OJSC Kapital Bank

Consolidated financial statements

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

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Building a better working world

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Independent auditor's report

To the Shareholders and Supervisory Board of OJSC Kapital Bank

Opinion

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

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the 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 consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the 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 consolidated financial statements

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

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

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

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

Ernst & Young Holdings (CIS) B.V.

2 March 2020

Baku, Azerbaijan

Consolidated statement of financial position

As at 31 December 2019

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	2019	2018
Assets			
Cash and cash equivalents	5	1,685,202	1,540,129
Amounts due from credit institutions	6	124,318	394,187
Investment securities	7	465,136	335,406
Loans to customers	8	1,705,632	1,409,746
Property and equipment	9	53,695	43,273
Right-of-use assets	3	41,132	–
Intangible assets	10	22,205	18,536
Current income tax assets		47,934	–
Deferred income tax assets	11	–	10,650
Other assets	13	51,422	50,382
Total assets		**4,196,676**	**3,802,309**
Liabilities			
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations	15	90,142	116,823
Amounts due to credit institutions	16	6,077	28,160
Amounts due to customers	14	3,360,854	3,098,537
Deferred income tax liabilities	11	17,071	–
Current income tax liabilities		–	40,046
Lease liabilities	3	43,215	–
Other liabilities	13	106,272	59,701
Subordinated loan	17	8,521	–
Total liabilities		**3,632,152**	**3,343,267**
Equity			
Share capital	18	225,850	225,850
Additional paid-in capital		20,870	20,870
Unrealized gain on investment securities		5,791	3,897
Revaluation reserve for premises		1,437	2,241
Retained earnings		310,576	206,184
Total equity		**564,524**	**459,042**
Total liabilities and equity		**4,196,676**	**3,802,309**

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

Rovshan Allahverdiyev — Chairman of the Management Board

Emin Mammadov — Board Member, Chief Financial Officer

2 March 2020

The accompanying notes on pages 6 to 61 are an integral part of these consolidated financial statements.

Consolidated statement of profit or loss

For the year ended 31 December 2019

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	*2019*	*2018*
Interest income			
Loans to customers		371,319	264,014
Investment securities		34,094	34,510
Amounts due from credit institutions		10,455	20,425
Cash and cash equivalents		10,446	13,516
Interest income calculated using effective interest rate		**426,314**	**332,465**
Interest expense			
Amounts due to customers		(59,834)	(79,575)
Lease liabilities		(4,773)	–
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations		(2,299)	(3,908)
Amounts due to credit institutions		(274)	(4,002)
Other		(958)	–
		(68,138)	**(87,485)**
Net interest income		**358,176**	**244,980**
Credit loss expense on financial assets	12	(24,657)	(15,568)
Net interest income after credit loss expense		**333,519**	**229,412**
Net fee and commission income	20	93,295	90,419
Net gains from foreign currencies		28,137	23,449
Net losses on initial recognition of financial instruments		(3,624)	(1,324)
Other operating income	21	4,059	2,977
Non-interest income		**121,867**	**115,521**
Personnel expenses	22	(96,610)	(78,180)
General and administrative expenses	23	(73,183)	(53,519)
Depreciation of property and equipment and amortisation of intangible assets	9, 10	(16,139)	(13,851)
Depreciation of right-of-use assets	3	(6,372)	–
Provision for credit related commitments and other impairment	12	(10,035)	(5,892)
Non-interest expenses		**(202,339)**	**(151,442)**
Profit before income tax expense		**253,047**	**193,491**
Income tax expense	11	(57,030)	(42,495)
Profit for the year		**196,017**	**150,996**

The accompanying notes on pages 6 to 61 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2019

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	2019	2018
Profit for the year		**196,017**	**150,996**
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Revaluation of premises	9	(1,005)	824
Gains on equity instruments at fair value through other comprehensive income		2,367	782
Income tax relating to components of other comprehensive income	11	(272)	(321)
Total other comprehensive income not to be reclassified to profit or loss in subsequent periods		**1,090**	**1,285**
Other comprehensive income for the year, net of tax		**1,090**	**1,285**
Total comprehensive income for the year		**197,107**	**152,281**

The accompanying notes on pages 6 to 61 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2019

(Amounts presented are in thousands of Azerbaijani manats)

	Share capital	Additional paid-in capital	Unrealized gain on investment securities	Revaluation reserve for premises	Retained earnings	Total equity
1 January 2018	185,850	20,870	3,271	1,582	150,028	361,601
Profit for the year	–	–	–	–	150,996	150,996
Other comprehensive income for the year	–	–	626	659	–	1,285
Total comprehensive income for the year	–	–	626	659	150,996	152,281
Issuance of preference shares (Note 18)	40,000	–	–	–	–	40,000
Dividends to shareholders of the Bank (Note 18)	–	–	–	–	(94,840)	(94,840)
31 December 2018	225,850	20,870	3,897	2,241	206,184	459,042
Profit for the year	–	–	–	–	196,017	196,017
Other comprehensive income/ (loss) for the year	–	–	1,894	(804)	–	1,090
Total comprehensive income/ (loss) for the year	–	–	1,894	(804)	196,017	197,107
Dividends to shareholders of the Bank (Note 18)	–	–	–	–	(91,625)	(91,625)
31 December 2019	225,850	20,870	5,791	1,437	310,576	564,524

The accompanying notes on pages 6 to 61 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2019

(Amounts presented are in thousands of Azerbaijani manats)

	Notes	2019	2018
Cash flows from operating activities			
Interest received		435,022	352,902
Interest paid		(87,962)	(87,722)
Fees and commissions received		118,562	103,002
Fees and commissions paid		(22,828)	(14,541)
Net realized gains from foreign currency operations		22,195	23,622
Other operating income received		3,908	1,173
Personnel expenses paid		(83,228)	(72,497)
General and administrative expenses paid		(68,574)	(53,793)
Cash flows from operating activities before changes in operating assets and liabilities		**317,095**	**252,146**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		268,154	173,989
Loans to customers		(331,007)	(285,612)
Other assets		(6,783)	(289)
Net increase/(decrease) in operating liabilities			
Amounts due to customers		288,513	649,937
Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations		(26,204)	(144,834)
Amounts due to credit institutions		(21,734)	(36,041)
Other liabilities		9,849	(8,679)
Net cash flows from operating activities before income tax		**497,883**	**600,617**
Income tax paid		(118,716)	(33,281)
Net cash from operating activities		**379,167**	**567,336**
Cash flows from investing activities			
Purchase of investment securities		(3,054,331)	(1,934,285)
Proceeds from sale and redemption of investment securities		2,929,801	1,892,767
Purchase of property and equipment		(17,807)	(13,851)
Proceeds from sale of property and equipment		151	57
Purchase of intangible assets		(6,426)	(4,751)
Net cash used in investing activities		**(148,612)**	**(60,063)**
Cash flows from financing activities			
Proceeds from issue of preference shares	18	-	40,000
Lease liability paid	3	(9,062)	-
Proceeds from subordinated loan		8,500	-
Dividends paid to shareholders of the Bank, net of tax	18	(82,463)	(85,356)
Net cash used in financing activities		**(83,025)**	**(45,356)**
Effect of exchange rates changes on cash and cash equivalents		(2,457)	(6,965)
Net increase in cash and cash equivalents		**145,073**	**454,952**
Cash and cash equivalents, beginning		1,540,129	1,085,177
Cash and cash equivalents, ending	5	**1,685,202**	**1,540,129**

The accompanying notes on pages 6 to 61 are an integral part of these consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani manats)

1. Principal activities

Open Joint Stock Company Kapital Bank (the "Bank") was established in accordance with the legislation of the Republic of Azerbaijan. The Bank operates under banking license No. 244 issued by the Central Bank of the Republic of Azerbaijan ("CBAR") on 25 February 2000.

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, 16 independent units (2018: 12) and 101 branches (2018: 98).

The Bank participates in the State deposit insurance program, which was introduced by the Azeri Law, *Insurance of Individual Deposits in the Republic of Azerbaijan* dated 29 December 2006. Azerbaijan Deposit Insurance Fund fully guarantees deposits for a period of three years in local currency with an interest rate up to 10% (2018: 15%), as well as deposits in foreign currency with an interest rate up to 2.5% (2018: 3%).

The number of Bank's employees as at 31 December 2019 was 3,250 (2018: 2,814).

The Bank's registered legal address is 71 Fuzuli Street, Baku, AZ1014, Azerbaijan.

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

Shareholder	*2019 %,*	*2018 %,*
Pasha Holding Ltd.	99.87	99.87
Individuals	0.13	0.13
Total	**100.00**	**100.00**

As at 31 December 2019, the Bank is ultimately owned by Mrs. Leyla Aliyeva, Mrs. Arzu Aliyeva and Mr. Arif Pashayev (31 December 2018: Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva), who exercise joint control over the Bank.

As at 31 December 2019, the Bank owns 100% of "Birkart non-bank credit organization" Limited Liability Company (the "subsidiary"), which was established by the Bank on 3 May 2018 in accordance with the legislation of the Republic of Azerbaijan. As at 31 December 2019 and 2018, the Bank fully paid up issued and outstanding share capital totalled AZN 500 divided into 50 shares, each with a par value of AZN 10,000. First branch of the subsidiary was opened on 3 April 2019. As at 31 December 2019, "Birkart NBCO" has 19 branches and 31 employees. The subsidiary facilitates lending via Birkart plastic cards and other bank-related financial services, such as leasing, factoring and issuance of bank guarantees.

OJSC Kapital Bank and its subsidiary (together – the "Bank") were consolidated in these consolidated financial statements.

2. Basis of preparation

General

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

The Azerbaijani manat is the functional and presentation currency of the Bank as the majority of the transactions are denominated, measured, or funded in Azerbaijani manat. Transactions in other currencies are treated as transactions in foreign currencies. The Bank maintains its records and prepares its consolidated financial statements in Azerbaijani manat and in accordance with IFRS. These consolidated financial statements are presented in thousands of Azerbaijani manat ("AZN"), except per share amounts and unless otherwise indicated. These consolidated financial statements have been prepared under the historical cost convention except for premises and investment securities at FVOCI and derivative financial assets and liabilities which have been measured at fair value.

(Amounts presented are in thousands of Azerbaijani manats)

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.

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	
Right-of-use assets	44,248
Total assets	**44,248**
Liabilities	
Lease liabilities	44,248
Total liabilities	**44,248**

(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.

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

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.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

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 44,248 were recognised;
- Lease liabilities of AZN 44,248 were recognised.

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	**–**
Weighted average incremental borrowing rate as at 1 January 2019	9.6%
Discounted operating lease commitments at 1 January 2019	**–**
Change in management estimations about lease agreement terms	44,248
Lease liabilities as at 1 January 2019	**44,248**

(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 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.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

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.

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 consolidated statement of financial position, consolidated income statement and consolidated 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:

	Right-of-use assets Premises	*Lease liabilities*
As at 1 January 2019	**44,248**	**44,248**
Additions	3,256	3,256
Depreciation expense	(6,372)	–
Interest expense	–	4,773
Payments	–	(9,062)
As at 31 December 2019	**41,132**	**43,215**

The Bank had total cash outflows for leases of AZN 9,062 in 2019. The Bank also had non-cash additions to right-of-use assets and lease liabilities of AZN 3,256 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 (including those for the subsidiaries) will be accepted by the taxation authorities. The Interpretation did not have an impact on the consolidated financial statements of the Bank.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

Amendments to IFRS 9 Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of an event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. These amendments had no impact on the consolidated financial statements of the Bank.

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 consolidated financial statements of the Bank.

Basis of consolidation

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

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

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

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

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

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interests even if that results in a deficit balance. If the Bank loses control over a subsidiary, it derecognises the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognises the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss.

3. Summary of accounting policies (continued)

Fair value measurement

The Bank measures financial instruments carried at FVPL and FVOCI and non-financial assets such as premises 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.

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.

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

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

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

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

The Bank only measures amounts due from credit institutions, loans to customers, investment debt securities and other financial investments 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).

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.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets and liabilities (continued)

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 consolidated 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.

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 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.

3. Summary of accounting policies (continued)

Derivative financial instruments

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

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

Derivatives embedded in liabilities and non-financial host contacts are treated as separate derivatives and recorded at fair value if they met the definition of a derivative (as defined above), their economic characteristics and risks were not closely related to those of the host contract, and the host contract was not itself held for trading or designated at FVPL. The embedded derivatives separated from the host were carried at fair value in the trading portfolio with changes in fair value recognised in the consolidated statement of profit or loss.

Financial assets are classified based on the business model and SPPI assessments.

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 customers, amounts due to the Central Bank of the Republic of Azerbaijan and government organizations, amounts due to credit institutions and debt securities issued. 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 amortization process.

If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognised in profit or loss.

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.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

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. Restructuring of impaired loans does not result in derecognition of financial instrument. 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, presented within interest income calculated using EIR in the consolidated statement of profit or loss, to the extent that an impairment loss has not already been recorded.

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.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

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.

Property and equipment

Equipment is 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 equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Following initial recognition at cost, premises are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, in which case the increase is recognised in profit or loss. A revaluation deficit is recognised in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

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:

	Years
Premises	20
Leasehold improvements	10
Computers and other office equipment	5
Furniture, fixtures, vehicles and others	5

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

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

3. Summary of accounting policies (continued)

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic lives of 1 to 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Provisions

Provisions are recognised 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 has no significant post-employment benefits.

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 and other contributions made by shareholders are recognised as additional paid-in capital.

Dividends

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

Contingencies

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

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the 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 income 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 income 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.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

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);
- Income which forms an integral part of the effective interest rate of a financial instrument is recognized as an adjustment to the effective interest rate and recorded in 'interest income'.

Customer loyalty programs

The Bank offers a number customer loyalty programs. Accounting for such programs varies depending on who is identified as the customer, and whether the Bank acts as an agent or as a principal under the contract. For point-based programs, the Bank generally recognized a liability for the accumulated points that are expected to be utilized by the customers, which is reversed to profit or loss as the points expire. Cashbacks on plastic card transactions reduce fee and commission income.

Dividend income

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

Foreign currency translation

The consolidated 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 consolidated statement of profit or loss as net gains (losses) from foreign currency 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 issued but not yet effective

The new and amended 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 new and amended standards and interpretations, 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' consolidated financial statements.

(Amounts presented are in thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

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' consolidated financial statements.

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 consolidated 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 consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 25.

Impairment losses on financial assets

The measurement of impairment 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 internal credit grading model, which assigns PDs to the individual grades;
- 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 8 and 24.

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 (for example, when the Bank does not enter into financing transactions) or when they need to be adjusted to reflect the terms and conditions of the lease (for example, when leases are not in the Bank's functional currency).

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 Bank's credit rating). More details are provided in Note 3.

(Amounts presented are in thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates (continued)

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.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2019	*2018*
Cash on hand	533,265	351,270
Current accounts with the CBAR	608,463	836,365
Current accounts with other credit institutions	38,877	157,756
Time deposits with the CBAR up to 90 days	41,727	62,739
Time deposits with the credit institutions up to 90 days	462,704	101,377
Cash in transit	166	30,622
Cash and cash equivalents	**1,685,202**	**1,540,129**

As at 31 December 2019, current accounts with other credit institutions consist of non-interest bearing correspondent accounts balances with resident and non-resident banks in the amount of AZN 12,647 (2018: AZN 24,768) and AZN 26,230 (2018: AZN 132,988), respectively.

As at 31 December 2019, time deposits with the credit institutions up to 90 days consist of interest bearing short-term deposits placed in four (2018: three) non-resident banks in the amount of AZN 462,704 (2018: AZN 101,377).

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

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2019	*2018*
Time deposits with the credit institutions	17,156	331,573
Blocked accounts with the credit institutions	52,658	41,627
Loans to credit institutions	13,873	803
Obligatory reserve with the CBAR	22,001	20,568
Other amounts from credit institutions	18,630	-
	124,318	**394,571**
Less – impairment loss allowance	-	(384)
Amounts due from credit institutions	**124,318**	**394,187**

As at 31 December 2019, time deposits with the credit institutions include interest bearing time deposits placed in two non-resident banks in the amount of AZN 17,156 (2018: six non-resident banks in the amount of AZN 331,573).

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

As at 31 December 2019, loans to credit institutions include AZN 13,873 (2018: AZN 803) issued to one non-resident bank and two resident non-bank credit institutions (2018: three resident non-bank credit institutions).

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

(Amounts presented are in thousands of Azerbaijani manats)

6. Amounts due from credit institutions (continued)

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2019 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**393,768**	**803**	**–**	**394,571**
New assets originated or purchased	49,513	–	–	**49,513**
Assets repaid	(319,109)	(657)	–	**(319,766)**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
At 31 December 2019	**124,172**	**146**	**–**	**124,318**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2019	**233**	**151**	**–**	**384**
New assets originated or purchased	–	–	–	**–**
Assets repaid	(233)	(151)	–	**(384)**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	–	–	–	**–**
At 31 December 2019	**–**	**–**	**–**	**–**

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2018 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**572,372**	**–**	**–**	**572,372**
New assets originated or purchased	372,940	–	–	**372,940**
Assets repaid	(550,741)	–	–	**(550,741)**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(803)	803	–	**–**
Transfers to Stage 3	–	–	–	**–**
At 31 December 2018	**393,768**	**803**	**–**	**394,571**

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL allowance as at 1 January 2018	**–**	**–**	**–**	**–**
New assets originated or purchased	384	–	–	**384**
Assets repaid	–	–	–	**–**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(151)	151	–	**–**
Transfers to Stage 3	–	–	–	**–**
At 31 December 2018	**233**	**151**	**–**	**384**

(Amounts presented are in thousands of Azerbaijani manats)

7. Investment securities

Investment securities comprise:

	2019	*2018*
Debt securities at amortized cost		
US Treasury bills	139,220	-
Notes issued by the CBAR	118,583	179,257
Notes issued by the Ministry of Finance of the Republic of Azerbaijan	117,368	123,608
Corporate bonds	19,917	26,971
	395,088	**329,836**
Debt securities at FVOCI		
Notes issued by the Azerbaijan Mortgage and Credit Guarantee Fund	62,110	-
	62,110	**-**
Equity securities at FVOCI		
Corporate shares	7,938	5,570
	7,938	**5,570**
Investment securities	**465,136**	**335,406**

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

8. Loans to customers

Loans to customers comprise:

	2019	*2018*
Government-related entities	145,814	327,594
Corporate loans	276,682	126,523
Loans to individuals – consumer loans	1,321,783	993,493
Loans to individuals – mortgage loans	52,818	34,745
Loans to individuals – entrepreneurs	14,777	8,263
Gross loans to customers at amortised cost	**1,811,874**	**1,490,618**
Less – allowance for loan impairment	(106,242)	(80,872)
Loans to customers at amortised cost	**1,705,632**	**1,409,746**

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Allowance for impairment of loans to customers at amortised cost

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

Government related entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**324,179**	**7**	**3,408**	**327,594**
New assets originated or purchased	53,270	–	–	53,270
Assets repaid	(232,790)	(7)	(2,253)	(235,050)
Assets sold	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	(11,564)	–	11,564	–
Unwinding of discount	–	–	–	–
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	–
Recoveries	–	–	–	–
Amounts written off	–	–	–	–
At 31 December 2019	**133,095**	**–**	**12,719**	**145,814**

Government related entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(11,470)**	–	**(1,667)**	(13,137)
New assets originated or purchased	(3,376)	–	–	(3,376)
Assets repaid	7,056	–	1,211	8,267
Assets sold	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	–	–	–	–
Transfers to Stage 3	2,532	–	(2,532)	–
Unwinding of discount (recognised in interest income)	–	–	3	3
Changes due to modifications not resulting in derecognition	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	–
Changes to inputs used for ECL calculations	(1,790)	–	19	(1,771)
Recoveries	–	–	–	–
Amounts written off	–	–	–	–
At 31 December 2019	**(7,048)**	**–**	**(2,966)**	**(10,014)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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	**76,885**	**24,830**	**24,808**	**126,523**
New assets originated or purchased	232,010	–	–	232,010
Assets repaid	(53,693)	(21,842)	(6,439)	(81,974)
Assets sold	–	–	–	–
Transfers to Stage 1	2,219	(2,219)	–	–
Transfers to Stage 2	(108,762)	108,762	–	–
Transfers to Stage 3	(2,858)	(7)	2,865	–
Unwinding of discount	–	–	–	–
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	–
Recoveries	–	–	196	196
Amounts written off	–	–	(73)	(73)
At 31 December 2019	**145,801**	**109,524**	**21,357**	**276,682**

Corporate loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(1,658)**	**(1,769)**	**(8,494)**	**(11,921)**
New assets originated or purchased	(7,207)	–	–	(7,207)
Assets repaid	857	701	2,059	3,617
Assets sold	–	–	–	–
Transfers to Stage 1	(1,062)	1,062	–	–
Transfers to Stage 2	3,845	(3,845)	–	–
Transfers to Stage 3	1,367	1	(1,368)	–
Unwinding of discount (recognised in interest income)	–	–	(756)	(756)
Changes due to modifications not resulting in derecognition	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	875	(1,875)	(68)	(1,068)
Changes to inputs used for ECL calculations	(6)	(3)	(113)	(122)
Recoveries	–	–	(196)	(196)
Amounts written off	–	–	73	73
At 31 December 2019	**(2,989)**	**(5,728)**	**(8,863)**	**(17,580)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 individuals – consumer loans during the year ended 31 December 2019 is as follows:

Loans to individuals – consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**482,635**	**484,213**	**26,645**	**993,493**
New assets originated or purchased	902,322	-	-	**902,322**
Assets repaid	(324,170)	(238,568)	(13,072)	**(575,810)**
Assets sold	-	-	-	-
Transfers to Stage 1	15,501	(15,328)	(173)	-
Transfers to Stage 2	(514,615)	518,431	(3,816)	-
Transfers to Stage 3	(24,217)	(6,376)	30,593	-
Unwinding of discount	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Recoveries	-	-	5,206	**5,206**
Amounts written off	-	-	(3,428)	**(3,428)**
At 31 December 2019	**537,456**	**742,372**	**41,955**	**1,321,783**

Loans to individuals – consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(7,567)**	**(25,239)**	**(18,004)**	**(50,810)**
New assets originated or purchased	(41,955)	-	-	**(41,955)**
Assets repaid	4,396	12,061	10,111	**26,568**
Assets sold	-	-	-	-
Transfers to Stage 1	(1,052)	961	91	-
Transfers to Stage 2	25,438	(27,648)	2,210	-
Transfers to Stage 3	12,898	1,035	(13,933)	-
Unwinding of discount (recognised in interest income)	-	-	(434)	**(434)**
Changes due to modifications not resulting in derecognition	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	823	562	(7,697)	**(6,312)**
Changes to inputs used for ECL calculations	1,252	3,258	(1,337)	**3,173**
Recoveries	-	-	(5,206)	**(5,206)**
Amounts written off	-	-	3,428	**3,428**
At 31 December 2019	**(5,767)**	**(35,010)**	**(30,771)**	**(71,548)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 individuals – mortgage loans during the year ended 31 December 2019 is as follows:

Loans to individuals – mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**34,448**	**166**	**131**	**34,745**
New assets originated or purchased	21,447	–	–	**21,447**
Assets repaid	(3,348)	(22)	(4)	**(3,374)**
Assets sold	–	–	–	**–**
Transfers to Stage 1	22	–	(22)	**–**
Transfers to Stage 2	(982)	982	–	**–**
Transfers to Stage 3	(346)	(19)	365	**–**
Unwinding of discount	–	–	–	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	**–**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2019	**51,241**	**1,107**	**470**	**52,818**

Loans to individuals – mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(305)**	**(28)**	**(3)**	**(336)**
New assets originated or purchased	(236)	–	–	**(236)**
Assets repaid	27	3	3	**33**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	126	(126)	–	**–**
Transfers to Stage 3	2	–	(2)	**–**
Unwinding of discount (recognised in interest income)	–	–	(3)	**(3)**
Changes due to modifications not resulting in derecognition	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	(438)	(230)	**(668)**
Changes to inputs used for ECL calculations	161	(43)	(62)	**56**
Recoveries	–	–	–	**–**
Amounts written off	–	–	–	**–**
At 31 December 2019	**(225)**	**(632)**	**(297)**	**(1,154)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 individuals – entrepreneurs loans during the year ended 31 December 2019 is as follows:

Loans to individuals – entrepreneurs	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2019	**1,085**	**554**	**6,624**	**8,263**
New assets originated or purchased	8,536	–	–	**8,536**
Assets repaid	(1,161)	(312)	(431)	**(1,904)**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	(3,991)	3,991	–	**–**
Transfers to Stage 3	(895)	–	895	**–**
Unwinding of discount	–	–	–	**–**
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	**–**
Recoveries	–	–	35	**35**
Amounts written off	–	–	(153)	**(153)**
At 31 December 2019	**3,574**	**4,233**	**6,970**	**14,777**

Loans to individuals – entrepreneurs	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(20)**	**(116)**	**(4,532)**	**(4,668)**
New assets originated or purchased	(1,544)	–	–	**(1,544)**
Assets repaid	38	50	1,177	**1,265**
Assets sold	–	–	–	**–**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	742	(742)	–	**–**
Transfers to Stage 3	654	–	(654)	**–**
Unwinding of discount (recognised in interest income)	–	–	(734)	**(734)**
Changes due to modifications not resulting in derecognition	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	(135)	–	**(135)**
Changes to inputs used for ECL calculations	–	11	(259)	**(248)**
Recoveries	–	–	(35)	**(35)**
Amounts written off	–	–	153	**153**
At 31 December 2019	**(130)**	**(932)**	**(4,884)**	**(5,946)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 Government related loans during the year ended 31 December 2018 is as follows:

Government related entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**444,050**	**4,241**	**1,958**	**450,249**
New assets originated or purchased	93,457	-	-	**93,457**
Assets repaid	(209,024)	(4,163)	(18)	**(213,205)**
Assets sold	-	-	-	**-**
Transfers to Stage 1	78	(78)	-	**-**
Transfers to Stage 2	(7)	7	-	**-**
Transfers to Stage 3	(3,866)	-	3,866	**-**
Unwinding of discount	-	-	-	**-**
Changes to contractual cash flows due to modifications not resulting in derecognition	(509)	-	-	**(509)**
Recoveries	-	-	-	**-**
Amounts written off	-	-	(2,398)	**(2,398)**
At 31 December 2018	**324,179**	**7**	**3,408**	**327,594**

Government related entities	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(8,902)**	**(86)**	**(1,704)**	**(10,692)**
New assets originated or purchased	(4,547)	-	-	**(4,547)**
Assets repaid	1,030	79	-	**1,109**
Assets sold	-	-	-	**-**
Transfers to Stage 1	(7)	7	-	**-**
Transfers to Stage 2	-	-	-	**-**
Transfers to Stage 3	1,782	-	(1,782)	**-**
Unwinding of discount (recognised in interest income)	-	-	(579)	**(579)**
Changes due to modifications not resulting in derecognition	-	-	-	**-**
Impact on period end ECL of exposures transferred between stages during the period	6	-	-	**6**
Changes to inputs used for ECL calculations	(832)	-	-	**(832)**
Recoveries	-	-	-	**-**
Amounts written off	-	-	2,398	**2,398**
At 31 December 2018	**(11,470)**	**-**	**(1,667)**	**(13,137)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 2018 is as follows:

Corporate loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**34,258**	**32,401**	**46,777**	**113,436**
New assets originated or purchased	83,035	–	–	**83,035**
Assets repaid	(21,453)	(20,348)	(15,877)	**(57,678)**
Assets sold	–	–	–	–
Transfers to Stage 1	7,984	(7,984)	–	–
Transfers to Stage 2	(23,008)	23,008	–	–
Transfers to Stage 3	(3,931)	(2,247)	6,178	–
Unwinding of discount	–	–	–	–
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	–
Recoveries	–	–	–	–
Amounts written off	–	–	(12,270)	**(12,270)**
At 31 December 2018	**76,885**	**24,830**	**24,808**	**126,523**

Corporate loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(755)**	**(6,540)**	**(22,709)**	**(30,004)**
New assets originated or purchased	(2,590)	–	–	**(2,590)**
Assets repaid	596	2,081	5,550	**8,227**
Assets sold	–	–	–	–
Transfers to Stage 1	(3,114)	3,114	–	–
Transfers to Stage 2	1,086	(1,086)	–	–
Transfers to Stage 3	492	259	(751)	–
Unwinding of discount (recognised in interest income)	–	–	(2,530)	**(2,530)**
Changes due to modifications not resulting in derecognition	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	2,667	(104)	155	**2,718**
Changes to inputs used for ECL calculations	(40)	507	(479)	**(12)**
Recoveries	–	–	–	–
Amounts written off	–	–	12,270	**12,270**
At 31 December 2018	**(1,658)**	**(1,769)**	**(8,494)**	**(11,921)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 individuals – consumer loans during the year ended 31 December 2018 is as follows:

Loans to individuals – consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**295,735**	**313,092**	**37,015**	**645,842**
New assets originated or purchased	793,092	-	-	**793,092**
Assets repaid	(261,355)	(151,481)	(9,729)	**(422,565)**
Assets sold	-	-	-	-
Transfers to Stage 1	93,022	(91,629)	(1,393)	-
Transfers to Stage 2	(419,411)	420,985	(1,574)	-
Transfers to Stage 3	(18,140)	(5,864)	24,004	-
Unwinding of discount	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Recoveries	-	-	-	-
Amounts written off	(308)	(890)	(21,678)	**(22,876)**
At 31 December 2018	**482,635**	**484,213**	**26,645**	**993,493**

Loans to individuals – consumer loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(4,436)**	**(16,533)**	**(31,654)**	**(52,623)**
New assets originated or purchased	(36,330)	-	-	**(36,330)**
Assets repaid	2,162	4,563	2,727	**9,452**
Assets sold	-	-	-	-
Transfers to Stage 1	(5,936)	5,289	647	-
Transfers to Stage 2	22,360	(23,313)	953	-
Transfers to Stage 3	8,110	709	(8,819)	-
Unwinding of discount (recognised in interest income)	-	-	(58)	**(58)**
Changes due to modifications not resulting in derecognition	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	4,906	819	(3,719)	**2,006**
Changes to inputs used for ECL calculations	1,289	2,337	241	**3,867**
Recoveries	-	-	-	-
Amounts written off	308	890	21,678	**22,876**
At 31 December 2018	**(7,567)**	**(25,239)**	**(18,004)**	**(50,810)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 individuals – mortgage loans during the year ended 31 December 2018 is as follows:

Loans to individuals – mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**29,246**	**492**	**2,614**	**32,352**
New assets originated or purchased	7,363	-	-	**7,363**
Assets repaid	(2,297)	(73)	(1,131)	**(3,501)**
Assets sold	-	-	-	-
Transfers to Stage 1	368	(284)	(84)	-
Transfers to Stage 2	(143)	143	-	-
Transfers to Stage 3	(89)	(112)	201	-
Unwinding of discount	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Recoveries	-	-	-	-
Amounts written off	-	-	(1,469)	**(1,469)**
At 31 December 2018	**34,448**	**166**	**131**	**34,745**

Loans to individuals – mortgage loans	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(197)**	**(188)**	**(2,605)**	**(2,990)**
New assets originated or purchased	(56)	-	-	**(56)**
Assets repaid	-	6	1,068	**1,074**
Assets sold	-	-	-	-
Transfers to Stage 1	(155)	77	78	-
Transfers to Stage 2	2	(2)	-	-
Transfers to Stage 3	-	64	(64)	-
Unwinding of discount (recognised in interest income)	-	-	(10)	**(10)**
Changes due to modifications not resulting in derecognition	-	-	-	-
Impact on period end ECL of exposures transferred between stages during the period	157	(18)	61	**200**
Changes to inputs used for ECL calculations	(56)	33	-	**(23)**
Recoveries	-	-	-	-
Amounts written off	-	-	1,469	**1,469**
At 31 December 2018	**(305)**	**(28)**	**(3)**	**(336)**

(Amounts presented are in thousands of Azerbaijani manats)

8. 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 individuals – entrepreneurs loans during the year ended 31 December 2018 is as follows:

Loans to individuals – entrepreneurs	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Gross carrying value as at 1 January 2018	**890**	**14**	**11,151**	**12,055**
New assets originated or purchased	2,491	–	–	**2,491**
Assets repaid	(771)	(54)	(1,863)	**(2,688)**
Assets sold	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	(594)	594	–	–
Transfers to Stage 3	(931)	–	931	–
Unwinding of discount	–	–	–	–
Changes to contractual cash flows due to modifications not resulting in derecognition	–	–	–	–
Recoveries	–	–	–	–
Amounts written off	–	–	(3,595)	**(3,595)**
At 31 December 2018	**1,085**	**554**	**6,624**	**8,263**

Loans to individuals – entrepreneurs	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2018	**(46)**	**(2)**	**(9,030)**	**(9,078)**
New assets originated or purchased	(133)	–	–	**(133)**
Assets repaid	35	2	1,532	**1,569**
Assets sold	–	–	–	–
Transfers to Stage 1	–	–	–	–
Transfers to Stage 2	122	(122)	–	–
Transfers to Stage 3	–	–	–	–
Unwinding of discount (recognised in interest income)	–	–	(629)	**(629)**
Changes due to modifications not resulting in derecognition	–	–	–	–
Impact on period end ECL of exposures transferred between stages during the period	–	6	–	**6**
Changes to inputs used for ECL calculations	2	–	–	**2**
Recoveries	–	–	–	–
Amounts written off	–	–	3,595	**3,595**
At 31 December 2018	**(20)**	**(116)**	**(4,532)**	**(4,668)**

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Modified and restructured loans

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes.

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

The table below includes Stage 2 and 3 assets that were modified during the period, with the related modification loss suffered by the Bank.

	2019	*2018*
Loans modified during the period		
Amortised cost before modification	–	31,210
Net modification loss	–	(509)

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 lending, charges over real estate properties and vehicles, third party guarantees;
- For retail lending, mortgages over residential properties.

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

The Bank calculates LGD rate of several corporate and small lending loans in Stage 3 using discounted value of collaterals. As at 31 December 2019, maximum exposure of such loans amounted to AZN 24,198 (2018: AZN 26,479) for which ECL of AZN 10,255 (2018: AZN 9,683) was created. If these loans were not collateralized, ECL amount for these loans would be AZN 22,252 (2018: AZN 15,307) based on the collective assessment.

Concentration of loans to customers

Loans are extended to the following types of customers:

	2019	*2018*
Government related entities	145,814	327,594
Private entities	276,682	126,523
Individuals	1,374,601	1,028,238
Individual entrepreneurs	14,777	8,263
Loans to customers, gross	**1,811,874**	**1,490,618**

Loans are made principally in the following industry sectors:

	2019	*2018*
Individuals	1,374,601	1,028,238
Trade and services	137,975	84,181
Construction	82,705	103,383
Manufacturing	65,185	47,744
Telecommunication	58,403	77,297
Transport	57,608	131,459
Agriculture and food processing	22,318	16,973
Other	13,079	1,343
Loans to customers, gross	**1,811,874**	**1,490,618**

(Amounts presented are in thousands of Azerbaijani manats)

8. Loans to customers (continued)

Concentration of loans to customers (continued)

As at 31 December 2019, the Bank had a concentration of loans represented by AZN 282,241 or 16% of gross loan portfolio (2018: AZN 375,884 or 25%) due from twelve (2018: twelve) largest borrowers of the Bank. An allowance of AZN 9,782 (2018: AZN 12,079) was recognized against these loans.

9. Property and equipment

The movements in property and equipment were as follows:

	Premises	*Leasehold improvements*	*Computers and other office equipment*	*Furniture, fixtures, vehicles and others*	*Total*
Cost or revaluation					
31 December 2017	**6,014**	**5,898**	**13,707**	**57,048**	**82,667**
Additions	–	1,516	3,435	9,386	**14,337**
Disposals	–	–	(68)	(455)	**(523)**
Effect of revaluation	523	–	–	–	**523**
31 December 2018	**6,537**	**7,414**	**17,074**	**65,979**	**97,004**
Additions	490	3,462	2,547	17,592	**24,091**
Disposals	–	(23)	(378)	(1,501)	**(1,902)**
Effect of revaluation	(1,338)	–	–	–	**(1,338)**
31 December 2019	**5,689**	**10,853**	**19,243**	**82,070**	**117,855**
Accumulated depreciation and impairment					
31 December 2017	**–**	**(844)**	**(7,313)**	**(35,712)**	**(43,869)**
Depreciation charge	(301)	(674)	(2,238)	(7,405)	**(10,618)**
Disposals	–	–	–	455	**455**
Effect of revaluation	301	–	–	–	**301**
31 December 2018	**–**	**(1,518)**	**(9,551)**	**(42,662)**	**(53,731)**
Depreciation charge	(333)	(900)	(2,607)	(8,266)	**(12,106)**
Disposals	–	21	390	933	**1,344**
Effect of revaluation	333	–	–	–	**333**
31 December 2019	**–**	**(2,397)**	**(11,768)**	**(49,995)**	**(64,160)**
Net book value					
31 December 2017	6,014	5,054	6,394	21,336	38,798
31 December 2018	6,537	5,896	7,523	23,317	43,273
31 December 2019	5,689	8,456	7,475	32,075	53,695

As at 31 December 2019, property and equipment amounting to AZN 36,071 (2018: AZN 27,769) were fully depreciated.

As at 31 December 2019, property and equipment contained items in warehouse amounting to AZN 8,989 (2018: AZN 2,293).

The Bank engaged an independent appraiser, KONEKO LLC, to determine the fair value of its premises as at 31 December 2019 and 2018. Fair value is determined by reference to market-based evidence. The valuation method used was comparison analysis. The revaluation loss (2018: gain) amounting to AZN 1,005 (2018: AZN 824) has been recognized through other comprehensive income.

If the premises were measured using the cost model, the carrying amounts would be as follows:

	2019	*2018*
Cost	7,658	7,658
Accumulated depreciation	(4,237)	(3,906)
Net carrying amount	**3,421**	**3,752**

(Amounts presented are in thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

	License	*Computer software*	*Total*
Cost			
31 December 2017	**10,277**	**12,851**	**23,128**
Additions	1,322	3,652	**4,974**
Disposals	(417)	(1,686)	**(2,103)**
31 December 2018	**11,182**	**14,817**	**25,999**
Additions	4,768	2,934	**7,702**
Disposal	(1,111)	(49)	**(1,160)**
31 December 2019	**14,839**	**17,702**	**32,541**
Accumulated amortization			
31 December 2017	**(2,309)**	**(4,067)**	**(6,376)**
Amortisation charge	(1,400)	(1,833)	**(3,233)**
Disposals	461	1,685	**2,146**
31 December 2018	**(3,248)**	**(4,215)**	**(7,463)**
Amortisation charge	(2,300)	(1,733)	**(4,033)**
Disposal	1,111	49	**1,160**
31 December 2019	**(4,437)**	**(5,899)**	**(10,336)**
Net book value			
31 December 2017	**7,968**	**8,784**	**16,752**
31 December 2018	**7,934**	**10,602**	**18,536**
31 December 2019	**10,402**	**11,803**	**22,205**

11. Taxation

The corporate income tax expense comprises:

	2019	*2018*
Current tax charge	(29,581)	(66,042)
Deferred tax (charge)/credit – origination and reversal of temporary differences	(27,721)	23,226
Less: deferred tax recognised in other comprehensive income	272	321
Income tax expense	**(57,030)**	**(42,495)**

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

	2019	*2018*
Net gains on equity instruments designated at fair value through OCI	(473)	(156)
Revaluation of premises	201	(165)
Income tax charged to other comprehensive income	**(272)**	**(321)**

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

	2019	*2018*
Profit before income tax expense	**253,047**	**193,491**
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	**(50,610)**	**(38,698)**
Tax effect of items which are not deductible or assessable for taxation purposes		
Non-deductible expenses	(6,405)	(2,586)
Prior year tax actualisation	–	(1,200)
Other	(15)	(11)
Income tax expense	**(57,030)**	**(42,495)**

(Amounts presented are in thousands of Azerbaijani manats)

11. Taxation (continued)

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

	2017	Effect of adoption of IFRS 9	Origination and reversal of temporary differences: In the statement of profit or loss	Origination and reversal of temporary differences: In other compre-hensive income	2018	Origination and reversal of temporary differences: In the statement of profit or loss	Origination and reversal of temporary differences: In other compre-hensive income	2019
Tax effect of deductible temporary differences								
Amounts due from credit institutions	1,035	–	(1,035)	–	–	122	–	122
Loans to customer	–	2,949	4,584	–	7,533	(7,533)	–	–
Provision for credit related commitments and other impairment	46	1,312	1,075	–	2,433	(53)	–	2,380
Intangible assets	116	–	(65)	–	51	46	–	97
Other assets	–	–	32	–	32	(32)	–	–
Right of use assets	–	–	–	–	–	623	–	623
Other liabilities	3,315	–	1,491	–	4,806	1,452	–	6,258
Deferred tax assets	**4,512**	**4,261**	**6,082**	**–**	**14,855**	**(5,375)**	**–**	**9,480**
Cash and cash equivalents	(295)	–	38	–	(257)	(745)	–	(1,002)
Investment securities	(997)	298	(146)	(156)	(1,001)	(1)	(473)	(1,475)
Loans to customers	(16,968)	–	16,968	–	–	(19,679)	–	(19,679)
Amounts due to customers	(1,449)	–	1,449	–	–	–	–	–
Amounts due from credit institutions	–	–	(671)	–	(671)	671	–	–
Amounts due to credit institutions	(753)	–	753	–	–	–	–	–
Property and equipment	(921)	–	(1,190)	(165)	(2,276)	(453)	201	(2,528)
Lease liability	–	–	–	–	–	(207)	–	(207)
Other assets	(264)	–	(264)	–	–	(1,660)	–	(1,660)
Deferred tax liabilities	**(21,647)**	**298**	**17,465**	**(321)**	**(4,205)**	**(22,074)**	**(272)**	**(26,551)**
Net deferred income tax (liabilities)/asset	**(17,135)**	**4,559**	**23,547**	**(321)**	**10,650**	**(27,449)**	**(272)**	**(17,071)**

12. Credit loss expense and other impairment and provisions

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Amounts due from credit institutions	6	233	151	–	**384**
Loans to customers at amortised cost	8	4,861	(15,150)	(11,374)	**(21,663)**
Other financial assets	13	(173)	(328)	(2,877)	**(3,378)**
Credit loss on financial assets		**4,921**	**(15,327)**	**(14,251)**	**(24,657)**
Financial guarantees	19	866	891	(81)	**1,676**
Letters of credit	19	(3)	16	(1,990)	**(1,977)**
Undrawn loan commitments	19	(2,892)	(9,418)	(806)	**(13,116)**
Credit related commitments		**(2,029)**	**(8,511)**	**(2,877)**	**(13,417)**
Total credit loss expense		**2,892**	**(23,838)**	**(17,128)**	**(38,074)**

(Amounts presented are in thousands of Azerbaijani manats)

12. Credit loss expense and other impairment and provisions (continued)

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

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Amounts due from credit institutions	6	(233)	(151)	-	**(384)**
Loans to customers at amortised cost	8	(6,992)	(4,693)	(2,602)	**(14,287)**
Other financial assets	13	(137)	(3)	(757)	**(897)**
Credit loss on financial assets		**(7,362)**	**(4,847)**	**(3,359)**	**(15,568)**
Financial guarantees	19	(1,706)	(743)	4,275	**1,826**
Letters of credit	19	4	25	(1,072)	**(1,043)**
Undrawn loan commitments	19	(1,839)	(632)	(11)	**(2,482)**
Credit related commitments		**(3,541)**	**(1,350)**	**3,192**	**(1,699)**
Total credit loss expense		**(10,903)**	**(6,197)**	**(167)**	**(17,267)**

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

	Other non-financial assets	*Performance guarantees*	*Total*
1 January 2018	-	**(3,144)**	**(3,144)**
Charge	(298)	(3,895)	**(4,193)**
31 December 2018	**(298)**	**(7,039)**	**(7,337)**
Reversal	298	3,084	**3,382**
Recoveries of amounts previously written off	-	297	**297**
31 December 2019	-	**(3,658)**	**(3,658)**

13. Other assets and liabilities

Other assets comprise:

	2019	*2018*
Other financial assets		
Funds in settlement	25,337	30,427
Derivative financial assets	5,885	113
Accrued commission	5,152	3,856
Receivable from local budget	4,319	6,260
Less – allowance for impairment of other assets	(7,100)	(3,722)
Total other financial assets	**33,593**	**36,934**
Other non-financial assets		
Repossessed collateral	8,284	7,777
Prepayments	5,423	2,546
Deferred expenses	3,470	2,410
Spare parts	652	715
Total other non-financial assets	**17,829**	**13,448**
Other assets	**51,422**	**50,382**

An analysis of changes in the ECLs for other financial assets for 31 December 2019 is, as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL at 1 January 2019	**(170)**	**(23)**	**(3,529)**	**(3,722)**
Charge for the period	(173)	(328)	(2,877)	**(3,378)**
At 31 December 2019	**(343)**	**(351)**	**(6,406)**	**(7,100)**

(Amounts presented are in thousands of Azerbaijani manats)

13. Other assets and liabilities (continued)

An analysis of changes in the ECLs for other financial assets for 31 December 2018 is, as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL at 1 January 2018	**(33)**	**(20)**	**(2,772)**	**(2,825)**
Charge for the period	(137)	(3)	(757)	**(897)**
At 31 December 2018	**(170)**	**(23)**	**(3,529)**	**(3,722)**

Other liabilities comprise:

	2019	*2018*
Other financial liabilities		
Funds in settlement	15,675	2,865
Accrued expenses	5,255	3,389
Total other financial liabilities	**20,930**	**6,254**
Other non-financial liabilities		
Payables to employees	31,923	19,716
Provision for ECL for credit related commitments (Note 19)	26,203	16,167
Deferred revenue	11,194	8,480
Payables to local budget	7,377	4,504
Taxes other than income tax	5,835	4,580
Contractual liability	2,810	–
Total other non-financial liabilities	**85,342**	**53,447**
Other liabilities	**106,272**	**59,701**

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

	31 December 2019			*31 December 2018*		
	Notional amount	*Fair value*		*Notional amount*	*Fair value*	
		Asset	*Liability*		*Asset*	*Liability*
Foreign exchange contracts						
Swaps – domestic	114,186	5,885	–	20,000	113	–
Total derivative assets		**5,885**	**–**		**113**	**–**

14. Amounts due to customers

Amounts due to customers comprise:

	2019	*2018*
Legal entities		
Current accounts	2,009,262	1,797,089
Term deposits	277,185	237,084
Individuals		
Current accounts	508,584	339,963
Term deposits	565,823	724,401
Amounts due to customers	**3,360,854**	**3,098,537**
Held as security against guarantees and letters of credit	(39,197)	(9,670)

At 31 December 2019, the Bank had amounts due to ten (2018: ten) largest customers with aggregate balance of AZN 1,393,329 or 41% of total amounts due to customers (2018: AZN 1,410,674 or 46%).

(Amounts presented are in thousands of Azerbaijani manats)

14. Amounts due to customers (continued)

An analysis of customer accounts by economic sector follows:

	2019		*2018*	
	Amount	*%*	*Amount*	*%*
Individuals	1,074,407	32%	1,064,364	34%
Government related entities	828,805	25%	898,398	29%
Construction	421,198	12%	265,583	9%
Energy	406,085	12%	222,801	7%
Trade	252,727	8%	188,077	6%
Transportation and communication	149,256	4%	239,359	8%
Education	121,770	4%	113,001	4%
Manufacturing	25,207	1%	10,964	0%
Insurance	15,048	0%	52,046	2%
Agriculture	6,381	0%	6,296	0%
Investment holding companies	37	0%	537	0%
Other	59,933	2%	37,111	1%
Amounts due to customers	**3,360,854**	**100%**	**3,098,537**	**100%**

15. Amounts due to the Central Bank of the Republic of Azerbaijan and government organizations

Amounts due to the CBAR and government organizations comprise:

	2019	*2018*
Azerbaijan Mortgage and Credit Guarantee Fund	48,446	38,954
Entrepreneurship Development Fund of the Republic of Azerbaijan	35,706	36,649
Agency for Agro Credit and Development	3,454	441
Central Bank of the Republic of Azerbaijan	2,160	501
Ministry of Finance of the Republic of Azerbaijan	376	40,278
Amounts due to the CBAR and government organizations	**90,142**	**116,823**

In 2005, the Bank signed a credit agreement with National Fund for Support of Entrepreneurship, a program under the Ministry of Economic Development of the Republic of Azerbaijan, for financing of small and medium sized enterprises. Name of the fund was change to Entrepreneurship Development Fund of the Republic of Azerbaijan in 2018. Under this program, funds are made available to the Bank at an interest rate of 1% p.a. (2018: 1% p.a.) and mature during 2020-2026 (2018: 2019-2026). The Bank uses these funds to issue loans to eligible borrowers at rates not higher than 7% p.a.

In 2016, the Bank signed a credit agreement with the Azerbaijan Mortgage Fund OJSC for granting long-term mortgage loans to individuals. Name of the fund was change to Azerbaijan Mortgage and Credit Guarantee Fund OJSC in 2018. Under this program, funds are made available to the Bank at interest rates between 1% and 4% p.a. (2018: 1% and 4% p.a.) and mature in 2019-2049 (2018: 2019-2048). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 8.0% p.a.

In 2018, the Bank signed a credit agreement with the Agency for Agro Credit and Development, a program under the Ministry of Agriculture of the Republic of Azerbaijan, for financing enterprises in agriculture sector. Under this program, funds are made available to the Bank at interest rates 2% p.a. (2018: 2% p.a.) and mature in 2021-2024 (2018: 2021-2022). The Bank is obliged to make these funds to issue loans to eligible borrowers at rates not higher than 7% p.a. (2018: 7% p.a.).

16. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2019	*2018*
Time deposits from financial institutions	5,385	24,205
Current accounts	692	3,955
Amounts due to credit institutions	**6,077**	**28,160**

(Amounts presented are in thousands of Azerbaijani manats)

17. Subordinated loan

Subordinated loan comprises:

	2019	*2018*
Subordinated loan	8,521	–
Subordinated loan	**8,521**	**–**

At 31 December 2019, the Bank had a subordinated loan from one resident bank with balance of AZN 8,521 denominated in USD.

18. Equity

As at 31 December 2019, the Bank's share capital is represented by ordinary and preference shares. Ordinary shares were registered at State Securities Committee of the Republic of Azerbaijan on 17 July 2014, thus, authorized, issued and fully paid up capital comprised of 15,000,000 ordinary shares with nominal amount of 12.39 Azerbaijani manat per ordinary share as at 31 December 2019 and 2018. Each ordinary share carries one vote.

On 14 March 2018, in accordance with the decision of shareholders, the Bank authorized to issue non-redeemable preference shares for the total amount of AZN 40,000 and an annual discretionary dividend of 15% per preference share. On 24 July 2018, the Bank issued the preference shares, which were fully paid by the shareholders by the end of 2018.

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. As at 31 December 2019, balance of share capital is AZN 225,850 (2018: AZN 225,850).

According to the decision of the General Shareholders' Meeting held on 14 March 2018, the Bank declared dividends in respect of the year ended 31 December 2017, totalling AZN 94,840 (including 10% withholding tax to be paid on behalf of shareholders) on ordinary shares. The dividends were fully paid during 2018.

According to the decision of the General Shareholders' Meeting held on 12 April 2019, the Bank declared dividends in respect of the year ended 31 December 2018, in the amount of AZN 90,600 on ordinary shares and in the amount of AZN 1,025 on preference shares (both amounts include 10% withholding tax to be paid on behalf of shareholders). The dividends were fully paid during 2019.

Revaluation reserve for premises

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

Unrealised gains on investment securities

This reserve records fair value changes on investment securities designated at FVOCI.

19. Commitments and contingencies

Operating environment

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

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

In response to these challenges, the Central Bank of Azerbaijan Republic (the "CBAR") 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".

(Amounts presented are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Operating environment (continued)

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 Bank'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.

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 first half of 2017.

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 ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 31 December 2019, the Bank was in compliance with these ratio except for:

- Maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 10 percent of the bank's Tier 1 capital on unsecured loan. As at 31 December 2019, the Bank's ratio was 24.87% (2018: 60.25%).
- Maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 20 percent of the bank's Tier 1 capital on loan of Azerbaijan bank or a non-resident bank that holds minimum investment rating issued by international rating agencies. As at 31 December 2019, the Bank's ratio was 27.06%.

Breach of first CBAR ratio caused by specific government funded projects and government organizations, mainly telecommunication related developments. Breach in second ratio was subsequently eliminated.

Throughout the year the Bank submitted information regarding these breaches to Regulator on a monthly basis and no sanctions were imposed on the Bank. Management believes that the Bank will not face any sanctions against the Bank in the future.

(Amounts presented are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

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.

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

	2019	*2018*
Credit related commitments		
Undrawn loan commitments	560,909	201,752
Financial guarantees	343,505	257,124
Letters of credit	32,877	2,795
Performance guarantees	165,749	112,681
Less – provisions for ECL for credit related commitments (Note 13)	(22,545)	(9,128)
Less – provisions for performance guarantees (Note 13)	(3,658)	(7,039)
Commitments and contingencies (before deducting collateral)	**1,076,837**	**558,185**
Less – cash held as security against guarantees and letters of credit	(39,197)	(9,670)
Commitments and contingencies	**1,037,640**	**548,515**

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	**(2,325)**	**(2,961)**	**–**	**(5,286)**
New exposures	(2,446)	–	–	**(2,446)**
Exposures derecognised or matured (excluding write-offs)	1,849	1,540	–	**3,389**
Transfers to Stage 1	(1,421)	1,421	–	**–**
Transfers to Stage 2	1,293	(1,293)	–	**–**
Transfers to Stage 3	81	–	(81)	**–**
Impact on period end ECL of exposures transferred between stages during the period	1,348	(777)	–	**571**
Changes to inputs used for ECL calculations	162	–	–	**162**
At 31 December 2019	**(1,459)**	**(2,070)**	**(81)**	**(3,610)**

Undrawn loan commitments	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2019	**(2,111)**	**(632)**	**(11)**	**(2,754)**
New exposures	(12,882)	–	–	**(12,882)**
Exposures derecognised or matured (excluding write-offs)	381	388	11	**780**
Transfers to Stage 1	(12)	12	–	**–**
Transfers to Stage 2	8,023	(8,023)	–	**–**
Transfers to Stage 3	828	–	(828)	**–**
Impact on period end ECL of exposures transferred between stages during the period	(17)	(885)	12	**(890)**
Changes to inputs used for ECL calculations	787	(910)	(1)	**(124)**
At 31 December 2019	**(5,003)**	**(10,050)**	**(817)**	**(15,870)**

(Amounts presented are in thousands of Azerbaijani manats)

19. Commitments and contingencies (continued)

Financial commitments and contingencies (continued)

Letters of credit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2019	**–**	**(16)**	**(1,072)**	**(1,088)**
New exposures	(3,065)	–	–	**(3,065)**
Exposures derecognised or matured (excluding write-offs)	–	16	1,072	**1,088**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	–	–	–	**–**
Transfers to Stage 3	3,062	–	(3,062)	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	–	–	–	**–**
At 31 December 2019	**(3)**	**–**	**(3,062)**	**(3,065)**

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	**(619)**	**(2,218)**	**(4,275)**	**(7,112)**
New exposures	(4,762)	–	–	**(4,762)**
Exposures derecognised or matured (excluding write-offs)	444	2,005	3,151	**5,600**
Transfers to Stage 1	(1,280)	156	1,124	**–**
Transfers to Stage 2	2,656	(2,656)	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	1,254	(291)	–	**963**
Changes to inputs used for ECL calculations	(18)	43	–	**25**
At 31 December 2018	**(2,325)**	**(2,961)**	**–**	**(5,286)**

Undrawn loan commitments	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2018	**(272)**	**–**	**–**	**(272)**
New exposures	(1,744)	–	–	**(1,744)**
Exposures derecognised or matured (excluding write-offs)	131	38	–	**169**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	33	(33)	–	**–**
Transfers to Stage 3	11	–	(11)	**–**
Impact on period end ECL of exposures transferred between stages during the period	(183)	(672)	–	**(855)**
Changes to inputs used for ECL calculations	(87)	35	–	**(52)**
At 31 December 2018	**(2,111)**	**(632)**	**(11)**	**(2,754)**

Letters of credit	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
ECLs as at 1 January 2018	**(4)**	**(41)**	**–**	**(45)**
New exposures	(1,088)	–	–	**(1,088)**
Exposures derecognised or matured (excluding write-offs)	4	41	–	**45**
Transfers to Stage 1	–	–	–	**–**
Transfers to Stage 2	16	(16)	–	**–**
Transfers to Stage 3	1,072	–	(1,072)	**–**
Impact on period end ECL of exposures transferred between stages during the period	–	–	–	**–**
Changes to inputs used for ECL calculations	–	–	–	**–**
At 31 December 2018	**–**	**(16)**	**(1,072)**	**(1,088)**

(Amounts presented are in thousands of Azerbaijani manats)

20. Net fee and commission income

Net fee and commission income comprises:

	2019	*2018*
Servicing plastic card operations	68,968	54,453
Cash operations	16,721	14,500
Settlement operations	14,536	12,865
Guarantees and commitments	10,243	7,710
Agency activities	-	12,730
Other	3,636	3,093
Fee and commission income	**114,104**	**105,351**
Servicing plastic card operations	(9,413)	(4,832)
Settlement operations	(5,138)	(3,142)
Cash operations	(3,814)	(4,707)
Guarantees and commitments	(688)	(1,373)
Other	(1,756)	(878)
Fee and commission expense	**(20,809)**	**(14,932)**
Net fee and commission income	**93,295**	**90,419**

21. Other operating income

As at 31 December 2019, other operating income of AZN 4,059 (2018: AZN 2,977) primarily comprise of penalty fee from customers due to early withdrawal of term deposits.

22. Personnel expenses

Personnel expenses comprise:

	2019	*2018*
Salaries and bonuses	(81,681)	(62,426)
Social security costs	(12,809)	(13,981)
Other employee related expenses	(2,120)	(1,773)
Personnel expenses	**(96,610)**	**(78,180)**

23. General and administrative expenses

General and administrative expenses comprise:

	2019	*2018*
Sponsorship	(22,780)	(5,493)
Legal and consultancy	(8,524)	(4,527)
Repair and maintenance of property and equipment	(6,893)	(5,542)
Marketing and advertising	(6,726)	(6,250)
Deposit Insurance Fund expenses	(4,822)	(4,528)
Communications	(4,139)	(3,009)
Office supplies	(3,442)	(3,089)
Security	(2,969)	(2,540)
Representation expenses	(2,623)	(1,390)
Occupancy and rent	(1,867)	(10,260)
Business travel and related expenses	(1,788)	(1,481)
Utilities	(1,228)	(1,124)
Insurance on properties and equipment	(932)	(603)
Regulatory fees	(789)	(903)
Transportation and vehicle maintenance	(665)	(539)
Taxes other than income tax	(421)	(403)
Other	(2,575)	(1,838)
General and administrative expenses	**(73,183)**	**(53,519)**

(Amounts presented are in thousands of Azerbaijani manats)

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

Supervisory Board

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

Audit Committee

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

Management Board

The Management Board has the responsibility to monitor the overall risk process within the 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 risks types and activities.

(Amounts presented are in thousands of Azerbaijani manats)

24. 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 eachbusiness 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 Management Board receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the 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

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.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the consolidated statement of financial position.

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 consolidated 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 8.

(Amounts presented are in thousands of Azerbaijani manats)

24. 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 recognized, the Bank recognizes 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.

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.

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

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;
  - 2 times within three years restructured loans that have been overdue (in principal amount and/or accrued interest and/or any of other payment) less than 30 days from the date specified in the contract at the moment of each particular restructuring;
  - "Non-healthy" restructured loans that were PAR 30 at the moment of restructuring; (originally in Stage 3), when NPV loss restructuring is more than 10%;
  - Any loan considered by management as non-performing (except non-performing loans that meet Stage 2 criteria).
- Existing of information that borrower will/has enter bankruptcy, insolvency or a similar condition.
- Default (according to IRB and External Rating).
- Default on other financial instruments of the same borrower.

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.

Internal rating and PD estimation process

The Bank's Risk Department operates its internal rating models. The Bank runs separate models for its key portfolios in which its corporate customers are rated based on Moody's model. Small and medium enterprises and consumer loans are scored from 1 to 20 and from 1 to 4 using internal grades, respectively. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilise supplemental external information that could affect the borrower's behaviour. Where practical, they also build on information from the national and international external rating agencies. PDs, incorporating forward looking 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, and assigns the internal rating, as shown in the table below.

Corporate and small business lending

For corporate loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

Consumer lending and residential mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with residential mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by debt to income (DTI) and payment to income (PTI) ratios. Other key inputs into the models are GDP growth, changes in personal income/salary levels, personal indebtedness.

The Bank's internal credit rating grades are as follows:

Internal rating grade for SME	*Moody's based internal/external ratings for Corporate and Financial institutions*	*Internal rating description*
1	Aaa	High grade
2-4	Aa1 to Aa3	
5-7	A1 to A3	
8-10	Baa1 to Baa3	Standard grade
11-13	Ba1 to Ba3	
14-16	B1 to B3	
17-19	Caa1 to Caa3	Sub-standard grade
20	Ca	
Default	C	Impaired

Internal rating for consumer loans is based on overdue days. High grade rating is used for Central Bank and Ministry of Finance of the Republic of Azerbaijan.

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. To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. For Stage 2, Stage 3 financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

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, Stage 3 and POCI segment of each asset class.

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

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:

- PD for all corporate and small business lending;
- LGD for Stage 3 corporate and small business lending which are above predetermined threshold and are collateralized.

Asset classes where the Bank calculates ECL on a collective basis include:

- PD and LGD for all retail consumer and mortgages lending;
- LGD for all corporate and small business lending which are in Stage 1 and Stage 2;
- LGD for corporate and small business lending which are in Stage 3, neither are above predetermined threshold nor are collateralized.

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 growth rates;
- NPL rates;
- Consumption growth rates;
- Inflation;
- Unemployment rate;
- Monetary policy rate;
- Dynamics of real and nominal effective exchange rates;
- Real estate price.

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.

The Bank obtains the forward-looking information from third party sources (external rating agencies, governmental bodies e.g. central banks, and international financial institutions). Experts of the Bank's Credit Risk Department determine the weights attributable to the multiple scenarios. The tables show the values of the key forward looking economic variables/assumptions used in each of the economic scenarios for the ECL calculations. The figures for "Subsequent years" represent a long-term average and so are the same for each scenario as at 31 December 2019.

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank's internal credit ratings, as described above. The table below shows the credit quality by class of asset for loan-related lines in the consolidated statement of financial position, based on the 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	1,126,267	25,551	119	–	**1,151,937**
Amounts due from credit institutions		Stage 1	63,448	60,724	–	–	**124,172**
	6	Stage 2	–	–	146	–	**146**
Loans to customers at amortised cost	8						
- Government related entities		Stage 1	–	59,515	73,580	–	**133,095**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	10,748	–	1,971	**12,719**
- Corporate loans		Stage 1	2,760	125,951	17,090	–	**145,801**
		Stage 2	–	5,164	104,360	–	**109,524**
		Stage 3	–	961	620	19,776	**21,357**
- Loans to individuals – consumer loans		Stage 1	–	537,456	–	–	**537,456**
		Stage 2	–	735,614	6,697	61	**742,372**
		Stage 3	–	18,669	2,347	20,939	**41,955**
- Loans to individuals – mortgage loans		Stage 1	–	50,947	294	–	**51,241**
		Stage 2	–	120	987	–	**1,107**
		Stage 3	–	233	138	99	**470**
- Loans to individuals – entrepreneurs		Stage 1	–	3,574	–	–	**3,574**
		Stage 2	–	1,215	3,018	–	**4,233**
		Stage 3	–	38	–	6,932	**6,970**
Debt securities at amortised cost	7	Stage 1	386,176	8,912	–	–	**395,088**
Debt securities at FVOCI	7	Stage 1	–	62,110	–	–	**62,110**
Financial guarantees	19	Stage 1	3,251	200,674	64,433	–	**268,358**
		Stage 2	–	2,717	72,320	–	**75,037**
		Stage 3	–	110	–	–	**110**
Undrawn loan commitments	19	Stage 1	3,647	384,939	6,222	–	**394,808**
		Stage 2	–	155,266	8,196	4	**163,466**
		Stage 3	–	687	1	1,947	**2,635**
Letters of credit	19	Stage 1	23,338	2,744	–	–	**26,082**
		Stage 2	–	–	–	–	**–**
		Stage 3	–	–	–	6,795	**6,795**
Total			**1,608,887**	**2,454,639**	**360,568**	**58,524**	**4,482,618**

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

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	1,178,327	10,532	–	–	**1,188,859**
Amounts due from credit institutions		Stage 1	236,125	157,643	–	–	**393,768**
	6	Stage 2	–	–	803	–	**803**
Loans to customers at amortised cost	8						
- Government related entities		Stage 1	26,158	217,678	80,343	–	**324,179**
		Stage 2	–	–	7	–	**7**
		Stage 3	–	171	–	3,237	**3,408**
- Corporate loans		Stage 1	425	52,080	24,380	–	**76,885**
		Stage 2	–	7,738	17,092	–	**24,830**
		Stage 3	–	–	333	24,475	**24,808**
- Loans to individuals – consumer loans		Stage 1	–	482,389	246	–	**482,635**
		Stage 2	–	477,243	6,957	13	**484,213**
		Stage 3	–	13,333	1,721	11,591	**26,645**
- Loans to individuals – mortgage loans		Stage 1	–	34,448	–	–	**34,448**
		Stage 2	–	–	166	–	**166**
		Stage 3	–	73	26	32	**131**
- Loans to individuals – entrepreneurs		Stage 1	–	1,085	–	–	**1,085**
		Stage 2	–	405	149	–	**554**
		Stage 3	–	–	–	6,624	**6,624**
Debt securities at amortised cost	7	Stage 1	329,836	–	–	–	**329,836**
Financial guarantees	19	Stage 1	18,343	168,706	106,442	–	**293,491**
		Stage 2	–	6,054	70,056	–	**76,110**
		Stage 3	–	202	2	–	**204**
Undrawn loan commitments	19	Stage 1	1,903	156,451	2,575	–	**160,929**
		Stage 2	–	34,903	5,451	–	**40,354**
		Stage 3	–	235	234	–	**469**
Letters of credit	19	Stage 1	–	–	–	–	**–**
		Stage 2	–	562	–	–	**562**
		Stage 3	–	–	–	2,233	**2,233**
Total			**1,791,117**	**1,821,931**	**316,983**	**48,205**	**3,978,236**

See Note 8 for more detailed information with respect to the allowance for impairment of loans to customers.

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

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Credit risk (continued)

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

	2019				2018			
	Azerbaijan	*OECD*	*CIS and other countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other countries*	*Total*
Assets								
Cash and cash equivalents	1,196,268	475,839	13,095	**1,685,202**	1,305,764	223,811	10,554	**1,540,129**
Amounts due from credit institutions	40,777	58,603	24,938	**124,318**	21,218	339,390	33,579	**394,187**
Investment securities	298,190	166,946	–	**465,136**	303,653	31,753	–	**335,406**
Loans to customers	1,705,005	10	617	**1,705,632**	1,383,588	–	26,158	**1,409,746**
Other financial assets	30,798	1,983	812	**33,593**	36,934	–	–	**36,934**
	3,271,038	**703,381**	**39,462**	**4,013,881**	**3,051,157**	**594,954**	**70,291**	**3,716,402**
Liabilities								
Amounts due to customers	3,310,288	39,639	10,927	**3,360,854**	2,936,421	160,215	1,901	**3,098,537**
Amounts due to the Central Bank of the Republic of Azerbaijan, and government organizations	90,142	–	–	**90,142**	116,823	–	–	**116,823**
Amounts due to credit institutions	6,022	–	55	**6,077**	4,795	23,365	–	**28,160**
Other financial liabilities	20,908	22	–	**20,930**	6,036	218	–	**6,254**
Subordinated loan	8,521	–	–	**8,521**	–	–	–	**–**
	3,435,881	**39,661**	**10,982**	**3,486,524**	**3,064,075**	**183,798**	**1,901**	**3,249,774**
Net assets/(liabilities)	**(164,843)**	**663,720**	**28,480**	**527,357**	**(12,918)**	**411,156**	**68,390**	**466,628**

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)	56.86	59.28

(Amounts presented are in thousands of Azerbaijani manats)

24. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes 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. 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 the Central Bank of the Republic of Azerbaijan and government organizations	8,943	12,189	35,807	48,098	**105,037**
Amounts due to credit institutions	5,399	30	712	–	**6,141**
Amounts due to customers	2,740,384	489,995	163,557	–	**3,393,936**
Lease liability	2,143	5,923	21,741	9,602	**39,409**
Other financial liabilities	20,930	–	–	–	**20,930**
Subordinated loan	–	765	1,530	9,483	**11,778**
Total undiscounted financial liabilities	**2,777,799**	**508,902**	**223,347**	**67,183**	**3,577,231**

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 the Central Bank of the Republic of Azerbaijan and government organizations	33,605	24,424	36,266	34,475	**128,770**
Amounts due to credit institutions	27,838	38	938	–	**28,814**
Amounts due to customers	2,397,636	571,097	179,284	–	**3,148,017**
Other financial liabilities	6,254	–	–	–	**6,254**
Total undiscounted financial liabilities	**2,465,333**	**595,559**	**216,488**	**34,475**	**3,311,855**

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 contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
2019	635,578	324,121	132,504	10,838	**1,103,041**
2018	258,157	215,025	90,062	11,221	**574,465**

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 amounts due to customers represented by government organizations in the period of 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.

(Amounts presented are in thousands of Azerbaijani manats)

24. 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, foreign exchanges, and equity prices. The Bank does not have any significant equity, corporate fixed income, or derivatives holdings.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's consolidated statement of profit or loss.

The sensitivity of the consolidated statement of profit or loss is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December.

Currency	*(Decrease)/ increase in % 2019*	*Sensitivity of net interest income 2019*
USD	–	–

Currency	*(Decrease)/ increase in % 2018*	*Sensitivity of net interest income 2018*
USD	-0.15%/+0.50%	20.48/(68.26)

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 Assets and Liabilities Management Committee controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of CBAR.

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 Azerbaijani manats, with all other variables held constant on the statement of profit or loss. The effect on equity does not differ from the effect on profit or loss. A negative amount in the table reflects a potential net reduction in profit or loss or equity, while a positive amount reflects a net potential increase.

Impact on profit before tax based on net assets value as at 31 December:

	31 December 2019		*31 December 2018*	
USD	+10%/-3%	12,858/(3,857)	+14%/-3%	9,521/(2,040)
EUR	+10%/-6%	1,150/(690)	+14%/-3%	87/(19)

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.

(Amounts presented are in thousands of Azerbaijani manats)

25. Fair value measurements

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.

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	7,150	62,110	788	**70,048**
Property and equipment – premises	31 December 2019	–	5,689	–	**5,689**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2019	1,685,202	–	–	**1,685,202**
Amounts due from credit institutions	31 December 2019	–	124,318	–	**124,318**
Investment securities measured at amortised cost	31 December 2019	159,137	235,232	–	**394,369**
Loans to customers	31 December 2019	–	–	1,704,352	**1,704,352**
Other financial assets	31 December 2019	–	–	33,593	**33,593**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Liabilities for which fair values are disclosed					
Amounts due to customers	31 December 2019	–	–	3,366,850	**3,366,850**
Amounts due to CBAR and government organizations	31 December 2019	–	2,536	87,190	**89,726**
Amounts due to credit institutions	31 December 2019	–	–	6,077	**6,077**
Subordinated loan	31 December 2019	–	–	8,521	**8,521**
Other financial liabilities	31 December 2019	–	–	20,930	**20,930**

(Amounts presented are in thousands of Azerbaijani manats)

25. Fair value measurements (continued)

Fair value hierarchy (continued)

	Date of valuation	Fair value measurement using: 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 2018	4,782	–	788	**5,570**
Property and equipment – premises	31 December 2018	–	6,537	–	**6,537**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2018	1,540,129	–	–	**1,540,129**
Amounts due from credit institutions	31 December 2018	–	394,187	–	**394,187**
Investment securities measured at amortized cost	31 December 2018	26,971	303,721	–	**330,692**
Loans to customers	31 December 2018	–	–	1,403,856	**1,403,856**
Other financial assets	31 December 2018	–	–	36,934	**36,934**

	Date of valuation	Fair value measurement using: Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Liabilities for which fair values are disclosed					
Amounts due to customers	31 December 2018	–	–	3,117,386	**3,117,386**
Amounts due to CBAR and government organizations	31 December 2018	–	76,044	40,779	**116,823**
Amounts due to credit institutions	31 December 2018	–	–	28,160	**28,160**
Other financial liabilities	31 December 2018	–	–	6,254	**6,254**

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 consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2019	Fair value 2019	Unrealized gain/(loss)	Carrying value 2018	Fair value 2018	Unrealized gain/(loss)
Financial assets						
Cash and cash equivalents	1,685,202	1,685,202	–	1,540,129	1,540,129	–
Amounts due from credit institutions	124,318	124,318	–	394,571	394,571	–
Investment securities – debt securities at amortized cost	395,088	394,369	(719)	329,836	330,692	856
Loans to customers	1,705,632	1,704,352	(1,280)	1,409,746	1,408,542	(1,204)
Other financial assets	33,584	33,584	–	36,934	36,934	–
Financial liabilities						
Amounts due to customers	3,360,854	3,366,850	(5,996)	3,098,537	3,117,386	(18,849)
Amounts due to CBAR and government organizations	90,142	89,726	416	116,823	116,823	–
Amounts due to credit institutions	6,077	6,077	–	28,160	28,160	–
Subordinated loan	8,521	8,521	–	–	–	–
Other financial liabilities	20,930	20,930	–	6,254	6,254	–
Total unrecognized change in unrealized fair value			**(7,579)**			**(19,197)**

(Amounts presented are in thousands of Azerbaijani manats)

25. Fair value measurements (continued)

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

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.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves. Derivatives valued using a valuation technique with significant non-market observable inputs are primarily long dated option contracts. These derivatives are valued using the binomial models. The models incorporate various non-observable assumptions, which include market rate volatilities.

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

Fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBAR and 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.

Property and equipment − premises

Fair value of the Property and equipment − premises was determined by using market comparable method. This means that valuations performed by the valuator are based on market transaction prices, significantly adjusted for difference in the nature, location or condition of the specific property. As at the date of revaluation, the premises' fair values are based on valuations performed on 31 December 2019 by KONEKO LLC, an accredited independent valuator.

Movements in level 3 assets and liabilities at fair value

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

	At 1 January 2019	*Total gain recorded in profit or loss*	*Total gain recorded in other comprehensive income*	*Purchases*	*Sales*	*At 31 December 2019*
Assets						
Investment securities at amortised cost	788	–	–	–	–	788
Total	**788**	**–**	**–**	**–**	**–**	**788**

	At 1 January 2018	*Total gain recorded in profit or loss*	*Total gain recorded in other comprehensive income*	*Purchases*	*Sales*	*At 31 December 2018*
Assets						
Investment securities at amortised cost	538	–	–	250	–	788
Total	**538**	**–**	**–**	**250**	**–**	**788**

(Amounts presented are in thousands of Azerbaijani manats)

26. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 24 "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	1,685,202	–	**1,685,202**	1,540,129	–	**1,540,129**
Amounts due from credit institutions	36,059	88,259	**124,318**	331,559	62,628	**394,187**
Investment securities	347,783	117,353	**465,136**	285,923	49,483	**335,406**
Loans to customers	781,874	923,758	**1,705,632**	716,621	693,125	**1,409,746**
Property and equipment	–	53,695	**53,695**	–	43,273	**43,273**
Intangible assets	–	22,205	**22,205**	–	18,536	**18,536**
Right of use assets	–	41,132	**41,132**	–	–	**–**
Deferred income tax assets	–	–	**–**	–	10,650	**10,650**
Current income tax assets	47,934	–	**47,934**	–	–	**–**
Other assets	51,422	–	**51,422**	50,382	–	**50,382**
Total	**2,950,274**	**1,246,402**	**4,196,676**	**2,924,614**	**877,695**	**3,802,309**
Amounts due to customers	3,213,261	147,593	**3,360,854**	2,938,928	159,609	**3,098,537**
Amounts due to the CBAR and government organizations	19,724	70,418	**90,142**	56,212	60,611	**116,823**
Amounts due to credit institutions	5,403	674	**6,077**	27,324	836	**28,160**
Subordinated loan	21	8,500	**8,521**			
Lease liability	11,894	31,321	**43,215**	–	–	**–**
Deferred income tax liabilities	–	17,071	**17,071**	–	–	**–**
Current tax liabilities	–	–	**–**	40,046	–	**40,046**
Other liabilities	106,272	–	**106,272**	59,701	–	**59,701**
Total	**3,356,575**	**275,577**	**3,632,152**	**3,122,211**	**221,056**	**3,343,267**
Net	**(406,301)**	**970,825**	**564,524**	**(197,597)**	**656,639**	**459,042**

Negative gap is due to significant concentration of amounts due to customers represented by related parties and government organizations in the period of one year. Management believes that 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.

27. Related party disclosures

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

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

(Amounts presented are in thousands of Azerbaijani manats)

27. Related party disclosures (continued)

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

	2019				2018			
	Share-holders / ultimate owners	*Entities under common control*	*Other related parties*	*Key management personnel*	*Share-holders / ultimate owners*	*Entities under common control*	*Other related parties*	*Key management personnel*
Loans outstanding at 1 January, gross	**–**	**–**	**20,012**	**4,665**	**–**	**931**	**–**	**3,534**
Loans issued during the year	–	58,000	10,060	5,817	–	–	25,347	9,180
Loan repayments during the year	–	(17,489)	(17,277)	(6,066)	–	(901)	(5,335)	(8,158)
Other movements	–	277	28	(6)	–	(30)	–	109
Loans outstanding at 31 December, gross	**–**	**40,788**	**12,823**	**4,410**	**–**	**–**	**20,012**	**4,665**
Less: allowance for impairment at 31 December	–	(317)	(622)	(21)	–	–	(386)	(15)
Loans outstanding at 31 December, net	**–**	**40,471**	**12,201**	**4,389**	**–**	**–**	**19,626**	**4,650**
Due from Credit Institutions	–	41,007	–	–	–	31,574	–	–
Interest income due from Credit Institutions	–	1,235	–	–	–	916	–	–
Interest income on loans	–	25,382	2,048	331	–	4,632	485	377
Impairment (charge)/reversal for loans	–	(317)	(236)	(6)	–	9	(386)	(1)
Right-of-use asset	–	35,622	–	–	–	–	–	–
Depreciation of right-of-use assets	–	(4,376)	–	–	–	–	–	–
Other assets	74	3,467	159	–	–	–	–	–
Deposits at 1 January	**–**	**14,587**	**–**	**41,484**	**–**	**72,639**	**–**	**43,330**
Deposits received during the year	–	2,561	–	37,591	–	192,671	–	17,253
Deposits repaid during the year	–	(9,793)	–	(36,438)	–	(249,756)	–	(18,521)
Other movements	–	(827)	–	(46)	–	(967)	–	(578)
Deposits at 31 December	**–**	**6,528**	**–**	**42,591**	**–**	**14,587**	**–**	**41,484**
Current accounts at 31 December	34,034	36,491	8,738	4,985	22	37,340	7,291	5,943
Cash and cash equivalents	–	12,647	–	–	–	18,244	–	–
Lease liability	–	35,154	–	–	–	–	–	–
Other liabilities	–	2,534	–	–	–	–	–	–
Interest expense on lease liability	–	(4,103)	–	–	–	–	–	–
Interest expense on deposits	–	(494)	–	(1,950)	–	(3,301)	–	(2,043)
General and administrative expenses	–	(8,204)	(12,170)	–	–	(9,942)	(3,167)	–
Commission Income	79	2,706	250	17	–	13,123	410	10
Commission expense	–	(332)	–	–	–	–	–	–
Net gains/(loss) from foreign currencies: dealing	–	291	180	2	–	277	413	–
Letters of credit and guarantees issued	–	13	2,750	–	–	17	18,620	–
Unused credit lines	–	1,000	1,089	1,169	–	–	–	–

Compensation of key management personnel is as follows:

	2019	*2018*
Salaries and other benefits	13,911	12,691
Social security costs	2,162	2,855
Total key management personnel compensation	**16,073**	**15,546**

As at 31 December 2019, the Bank has guarantee from its parent received as a collateral in respect of loans issued to borrowers in the amount of AZN 75,078.

(Amounts presented are in thousands of Azerbaijani manats)

28. Changes in liabilities arising from financing activities

	Note	*Subordinated loan*
Carrying amount at 31 December 2018		–
Proceeds from issue		8,500
Other		21
Carrying amount at 31 December 2019	17	**8,521**

The "Other" line includes the effect of accrued but not yet paid interest on subordinated loans. The Bank classifies interest paid as cash flows from operating activities.

29. Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored by the CBAR using the ratios established 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 changes were made in the objectives, policies and processes from the previous years.

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 5.5% (2018: 5%) and 11% (2018: 10%) for Tier 1 Capital and Total Capital, respectively, based on its guidelines.

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

	2019	*2018*
Tier 1 capital	232,423	229,632
Tier 2 capital	172,153	122,079
Less: deductions from capital	(6,070)	(5,289)
Total regulatory capital	**398,506**	**346,422**
Risk weighted assets	**2,496,474**	**2,146,613**
Other deductions from total regulatory capital and risk weighted assets	–	**(14,906)**
Capital adequacy ratio (Tier 1)	9.31%	10.07%
Capital adequacy ratio (Total Capital)	15.96%	15.55%

30. Events after the reporting period

On 30 January 2020, the World Health Organization (WHO) declared the coronavirus outbreak a "Public Health Emergency of International Concern". Subsequent to yearend there has been increased volatility in the global financial and commodity markets. Currently, Azerbaijani health authorities are taking necessary precautional measures. Management of the Bank will further monitor possible effects of the outbreak on the Bank's activities.