Premium Bank Open Joint Stock Company

(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)

Financial Statements
For the year ended 31 December 2018

Premium Bank Open Joint Stock Company
(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)
Financial Statements

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Statement of management's responsibilities for the preparation and approval of the financial statements
For the year ended 31 December 2018

Management is responsible for the preparation of the financial statements that give a true and fair view of the financial position of **Premium Bank Open Joint Stock Company (the "Bank")** ***(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)*** as at 31 December 2018, 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 31 December 2018 were approved by the Management Board on 30 April 2019 and were signed on their behalf by:

Mahir Ahmedov
Chairman of Management Board

Mahir Necefov
Chief Financial Officer

Baku, Azerbaijan Republic

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Independent auditors' report
To the Shareholders of
Premium Bank Open Joint Stock Company
(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of **Premium Bank Open Joint Stock Company** (the "Bank") *(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)*, which comprise the statement of financial position as at 31 December 2018, and the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

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.

Independent auditors' report (continued)

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

Grant Thornton
Baku, Republic of Azerbaijan
Date: 30 April 2019

Premium Bank Open Joint Stock Company
(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)
Financial Statements
Statement of financial position
As at 31 December 2018
(in thousands of Azerbaijan Manats)

	Notes	2018 AZN	2017 AZN
Assets			
Cash and balances with Central Bank	5	**53,302**	48,140
Balances with other banks	7	**10,459**	12,580
Loans and advances to customers	8	**552,127**	393,630
Property and equipment	9	**4,184**	3,431
Intangible assets		**724**	448
Other assets	10	**4,032**	4,450
Total assets		**624,828**	462,679
Liabilities			
Loans and deposits from banks and financial institutions	11	**40,810**	109,951
Deposits from customers	12	**466,111**	242,055
Other liabilities	13	**4,637**	4,084
Total liabilities		**511,558**	356,090
Equity			
Share capital	14	**104,601**	104,601
Retained earnings		**8,669**	1,988
Total equity		**113,270**	106,589
Total equity and liabilities		**624,828**	462,679

These financial statements for the year ended 31 December 2018 were approved by the Management Board on 30 April 2019 and were signed on their behalf by:

Mahir Ahmedov
Chairman of Management Board

Mahir Necefov
Chief Financial Officer

Baku, Azerbaijan Republic

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

Premium Bank Open Joint Stock Company
(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)
Financial Statements
Statement of comprehensive income
For the year ended 31 December 2018
(in thousands of Azerbaijan Manats)

	Notes	2018 AZN	2017 AZN
Interest income	15	**37,556**	27,803
Interest expense	15	**(14,803)**	(11,751)
Net interest income	15	**22,753**	16,052
Reversal of/(Allowance for) impairment losses on loans and advances to customers	8.1	**5,867**	(7,214)
Net interest income after reversal of /(allowance for) impairment losses		**28,620**	8,838
Gains from foreign exchange operations - net	16	**7,334**	9,083
Fees and commission income	17	**14,204**	9,495
Fees and commission expense	18	**(3,890)**	(2,605)
Operating profit		**46,268**	24,811
Other (expense)/income - net	19	**(60)**	36
Depreciation and amortization expense	20	**(769)**	(570)
Administrative and general expenses	21	**(29,764)**	(22,139)
Profit for the year before tax		**15,675**	2,138
Income tax expense	22	**(2,992)**	(539)
Profit for the year		**12,683**	1,599
Other comprehensive income		**-**	-
Total comprehensive income for the year		**12,683**	1,599
Earnings per share attributable to the owners of the Bank, basic and diluted (expressed in AZN per share)	29	**18.68**	2.35

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

Statement of changes in equity

For the year ended 31 December 2018
(in thousands of Azerbaijan Manats)

	Share capital AZN	Retained earnings AZN	Total equity AZN
Balance at 1 January 2017	101,545	3,445	104,990
Issue of share capital	3,056	(3,056)	-
Transactions with owners	3,056	(3,056)	-
Profit for the year	-	1,599	1,599
Total comprehensive income	-	1,599	1,599
Balance at 31 December 2017	104,601	1,988	106,589
Impact of adopting IFRS 9 at 1 January 2018 (Refer to note 4.4 and note 4.24.1)	**-**	**(4,102)**	**(4,102)**
Restated balance at 1 January 2018	**104,601**	**(2,114)**	**102,487**
Dividend paid	**-**	**(1,900)**	**(1,900)**
Transactions with owners	**-**	**(1,900)**	**(1,900)**
Profit for the year	**-**	**12,683**	**12,683**
Total comprehensive income	**-**	**12,683**	**12,683**
Balance at 31 December 2018	**104,601**	**8,669**	**113,270**

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

Statement of cash flows

For the year ended 31 December 2018
(in thousands of Azerbaijan Manats)

	Notes	2018 AZN	2017 AZN
OPERATING ACTIVITIES			
Profit before tax		**15,675**	2,138
Adjustments for non-cash and non-operating items:			
Depreciation and amortisation expense	20	**769**	570
Loss on disposal of property and equipment		**86**	-
Reversal of/(Allowance for) impairment losses on balances with other banks	7	**(1)**	81
Reversal of/(Allowance for) impairment losses on loans and advances to customers	8.1	**(5,867)**	7,214
		10,662	10,003
Changes in operating assets and liabilities:			
Mandatory minimum reserve deposits with Central Bank		**(2,305)**	(384)
Loans and advances to customers		**(156,732)**	(37,103)
Other assets		**(177)**	(990)
Deposits from customers		**224,056**	71,914
Other liabilities		**(496)**	2,571
Cash from operations		**75,008**	46,011
Income tax paid		**(1,943)**	(539)
Net cash generated from operating activities		**73,065**	45,472
INVESTING ACTIVITIES			
Purchase of property and equipment		**(1,576)**	(1,629)
Purchase of intangible assets		**(335)**	(195)
Sales proceed from disposal of property and equipment		**27**	-
Net cash used in investing activities		**(1,884)**	(1,824)
FINANCING ACTIVITIES			
Loans and deposits from banks and financial institutions		**(69,141)**	(5,937)
Dividend paid		**(1,900)**	-
Net cash used in financing activities		**(71,041)**	(5,937)
Net change in cash and cash equivalents		**140**	37,711
Cash and cash equivalents, beginning of year		**59,652**	21,941
Cash and cash equivalents, end of year	6	**59,792**	59,652

(in thousands of Azerbaijan Manats)

1 Legal status and nature of operations

Premium Bank Open Joint Stock Company (the "Bank") *(Formerly: Open Joint Stock Venture Silk Way Bank OJSC)* was established on 6 January 1994 and held license no. 175 for commercial banking issued Central Bank of Azerbaijan Republic (CBAR or Central Bank). The activities of the Bank are regulated by the Financial Markets Supervisory Authority (the "FIMSA"). As at 31 December 2018 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 51 (2017: 50) automatic teller machines. The Bank has 175 employees (2017: 163 employees) as at 31 December 2018.

As at 31 December 2018 and 2017, the following shareholders owned the issued share capital of the bank.

	2018	2017
	%	%
Legal entity	15.22	30.00
Individuals	84.78	70.00
	100.00	100.00

During the current year bank shareholding has changed. Miss. Zarifa Hamzayeva acquired 14.78% from VIP Aviation Services LLC resulting into total holding of 84.47% by her. Whereas, Miss Ahmedova Elvira İsmayil and VIP Aviation Services LLC holds 0.31% and 15.22% respectively.

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 and FIMSA Regulations is included where appropriate. Further the accounting policies applied in the preparation of these financial statements are consistent with those applied in the financial statements for the year ended 31 December 2017, except for changes in accounting policies explained in note 4.4 and changes in management judgement and estimates explained in note 4.24.1.

3 Standards, interpretations and amendments to existing standards

3.1 Standards, interpretations and amendments to existing standards that are effective in 2018

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 2018 and have been adopted by the Bank:

Standard number	Title	Effective date
IFRS 9	Financial Instruments (refer to note 4.4 and note 4.24.1)	1 January 2018
IFRS 15	Revenue from Contracts with Customers	1 January 2018
IAS 28	Investments in Associates and Joint Ventures	1 January 2018

(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 relevant 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. Information on the relevant new standards, amendments and interpretations that are not yet effective has been provided below.

New standards and significant amendments to standards:	Effective for annual periods beginning on or after
IFRs 16, leases. The IASB issued the new standard for accounting for leases. (a) The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on the balance sheets as lease liabilities, with the corresponding right-of-use assets. (b) Lessees must apply a single model for all recognised leases but will have the option not to recognise 'shortterm' leases and leases of 'low-value' assets. (c) Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of profit or loss. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach. Management has yet to assess the impact of this revised standard on the Bank's financial statements.	1 January 2019
Annual Improvements to IFRS 2015–2017 Cycle amending IFRS 3, IFRS 11, IAS 12 and IAS 23.	1 January 2019
IFRIC 23 Uncertainty over Income Tax Treatments: The interpretation addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers: Whether tax treatments should be considered collectively; Assumptions for taxation authorities' examinations; The determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates and the effect of changes in facts and circumstances.	1 January 2019
Amendments in IFRS 9 Financial Instruments relating to prepayment features with negative compensation. This amends the existing requirements in IFRS 9 regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments.	1 January 2019
Amendment to IAS 19 Employee Benefits: The amendments clarify that: on amendment, curtailment or settlement of a defined benefit plan, a company now uses updated actuarial assumptions to determine its current service cost and net interest for the period and the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in other comprehensive income.	1 January 2019

(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 (continued)

New standards and significant amendments to standards:	Effective for annual periods beginning on or after
Amendments in IAS 28 Investments in Associates and Joint Ventures relating to long-term interests in associates and joint ventures. These amendments clarify that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.	1 January 2019
Amendments to References to the Conceptual Framework in IFRS Standards - amendments to IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22, and SIC-32 to update those pronouncements with regard to references to and quotes from the framework or to indicate where they refer to a different version of the Conceptual Framework.	1 January 2020
Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures (2011) relating to the treatment of the sale or contribution of assets from and investor to its associate or joint venture.	Effective date deferred indefinitely. Adoption is still permitted.

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. The Bank's management has yet to assess the impact of these changes on the Bank's financial statements.

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 applied in the preparation of these financial statements are consistent with those applied in the annual financial statements for the year ended 31 December 2017, except for changes in accounting policies explained in note 4.4 and changes in management judgement and estimates explained in note 4.24.1.

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 management judgments in applying accounting policies and changes in estimation uncertainty and critical management judgments that have the most significant effect on the amounts recognised in the financial statements are described in note 4.24 and 4.25.

(in thousands of Azerbaijan Manats)

4 Summary of significant accounting policies (continued)

4.3 Foreign currency translation

Functional and presentation currency

These financial statements are presented in Azerbaijan 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:

	2018	2017
AZN/1 USD	1.7000	1.7001
AZN/1 Euro	1.9468	2.0307
AZN/1 GBP	2.1529	2.2881
AZN/1 RUB	0.0245	0.0295

4.4 Changes in accounting policies - applicable from 1 January 2018

The Bank has consistently applied the accounting policies as set out in note 4.5 to note 4.25 to all periods presented in these financial statements, except for the accounting policies as set out in note 4.4.1 and note 4.4.2 and judgements and estimates as set out in 4.24.1. These changes are applicable from 1 January 2018.

4.4.1 Financial instruments - applicable from 1 January 2018

The Bank has adopted IFRS 9 Financial Instruments issued in July 2014 with a date of initial application of 1 January 2018. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

IFRS 9 also contains new requirements on the application of hedge accounting. The new requirements look to align hedge accounting more closely with entities' risk management activities by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles-based approach to assessing hedge effectiveness.

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.1 Financial instruments - applicable from 1 January 2018 (continued)

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 measurement

Financial assets

On initial recognition, a financial asset is classified as measured: at amortised cost, Fair Value through Other Comprehensive Income (FVOCI) or Fair Value through Profit and Loss (FVTPL).

A financial asset is measured at amortised cost if it meets both the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and

- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and profit on the principal amount outstanding.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and profit on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.1 Financial instruments - applicable from 1 January 2018 (continued)

Classification and measurement (continued)

Financial assets (continued)

Business model assessment:

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is being managed and information is provided to management.

The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about the future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realized.

Assessment whether contractual cash flows are solely payments of principal and profit:

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Profit' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic financing risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and profit, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rate.

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.1 Financial instruments - applicable from 1 January 2018 (continued)

Classification and measurement (continued)

Financial assets (continued)

Reclassifications:

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

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.

Impairment

The Bank calculate provision as per IFRS and CBAR regulations and record the higher of both. The Bank recognises allowance for impairment for expected credit losses (ECL) on financial assets measured at amortised cost, loan commitments issued, and financial guarantee contracts issued. Impairment losses are recognized in the profit or loss.

The Bank measures allowance for impairment at an amount equal to lifetime ECL, except for those financial instruments on which credit risk has not increased significantly since their initial recognition, in which case 12-month ECL is measured.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after reporting date.

Measurement of ECL:

ECL are probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive).
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn finance commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.1 Financial instruments - applicable from 1 January 2018 (continued)

Impairment (continued)

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset. The cash shortfalls are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets:

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit- impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

Purchased or originated credit impaired assets (POCI)

POCI assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest income is subsequently recognized based on a credit-adjusted EIR. Life time ECLs are only recognized or released to the extent that there is a subsequent change in the ECL.

Revolving facilities

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities at a short notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products, is estimated based on the period over which the Bank is exposed to credit risk and where the credit losses would not be mitigated by management actions.

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.1 Financial instruments - applicable from 1 January 2018 (continued)

Impairment (continued)

Write-off:

Assets carried at amortised cost and debt securities at FVOCI are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank has exhausted all legal and remedial efforts to recover from the customers. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

Reversals of impairment loss

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.

Financial guarantees and loan commitments - applicable from 1 January 2018

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holders for a loss they incur because a specified debtor fails to make payment when due, in accordance with the terms of a debt instrument. The financial guarantee liability is carried at amortised cost when payment under the contract has become probable.

'Loans commitments' are firm irrevocable commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or irrevocable commitments to provide credit are initially measured at fair value and their initial fair value is amortised over the life of the guarantee or the commitment.

Subsequently, they are measured at the higher of this amortised amount and the amount of loss allowance.

Loans and advances to customers - applicable from 1 January 2018

'Loans and advances to customers' captions in the statement of financial position include loans and advances measured at amortised cost: they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

Cash and cash equivalents - applicable from 1 January 2018

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 on hand and balances with Central Bank and balances with other banks with original maturities of three months or less from the date of acquisition. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

(in thousands of Azerbaijan Manats)

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.1 Financial instruments - applicable from 1 January 2018 (continued)

Transition

When adopting IFRS 9, the Bank has applied transitional relief and opted not to restate prior periods. Differences arising from the adoption of IFRS 9 in relation to classification, measurement, and impairment are recognised in retained earnings as at January 1, 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore not comparable to the information presented for period under IFRS 9.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

- The determination of the business model within which a financial asset is held.
- The designation of certain investments in equity instruments not held for trading as at FVOCI.

The table below lists the financial instruments of the Bank which were reclassified. However, except for the financial statement caption listed in the table below there have been no changes in the classification of assets and liabilities on application of IFRS 9 as at 1 January 2018.

	Measurement category		Carrying amount (AZN '000))		
	Original IAS 39 category	New IFRS 9 category	Closing balance 31 December 2017 (IAS 39)	Adoption of IFRS 9	Opening balance 1 January 2018 (IFRS 9)
Assets					
Cash and balances with Central bank	Loans and receivables	Amortised cost	48,140	-	48,140
Balances with other banks	Loans and receivables	Amortised cost	12,580	-	12,580
Loans and advances to customers	Loans and receivables	Amortised cost	393,630	(3,320)	390,310
Other assets	Loans and receivables	Amortised cost	4,450	-	4,450
Provision on off balance sheet items:					
Guarantees and commitments				(782)	
Effect of IFRS 9 adoption on 1 January 2018				**(4,102)**	

4 Summary of significant accounting policies (continued)

4.4 Changes in accounting policies - applicable from 1 January 2018 (continued)

4.4.2 IFRS 15 Revenue from contracts with customers - applicable from 1 January 2018

This standard on revenue recognition replaces IAS 11, 'Construction contracts', and IAS 18,'Revenue' and related interpretations.

IFRS 15 is more prescriptive, provides detailed guidance on revenue recognition and reduces the use of judgment in applying revenue recognition policies and practices as compared to the replaced IFRS and related interpretations.

Revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service

The Bank also operates a rewards programme which allows customers to accumulate points when they purchase products on the Bank's credit cards. The points can then be redeemed for shopping rewards, cash back or air miles, subject to a minimum number of points being obtained.

The core principle of IFRS 15 is that an entity recognizes revenue as it transfers the promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

IFRS 15 also includes a comprehensive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

The Bank has assessed the impact of IFRS 15 and has adopted with no material impact on the financial statements of the Bank as at the adoption date and the reporting date.

4 Summary of significant accounting policies (continued)

4.5 Financial instruments - applicable before 1 January 2018

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)

4.6 Loans and advances to customers - applicable before 1 January 2018

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.

4.7 Impairment of financial assets - applicable before 1 January 2018

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. 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.

Impairment of loans and advances

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.

4 Summary of significant accounting policies (continued)

4.7 Impairment of financial assets - applicable before 1 January 2018 (continued)

Impairment of loans and advances (continued)

Along with the prudential regulations of 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.

Reversals of impairment of loans and advances

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.

4.8 Cash and cash equivalents - applicable before 1 January 2018

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 on hand 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 Summary of significant accounting policies (continued)

4.9 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.

These assets are subsequently measured using the cost model and are 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, was 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	4 years
• Equipment	5 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)

4.10 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.

4.11 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'.

4.12 Impairment of 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.

4.13 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 Summary of significant accounting policies (continued)

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 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.

4.16 Other liabilities

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

4.17 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.

4.18 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.

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 Summary of significant accounting policies (continued)

4.19 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. Further, in accordance with amendments in the Tax Code of the Republic of Azerbaijan during the current year, these rates have been set as 15% and 10% for the Bank and employees respectively which are applicable from 1 January 2019. Upon retirement all retirement benefit payments are made by the state pension fund.

4.20 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, interest income is recognized on receipt basis in compliance with applicable Prudential Regulations.

Fee and commission income

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

4.21 Operating expenses

Operating expenses are recognised in profit or loss upon utilisation of the service or at the date of their origin.

4 Summary of significant accounting policies (continued)

4.22 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.

4.23 Earnings/Losses per share

Earnings/Losses per share are determined by dividing the profit or loss attributable to owners of the Bank by the weighted average number of participating shares outstanding during the reporting year.

4 Summary of significant accounting policies (continued)

4.24 Significant management judgement in applying accounting policies

The preparation of the financial statements requires management to make certain judgements, estimates and assumptions that affect the reported amount of financial assets and liabilities and the resultant allowances for impairment and fair values. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowances required for impaired loans to customers. Estimates and judgments are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

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 4.25.

4.24.1 Judgement and estimates related to Financial instruments - applicable from 1 January 2018

Judgements made in applying accounting policies that have most significant effects on the amount recognized in the financial statements of the period ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments which impact:

- Classification of financial assets: assessment of business model within which the assets are held and assessment of whether the contractual terms of the financial assets are solely payment of principal and interest of the principal amount outstanding.
- Calculation of expected credit loss (ECL): changes to the assumptions and estimation uncertainties that have a significant impact on ECL for the year ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments. The impact is mainly driven by inputs, assumptions and techniques used for ECL calculation under IFRS 9 methodology

Inputs, assumptions and techniques used for ECL calculation – IFRS 9 Methodology

Key concepts in IFRS 9 that have the most significant impact and require a high level of judgment, as considered by the Bank while determining the impact assessment, are:

Assessment of significant increase in credit risk:

The assessment of a significant increase in credit risk is done on a relative basis. To assess whether the credit risk on a financial asset has increased significantly since origination, the Bank compares the risk of default occurring over the expected life of the financial asset at the reporting date to the corresponding risk of default at origination, using key risk indicators that are used in the Bank's existing risk management processes.

The assessment of significant increases in credit risk is being performed at least quarterly for each individual exposure based on below mentioned factors. If any of the following factors indicates that a significant increase in credit risk has occurred, the instrument will be moved from Stage 1 to Stage 2:

1. The Bank have established thresholds for significant increases in credit risk relative to initial recognition.
2. Additional qualitative reviews have been performed to assess the staging results and make adjustments, as necessary, to better reflect the positions which have significantly increased in risk.

4 Summary of significant accounting policies (continued)

4.24 Significant management judgement in applying accounting policies (continued)

4.24.1 Judgement and estimates related to Financial instruments - applicable from 1 January 2018 (continued)

Assessment of Significant Increase in Credit Risk (continued):

Movements between Stage 2 and Stage 3 are based on whether financial assets are credit impaired as at the reporting date. The determination of credit-impairment under IFRS 9 is similar to the individual assessment of financial assets for objective evidence of impairment under IAS 39.

Macroeconomic Factors, Forward Looking Information (FLI) and Multiple Scenarios:

The measurement of expected credit losses for each stage and the assessment of significant increases in credit risk must consider information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information requires significant judgment.

PD, Loss Given Default (LGD) and Exposure At Default (EAD) inputs used to estimate Stage 1 and Stage 2 credit loss allowances are modelled based on the macroeconomic variables (or changes in macroeconomic variables) that are most closely correlated with credit losses in the relevant portfolio. Management overlay is also used to align the macroeconomics factors with the current condition of portfolio based on best management estimate and information.

The estimation of expected credit losses in Stage1 and Stage 2 is a discounted probability weighted estimate that considers a minimum of three future macroeconomic scenarios.

Definition of default:

The definition of default used in the measurement of expected credit losses and the assessment to determine movement between stages is consistent with the definition of default used for internal credit risk management purposes. IFRS 9 does not define default but contains a rebuttable presumption that default has occurred when an exposure is greater than 90 days past due.

Expected Life

When measuring ECL, the Bank must consider the maximum contractual period over which the Bank is exposed to credit risk. All applicable contractual terms are considered when determining the expected life, including prepayment options and extension and rollover options. For certain revolving credit facilities that do not have a fixed maturity, the expected life is estimated based on the period over which the Bank is exposed to credit risk

Governance:

In addition to the existing risk management framework, the Bank has established an internal Committee to provide oversight to the IFRS 9 impairment process. The Committee is comprised of senior representatives from Finance, Risk Management and Economics and is responsible for reviewing and approving key inputs and assumptions used in our expected credit loss estimates. It also assesses the appropriateness of the overall allowance results to be included in the financial statements.

4 Summary of significant accounting policies (continued)

4.24 Significant management judgement in applying accounting policies (continued)

4.24.2 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.

4.24.3 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.

4.24.4 Leases

In applying the classification of leases in IAS 17, as a lessee, the management considers its leases as operating lease. In some cases, the lease transaction is not always conclusive, and management uses judgment in determining whether the lease in an operating lease arrangement.

4.24.5 Recognition of deferred tax assets

The extent to which deferred tax assets can be recognised is based on an assessment of the probability of the Bank's future taxable income against which the deductible temporary differences can be utilised. In addition, significant judgement is required in assessing the impact of any legal or economic limits or uncertainties in various tax jurisdictions (see note 4.22).

4.25 Estimation uncertainty

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

Useful lives of depreciable and amortisable assets

Management reviews the useful lives of depreciable and amortisable assets which include property and equipment, 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.

4 Summary of significant accounting policies (continued)

4.25 Estimation uncertainty (continued)

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.

Provision for impairment of loans and advances to customers

Loans and advances to customers are measured at amortized cost less allowance for impairment losses. The estimation of allowances for impairment involves the exercise of significant judgment and estimates. 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 is mainly made using ECL model and also time base criteria determined by the applicable prudential regulations.

Provisions

Provisions are raised based on management's estimates from information available surrounding particular transactions. Prudence is exercised when estimating provisions so as not to materially overstate the Bank's reported net income and understates its liabilities.

Contingent liability arising from litigations

Due to the nature of its operations, the Bank may be involved in litigations arising in the ordinary course of business. Provision for contingent liabilities arising from litigations is based on the probability of outflow of economic resources and reliability of estimating such outflow. Such matters are subject to many uncertainties and the outcome of individual matters is not predictable with assurance. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are applied prospectively.

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

	2018 AZN	2017 AZN
Cash in hand	**35,161**	37,203
Balances with Central Bank other than mandatory minimum reserve deposits	**13,791**	8,892
Included in cash and cash equivalents (note 6)	**48,952**	46,095
Mandatory minimum reserve deposits with Central Bank	**4,350**	2,045
Cash and cash equivalents	**53,302**	48,140

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

At the reporting date, this includes blocked correspondent accounts of Nil (2017: AZN Nil).

6 Cash and cash equivalent

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

	2018 AZN	2017 AZN
Cash and balances with Central Bank (note 5)	**48,952**	46,095
Balances with other banks (note 7)	**10,585**	12,707
Other assets	**255**	850
	59,792	59,652

7 Balances with other banks

	2018	2017
Correspondent accounts	**10,585**	12,707
Less: Allowance for impairment losses (note 7.1)	**(126)**	(127)
	10,459	12,580

7.1 Allowance for impairment losses

	2018	2017
Balance at 1 January,	**127**	46
Allowance for impairment losses charge for the year	**(1)**	81
Balance at 31 December	**126**	127

8 Loans and advances to customers

	2018 AZN	2017 AZN
Loans and advances	**584,593**	424,028
Accrued interest income	**1,886**	5,647
	586,479	429,675
Less: allowance for impairment losses (note 8.1)	**(34,352)**	(36,045)
	552,127	393,630

(in thousands of Azerbaijan Manats)

8 Loans and advances to customers (continued)

Loans and advances to customers carry interest rates ranging from 4% to 25% per annum (2017: 3.2% to 27% per annum).

For lending limits breach please refer note 24.1

Analysis by industry for loans and advances to customers

	2018 AZN	2017 AZN
Transportation	**556,249**	398,053
Individuals	**20,163**	21,798
Trading and service	**8,181**	4,177
	584,593	424,028

Analysis by currency for loans and advances to customers

	2018 AZN	2017 AZN
AZN	**179,467**	158,335
USD	**386,508**	253,636
EUR	**18,618**	12,057
	584,593	424,028

8.1 Allowance for impairment losses

The following table show reconciliations from the opening to the closing balance of the allowance for impairment loss as a result of the adoption of IFRS 9: Financial instruments. Refer to note 4.4 and note 4.24.1.

	2018 AZN	2017 AZN
Balance at 1 January	**36,045**	28,902
Add: Opening adjustment as per IFRS 9 (note 4.4 and note 4.24.1)	**4,102**	-
(Reversal)/Charge for the year	**(5,867)**	7,214
Write-off of loans	**(8)**	(8)
Write back due to recoveries	**80**	(63)
Balance at 31 December	**34,352**	36,045

The provision against loans and advances has been provided based on bank internal policies in compliance with IFRS requirements of AZN 34.35 million as at 31 December 2018. However, management reported provision against loans and advance of AZN 27 million in their prudential returns as of 31 December 2018 in compliance with Financial Market Supervisory Authority of Azerbaijan (FIMSA) and Central Bank of Azerbaijan (CBAR) requirements.

(in thousands of Azerbaijan Manats)

9 Property and equipment

2018	Furniture and equipment AZN	Computers AZN	Motor vehicles AZN	Other assets AZN	Leasehold improvements AZN	Total AZN
Gross carrying amount						
Balance at 1 January 2018	2,998	847	662	305	1,469	6,281
Additions	798	351	424	3	-	1,576
Disposals	(36)	(59)	(260)	-	-	(355)
Balance at 31 December 2018	3,760	1,139	826	308	1,469	7,502
Accumulated depreciation						
Balance at 1 January 2018	1,634	485	408	141	182	2,850
Depreciation charge	338	150	100	33	89	710
Disposals	(35)	(56)	(149)	(1)	(1)	(242)
Balance at 31 December 2018	1,937	579	359	173	270	3,318
Net carrying amount at 31 December 2018	1,823	560	467	135	1,199	4,184

(in thousands of Azerbaijan Manats)

9 Property and equipment (continued)

2017	Furniture and equipment AZN	Computers AZN	Motor vehicles AZN	Other assets AZN	Leasehold improvements AZN	Total AZN
Gross carrying amount						
Balance at 1 January 2017	2,291	810	584	275	723	4,683
Additions	717	58	78	30	746	1,629
Disposals	(10)	(21)	-	-	-	(31)
Balance at 31 December 2017	2,998	847	662	305	1,469	6,281
Accumulated depreciation						
Balance at 1 January 2017	1,419	366	330	104	135	2,354
Depreciation charge	225	140	78	37	47	527
Disposals	(10)	(21)	-	-	-	(31)
Balance at 31 December 2017	1,634	485	408	141	182	2,850
Net carrying amount at 31 December 2017	1,364	362	254	164	1,287	3,431

In the opinion of the management, there has been no impairment in the carrying amount of property and equipment as at 31 December 2018 (2017: Nil). No property and equipment have been pledged as security for liabilities.

(in thousands of Azerbaijan Manats)

10 Other assets

	2018 AZN	2017 AZN
Amounts in course of settlements	**3,408**	3,710
Prepayments	**432**	440
Other assets	**192**	300
	4,032	4,450

11 Loans and deposits from banks and financial institutions

	2018 AZN	2017 AZN
Loans from Central Bank	**22,731**	17,751
Deposits from other banks and financial institutions	**13,531**	88,729
Due to Azerbaijan Mortgage Fund	**4,548**	3,471
	40,810	109,951

The loans from CBAR carry interest rates ranging from 3% to 9.75% per annum (2017: 3% per annum), secured and are payable within one year

Deposits from other banks and financial institutions carry interest rates ranging from 3% to 6% per annum (2017: 3% to 6.67% per annum).

The loans from Azerbaijan Mortgage Fund carry interest rates of 1% to 4% per annum (2017: 1% to 4% per annum) and are unsecured and loans are repayable within 18 to 30 years.

12 Deposits from customers

	2018 AZN	2017 AZN
Term deposits	**346,484**	161,385
Current accounts	**118,895**	80,241
Accrued interest expense on term deposits	**732**	429
	466,111	242,055

(in thousands of Azerbaijan Manats)

12 Deposits from customers (continued)

Term deposits

These are unsecured and carry interest rates ranging from 1% to 12% per annum (2017: 1% to 8% per annum).

Analysis by industry for deposits from customers

	2018	2017
	AZN	AZN
Individuals	**429,359**	201,232
Trade	**22,679**	6,021
Agriculture	**5**	9
Construction	**8**	26
Transport and communication	**13,824**	34,212
Other	**236**	555
	466,111	242,055

13 Other liabilities

	2018	2017
	AZN	AZN
Payable to state-owned organisation	**1,244**	208
Accruals and other payables	**3,393**	3,876
	4,637	4,084

14 Share capital

The share capital of the Bank consists only of fully paid ordinary shares with a par value of AZN 154 (2017: AZN 154) 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	2018	2017
Shares issued and fully paid: at 31 December	**679**	679
Total shares authorised at 31 December	**679**	679
Total shares authorised, issued and fully paid at 31 December (in AZN)	**104,601**	104,601

Bank declared AZN 1,900 dividend on ordinary shares during the year ended 31 December 2018 (2017: Nil).

(in thousands of Azerbaijan Manats)

15 Net interest income

	2018	2017
Interest income	**AZN**	AZN
Interest on loans and advances to customers	**35,524**	26,623
Interest on guarantees	**2,006**	1,178
Interest on balances with other banks	**26**	2
	37,556	27,803
Interest expense		
Interest on loans and deposits from banks and financial institutions	**2,042**	6,540
Interest on deposits from customers	**12,761**	5,211
	14,803	11,751
Net interest income	**22,753**	16,052

16 Gains from foreign exchange operations - net

	2018	2017
	AZN	AZN
Translation differences – net	**(235)**	(296)
Dealing - net	**7,569**	9,379
Total	**7,334**	9,083

17 Fees and commission income

	2018	2017
	AZN	AZN
Plastic card operations	**9,367**	6,011
Settlements	**3,152**	2,082
Cash operations	**1,627**	1,373
Guarantee commission	**58**	29
Total	**14,204**	9,495

18 Fees and commission expense

	2018	2017
	AZN	AZN
Plastic card operations	**3,086**	1,942
Settlements	**605**	463
Guarantee commission	**18**	80
Other	**181**	120
Total	**3,890**	2,605

(in thousands of Azerbaijan Manats)

19 Other (expense/)/income - net

	2018 AZN	2017 AZN
Loss on disposal of property and equipment	**(86)**	-
Other income	**26**	36
	(60)	36

20 Depreciation and amortization expense

	2018 AZN	2017 AZN
Depreciation of property and equipment	**704**	527
Amortization of intangible assets	**65**	43
Total	**769**	570

21 Administrative and general expenses

	2018 AZN	2017 AZN
Advertising and marketing expenses	**17,775**	13,358
Salaries and benefits	**4,925**	4,030
Rent expenses	**2,806**	2,020
Insurance expenses	**831**	487
Travelling and entertainment	**678**	103
Fines, penalties and forfeits	**566**	-
Legal and professional expenses	**515**	300
Security expenses	**349**	394
Office supplies	**260**	125
Repairs and maintenance expenses	**219**	495
Communications expenses	**199**	177
Vehicle running expenses	**80**	71
Taxes other than income tax	**79**	50
Utilities expenses	**45**	39
Other expenses	**437**	490
Total	**29,764**	22,139

(in thousands of Azerbaijan Manats)

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. Deferred tax asset of AZN 820 thousand at 1 January 2018, on the adoption of IFRS 9, and deferred tax asset of AZN 653 thousand for the year has not been recognised based on the management assumption that the effect is immaterial.

	2018 AZN	2017 AZN
Current tax	2,992	539
	2,992	539

22.1 Current tax

Relationship between tax expense and accounting profit

	2018 AZN	2017 AZN
Accounting profit before tax	15,675	2,138
Tax calculated at the rate of 20% (2017: 20%) on:		
- Accounting profit	3,135	427
- Tax effect of expenses not deductible for tax purposes	(143)	112
Income tax expense for the year	2,992	539

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

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

	2018 AZN	2017 AZN
Loans and advances		
(a) Shareholders	**6,476**	5,937
(b) Entities under shareholding	**-**	4,106
(c) Key management personnel	**130**	14
(d) Other related parties	**494**	595
	7,100	10,652
Accrued interest income		
(a) Shareholders	**18**	30
(b) Entities under common control	**1**	23
(c) Key management personnel	**2**	1
(d) Other related parties	**-**	-
	21	54
Total	**7,121**	10,706

Deposits from customers

	2018 AZN	2017 AZN
Term deposits		
(a) Shareholder	**130,373**	37,143
(c) Other related parties	**55,253**	38,978
	185,626	76,121
Current/demand accounts		
(a) Shareholders	**15,232**	6,093
(b) Entities under common control	**640**	867
(c) Key management personnel	**74**	40
(d) Other related parties	**7,719**	6,341
	23,665	13,341
Accrued interest expense on term deposits		
(a) Shareholder	**277**	255
(b) Other related parties	**168**	68
	445	323
Total	**209,736**	89,785

(in thousands of Azerbaijan Manats)

23 Related parties (continued)

23.2 Amounts included in the statement of comprehensive income

Interest income	2018 AZN	2017 AZN
(a) Shareholders	**621**	730
(b) Entities under common control	**58**	100
(c) Key management personnel	**3**	8
(d) Other related parties	**44**	42
	726	880

Interest expense

	2018 AZN	2017 AZN
(a) Shareholder	**5,519**	2,251
(b) Key management personnel	**177**	-
(c) Other related parties	**2,380**	484
	8,076	2,735

Compensation to key management personnel

	2018 AZN	2017 AZN
Compensation to key management personnel	**460**	451

Fees and commission income on settlements

Fees and commission income on settlements	**817**	808

Guarantees issued on behalf of related parties

Entity under common control	**3,967**	1,864

Operating expense – Advertisement expenses

Shareholder	**8,344**	11,774

(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.

	2018	2017
	AZN	AZN
Guarantees issued on behalf of customer	**108,945**	78,482
Credit lines	**41,788**	264,214

At the reporting date, the Bank has no major capital commitments (2018: 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 Manats 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 regulator 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 Bank's business activities, was to be challenged by the tax authorities, the Bank 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 regulatory 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 31 December 2018, 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 31 December 2018, the Bank exceeded the required limits.

ii) As at 31 December 2018 the Bank granted loans to 3 costomers which exceeded 10% of the Banks total capital.

(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 regulator. 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 regulator 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.

	2018	2017
	AZN	AZN
Total regulatory capital held	**130,440**	116,248
Tier 1 capital	**103,963**	104,538
Total risk weighted assets	**832,913**	808,734
Total regulatory capital ratio (minimum requirement 10% (2017: 10%))	**13.27%**	13.24%
Tier 1 capital ratio (minimum requirement 5% (2017: 5%))	**10.01%**	11.77%

(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	2018 AZN	2017 AZN
Financial assets			
Loans and receivables:			
- Cash and balances with Central Bank	5	**53,302**	48,140
- Balances with other banks	7	**10,459**	12,580
- Loans and advances to customers	8	**552,127**	393,630
- Other assets		**3,600**	4,010
Total		**619,488**	458,360
Financial liabilities			
Measured at amortised cost:			
- Loans and deposits from banks and financial institutions	11	**40,810**	109,951
- Deposits from customers	12	**466,111**	242,055
- Other liabilities		**3,393**	3,876
Total		**510,314**	355,882

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 (continued)

27.1 Fair value measurement of financial instruments (continued)

	2018		2017	
	Carrying value AZN	Fair value AZN	Carrying value AZN	Fair value AZN
Financial assets:				
- Cash and balances with Central Bank	53,302	53,302	48,140	48,140
- Balances with other banks	10,459	10,459	12,580	12,580
- Loans and advances to customers	552,127	552,127	393,630	393,630
- Other assets	3,600	3,600	4,010	4,010
Total	619,488	619,488	458,360	458,360
Financial liabilities:				
- Loans and deposits from banks and financial institutions	40,810	40,810	109,951	109,951
- Deposits from customers	466,111	466,111	242,055	242,055
- Other liabilities	3,393	3,393	3,876	3,876
Total	510,314	510,314	355,882	355,882

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 measurement of financial instruments (continued)

The following table shows the Levels within the hierarchy of financial assets and liabilities as at 31 December 2018 and 31 December 2017:

31 December 2018	Level 1 AZN	Level 2 AZN	Level 3 AZN	Total AZN
Assets for which fair values are disclosed:				
- Cash and balances with Central Bank	-	-	**53,302**	**53,302**
- Balances with other banks	-	-	**10,459**	**10,459**
- Loans and advances to customers	-	-	**552,127**	**552,127**
- Other assets	-	-	**3,600**	**3,600**
Liabilities for which fair values are disclosed:				
- Loans and deposits from banks and financial institutions	-	-	**40,810**	**40,810**
- Deposits from customers	-	-	**466,111**	**466,111**
- Other liabilities	-	-	**3,393**	**3,393**
31 December 2017				
Assets for which fair values are disclosed:				
- Cash and balances with Central Bank	-	-	48,140	48,140
- Balances with other banks	-	-	12,580	12,580
- Loans and advances to customers	-	-	393,630	393,630
- Other assets	-	-	4,010	4,010
Liabilities for which fair values are disclosed:				
- Loans and deposits from banks and financial institutions	-	-	109,951	109,951
- Deposits from customers	-	-	242,055	242,055
- Other liabilities	-	-	3,876	3,876

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**
31 December 2018	**AZN**	**AZN**	**AZN**	**AZN**
- Financial assets	**424,514**	**40,775**	**3,158**	**468,447**
- Financial liabilities	**(412,660)**	**(37,335)**	**(3,673)**	**(453,668)**
Total exposure – net	**11,854**	**3,440**	**(515)**	**14,779**

	Foreign currency exposure			
	USD	EUR	Other	Total
31 December 2017	AZN	AZN	AZN	AZN
- Financial assets	277,040	20,842	2,264	300,146
- Financial liabilities	(269,828)	(20,717)	(2,267)	(292,812)
Total exposure – net	7,212	125	(3)	7,334

The following table illustrates the sensitivity of profit/(loss) before tax and equity in regard 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 ±10% change of the USD/AZN exchange rate for the year ended at 31 December 2018 (2017: ±10%). A ±10% change is considered for the EUR/AZN exchange rate (2017: ±10%). The sensitivity analysis is based on the Bank's foreign currency financial instruments held at each reporting date.

If the AZN had weakened against the USD by 10% (2017: 10%) and EUR by 10% (2017: 10%) respectively then this would have had the following impact:

	Profit/(loss) before tax			**Equity**		
	USD	**EUR**	**Others**	**USD**	**EUR**	**Others**
	AZN	**AZN**	**AZN**	**AZN**	**AZN**	**AZN**
31 December 2018	**1,185**	**344**	**(52)**	**948**	**275**	**(41)**
31 December 2017	721	13	(2)	577	10	(2)

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

If the AZN had strengthened against the USD by 10% (2017: 10%) and EUR by 10% (2017: 10%) respectively then this would have had the following impact:

	Profit/(loss) before tax			Equity		
	USD	EUR	Other	USD	EUR	Others
	AZN	AZN	AZN	AZN	AZN	AZN
31 December 2018	**(1,185)**	**(344)**	**52**	**(948)**	**(275)**	**41**
31 December 2017	(721)	(13)	2	(577)	(10)	2

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 below page illustrates the sensitivity of profit/(loss) before tax and equity to a reasonably possible change in interest rates of ±1% (2017: ±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, 2018	+1%	-1%	+1%	-1%
Financial assets:				
- Loans and advances to customers	**5,521**	**(5,521)**	**4,443**	**(4,443)**
Financial liabilities:				
- Loans and deposits from banks and financial institutions	**(408)**	**408**	**(326)**	**326**
- Deposits from customers	**(3,472)**	**3,472**	**(2,778)**	**2,778**
	1,641	**(1,641)**	**1,339**	**(1,339)**

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Interest rate risk (continued)

	Profit/(loss) before tax		Equity	
	AZN	AZN	AZN	AZN
December 31, 2017	+1%	-1%	+1%	-1%
Financial assets:				
- Loans and advances to customers	3,936	(3,936)	3,149	(3,149)
Financial liabilities:				
- Loans and deposits from banks and financial institutions	(1,100)	1,100	(880)	880
- Deposits from customers	(1,618)	1,618	(1,295)	1,295
	1,218	(1,218)	974	(974)

(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:

31 December 2018	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	-	-	-	-	-	-	53,302	53,302
- Balances with other banks	-	-	-	-	-	-	10,459	10,459
- Loans and advances to customers	6.94%	62,625	43,215	104,724	330,284	11,279	-	552,127
- Other assets	-	-	-	-	-	-	3,600	3,600
		62,625	43,215	104,724	330,284	11,279	67,361	619,488
Financial liabilities:								
- Loans and deposits from banks and	6.71%	29	4,350	5,900	2,579	27,952	-	40,810
- Deposits from customers	4.72%	4,524	12,732	66,330	263,630	-	118,895	466,111
- Other liabilities	-	-	-	-	-	-	3,393	3,393
		4,553	17,082	72,230	266,209	27,952	122,288	510,314
Total interest re-pricing gap		58,072	26,133	32,494	64,075	(16,673)	(54,927)	109,174

(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:

31 December 2017	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	-	-	-	-	-	-	48,140	48,140
- Balances with other banks	-	-	-	-	-	-	12,580	12,580
- Loans and advances to customers	6.99%	8424	8948	47313	317,972	10,973	-	393,630
- Other assets	-	-	-	-	-	-	4,010	4,010
		8,424	8,948	47,313	317,972	10,973	64,730	458,360
Financial liabilities:								
- Loans and deposits from banks and	5.73%	2,639	45,586	56,349	1,905	3,472	-	109,951
- Deposits from customers	6.05%	323	9,166	58,633	93,692	-	80,241	242,055
- Other liabilities	-	-	-	-	-	-	3,876	3,876
		2,962	54,752	114,982	95,597	3,472	84,117	355,882
Total interest re-pricing gap		5,462	(45,804)	(67,669)	222,375	7,501	(19,387)	102,478

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:

31 December 2018	Gross value AZN	Impaired AZN	Net carrying value AZN
Financial assets:			
- Cash and balances with Central Bank	**53,302**	**-**	**53,302**
- Balances with other banks	**10,585**	**(126)**	**10,459**
- Loans and advances to customers	**586,479**	**(34,352)**	**552,127**
- Other assets	**3,600**	**-**	**3,600**
	653,840	**(34,352)**	**619,488**
31 December 2017			
Financial assets:			
- Cash and balances with Central Bank	48,140	-	48,140
- Balances with other banks	12,707	(127)	12,580
- Loans and advances to customers	429,675	(36,045)	393,630
- Other assets	4,010	-	4,010
	494,532	(36,172)	458,360

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
31 December 2018			
Cash and balances with Central Bank	**53,302**	**-**	**53,302**
Balances with other banks	**10,459**	**-**	**10,459**
Loans and advances to customers	**552,127**	**(135,804)**	**416,323**
Other assets	**3,600**	**-**	**3,600**
Financial guarantees extended on behalf of customers	**108,945**	**-**	**-**
Credit lines	**41788**	**-**	**-**

	Net exposure AZN	Gross collateral pledged AZN	Net exposure AZN
31 December 2017			
Cash and balances with Central Bank	48,140	-	48,140
Balances with other banks	12,580	-	12,580
Loans and advances to customers	393,630	(202,209)	191,421
Other assets	4,010	-	4,010
Financial guarantees extended on behalf of customers	78,482	-	78,482
Credit lines	264,214	-	264,214

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, 2018	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	48,952	-	-	-	-	4,350	53,302
- Balances with other banks	10,459	-	-	-	-	-	10,459
- Loans and advances to customers	62,625	43,215	104,724	330,284	11,279	-	552,127
- Other assets	-	3,600	-	-	-	-	3,600
	122,036	46,815	104,724	330,284	11,279	4,350	619,488

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Liquidity risk (continued)

December 31, 2018	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	29	4,350	5,900	2,579	27,952	-	40,810
- Deposits from customers	123,419	12,732	66,330	263,630	-	-	466,111
- Other liabilities	-	3,393	-	-	-	-	3,393
	123,448	20,475	72,230	266,209	27,952	-	510,314
On-balance sheet liquidity gap	1,838	26,340	32,494	64,075	(16,673)	4,350	112,424

(in thousands of Azerbaijan Manats)

27 Financial instrument risk (continued)

27.2 Risk management objectives and policies (continued)

Liquidity risk (continued)

31 December 2017	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	46,095	-	-	-	-	2,045	48,140
- Balances with other banks	12,580	-	-	-	-	-	12,580
- Loans and advances to customers	8,424	8,948	47,313	31,7972	10,973	-	393,630
- Other assets	-	4,010	-	-	-	-	4,010
	6 ,099	12,958	4 ,313	31 ,9 2	10,9 3	2045	458,360
Financial liabilities:							
- Loans and deposits from banks and financial institutions	2,639	45,586	56,349	1,905	3,472	-	109,951
- Deposits from customers	80,564	9,166	58,633	93,692	-	-	242,055
- Other liabilities	-	3,876	-	-	-	-	3,876
	83,203	58,628	114,982	95,597	3,472	-	355,882
On balance sheet liquidity gap	(16,104)	(45,670)	(67,669)	222,375	7,501	2,045	102,478

(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:

31 December 2018	Azerbaijan Republic AZN	CIS countries AZN	Other countries AZN	Total AZN
Financial assets:				
- Cash and balances with Central Bank	53,302	-	-	53,302
- Balances with other banks	523	2,290	7,646	10,459
- Loans and advances to customers	552,127	-	-	552,127
- Other assets	3,600	-	-	3,600
	609,552	2,290	7,646	619,488
Financial liabilities:				
- Loans and deposits from banks and financial institutions	40,810	-	-	40,810
- Deposits from customers	466,111	-	-	466,111
- Other liabilities	3,393	-	-	3,393
	510,314	-	-	510,314
Net gap	102,488	2,290	7,646	112,424

(in thousands of Azerbaijan Manats)

28 Concentration of financial instruments (continued)

31 December 2017	Azerbaijan Republic AZN	CIS countries AZN	Other countries AZN	Total AZN
Financial assets:				
- Cash and balances with Central Bank	48,140	-	-	48,140
- Balances with other banks	2,962	536	9,082	12,580
- Loans and advances to customers	393,630	-	-	393,630
- Other assets	4,010	-	-	4,010
	448,742	536	9,082	458,360
Financial liabilities:				
- Loans and deposits from banks and financial institutions	109,951	-	-	109,951
- Deposits from customers	242,055	-	-	242,055
- Other liabilities	3,876	-	-	3,876
	355,882	-	-	355,882
Net gap	92,860	536	9082	102,478

29 Earnings per share

	2018	2017
Net profit for the year attributable to the owners of the Bank – AZN '000	12,683	1,599
Weighted average number of ordinary shares for the purpose of basic and diluted earnings per share	679	679
Earnings per share - basic and diluted (manat)	18.68	2.35

30 Post-reporting date events

Subsequent to the year end, the President of Azerbaijan issued a decree to compensate the banks in relation to foreign currency loans because of devaluation of local currency on February 21, 2015 and December 21, 2015. The effect of this is immaterial on the Bank's financial statements.