Open Joint Stock Venture Silk Way Bank OJSV

Financial Statements
For the year ended December 31, 2016

Open Joint Stock Venture Silk Way Bank
Financial Statements

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Statement of management's responsibilities for the preparation and approval of the financial statements
For the year ended December 31, 2016

Management is responsible for the preparation of the financial statements that give a true and fair view of the financial position of Open Joint Stock Venture Silk Way Bank (the "Bank") as at December 31, 2016, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Bank's financial position and financial performance; and
- Making an assessment of the Bank's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud, errors and other irregularities.

These financial statements for the year ended December 31, 2016 were approved by the Management Board on May 5, 2017 and were signed on their behalf by:

Elchin Ahmedov
Chairman of Management Board

Mahir Necefov
Chief Accountant

Baku, Azerbaijan Republic

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Independent auditors' report
To the Shareholders of Open Joint Stock Venture Silk Way Bank

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Open Joint Stock Venture Silk Way Bank (the "Bank"), which comprise the statement of financial position as at December 31, 2016, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Other Matter

The financial statements of the Bank's for the year ended December 31, 2015, were audited by another auditor who expressed an unqualified opinion on these financial statements on May 27, 2016 .

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 Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and 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 Those Charged with Governance for the Financial Statements

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

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

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

We communicate with those charged with governance 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.

Grant Thornton

Məhdud Məsuliyyətli Cəmiyyəti, Dubai, BƏƏ Azərbaycan Respublikasındakı FİLİALI
Grant Thornton
BRANCH in the Republic of Azerbaijan Limited Liability Partnership, Dubai, UAE

Grant Thornton
Baku, Republic of Azerbaijan
Date: May 5, 2017

Open Joint Stock Venture Silk Way Bank
Financial Statements
Statement of financial position
As at December 31, 2016
(in thousands of Azerbaijan Manats)

	Notes	2016 AZN	2015 AZN
Assets			
Cash and balances with Central Bank	5	19,449	10,740
Balances with other banks	7	4,153	9,694
Loans and advances to customers	8	363,741	335,729
Property and equipment	9	2,329	3,704
Intangible assets		296	98
Other assets	10	2,564	1,988
Total assets		392,532	361,953
Liabilities			
Loans and deposits from banks and financial institutions	11	115,888	108,354
Deposits from customers	12	170,141	149,240
Deferred tax liability	22.2	-	110
Other liabilities	13	1,513	805
Total liabilities		287,542	258,509
Equity			
Share capital	14	101,545	101,545
Retained earnings		3,445	1,899
Total equity		104,990	103,444
Total equity and liabilities		392,532	361,953

These financial statements for the year ended December 31, 2016 were approved by the Management Board on May 5, 2017 and were signed on their behalf by:

Elchin Ahmedov
Chairman of Management Board

Mahir Necefov
Chief Accountant

Baku, Azerbaijan Republic

The accompanying notes 1 to 30 form an integral part of these financial statements.

Open Joint Stock Venture Silk Way Bank
Financial Statements
Statement of comprehensive income
For the year ended December 31, 2016
(in thousands of Azerbaijan Manats)

	Notes	2016 AZN	2015 AZN
Interest income	15	26,235	24,121
Interest expense	15	(13,125)	(12,833)
Net interest income	15	13,110	11,288
Allowance for impairment losses on loans and advances to customers	8.1	(14,856)	(5,595)
Net interest (expense)/income after allowance for impairment losses		(1,746)	5,693
Gains from foreign exchange operations - net	16	10,856	5,467
Fees and commission income	17	5,818	4,297
Fees and commission expense	18	(1,444)	(1,257)
Operating profit		13,484	14,200
Other income	19	61	368
Depreciation and amortization expense	20	(525)	(483)
Administrative and general expenses	21	(11,139)	(11,594)
Profit for the year before tax		1,881	2,491
Income tax expense	22	(335)	(961)
Profit for the year		1,546	1,530
Other comprehensive income		-	-
Total comprehensive income for the year		1,546	1,530
EARNING PER SHARE			
Basis and Diluted	29	2.28	2.25

The accompanying notes 1 to 30 form an integral part of these financial statements.

Open Joint Stock Venture Silk Way Bank
Financial Statements
Statement of changes in equity
For the year ended December 31, 2016
(in thousands of Azerbaijan Manats)

	Share capital AZN	Revaluation reserve AZN	Retained earnings AZN	Total equity AZN
Balance at January 1, 2015	99,168	345	2,746	102,259
Issue of share capital	2,377		(2,377)	-
Property revaluation		(345)		(345)
Transactions with owners	101,545	-	369	101,914
Profit for the year	-	-	1,530	1,530
Total comprehensive income	-	-	1,530	1,530
Balance at December 31, 2015	101,545	-	1,899	103,444
Profit for the year	-	-	1,546	1,546
Total comprehensive income	-	-	1,546	1,546
Balance at December 31, 2016	101,545	-	3,445	104,990

The accompanying notes 1 to 30 form an integral part of these financial statements.

Open Joint Stock Venture Silk Way Bank
Financial Statements
Statement of cash flows
For the year ended December 31, 2016
(in thousands of Azerbaijan Manats)

	Notes	2016 AZN	2015 AZN
Cash flows from operating activities			
Profit before tax		1,881	2,491
Adjustments for:			
Depreciation and amortisation expense	20	525	483
Loss on disposal of property and equipment		159	-
Net loss on impairment of property and equipment		-	1,149
Net loss/(gain) on foreign exchange operation		372	(1,867)
Allowance for impairment losses on loans and advances to customers	8.1	14,856	5,612
		17,793	7,868
Changes in operating assets and liabilities:			
Mandatory minimum reserve deposits with Central Bank		(906)	1,064
Deposits placed with other banks		4,254	(386)
Loans and advances to customers		(43,240)	(168,594)
Other assets		(576)	2,548
Deposits from customers		20,901	96,569
Other liabilities		708	335
Cash used in operations		(1,066)	(60,596)
Income tax paid		(445)	(975)
Net cash used in operating activities		(1,511)	(61,571)
Cash flows from investing activities			
Purchase of property and equipment		(629)	(682)
Purchase of intangible assets		(228)	(41)
Sales proceed from disposal of property and equipment		1,350	-
Proceeds on redemption of investments held to maturity		-	21,936
Net cash from investing activities		493	21,213
Cash flows from financing activity			
Loans and deposits from banks and financial institutions		7,534	37,876
Net cash from financing activity		7,534	37,876
Net change in cash and cash equivalents		6,516	(2,482)
Cash and cash equivalents, beginning of year		15,425	18,128
Cash and cash equivalents, end of year	6	21,941	15,646

The accompanying notes 1 to 30 form an integral part of these financial statements.

(in thousands of Azerbaijan Manats)

1 Legal status and nature of operations

Open Joint Stock Venture Silk Way Bank (the "Bank") was established on January 6, 1994 and is regulated by Central Bank of Azerbaijan Republic (CBAR or Central Bank) under license no. 175 for commercial banking. As at December 31, 2016 the registered address of the Bank is located Hasan Aliyev Street 131A, AZ 1110, Baku, Azerbaijan Republic.

The principal activity of the Bank is providing commercial banking services to legal entities and physical persons. The Bank has five branches and one service point. The Bank operates a network of 49 (2015: 23) automatic teller machines. The Bank has 139 employees (2015: 116 employees) as at December 31, 2016.

As at December 31, 2016 and 2015, the following shareholders owned the issued share capital of the bank.

	2016	2015
	%	%
Legal entity	30	-
Individuals	70	100
	100	100

During the year bank shareholding changed and Miss. Zarifa Hamzayeva, VIP Aviation Services LLC and Elchin Ahmadov acquired 69.7%, 30% and 0.3% respectively. Further, Miss. Zarifa Hamzayeva is the ultimate controlling party.

2 Statement of compliance with International Financial Reporting Standards (IFRS)

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Additional information required by CBAR's Regulations is included where appropriate.

3 Standards, interpretations and amendments to existing standards

3.1 Standards, interpretations and amendments to existing standards that are effective in 2016

Following relevant new standards, revisions and amendments to existing standards were issued by the IASB, which are effective for the accounting period beginning on or after 1 January 2016 and have been adopted by the Bank:

Standard number	Title	Effectivedate
IAS 16 and IAS 38	Property, Plant and Equipment and Intangible Assets – Amendments	1 January 2016
IAS 16 and IAS 41	Property, Plant and Equipment and Investment Property – Amendments	1 January 2016
IAS 19	Employee Benefits – Amendments	1 January 2016
IFRS 7	Financial Instruments: Disclosures – Amendments	1 January 2016

(in thousands of Azerbaijan Manats)

3 Standards, interpretations and amendments to existing standards (continued)

3.2 Standards, interpretations and amendments to existing standards that are not yet effective and have not been adopted early by the Bank

At the date of authorisation of these financial statements, the following new standards, interpretations and amendments to existing standards have been published but are not yet effective, and have not been adopted early by the Bank.

Standard number	Title	Effective date
IFRS 16	Leases	1 January 2019
IFRS 15	Revenue from Contracts with Customers – New	1 January 2018
IFRS 9	Financial Instruments – Amendments	1 January 2018

Management anticipates that all the relevant pronouncements will be adopted in the Bank's accounting policies for the first period beginning after the effective date of the pronouncement. Information on the relevant new standards, amendments and interpretations that are not yet effective has been provided below.

IFRS 16 Leases - New (effective for accounting period beginning on or after 1 January 2019)

IFRS 16 Leases specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 15 Revenue from Contracts with Customers - New (effective for accounting period beginning on or after 1 January 2018)

IFRS 15 establishes a single comprehensive five-step model for entities to use in accounting for revenue arising from contracts with customers. It will supersede the following revenue Standards and Interpretations upon its effective date:

- IAS 18 *Revenue*;
- IAS 11 *Construction Contracts;*
- IFRIC 13 *Customer Loyalty Programmes*;
- IFRIC 15 *Agreements for the Construction of Real Estate*;
- IFRIC 18 *Transfers of Assets from Customers*; and
- SIC 31 *Revenue-Barter Transactions Involving Advertising Services.*

The five steps in the model are as follows:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contracts; and
  Recognise revenue when (or as) the entity satisfies a performance obligation.

3 Standards, interpretations and amendments (continued)

3.2 Standards, interpretations and amendments to existing standards that are not yet effective and have not been adopted early by the Bank (continued)

Guidance is also provided on topics such as the point in which revenue is recognised, accounting for variable consideration, costs of fulfilling and obtaining a contract and various related matters. New disclosures about revenue are also introduced.

IFRS 9 Financial Instruments – Amendments (effective for accounting period beginning on or after 1 January 2018)

In July 2014, the IASB issued the final version of IFRS 9 'Financial Instruments' which reflects all phases of the financial instruments project and replaces IAS 39 'Financial Instruments: Recognition and Measurement' and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting.

Classification and measurement

Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. The 2014 version of IFRS 9 introduces a 'fair value through other comprehensive income' category for certain debt instruments.

Financial liabilities are classified in a similar manner to under IAS 39; however, there are differences in the requirements applying to the measurement of an entity's own credit risk.

Impairment

The 2014 version of IFRS 9 introduces an 'expected credit loss' model for the measurement of the impairment of financial assets, so it is no longer necessary for a credit event to have occurred before a credit loss is recognised.

Hedge accounting

Introduces a new hedge accounting model that is designed to be more closely aligned with how entities undertake risk management activities when hedging financial and non-financial risk exposures.

Derecognition

The requirements for derecognition of financial assets and liabilities are carried forward from IAS 39.IFRS 9 is effective for accounting period beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015.

Management has yet to assess the impact of this revised standard on the Bank's financial statements.

(in thousands of Azerbaijan Manats)

4 Summary of significant accounting policies

4.1 Overall considerations

These financial statements have been prepared using the measurement bases specified by IFRS for each type of asset, liability, income and expense. There has been no significant reclassification or adjustments in the comparatives. The measurement bases are more fully described in the accounting policies below.

4.2 Basis of preparation

The accounting policies have been consistently applied by the Bank during the year and are consistent with those used in the previous year.

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 4.20 and 4.21.

4.3 Foreign currency translation

Functional and presentation currency

These financial statements are presented in Azerbaijan New Manat (AZN), which is also Bank's functional currency.

Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency, using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the remeasurement of monetary items at year-end exchange rates are recognised in statement of comprehensive income.

Non-monetary items measured at historical cost are translated using the exchange rates at the date of the transaction (not retranslated). Non-monetary items measured at fair value are translated using the exchange rates at the date when fair value was determined. For the purpose of translation of financial assets and financial liabilities denominated in foreign currencies the following year-end exchange rates have been used:

	2016	2015
AZN/1 USD	**1.7707**	1.5594
AZN/1 Euro	**1.8644**	1.7046
AZN/1 GBP	**2.1745**	2.3133
AZN/1 RUB	**0.0293**	0.0216

4.4 Financial instruments

Recognition, initial measurement and derecognition

Financial assets and financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the financial instrument and are measured initially at fair value plus transactions costs. Regular purchases and sales of financial assets are recognised on the trade-date – the date on which the Bank commits to purchase or sell the asset.

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred.

A financial liability is derecognised when it is extinguished, discharged, cancelled or expired.

Financial assets and financial liabilities are measured subsequently as described below.

Classification and subsequent measurement of financial assets

For the purpose of subsequent measurement, financial assets other than those designated and effective as hedging instruments are classified into the following categories upon initial recognition:

- loans and receivables.

The category determines subsequent measurement and whether any resulting income or expense is recognised in profit or loss or in other comprehensive income.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition these are measured at amortised cost using the effective interest method, less provision for impairment. Discounting is omitted where the effect of discounting is immaterial. The Bank's cash and balances with Central Bank, balances with other banks, loans and advances to customers and certain other assets fall into this category of financial instruments.

Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Receivables that are not considered to be individually impaired are reviewed for impairment in groups, which are determined by reference to the industry and region of a counterparty and other shared credit risk characteristics. The impairment loss estimate is then based on recent historical counterparty default rates for each identified group.

Classification and subsequent measurement of financial liabilities

The Bank's financial liabilities include loans and deposits from banks and financial institutions, deposits from customers and certain other liabilities.

Financial liabilities are measured subsequently at amortised cost using the effective interest method.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

4 Summary of significant accounting policies (continued)

4.5 Loans and advances to customers

Loans and advances to customers include loans and advances originated by the Bank and these are recognised when cash is advanced to borrowers. These are derecognised when either borrower repays their obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses, if any.

Impairment

Losses on impaired loans are recognised promptly when there is objective evidence that impairment of a loan has occurred. Impairment losses are calculated on individual loans and on group of loans assessed collectively. Impairment losses are recorded as charges to the statement of comprehensive income. The carrying amount of impaired loans on the statement of financial position is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

Impairment losses are recognised promptly when there is an objective evidence that impairment of a financial asset has occurred as a result of one or more events that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Along with the prudential regulations of CBAR the primary factors that the Bank considers whether a financial asset is impaired are its overdue status and realizability of related collateral, if any. The following other principal criteria are also used to determine that there is objective evidence that an impairment loss has occurred:

- the viability of the customer's business model and its capability to trade successfully out of financial difficulties and generate sufficient cash flow to service its debt obligations;
- One of the major customer is a government entity.
- the realisable value of security (or other credit mitigations) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the borrower experiences a significant financial difficulty as evidenced by borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation; or
- the adverse change in the payment status of the borrower as a result of changes in the international or local economic conditions that impact the borrower.

Write-offs of loans and advances and guarantees

A loan and guarantee (and the related impairment allowance) is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount and, for a collateralised loan, when the proceeds from realising the security have been received.

4 Summary of significant accounting policies (continued)

4.5 Loans and advances to customers (continued)

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write back is recognised in the statement of comprehensive income.

4.6 Cash and cash equivalents

Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash and balances with Central Bank and balances with other banks with original maturities of three months or less. Cash and cash equivalents are carried in the statement of financial position at cost which is the fair value of these balances.

4.7 Other assets

Other assets are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method.

4.8 Impairment testing

Financial assets

All financial assets except for those at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired.

For amounts due to the Bank, significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy and default of payments are all considered indicators of impairment.

Impairment losses are recognized in the profit or loss.

Impairment losses are reversed when an increase in the financial asset's recoverable amount can be related objectively to an event occurring after the impairment was recognized, subject to the restriction that the carrying amount of the financial asset at the date that the impairment is reversed shall not exceed what the carrying amount would have been had the impairment not been recognized.

Where financial assets are impaired through use of an allowance account, the amount of the loss is recognized in the statement of comprehensive income within 'administrative and general expenses'. When such assets are written-off, the write-off is made against the relevant allowance account. Subsequent recoveries of amounts previously written-off are credited against operating expenses.

4 Summary of significant accounting policies (continued)

4.8 Impairment testing (continued)

Non-financial assets

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level.

All individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows.

All assets are subsequently reassessed for indications that an impairment loss previously recognised may no longer exist. An impairment charge is reversed if the cash-generating unit's recoverable amount exceeds its carrying amount.

4.9 Loans and deposits from banks and financial institutions and deposits from customers

These are recognised initially at fair value, net of transaction costs incurred. Loans and deposits are subsequently stated at amortised cost, any difference between proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income over the period of the loans and deposit using the effective interest method.

4.10 Other liabilities

Other liabilities are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

4.11 Repossessed collaterals

Repossessed collateral represents non-financial assets acquired by the Bank in settlement of overdue loans. These assets are initially recognized at lower of their previous carrying amount or fair value less costs to sell and are included in other assets. These assets are subsequently measured and accounted for in accordance with the accounting policies for these categories of assets.

4.12 Property and equipment

Property and equipment are initially recognised at acquisition cost, including any costs directly attributable to bringing the assets to the location and condition necessary for it to be capable of operating in the manner intended by the Bank's management

4 Summary of significant accounting policies (continued)

4.12 Property and equipment (continued)

These assets are subsequently measured using the cost model and is stated at cost less subsequent depreciation and impairment losses, except for building.

Building held for use in the production or supply of goods or services, or for administrative purposes, is stated in the statement of financial position at the revalued amount, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluation is made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date.

Any increase in an asset's carrying amount, as a result of a revaluation, is recognised in other comprehensive income and credited to the 'revaluation reserve' in equity. The increase is recognised in the profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in the profit or loss and any remaining increase is recognised in other comprehensive income.

Any decrease in an asset's carrying amount, as a result of a revaluation, is recognised in the profit or loss in the current period. The decrease is debited directly to equity in the revaluation reserve to the extent of any credit balance existing in the revaluation surplus in respect of that asset and any remaining decrease recognised in profit or loss.

Depreciation is recognised on reducing balance method to write down the cost less estimated residual value of property and equipment. The following estimated useful lives are applied:

- Building 100 years
- Furniture and equipment 4 years
- Computers 4 years
- Motor vehicles 4 years
- Other assets 5 years

Material residual value estimates and estimates of useful life are updated as required, but at least annually, whether or not the asset is revalued.

Gains or losses arising on the disposal of property and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognised in profit or loss within 'other income'.

4 Summary of significant accounting policies (continued)

4.13 Intangible assets

Intangible assets include acquired software used in operations. They are accounted for using the cost model whereby capitalised costs are amortised on a reducing balance method over their estimated useful lives, as these assets are considered finite. Residual values and useful lives are reviewed at each reporting date. In addition, they are subject to impairment testing. The useful life of software is 10 years.

Costs associated with maintaining computer software, i.e. expenditure relating to patches and other minor updates as well as their installation, is expensed as incurred.

The gain or loss arising on the disposal of an intangible asset is determined as the difference between the proceeds and the carrying amount of the asset, and is recognised in profit or loss within 'other income'.

4.14 Leased assets

Operating lease – as lessee

Leases where the lessor retains a significant portion of the risks and rewards of ownership are classified as operating leases. Payments on operating lease agreements are recognised as an expense on a straight-line basis over the lease term. Associated costs are expensed as incurred.

4.15 Equity and reserves

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

Retained earnings include all current and prior period retained profits.

All transactions with owners are recorded separately within equity.

4.16 Provisions and contingent liabilities

Provisions are recognised when present obligations as a result of a past event will probably lead to an outflow of economic resources from the Bank and amounts can be estimated reliably. Timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events.

Provision for guarantee claims and other off-balance sheet obligations is recognized when intimated and reasonable certainty exists to settle the obligations. Expected recoveries are recognized by debiting customer accounts. Charge to profit and loss account is stated net of expected recoveries. Provisions are not recognised for future operating losses.

Provisions are discounted to their present values, where the time value of money is material.

All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

4 Summary of significant accounting policies (continued)

In those cases where the possible outflow of economic resources as a result of present obligations is considered improbable or remote, no liability is recognised, unless it was assumed in the course of a business combination.

4.17 Employees' benefits

Short-term employee benefits

The Bank grants compensated absences to all its regular employees. The expected cost of compensated absences is recognized as an expense when the employee renders services that increase their entitlement or, in the case of non-accumulating absences, when the absences occur. Outstanding balance of such absences is paid to employees at the end of each financial year hence no liability has been booked in the financial statements.

Defined contribution plan

The Bank contributes to the Social Security Fund constituted by Government as per the Azerbaijan Republic legislation. These contributions are made at 22% and 3% of gross salary by the Bank and employees respectively. Upon retirement all retirement benefit payments are made by the state pension fund.

4.18 Revenue recognition

Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised within 'interest income' and 'interest expense' in the statement of comprehensive income using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. Once a loan has been written down or partly written down as a result of impairment loss (categorised as "classified loan"), interest income is recognized on receipt basis in compliance with Prudential Regulations issued by CBAR.

Fee and commission income

Fees and commission income is generally recognised on accrual basis when the services have been provided.

4 Summary of significant accounting policies (continued)

4.19 Taxation

Income tax expense represents the sum of the current and deferred tax expense.

Current

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's current tax expense is calculated using tax rates that have been enacted or substantively enacted during the reporting period.

Deferred

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities: and
- Deferred tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Azerbaijan Republic also has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the statement of comprehensive income.

4 Summary of significant accounting policies (continued)

4.20 Significant management judgement in applying accounting policies

The following are significant management judgements in applying the accounting policies of the Bank that have the most significant effect on the financial statements. Critical estimation uncertainties are described in note 4.21.

Initial recognition of related party transactions

In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

Term borrowings

The Bank obtains long-term financing from the government at interest rates which are lower than rates at which the Bank could source the funds from local lenders. As a result of such financing, the Bank is able to advance funds to specific customers (under specific lending programmes) at advantageous rates. Management have considered whether gains or losses should arise on initial recognition of such instruments. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market rates and no initial recognition gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment.

4.21 Estimation uncertainty

When preparing the financial statements, management undertakes a number of judgements, estimates and assumptions about recognition and measurement of assets, liabilities, income and expenses.

The actual results may differ from the judgements, estimates and assumptions made by management, and will seldom equal the estimated results.

Information about significant judgements, estimates and assumptions that have the most significant effect on recognition and measurement of assets, liabilities, income and expenses is provided below.

Impairment of property and equipment and intangible assets

An impairment loss is recognised for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount. To determine the recoverable amount, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. In the process of measuring expected future cash flows management makes assumptions about future operating results. These assumptions relate to future events and circumstances. The actual results may vary, and may cause significant adjustments to the Bank's assets within the next financial year.

In most cases, determining the applicable discount rate involves estimating the appropriate adjustment to market risk and the appropriate adjustment to asset-specific risk factors.

4 Summary of significant accounting policies (continued)

4.21 Estimation uncertainty (continued)

Provision for impairment of loans and advances to customers

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Loans and advances to customers are measured at amortized cost less allowance for impairment losses. The estimation of allowances for impairments involves the exercise of significant judgment. The Bank estimates allowances for impairment with the objective of maintaining provisions at a level believed by management to be sufficient to absorb losses incurred in the Bank's loan portfolio. The calculation of provisions on impaired loans is based on the likelihood of the asset being written off and the estimated loss on such a write-off. These assessments are mainly made using time based criteria determined by the prudential regulations issued by CBAR.

Useful lives of depreciable assets

Management reviews the useful lives of depreciable assets which include property and equipment, investment property and intangible assets at each reporting date, based on the expected utility of the assets to the Bank. Actual results, however, may vary due to technical obsolescence, particularly relating to software and IT equipment.

Fair value of property and equipment

Management estimates the fair values of property and equipment based on current market prices of recent transactions and rental yields in neighbouring and adjoining areas if an independent valuer determines the fair value on a different date than reporting date.

(in thousands of Azerbaijan Manats)

5 Cash and balances with Central Bank

	2016 AZN	2015 AZN
Cash on hand	17,122	6,498
Balances with Central Bank other than mandatory minimum reserve deposits	666	3,487
Included in cash and cash equivalents (note 6)	17,788	9,985
Mandatory minimum reserve deposits with Central Bank	1,661	755
	19,449	10,740

Mandatory minimum reserve deposits are not available for use in the Bank's day-to-day operations. Cash on hand, balances with Central Bank and mandatory minimum reserve deposits are non-interest-bearing.

At the reporting date, this includes blocked correspondent accounts of AZN 7 (2015: AZN 7).

6 Cash and cash equivalents

Cash and cash equivalents for the purpose of the statement of cash flows include the following components:

	2016 AZN	2015 AZN
Cash and balances with Central Bank (note 5)	17,788	9,985
Balances with other banks (note 7)	4,153	5,661
	21,941	15,646

7 Balances with other banks

Correspondent accounts (note 7.1)	4,199	5,661
Less: Allowance for impairment losses	(46)	(221)
Included in cash and cash equivalents (note 6)	4,153	5,440
Deposits placed with other banks	-	4,254
	4,153	9,694

7.1 Allowance for impairment losses

Balance at January 1,	221	1,895
Allowance for impairment losses charge for the year	-	622
Write back due to recoveries	(175)	(2,296)
Balance at December 31,	46	221

(in thousands of Azerbaijan Manats)

8 Loans and advances to customers

	2016 AZN	2015 AZN
Loans and advances	388,333	346,953
Accrued interest income	4,310	2,914
	392,643	349,867
Less: allowance for impairment losses (note 8.1)	(28,902)	(14,138)
	363,741	335,729

Loans and advances to customers carry interest rates ranging from 3.2% to 25% per annum (2015: 3.2% to 25% per annum).

For lending limits breach please refer note 24.1

Analysis by industry for loans and advances to customers

	2016 AZN	2015 AZN
Transportation	366,349	317,872
Individuals	21,912	29,008
Trading and service	72	73
	388,333	346,953

Analysis by currency for loans and advances to customers

AZN	156,369	148,143
USD	222,896	190,433
EUR	9,068	8,377
	388,333	346,953

8.1 Allowance for impairment losses

	2016 AZN	2015 AZN
Balance at January 1,	14,138	8,973
Charge for the year	14,856	5,595
Write-off of loans	(488)	(430)
Write back due to recoveries	396	-
Balance at December 31,	28,902	14,138

(in thousands of Azerbaijan Manats)

8 Loans and advances to customers (continued)

Classified loans and advances and allowance for impairment losses

	2016			
	Loans and advances AZN	Accrued Interest AZN	Total Loans and advances AZN	Allowance for impairment losses AZN
- Un-satisfactory	83	2	85	34
- Risky	-	-	-	-
- Bad	16,730	1,549	18,279	17,453
	16,813	1,551	18,364	17,487
Satisfactory	371,520	2,759	374,279	11,415
	388,333	4,310	392,643	28,902

	2015			
	Loans and advances AZN	Accrued Interest AZN	Total Loans and advances AZN	Allowance for impairment losses AZN
- Un-satisfactory	11,292	163	11,455	3,476
- Risky	10,897	358	11,255	6,626
- Bad	298	185	483	353
	22,487	706	23,193	10,455
Satisfactory	324,466	2,208	326,674	3,683
	346,953	2,914	349,867	14,138

(in thousands of Azerbaijan Manats)

9 Property and equipment

2016	Building AZN	Furniture and equipment AZN	Computers AZN	Motor vehicles AZN	Other assets AZN	Leasehold improvements AZN	Total AZN
Gross carrying amount							
Balance at January 1, 2016	1,500	2,008	551	600	271	723	5,653
Additions	-	314	297	14	4	-	629
Disposals	(1,500)	(31)	(38)	(30)	-	-	(1,599)
Balance at December 31, 2016	-	2,291	810	584	275	723	4,683
Accumulated depreciation							
Balance at January 1, 2016	5	1,182	330	279	62	91	1,949
Depreciation charge	4	266	72	67	42	44	495
Disposals	(9)	(29)	(36)	(16)	-	-	(90)
Balance at December 31, 2016	-	1,419	366	330	104	135	2,354
Net carrying amount at December 31, 2016	-	872	444	254	171	588	2,329

(in thousands of Azerbaijan Manats)

9 Property and equipment (continued)

2015	Building AZN	Furniture and equipment AZN	Computers AZN	Motor vehicles AZN	Other assets AZN	Leasehold improvements AZN	Total AZN
Gross carrying amount							
Balance at January 1, 2015	3,100	1,781	489	440	98	723	6,631
Additions	-	227	67	215	173	-	682
Write-offs	-	-	(5)	(55)	-	-	(60)
Revaluation	(1,600)	-	-	-	-	-	(1,600)
Balance at December 31, 2015	1,500	2,008	551	600	271	723	5,653
Accumulated depreciation							
Balance at January 1, 2015	89	945	273	268	18	42	1,635
Depreciation charge	23	237	62	60	44	49	475
Write-offs	-	-	(5)	(49)	-	-	(54)
Revaluation	(107)	-	-	-	-	-	(107)
Balance at December 31, 2015	5	1,182	330	279	62	91	1,949
Net carrying amount at December 31, 2015	1,495	826	221	321	209	632	3,704

In the opinion of the management, there has been no impairment in the carrying amount of property and equipment as at December 31, 2016 (2015: Nil). No property and equipment have been pledged as security for liabilities.

(in thousands of Azerbaijan Manats)

10 Other assets

	2016 AZN	2015 AZN
Receivable from Tax Authority and state-owned organisation	633	212
Other assets	326	528
Amounts in course of settlements	1,292	862
Prepayments	313	520
	2,564	2,122
Less: impairment	-	(134)
	2,564	1,988

11 Loans and deposits from banks and financial institutions

Loans from Central Bank	22,696	28,760
Deposits from other banks and financial institutions	90,548	77,051
Due to Azerbaijan Mortgage Fund	2,644	2,543
	115,888	108,354

The loans from CBAR carry an average interest rate of 3% per annum (2015: 4% per annum) and are secured. A total is AZN 22,696, out of which AZN 20,000 thousands are repayable in July 2017.

Deposits from other banks and financial institutions carry interest rates ranging from 3% to 7.78% per annum (2015: 3% to 7.78% per annum) and are unsecured and repayable within twelve months.

The loans from Azerbaijan Mortgage Fund carry interest rates of 4% per annum (2015: 4% per annum) and are unsecured and all loans are repayable after twelve months (2015: after twelve months).

12 Deposits from customers

	2016 AZN	2015 AZN
Current accounts	43,012	30,772
Term deposits	126,907	118,018
Accrued interest expense on term deposits	222	450
	170,141	149,240

(in thousands of Azerbaijan Manats)

12 Deposits from customers (continued)

Term deposits

These are unsecured and carry interest rates ranging from 1.5% to 12% per annum (2015: 3% to 12% per annum).

Analysis by industry for deposits from customers

	2016 AZN	2015 AZN
Individuals	156,018	129,500
Insurance	-	8,644
Trade	4,143	1,879
Agriculture	-	13
Construction	26	75
Public entities	132	-
Transport and communication	9,598	8,190
Other	224	939
	170,141	149,240

13 Other liabilities

Payable to state-owned organisation	24	72
Accruals and other payables	1,489	733
	1,513	805

14 Share capital

The share capital of the Bank consists only of fully paid ordinary shares with a par value of AZN 149.5 (2015: AZN 149.5) each. All shares are equally eligible to receive dividends and the repayment of capital and represent one vote at the shareholders' meeting of the Bank.

Number of shares	2016	2015
Shares issued and fully paid: at December 31	679	679
Total shares authorised at December 31,	679	679
Total shares authorised, issued and fully paid at December 31, (in AZN)	**101,545**	**101,545**

Bank did not declare any dividend on ordinary shares during the year ended December 31, 2016 (2015: Nil)

In year 2015, bank increased par value of ordinary shares from AZN 146 to 149.5 each.

(in thousands of Azerbaijan Manats)

15 Net interest income

	2016 AZN	2015 AZN
Interest income		
Interest on balances with other banks	191	371
Interest on loans and advances to customers	25,738	23,638
Interest on guarantees	306	112
	26,235	24,121
Interest expense		
Interest on loans and deposits from banks and financial institutions	7,244	6,991
Interest on deposits from customers	5,881	5,842
	13,125	12,833
Net interest income	13,110	11,288

16 Gains from foreign exchange operations - net

Translation differences - net	(372)	1,867
Dealing - net	11,228	3,600
Total	10,856	5,467

17 Fees and commission income

Plastic card operations	2,859	1,863
Settlements	1,655	1,493
Cash operations	1,303	909
Guarantee commission	1	7
Other	-	25
Total	5,818	4,297

18 Fees and commission expense

Plastic card operations	1,028	953
Settlements	314	244
Guarantee commission	72	45
Other	30	15
Total	1,444	1,257

19 Other income

Miscellaneous income	61	368

(in thousands of Azerbaijan Manats)

20 Depreciation and amortization expense

	2016 AZN	2015 AZN
Depreciation of property and equipment	495	475
Amortization of intangible assets	30	8
Total	525	483

21 Administrative and general expenses

	2016 AZN	2015 AZN
Salaries and benefits	3,482	3,177
Advertising and marketing	3,837	3,279
Rent	1,892	1,597
Insurance	291	164
Repairs and maintenance	185	86
Security	285	259
Loss on disposal of fixed assets	159	-
Net loss on impairment of property and equipment	-	1,149
Loss on sale of collaterals	-	929
Communications	147	129
Office supplies	125	171
Travelling and entertainment	98	207
Legal and professional fee	95	107
Taxes other than income tax	83	75
Vehicle running expenses	59	59
Utilities	26	28
Other	375	178
Total	11,139	11,594

22 Taxation

Azerbaijan commercial and tax legislation in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transaction may be challenged by the tax authorities, and as a result the Bank may be assessed for additional tax, penalties and interest. The management believes that the Bank is in substantial compliance of tax legislation.

	2016 AZN	2015 AZN
Current tax	445	975
Deferred tax	(110)	(14)
	335	961

(in thousands of Azerbaijan Manats)

22 Taxation (continued)

22.1 Current tax

Relationship between tax expense and accounting profit

	2016 AZN	2015 AZN
Accounting profit before tax	1,881	2,491
Tax calculated at the rate of 20% (2015: 20%) on:		
- Accounting profit	376	498
- Expenses not deductible for tax purposes	(104)	282
- Income tax related to previous periods	173	195
- Deferred tax reversal	(110)	(14)
Income tax expense for the year	335	961

Management believes that the Bank is in substantial compliance with the tax laws affecting its operations.

22.2 Deferred tax

Difference between IFRS and Azerbaijan statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and profit tax purposes. Deferred profit tax assets and liabilities are measured at 20%, the anticipated rate applicable when the assets or liabilities will reverse. The deferred tax liability is recognised on the following:

Deferred tax liabilities	2016 AZN	2015 AZN
As at January 1,	110	124
Change in deferred income tax balances recognised in profit and loss	-110	-14
As at December 31,	-	110

23 Related parties

The Bank in the normal course of business carries on business with other entities that fall within the definition of related party contained in IFRS as issued by the IASB. These transactions are carried out in the normal course of business and are measured at exchange amounts, being the amounts agreed by both the parties.

For the purpose of these financial statements, entities are considered to be related to the Bank if it has the ability, directly or indirectly, to exercise significant influence over the entities in making financial and operating decisions, or vice versa, or where the Bank and other entity is subject to common control or significant influence, key management personnel and other related parties.

Details of related party transactions entered into during the year are set out on next page.

(in thousands of Azerbaijan Manats)

23 Related parties (continued)

23.1 Balances outstanding with related parties

Loans and advances to customers

	2016 AZN	2015 AZN
Loans and advances		
(a) Shareholders	13,818	50
(b) Key management personnel	100	538
(c) Other related parties	287	5,211
	14,205	5,799
Accrued interest income		
(a) Shareholders	37	-
(b) Key management personnel	-	5
(c) Other related parties	1	22
	38	27
Total	14,243	5,826

Deposits from customers

	2016 AZN	2015 AZN
Term deposits		
(a) Shareholder	63,007	61,006
(b) Key management personnel	53	826
(c) Other related parties	4,678	9,223
	67,738	71,055
Current/demand accounts		
(a) Shareholders	9,562	8,644
(b) Entities under common control	804	123
(c) Key management personnel	89	37
(d) Other related parties	5,632	5,174
	16,087	13,978
Accrued interest expense on term deposits		
(a) Shareholder	118	249
(b) Key management personnel	-	5
(c) Other related parties	7	46
	125	300
Total	83,950	85,333

(in thousands of Azerbaijan Manats)

23 Related parties (continued)

23.1 Balances outstanding with related parties (continued)

23.2 Amounts included in the statement of comprehensive income

Interest income

(a) Shareholders	466	23
(b) Entities under common control	114	178
(c) Key management personnel	10	47
(d) Other related parties	23	30
	613	278

Interest expense

(a) Shareholder	3,777	3,557
(b) Key management personnel	2	54
(c) Other related parties	202	189
	3,981	3,800

Compensation to key management personnel

	2016 AZN	2015 AZN
Compensation to key management personnel	378	389

Fees and commission income on settlements

Fees and commission income on settlements	1,646	259

23.3 Guarantees issued on behalf of related parties

(a) Entity under common control	2,580	2,168
	2,580	2,168

23.4 Other transactions

The Financial Market Supervisory Authority of the Republic of Azerbaijan require banks to maintain certain prudential ratios with regard to related parties, computed based on statutory financial statements. As at December 31, 2016 the Bank was in compliance with these ratios except as mentioned in note 24.1

(in thousands of Azerbaijan Manats)

24 Contingencies and commitments

In the normal course of business the Bank is party to financial instruments with off-balance sheet risk in order to meet the need of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the statement of financial position.

The Bank uses the same credit control and management policies in under taking off-balance sheet contingent liabilities and commitments as it does for on-balance sheet operations.

	2016	2015
	AZN	AZN
Guarantees issued on behalf of customer	48,001	4,326
Credit lines	11,331	24,793

At the reporting date, the Bank has no major capital commitments (2016: Nil).

Operating environment

Emerging markets such as Azerbaijan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. As has happened in the past, actual or perceived financial problems or an increase in the perceived risks associated with investing in emerging economies could adversely affect the investment climate in Azerbaijan and the Azerbaijan's economy in general.

Laws and regulations affecting businesses in Azerbaijan continue to change rapidly. Tax, currency and customs legislation within Azerbaijan are subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in Azerbaijan. The future economic direction of Azerbaijan is largely dependent upon economic, fiscal and monetary measures undertaken by the government, together with legal, regulatory, and political developments. There has been major devaluation in Azerbaijan Mannats against US dollars since February 21, 2015. The government has introduced a floating exchange rate since December 21, 2015, which was previously pegged against US dollars. Furthermore, the Govt. remove the restriction on maximum and minimum margin deviation from CBAR exchange rate during the year and now Bank can set their own exchange rate based on market supply and demand basis.

The global financial turmoil that has negatively affected Azerbaijan's financial and capital markets in 2009 and 2010 receded and Azerbaijan's economy returned to growth in 2011 and 2012. However significant economic uncertainties remain. Adverse changes arising from systemic risks in global financial systems, including any tightening of the credit environment or from decline in the oil and gas prices could slow or disrupt the Azerbaijan's economy, adversely affect the Group's access to capital and cost of capital for the Group and, more generally, its business, results of operations, financial condition and prospects. Because Azerbaijan produces and exports large volumes of oil and gas, Azerbaijan's economy is particularly sensitive to the price of oil and gas on the world market which has fluctuated significantly during the year.

Legal proceedings

From time to time and in the normal course of business, claims against the Bank are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

24 Contingencies and commitments (continued)

Taxation

Commercial legislation of the Republic of Azerbaijan, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed for additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally, such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans and advances to customers and receivables, as an underestimation of the taxable profit.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates.

24.1 Compliance with CBAR ratios

The Financial Market Supervisory Authority of the Republic of Azerbaijan require banks to maintain certain prudential ratios computed based on statutory financial statements. As at December 31, 2016, the Bank was in compliance with these ratios except for below ratio of:

i. Maximum credit exposure of a bank per single borrower that should not exceed 7% of the Bank's total capital when the market value of the collateral in any other form of credit exposures is less than 100% of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value. As at December 31, 2016, the Bank exceeded the required limits.

ii. Maximum credit exposure of a bank per one related party borrower, which is natural person has exceeded the Bank's total capital ratio required as at 31 December 2016.

iii. As at December 31, 2016 the Bank granted loans to 2 customers which exceeded 10% of the Bank's total equity.

(in thousands of Azerbaijan Manats)

25 Capital adequacy and management

Capital management policies and procedures

Capital management objectives are to ensure that there is sufficient capital to meet the capital requirements of the Bank as determined by the underlying business strategy and the minimum requirements of the CBAR. The capital management process is governed by the Supervisory Board. The Supervisory Board is responsible for managing the Bank's capital position in line with internal as well as regulatory requirements.

The Supervisory Board also reviews the volume and mix of the Bank's assets, liabilities and funding sources in light of liquidity, capital, risk and profitability considerations.

The Bank's capital management seeks:

- to comply with the capital requirements set by the regulators and comparable to the peers;
- to actively manage the supply of capital costs and increase capital velocity;
- to increase strategic and tactical flexibility in the deployment of capital to allow for the timely reallocation of capital;
- to improve the liquidity of the Bank's assets to allow for an optimal deployment of the Bank's resources;
- to protect the Bank against unexpected events and maintain strong ratings;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide adequate return to shareholders;
- availability of adequate capital (including the quantum) at a reasonable cost so as to enable the Bank to expand; and
- to achieve low overall cost of capital with appropriate mix of capital elements.

Capital adequacy ratio

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain amounts and ratios of total and tier 1 capital to risk weighted assets. The capital to risk weighted assets ratio was calculated in accordance with the guidelines issued by CBAR on capital adequacy using the principles employed by the Basel Committee by applying following risk estimates to the assets and off-balance sheet commitments net of allowances for impairment losses.

	2016 AZN	2015 AZN
Total regulatory capital held	106,973	113,527
Tier 1 capital	103,146	101,622
Total risk weighted assets	705,781	647,338
Total regulatory capital ratio (minimum requirement 10% (2015: 10%))	14.61%	15.7%
Tier 1 capital ratio (minimum requirement 5% (2015: 5%))	14.54%	16.52%

(in thousands of Azerbaijan Manats)

26 Categories of financial assets and liabilities

The carrying amounts presented in the statement of financial position relate to the following categories of assets and liabilities:

	Notes	2016 AZN	2015 AZN
Financial assets			
Loans and receivables:			
- Cash and balances with Central Bank	5	19,449	10,740
- Balances with other banks	7	4,153	9,694
- Loans and advances to customers	8	363,741	335,729
- Other assets		1,618	1,390
		388,961	357,553
Financial liabilities			
Measured at amortised cost:			
- Loans and deposits from banks and financial institutions	11	115,888	108,354
- Deposits from customers	12	170,141	149,240
- Other liabilities		1,489	733
Total		287,518	258,327

27 Financial instrument risk

27.1 Fair value measurement of financial instruments

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. Differences can therefore arise between the carrying values under the historical cost method and fair value estimates. Underlying the definition of fair value is a presumption that an enterprise is a going concern without any intention or need to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms. As per management's estimates fair value of the Bank's financial instruments that are not carried at fair value in the statement of financial position is stated below:

(in thousands of Azerbaijan Manats)

27 Financial instrument risk

27.1 Fair value measurement of financial instruments

	2016		2015	
	Carrying value AZN	Fair value AZN	Carrying value AZN	Fair value AZN
Financial assets:				
- Cash and balances with Central Bank	19,449	19,449	10,740	10,740
- Balances with other banks	4,153	4,153	9,694	9,694
- Loans and advances to customers	363,741	363,741	335,729	335,729
- Other assets	1,618	1,618	1,390	1,390
Total	388,961	388,961	357,553	357,553
Financial liabilities:				
- Loans and deposits from banks and financial institutions	115,888	115,888	108,354	108,354
- Deposits from customers	170,141	170,141	149,240	149,240
- Other liabilities	1,489	1,489	733	733
Total	287,518	287,518	258,327	258,327

Sufficient financial assets are available to meet the financial liabilities.

Assets and liabilities in the statement of financial position measured at fair value are grouped into three levels of fair value hierarchy. This grouping is determined based on the lowest level of significant inputs used in fair value measurement, as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.1 Fair value of financial instruments (continued)

The following table shows the Levels within the hierarchy of financial assets and liabilities as at December 31, 2016 and December 31, 2015:

December 31, 2016	Level 1 AZN	Level 2 AZN	Level 3 AZN	Total AZN
Assets for which fair values are disclosed:				
- Cash and balances with Central Bank	19,449	-	-	19,449
- Balances with other banks	-	-	4,153	4,153
- Loans and advances to customers	-	-	363,741	363,741
- Other assets	-	-	1,618	1,618
Liabilities for which fair values are disclosed:				
- Loans and deposits from banks and financial institutions	-	-	115,888	115,888
- Deposits from customers	-	-	170,141	171,630
- Other liabilities	-	-	1,489	1,489
December 31, 2015				
Assets for which fair values are disclosed:				
- Cash and balances with Central Bank	10,740	-	-	10,740
- Balances with other banks	-	-	9,694	9,694
- Loans and advances to customers	-	-	335,729	335,729
- Other assets	-	-	1,390	1,390
Liabilities for which fair values are disclosed:				
- Loans and deposits from banks and financial institutions	-	-	108,354	108,354
- Deposits from customers	-	-	149,240	149,240
- Other liabilities	-	-	733	733

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies

The Bank's business involves taking on risks in a targeted manner and managing them professionally. The core functions of the Bank's risk management are to identify all key risks for the Bank, measure these risks, manage the risk positions and determine capital allocations. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice.

The Bank's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The Bank defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors.

The Bank's risk management is coordinated at its head office, in close cooperation with the Supervisory Board. The Supervisory Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk and use of non-derivative financial instruments.

The Bank is exposed to various risks in relation to financial instruments. The Bank's financial assets and liabilities by category are summarised in note 26. The main types of risks are market risk, credit risk, liquidity risk and operational risk.

Market risk

Market risk is the risk that market prices and rates can change and this can have an adverse effect on profitability and/or capital. The Bank is exposed to number of market risks relating to its daily operations, arising from open positions in interest rates and currency, all of which are exposed to general and specific market movements. For the purpose of market risk, management identifies its main market risk factors as equity position risk, interest rate risk and foreign currency risk. The predominant market risk is foreign currency risk and interest rate risk. The Bank is not exposed significantly to equity position risk as it has no capital market operations.

The Bank, as a matter of policy, seeks to identify, measure, monitor and control market risks in order to protect against adverse movement in market prices and rates and to optimize the risk / return profile of its open positions. The Supervisory Board mainly oversees development and implementation of market risk policy and risk measuring / monitoring methodology and review and reporting of market risks against limits.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Foreign exchange risk is the risk that the earnings and/or capital will fluctuate due to changes in foreign exchange rates. The Bank's foreign exchange exposure consists of foreign currency cash on hand, balances with other banks, loans and advances to customers, loans and deposits from banks and financial institutions and deposits from customers.

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

The Bank manages its foreign exchange exposures by matching foreign currency assets and liabilities. Net open position and counterparty limits have been established to limit risk concentration.

Foreign currency denominated financial assets and liabilities which expose the Bank to currency risk are disclosed below. The amounts shown are those reported to key management personnel translated into AZN at the closing rate:

	Foreign currency exposure			
	USD	**EUR**	**Other**	**Total**
December 31, 2016	**AZN**	**AZN**	**AZN**	**AZN**
- Financial assets	238,511	16,126	399	255,036
- Financial liabilities	(238,106)	(14,880)	(1,363)	(254,349)
Total exposure – net	405	1,246	(964)	687

	Foreign currency exposure			
	USD	**EUR**	**Other**	**Total**
December 31, 2015	**AZN**	**AZN**	**AZN**	**AZN**
- Financial assets	195,261	9,591	695	205,547
- Financial liabilities	(202,806)	(10,362)	-	(213,168)
Total exposure – net	(7,545)	(771)	695	(7,621)

The following table illustrates the sensitivity of profit/(loss) before tax and equity in regards to the Bank's financial assets and financial liabilities and the USD/AZN exchange rate and EUR/AZN exchange rate 'all other things being equal'. It assumes a ±15% change of the USD/AZN exchange rate for the year ended at December 31, 2016 (2015: ±50%). A ±10% change is considered for the EUR/AZN exchange rate (2012: ±50%). Both of these percentages have been determined based on the average market volatility in exchange rates in the previous 12 months. The sensitivity analysis is based on the Bank's foreign currency financial instruments held at each reporting date.

If the AZN had strengthened against the USD by 15% (2015: 50%) and EUR by 10% (2015: 50%) respectively then this would have had the following impact:

	Profit/(loss) before tax			Equity		
	USD	**EUR**	**Total**	**USD**	**EUR**	**Total**
	AZN	**AZN**	**AZN**	**AZN**	**AZN**	**AZN**
December 31, 2016	61	125	185	49	100	148
December 31, 2015	(3,773)	(386)	(4,158)	(3,018)	(308)	(3,326)

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

If the AZN had weakened against the USD by 15% (2012: 50%) and EUR by 10% (2012: 50%) respectively then this would have had the following impact:

	Profit/(loss) before tax				Equity		
	USD	EUR	Total		USD	EUR	Total
	AZN	AZN	AZN		AZN	AZN	AZN
December 31, 2016	(61)	(125)	(185)	-	(49)	(100)	(148)
December 31, 2015	3,773	386	4,158	-	3,018	308	3,326

Exposures to foreign exchange rates vary during the year depending on the volume of overseas transactions. Nonetheless, the analysis above is considered to be representative of the Bank's exposure to foreign currency risk.

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce losses in the event that unexpected movements arise. The Supervisory Board sets limits on the level of mismatch of interest rate re-pricing and value at risk that may be undertaken, which is monitored daily by Risk Management Specialist.

The table on next page illustrates the sensitivity of profit/(loss) before tax and equity to a reasonably possible change in interest rates of ±1% (2015: ±1%). These changes are considered to be reasonably possible based on observation of current market conditions. The calculations are based on a change in the average market interest rate for each period, and the interest-bearing financial instruments held at each reporting date that are sensitive to changes in interest rates. All other variables are held constant.

	Profit/(loss) before tax		Equity	
	AZN	AZN	AZN	AZN
December 31, 2016	+1%	-1%	+1%	-1%
Financial assets:				
- Loans and advances to customers	3,637	(3,637)	2,910	(2,910)
Financial liabilities:				
- Loans and deposits from banks and financial institutions	(1,159)	1,159	(927)	927
- Deposits from customers	(25)	25	(20)	20
	1,269	(1,269)	1,015	(1,015)

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Interest rate risk (continued)

The following table illustrates level of mismatch of interest rate re-pricing:

December 31, 2016	Effective average interest rate %	Within 1 month AZN	More than 1 month but within 3 months AZN	More than 3 months but within 1 year AZN	More than 1 year but within 5 years AZN	More than 5 years AZN	Non-interest bearing AZN	Total AZN
Financial assets:								
- Cash and balances with Central Bank	-	-	-	-	-	-	19,449	19,449
- Balances with other banks	-	-	-	-	-	-	4,153	4,153
- Loans and advances to customers	7	83,437	3,703	31,374	232,749	12,478	-	363,741
- Other assets	-	313	-	-	-	-	2,251	2,564
		83,750	3,703	31,374	232,749	12,478	25,853	389,907
Financial liabilities:								
- Loans and deposits from banks and financial institutions	6.15	2,500	48,005	62,747	-	2,636		115,888
- Deposits from customers	6.21	83,235	10,647	26,954	6,071	-	43,234	170,141
- Other liabilities	-	-	-	-	-	-	1,489	1,489
		85,735	58,652	89,701	6,071	2,636	44,723	287,518
Total interest re-pricing gap		(1,985)	(54,949)	(58,327)	226,678	9,842	(18,870)	102,389

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Credit risk

Credit risk is the risk that arises from the potential that an obligor is either unwilling to perform an obligation or its ability to perform such obligation is impaired resulting in economic loss to the Bank. The Bank attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counter parties and continually assessing the creditworthiness of counter parties.

The focus of the Bank's commercial lending continues to be short-term trade related financing on a secured and self liquidating basis. The Bank will also continue its emphasis on diversification of its assets to avert large single industry or group exposure. A significant portion of loans is extended to related parties and the management considered minimal credit risk for these financing.

The Bank has built and maintained a sound loan portfolio in terms of a well defined credit policy. The Bank's credit evaluation system comprises of well-designed credit appraisal, sanctioning and review procedures for the purpose of emphasizing prudence in its lending activities and ensuring quality of asset portfolio. Special attention is paid to the management of non-performing loans. A "watch list" procedure is also functioning which identifies loans showing early warning signals of becoming non-performing.

The Bank is further diversifying its asset portfolio by offering, Consumer Banking Products (Personal Finance, Business Finance, Mortgage Finance and Auto Financing etc.) to its customers, as it provides better margins than traditional business lending opportunities, whilst spreading the risk over a large number of individual customers.

The Bank has developed an internal rating model, which allows it to determine the rating of counterparties. The rating of corporate borrowers is based on an analysis of the financial ratios of the borrower, and an analysis of the market and industry sector, in which the borrower operates. The model also takes into consideration various qualitative factors, such as management efficiency and borrower's market share.

The application of the internal rating model results in a standardized approach in the analysis of corporate borrowers and provides a quantitative assessment of the creditworthiness of a borrower that does not have a rating from an international rating agency. The model takes into account specific local market conditions.

The quality of the internal rating model is examined on a regular basis through an assessment of both its effectiveness and validity. The Bank revises the model when deficiencies are identified.

The Bank applies internal rating methodologies to specific corporate loans and groups of retail and small business loans, which incorporate various underlying master scales that are different from those used by international rating agencies. As a result, it is not possible to make a cross-product score comparison which would agree to the outstanding balance of loans to customers per the statement of financial position. As such, more detailed information is not being presented.

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. The credit risk exposure of the Bank is concentrated within the Azerbaijan Republic. The exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the Bank's risk management policy are not breached.

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Credit risk (continued)

The following table details the gross carrying value of financial assets and those that are impaired:

December 31, 2016	Gross value AZN	Impaired AZN	Net carrying value AZN
Financial assets:			
- Cash and balances with Central Bank	19,449	-	19,449
- Balances with other banks	4,199	(46)	4,153
- Loans and advances to customers	392,643	(28,902)	363,741
- Other assets	1,618	-	1,618
	417,909	-28,948	388,961
December 31, 2015			
Financial assets:			
- Cash and balances with Central Bank	10,740	-	10,740
- Balances with other banks	9,915	(221)	9,694
- Loans and advances to customers	349,867	(14,138)	335,729
- Other assets	1,390	-	1,390
	371,912	(14,359)	357,553

Net exposure of credit risk

The Banks net exposure to credit risk varies significantly and is dependent on both individual risks and general market economy risks.

The following table presents the net exposure to credit risk of on-balance sheet and off-balance sheet financial assets. For financial assets in the statement of financial position, the net exposure is equal to the carrying amount of those assets prior to any collateral. The Bank's net exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Credit risk (continued)

Net exposure of credit risk (continued)

	Net exposure AZN	Gross collateral pledged AZN	Net exposure AZN
December 31, 2016			
Cash and balances with Central Bank	19,449	-	19,449
Balances with other banks	4,153	-	4,153
Loans and advances to customers	363,741	(263,712)	100,029
Other assets	1,618	-	1,618
Financial guarantees extended on behalf of customers	48,001	-	48,001
Credit lines	11,331	-	11,331

	Net exposure AZN	Gross collateral pledged AZN	Net exposure AZN
December 31, 2015			
Cash and balances with Central Bank	10,740	-	10,740
Balances with other banks	9,694	-	9,694
Loans and advances to customers	335,729	(243,523)	92,206
Other assets	1,390	-	1,390
Financial guarantees extended on behalf of customers	43,262	(2,031)	41,231
Credit lines	24,793	-	24,793

Off-balance sheet risk

The Bank applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances. Collateral may be sought depending on the strength of the counterparty and the nature of the transaction.

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Credit risk (continued)

Risk limit control and mitigation policies

The Bank manages, limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries and countries. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product, industry sector are approved by the Board of Directors. Actual exposures against limits are monitored regularly. Lending limits are reviewed in the light of changing market and economic conditions and periodic credit reviews and assessments of probability of default. Some other specific control and mitigation measures are outlined below:

Collateral

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

- For commercial lending, charges over real estate properties, moveable assets, deposits and guarantees; and
- For retail lending, mortgages over residential properties and moveable assets.

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 impairment losses.

Lending limits

The Bank maintains strict control limits over its lending to customers. This credit risk exposure is managed as part of the overall lending limits with customers and is approved by the Credit Committee and ultimately by the Supervisory Board of the Bank. Collateral or other security is not always obtained for credit risk exposures on loans to customers and therefore the Bank is exposed to settlement risk on the uncollateralized portion of the loans.

Financial covenants (for credit related commitments)

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees carry the same credit risk as loans. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans or guarantees. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards (often referred to as financial covenants).

The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows, such as debt maturities. Such outflows would deplete available cash resources for client lending and investments. In extreme circumstances, lack of liquidity could result in reductions in the statement of financial position and sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Bank will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, systemic shocks and natural disasters.

The Supervisory Board monitors the maintenance of statement of financial position liquidity ratios, depositors' concentration both in terms of the overall funding mix and avoidance of undue reliance on large individual deposits and liquidity contingency plans. Moreover, core retail deposits (current accounts and saving accounts) form a considerable part of the Bank's overall funding and significant importance is attached to the stability and growth of these deposits.

December 31, 2016	Within 1 month AZN	More than 1 month but within 3 months AZN	More than 3 months but within 1 year AZN	More than 1 year but within 5 years AZN	More than 5 years AZN	Undefined maturity AZN	Total AZN
Financial assets:							
- Cash and balances with Central Bank	17,788	-	-	-	-	1,661	19,449
- Balances with other banks	4,153	-	-	-	-	-	4,153
- Loans and advances to customers	83,437	3,703	31,374	232,749	12,478	-	363,741
- Other assets	2,564	-	-	-	-	-	2,564
	107,942	3,703	31,374	232,749	12,478	1,661	389,907

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Liquidity risk (continued)

December 31, 2016	Within 1 month AZN	More than 1 month but within 3 months AZN	More than 3 months but within 1 year AZN	More than 1 year but within 5 years AZN	More than 5 years AZN	Undefined maturity AZN	Total AZN
Financial liabilities:							
- Loans and deposits from banks and financial institutions	126,469	10,647	26,954	6,071	-	-	170,141
- Deposits from customers	2,500	48,005	62,747	-	2,636	-	115,888
- Other liabilities	1,513	-	-	-	-	-	1,513
	130,482	58,652	89,701	6,071	2,636	-	287,542
On-balance sheet liquidity gap	(22,540)	(54,949)	(58,327)	226,678	9,842	1,661	102,365

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Liquidity risk (continued)

December 31, 2015	Within 1 month AZN	More than 1 month but within 3 months AZN	More than 3 months but within 1 year AZN	More than 1 year but within 5 years AZN	More than 5 years AZN	Undefined maturity AZN	Total AZN
Financial assets:							
- Cash and balances with Central Bank	9,403	224	334	24	-	755	10,740
- Balances with other banks	7,300	-	2,378	-	-	16	9,694
- Loans and advances to customers	2,102	8,482	94,831	155,584	74,730	-	335,729
- Other assets	1,372	-	-	-	-	-	1,372
	20,177	8,706	97,543	155,608	74,730	771	357,535
Financial liabilities:							
- Loans and deposits from banks and financial institutions	-	3,119	60,237	42,455	-	-	105,811
- Deposits from customers	32,059	41,814	70,917	4,450	2,543	-	151,783
- Other liabilities	578	-	-	-	-	-	578
	32,637	44,933	131,154	46,905	2,543	-	258,172
On-balance sheet liquidity gap	(12,460)	(36,227)	(33,611)	108,703	72,187	771	99,363

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Operational risk

The Bank's operational risk is related to possible losses which may be incurred as a result of failures occurring in the Bank's day-to-day operations, such as breakdown in electronic and telecommunication, routines or other systems - additional factors being insufficient levels of professional skills or human errors. In order to keep the Bank's operational risks to a minimum level, various tools are used to manage operational risk using a common categorization of risk.

The Bank's approach to operational risk is not designed to eliminate risk, rather, to contain it within the acceptable levels, as determined by senior management, and to ensure that they have sufficient information to make informed decisions about additional controls, adjustments to controls, or other risk responses.

28 Concentration of financial instruments

The majority of concentration of financial assets and liabilities related to banking activities is within the boundaries of Azerbaijan Republic. The following is the detail of geographical concentration of financial instruments:

December 31, 2016	Azerbaijan Republic AZN	CIS countries AZN	Other countries AZN	Total AZN
Financial assets:				
- Cash and balances with Central Bank	19,449	-	-	19,449
- Balances with other banks	1,377	159	2,617	4,153
- Loans and advances to customers	363,741	-	-	363,741
- Other assets	1,618	-	-	1,618
	386,185	159	2,617	388,961
Financial liabilities:				
- Loans and deposits from banks and financial institutions	115,888	-	-	115,888
- Deposits from customers	170,141	-	-	170,141
- Other liabilities	1,489	-	-	1,489
	287,518	-	-	287,518
Net gap	98,667	159	2,617	101,443

(in thousands of Azerbaijan Manats)

28 Concentration of financial instruments (continued)

December 31, 2015	Azerbaijan Republic AZN	CIS countries AZN	Other countries AZN	Total AZN
Financial assets:				
- Cash and balances with Central Bank	10,740	-	-	10,740
- Balances with other banks	4,694	456	4,544	9,694
- Loans and advances to customers	335,729	-	-	335,729
- Other assets	1,390	-	-	1,390
	352,553	456	4,544	357,553
Financial liabilities:				
- Loans and deposits from banks and financial institutions	108,354	-	-	108,354
- Deposits from customers	149,240	-	-	149,240
- Other liabilities	733	-	-	733
	258,327	-	-	258,327
Net gap	94,226	456	4,544	99,226

29 Earning per share

	2016	2015
Net profit for the year attributable to the owner of the Bank	1,546	1,530
Weighted average number of ordinary shares for the purpose of basis and diluted earnings per share	679	679
Earning per share - basis and diluted	2.28	2.25

30 Post-reporting date events

Adjusting events

No significant adjusting or non-adjusting event has occurred between the reporting date and the date of authorisation of these financial statements.