ratio of PASHA Bank Georgia JSC (average volume of liquid assets/average volume of liabilities) based on requirements established by the NBG was 47% (31 December 2016 – 39%). Minimum required level of liquidity by NBG is 30%.

As at 31 December 2017, liquidity ratio of PASHA Yatirim Bankasi A.S. based on requirements established by the CBRT was 220% (31 December 2016 – 295%). 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 2017 and 2016 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 2017*
As at 31 December 2017					
Amounts due to banks and government funds	173,361	52,735	124,869	64,654	**415,619**
Amounts due to customers	1,986,147	569,100	379,726	–	**2,934,973**
Other borrowed funds	3,370	12,285	24,497	–	**40,152**
Gross settled financial liabilities					
- Contractual amounts payable	(19,609)	(5,079)	–	–	**(24,688)**
- Contractual amounts receivable	19,260	5,240	–	–	**24,500**
Net settled derivative financial liabilities	569	1,489	–	–	**2,058**
Debt securities issued	39,919	–	52,713	–	**92,632**
Other financial liabilities	14,593	–	–	–	**14,593**
Total undiscounted financial liabilities	**2,217,610**	**635,770**	**581,805**	**64,654**	**3,499,839**

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**

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Liquidity risk and funding management (continued)

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

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Maturity undefined*	*Total*
As at 31 December 2017	278,494	151,338	70,835	–	49,479	**550,146**
As at 31 December 2016	135,990	123,340	7,651	26,170	45,648	**338,799**

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 2017. The Group does not have substantial amount of floating rate non-trading financial instruments as at 31 December 2017 and 2016.

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)

25. Risk management (continued)

Currency risk (continued)

As at 31 December 2017, the Group had the following exposure to foreign currency exchange rate risk:

	AZN	*USD*	*EUR*	*GEL*	*TRY*	*Other*	*Total 2017*
Financial assets							
Cash and cash equivalents	196,085	865,637	379,731	8,305	4,499	11,514	**1,465,771**
Trading securities	–	–	–	–	2,224	–	**2,224**
Amounts due from credit institutions	45,244	456,286	66,911	5,237	–	18,351	**592,029**
Investment securities	385,851	27,582	–	22,919	6,307	3,279	**445,938**
Derivative financial assets	1,625	–	–	40	–	–	**1,665**
Loans to customers	458,845	418,444	233,957	38,065	201,328	29	**1,350,668**
Other financial assets	10,157	559	1,064	3	1,443	5	**13,231**
Total financial assets	**1,097,807**	**1,768,508**	**681,663**	**74,569**	**215,801**	**33,178**	**3,871,526**
The effect of derivatives	–	**14,424**	–	–	**10,076**	–	**24,500**
Financial liabilities							
Amounts due to banks and government funds	155,215	162,513	29,681	6,510	46,035	19	**399,973**
Amounts due to customers	696,416	1,551,068	603,266	5,433	3,874	29,904	**2,889,961**
Other borrowed funds	–	7,073	32,032	–	–	–	**39,105**
Derivative financial liabilities	1,576	–	–	–	482	–	**2,058**
Debt securities issued (Note 17)	–	42,476	–	–	39,289	–	**81,765**
Other financial liabilities	11,299	629	1,087	80	1,456	42	**14,593**
Total financial liabilities	**864,506**	**1,763,759**	**666,066**	**12,023**	**91,136**	**29,965**	**3,427,455**
The effect of derivatives	–	–	**9,934**	–	**14,754**	–	**24,688**
Net position	**233,301**	**19,173**	**5,663**	**62,546**	**119,987**	**3,213**	**443,883**

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**

(Figures in tables are in thousands of Azerbaijani manats)

25. Risk management (continued)

Currency risk (continued)

Currency risk sensitivity

The following table details the Group's sensitivity to 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 2017 and 2016:

	2017		*2016*	
	AZN/USD +11.3%	*AZN/USD -11.3%*	*AZN/USD +20%*	*AZN/USD -20%*
Impact on profit before tax	(2,167)	2,167	(8,612)	8,612

	2017		*2016*	
	AZN/EUR +13.5%	*AZN/EUR -13.5%*	*AZN/EUR +20%*	*AZN/EUR -20%*
Impact on profit before tax	(765)	765	(2,260)	2,260

	2017		*2016*	
	AZN/GEL +15%	*AZN/GEL -15%*	*AZN/GEL +15%*	*AZN/GEL -15%*
Impact on profit before tax	(9,382)	9,382	(9,208)	9,208

	2017		*2016*	
	AZN/TRY +20%	*AZN/TRY -14%*	*AZN/TRY +10%*	*AZN/TRY -10%*
Impact on profit before tax	(23,997)	16,798	(13,645)	13,645

(Figures in tables are in thousands of Azerbaijani manats)

26. Fair values of financial instruments

Fair value hierarchy

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

		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 2017	2,224	–	–	**2,224**
Investment securities – available for sale	31 December 2017	16,400	385,851	3,279	**405,530**
Derivative financial assets	31 December 2017	–	1,665	–	**1,665**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2017	1,465,771	–	–	**1,465,771**
Amounts due from credit institutions	31 December 2017	–	–	592,029	**592,029**
Investment securities – loans and receivables	31 December 2017	–	–	41,084	**41,084**
Loans to customers	31 December 2017	–	–	1,326,636	**1,326,636**
Investment property	31 December 2017	–	–	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 2017	–	2,058	–	**2,058**
Liabilities for which fair values are disclosed					
Amounts due to banks and government funds	31 December 2017	–	–	399,973	**399,973**
Amounts due to customers	31 December 2017	–	–	2,895,186	**2,895,186**
Other borrowed funds	31 December 2017	–	–	39,105	**39,105**
Debt securities issued	31 December 2017	–	–	81,701	**81,701**

(Figures in tables are in thousands of Azerbaijani manats)

26. 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 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)

26. Fair values of financial instruments (continued)

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

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

	Carrying value 2017	*Fair value 2017*	*Unrecognized gain/(loss) 2017*	*Carrying value 2016*	*Fair value 2016*	*Unrecognized gain/(loss) 2016*
Financial assets						
Cash and cash equivalents	1,465,771	1,465,771	–	1,105,769	1,105,769	–
Amounts due from credit institutions	592,029	592,029	–	728,121	728,121	–
Investment securities – loans and receivables	40,408	41,084	676	61,220	63,101	1,881
Loans to customers	1,350,668	1,326,636	(24,032)	1,107,274	1,088,091	(19,183)
Financial liabilities						
Amounts due to banks and government funds	399,973	399,973	–	330,294	330,294	–
Amounts due to customers	2,889,961	2,895,186	(5,225)	2,350,687	2,354,701	(4,014)
Other borrowed funds	39,105	39,105	–	51,473	51,473	–
Debt securities issued	81,765	81,701	64	18,705	18,690	15
Total unrecognised change in unrealised fair value			**(28,517)**			**(21,301)**

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 close to reporting period ending 31 December 2016. Level 3 financial assets include corporate bonds with floating rates, which are valued using discounted cash flow techniques based on current rates available for debt instruments with similar terms and credit risk characteristics as at 31 December 2017. There was not any movement except change in fair value and translation difference as at 31 December 2017.

(Figures in tables are in thousands of Azerbaijani manats)

27. Maturity analysis of assets and liabilities

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

	2017			*2016*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	1,465,771	–	**1,465,771**	1,105,769	–	**1,105,769**
Trading securities	2,224	–	**2,224**	19,479	3,190	**22,669**
Amounts due from credit institutions	592,029	–	**592,029**	728,121	–	**728,121**
Investment securities	397,343	48,595	**445,938**	186,387	48,162	**234,549**
Derivative financial assets	1,665	–	**1,665**	984	–	**984**
Loans to customers	662,823	687,845	**1,350,668**	512,518	594,756	**1,107,274**
Investment property	–	1,668	**1,668**	–	1,654	**1,654**
Property and equipment	–	12,808	**12,808**	–	12,809	**12,809**
Intangible assets	–	48,954	**48,954**	–	55,067	**55,067**
Current income tax assets	2,154	–	**2,154**	–	–	**–**
Deferred income tax assets	–	640	**640**	–	1,647	**1,647**
Other assets	32,907	989	**33,896**	17,431	1,871	**19,302**
Total assets	**3,156,916**	**801,499**	**3,958,415**	**2,570,689**	**719,156**	**3,289,845**
Amounts due to banks and government funds	223,731	176,242	**399,973**	161,616	168,678	**330,294**
Amounts due to customers	2,530,743	359,218	**2,889,961**	1,876,555	474,132	**2,350,687**
Other borrowed funds	15,153	23,952	**39,105**	14,796	36,677	**51,473**
Debt securities issued	39,289	42,476	**81,765**	18,705	–	**18,705**
Derivative financial liabilities	2,058	–	**2,058**	2,468	–	**2,468**
Current income tax liability	1,136	–	**1,136**	12,436	–	**12,436**
Deferred income tax liabilities	–	10,056	**10,056**	–	8,446	**8,446**
Provision for guarantees and letters of credit	3,112	–	**3,112**	6,959	–	**6,959**
Other liabilities	30,266	1,834	**32,100**	18,880	2,231	**21,111**
Total liabilities	**2,845,488**	**613,778**	**3,459,266**	**2,112,415**	**690,164**	**2,802,579**
Net assets	**311,428**	**187,721**	**499,149**	**458,274**	**28,992**	**487,266**

28. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

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

	2017					*2016*				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Cash and cash equivalents	–	2,225	–	–	**2,225**	–	18,203	–	–	**18,203**
Amounts due from credit institutions	–	–	–	–	**–**	–	34,487	–	–	**34,487**

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

	2017					2016				
	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	–	124,512	3,293	214	128,019	–	31,128	2,690	–	33,818
Loans issued during the year	–	134,117	2,219	6	136,342	–	172,952	4,057	291	177,300
Loan repayments during the year	–	(122,899)	(2,120)	(80)	(125,099)	–	(88,591)	(3,598)	(97)	(92,286)
Interest accrual	–	1,853	32	13	1,898	–	2,115	63	8	2,186
Foreign currency translation difference	–	(2,478)	(44)	1	(2,521)	–	6,908	81	12	7,001
Loans outstanding at 31 December, gross	–	135,105	3,380	154	138,639	–	124,512	3,293	214	128,019
Less: allowance for impairment at 31 December	–	(977)	(2)	–	(979)	–	(1,097)	(9)	–	(1,106)
Loans outstanding at 31 December, net	–	134,128	3,378	154	137,660	–	123,415	3,284	214	126,913
Interest income on loans	–	7,876	463	22	8,361	–	6,434	258	13	6,705

	2017					2016				
	Parent	*Entities under common control*	*Key management personnel*	*Other*	*Total*	*Parent*	*Entities under common control*	*Key management personnel*	*Other*	*Total*
Deposit at 1 January	–	454,434	5,800	58,806	519,040	25,605	135,220	557	85,873	247,255
Deposits received during the year	–	404,684	563	56,043	461,290	–	405,758	5,650	81,268	492,676
Deposits repaid during the year	–	(442,625)	(1,344)	(20,918)	(464,887)	(26,740)	(93,555)	(616)	(114,906)	(235,817)
Interest accrual	–	167	3	59	229	–	136	–	–	136
Foreign currency translation difference	–	19,776	(44)	695	20,427	1,135	6,875	209	6,571	14,790
Deposits at 31 December	–	436,436	4,978	94,685	536,099	–	454,434	5,800	58,806	519,040
Amounts due to banks and government funds	–	52,557	–	–	52,557	–	48,317	–	–	48,317
Current accounts at 31 December	43,374	280,136	321,681	75,609	720,800	29,564	240,425	1,712	248,151	519,852
Debt securities issued	–	40,692	–	–	40,692	–	–	–	–	–
Interest expense on deposits	(117)	(15,762)	(549)	(617)	(17,045)	(467)	(12,859)	(123)	(3,176)	(16,625)
Guarantees issued	–	21,917	–	–	21,917	–	12,146	–	–	12,146
Letters of credit issued	–	387	–	–	387	–	6,465	–	–	6,465
Unused credit lines	187	39,839	1,148	285	41,459	182	1,787	801	231	3,001
Fee and commission income	56	4,049	20	3	4,128	55	3,537	8	5	3,605
Net gains/(losses) from foreign currencies: dealing	307	4,062	1,447	2,168	7,984	437	14,722	122	3,180	18,461
Other operating expenses	–	(1,725)	–	–	(1,725)	–	(4,810)	–	–	(4,810)

The Bank has guarantee from its parent received as a collateral in respect of loans issued to borrowers and deposits placed in local banks in the amount of AZN 122,401 thousand (2016 – AZN 86,264 thousand) and in the amount of nil (2016 – AZN 6,872 thousand) respectively, as at 31 December 2017.

(Figures in tables are in thousands of Azerbaijani manats)

28. Related party disclosures (continued)

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

	2017	*2016*
Salaries and other benefits	(12,147)	(6,291)
Social security costs	(563)	(550)
Total key management compensation	**(12,710)**	**(6,841)**

29. Changes in liabilities arising from financing activities

	Note	*Bonds issued*	*Total liabilities from financing activities*
Carrying amount at 31 December 2015		–	–
Proceeds from issue		19,258	19,258
Foreign currency translation		(930)	(930)
Other		377	377
Carrying amount at 31 December 2016	17	**18,705**	**18,705**
Proceeds from issue		165,216	165,216
Redemption		(101,321)	(101,321)
Foreign currency translation		(1,747)	(1,747)
Other		912	912
Carrying amount at 31 December 2017	17	**81,765**	**81,765**

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% (2016 – 10%) of risk-weighted assets for regulatory capital. As at 31 December 2017 and 2016 the Bank's capital adequacy ratio on this basis was as follows:

	2017	*2016*
Tier 1 capital	328,238	330,438
Tier 2 capital	78,294	75,195
Less: deductions from capital	(148,987)	(148,987)
Total regulatory capital	**257,545**	**256,646**
Risk-weighted assets	**1,553,166**	**1,136,889**
Capital adequacy ratio	**15%**	**20%**

30. Capital adequacy (continued)

NBG capital adequacy ratio

The NBG requires banks to maintain a minimum total capital adequacy ratio of 9.6% (2016 – 10.8%) of risk-weighted assets for regulatory capital. As at 31 December 2017, capital adequacy ratio of PASHA Bank Georgia was 39% (31 December 2016 – 46%).

The BRSA requires banks to maintain a minimum total capital adequacy ratio of 8% (2016 – 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 2017 the bank's capital adequacy ratio was 32% (31 December 2016 – 54%).