Azer-Turk Bank Open Joint Stock Company

Financial statements

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

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To the Shareholders and Management Board of
Azer-Turk Bank OJSC

Opinion

We have audited the financial statements of Azer-Turk Bank OJSC (the "Bank"), which comprise the statement of financial position as at 31 December 2019, and the statement of profit or loss, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompaning financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

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

Responsibilities of management and Audit Committee for the financial statements

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

In preparing the financial statements, management is responsible for assessing the Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 Bank'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 Bank'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 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 Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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.

18 April 2020

Baku, Azerbaijan

Statement of financial position

As at 31 December

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2019*	*2018*
Assets			
Cash and cash equivalents	5	85,042	120,792
Amounts due from credit institutions	6	3,806	15,746
Loans to customers	7	180,269	165,326
Investment securities	8	56,260	51,827
Property and equipment	9	9,065	5,626
Intangible assets	10	5,264	3,076
Current Income Tax Asset		–	483
Other assets	13	5,922	3,980
Total assets		**345,628**	**366,856**
Liabilities			
Amounts due to credit institutions and government organizations	14	97,717	90,337
Amounts due to customers	15	188,295	220,008
Current income tax liability		765	–
Deferred income tax liabilities	11	9	95
Lease liabilities	3	4,640	–
Other liabilities	13	2,248	4,522
Total liabilities		**293,674**	**314,962**
Equity	16		
Share capital		50,000	50,000
Retained earnings		1,989	1,855
Fair value reserve		(35)	39
Total equity		**51,954**	**51,894**
Total liabilities and equity		**345,628**	**366,856**

Signed and authorized for release on behalf of the Management Board of the Bank:

Orkhan Huseynov — Chairman of the Management Board

Orkhan Gadirbey — Deputy Chairman of the Management Board

18 April 2020

The accompanying notes on pages 6 to 51 are an integral part of these financial statements.

Statement of profit or loss

For the year ended 31 December

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2019*	*2018*
Interest income			
Loans to customers		17,123	12,553
Amounts due from credit institutions		1,746	2,837
Investment securities		2,613	1,536
Interest income calculated using the effective interest method		**21,482**	**16,926**
Other interest income		12	54
		21,494	**16,980**
Interest expense			
Amounts due to customers		(6,354)	(5,286)
Lease liabilities		(509)	–
Amounts due to credit institutions and government organizations		(1,669)	(2,281)
		(8,532)	**(7,567)**
Net interest income		**12,962**	**9,413**
Credit loss (expense)/reversal on financial assets	12	(390)	5,186
Net interest income after credit loss (expense) / reversal		**12,572**	**14,599**
Fee and commission income	18	**3,838**	**3,955**
Net gains/(losses) from foreign currencies:			
- dealing		2,611	3,516
- translation differences		(289)	(220)
Net gains arising on initial recognition of financial instruments	14	250	–
Other income	19	1,951	184
Non-interest income		**8,361**	**7,435**
Personnel expenses	20	(11,039)	(9,666)
General and administrative expenses	20	(4,854)	(7,812)
Depreciation and amortization	9, 10	(4,415)	(2,008)
Reversal of provision for credit related commitments and other impairment	12	186	892
Non-interest expenses		**(20,122)**	**(18,594)**
Profit before income tax expense		**811**	**3,440**
Income tax expense	11	(377)	(1,326)
Profit for the year		**434**	**2,114**

The accompanying notes on pages 6 to 51 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2019*	*2018*
Profit for the year		**434**	**2,114**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Net change in fair value of debt instruments at fair value through other comprehensive income		(92)	49
Income tax relating to components of other comprehensive income	11	18	(10)
Other comprehensive (loss)/income for the year, net of tax		**(74)**	**39**
Total comprehensive income for the year		**360**	**2,153**

The accompanying notes on pages 6 to 51 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2019

(Figures in tables are in thousands of Azerbaijani manats)

	Share capital	*Fair value reserve*	*Retained earnings*	*Total equity*
1 January 2018	**50,000**	**–**	**669**	**50,669**
Profit for the year	–	–	2,114	**2,114**
Other comprehensive income for the year	–	39	–	**39**
Total comprehensive income for the year	**–**	**39**	**2,114**	**2,153**
Dividends declared and paid (Note 16)	–	–	(928)	**(928)**
31 December 2018	**50,000**	**39**	**1,855**	**51,894**
Profit for the year	–	–	434	**434**
Other comprehensive loss for the year	–	(74)	–	**(74)**
Total comprehensive income for the year	**–**	**(74)**	**434**	**360**
Dividends declared and paid (Note 16)	–	–	(300)	**(300)**
31 December 2019	**50,000**	**(35)**	**1,989**	**51,954**

The accompanying notes on pages 6 to 51 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2019	2018
Cash flows from operating activities			
Interest received		20,479	15,378
Interest paid		(9,017)	(5,748)
Fees and commissions received		8,551	7,335
Fees and commissions paid		(4,033)	(3,609)
Net realized gains from currency dealing operations		2,611	3,327
Personnel expenses paid		(10,958)	(10,364)
General and administrative expenses paid		(5,013)	(7,923)
Other income received		204	28
Cash flows from / (used in) operating activities before changes in operating assets and liabilities		**2,824**	**(1,576)**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		11,747	10,025
Loans to customers		(15,640)	(42,991)
Other assets		(2,491)	(1,093)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions and government organizations		9,117	16,600
Amounts due to customers		(28,518)	17,367
Other liabilities		(1,538)	3,327
Net cash flows (used in) / from operating activities before income tax		**(24,499)**	**1,659**
Income tax paid		(250)	(385)
Net cash (used in) / from operating activities		**(24,749)**	**1,274**
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities		341,000	162,473
Purchase of investment securities		(345,298)	(209,810)
Purchase of property and equipment		(853)	(966)
Acquisition of intangible assets		(2,250)	(962)
Net cash used in investing activities		**(7,401)**	**(49,265)**
Lease liability paid	3	(2,408)	-
Dividends paid to shareholders of the Bank	16	(300)	(928)
Net cash used in financing activities		**(2,708)**	**(928)**
Effect of exchange rates changes on cash and cash equivalents		(892)	(595)
Net decrease in cash and cash equivalents		**(35,750)**	**(49,514)**
Cash and cash equivalents, beginning		120,792	170,306
Cash and cash equivalents, ending	5	**85,042**	**120,792**

	Notes	2019	2018
Non-cash transactions performed comprise			
Settlement of withholding tax, value added tax and other taxes		378	–

The accompanying notes on pages 6 to 51 are an integral part of these financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

Azer-Turk Bank Open Joint Stock Company (the "Bank") was incorporated in the Republic of Azerbaijan in May 1995. The Bank is regulated by the Financial Markets Supervision Authority of Republic of Azerbaijan (the "FMSA") and conducts its business under license number 234.

The Bank's principal business activity is corporate and retail banking operations. This includes deposit taking and commercial lending in freely convertible currencies and in Azerbaijani manat ("AZN"), transfer payments in Azerbaijan and abroad, support of clients' export/import transactions, foreign currency exchange and other banking services to its commercial and retail customers.

As at 31 December 2019, the Bank's network comprised of head office, 1 customer service department, 6 branches and 3 unit service (2018: head office, 1 customer service department, 6 branches and 3 unit service).

The number of Bank's employees as at 31 December 2019 was 421 (2018: 389).

The Bank's registered address is 85, J. Mammadguluzade str., 192/193, Baku, AZ1078, Azerbaijan.

As at 31 December, the following shareholders owned the outstanding shares of the Bank*:*

Shareholder	***2019, %***	***2018, %***
Government of the Republic of Azerbaijan	75.00	75.00
T.C. Ziraat Bankasi A.Ş.	12.37	12.37
"AzRe Reinsurance" OJSC	6.55	6.55
"Qala Life" Insurance Company OJSC	5.00	5.00
"Ziraat Bank International AG"	1.08	1.08
Total	**100.00**	**100.00**

As at 31 December 2019 and 2018, the ultimate shareholder of the Bank is the Government of the Republic of Azerbaijan, acting through the State Committee on Property Issues of Azerbaijan Republic (the "Government").

2. Basis of preparation

General

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

The Azerbaijani manat ("AZN") is the functional and presentation currency of the Bank as the majority of transactions are denominated, measured, or funded in AZN. Transactions in other currencies are treated as transactions in foreign currencies. The Bank is required to maintain its records and prepare its financial statements in AZN and in accordance with IFRS. The financial statements are presented in thousands of AZN except per share amounts and unless otherwise indicated. The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, investment securities have been measured at fair value.

3. Summary of accounting policies

Changes in accounting policies

The Bank applied for the first time certain amendments to the standards, which are effective for annual periods beginning on or after 1 January 2019. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below:

IFRS 16 Leases

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

IFRS 16 Leases (continued)

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

The effect of adoption IFRS 16 as at 1 January 2019 (increase/(decrease)) is as follows:

Assets	
Property and equipment	6,243
Total assets	**6,243**
Liabilities	
Lease liabilities	6,243
Total liabilities	**6,243**

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

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

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

Leases previously accounted for as operating leases

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

The Bank also applied the available practical expedients wherein it:

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

Based on the foregoing, as at 1 January 2019:

- Right-of-use assets of AZN 6,243 were recognised;
- Lease liabilities of AZN 6,243 were recognised.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

The lease liabilities as at 1 January 2019 can be reconciled to the operating lease commitments as of 31 December 2018 as follows:

Operating lease commitments as at 31 December 2018	**1,626**
Weighted average incremental borrowing rate as at 1 January 2019	9%
Discounted operating lease commitments at 1 January 2019	**1,205**
Commitments relating to short-term leases	(242)
Change in management estimations about lease agreement terms	5,280
Lease liabilities as at 1 January 2019	**6,243**

(b) Summary of new accounting policies

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

Bank as a lessee

The Bank applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Bank recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

Right-of-use assets

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

Lease liabilities

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

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

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below USD 5,000). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

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

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

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

	Property and equipment (Right-of-use assets)	***Lease liabilities***
As at 1 January 2019	**6,243**	**6,243**
Additions	296	296
Depreciation expense	(2,111)	–
Interest expense	–	509
Payments	–	(2,408)
As at 31 December 2019	**4,428**	**4,640**

The Bank had total cash outflows for leases of AZN 2,408 in 2019. The Bank also had non-cash additions to right-of-use assets and lease liabilities of AZN 296 in 2019.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

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

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

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

Upon adoption of the Interpretation, the Bank considered whether it has any uncertain tax positions, particularly those relating to transfer pricing. The Bank determined, based on its tax compliance and transfer pricing study, that it is probable that its tax treatments will be accepted by the taxation authorities. The Interpretation did not have an impact on the financial statements of the Bank.

Amendments to IFRS 9 Prepayment Features with Negative Compensation

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

These amendments had no impact on the financial statements of the Bank.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Annual improvements 2015-2017 cycle

IAS 12 Income Taxes

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

An entity applies the amendments for annual reporting periods beginning on or after 1 January 2019, with early application permitted. When the entity first applies those amendments, it applies them to the income tax consequences of dividends recognised on or after the beginning of the earliest comparative period.

Since the Bank's current practice is in line with these amendments, they had no impact on the financial statements of the Bank.

Fair value measurement

The Bank measures financial instruments carried at FVOCI such as investment securities, at fair value at each balance sheet date.

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

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

The principal or the most advantageous market must be accessible by the Bank. 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 Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the 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 financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Financial assets and liabilities

Initial recognition

Date of recognition

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Initial measurement

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

Measurement categories of financial assets and liabilities

The Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost;
- FVOCI;
- FVPL.

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

Amounts due from credit institutions, loans to customers, investments securities at amortised cost

The Bank only measures amounts due from credit institutions and loans to customers, investment debt securities and other financial investment at amortized cost if both of the following conditions are met:

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

The details of these conditions are outlined below.

Business model assessment

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

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

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

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

The SPPI test

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

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

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

Debt instruments at FVOCI

The Bank measures debt instruments at FVOCI when both of the following conditions are met:

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

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

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

Equity instruments at FVOCI

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognised in profit or loss as other income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

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

Financial guarantees are initially recognised in the financial statements at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and an ECL provision.

Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of the ECL requirements.

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

Performance guarantees

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

Reclassification of financial assets and liabilities

The Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank changes the business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets and liabilities in 2019.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the Central Bank of Azerbaijan Republic ("CBAR"), excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank 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 credit insitutions and government 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.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the 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 statement of financial position.

Renegotiated loans

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities

Financial assets

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

- The rights to receive cash flows from the asset have expired;
- The Bank 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 Bank 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 Bank 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 recognised to the extent of the Bank`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 Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank`s continuing involvement is the amount of the transferred asset that the Bank 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 Bank`s continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Write-off

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

Financial liabilities

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

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

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

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 Bank's activities. These taxes are included as a component of general and administrative expenses.

Current and deferred taxes 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of 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 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 begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Useful life in years
Furniture and fixtures	5-10
Computer	5
Vehicles	5
Right of use assets	3-5
Leasehold improvements	3-5
Other fixed assets	5-8

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

In 2019 the Bank changed its estimate about useful life of leasehold improvements from 14 years to 3-5 years. The effect of this change was the increase in depreciation expense of AZN 569 in the statement of profit or loss for the year ended 31 December 2019.

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

Intangible assets

Intangible assets include computer software and licenses.

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 amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic lives of ten years and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

Provisions

Provisions are recognized when the Bank 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 Bank 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 Bank does not provide post-retirement benefits to its employees.

Share capital

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both 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.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Share capital (continued)

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 financial statements are authorised for issue.

Government grants and government assistance

Government grants are recognized where there is reasonable assurance that the grant will be received and all the related conditions will be, or have already been complied with. Where the grant relates to an expense item, it is recognized as income in the same periods as the respective expenses it is intended to compensate on a systematic basis. Where the grant relates to an asset, it is recognized as deferred income and released to income in equal amounts over the expected useful life of the related asset. Government loans provided at below market interest rates are recognized in accordance with IFRS 9. The benefit of the government loan is measured at the inception of the loan as the difference between the cash received and the amount at which the loan is initially recognized in the statement of financial position. This benefit is accounted for in accordance with IAS 20. A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognized against the expenses which government grants are intended to compensate in the statement of profit or loss for the period in which it becomes receivable.

Contingencies

Contingent liabilities are not recognised in the 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 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 Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

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

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

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

Interest revenue on all financial assets at FVPL is recognised using the contractual interest rate in “Other interest income” in the statement of profit or loss.

Fees and commissions

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- Income earned from the provision of service is recognized as revenue as the service are provided (for example, servicing plastic card operations, settlement operations, cash operations and others);
- Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

(Figures in tables are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Dividend income

Revenue is recognized when the Bank's right to receive the payment is established.

Foreign currency translation

The financial statements are presented in Azerbaijani manat, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss 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 from dealing operations.

The Bank used the following official exchange rates at 31 December in the preparation of these financial statements:

	2019	***2018***
1 US dollar	AZN 1.7000	AZN 1.7000
1 euro	AZN 1.9035	AZN 1.9468

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 Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

Amendments to IAS 1 and IAS 8: Definition of Material

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

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

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

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

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

(Figures in tables are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates

Estimation uncertainty

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the 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. Additional details are provided in Note 22.

Impairment losses on financial assets

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

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

More details are provided in Notes 7 and 21.

Leases − estimating the incremental borrowing rate

The Bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay', which requires estimation when no observable rates are available or when they need to be adjusted to reflect the terms and conditions of the lease.

The Bank estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific estimates (such as the proxy Bank's credit rating). More details are provided in Note 3.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management believes that as at 31 December 2019 and 2018 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

(Figures in tables are in thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2019	*2018*
Cash on hand	26,344	18,695
Current accounts with the CBAR	23,184	11,096
Current accounts with other banks	27,702	22,246
Time deposits with the CBAR up to 90 days	7,812	35,505
Cash in transit	–	33,250
Cash and cash equivalents	**85,042**	**120,792**

Current accounts with other banks consist of correspondent account balances with resident and non-resident banks in the amount of AZN 40 (2018: AZN 118) and AZN 27,662 (2018: AZN 22,128), respectively.

All balances of cash equivalents are allocated to Stage 1. As at 31 December 2019 and 31 December 2018 ECL relating to cash and cash equivalents rounds to zero.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2019	*2018*
Time deposits for more than 90 days	1,725	10,318
Blocked accounts with credit institutions	881	3,352
Obligatory reserve with the CBAR	1,200	1,351
Loans to credit institutions	–	725
Amounts due from credit institutions	**3,806**	**15,746**

As at 31 December 2019, time deposits for more than 90 days include interest bearing time deposits in amount of AZN 1,725 placed in one resident credit institution (2018: AZN 1,714 and AZN 8,604 placed in one resident credit institution and two non-resident credit institutions, respectively).

As at 31 December 2019, blocked accounts with credit institutions represented funds blocked by one (2018: one) non-resident credit institutions against letters of guarantee and letters of credit (2018: letters of guarantee) issued to three customers (2018: sixteen customers).

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 0.5% (2018: 0.5%) of the previous month average balances in AZN and 1% (2018: 1%) of the previous month average balances in foreign currencies respectively, attracted from customers by the credit institution. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

As at 31 December 2018, Loans to credit institutions represent loans issued to two resident non-bank credit institutions.

All balances of due from credit institutions are allocated to Stage 1. As at 31 December 2019 and 31 December 2018 ECL relating to amounts due from credit institutions rounds to zero.

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers

Loans to customers comprise:

	2019	*2018*
Loans to individuals-consumer	65,032	51,271
Loans to individuals-mortgage	61,750	48,239
Corporate loans	45,514	48,442
Loans to government owned entities	16,323	27,818
Loans to individuals-entrepreneurship	2,477	6,116
Gross loans to customers at amortised cost	**191,096**	**181,886**
Less: allowance for impairment	(10,827)	(17,088)
Loans to customers at amortised cost	**180,269**	**164,798**
Corporate loans	–	528
Loans to customers at FVPL	**–**	**528**
Loans to customers	**180,269**	**165,326**

Loans to customers at FVPL

Loans to customers at FVPL are represented by project financing loans that are economically or contractually non-recourse. Information on fair value measurement of Loans to customers at FVPL is presented in Note 22.

Concentration of loans to customers

Loans are made principally in the following industry sectors:

	2019	*2018*
Individuals	126,782	99,510
Transport	16,323	27,780
Trading enterprises	14,414	8,367
Oil and gas	10,569	10,727
Telecommunication	6,421	4,680
Agriculture and food processing	6,206	7,397
Metallurgy	2,461	5,338
Manufacturing	876	7,257
Other	7,044	11,358
Loans to customers, gross	**191,096**	**182,414**

Corporate loan granted to an entity operating in transport sector amounting to AZN 16,323 (2018: AZN 26,334) was provided by the funds received from the Ministry of Finance of the Republic of Azerbaijan.

As at 31 December 2019, the Bank had a concentration of loans represented by AZN 47,399 or 25% of gross loan portfolio (2018: AZN 49,806 or 27%) due from ten (2018: ten) largest borrowers of the Bank. An allowance of AZN 3,705 (2018: AZN 5,451) was recognized against these loans.

Allowance for impairment of loans to customers at amortised cost

An analysis of changes in the gross carrying value and corresponding ECL in relation to individuals-consumer loans during the year ended 31 December 2019 is as follows:

Loans to individuals-consumer	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**48,296**	**568**	**2,407**	**51,271**
New assets originated or purchased	40,782	–	–	**40,782**
Assets repaid	(24,662)	(156)	(1,245)	**(26,063)**
Transfers to Stage 1	235	(195)	(40)	**–**
Transfers to Stage 2	(372)	372	–	**–**
Transfers to Stage 3	(1,734)	(231)	1,965	**–**
Unwinding of discount	–	–	16	**16**
Recoveries	–	–	646	**646**
Amounts written off	–	–	(1,620)	**(1,620)**
At 31 December 2019	**62,545**	**358**	**2,129**	**65,032**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

Loans to individuals-consumer	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(242)**	**(120)**	**(1,476)**	**(1,838)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(438)	–	–	**(438)**
Assets repaid	186	33	810	**1,029**
Transfers to Stage 1	(72)	58	14	**–**
Transfers to Stage 2	2	(2)	–	**–**
Transfers to Stage 3	205	43	(248)	**–**
Impact on period end ECL of exposures transferred between stages during the period	71	(76)	(969)	**(974)**
Changes to inputs used for ECL calculations	(16)	(25)	(425)	**(466)**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	(16)	**(16)**
Recoveries	–	–	(646)	**(646)**
Amounts written off	–	–	1,620	**1,620**
At 31 December 2019	**(304)**	**(89)**	**(1,336)**	**(1,729)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to loans individuals-mortgage during the year ended 31 December 2019 is as follows:

Loans to individuals-mortgage	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**47,979**	**199**	**61**	**48,239**
New assets originated or purchased	15,964	–	–	**15,964**
Assets repaid	(2,424)	(18)	(11)	**(2,453)**
Transfers to Stage 1	250	(189)	(61)	**–**
Transfers to Stage 2	(249)	249	–	**–**
Transfers to Stage 3	(128)	–	128	**–**
Unwinding of discount	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2019	**61,392**	**241**	**117**	**61,750**

Loans to individuals-mortgage	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(225)**	**(63)**	**(21)**	**(309)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(90)	–	–	**(90)**
Assets repaid	21	5	4	**30**
Transfers to Stage 1	(84)	63	21	**–**
Transfers to Stage 2	2	(2)	–	**–**
Transfers to Stage 3	1	–	(1)	**–**
Impact on period end ECL of exposures transferred between stages during the period	82	(86)	(47)	**(51)**
Changes to inputs used for ECL calculations	(40)	(1)	3	**(38)**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2019	**(333)**	**(84)**	**(41)**	**(458)**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate loans during the year ended 31 December 2019 is as follows:

Corporate loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**33,763**	**248**	**14,431**	**48,442**
New assets originated or purchased	25,029	–	–	**25,029**
Assets repaid	(21,803)	(102)	(2,336)	**(24,241)**
Transfers to Stage 1	146	(146)	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(1,545)	–	1,545	**–**
Unwinding of discount	–	–	93	**93**
Recoveries	–	–	–	**–**
Amounts written off	–	–	(3,809)	**(3,809)**
At 31 December 2019	**35,590**	**–**	**9,924**	**45,514**

Corporate loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(2,423)**	**(26)**	**(9,250)**	**(11,699)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(1,350)	–	–	**(1,350)**
Assets repaid	1,449	11	911	**2,371**
Transfers to Stage 1	(15)	15	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	476	–	(476)	**–**
Impact on period end ECL of exposures transferred between stages during the period	13	–	(459)	**(446)**
Changes to inputs used for ECL calculations	411	–	(651)	**(240)**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	(93)	**(93)**
Recoveries	–	–	–	**–**
Amounts written off	–	–	3,809	**3,809**
At 31 December 2019	**(1,439)**	**–**	**(6,209)**	**(7,648)**

An analysis of changes in the gross carrying value and corresponding ECL in relation to loans to government owned entities during the year ended 31 December 2019 is as follows:

Loans to government owned entities	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**27,818**	**–**	**–**	**27,818**
New assets originated or purchased	712	–	–	**712**
Assets repaid	(12,207)	–	–	**(12,207)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Unwinding of discount	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2019	**16,323**	**–**	**–**	**16,323**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

Loans to government owned entities	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(18)**	**–**	**–**	**(18)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	–	–	–	**–**
Assets repaid	18	–	–	**18**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	–	–	–	**–**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2019	**–**	**–**	**–**	**–**

An analysis of changes in the gross carrying value and corresponding ECL in relation to loans individuals-entrepreneurship during the year ended 31 December 2019 is as follows:

Loans to individuals-entrepreneurship	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**1,233**	**52**	**4,831**	**6,116**
New assets originated or purchased	399	–	–	**399**
Assets repaid	(861)	(52)	(1,148)	**(2,061)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(169)	–	169	**–**
Unwinding of discount	–	–	13	**13**
Recoveries	–	–	22	**22**
Amounts written off	–	–	(2,012)	**(2,012)**
At 31 December 2019	**602**	**–**	**1,875**	**2,477**

Loans to individuals-entrepreneurship	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(62)**	**(5)**	**(3,157)**	**(3,224)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(20)	–	–	**(20)**
Assets repaid	42	5	483	**530**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	10	–	(10)	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	(50)	**(50)**
Changes to inputs used for ECL calculations	3	–	(208)	**(205)**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	(13)	**(13)**
Recoveries	–	–	(22)	**(22)**
Amounts written off	–	–	2,012	**2,012**
At 31 December 2019	**(27)**	**–**	**(965)**	**(992)**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

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

Loans to individuals-consumer	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**21,132**	**470**	**2,851**	**24,453**
New assets originated or purchased	35,620	–	–	**35,620**
Assets repaid	(7,657)	(377)	(1,391)	**(9,425)**
Transfers to Stage 1	125	(62)	(63)	**–**
Transfers to Stage 2	(564)	569	(5)	**–**
Transfers to Stage 3	(360)	(32)	392	**–**
Unwinding of discount	–	–	51	**51**
Recoveries	–	–	596	**596**
Amounts written off	–	–	(24)	**(24)**
At 31 December 2018	**48,296**	**568**	**2,407**	**51,271**

Loans to individuals-consumer	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(413)**	**(67)**	**(1,857)**	**(2,337)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(217)	–	–	**(217)**
Assets repaid	166	38	1,174	**1,378**
Transfers to Stage 1	(48)	20	28	**–**
Transfers to Stage 2	36	(41)	5	**–**
Transfers to Stage 3	81	15	(96)	**–**
Impact on period end ECL of exposures transferred between stages during the period	47	(85)	(78)	**(116)**
Changes to inputs used for ECL calculations	106	–	(29)	**77**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	(51)	**(51)**
Recoveries	–	–	(596)	**(596)**
Amounts written off	–	–	24	**24**
At 31 December 2018	**(242)**	**(120)**	**(1,476)**	**(1,838)**

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

Loans to individuals-mortgage	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**26,611**	**–**	**–**	**26,611**
New assets originated or purchased	22,731	–	–	**22,731**
Assets repaid	(1,103)	–	–	**(1,103)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(199)	199	–	**–**
Transfers to Stage 3	(61)	–	61	**–**
Unwinding of discount	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2018	**47,979**	**199**	**61**	**48,239**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

Loans to individuals-mortgage	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(252)**	**–**	**–**	**(252)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(107)	–	–	**(107)**
Assets repaid	10	–	–	**10**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	2	(2)	–	**–**
Transfers to Stage 3	1	–	(1)	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	(61)	(20)	**(81)**
Changes to inputs used for ECL calculations	121	–	–	**121**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2018	**(225)**	**(63)**	**(21)**	**(309)**

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

Corporate loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**12,653**	**3,963**	**16,201**	**32,817**
New assets originated or purchased	26,483	–	–	**26,483**
Assets repaid	(7,590)	(1,195)	(2,065)	**(10,850)**
Transfers to Stage 1	2,217	(2,217)	–	**–**
Transfers to Stage 2	–	248	(248)	**–**
Transfers to Stage 3	–	(551)	551	**–**
Unwinding of discount	–	–	419	**419**
Recoveries	–	–	–	**–**
Amounts written off	–	–	(427)	**(427)**
At 31 December 2018	**33,763**	**248**	**14,431**	**48,442**

Corporate loans	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(1,299)**	**(1,059)**	**(10,699)**	**(13,057)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(2,031)	–	–	**(2,031)**
Assets repaid	771	409	1,128	**2,308**
Transfers to Stage 1	(922)	922	–	**–**
Transfers to Stage 2	–	(165)	165	**–**
Transfers to Stage 3	–	130	(130)	**–**
Impact on period end ECL of exposures transferred between stages during the period	838	(263)	278	**853**
Changes to inputs used for ECL calculations	220	–	–	**220**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognised in interest revenue)	–	–	(419)	**(419)**
Recoveries	–	–	–	**–**
Amounts written off	–	–	427	**427**
At 31 December 2018	**(2,423)**	**(26)**	**(9,250)**	**(11,699)**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

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

Loans to government owned entities	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**41,102**	**–**	**2,009**	**43,111**
New assets originated or purchased	–	–	–	**–**
Assets repaid	(13,284)	–	(1,678)	**(14,962)**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Unwinding of discount	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	(331)	**(331)**
At 31 December 2018	**27,818**	**–**	**–**	**27,818**

Loans to government owned entities	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(86)**	–	**(1,828)**	**(1,914)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	–	–	–	**–**
Assets repaid	59	–	1,497	**1,556**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	9	–	–	**9**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	331	**331**
At 31 December 2018	**(18)**	**–**	**–**	**(18)**

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

Loans to individuals-entrepreneurship	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**3,529**	**1,042**	**5,972**	**10,543**
New assets originated or purchased	693	–	–	**693**
Assets repaid	(3,009)	(831)	(1,339)	**(5,179)**
Transfers to Stage 1	159	(159)	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	(139)	–	139	**–**
Unwinding of discount	–	–	110	**110**
Recoveries	–	–	–	**–**
Amounts written off	–	–	(51)	**(51)**
At 31 December 2018	**1,233**	**52**	**4,831**	**6,116**

(Figures in tables are in thousands of Azerbaijani manats)

7. Loans to customers (continued)

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

Loans to individuals-entrepreneurship	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(282)**	**(217)**	**(3,872)**	**(4,371)**
Movements with impact on credit loss allowance (charge)/reversal in profit or loss				
New assets originated or purchased	(43)	–	–	**(43)**
Assets repaid	254	176	826	**1,256**
Transfers to Stage 1	(42)	42	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	24	–	(24)	**–**
Impact on period end ECL of exposures transferred between stages during the period	21	(14)	(28)	**(21)**
Changes to inputs used for ECL calculations	6	8	–	**14**
Movements without impact on credit loss allowance (charge)/reversal in profit or loss				
Unwinding of discount (recognized as a reduction in interest income for stage 3 loans)	–	–	(110)	**(110)**
Recoveries	–	–	–	**–**
Amounts written off	–	–	51	**51**
At 31 December 2018	**(62)**	**(5)**	**(3,157)**	**(3,224)**

Collateral and other credit enhancements

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 corporate and governmental lending, charges over real estate properties and blocked cash;
- For retail lending, mortgages over residential properties.

Management monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement during its review of the adequacy of the allowance for loan impairment. As at 31 December 2019, maximum exposure of collateralized loans in Stage 3 amounted to AZN 11,548 (2018: AZN 19,715) for which ECL of AZN 6,717 (2018: AZN 12,244) was recognized. If these loans were not collateralized, ECL amount for these loans would be AZN 8,978 (2018: AZN 17,793).

Loans issued at below-market interest rate

During 2019 the Bank issued a loan to customer at below-market interest rate in amount of AZN 2,700 (2018: nil) which resulted in loss of AZN 601 (2018: nil) on initial recognition of the loan. The loan has been financed by deposit placed by the Ministry of Finance of Azerbaijan Republic in the same amount as the loan.

8. Investment securities

Investment securities comprises:

	2019	***2018***
Debt securities at FVOCI		
Notes issued by the CBAR	33,821	47,470
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	20,341	4,312
Notes issued by the Azerbaijan Mortgage and Credit Guarantee Fund	2,053	–
	56,215	**51,782**
Equity securities at FVOCI		
Corporate shares	45	45
	45	**45**
Total investment securities	**56,260**	**51,827**

All balances of investment securities are allocated to Stage 1. As at 31 December 2019 and 31 December 2018 ECL relating to investment securities rounds to zero.

(Figures in tables are in thousands of Azerbaijani manats)

9. Property and equipment

The movements in property and equipment were as follows:

	Furniture and fixtures	*Computer*	*Vehicles*	*Other fixed assets*	*Leasehold improve-ments*	*Right of use asset (Note 3)*	*Total*
Cost							
31 December 2017	**3,631**	**3,191**	**959**	**249**	**2,801**	**–**	**10,831**
Additions	226	409	38	16	209	–	**898**
Disposals	(81)	(103)	–	(38)	–	–	**(222)**
31 December 2018	**3,776**	**3,497**	**997**	**227**	**3,010**	**–**	**11,507**
Impact of adopting IFRS 16 (Note 3)	–	–	–	–	–	6,243	**6,243**
1 January 2019	**3,776**	**3,497**	**997**	**227**	**3,010**	**6,243**	**17,750**
Additions	305	499	–	17	–	296	**1,117**
Disposals	(35)	(14)	–	–	–	–	**(49)**
31 December 2019	**4,046**	**3,982**	**997**	**244**	**3,010**	**6,539**	**18,818**
Accumulated depreciation							
31 December 2017	**(1,779)**	**(1,501)**	**(577)**	**(104)**	**(449)**	**–**	**(4,410)**
Depreciation charge	(672)	(577)	(170)	(45)	(206)	–	**(1,670)**
Disposals	73	100	–	26	–	–	**199**
31 December 2018	**(2,378)**	**(1,978)**	**(747)**	**(123)**	**(655)**	**–**	**(5,881)**
Depreciation charge	(393)	(413)	(170)	(51)	(779)	(2,111)	**(3,917)**
Disposals	34	11	–	–	–	–	**45**
31 December 2019	**(2,737)**	**(2,380)**	**(917)**	**(174)**	**(1,434)**	**(2,111)**	**(9,753)**
Net book value							
31 December 2017	**1,852**	**1,690**	**382**	**145**	**2,352**	**–**	**6,421**
31 December 2018	**1,398**	**1,519**	**250**	**104**	**2,355**	**–**	**5,626**
31 December 2019	**1,309**	**1,602**	**80**	**70**	**1,576**	**4,428**	**9,065**

As at 31 December 2019, property and equipment amounting to AZN 1,126 (2018: AZN 791) were fully depreciated.

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2017	**1,092**	**2,139**	**3,231**
Additions	106	780	**886**
Disposals	(110)	(25)	**(135)**
31 December 2018	**1,088**	**2,894**	**3,982**
Additions	758	1,928	**2,686**
Disposals	–	–	**–**
31 December 2019	**1,846**	**4,822**	**6,668**
Accumulated amortization			
31 December 2017	**(363)**	**(298)**	**(661)**
Amortization charge	(98)	(240)	**(338)**
Disposal	82	11	**93**
31 December 2018	**(379)**	**(527)**	**(906)**
Amortization charge	(195)	(303)	**(498)**
Disposal	–	–	**–**
31 December 2019	**(574)**	**(830)**	**(1,404)**
Net book value			
31 December 2017	**729**	**1,841**	**2,570**
31 December 2018	**709**	**2,367**	**3,076**
31 December 2019	**1,272**	**3,992**	**5,264**

As at 31 December 2019, intangible assets amounting to AZN 16 (2018: AZN nil) were fully depreciated.

(Figures in tables are in thousands of Azerbaijani manats)

11. Taxation

The corporate income tax expense comprises:

	2019	*2018*
Current tax charge	(445)	(706)
Deferred tax credit/(charge) − origination and reversal of temporary differences	86	(630)
Less: deferred tax recognised in other comprehensive income	(18)	10
Income tax expense	**(377)**	**(1,326)**

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

	2019	*2018*
Net losses/(gains) on debt instruments designated at FVOCI	18	(10)
Income tax credited/(charged) to other comprehensive income	**18**	**(10)**

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

	2019	*2018*
Profit before tax	**811**	**3,440**
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	**(162)**	**(688)**
Tax effect of non-deductible expenses	(215)	(182)
Prior year tax actualization	−	(456)
Income tax charge	**(377)**	**(1,326)**

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

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	1 January 2018	*In the statement of profit or loss*	*In other compre-hensive income*	*31 December 2018*	*In the statement of profit or loss*	*In other compre-hensive income*	*31 December 2019*
Tax effect of deductible temporary differences							
Loans to customers	610	(532)	−	78	112	−	190
Property and equipment	−	−	−	−	488	−	488
Investment securities	77	(30)	−	47	39	−	86
Other liabilities	547	(84)	−	463	(158)	−	305
Other assets	5	17	−	22	3	−	25
Deferred tax assets	**1,239**	**(629)**	**−**	**610**	**484**	**−**	**1,094**
Tax effect of taxable temporary differences							
Cash and cash equivalents	(30)	4	−	(26)	16	−	(10)
Amounts due to banks and government organizations	(36)	36	−	−	(153)	−	(153)
Amounts due from credit institutions	−	−	−	−	−	−	−
Amount due to customers	(278)	(28)	−	(306)	230	−	(76)
Loan to customers	−	(43)	−	(43)	(212)	−	(255)
Investment securities	−	−	(10)	(10)	(8)	18	−
Intangible assets	(59)	(22)	−	(81)	1	−	(80)
Property and equipment	(192)	99	−	(93)	93	−	−
Lease Liability	−	−	−	−	(380)	−	(380)
Other assets	(109)	(37)	−	(146)	(3)	−	(149)
Deferred tax liabilities	**(704)**	**9**	**(10)**	**(705)**	**(416)**	**18**	**(1,103)**
Net deferred tax assets/(liabilities)	**535**	**(620)**	**(10)**	**(95)**	**68**	**18**	**(9)**

(Figures in tables are in thousands of Azerbaijani manats)

12. Credit loss expense and other impairment and provisions

The table below shows the ECL charges on financial instruments recorded in the statement of profit or loss for the year ended 31 December 2019:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans to customers at amortised cost	7	867	41	(1,298)	**(390)**
Credit loss on financial assets		**867**	**41**	**(1,298)**	**(390)**
Financial guarantees	17	915	–	–	**915**
Letter of credits	17	(8)	–	–	**(8)**
Credit related commitments		**907**	**–**	**–**	**907**
Total credit loss expense		**1,774**	**41**	**(1,298)**	**517**

The reversal of credit loss expense on loans to customers at amortised cost includes AZN 140 of government grant which was repaid by Government of Azerbaijan on behalf of customers in accordance with decree of President of the Republic of Azerbaijan dated February 28, 2019 on “Additional measures to resolve problematic loans of individuals in the Republic of Azerbaijan”.

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Loans to customers at amortised cost	7	(638)	1,129	4,695	**5,186**
Credit loss on financial assets		**(638)**	**1,129**	**4,695**	**5,186**
Financial guarantees	17	482	–	391	**873**
Letter of credits	17	19	–	–	**19**
Credit related commitments		**501**	**–**	**391**	**892**
Total credit loss expense		**(137)**	**1,129**	**5,086**	**6,078**

The movements in other impairment allowances and provisions were as follows:

	Performance guarantees	*Irrecoverable tax positions*	*Total*
31 December 2017	**–**	**–**	**–**
Charge	–	–	**–**
31 December 2018	**–**	**–**	**–**
Charge	(46)	(675)	**(721)**
31 December 2019	**(46)**	**(675)**	**(721)**

Provisions for credit related commitments and performance guarantees are recorded in other liabilities.

Irrecoverable tax positions represent amounts of income tax credits which are no longer recoverable from tax authorities due to expiry of statutory limitation of three years for resubmission of profit tax returns. The Bank recognized additional tax liability within current income tax liabilities in the statement of financial position.

(Figures in tables are in thousands of Azerbaijani manats)

13. Other assets and liabilities

Other assets comprise:

	2019	*2018*
Other financial assets		
Settlements on money transfers	2,456	1,139
Settlements on operations with plastic cards	830	155
Total other financial assets	**3,286**	**1,294**
Other non-financial assets		
Repossessed collaterals	1,789	1,502
Prepayments for acquisition of property, equipment and intangible assets	501	905
Deferred expenses	340	279
Settlement with government budget	6	–
Total other non-financial assets	**2,636**	**2,686**
Other assets	**5,922**	**3,980**

All balances of other assets are allocated to Stage 1. As at 31 December 2019 ECL and 31 December 2018 relating to other assets rounds to zero.

Other liabilities comprise:

	2019	*2018*
Other financial liabilities		
Funds in settlement	284	1,953
Other	67	–
Total other financial liabilities	**351**	**1,953**
Other non-financial liabilities		
Accrued expenses	393	378
Payable to employees	455	374
Provision for ECL for credit related commitment and other provision (Note 17)	431	1,292
Deferred income	521	277
Settlements with government budget	97	248
Total other non-financial liabilities	**1,897**	**2,569**
Other liabilities	**2,248**	**4,522**

14. Amounts due to credit institutions and government organizations

Amounts due to credit institutions and government organizations comprise:

	2019	*2018*
Amounts due to the Ministry of Finance	33,060	26,421
Amounts due to the Azerbaijan Mortgage and Credit Guarantee Fund	59,545	43,388
Current accounts	2,436	17,490
Loans received from the National Fund for Support of Entrepreneurship	2,248	2,607
Amounts due to CBAR	380	–
Blocked accounts	48	431
Amounts due to credit institutions and government organizations	**97,717**	**90,337**
Held as security against letters of guarantee (Note 17)	48	91
Held as security against loans issued to credit institutions	–	340

As at 31 December 2019, the Bank had time deposit placed by the Ministry of Finance in the amount of AZN 16,321 (2018: AZN 26,421) that matures during 2021 and bears interest rate of monthly LIBOR plus 1.75% p.a. The fund was used for refinancing loan to one related party company.

(Figures in tables are in thousands of Azerbaijani manats)

14. Amounts due to credit institutions and government organizations (continued)

In addition, as at 31 December 2019, the Bank had two time deposits placed by the Ministry of Finance in the amount of AZN 9,047 (2018: AZN nil) and AZN 7,692 (2018: AZN nil) which matured in 2020 and 2024, respectively. The long-term deposit in amount of AZN 7,692 bears contractual interest rate of 0.5% p.a., and was used for financing of a loan. Because the interest rate was below market rate, the Bank recognized gain on initial recognition of this deposit as a government grant in amount of AZN 851 and a loss of AZN 601 on respective loan issued to customer. Both government grant and loss on initial recognition of below-market rate loan were recognized as “net gains arising on initial recognition of financial instruments” in the statement of profit and loss in net amount of AZN 250.

On 20 December 2006, the Bank signed a credit agreement with the Azerbaijan Mortgage and Credit Guarantee Fund, for granting long term mortgage loans to individuals. Under this program, funds are made available to the Bank at an interest rate of 1-4% p.a. (2018: 1-4% p.a.) which matures through in 2020-2049 (2018: 2019-2048). The Bank relends these funds to eligible borrowers at rates not higher than 8.0% p.a.

On 23 December 2010, the Bank signed a credit agreement with the National Fund for Support of Entrepreneurship, a program under the Ministry of Economy of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Under this program, funds are made available to the Bank at an interest rate of 1% p.a. (2018: 1% p.a.) which matures through 2020-2023 (2018: 2019-2023). The Bank uses these funds to issue loans to eligible borrowers at rate of 6% p.a.

Long term loans due to Central Bank of the Republic of Azerbaijan are funds provided in accordance with Presidential Decree on additional measures for resolution of the issues relating to non-performing loans of individuals in the Republic of Azerbaijan, which was signed on 28 February 2019. The loan matures on 31 December 2024 and bears contractual interest rate of 0.1% p.a.

15. Amounts due to customers

The amounts due to customers include the following:

	2019	*2018*
Current accounts	140,550	144,508
Time deposits	47,745	75,500
Amounts due to customers	**188,295**	**220,008**
Held as security against letters of guarantee (Note 17)	661	890
Held as security against loans to customers	22,955	13,297

At 31 December 2019, the Bank had amounts due to 10 (2018: 10) largest customers with aggregate balance of AZN 86,586 or 46% of total amounts due to customers (2018: AZN 112,127 or 51%).

Customer accounts by economic sectors are as follows:

	2019	*2018*
Individuals	74,588	113,414
Insurance companies and other non-bank financial institutions	50,407	50,504
Transportation and communication	17,766	2,724
Trade and services	17,616	15,845
Construction	11,245	7,451
State and public organizations	8,891	18,892
Manufacturing	3,352	8,907
Agriculture	2,319	943
Other	2,111	1,328
Amounts due to customers	**188,295**	**220,008**

(Figures in tables are in thousands of Azerbaijani manats)

16. Equity

As at 31 December 2019 and 2018, the Bank's share capital is represented by authorized, issued and fully paid up 50,000,000 ordinary shares with nominal amount of 1 (one) Azerbaijani manat per share. Each ordinary share carries one vote.

The share capital of the Bank was contributed by shareholders in Azerbaijani manat and they are entitled to dividends and any capital distribution in Azerbaijani manat.

According to the decision of the General Shareholders' Meeting held on 29 April 2019, the Bank declared dividends in respect of the year ended 31 December 2018, totalling AZN 300 (including 10% withholding tax to be paid on behalf of shareholders) on ordinary shares. The dividends were fully paid during 2019.

According to the decision of the General Shareholders' Meeting held on 27 June 2018, the Bank declared dividends in respect of the year ended 31 December 2017, totalling AZN 928 (including 10% withholding tax to be paid on behalf of shareholders) on ordinary shares. The dividends were fully paid during 2018.

Fair value reserve

This reserve records fair value changes on financial assets at FVOCI.

17. Commitment 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, the Central Bank of Azerbaijan Republic tightened monetary policy and introduced a number of measures to stabilize macroeconomic situation. In addition, Azerbaijani government announced plans to accelerate reforms and support to 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".

During 2018 CBAR maintained monetary policy aimed at macroeconomic stability, including low one-digit inflation and steady AZN rate. At the same time the CBAR gradually reduced refinancing rate from 15% to 9.75%.

Furthermore, over 2019 the CBAR continued easing monetary conditions while maintaining stability of Azerbaijani manat. As a result, CBAR refinancing rate further declined from 9.75% to 7.5% and AZN rate remained unchanged.

Finally, on 28 February 2019 according to the Decree of the President of Azerbaijan Republic on problematic loans, the government provided funds for compensation to citizens, whose loans burden increased due to the devaluation of Azerbaijani manat in 2015. This measure significantly reduced amounts of non-performing loans as well as supported capital and liquidity in the banking system.

The Bank'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 Banks's business in the foreseeable future.

Legal

In the ordinary course of business, the Bank 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 Bank.

(Figures in tables are in thousands of Azerbaijani manats)

17. Commitment and contingencies (continued)

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Republic of Azerbaijan suggest that the tax authorities may be taking a more assertive position in their interpretation and application of this legislation and assessments. It is therefore possible that transactions and activities of the Bank that have not been challenged in the past may be challenged at any time in the future. As a result, significant additional taxes, penalties and interest may be assessed by the relevant authorities.

Fiscal periods remain open and subject to review by the tax authorities for a period of three calendar years immediately preceding the year in which the decision to conduct a tax review is taken. The last tax audit covered second quarter of 2015 and third quarter of 2016.

Management's interpretation of the relevant legislation as at 31 December 2019 is appropriate and the Bank'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.

Compliance with CBAR requirements

CBAR requires banks to maintain certain prudential norms computed based on statutory financial statements. As at 31 December 2019 and 2018, the Bank was in compliance with these norms except for minimum regulatory capital requirement of AZN 50,000, which was breached as at 31 December 2019. More details are provided in Note 25.

Financial commitments and contingencies

The Bank 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 Bank 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 Bank on behalf of a customer authorizing a third party to draw drafts on the Bank 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.

The undrawn loan commitment agreements stipulate the right of the Bank to unilaterally withdraw from the agreement should any conditions unfavourable to the Bank arise, including change of the refinance rate, inflation, exchange rates and others.

As at 31 December, the Bank's commitments and contingencies comprised the following:

	2019	***2018***
Credit related commitments		
Undrawn loan commitments	14,163	14,953
Letters of credit	941	272
Financial guarantees	33,293	36,032
	48,397	**51,257**
Operating lease commitments		
Not later than 1 year	X	1,024
Later than 1 year but not later than 5 years	X	602
Later than 5 years	X	–
	X	**1,626**
Performance guarantees	4,485	–
Commitments and contingencies	**52,882**	**52,883**
Provisions for ECL for credit related commitments	(385)	(1,292)
Provisions for other commitments	(46)	–
Deposits held as security against financial guarantees (Note 14, 15)	(529)	(981)
Deposits held as security against performance guarantees (Note 14, 15)	(180)	–

(Figures in tables are in thousands of Azerbaijani manats)

17. Commitment and contingencies (continued)

Financial commitments and contingencies

An analysis of changes in the ECLs during the year ended 31 December 2019 is as follows:

Financial guarantees	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2019	**(1,288)**	**–**	**–**	**(1,288)**
New exposures	(304)	–	–	**(304)**
Exposures derecognised or matured (excluding write-offs)	919	–	–	**919**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	300	–	–	**300**
At 31 December 2019	**(373)**	**–**	**–**	**(373)**

Letters of credit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2019	**(4)**	**–**	**–**	**(4)**
New exposures	(10)	–	–	**(10)**
Exposures derecognised or matured (excluding write-offs)	2	–	–	**2**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	–	–	–	**–**
At 31 December 2019	**(12)**	**–**	**–**	**(12)**

As at 31 December 2019 and 31 December 2018 ECL relating to undrawn loan commitments rounds to zero.

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

Financial guarantees	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2018	**(1,770)**	**–**	**(391)**	**(2,161)**
New exposures	(876)	–	–	**(876)**
Exposures derecognised or matured (excluding write-offs)	843	–	–	**843**
Transfers to Stage 1	(391)	–	391	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	376	–	–	**376**
Changes to inputs used for ECL calculations	530	–	–	**530**
At 31 December 2018	**(1,288)**	**–**	**–**	**(1,288)**

Letters of credit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2018	**(23)**	**–**	**–**	**(23)**
New exposures	(1)	–	–	**(1)**
Exposures derecognised or matured (excluding write-offs)	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	20	–	–	**20**
At 31 December 2018	**(4)**	**–**	**–**	**(4)**

(Figures in tables are in thousands of Azerbaijani manats)

18. Net fee and commission income

Net fee and commission income comprises:

	2019	*2018*
Servicing plastic card operations	2,401	2,200
Settlements operations	2,137	2,475
Cash operations	1,825	1,571
Guarantees and letter of credit	1,057	900
Other	365	312
Fee and commission income	**7,785**	**7,458**
Servicing plastic card operations	(2,723)	(1,971)
Settlements operations	(515)	(716)
Cash operations	(349)	(602)
Guarantees and commitments	(136)	(61)
Other	(224)	(153)
Fee and commission expense	**(3,947)**	**(3,503)**
Net fee and commission income	**3,838**	**3,955**

19. Other income

As at 31 December 2019, other income of AZN 1,951 (2018: AZN 184) primarily comprises penalty fees from customers due to early withdrawal of term deposits.

20. Personnel, general and administrative expenses

Personnel expenses comprise:

	2019	*2018*
Salaries and bonuses	(8,707)	(7,563)
Social security costs	(1,952)	(1,685)
Other employee related expenses	(380)	(418)
Personnel expenses	**(11,039)**	**(9,666)**

General and administrative expenses comprise:

	2019	*2018*
Operating taxes other than income tax	(994)	(675)
Marketing and advertising	(497)	(724)
Deposit insurance expense	(433)	(337)
Data processing	(406)	(305)
Communication	(372)	(384)
Membership expenses	(321)	(431)
Repair and maintenance of property and equipment	(312)	(208)
Utility expenses	(309)	(158)
Security	(266)	(308)
Office supplies	(251)	(223)
Legal and consultancy	(223)	(325)
Business travel and related expenses	(143)	(123)
Other	(327)	(845)
Occupancy and rent	–	(2,766)
Total general and administrative expenses	**(4,854)**	**(7,812)**

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management

Introduction

Risk is inherent in the Bank'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 Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. 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 Bank'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 Bank.

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

Internal Audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank'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 Bank'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 Bank also runs worse case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

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

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Introduction (continued)

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 Bank.

For all levels throughout the Bank, 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 Bank on the utilization of market limits and liquidity, plus any other risk developments.

Risk mitigation

The 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 Bank's performance to developments affecting a particular industry.

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

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank 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 Bank 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 Bank 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 Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank 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 statement of financial position, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

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

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 7.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Impairment assessment

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

PD	The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
EAD	The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.
LGD	The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

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

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

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

Definition of default and cure

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

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

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

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

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

PD estimation process

The Bank runs separate models for its key portfolios. The models incorporate quantitative information and utilise supplemental external information that could affect the borrower's behaviour. In order to consider the impact of macroeconomic factors on probability of default, sensitivity of probabilities to the macroeconomic factors are calculated by statistical regression method. Where practicable, PDs, incorporate forward looking macroeconomic information and the IFRS 9 stage classification of the exposure, are assigned for each grade. This is repeated for each economic scenario as appropriate.

Treasury and interbank relationships

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

Consumer lending and residential mortgages

Consumer lending comprises secured and unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by days past due.

The probability of default for consumer loans is calculated using migration matrices. For this purpose, simplified migration matrices, which reflect the change from respective month of one year to the same month of the next year are prepared based on the amounts of loans in each matrices. Other key inputs into the models are real GDP growth, AZN/USD rates, and LTV ratios.

Corporate and small business lending

The same approach and inputs as for consumer lending applies to corporate and small business lending. For corporate loans, migration matrices used in the PD and LGD calculations are determined by the number of loans in each matrices.

Exposure at default

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

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Loss given default

For corporate lending assets, LGD values are assessed at least quarterly by account managers and reviewed and approved by the Bank.

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

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

Where appropriate, further recent data is used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the group.

LGD rates are estimated for the Stage 1, Stage 2 and Stage 3 segment of each asset class.

Significant increase in credit risk

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

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

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

Grouping financial assets measured on a collective basis

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

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

- The treasury and interbank relationships (such as amounts due from banks, cash equivalents and debt investment securities at amortised cost and FVOCI).

ECL on all other assets calculated on collective basis.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Forward-looking information and multiple economic scenarios

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

- GDP;
- Non-oil GDP;
- Real GDP;
- Non-oil real GDP;
- Nominal people income;
- Nominal salaries;
- Budget income;
- Budget expenses;
- Budget deficit;
- Investments in basic capital;
- Consumer Price Index;
- USD/AZN rate;
- Nominal effective FX rate;
- Non-oil Nominal effective FX rate;
- Real effective FX rate;
- Non-oil Real effective FX rate;
- Volume of overdue credits in the country;
- Percentage of overdue loans to total loans.

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

Credit quality per class of financial assets

The Bank classifies its credit related assets as follows:

High grade − counterparties with highly liquid collaterals or strong government support, excellent financial performance, 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 no overdue in principal and interest.

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.

Impaired − counterparties with unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

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

31 December 2019	*Note*		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	57,138	1,560	–	–	**58,698**
Amounts due from credit institutions	6	Stage 1	2,081	1,725	–	–	**3,806**
Loans to customers at amortised cost	7						
- Government related entities		Stage 1	16,323	–	–	–	**16,323**
- Loans to individuals − consumer loans		Stage 1	14,023	48,522	–	–	**62,545**
		Stage 2	–	–	358	–	**358**
		Stage 3	–	–	–	2,129	**2,129**
- Corporate loans		Stage 1	8,932	26,658	–	–	**35,590**
		Stage 3	–	–	–	9,924	**9,924**
- Loans to individuals − entrepreneurs		Stage 1	–	602	–	–	**602**
		Stage 3	–	–	–	1,875	**1,875**
- Loans to individuals − mortgage loans		Stage 1	–	61,392	–	–	**61,392**
		Stage 2	–	–	241	–	**241**
		Stage 3	–	–	–	117	**117**
Debt securities at FVOCI	8	Stage 1	56,215	–	–	–	**56,215**
Other financial assets	13	Stage 1	1,587	1,699	–	–	**3,286**
Undrawn loan commitments	17	Stage 1	2,599	11,564	–	–	**14,163**
Letters of credit	17	Stage 1	–	941	–	–	**941**
Financial guarantees	17	Stage 1	14,000	19,293	–	–	**33,293**
Total			**172,898**	**173,956**	**599**	**14,045**	**361,498**

31 December 2018	*Note*		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	66,417	35,680	–	–	**102,097**
Amounts due from credit institutions	6	Stage 1	4,704	11,042	–	–	**15,746**
Loans to customers at amortised cost	7						
- Government related entities		Stage 1	26,334	1,484	–	–	**27,818**
- Loans to individuals − consumer loans		Stage 1	12,572	35,724	–	–	**48,296**
		Stage 2	–	–	568	–	**568**
		Stage 3	–	–	–	2,407	**2,407**
- Corporate loans		Stage 1	709	33,054	–	–	**33,763**
		Stage 2	–	–	248	–	**248**
		Stage 3	–	–	–	14,431	**14,431**
- Loans to individuals − entrepreneurs		Stage 1	–	1,233	–	–	**1,233**
		Stage 2	–	–	52	–	**52**
		Stage 3	–	–	–	4,831	**4,831**
- Loans to individuals − mortgage loans		Stage 1	–	47,979	–	–	**47,979**
		Stage 2	–	–	199	–	**199**
		Stage 3	–	–	–	61	**61**
Debt securities at FVOCI	8	Stage 1	51,782	–	–	–	**51,782**
Other financial assets	13	Stage 1	945	349	–	–	**1,294**
Undrawn loan commitments	17	Stage 1	2,491	12,430	–	–	**14,921**
		Stage 2	–	–	32	–	**32**
Letters of credit	17	Stage 1	–	272	–	–	**272**
Financial guarantees	17	Stage 1	969	35,063	–	–	**36,032**
Total			**166,923**	**214,310**	**1,099**	**21,730**	**404,062**

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

See Note 7 for more detailed information with respect to the allowance for impairment of loans to customers.

Financial guarantees, undrawn loan commitments and letters of credit are assessed and a provision for expected credit losses is calculated in similar manner as for loans, see Note 17.

The geographical concentration of Bank's financial assets and liabilities is set out below:

	2019				*2018*			
	Azerbaijan	*OECD*	*CIS and other foreign countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other foreign countries*	*Total*
Assets								
Cash and cash equivalents	57,380	26,397	1,265	**85,042**	98,664	19,935	2,193	**120,792**
Amounts due from credit institutions	2,925	881	–	**3,806**	3,790	6,830	5,126	**15,746**
Investment securities	56,260	–	–	**56,260**	51,827	–	–	**51,827**
Loans to customers	180,269	–	–	**180,269**	165,326	–	–	**165,326**
Other financial assets	1,015	2,222	49	**3,286**	201	986	107	**1,294**
	297,849	**29,500**	**1,314**	**328,663**	**319,808**	**27,751**	**7,426**	**354,985**
Liabilities								
Amounts due to credit institutions and government organizations	97,577	8	132	**97,717**	88,378	12	1,947	**90,337**
Amounts due to customers	182,195	5,025	1,075	**188,295**	216,135	2,554	1,319	**220,008**
Lease Liabilities	4,640	–	–	**4,640**	–	–	–	**–**
Other financial liabilities	335	–	16	**351**	1,151	766	36	**1,953**
	284,747	**5,033**	**1,223**	**291,003**	**305,664**	**3,332**	**3,302**	**312,298**
Net assets	**13,102**	**24,467**	**91**	**37,660**	**14,144**	**24,419**	**4,124**	**42,687**

Liquidity risk and funding management

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

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

The liquidity position is assessed and managed by the Bank based on certain liquidity ratios established by the CBAR. The CBAR requires banks to maintain instant liquidity ratio of more than 30%. As at 31 December, these ratios were as follows:

	2019, %	*2018, %*
Instant liquidity ratio (assets receivable or realisable within one day / liabilities repayable on demand)	73.7	72.77

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The tables below summarise the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. In accordance with Azerbaijani legislation, the Bank is obliged to repay the principal amounts of a term deposit upon demand of the depositor. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

As at 31 December 2019	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions and government organizations	4,909	13,116	39,174	55,078	**112,277**
Amounts due to customers	148,341	20,750	16,524	8,381	**193,996**
Lease Liabilities	618	1,853	2,681	–	**5,152**
Other liabilities	351	–	–	–	**351**
Total undiscounted financial liabilities	**154,219**	**35,719**	**58,379**	**63,459**	**311,776**

As at 31 December 2018	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to credit institutions and government organizations	18,715	3,245	36,987	40,869	**99,816**
Amounts due to customers	163,120	32,313	10,669	27,824	**233,926**
Other liabilities	1,953	–	–	–	**1,953**
Total undiscounted financial liabilities	**183,788**	**35,558**	**47,656**	**68,693**	**335,695**

The table below shows the contractual expiry by maturity of the Bank's credit related commitments. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee and letters of credit contracts, the maximum amount is allocated to the earliest period in which the contract could be called.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2019	48,397	–	–	–	**48,397**
2018	51,257	–	–	–	**51,257**

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

The Bank'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 individuals and entities period less than one year. Any significant withdrawal of these funds would have an adverse impact on the operations of the Bank. This level of funding will remain with the Bank for the foreseeable future and that in the event of withdrawal of funds, the Bank 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.

(Figures in tables are in thousands of Azerbaijani manats)

21. Risk management (continued)

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 and foreign exchanges. The Bank classifies exposures to market risk into non-trading portfolios. Non-trading positions are managed and monitored using sensitivity analysis. Except for the concentrations within foreign currency, the Bank 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. As at 31 December 2019 and 31 December 2018, the Bank does not have any significant floating rate non-trading financial instruments.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the manat, with all other variables held constant on the statement of profit or loss (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of profit or loss. A negative amount in the table reflects a potential net reduction in statement of profit or loss or equity, while a positive amount reflects a net potential increase.

Currency	*Increase in currency rate in % 2019*	*Effect on profit before tax 2019*	*Increase in currency rate in % 2018*	*Effect on profit before tax 2018*
USD	10.00%	994	14.00%	(32)
EUR	10.00%	74	14.00%	2,172

Currency	*Decrease in currency rate in % 2019*	*Effect on profit before tax 2019*	*Decrease in currency rate in % 2018*	*Effect on profit before tax 2018*
USD	-3.00%	(298)	-3.00%	7
EUR	-6.00%	(44)	-3.00%	(466)

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 Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

22. Fair value measurement

Fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair value measurement (continued)

Fair value hierarchy (continued)

For the purpose of fair value disclosures, the Bank 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 as explained above.

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities at FVOCI	31 December 2019	–	56,215	45	**56,260**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2019	85,042	–	–	**85,042**
Amounts due from credit institutions	31 December 2019	–	–	3,806	**3,806**
Loans to customers	31 December 2019	–	–	178,620	**178,620**
Other financial assets	31 December 2019	–	–	3,286	**3,286**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions and government organizations	31 December 2019	–	59,545	38,001	**97,546**
Amounts due to customers	31 December 2019	–	–	190,027	**190,027**
Other financial liabilities	31 December 2019	–	–	351	**351**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Investment securities FVOCI	31 December 2018	–	51,782	45	**51,827**
Loans to customers at FVPL	31 December 2018	–	–	528	**528**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2018	120,792	–	–	**120,792**
Amounts due from credit institutions	31 December 2018	–	–	15,746	**15,746**
Loans to customers	31 December 2018	–	–	160,156	**160,156**
Other financial assets	31 December 2018	–	–	1,294	**1,294**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions and government organizations	31 December 2018	–	43,388	46,949	**90,337**
Amounts due to customers	31 December 2018	–	–	228,231	**228,231**
Other financial liabilities	31 December 2018	–	–	1,953	**1,953**

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair value measurement (continued)

Fair value hierarchy (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 Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2019	*Fair value 2019*	*Unrecognised gain/(loss)*	*Carrying value 2018*	*Fair value 2018*	*Unrecognised gain/(loss)*
Financial assets						
Cash and cash equivalents	85,042	85,042	–	120,792	120,792	–
Amounts due from credit institutions	3,806	3,806	–	15,746	15,746	–
Loans to customers	180,269	178,620	(1,649)	165,326	160,156	(5,170)
Other financial assets	3,286	3,286	–	1,294	1,294	–
Financial liabilities						
Amounts due to credit institutions and government organizations	97,717	97,546	171	90,337	90,337	–
Amounts due to customers	188,295	190,027	(1,732)	220,008	228,231	(8,223)
Other financial liabilities	351	351	–	1,953	1,953	–
			(3,210)			**(13,393)**

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the financial statements and those items that are not measured at fair value in the statement of financial position, but whose fair value is disclosed.

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 and savings accounts without a specific maturity.

Loans at fair value through profit or loss

Loans at fair value through profit or loss are valued using a combination of approaches. Where appropriate, loans are valued with reference to observable prices of debt securities issued by the borrower or by comparable entities. In other cases, valuation is performed using internal models based on present value techniques or, in some circumstances (for example, in respect of cash flow from assets held as collateral), external valuation reports. The non-observable inputs to the models include adjustments for credit, market and liquidity risks associated with the expected cash flows from the borrower's operations or in respect of collateral valuation.

Investment securities

Investment securities valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which sometimes only incorporate data observable in the market and at other times use both observable and non-observable data. The non-observable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and geographical jurisdiction in which the investee operates.

Financial assets and financial liabilities carried at amortized cost

The fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to government organizations and credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Figures in tables are in thousands of Azerbaijani manats)

23. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be due or settled. See Note 21 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2019			*2018*		
	Within one year	***More than one year***	***Total***	***Within one year***	***More than one year***	***Total***
Cash and cash equivalents	85,042	–	**85,042**	120,792	–	**120,792**
Amounts due from credit institutions	3,806	–	**3,806**	15,746	–	**15,746**
Investment securities	53,120	3,140	**56,260**	51,782	45	**51,827**
Loans to customers	76,778	103,491	**180,269**	57,203	108,123	**165,326**
Property and equipment	–	9,065	**9,065**	–	5,626	**5,626**
Intangible assets	–	5,264	**5,264**	–	3,076	**3,076**
Current income tax assets	–	–	**–**	483	–	**483**
Other assets	5,922	–	**5,922**	3,980	–	**3,980**
Total	**224,668**	**120,960**	**345,628**	**249,986**	**116,870**	**366,856**
Amounts due to credit institutions and government organizations	30,962	66,755	**97,717**	21,234	69,103	**90,337**
Amounts due to customers	167,824	20,471	**188,295**	193,523	26,485	**220,008**
Current Income tax liability	765	–	**765**	–	–	**–**
Deferred income tax liability	–	9	**9**	–	95	**95**
Lease liabilities	2,129	2,511	**4,640**	–	–	**–**
Other liabilities	2,181	67	**2,248**	4,522	–	**4,522**
Total	**203,861**	**89,813**	**293,674**	**219,279**	**95,683**	**314,962**
Net	**20,807**	**31,147**	**51,954**	**30,707**	**21,187**	**51,894**

24. 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.

The Government of the Republic of Azerbaijan, acting through the Shareholders, controls the Bank activities. The Government of the Republic of Azerbaijan directly and indirectly controls and has significant influence over a significant number of entities through its government agencies and other organizations (together referred to as "government institutions"). The Government of the Republic of Azerbaijan does not provide to the general public or entities under its ownership/control a complete list of the entities, which are owned or controlled directly or indirectly by the government. Under these circumstances, the management of the Bank disclosed only information that its current internal management system allows to present in relation to operations with government-controlled entities and where the management believes such entities could be considered as government-controlled based on its best knowledge.

(Figures in tables are in thousands of Azerbaijani manats)

24. Related party disclosures (continued)

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:

	2019			*2018*		
	Shareholders	*Entities under common control*	*Key management personnel*	*Shareholders*	*Entities under common control*	*Key management personnel*
Loans outstanding at 1 January, gross	**–**	**27,818**	**231**	**–**	**43,078**	**172**
Loans issued during the year	–	–	–	–	–	117
Loan repayments during the year	–	(11,495)	(69)	–	(14,930)	(58)
Other movements	–	–	–	–	(330)	–
Loans outstanding at 31 December, gross	**–**	**16,323**	**162**	**–**	**27,818**	**231**
Less: allowance for impairment at 31 December	–	–	–	–	(18)	–
Loans outstanding at 31 December, net	**–**	**16,323**	**162**	**–**	**27,800**	**231**
Interest income on loans	–	758	16	–	1,373	16
Credit loss reversal	–	18	–	–	1,565	4

	2019			*2018*		
	Shareholders	*Entities under common control*	*Key management personnel*	*Shareholders*	*Entities under common control*	*Key management personnel*
Deposits at 1 January	**–**	**76,960**	**–**	**–**	**71,103**	**–**
Deposits received during the year	–	–	–	–	19,092	–
Deposits repaid during the year	–	(76,960)	–	–	(13,235)	–
Deposits at 31 December	**–**	**–**	**–**	**–**	**76,960**	**–**
Current accounts as at 31 December	–	21,222	10	–	20,568	36
Cash and cash equivalents	–	31,084	–	–	46,771	–
Due from credit institutions	–	1,725	–	–	1,351	–
Due to credit institutions and government organizations	–	96,163	–	–	73,616	–
Investment securities	–	56,215	–	–	51,782	–
Interest income on due from credit institutions	–	1,746	–	–	2,177	–
Interest income on investment securities	–	2,613	–	–	1,536	–
Interest expense on customer deposits	–	205	–	–	2,504	–
Interest expense on due to credit institutions and government organizations	–	1,669	–	–	1,509	–
Other operating expenses	–	2,902	–	–	2,071	–
Operating income	–	768	–	–	794	–

Compensation of key management personnel is as follows:

	2019	*2018*
Salaries and other benefits	412	326
Social security costs	91	72
Total key management personnel compensation	**503**	**398**

For the year ended 31 December 2019, key management personnel comprised of three (2018: three) members.

(Figures in tables are in thousands of Azerbaijani manats)

25. 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 by the CBAR in supervising the Bank.

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 maximize 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 change was made in the objectives, policies and processes from the previous years.

As at 31 December 2019 the Bank's regulatory capital after deductions were AZN 47,755 which is below the required minimum of AZN 50,000 set by CBAR.

The government of Azerbaijan Republic stands ready to provide capital injection necessary to ensure Bank's compliance with regulatory requirements of the CBAR and enable it to continue normal operations.

Management believes that the Bank will not face any sanctions against the Bank in the future.

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum Tier 1 and total capital adequacy ratio of 5.5% (2018: 5%) and 11% (2018: 10%), respectively, of risk-weighted assets for regulatory capital.

As at 31 December 2019 and 2018, the Bank's capital adequacy ratios on this basis were as follows:

	2019	***2018***
Tier 1 capital	45,657	50,223
Tier 2 capital	2,453	2,104
Less: deductions from capital	(355)	(280)
Total regulatory capital	**47,755**	**52,047**
Risk weighted assets	**144,167**	**210,664**
Capital adequacy ratio (Tier 1)	31.67%	23.30%
Capital adequacy ratio (Total Capital)	33.12%	24.18%

26. Events after reporting period

In light of the recent rapid development of the coronavirus (COVID-19) pandemic, many countries, including the Republic of Azerbaijan, introduced quarantine measures which had significant impact on the level and scale of business activity of market participants. It is expected that both the pandemic itself and measures to minimize its consequences can affect the operations of companies from various industries. The Bank considers this pandemic as a non-adjusting event after the reporting period, the quantitative effect of which cannot be estimated reasonably certain at the current date.

There has been significant volatility in the stock, currency and commodity markets since March 2020, including declining oil prices. As a response to this development, in March 2020 the President of the Republic of Azerbaijan signed a decree for action plans to minimize the impact of the pandemic. In accordance with this decree, anti-crisis stimulus package of AZN 2.5 billion is being developed to support individuals and various businesses in the country. The Central Bank of the Republic of Azerbaijan continues its monetary policy to ensure stability of AZN exchange rates. Currently, the Bank's management is analysing potential impact of changing micro and macro-economic conditions on the financial position and performance of the Bank.

On 3 March 2020, a loan in the amount of AZN 9,000 was fully repaid, which was financed by deposit of the Ministry of Finance of Azerbaijan Republic in the same amount. The respective deposit has also been withdrawn.