# Nikoil OJSC ICB

## Financial Statements

## for the year ended 31 December 2016

## Contents

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# Independent Auditors' Report

To the Shareholders and Supervisory Board of Nikoil Open Joint-Stock Company Investment Commercial Bank

## *Opinion*

We have audited the financial statements of Nikoil Open Joint-Stock Company Investment Commercial Bank (the "Bank"), which comprise the statement of financial position as at 31 December 2016, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

## *Basis for our 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 the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## *Responsibilities of Management and Those Charged wih Governance for the Financial Statements*

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

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

Those Charged with Governance are responsible for overseeing the Bank's financial reporting process.

### *Auditors' Responsibilities for the Audit of the Financial Statements*

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism 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.

The engagement partner on the audit resulting in this independent auditors' report is:

Andrey Kouznetsov
KPMG Audit Azerbaijan LLC
Baku, Azerbajan
8 June 2017

| | Notes | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|---|
| Interest income | 4 | 67,805 | 73,965 |
| Interest expense | 4 | (31,114) | (29,691) |
| **Net interest income** | | **36,691** | **44,274** |
| Fee and commission income | 5 | 4,104 | 5,469 |
| Fee and commission expense | 6 | (1,510) | (1,513) |
| **Net fee and commission income** | | **2,594** | **3,956** |
| Net gain on trading in foreign currencies | | 5,487 | 2,211 |
| Net foreign exchange translation gain/(loss) | | 10,985 | (11,419) |
| Other operating (losses)/gains | 7 | (1,631) | 78 |
| **Operating income** | | **54,126** | **39,100** |
| Impairment losses | 8 | (176,422) | (43,109) |
| Personnel expenses | 9 | (8,722) | (10,591) |
| Other general administrative expenses | 10 | (16,280) | (14,521) |
| **Loss before income tax** | | **(147,298)** | **(29,121)** |
| Income tax (expense)/benefit | 11 | (5,493) | 5,532 |
| **Loss and total comprehensive loss for the year** | | **(152,791)** | **(23,589)** |
| | | | |
| **Loss per share** | | | |
| Basic and diluted (expressed in AZN) | 24 | (4.21) | (1.37) |

The financial statements as set out on pages 5 to 67 were approved by management on 8 June 2017 and were signed on its behalf by:

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Azərbaycan Respublikası Investisiya Kommersiya Bankı "NIKOYL" ASC
Азербайджанская Республика Инвестиционно-Коммерческий Банк "НИКОЙЛ" ОАО
Azerbaijan Republic Investment Commercial Bank "NIKOIL" OJSC

Ms. Samira Gahramanova
Financial Director

The statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the financial statements.

| | Note | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 12 | 64,473 | 27,477 |
| Available-for-sale financial assets | 13 | 1,990 | 6,189 |
| Due from banks | 14 | 55,338 | 113,155 |
| Loans to customers | 15 | 271,661 | 382,759 |
| Advances to the Ministry of Taxes of the Republic of Azerbaijan | | 598 | 193 |
| Property, equipment and intangible assets | 16 | 14,493 | 17,788 |
| Deferred tax assets | 10 | - | 5,493 |
| Assets held for sale | 17 | 7,211 | 10,194 |
| Other assets | 18 | 2,210 | 6,702 |
| **Total assets** | | **417,974** | **569,950** |
| **LIABILITIES** | | | |
| Deposits and balances from banks | 19 | 14 | 11,164 |
| Current accounts and deposits from customers | 20 | 269,758 | 388,066 |
| Debt securities in issue | | - | 3,165 |
| Other borrowed funds | 21 | 91,828 | 112,796 |
| Other liabilities | 22 | 1,621 | 1,868 |
| Subordinated borrowings | 21 | 36,136 | 31,483 |
| **Total liabilities** | | **399,357** | **548,542** |
| **EQUITY** | | | |
| Share capital | 23 | 184,500 | 34,500 |
| Share premium | 23 | 401 | 401 |
| Accumulated losses | | (166,284) | (13,493) |
| **Total equity** | | **18,617** | **21,408** |
| **Total liabilities and equity** | | **417,974** | **569,950** |

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Ms. Samira Gahramanova
Financial Director

The statement of financial position is to be read in conjunction with the notes to, and forming part of, the financial statements.

| | Note | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Interest receipts | | 24,339 | 43,807 |
| Interest payments | | (33,843) | (26,753) |
| Fee and commission receipts | | 4,104 | 5,469 |
| Fee and commission payments | | (1,510) | (1,513) |
| Net receipts from foreign exchange | | 5,487 | 2,211 |
| Other (expense) income (payments)/receipts | | (1,631) | 78 |
| General administrative and personnel expenses payments | | (17,047) | (24,184) |
| **(Increase) decrease in operating assets** | | | |
| Due from banks | | 64,279 | (59,532) |
| Loans to customers | | 19,852 | 8,024 |
| Other assets | | 1,666 | (76) |
| **Increase (decrease) in operating liabilities** | | | |
| Deposits and balances from banks | | (11,179) | (13,475) |
| Current accounts and deposits from customers | | (146,453) | (9,957) |
| Other liabilities | | (565) | (289) |
| **Net cash used in operating activities before income tax paid** | | **(92,501)** | **(76,190)** |
| Income tax paid | | - | (211) |
| **Cash flows used in operations** | | **(92,501)** | **(76,401)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Purchases of available-for-sale financial assets | | (815) | (5,623) |
| Sales of available-for-sale financial assets | | - | 2,869 |
| Purchases of property, equipment and intangible assets | | (2,025) | (6,838) |
| **Cash flows used in investing activities** | | **(2,840)** | **(9,592)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from issue of share capital | | 150,000 | - |
| Receipts of other borrowed funds | | 6,732 | 81,910 |
| Repayment of other borrowed funds | | (27,681) | (5,615) |
| Receipts of subordinated borrowings | | - | 5,400 |
| Proceeds from debt securities issued | | - | 5,244 |
| Repayment of debt securities | | (3,040) | (3,136) |
| **Cash flows from financing activities** | | **126,011** | 83,803 |
| **Net increase/(decrease) in cash and cash equivalents** | | **30,670** | **(2,190)** |
| Effect of changes in exchange rates on cash and cash equivalents | | 6,326 | 6,062 |
| Cash and cash equivalents as at the beginning of the year | | 27,477 | 23,605 |
| **Cash and cash equivalents as at the end of the year** | 12 | **64,473** | **27,477** |

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Ms. Samira Gahramanova
Financial Director

The statement of cash flows is to be read in conjunction with the notes to, and forming part of, the financial statements.

| AZN'000 | Share capital | Share premium | Retained earnings /(accumulated deficit) | Total equity |
|---|---|---|---|---|
| **Balance as at 1 January 2015** | **34,500** | **401** | **10,096** | **44,997** |
| **Total comprehensive income** | | | | |
| Loss and total comprehensive loss for the year | - | - | (23,589) | (23,589) |
| **Loss and total comprehensive loss for the year** | **-** | **-** | **(23,589)** | **(23,589)** |
| **Balance as at 31 December 2015** | **34,500** | **401** | **(13,493)** | **21,408** |
| | | | | |
| **Balance as at 1 January 2016** | **34,500** | **401** | **(13,493)** | **21,408** |
| **Total comprehensive loss** | | | | |
| Loss and total comprehensive loss for the year | - | - | (152,791) | (152,791) |
| **Loss and total comprehensive loss for the year** | **-** | **-** | **(152,791)** | **(152,791)** |
| **Transactions with owners, recorded directly in equity** | | | | |
| Shares issued | 150,000 | - | - | 150,000 |
| **Total transactions with owners** | **150,000** | **-** | **-** | **150,000** |
| **Balance as at 31 December 2016** | **184,500** | **401** | **(166,284)** | **18,617** |

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Ms. Samira Gahramanova
Financial Director

The statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the financial statements.

# 1 Background

## (a) Organization and operations

These financial statements comprise the financial statements of Nikoil OJSC ICB (the “Bank”).

Originally, “Ulpar” JSCB was founded in 1994 in the Republic of Azerbaijan and held general banking license No 203 issued in 1994. During 2002, “Nikoil” Closed Joint Stock Company and “Lukoil Azerbaijan” Closed Joint Stock Company acquired the controlling interest in the Bank and the Bank was renamed to “Nikoil” OJSC Investment Commercial Bank. The Bank has started operations under a full banking license No 203 issued by the Central Bank of the Azerbaijan Republic (the “CBAR”) since May 2, 2002. On July 2008, “Topaz Investments” LLC has acquired the controlling interest in the Bank. Its principal activities are deposit taking, customer account maintenance, credit operations, issuing guarantees, cash and settlement operations, and securities and foreign exchange transactions. The Bank’s activities are regulated by the Financial Markets Supervisory Authority (the “FIMSA”) of the Republic of Azerbaijan. The Bank has a general banking license, and is a member of the state deposit insurance system in the Republic of Azerbaijan.

The Bank’s registered office is Pushkin Street 30, Baku AZ 1010, the Republic of Azerbaijan.

As at 31 December 2016, the Bank had fifteen branches (2015: twenty). The majority of its assets and liabilities are located in the Republic of Azerbaijan.

The Bank is owned by:

| | 31 December 2016, % | 31 December 2015, % |
|---|---|---|
| **Shareholder** | | |
| “Topaz Investments Limited” LLC | 91.84 | 56.38 |
| “Nikoil” CJSC | 7.97 | 42.62 |
| “ISR Holding” LLC | 0.19 | 1.00 |
| **Total** | **100.0** | **100.0** |

The Bank’s parent company is “Topaz Investment Limited” LLC (the “Parent”). The Bank is ultimately controlled by a single individual, Mr. V.Alekperov.

## (b) Business environment

### Azerbaijan business environment

The Bank’s operations are primarily located in Azerbaijan. Consequently, the Bank is exposed to the economic and financial markets of Azerbaijan which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in Azerbaijan.

In addition, the recent significant depreciation of the Azerbaijani Manat, and the reduction in the global price of oil, have increased the level of uncertainty in the business environment.

The financial statements reflect management’s assessment of the impact of the Azerbaijani business environment on the operations and the financial position of the Bank. The future business environment may differ from management’s assessment.

# 2 Basis of preparation

## (a) Statement of compliance

The accompanying financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

## (b) Basis of measurement

The financial statements are prepared on the historical cost basis except that available-for-sale financial assets are stated at fair value.

## (c) Functional and presentation currency

The functional currency of the Bank is the Azerbaijani Manat ("AZN") as, being the national currency of the Republic of Azerbaijan, it reflects the economic substance of the majority of underlying events and circumstances relevant to them.

At 31 December 2016, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.7707 and EUR 1 = AZN 1.8644 (31 December 2015: USD 1 = AZN 1.5594 and EUR 1 = AZN 1.7046).

The AZN is also the presentation currency for the purposes of these financial statements.

Financial information presented in AZN is rounded to the nearest thousand, unless otherwise stated.

## (d) Use of estimates and judgments

The preparation of 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 could differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies is described in the following notes:

- loan impairment estimates - Note 15;
- estimates of fair values of financial assets and liabilities – Note 32;
- recoverability of deferred tax assets – Note 11;

### Other borrowed funds

The Bank obtains long term financing from the government financial institutions at interest rates which are lower than rates at which the Bank could source the funds from other 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 losse should arise on initial recognition of such instruments. As the transactions are with unrelated parties, management's judgment is that these funds and the related lending are at the market interest rates and no initial recognition gains or losses should arise. In making this judgment management also considered that these instruments are a separate market segment.

# 2 Basis of preparation (continued)

## (e) Going concern and liquidity gap

Management have prepared these financial statements on a going concern basis. In making this judgment, management have considered current intentions, the profitability of operations and access to financial resources.

During the year ended 31 December 2016, the Bank incurred a net loss in the amount of AZN 152,791 thousand. The key factors of the negative financial results were an increase of the loan impairment allowance, decrease of interest income due to the decrease of the loan portfolio as a result of a temporary stoppage of lending operations during 2015 and 2016. The decrease of the loan portfolio was caused by the tightening of lending underwriting criteria and decrease in the creditworthiness of borrowers.

Therefore, the level of allowance for impairment of the loans to customers notably grew in 2016 from 15% as at 31 December 2015 to 39% as at 31 December 2016. The Bank's management believes that this increase in provisioning levels adequately reflects the impairments in the Bank's loan portfolio taking into account current economic conditions.

The decline in most sectors of Azerbaijani economy and decline in oil prices in 2015 had a serious impact on the Azerbaijan banking sector. To ensure future operational profitability and maintain financial stability, the Bank's management and shareholders intend to develop the Bank's business in retail sector focusing on operational income, lending to low-risk clientele and further improvement of cost efficiency.

Consequently, during the year ended 31 December 2016, the Bank's regulatory capital fell below the minimum required level, and the FIMSA temporarily imposed restrictions over attraction of new deposits until the Bank increased the total regulatory capital above the minimum required level.

On 22 September 2016 and 5 October 2016, the Bank issued 30,000 thousand and 45,000 thousand ordinary shares respectively, at a par value of AZN 2 per share. All the shares were paid-up by the parent company, during the year. As a result, the Bank's total regulatory capital exceeded the minimum required level and the FIMSA withdrew its restrictions over deposit taking activity.

As set out in Note 27, as at 31 December 2016, the Bank's total regulatory capital in accordance with the FIMSA requirements amounted to AZN 52,280 thousand exceeding the minimum requirement of AZN 50,000 thousand and regulatory capital adequacy ratio was 14% exceeding the minimum requirement of 10%. However, as at 31 December 2016, the total capital of the Bank in accordance with the Basel Capital Accord calculated for internal management reporting purposes amounted to AZN 27,926 thousand (31 December 2015: AZN 32,112 thousand).

As disclosed in Note 33 to these financial statements, subsequent to the end of the reporting period a decision was made at a General Meeting of Shareholders of the Bank to increase the share capital by AZN 35,500 thousand through an issue of 17,750 ordinary shares at a par value of AZN 2 each. The management believes after an increase of the share capital the total capitalization of the Bank will be at the level appropriate to the nature and volume of its operations for the foreseeable future.

As set out in the expected maturity analysis table in Note 26, as at 31 December 2016 the Bank had a cumulative liquidity gap of AZN 72,709 thousand in the period up to twelve months (31 December 2015: AZN 142,366 thousand).

# 2 Basis of preparation (continued)

Management believes that although current accounts' balance of AZN 36,471 thousand is included under "demand and less than one month" category in expected maturity table in the Note 26, apparently not all of these amounts will be withdrawn in the period of one year as an average balance of current accounts during the period from 1 January 2016 till April 2017 amounted AZN 40 million.

Subsequent to 31 December 2016, the Bank attracted new term deposits from individuals and corporate customers as well as prolonged term deposits originally maturing during period from January to April 2017 for the total amount of AZN 63 million for a contractual maturity of one year and more.

The shareholders of the Bank and the CBAR have been providing a continuous support to the Bank in the periods of problems with liquidity. The management expects that a support from the shareholders will be available to the Bank in the future as well, if the Bank faces problems with liquidity and sufficiency of capital.

As a result of the assessment and the actions undertaken, the management believes that the Bank will be able to cover its liquidity and capital needs over the next twelve months.

# 3 Significant accounting policies

The accounting policies set out below are applied consistently to all periods presented in these financial statements.

## (a) Foreign currency

Transactions in foreign currencies are translated to the respective functional currencies of the Bank at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments unless the difference is due to impairment in which case foreign currency differences that have been recognised in other comprehensive income are reclassified to profit or loss.

## (b) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances (nostro accounts) held with the CBAR and other banks. The mandatory reserve deposit with the CBAR is not considered to be a cash equivalent due to restrictions on its withdrawability. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

# 3 Significant accounting policies (continued)

## (c) Financial instruments

### *(i) Classification*

*Loans and receivables* are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Bank:

- intends to sell immediately or in the near term
- upon initial recognition designates as at fair value through profit or loss
- upon initial recognition designates as available-for-sale or,
- may not recover substantially all of its initial investment, other than because of credit deterioration.

*Available-for-sale financial assets* are those non-derivative financial assets that are designated as available-for-sale or are not classified as loans and receivables, held-to-maturity investments or financial instruments at fair value through profit or loss.

### *(ii) Recognition*

Financial assets and liabilities are recognized in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument. All regular way purchases of financial assets are accounted for at the settlement date.

### *(iii) Measurement*

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets are measured at their fair values, without any deduction for transaction costs that may be incurred on sale or other disposal, except for:

- loans and receivables which are measured at amortised cost using the effective interest method
- held-to-maturity investments that are measured at amortised cost using the effective interest method
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured which are measured at cost.

All financial liabilities are measured at amortised cost.

### *(iv) Amortised cost*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

### *(v) Fair value measurement principles*

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 in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

# 3 Significant accounting policies (continued)

When there is no quoted price in an active market, the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e., the fair value of the consideration given or received.

If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument, but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, the Bank measures assets and long positions at the bid price and liabilities and short positions at the ask price.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

### *(vi) Gains and losses on subsequent measurement*

A gain or loss arising from a change in the fair value of a financial asset or liability is recognized as follows:

- a gain or loss on a financial instrument classified as at fair value through profit or loss is recognized in profit or loss

- a gain or loss on an available-for-sale financial asset is recognized as other comprehensive income in equity (except for impairment losses and foreign exchange gains and losses on debt financial instruments available-for-sale) until the asset is derecognized, at which time the cumulative gain or loss previously recognised in equity is recognized in profit or loss. Interest in relation to an available-for-sale financial asset is recognized in profit or loss using the effective interest method.

For financial assets and liabilities carried at amortised cost, a gain or loss is recognized in profit or loss when the financial asset or liability is derecognized or impaired, and through the amortization process.

### *(vii) Derecognition*

The Company derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

In transactions where the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if control over the asset is lost.

# 3 Significant accounting policies (continued)

In transfers where control over the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred assets.

If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

The Bank writes off assets deemed to be uncollectible.

### *(viii) Offsetting*

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

## (d) Property and equipment

### *(i) Owned assets*

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

### *(ii) Depreciation*

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

The estimated useful lives are as follows:

| | |
|---|---|
| - buildings | 20 years |
| - furniture and fixtures | 10 years |
| - computers and communication equipment | 4 years |
| - vehicles | 10 years |
| - other fixed assets | 5 years |
| - leasehold improvements | lower of expected lease term and 14 years |

## (e) Intangible assets

Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses.

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 5 to 10 years.

## (f) Assets held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Bank's accounting policies. Thereafter generally, the assets are measured at the lower of their carrying amount and fair value less cost to sell.

# 3 Significant accounting policies (continued)

## (g) Impairment

The Bank assesses at the end of each reporting period whether there is any objective evidence that a financial asset is impaired. If any such evidence exists, the Bank determines the amount of any impairment loss.

Financial asset is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security available-for-sale a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

### *(i) Financial assets carried at amortised cost*

Financial assets carried at amortised cost consist principally of loans and other receivables. The Bank reviews its loans and receivables to assess impairment on a regular basis.

The Bank first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable’s original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, the Bank uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognized in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Bank writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

# 3 Significant accounting policies (continued)

### *(ii) Financial assets carried at cost*

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that are not carried at fair value because their fair value cannot be reliably measured.

If there is objective evidence that such investments are impaired, the impairment loss is calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments are recognized in profit or loss and cannot be reversed

### *(iii) Available-for-sale financial assets*

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that is recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

### *(iv) Non financial assets*

Other non financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of non financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non financial assets are recognized in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

## (h) Provisions

A provision is recognised in the statement of financial position when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

# 3 Significant accounting policies (continued)

## (i) Credit related commitments

In the normal course of business, the Bank enters into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

A financial guarantee liability is recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognised when losses are considered probable and can be measured reliably.

Financial guarantee liabilities and provisions for other credit related commitment are included in other liabilities.

Loan commitments are not recognised, except in the following cases:

- loan commitments that the Bank designates as financial liabilities at fair value through profit or loss
- if the Bank has a past practice of selling the assets resulting from its loan commitments shortly after origination, then the loan commitments in the same class are treated as derivative instruments
- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument
- commitments to provide a loan at a below-market interest rate.

## (j) Share capital

### *(i) Ordinary shares*

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

### *(ii) Dividends*

The ability of the Bank to declare and pay dividends is subject to the rules and regulations of the Azerbaijani legislation.

Dividends in relation to ordinary shares are reflected as an appropriation of retained earnings in the period when they are declared.

## (k) Taxation

Income tax comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items of other comprehensive income or transactions with shareholders recognised directly in equity, in which case it is recognised within other comprehensive income or directly within equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are not recognised for the following temporary differences: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit.

# 3 Significant accounting policies (continued)

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences, unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that taxable profit will be available against which the deductible temporary differences can be utilized.

## (l) Income and expense recognition

Interest income and expense are recognised in profit or loss using the effective interest method.

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related transaction costs, are deferred and amortised to interest income over the estimated life of the financial instrument using the effective interest method.

Other fees, commissions and other income and expense items are recognised in profit or loss when the corresponding service is provided.

Dividend income is recognised in profit or loss on the date that the dividend is declared.

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

## (m) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective as at 31 December 2016, and are not applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the financial position and performance. The Bank plans to adopt these pronouncements when they become effective:

- IFRS 9 *Financial Instruments*, published in July 2014, replaces the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018 and will be applied retrospectively with some exemptions. Early adoption of the standard is permitted. The Bank does not intend to adopt this standard early. The Bank has not yet analysed the likely impact of this new standard on its financial position or performance.

- **Classification - Financial assets**

- IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

# 3 Significant accounting policies (continued)

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The standard eliminates the existing IAS 39 categories of fair value through profit or loss (FVTPL), held to maturity, loans and receivables and available for sale. Based on its preliminary assessment, the Bank does not believe that the new classification requirements, if applied at 31 December 2016, would have had a material impact on its accounting for trade receivables, investments in debt securities and investments in equity securities that are managed on a fair value basis and held for long-term strategic purposes.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Based on its preliminary assessment, the Bank believes that the analysis of cash flow characteristics of loans to customers will result in that a part of loans to customers will be classified as financial assets measured at fair value through profit or loss.

**Impairment - Financial assets and contract assets**

IFRS 9 replaces the "incurred loss" model in IAS 39 with a forward-looking "expected credit loss" (ECL) model. This will require considerable judgement as to how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments, and to contract assets.

Under IFRS 9, loss allowances will be measured on either of the following bases:

- 12-month ECLs. These are ECLs that result from possible default events within the 12 months after the reporting date; and
- Lifetime ECLs. These are ECLs that result from all possible default events over the expected life of a financial instrument

Lifetime ECL measurement applies if the credit risk of a financial asset at the reporting date has increased significantly since initial recognition and 12-month ECL measurement applies if it has not. An entity may determine that a financial asset’s credit risk has not increased significantly if the asset has low credit risk at the reporting date. However, lifetime ECL measurement always applies for trade receivables and contract assets without a significant financing component; an entity may choose to apply this policy also for trade receivables and contract assets with a significant financing component.

The Bank believes that impairment losses are likely to increase and become more volatile for assets in the scope of the IFRS 9 impairment model. The Bank has not yet finalised the impairment methodologies that it will apply under IFRS 9.

**Classification - Financial liabilities**

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes of liabilities designated as at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes are generally presented as follows:

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- The remaining amount of change in the fair value is presented in profit or loss.

The Bank’s preliminary assessment did not indicate any material impact if IFRS 9 requirements regarding the classification of financial liabilities were applied at 31 December 2016.

# 3 Significant accounting policies (continued)

**Hedge accounting**

When initially applying IFRS 9, the Bank may choose as its accounting policy to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in IFRS 9. The Bank's current plan is that it will elect to apply the new requirements of IFRS 9.

IFRS 9 will require the Bank to ensure that hedge accounting relationships are aligned with the Bank's risk management objectives and strategy and to apply a more qualitative and forwardlooking approach to assessing hedge effectiveness. IFRS 9 also introduces new requirements regarding rebalancing of hedge relationships and prohibiting voluntary discontinuation of hedge accounting. Under the new model, it is possible that more risk management strategies, particularly those involving hedging a risk component (other than foreign currency risk) of a non-financial item, will be likely to qualify for hedge accounting. The Bank currently does not undertake hedges of such risk components.

**Disclosures**

IFRS 9 will require extensive new disclosures, in particular about credit risk, expected credit losses and hedge accounting. The Bank's preliminary assessment included an analysis to identify data gaps against current processes and the Bank plans to implement the system and controls changes that it believes will be necessary to capture the required data.

**Transition**

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, except as described below:

- The Bank plans to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally will be recognised in retained earnings and reserves as at 1 January 2018.
- New hedge accounting requirements should generally be applied prospectively. However, the Bank may elect to apply the expected change in accounting for the forward element of forward contracts retrospectively. The Bank has not made a decision in relation to this election.
- The following assessments have to be made on the basis of the facts and circumstances that exist at the date of initial application:
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
  - The designation of certain investments in equity instruments not held for trading as at FVOCI.

- *IFRS 16 Leases* replaces the existing lease accounting guidance in IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. It eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, early adoption is permitted if IFRS 15 Revenue from Contracts with Customers is also adopted. The Bank does not intend to adopt this standard early. The Bank has not yet analysed the likely impact of this new standard on its financial position or performance.

# 3 Significant accounting policies (continued)

- *IFRS 15 Revenue from Contracts with Customers* establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes. The core principle of the new standard is that an entity recognises revenue to depict the transfer of 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. The new standard results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Bank has not yet analysed the likely impact of this new standard on its financial position or performance.

The following new or amended standards are not expected to have a significant impact on the Bank's financial statements.

- Disclosure Initiative (Amendments to IAS 7 *Statement of Cash Flows*)
- Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12 *Income Taxes*)
- Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2 *Share-Based Payment*).

# 4 Net interest income

| | **2016 AZN'000** | **2015 AZN'000** |
|---|---|---|
| **Interest income** | | |
| Loans to customers | 65,749 | 72,404 |
| Due from banks | 1,462 | 1,048 |
| Available-for-sale investments | 594 | 513 |
| | **67,805** | **73,965** |
| **Interest expense** | | |
| Current accounts and deposits from customers | 23,642 | 23,408 |
| Other borrowed funds | 3,533 | 2,297 |
| Subordinated borrowings | 3,024 | 2,300 |
| Deposits and balances from banks | 798 | 1,551 |
| Debt securities in issue | 117 | 135 |
| | **31,114** | **29,691** |
| | **36,691** | **44,274** |

Included within various line items under interest income for the year ended 31 December 2016 is a total of AZN 22,348 thousand (2015: AZN 18,214 thousand) accrued on impaired financial assets.

# 5 Fee and commission income

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Cash withdrawals | 1,708 | 2,691 |
| Settlement | 1,150 | 797 |
| Guarantee and letter of credit issuance | 941 | 618 |
| Plastic card operations | 138 | 1,262 |
| Other | 167 | 101 |
| | **4,104** | **5,469** |

# 6 Fee and commission expense

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Agency fees | 736 | 598 |
| Plastic card operations | 320 | 252 |
| Settlement | 208 | 231 |
| Cash withdrawals | 191 | 349 |
| Other | 55 | 83 |
| | **1,510** | **1,513** |

# 7 Other operating (losses)/gains

During the year ended 31 December 2016, the Bank signed an agreement to exchange financial assets with a local commercial bank in the process of liquidation due to withdrawal of banking license by the regulator. The agreement stipulated transfer to the Bank of a portfolio of mortgage and corporate loans in exchange of the Bank's placement in that commercial bank with gross outstanding balance of AZN 8,421 thousand. As at the date of the exchange, the management of the Bank assessed fair value of the acquired loan portfolio to be approximately equal to their gross outstanding balance. The Bank additionally incurred AZN 1,757 thousand of transaction costs as part of the exchange and this loss from exchange was included in other operating losses in the statement of profit or loss and other comprehensive income for the year ended 31 December 2016.

# 8 Impairment losses

| | Notes | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|---|
| Loans to customers | 15 | 173,863 | 42,414 |
| Assets held for sale | 17 | 2,353 | 90 |
| Other assets | 18 | 206 | 605 |
| | | **176,422** | **43,109** |

# 9 Personnel expenses

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Employee compensation | 7,168 | 8,724 |
| Contributions to Social Security Fund | 1,554 | 1,867 |
| | **8,722** | **10,591** |

# 10 Other general administrative expenses

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Loss on disposal of fixed assets | 3,247 | 46 |
| Depreciation and amortization | 2,960 | 2,240 |
| Rent expenses | 2,460 | 3,574 |
| Professional services | 2,059 | 2,282 |
| Office cleaning expenses | 1,044 | 1,749 |
| Insurance of customer deposits | 1,026 | 826 |
| Security expenses | 586 | 678 |
| Communication expenses | 505 | 514 |
| Advertising and marketing expenses | 472 | 783 |
| Legal and court expenses | 307 | 209 |
| Repair and maintenance expenses | 293 | 291 |
| Taxes other than on income | 263 | 130 |
| Office supplies and printing expenses | 257 | 279 |
| Computer software cost | 256 | 157 |
| Other expenses | 545 | 763 |
| | **16,280** | **14,521** |

During the year ended 31 December 2016, included in professional services were expenses in the amount of AZN 1,171 thousand (2015: AZN 1,089 thousand) to individuals working under temporary service agreements.

# 11 Income tax expense (benefit)

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Current year tax expense | - | - |
| Current tax expense under provided in prior years | - | 275 |
| Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences | 5,493 | (5,807) |
| **Total income tax expense (benefit)** | **5,493** | **(5,532)** |

In 2016, the applicable tax rate for current and deferred tax is 20% (2015: 20%).

**Reconciliation of effective tax rate for the years ended 31 December:**

| | 2016 AZN'000 | % | 2015 AZN'000 | % |
|---|---|---|---|---|
| Loss before income tax | **(147,298)** | | **(29,121)** | |
| Income tax at the applicable tax rate | (29,460) | (20.00) | (5,824) | (20.00) |
| Non-deductible costs | 2,308 | 1.57 | 17 | 0.06 |
| Change in unrecognized deferred tax assets | 32,645 | 22.16 | - | - |
| Under provided in prior years | - | - | 275 | 0.94 |
| | **5,493** | **3.73** | **(5,532)** | **(19.00)** |

# 11 Income tax expense (benefit) (continued)

## Deferred tax assets and liabilities

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes give rise to net deferred tax assets as at 31 December 2016 and 31 December 2015. The deferred tax assets are not recognised in these financial statements. Future tax benefits will only be realised if profits will be available against which unused tax losses can be utilised and there are no changes to the law and regulations that adversely affect the Bank's ability to claim deductions in future periods. These future tax benefits are not recognised due to uncertainties concerning their realisation.

The deductible temporary differences do not expire under current tax legislation. The tax loss carry-forwards in the amount of AZN 1,810 thousand from tax losses for the year 2015 and AZN 28,336 thousand from tax losses for the year 2016 expire in 2020 and 2021, respectively.

Movements in temporary differences during the years ended 31 December 2016 and 2015 are presented as follows.

| **2016**<br>**AZN'000** | **Balance at 1 January 2016** | **Recognised in profit or loss** | **Balance at 31 December 2016** |
|---|---|---|---|
| Loans to customers | 3,845 | (1,578) | 2,267 |
| Property, equipment and intangible assets | (154) | 247 | 93 |
| Due from banks | (58) | 64 | 6 |
| Available-for-sale investments | (13) | - | (13) |
| Assets held for sale | 63 | - | 63 |
| Subordinated borrowings | - | 42 | 42 |
| Other assets | - | 41 | 41 |
| Tax loss carry-forwards | 1,810 | 28,336 | 30,146 |
| Net deferred tax asset | 5,493 | 27,152 | 32,645 |
| Deferred tax asset not recognized | - | (32,645) | (32,645) |
| | **5,493** | **(5,493)** | **-** |

| **2015**<br>**AZN'000** | **Balance at 1 January 2015** | **Recognised in profit or loss** | **Balance at 31 December 2015** |
|---|---|---|---|
| Loans to customers | (301) | 4,146 | 3,845 |
| Property, equipment and intangible assets | (13) | (141) | (154) |
| Due from banks | - | (58) | (58) |
| Available-for-sale investments | - | (13) | (13) |
| Assest held for sale | - | 63 | 63 |
| Tax loss carry-forwards | - | 1,810 | 1,810 |
| | **(314)** | **5,807** | **5,493** |

# 12 Cash and cash equivalents

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Cash on hand** | **8,718** | **12,265** |
| **Nostro accounts with the CBAR** | **44,269** | **3,056** |
| **Nostro accounts and overnight placements with other banks** | | |
| - rated from BBB- to BBB+ | 10,079 | 3,201 |
| - rated from BB- to BB+ | 728 | 8,509 |
| - rated from B- to B+ | 277 | 138 |
| - not rated | 402 | 308 |
| **Total nostro accounts and overnight placements with other banks** | **11,486** | **12,156** |
| | **64,473** | **27,477** |

No cash and cash equivalents are impaired or past due.

As at 31 December 2016, the Bank had one bank (31 December 2015: two), whose balance exceeded 10% of total cash and cash equivalents. The gross value of this balance as at 31 December 2016 was AZN 10,079 thousand (31 December 2015: AZN 11,609 thousand).

# 13 Available-for-sale financial assets

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Debt and other fixed-income instruments** | | |
| **- Corporate shares** | | |
| - Sumgait Ashgarlar OJSC | 304 | 304 |
| - AzerKabel OJSC | 761 | 761 |
| **Total corporate shares** | **1,065** | **1,065** |
| **- Corporate bonds** | | |
| - not rated | 925 | 5,124 |
| **Total corporate bonds** | **925** | **5,124** |
| **Total debt securities** | **1,990** | **6,189** |

## Investments without a determinable fair value

Available-for-sale investments stated at cost comprise unquoted equity securities in Sumgait Ashgarlar OJSC and AzerKabel OJSC. There is no market for these investments and there have not been any recent transactions that provide evidence of the current fair value. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty regarding future cash flows in the respective industry of each company. However, management believes it is unlikely that the fair value at the end of the year would differ significantly from that carrying amount.

At 31 December 2016, the debt securities included corporate bonds of State Oil Company of Azerbaijan Republic, carrying an annual interest rate of 5% with maturities in September 2021. These corporate bonds are quoted in active market and their fair value approximated carrying value at 31 December 2016. The corporate bonds are categorized into Level 1 in the fair value hierarchy disclosed in Note 32.

During the year ended 31 December 2016, the Bank reclassified the unquoted corporate bonds of a local company with a fair value of AZN 5,157 thousand out of the availabe-for-sale financial assets to the loans to customers, after the management changed their intention to hold these financial assets until maturity.

# 14 Due from banks

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Mandatory reserve with the CBAR** | **2,389** | **1,755** |
| **Loans and deposits** | | |
| - rated from BBB- to BBB+ | - | 78,750 |
| - rated from BB- to BB+ | 48,077 | - |
| - rated below B+ | - | 17,431 |
| - not rated | 4,872 | 15,219 |
| **Total loans and deposits** | **52,949** | **111,400** |
| **Total due from banks** | **55,338** | **113,155** |

At 31 December 2016 and 2015, due from banks did not include any overdue or impaired balances.

As at 31 December 2016, included in loans and deposits were AZN 40,523 thousand (31 December 2015: AZN 62,241 thousand) blocked by the CBAR as a collateral for the loans issued to the Bank.

## (a) Concentration of due from banks

As at 31 December 2016, the Bank had one bank (31 December 2015: two), whose balance exceeded 10% of total due from banks. The gross value of this balance as at 31 December 2016 was AZN 45,189 thousand (31 December 2015: AZN 78,750 thousand).

## (b) Mandatory reserve with the CBAR

The mandatory reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBAR and whose withdrawal ability is restricted. Reserves are measured in accordance with regulations issued by the CBAR and equal to 0.5 and 1% (2015: 0.5%) of the average qualifying customer accounts balances denominated in AZN and foreign currency, respectively.

# 15 Loans to customers

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Loans to corporate customers** | | |
| Loans to large corporates | 172,301 | 132,158 |
| **Total loans to corporate customers** | **172,301** | **132,158** |
| | | |
| **Loans to individuals** | | |
| Entrepreneur loans | 83,704 | 96,062 |
| Consumer loans | 108,425 | 125,542 |
| Mortgage loans | 49,725 | 47,972 |
| Auto loans | 33,184 | 46,242 |
| **Total loans to individuals** | **275,038** | **315,818** |
| | | |
| **Gross loans to customers** | **447,339** | **447,976** |
| Impairment allowance | (175,678) | (65,217) |
| **Net loans to customers** | **271,661** | **382,759** |

# 15 Loans to customers (continued)

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2016 are as follows:

| | Loans to corporate customers AZN'000 | Loans to individuals AZN'000 | Total AZN'000 |
|---|---|---|---|
| Balance at the beginning of the year | 17,351 | 47,866 | 65,217 |
| Net charge | 56,783 | 117,080 | 173,863 |
| Write-offs | (5,945) | (57,457) | (63,402) |
| **Balance at the end of the year** | **68,189** | **107,489** | **175,678** |

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2015 are as follows:

| | Loans to corporate customers AZN'000 | Loans to individuals AZN'000 | Total AZN'000 |
|---|---|---|---|
| Balance at the beginning of the year | 9,297 | 16,053 | 25,350 |
| Net charge | 8,693 | 33,721 | 42,414 |
| Write-offs | (639) | (1,908) | (2,547) |
| **Balance at the end of the year** | **17,351** | **47,866** | **65,217** |

## (a) Credit quality of loans to customers

The following table provides information on the credit quality of loans to customers as at 31 December 2016:

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| **Loans to corporate customers** | | | | |
| **Loans to large corporates** | | | | |
| Current loans without signs of impairment | 22,554 | 1,324 | 21,230 | 5.9 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 19 | - | 19 | - |
| - overdue 30-89 days | 629 | 75 | 554 | 11.9 |
| Total past due but not impaired loans | 648 | 75 | 573 | 11.6 |
| Impaired loans | | | | |
| - not overdue | 109,531 | 44,536 | 64,995 | 40.7 |
| - overdue 30-89 days | 1,986 | 732 | 1,254 | 36.9 |
| - overdue 90-179 days | 8,664 | 1,844 | 6,820 | 21.3 |
| - overdue 180-360 days | 458 | 196 | 262 | 42.8 |
| - overdue more than 360 days | 28,460 | 19,482 | 8,978 | 68.5 |
| Total impaired loans | 149,099 | 66,790 | 82,309 | 44.8 |
| **Total loans to large corporates** | **172,301** | **68,189** | **104,112** | **39.6** |
| **Total loans to corporate customers** | **172,301** | **68,189** | **104,112** | **39.6** |

# 15 Loans to customers (continued)

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| **Entrepreneur loans** | | | | |
| Current loans without signs of impairment | 22,159 | 3,084 | 19,075 | 13.9 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 1,881 | 1,178 | 703 | 62.6 |
| - overdue 30-89 days | 3,304 | 2,070 | 1,234 | 62.7 |
| Total past due but not impaired loans | 5,185 | 3,248 | 1,937 | 62.6 |
| Impaired loans | | | | |
| - not overdue | 6,781 | 2,479 | 4,302 | 36.6 |
| - overdue 90-179 days | 6,965 | 5,073 | 1,892 | 72.8 |
| - overdue 180-360 days | 19,665 | 13,844 | 5,821 | 70.4 |
| - overdue more than 360 days | 22,949 | 16,540 | 6,409 | 72.1 |
| Total impaired loans | 56,360 | 37,936 | 18,424 | 67.3 |
| **Total enterpreneur loans** | **83,704** | **44,268** | **39,436** | **52.9** |
| **Consumer loans** | | | | |
| Current loans without signs of impairment | 32,134 | 7,417 | 24,717 | 23.1 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 2,316 | 687 | 1,629 | 29.7 |
| - overdue 30-89 days | 3,705 | 1,367 | 2,338 | 36.9 |
| Total past due but not impaired loans | 6,021 | 2,054 | 3,967 | 34.1 |
| Impaired loans | | | | |
| - not overdue | 10,009 | 2,702 | 7,307 | 27.0 |
| - overdue 90-179 days | 10,352 | 5,943 | 4,409 | 57.4 |
| - overdue 180-360 days | 9,988 | 4,669 | 5,319 | 46.7 |
| - overdue more than 360 days | 39,921 | 23,919 | 16,002 | 59.9 |
| Total impaired loans | 70,270 | 37,233 | 33,037 | 53.0 |
| **Total consumer loans** | **108,425** | **46,704** | **61,721** | **43.1** |
| **Mortgage loans** | | | | |
| Current loans without signs of impairment | 44,650 | 2,156 | 42,494 | 4.8 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 131 | 4 | 127 | 3.1 |
| - overdue 30-89 days | 1,023 | 157 | 866 | 15.3 |
| Total past due but not impaired loans | 1,154 | 161 | 993 | 14.0 |
| Impaired loans | | | | |
| - not overdue | 1,532 | 1,173 | 359 | 76.6 |
| - overdue 90-179 days | 823 | 223 | 600 | 27.1 |
| - overdue 180-360 days | 403 | 203 | 200 | 50.4 |
| - overdue more than 360 days | 1,163 | 634 | 529 | 54.5 |
| Total impaired loans | 3,921 | 2,233 | 1,688 | 56.9 |
| **Total mortgage loans** | **49,725** | **4,550** | **45,175** | **9.2** |

# 15 Loans to customers (continued)

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| **Auto loans** | | | | |
| Current loans without signs of impairment | 5,027 | 1,259 | 3,768 | 25.0 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 755 | 165 | 590 | 21.9 |
| - overdue 30-89 days | 1,471 | 545 | 926 | 37.0 |
| Total past due but not impaired loans | 2,226 | 710 | 1,516 | 31.9 |
| Impaired loans | | | | |
| - overdue 90-179 days | 1,900 | 682 | 1,218 | 35.9 |
| - overdue 180-360 days | 8,073 | 3,263 | 4,810 | 40.4 |
| - overdue more than 360 days | 15,958 | 6,053 | 9,905 | 37.9 |
| Total impaired loans | 25,931 | 9,998 | 15,933 | 38.6 |
| **Total auto loans** | **33,184** | **11,967** | **21,217** | **36.1** |
| **Total loans to individuals** | **275,038** | **107,489** | **167,549** | **39.1** |
| **Total loans to customers** | **447,339** | **175,678** | **271,661** | **39.3** |

The following table provides summary of information on the credit quality of loans to customers as at 31 December 2016:

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| Current loans without signs of impairment | 126,524 | 15,240 | 111,284 | 12.0 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 5,102 | 2,034 | 3,068 | 39.9 |
| - overdue 30-89 days | 10,133 | 4,214 | 5,919 | 41.6 |
| Total past due but not impaired loans | 15,235 | 6,248 | 8,987 | 41.0 |
| Impaired loans | | | | |
| - not overdue | 127,852 | 50,889 | 76,963 | 39.8 |
| - overdue 30-89 days | 1,986 | 732 | 1,254 | 36.9 |
| - overdue 90-179 days | 28,704 | 13,764 | 14,940 | 48.0 |
| - overdue 180-360 days | 38,586 | 22,176 | 16,410 | 57.5 |
| - overdue more than 360 days | 108,452 | 66,629 | 41,823 | 61.4 |
| Total impaired loans | 305,580 | 154,190 | 151,390 | 50.5 |
| **Total loans to customers** | **447,339** | **175,678** | **271,661** | **39.3** |

# 15 Loans to customers (continued)

The following table provides information on the credit quality of loans to customers as at 31 December 2015:

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| **Loans to corporate customers** | | | | |
| **Loans to large corporates** | | | | |
| Current loans without signs of impairment | 18,956 | 578 | 18,378 | 3.0 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 433 | 1 | 432 | 0.2 |
| - overdue 30-89 days | 2,190 | 33 | 2,157 | 1.5 |
| Total past due but not impaired loans | 2,623 | 34 | 2,589 | 1.3 |
| Impaired loans | | | | |
| - not overdue | 7,875 | 3,403 | 4,472 | 43.2 |
| - overdue less than 30 days | 865 | 9 | 856 | 1.0 |
| - overdue 30-89 days | 7,876 | 78 | 7,798 | 1.0 |
| - overdue 90-179 days | 23,617 | 221 | 23,396 | 0.9 |
| - overdue 180-360 days | 33,481 | 2,104 | 31,377 | 6.3 |
| - overdue more than 360 days | 36,865 | 10,924 | 25,941 | 29.6 |
| Total impaired loans | 110,579 | 16,739 | 93,840 | 15.1 |
| **Total loans to large corporates** | **132,158** | **17,351** | **114,807** | **13.1** |
| **Total loans to corporate customers** | **132,158** | **17,351** | **114,807** | **13.1** |
| | | | | |
| **Entrepreneur loans** | | | | |
| Current loans without signs of impairment | 40,772 | 1,249 | 39,523 | 3.1 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 14,226 | 670 | 13,556 | 4.7 |
| - overdue 30-89 days | 6,936 | 1,218 | 5,718 | 17.6 |
| Total past due but not impaired loans | 21,162 | 1,888 | 19,274 | 8.9 |
| Impaired loans | | | | |
| - overdue 90-179 days | 9,587 | 3,144 | 6,443 | 32.8 |
| - overdue 180-360 days | 9,680 | 3,907 | 5,773 | 40.4 |
| - overdue more than 360 days | 14,861 | 6,780 | 8,081 | 45.6 |
| Total impaired loans | 34,128 | 13,831 | 20,297 | 40.5 |
| **Total enterpreneur loans** | **96,062** | **16,968** | **79,094** | **17.7** |

# 15 Loans to customers (continued)

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| **Consumer loans** | | | | |
| Current loans without signs of impairment | 54,651 | 1,814 | 52,837 | 3.3 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 14,999 | 1,753 | 13,246 | 11.7 |
| - overdue 30-89 days | 7,919 | 2,378 | 5,541 | 30.0 |
| Total past due but not impaired loans | 22,918 | 4,131 | 18,787 | 18.0 |
| Impaired loans | | | | |
| - not overdue | 1,751 | 146 | 1,605 | 8.3 |
| - overdue 30-89 days | 338 | 251 | 87 | 74.3 |
| - overdue 90-179 days | 5,636 | 2,649 | 2,987 | 47.0 |
| - overdue 180-360 days | 7,754 | 2,439 | 5,315 | 31.5 |
| - overdue more than 360 days | 32,494 | 13,146 | 19,348 | 40.5 |
| Total impaired loans | 47,973 | 18,631 | 29,342 | 38.8 |
| **Total consumer loans** | **125,542** | **24,576** | **100,966** | **19.6** |
| **Mortgage loans** | | | | |
| Current loans without signs of impairment | 42,368 | 639 | 41,729 | 1.5 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 690 | 70 | 620 | 10.1 |
| - overdue 30-89 days | 976 | 193 | 783 | 19.8 |
| Total past due but not impaired loans | 1,666 | 263 | 1,403 | 15.8 |
| Impaired loans | | | | |
| - not overdue | 45 | 38 | 7 | 84.4 |
| - overdue 90-179 days | 100 | 9 | 91 | 9.0 |
| - overdue 180-360 days | 589 | 129 | 460 | 21.9 |
| - overdue more than 360 days | 3,204 | 939 | 2,265 | 29.3 |
| Total impaired loans | 3,938 | 1,115 | 2,823 | 28.3 |
| **Total mortgage loans** | **47,972** | **2,017** | **45,955** | **4.2** |
| **Auto loans** | | | | |
| Current loans without signs of impairment | 22,198 | 164 | 22,034 | 0.7 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 10,695 | 163 | 10,532 | 1.5 |
| - overdue 30-89 days | 5,399 | 198 | 5,201 | 3.7 |
| Total past due but not impaired loans | 16,094 | 361 | 15,733 | 2.2 |
| Impaired loans | | | | |
| - overdue 90-179 days | 1,657 | 294 | 1,363 | 17.7 |
| - overdue 180-360 days | 955 | 537 | 418 | 56.2 |
| - overdue more than 360 days | 5,338 | 2,949 | 2,389 | 55.2 |
| Total impaired loans | 7,950 | 3,780 | 4,170 | 47.5 |
| **Total auto loans** | **46,242** | **4,305** | **41,937** | **9.3** |
| **Total loans to individuals** | **315,818** | **47,866** | **267,952** | **15.2** |
| **Total loans to customers** | **447,976** | **65,217** | **382,759** | **14.6** |

# 15 Loans to customers (continued)

The following table provides summary of information on the credit quality of loans to customers as at 31 December 2015:

| | Gross loans AZN'000 | Impairment allowance AZN'000 | Net loans AZN'000 | Impairment allowance to gross loans, % |
|---|---|---|---|---|
| Current loans without signs of impairment | 178,945 | 4,444 | 174,501 | 2.5 |
| Past due but not impaired loans | | | | |
| - overdue less than 30 days | 41,043 | 2,657 | 38,386 | 6.5 |
| - overdue 30-89 days | 23,420 | 4,020 | 19,400 | 17.2 |
| Total past due but not impaired loans | 64,463 | 6,677 | 57,786 | 10.4 |
| Impaired loans | | | | |
| - not overdue | 9,671 | 3,587 | 6,084 | 58.9 |
| - overdue less than 30 days | 865 | 9 | 856 | 1.0 |
| - overdue 30-89 days | 8,214 | 329 | 7,885 | 4.0 |
| - overdue 90-179 days | 40,597 | 6,317 | 34,280 | 15.6 |
| - overdue 180-360 days | 52,459 | 9,116 | 43,343 | 17.4 |
| - overdue more than 360 days | 92,762 | 34,738 | 58,024 | 37.4 |
| Total impaired loans | 204,568 | 54,096 | 150,472 | 26.4 |
| **Total loans to customers** | **447,976** | **65,217** | **382,759** | **14.6** |

As at 31 December 2016, included in the loan portfolio were renegotiated loans to corporate customers and individuals that would otherwise be past due or impaired of AZN 4,862 thousand and AZN 14,533 thousand, respectively (31 December 2015: AZN 2,337 thousand and AZN 25,602 thousand, respectively). Such restructuring activity is aimed at managing customer relationships and maximising collection opportunities. Renegotiated loans are included in the category of assets without individual signs of impairment in the tables above, unless the borrower fails to comply with the renegotiated terms.

## (b) Key assumptions and judgments for estimating the loan impairment

Loan impairment results from one or more events that occurred after the initial recognition of the loan and that have an impact on the estimated future cash flows associated with the loan, and that can be reliably estimated. Loans without individual signs of impairment do not have objective evidence of impairment that can be directly attributed to them.

The Bank estimates loan impairment for significant loans with signs of impairment based on an individual review of each loan and estimation of its future cash flows. This estimate of future cash flows is dependent on factors such as the estimated value of underlying collateral and delay of 12 to 36 months in obtaining proceeds from the foreclosure of collateral. The Bank then calculates the net present value of these cash flows using a discount rate which equates to the original effective interest rate of the loan, in order to determine the required amount of loan impairment.

For the remaining portfolio of loans with signs of impairment which are not individually significant, and for loans without individual signs of impairment, the Bank calculates collective impairment based on the historic loss experience on each type of loan. This collective impairment reflects the Bank's estimate of the impairment losses inherent in the portfolio which have been incurred but which have not been specifcially identified at the reporting date. The key areas of uncertainty and assumptions used in the calculation of the collective impairment included:

# 15 Loans to customers (continued)

- loss rates are constant and can be estimated based on the historic loss migration pattern for the past 24 months.
- a delay of 12 months in obtaining proceeds from the foreclosure of collateral and a discount of 30% and 80% for real estates and other type of collaterals to the originally appraised value, respectively, if the property pledged is sold through court procedures.

Changes in these estimates could effect the loan impairment provision. For example, to the extent that the net present value of the estimated cash flows differs by plus minus one percent, the impairment allowance on loans to customers as at 31 December 2016 would be AZN 2,717 thousand lower/higher (31 December 2015: AZN 3,828 thousand lower/higher).

## (c) Analysis of collateral and other credit enhancements

### *(i)* Loans to corporate customers

Loans to corporate customers are subject to individual credit appraisal and impairment testing. The general creditworthiness of a corporate customer tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and the Bank generally requests corporate borrowers to provide it.The following tables provides information on collateral and other credit enhancements securing loans to corporate customers, net of impairment, by types of collateral:

| **31 December 2016 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | | |
| Cash and deposits | 362 | 362 |
| Real estate | 10,029 | 5,802 |
| Motor vehicles | 14 | 14 |
| Equipments | 3,111 | 3,111 |
| Goods and materials | 323 | 323 |
| Securities | 686 | 686 |
| Guarantee letters | 4,645 | 4,645 |
| No collateral or other credit enhancement | 2,634 | - |
| Total loans without sign of impairment: | 21,804 | 14,943 |
| Overdue or impaired loans | | |
| Cash and deposits | 6,042 | 4,519 |
| Real estate | 10,280 | 10,092 |
| Motor vehicles | 1,489 | 1,489 |
| Equipments | 12,967 | 12,967 |
| Goods and materials | 14,608 | 14,569 |
| Securities | 2,387 | 2,387 |
| Guarantee letters | 29,386 | 27,293 |
| No collateral or other credit enhancement | 5,149 | - |
| Total impaired loans: | 82,308 | 73,316 |
| **Total loans to corporate customers** | **104,112** | **88,259** |

# 15 Loans to customers (continued)

| **31 December 2015 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | | |
| Cash and deposits | 5,303 | 4,597 |
| Real estate | 8,759 | 7,100 |
| Equipments | 6,409 | 5,238 |
| Guarantee letters | 424 | 362 |
| No collateral or other credit enhancement | 72 | - |
| Total loans without sign of impairment: | 20,967 | 17,297 |
| Overdue or impaired loans | | |
| Cash and deposits | 1,066 | 687 |
| Real estate | 22,283 | 11,317 |
| Motor vehicles | 2,097 | 2,097 |
| Equipments | 29,820 | 23,158 |
| Goods and materials | 11,300 | 8,127 |
| Securities | 19,727 | 18,774 |
| Guarantee letters | 251 | 251 |
| No collateral or other credit enhancement | 7,296 | - |
| Total impaired loans: | 93,840 | 64,411 |
| **Total loans to corporate customers** | **114,807** | **81,708** |

The tables above exclude overcollateralization.

The Bank has loans, for which fair value of collateral was assessed at the loan inception date and it was not updated for further changes, and loans for which fair value of collateral is not determined. Information on valuation of collateral is based on when this estimate was made, if any.

### *(ii)* Loans to individuals

For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed. Sureties received from individuals, such as shareholders of SME borrowers, are not considered for impairment assessment purposes. Accordingly, such loans and unsecured portions of partially secured exposures are presented as loans without collateral or other credit enhancement.

The recoverability of loans which are neither past due nor impaired is primarily dependent on the creditworthiness of the borrowers rather than the value of collateral, and the Bank does not necessarily update the valuation of collateral as at each reporting date.

# 15 Loans to customers (continued)

The following tables provides information on collateral and other credit enhancements securing loans to entrepreneurs, net of impairment, by types of collateral:

| **31 December 2016**<br>**AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | | |
| Cash and deposits | 81 | 81 |
| Precious metals | 10 | 10 |
| Real estate | 11,005 | 10,976 |
| Motor vehicles | 100 | 100 |
| Equipments | 645 | 645 |
| Goods and materials | 1,642 | 1,642 |
| Guarantee letters | 2,340 | 2,340 |
| No collateral or other credit enhancement | 5,190 | - |
| Total loans without signs of impairment: | 21,013 | 15,794 |
| Impaired loans | | |
| Precious metals | 29 | 29 |
| Real estate | 5,597 | 5,065 |
| Motor vehicles | 58 | 58 |
| Equipments | 2,237 | 2,232 |
| Goods and materials | 3,791 | 3,789 |
| Guarantee letters | 4,125 | 4,117 |
| No collateral or other credit enhancement | 2,586 | - |
| Total impaired loans: | 18,423 | 15,290 |
| **Total loans to entrepreneurs** | **39,436** | **31,084** |

# 15 Loans to customers (continued)

| **31 December 2015 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | | |
| Cash and deposits | 30 | 27 |
| Precious metals | 158 | 145 |
| Real estate | 12,604 | 12,558 |
| Motor vehicles | 194 | 175 |
| Equipments | 39,115 | 38,670 |
| Goods and materials | 3,639 | 3,625 |
| Guarantee letters | 2 | - |
| No collateral or other credit enhancement | 3,055 | - |
| Total loans without signs of impairment: | 58,797 | 55,200 |
| Impaired loans | | |
| Precious metals | 105 | 105 |
| Real estate | 4,196 | 1,708 |
| Equipments | 13,247 | 13,102 |
| Goods and materials | 193 | 193 |
| Guarantee letters | 1,493 | 1,492 |
| No collateral or other credit enhancement | 1,063 | - |
| Total impaired loans: | 20,297 | 16,600 |
| **Total loans to entrepreneurs** | **79,094** | **71,800** |

The tables above exclude overcollateralization.

Fair value of collateral was assessed at the loan inception date and it was not updated for further changes for all loans of the Bank. Information on valuation of collateral is based on when this estimate was made, if any.

For loans secured by multiple types of collateral, collateral that is most relevant for impairment assessment is disclosed. Sureties received from individuals, such as shareholders of SME borrowers, are not considered for impairment assessment purposes. Accordingly, such loans and unsecured portions of partially secured exposures are presented as loans without collateral or other credit enhancement.

The recoverability of loans which are neither past due nor impaired is primarily dependent on the creditworthiness of the borrowers rather than the value of collateral, and the Bank does not necessarily update the valuation of collateral as at each reporting date.

# 15 Loans to customers (continued)

The following tables provides information on collateral and other credit enhancements securing consumer loans, net of impairment, by types of collateral:

| **31 December 2016 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | | |
| Cash and deposits | 6,574 | 6,363 |
| Precious metals | 275 | 271 |
| Real estate | 11,731 | 11,724 |
| Motor vehicles | 91 | 91 |
| Equipments | 28 | 25 |
| Goods and materials | 23 | 23 |
| Guarantee letters | 3,846 | 3,744 |
| No collateral or other credit enhancement | 6,115 | - |
| Total loans without signs of impairment: | 28,683 | 22,241 |
| Impaired loans | | |
| Cash and deposits | 7,561 | 6,933 |
| Precious metals | 20 | 19 |
| Real estate | 19,145 | 19,139 |
| Motor vehicles | 193 | 158 |
| Equipments | 789 | 767 |
| Goods and materials | 132 | 132 |
| Securities | 38 | 38 |
| Guarantee letters | 3,499 | 3,380 |
| No collateral or other credit enhancement | 1,661 | - |
| Total impaired loans: | 33,038 | 30,566 |
| **Total consumer loans** | **61,721** | **52,807** |

| **31 December 2015 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | | |
| Cash and deposits | 14,569 | 8,595 |
| Precious metals | 958 | 777 |
| Real estate | 30,411 | 30,160 |
| Motor vehicles | 46 | 42 |
| Equipments | 413 | 401 |
| Guarantee letters | 14,156 | 13,224 |
| No collateral or other credit enhancement | 11,071 | - |
| Total loans without signs of impairment: | 71,624 | 53,199 |

# 15 Loans to customers (continued)

| | | |
|---|---|---|
| Impaired loans | | |
| Cash and deposits | 2,453 | 1,882 |
| Precious metals | 3 | 3 |
| Real estate | 20,756 | 18,871 |
| Motor vehicles | 77 | 32 |
| Equipments | 1,109 | 1,087 |
| Goods and materials | 15 | 15 |
| Securities | 31 | 31 |
| Guarantee letters | 3,793 | 3,491 |
| No collateral or other credit enhancement | 1,105 | - |
| Total impaired loans: | 29,342 | 25,412 |
| **Total consumer loans** | **100,966** | **78,611** |

Mortgage loans are secured by the underlying housing real estate. The Bank's policy is to issue mortgage loans with a loan-to-value ratio of a maximum of 85%.

The following tables provides information on collateral and other credit enhancements securing mortgage loans, net of impairment, by types of collateral:

| **31 December 2016 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | 43,487 | 42,724 |
| Impaired loans | 1,688 | 1,688 |
| **Total mortgage loans** | **45,175** | **44,412** |

| **31 December 2015 AZN'000** | **Loans to customers, carrying amount** | **Fair value of collateral - for collateral assessed as of inception date** |
|---|---|---|
| Loans without individual signs of impairment | 43,132 | 33,783 |
| Impaired loans | 2,823 | 2,341 |
| **Total mortgage loans** | **45,955** | **36,124** |

The table above is presented on the basis of excluding overcollateralization.

For mortgage loans, the fair value of collateral was estimated at inception of the loans and was not adjusted for subsequent changes to the reporting date.

24% (2015: 16%) of the consumer loans are collateralised by cash deposits with a loan-to-value ratio of a maximum of 50% for deposits in national currency and loan-to-value ratio of a maximum 90% for deposits in foreign currency.

Auto loans are secured by the underlying cars. The Bank's policy is to issue auto loans with a loan-to-value ratio of a maximum of 50%.

### *(iii) Repossessed collateral*

During the year ended 31 December 2016, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 750 thousand (2015: AZN 5,741 thousand). Assets held for sale are comprised of real estates and other assets. See Note 17.

# 15 Loans to customers (continued)

## (d) Industry and geographical analysis of the loan portfolio

Loans to individuals were issued primarily for consumer purposes. Loans to corporate customers and entrepreneurs were issued primarily to customers located within the Republic of Azerbaijan who operate in the following economic sectors:

| | 31 December 2016 AZN'000 | % | 31 December 2015 AZN'000 | % |
|---|---|---|---|---|
| Corporate loans | | | | |
| - trade and services | 74,237 | 16.6 | 52,154 | 11.7 |
| - construction | 31,825 | 7.1 | 32,708 | 7.3 |
| - manufacturing | 21,546 | 4.8 | 17,226 | 3.8 |
| - agriculture | 18,305 | 4.1 | 12,527 | 2.8 |
| - financial services | 26,231 | 5.9 | 11,936 | 2.7 |
| - transportation and communication | - | - | 5,062 | 1.1 |
| - other | 157 | - | 545 | 0.1 |
| **Total corporate loans** | **172,301** | **38.5** | **132,158** | **29.5** |
| Enterpreneurs | 83,704 | 18.7 | 96,062 | 21.4 |
| **Total enterpreneur loans** | **83,704** | **18.7** | **96,062** | **21.4** |
| Loans to individuals | | | | |
| - consumer loans | 104,182 | 23.3 | 119,344 | 26.6 |
| - mortgage loans | 49,725 | 11.1 | 47,972 | 10.7 |
| - auto loans | 33,184 | 7.4 | 46,242 | 10.3 |
| - credit cards | 4,243 | 1.0 | 6,198 | 1.4 |
| **Total loans to individuals** | **191,334** | **42.8** | **219,756** | **49.1** |
| **Total loans to customers** | **447,339** | **100.0** | **447,976** | **100.0** |
| Impairment allowance | (175,678) | | (65,217) | |
| **Net loans to customers** | **271,661** | | **382,759** | |

## (e) Significant credit exposures

As at 31 December 2016, the Bank had thirty one borrowers or groups of connected borrowers (31 December 2015: eighteen borrowers) with gross loan balances exceeding AZN 1,000 thousand. The gross value of these loans as at 31 December 2016 was AZN 174,055 thousand or 38.9% of the total loans to customers (31 December 2015: AZN 158,304 thousand or 35.3%).

## (f) Loan maturities

The maturity of the loan portfolio is presented in Note 26, which shows the remaining period from the reporting date to the contractual maturity of the loans. Due to the short-term nature of the loans issued by the Bank, it is likely that many of the loans will be prolonged at maturity. Accordingly, the effective maturity of the loan portfolio may be significantly longer than the term based on contractual terms.

# 16 Property, equipment and intangible assets

| AZN'000 | Buildings | Furniture and fixtures | Computers and communication equipment | Vehicles | Other fixed assets | Leasehold imporvements | Intangible assets | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost amount** | | | | | | | | |
| Balance at 1 January 2016 | 3,145 | 3,790 | 3,918 | 1,222 | 440 | 9,034 | 4,133 | 25,682 |
| Additions | - | 191 | 444 | 74 | 36 | 1,418 | 755 | 2,918 |
| Disposals | - | (44) | (39) | (141) | (6) | (3,858) | - | (4,088) |
| **Balance at 31 December 2016** | **3,145** | **3,937** | **4,323** | **1,155** | **470** | **6,594** | **4,888** | **24,512** |
| **Depreciation and amortisation** | | | | | | | | |
| Balance at 1 January 2016 | (540) | (1,799) | (2,230) | (782) | (147) | (1,326) | (1,070) | (7,894) |
| Depreciation and amortisation for the year | (158) | (298) | (793) | (77) | (92) | (1,088) | (454) | (2,960) |
| Disposals | - | 37 | 33 | 104 | 5 | 656 | - | 835 |
| **Balance at 31 December 2016** | **(698)** | **(2,060)** | **(2,990)** | **(755)** | **(234)** | **(1,758)** | **(1,524)** | **(10,019)** |
| **Carrying amount** | | | | | | | | |
| **At 31 December 2016** | **2,447** | **1,877** | **1,333** | **400** | **236** | **4,836** | **3,364** | **14,493** |

During 2016 the Bank revised the useful lifes of leasehold improvements in certain branches, which management expects to relocate or close down in 2 years period. As a result, the remaining useful lifes of those leasehold improvements were reduced to 2 years from 31 December 2016. The disposals in leasehold improvements were due to relocation and closure of several branches during 2016.

# 16 Property, equipment and intangible assets (continued)

| AZN'000 | Buildings | Furniture and fixtures | Computers and communication equipment | Vehicles | Other fixed assets | Leasehold imporvements | Intangible assets | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost amount** | | | | | | | | |
| Balance at 1 January 2015 | 3,105 | 3,373 | 3,330 | 1,039 | 384 | 5,399 | 2,486 | 19,116 |
| Additions | 40 | 534 | 809 | 235 | 114 | 3,635 | 1,666 | 7,033 |
| Disposals | - | (117) | (221) | (52) | (58) | - | (19) | (467) |
| **Balance at 31 December 2015** | **3,145** | **3,790** | **3,918** | **1,222** | **440** | **9,034** | **4,133** | **25,682** |
| **Depreciation and amortisation** | | | | | | | | |
| Balance at 1 January 2015 | (384) | (1,628) | (1,657) | (753) | (103) | (828) | (722) | (6,075) |
| Depreciation and amortisation for the year | (156) | (275) | (778) | (79) | (87) | (498) | (367) | (2,240) |
| Disposals | - | 104 | 205 | 50 | 43 | - | 19 | 421 |
| **Balance at 31 December 2015** | **(540)** | **(1,799)** | **(2,230)** | **(782)** | **(147)** | **(1,326)** | **(1,070)** | **(7,894)** |
| **Carrying amount** | | | | | | | | |
| **At 31 December 2015** | **2,605** | **1,991** | **1,688** | **440** | **293** | **7,708** | **3,063** | **17,788** |

# 17 Assets held for sale

During the years ended 31 December 2016 and 2015 the Bank received non-financial assets held for sale at fair value by taking possession of collateral held as security against loans to customer. As at 31 December 2016 and 2015 such assets amounted to AZN 7,211 thousand and AZN 10,194 thousand, respectively, net of impairment allowance. Initially, it was intended that fair value of these assets would be recovered principally through a sale transaction within one year from the date of classification. However, during the year ended 31 December 2016, the market conditions that existed at the date the assets were classified initially as held for sale deteriorated and as a result, the assets could not be sold within one year period. The Bank continues to actively market the assets held for sale at a price that is reasonable given the change in market conditions. Assets held for sale are comprised of the following assets:

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| Real estate | 8,194 | 8,852 |
| Other assets | 1,812 | 1,811 |
| Impairment allowance | (2,795) | (469) |
| **Balance at the end of the year** | **7,211** | **10,194** |

## Analysis of movements in the impairment

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Balance at the beginning of the year | 469 | 379 |
| Net charge | 2,353 | 90 |
| Write-offs | (27) | - |
| **Balance at the end of the year** | **2,795** | **469** |

# 18 Other assets

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| Settlements on monetary transfers | 1,709 | 633 |
| Amounts in course of settlement | 297 | 1,343 |
| Other receivables | 97 | 409 |
| Receivables from brokerage companies | - | 1,947 |
| Less: provision for impairment of other financial assets | (284) | (1,237) |
| **Total other financial assets** | **1,819** | **3,095** |
| Prepayments for purchase of intangible assets and equipment | 63 | 955 |
| Prepaid expenses | 215 | 2,363 |
| Other | 113 | 289 |
| **Total other non-financial assets** | **391** | **3,607** |
| **Total other assets** | **2,210** | **6,702** |

As at 31 December 2016, the Bank had no receivables overdue for more than one year (31 December 2015: AZN 1,132 thousand).

# 18 Other assets (continued)

### Analysis of movements in the impairment allowance

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Balance at the beginning of the year | 1,237 | 632 |
| Net charge | 205 | 605 |
| Write-offs | (1,158) | - |
| **Balance at the end of the year** | **284** | **1,237** |

# 19 Deposits and balances from banks

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| Current term placements of other banks | - | 11,032 |
| Correspondent accounts and overnight placements of other banks | 14 | 132 |
| | **14** | **11,164** |

As at 31 December 2016, the Bank had no bank (31 December 2015: three banks), whose balance exceeded 10% of total deposits and balances from banks. The gross value of this balance as at 31 December 2016 was nil (31 December 2015: AZN 11,032 thousand).

# 20 Current accounts and deposits from customers

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Current accounts and demand deposits** | | |
| - Retail | 13,419 | 18,430 |
| - Corporate | 22,933 | 25,854 |
| **Term deposits** | | |
| - Retail | 229,817 | 296,368 |
| - Corporate | 3,589 | 47,414 |
| | **269,758** | **388,066** |

As at 31 December 2016, the Bank had thirty nine customers (31 December 2015: sixty two customers), whose balances exceeded AZN 1,000 thousand. The total amount of these balances as at 31 December 2016 was AZN 125,469 thousand (31 December 2015: AZN 175,628 thousand).

As at 31 December 2016, the Bank maintained customer deposit balances of AZN 50,467 thousand (31 December 2015: AZN 28,818 thousand) that served as collateral for loans and unrecognized credit instruments granted by the Bank.

# 21 Other borrowed funds and subordinated borrowings

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Subordinated borrowings** | **36,136** | **31,483** |
| **Other borrowed funds** | | |
| Central Bank of Azerbaijan Republic | 40,523 | 62,241 |
| Azerbaijan Mortgage Fund | 39,008 | 41,155 |
| National Fund for Entrepreneurship Support of Azerbaijan Republic | 7,967 | 8,244 |
| Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture | 4,330 | 1,156 |
| **Total other borrowed funds** | **91,828** | **112,796** |
| | **127,964** | **144,279** |

### *Azerbaijan Mortgage Fund*

On 17 February 2006, the Bank signed borrowing agreement with the State Mortgage Fund of Azerbaijan Republic, a programme under the auspices of the Central Bank of Azerbaijan Republic, for granting long-term mortgage loans to individuals. Under this programme, funds are made available to the Bank at an interest rate of 1%-4% per annum and the Bank further lends these funds to eligible borrowers at rates ranging between 4.0%-8.0% per annum. There are no financial covenants with regard to borrowing from the Azerbaijan Mortgage Fund that the Bank should comply with.

### *National Fund for Entrepreneurship Support of Azerbaijan Republic*

On 26 November 2009, the Bank signed a credit agreement with the National Fund for Support to Entrepreneurship, a programme under the auspices of the Ministry for Economic Development of the Republic of Azerbaijan, for the financing of small and medium size enterprises. Under this programme, funds are made available to the Bank at an interest rate of 1.0%-2.0% per annum and the Bank further on lends these funds to eligible borrowers at rates not higher than 7.0%-8.0% per annum. There are no financial covenants with regard to the borrowing from the National Fund for Support of Entrepreneurship of the Republic of Azerbaijan that the Bank should comply with.

### *Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture*

On 30 September 2015, the Bank signed a credit agreement with the National Fund for Support to Entrepreneurship, a programme under the auspices of the Ministry for Agriculture of the Republic of Azerbaijan, for the financing of small and medium size enterprises. Under this programme, funds are made available to the Bank at an interest rate of 2.0% per annum and the Bank further on lends these funds to eligible borrowers at rates not higher than 6.0%-7.0% per annum. There are no financial covenants with regard to the borrowing from the Azerbaijan State Agency on Agricultural Credits under the Ministry of Agriculture that the Bank should comply with.

### *CBAR*

The Bank signed agreements during December 2014 – October 2015 with the CBAR to borrow funds at interest rates ranging between 3.2%-3.5% per annum and maturing during August 2017 – September 2018. The principal amount on the issued loans is repayable upon maturity and the interest is repayable on quarterly basis starting from the origination date. There are no financial covenants with regard to borrowing from CBAR that the Bank should comply with.

### *Subordinated borrowings*

As at 31 December 2016, subordinated borrowings included deposits placed by related parties and other entity in the amount AZN 36,136 thousand (31 December 2015: AZN 31,483 thousand) maturing in 2020-2023 (31 December 2015: 2020) and carried annual interest rates of 8%-12% (31 December 2015: 12%). In case of bankruptcy, the repayment of the subordinated borrowings will be made after repayment in full of all other liabilities of the Bank.

# 22 Other liabilities

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| Settlement on other operations | 853 | 1,710 |
| Accrued expenses | 59 | 64 |
| **Total other financial liabilities** | **912** | **1,774** |
| Other taxes payable | 675 | 77 |
| Other non-financial liabilities | 34 | 17 |
| **Total other non-financial liabilities** | **709** | **94** |
| **Total other liabilities** | **1,621** | **1,868** |

# 23 Share capital and reserves

## (a) Issued capital

The authorised, issued and outstanding share capital comprises 92,250,000 ordinary shares (2015: 17,250,000). All shares have a nominal value of AZN 2 per share. During the year ended 31 December 2016, 75,000,000 ordinary shares were issued for cash (2015: no share issue).

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Bank.

## (b) Dividends

Dividends payable are restricted to the maximum retained earnings of the Bank, which are determined according to legislation of the Azerbaijan Republic. Bank are not allowed to pay dividends if net assets are less than Share Capital. There were no dividends declared by the Bank during 2016 (2015: nil).

# 24 Loss per share

## Basic and diluted loss per share

The calculation of basic loss per share as at 31 December 2016 is based on the loss attributable to ordinary shareholders of AZN 152,791 thousand (2015: AZN 23,589 thousand), and a weighted average number of ordinary shares outstanding of 36,250,000 (2015: 17,250,000) calculated as follows.

| | 2016 | 2015 |
|---|---|---|
| Net loss attributable to ordinary shareholders (AZN'000) | (152,791) | (23,589) |
| Weighted average number of ordinary shares for the year ended 31 December (thousands of shares) | 36,250 | 17,250 |
| **Basic and diluted loss per share (AZN)** | **(4.21)** | **(1.37)** |

# 25 Analysis by segment

The Bank has one reportable segment and one strategic business unit which includes loans, deposits and other transactions with customers.

The majority of income from external customers relate to residents of the Republic of Azerbaijan.

The majority of non-current assets are located in the Republic of Azerbaijan.

# 26 Risk management, corporate governance and internal control

Management of risk is fundamental to the business of banking and is an essential element of the Bank’s operations. The major risks faced by the Bank are those related to market risk, credit risk and liquidity risk.

## (a) Corporate governance framework

The Bank is established as an open joint stock company in accordance with Azerbaijani law. The supreme governing body of the Bank is the General Shareholders’ meeting that is called for annual or extraordinary meetings. The General Shareholders’ meeting makes strategic decisions on the Bank’s operations.

The General Shareholders’ meeting elects the Supervisory Board. The Supervisory Board is responsible for overall governance of the Bank's activities.

## Corporate governance framework

Azerbaijani legislation and the charter of the Bank establish lists of decisions that are exclusively approved by the general shareholders’ meeting and that are approved by the Supervisory Board.

As at 31 December 2016 the Supervisory Board included:

Marina Kulishova – Chairman of the Supervisory Board

Ivan Romanovsky – Member of the Supervisory Board

Alexey Sazonov – Member of the Supervisory Board

Roman Novikov – Member of the Supervisory Board

Pavel Sukhoruchkin – Member of the Supervisory Board

During the year ended 31 December 2016, the following changes occurred in composition of the Supervisory Board:

| | |
|---|---|
| Resignation of Ilgar Muslimov as Member of the Supervisory Board | 31 August 2016 |
| Resignation of Sergey Mitirev as Member of the Suprvisory Board | 31 August 2016 |
| Resignation of Ivan Romanovski as Member of the Supervisory Board | 31 August 2016 |
| Appointment of Roman Novikov as Member of the Supervisory Board | 31 August 2016 |
| Resignation of Iskandar Khalilov as Chairman of the Supervisory Board | 5 October 2016 |
| Appointment of Marina Kulishova as Chairman of the Supervisory Board | 5 October 2016 |
| Appointment of Ivan Romanovsky as Member of the Supervisory Board | 5 October 2016 |

General activities of the Bank are managed by the collective executive body of the Bank. The General Shareholders’ meeting elects the Management Board. The executive body of the Bank is responsible for implementation of decisions of the General Shareholders’ meeting and the Supervisory Board of the Bank. Executive body of the Bank reports to the Supervisory Board of the Bank and to the general shareholders’ meeting.

As at 31 December 2016 the Management Board included:

Nikoloz Shurgaia – Chairman of the Management Board

Hajinski Farhad – First Deputy Chairman of the Management Board

Tagiyev Fuad – Deputy Chairman of the Management Board

# 26 Risk management, corporate governance and internal control (continued)

During the year ended 31 December 2016 the following changes occurred in composition of the Management Board:

| | |
|---|---|
| Resignation of Aleksey Chernin as Member of the Management Board | 17 February 2016 |
| Resignation of Zaur Abiyev as Member of the Management Board | 17 February 2016 |
| Resignation of Khamaza Vasiliy as Chairman of the Management Board | 21 July 2016 |
| Resignation of Savelyev Sergey as Member of the Management Board | 21 July 2016 |
| Resignation of Fazil Huseynov as Member of the Management Board | 21 July 2016 |
| Appointment of Nikoloz Shurgaia as Chairman of the Management Board | 21 July 2016 |
| Appointment of Hajinski Farhad as Member of the Management Board | 21 July 2016 |
| Resignation of Emil Mammadov as Member of the Management Board | 5 October 2016 |

## (b) Internal control policies and procedures

The Supervisory Board and the Management Board have responsibility for the development, implementation and maintaining of internal controls in the Bank that are commensurate with the scale and nature of operations.

The purpose of internal controls is to ensure:

- proper and comprehensive risk assessment and management
- proper business and accounting and financial reporting functions, including proper authorization, processing and recording of transactions
- completeness, accuracy and timeliness of accounting records, managerial information, regulatory reports, etc.
- reliability of IT-systems, data and systems integrity and protection
- prevention of fraudulent or illegal activities, including misappropriation of assets
- compliance with laws and regulations

Management is responsible for identifying and assessing risks, designing controls and monitoring their effectiveness. Management monitors the effectiveness of the Bank's internal controls and periodically implements additional controls or modifies existing controls as considered necessary.

The Bank developed a system of standards, policies and procedures to ensure effective operations and compliance with relevant legal and regulatory requirements, including the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the recording, reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards and
- risk mitigation, including insurance where this is effective.

There is a hierarchy of requirements for authorization of transactions depending on their size and complexity. A significant portion of operations are automated and the Bank put in place a system of automated controls.

# 26 Risk management, corporate governance and internal control (continued)

The main functions of internal audit service include the following:

- audit and efficiency assessment of the system of internal control as a whole, fulfillment of the decisions of key management structures
- audit of efficiency of methodology of assessment of banking risks and risk management procedures, regulated by internal documents in credit organisation (methods, programs, rules and procedures for banking operations and transactions, and for the management of banking risks)
- audit of reliability of internal control system over automated information systems
- audit and testing of fairness, completeness and timeliness of accounting and reporting function and the reliability (including the trustworthiness, fullness and objectivity) of the collection and submission of financial information
- audit of applicable methods of safekeeping the credit organisation's property
- assessment of economic reasonability and efficiency of operations and other deals
- audit of internal control processes and procedures
- audit of internal control service and risk management service.

Compliance with the Bank's standards is supported by a program of periodic reviews undertaken by Internal Audit. The Internal Audit function is independent from management and reports directly to the Audit Committee and Supervisory Board. The results of Internal Audit reviews are discussed with relevant business process managers, with summaries submitted to the Audit Committee and Supervisory Board and senior management of the Bank.

The internal control system in the Bank comprises:

- the Supervisory Board and its committees,
- the Management Board
- the Finance Director
- the risk management function
- the security function, including IT-security
- the human resource function
- the internal audit service
- the internal control (compliance) service
- other employees, division and functions that are responsible for compliance with the established standards, policies and procedures, including:
  - heads of branches and heads of business-units
  - business processes managers
  - division responsible for compliance with anti-money laundering requirements
  - professional securities market participant controller – an executive office responsible for compliance with the requirements for securities market participants
  - the legal officer – an employee responsible for compliance with the legal and regulatory requirements
  - other employees with control responsibilities

The Bank complies with the FIMSA requirements related to risk management and internal control systems, including requirements related to the internal audit function, and that risk management and internal control systems are appropriate for the scale, nature and complexity of operations.

# 26 Risk management, corporate governance and internal control (continued)

## (c) Risk management policies and procedures

Management of risk is fundamental to the business of banking and forms an essential element of the Bank’s operations. The major risks faced by the Bank are those related to market risk, credit risk, liquidity risk and operational risks.

The risk management policies aim to identify, analyse and manage the risks faced by the Bank, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice.

The Supervisory Board has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures as well as approving significantly large exposures.

The Management Board is responsible for monitoring and implementing risk mitigation measures, and ensuring that the Bank operates within established risk parameters. The Head of the Risk Department is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to the CEO and indirectly to the Supervisory Board.

Credit, market and liquidity risks both at the portfolio and transactional levels are managed and controlled through a system of Risk Management Committee, Credit Committees and an Asset and Liability Management Committee (ALCO). In order to facilitate efficient and effective decision-making, the Bank established a hierarchy of credit committees depending on the type and amount of the exposure

Overall authority for market risk is vested in the ALCO, which is chaired by the Chairman of the Management Board.

Both external and internal risk factors are identified and managed throughout the organisation. Particular attention is given to identifying the full range of risk factors and determination of the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Department monitors financial and non-financial risks by holding regular meetings with operational units in order to obtain expert judgments in their areas of expertise.

## (d) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimizing the return on risk.

Market risk limits are approved by ALCO based on recommendations of the Risk Department.

The Bank manages its market risk by setting open position limits in relation to financial instruments, interest rate maturity and currency positions and stop-loss limits. These are monitored on a regular basis and reviewed and approved by the Supervisory Board.

### *(i) Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may also reduce or create losses in the event that unexpected movements occur.

# 26 Risk management, corporate governance and internal control (continued)

### *Interest rate gap analysis*

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments is as follows:

| AZN '000 | Less than 1 month | 1-3 months | 3-12 months | 1-5 years | More than 5 years | Non-interest bearing | Carrying amount |
|---|---|---|---|---|---|---|---|
| **31 December 2016** | | | | | | | |
| **ASSETS** | | | | | | | |
| Cash and cash equivalents | - | - | - | - | - | 64,473 | 64,473 |
| Available-for-sale financial assets | - | - | - | 925 | - | 1,065 | 1,990 |
| Due from banks | 3,735 | 1,610 | 2,416 | 45,188 | - | 2,389 | 55,338 |
| Loans to customers | 15,915 | 20,347 | 37,520 | 122,725 | 75,154 | - | 271,661 |
| Other financial assets | - | - | - | - | - | 1,819 | 1,819 |
| | **19,650** | **21,957** | **39,936** | **168,838** | **75,154** | **69,746** | **395,281** |
| **LIABILITIES** | | | | | | | |
| Deposits and balances from banks | - | - | - | - | - | 14 | 14 |
| Current accounts and deposits from customers | 17,836 | 37,790 | 112,965 | 64,796 | 19 | 36,352 | 269,758 |
| Other borrowed funds | 598 | 997 | 12,281 | 44,691 | 33,261 | - | 91,828 |
| Other financial liabilities | - | - | - | - | - | 912 | 912 |
| Subordinated borrowings | - | - | 1,378 | 8,197 | 26,561 | - | 36,136 |
| | **18,434** | **38,787** | **126,624** | **117,684** | **59,841** | **37,278** | **398,648** |
| | **1,216** | **(16,830)** | **(86,688)** | **51,154** | **15,313** | **32,468** | **(3,367)** |

| AZN '000 | Less than 1 month | 1-3 months | 3-12 months | 1-5 years | More than 5 years | Non-interest bearing | Carrying amount |
|---|---|---|---|---|---|---|---|
| **31 December 2015** | | | | | | | |
| **ASSETS** | | | | | | | |
| Cash and cash equivalents | - | - | - | - | - | 27,477 | 27,477 |
| Available-for-sale financial assets | - | - | 5,078 | - | - | 1,111 | 6,189 |
| Due from banks | 757 | 18,831 | 23,160 | 68,642 | - | 1,765 | 113,155 |
| Loans to customers | 22,636 | 19,452 | 75,849 | 222,146 | 42,676 | - | 382,759 |
| Other financial assets | - | - | - | - | - | 3,095 | 3,095 |
| | **23,393** | **38,283** | **104,087** | **290,788** | **42,676** | **33,448** | **532,675** |
| **LIABILITIES** | | | | | | | |
| Deposits and balances from banks | - | 7,797 | 3,119 | - | - | 248 | 11,164 |
| Current accounts and deposits from customers | 15,590 | 51,648 | 180,734 | 95,691 | 25 | 44,378 | 388,066 |
| Debt securities in issue | - | 15 | 3,150 | - | - | - | 3,165 |
| Other borrowed funds | 562 | 5,933 | 20,737 | 51,615 | 33,949 | - | 112,796 |
| Other financial liabilities | - | - | - | - | - | 1,774 | 1,774 |
| Subordinated borrowings | - | - | 634 | 7,458 | 23,391 | - | 31,483 |
| | **16,152** | **65,393** | **208,374** | **154,764** | **57,365** | **46,400** | **548,448** |
| | **7,241** | **(27,110)** | **(104,287)** | **136,024** | **(14,689)** | **(12,952)** | **(15,773)** |

# 26 Risk management, corporate governance and internal control (continued)

***Average effective interest rates***

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2016 and 2015. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

| | 2016 Average effective interest rate, % | | | 2015 Average effective interest rate, % | | |
|---|---|---|---|---|---|---|
| | **AZN** | **USD** | **EUR** | **AZN** | **USD** | **EUR** |
| **Interest bearing assets** | | | | | | |
| Available-for-sale financial assets | - | 5.00% | - | 11.00% | - | - |
| Due from banks | - | 2.00% | - | - | 7.00% | - |
| Loans to customers | 13.77% | 16.16% | 22.11% | 17.91% | 20.45% | 12.36% |
| **Interest bearing liabilities** | | | | | | |
| Deposits and balances from banks | - | - | - | - | 8.64% | - |
| Debt securities in issue | - | - | - | - | 9.50% | - |
| Current accounts and deposits from customers | 13.61% | 6.77% | 6.21% | 10.68% | 10.20% | 7.51% |
| Other borrowed funds | 2.95% | - | - | 3.15% | - | - |
| Subordinated borrowings | 8.00% | 9.38% | - | 12.00% | 12.00% | - |

***Interest rate sensitivity analysis***

The management of interest rate risk based on interest rate gap analysis, is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of net profit or loss and equity (net of taxes) to changes in interest rates (repricing risk), based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2016 and 2015 is as follows:

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| 100 bp parallel fall | 438 | 525 |
| 100 bp parallel rise | (438) | (525) |

## *(ii) Currency risk*

The Bank has assets and liabilities denominated in several foreign currencies.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. Although the Bank hedges its exposure to currency risk, such activities do not qualify as hedging relationships in accordance with IFRS.

# 26 Risk management, corporate governance and internal control (continued)

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2016:

| | AZN AZN'000 | USD AZN'000 | EUR AZN'000 | Other currencies AZN'000 | Total AZN'000 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | 16,266 | 42,086 | 5,196 | 925 | 64,473 |
| Available-for-sale financial assets | 1,065 | 925 | - | - | 1,990 |
| Due from banks | 235 | 55,103 | - | - | 55,338 |
| Loans to customers | 155,113 | 116,094 | 454 | - | 271,661 |
| Other financial assets | 1,009 | 618 | 10 | 182 | 1,819 |
| **Total financial assets** | **173,688** | **214,826** | **5,660** | **1,107** | **395,281** |
| **LIABILITIES** | | | | | |
| Deposits and balances from banks | 14 | - | - | - | 14 |
| Current accounts and deposits from customers | 55,455 | 208,242 | 6,024 | 37 | 269,758 |
| Other borrowed funds | 91,828 | - | - | - | 91,828 |
| Other financial liabilities | 437 | 390 | 80 | 5 | 912 |
| Subordinated borrowings | 2,008 | 34,128 | - | - | 36,136 |
| **Total financial liabilities** | **149,742** | **242,760** | **6,104** | **42** | **398,648** |
| **Net position** | **23,946** | **(27,934)** | **(444)** | **1,065** | |

The following table shows the currency structure of financial assets and liabilities as at 31 December 2015:

| | AZN AZN'000 | USD AZN'000 | EUR AZN'000 | Other currencies AZN'000 | Total AZN'000 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | 7,913 | 19,080 | 160 | 324 | 27,477 |
| Available-for-sale financial assets | 6,189 | - | - | - | 6,189 |
| Due from banks | 261 | 112,894 | - | - | 113,155 |
| Loans to customers | 175,120 | 199,454 | 8,185 | - | 382,759 |
| Other financial assets | 379 | 2,651 | 10 | 55 | 3,095 |
| **Total financial assets** | **189,862** | **334,079** | **8,355** | **379** | **532,675** |
| **LIABILITIES** | | | | | |
| Deposits and balances from banks | 3 | 11,115 | 44 | 2 | 11,164 |
| Current accounts and deposits from customers | 50,043 | 329,120 | 8,862 | 41 | 388,066 |
| Debt securities in issue | - | 3,165 | - | - | 3,165 |
| Other borrowed funds | 112,796 | - | - | - | 112,796 |
| Other financial liabilities | 568 | 1,140 | 65 | 1 | 1,774 |
| Subordinated borrowings | 2,058 | 29,425 | - | - | 31,483 |
| **Total financial liabilities** | **165,468** | **373,965** | **8,971** | **44** | **548,448** |
| **Net position** | **24,394** | **(39,886)** | **(616)** | **335** | |

# 26 Risk management, corporate governance and internal control (continued)

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2016 and 2015, would have decreased equity and profit or loss by the amounts shown below. This analysis is on net of tax basis and is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| 50% appreciation of USD against AZN | (13,967) | (15,954) |
| 50% appreciation of EUR against AZN | (222) | (246) |

A strengthening of the AZN against the above currencies at 31 December 2016 and 2015 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

## (e) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Bank has policies and procedures for the management of credit exposures (both for recognised financial assets and unrecognised contractual commitments), including guidelines to limit portfolio concentration and the establishment of a Credit Committee, which actively monitors credit risk. The credit policy is reviewed and approved by the Management Board.

The credit policy establishes:

- procedures for review and approval of loan credit applications;
- methodology for the credit assessment of borrowers (corporate and individual);
- methodology for the credit assessment of counterparties, issuers and insurance companies;
- methodology for the evaluation of collateral;
- credit documentation requirements;
- procedures for the ongoing monitoring of loans and other credit exposures.

Corporate loan credit applications are originated by the relevant client managers and are then passed on to the Loan Department, which is responsible for the corporate loan portfolio. Analysis reports are based on a structured analysis focusing on the customer's business and financial performance. The loan credit application and the report are then independently reviewed by the Risk Management Department and a second opinion is given accompanied by a verification that credit policy requirements are met. The Credit Committee reviews the loan credit application on the basis of submissions by the Loan Department and the Risk Department. Individual transactions are also reviewed by the Legal, Accounting and Tax departments depending on the specific risks and pending final approval of the Credit Committee.

The Bank continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Bank. Retail loan credit applications are reviewed by the Retail Lending Department through the use of scoring models and application data verification procedures developed together with the Risk Management Department.

Apart from individual customer analysis, the credit portfolio is assessed by the Risk Management Department with regard to credit concentration and market risks.

The maximum exposure to credit risk is generally reflected in the carrying amounts of financial assets in the statement of financial position and unrecognised contractual commitment amounts. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

# 26 Risk management, corporate governance and internal control (continued)

The maximum exposure to credit risk from financial assets at the reporting date is as follows:

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents (excluding cash on hand) | 55,755 | 15,212 |
| Available-for-sale financial assets (excluding equity securities) | 925 | 5,124 |
| Due from banks | 55,338 | 113,155 |
| Loans to customers | 271,661 | 382,759 |
| Other financial assets | 1,819 | 3,095 |
| **Total maximum exposure** | **385,498** | **519,345** |

Collateral generally is not held against claims under derivative financial instruments, investments in securities, and loans to banks, except when securities are held as part of reverse repurchase and securities borrowing activities. For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers refer to Note 15.

The maximum exposure to credit risk from unrecognised contractual commitments at the reporting date is presented in Note 28.

As at 31 December 2016, the Bank had one group of connected debtors (31 December 2015: nil), with gross credit risk exposure of AZN 68,239 thousand and exceeding 10% of maximum credit risk exposure.

## (f) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Supervisory Board.

The Bank seeks to actively support a diversified and stable funding base comprising debt securities in issue, long-term and short-term loans from other banks, core corporate and retail customer deposits, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements. The liquidity management policy requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;
- maintaining debt financing plans;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;
- monitoring liquidity ratios against regulatory requirements.

The Treasury Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury Department then provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term liquid trading securities, loans to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

# 26 Risk management, corporate governance and internal control (continued)

The daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury Department. Under the normal market conditions, liquidity reports covering the liquidity position are presented to senior management on a weekly basis. Decisions on liquidity management are made by ALCO and implemented by the Treasury Department.

The following tables show the undiscounted cash flows on financial assets, liabilities and credit-related commitments on the basis of their earliest possible contractual maturity. The total gross outflow disclosed in the tables is the contractual, undiscounted cash flow on the financial liability or credit related commitment. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee can be called.

The maturity analysis for financial liabilities as at 31 December 2016 is as follows:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | Total gross amount outflow | Carrying amount |
|---|---|---|---|---|---|---|---|
| **Non-derivative liabilities** | | | | | | | |
| Deposits and balances from banks | 14 | - | - | - | - | 14 | 14 |
| Current accounts and deposits from customers | 53,296 | 40,917 | 121,369 | 69,191 | 39 | 284,812 | 269,758 |
| Other borrowed funds | 691 | 1,315 | 13,489 | 49,100 | 40,843 | 105,438 | 91,828 |
| Other financial liabilities | 912 | - | - | - | - | 912 | 912 |
| Subordinated borrowings | - | - | 4,159 | 18,296 | 30,633 | 53,088 | 36,136 |
| **Total financial liabilities** | **54,913** | **42,232** | **139,017** | **136,587** | **71,515** | **444,264** | **398,648** |
| **Credit related commitments** | **2,199** | **17,089** | **42,517** | **26,368** | **446** | **88,619** | **88,619** |

The maturity analysis for financial liabilities as at 31 December 2015 is as follows:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | Total gross amount outflow | Carrying amount |
|---|---|---|---|---|---|---|---|
| **Non-derivative liabilities** | | | | | | | |
| Deposits and balances from banks | 213 | 8,029 | 3,153 | - | - | 11,395 | 11,164 |
| Current accounts and deposits from customers | 56,525 | 57,505 | 198,498 | 104,782 | 50 | 417,360 | 388,066 |
| Debt securities in issue | - | 54 | 3,270 | - | - | 3,324 | 3,165 |
| Other borrowed funds | 676 | 6,383 | 22,333 | 57,359 | 43,382 | 130,133 | 112,796 |
| Other financial liabilities | 1,774 | - | - | - | - | 1,774 | 1,774 |
| Subordinated borrowings | - | - | 2,530 | 15,040 | 27,339 | 44,909 | 31,483 |
| **Total financial liabilities** | **59,188** | **71,971** | **229,784** | **177,181** | **70,771** | **608,895** | **548,448** |
| **Credit related commitments** | **4,763** | **4,455** | **20,016** | **20,407** | **-** | **49,641** | **49,642** |

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, forfeiting in most of the cases the accrued interest. These deposits are classified in accordance with their stated maturity dates in the above undiscounted maturity tables. The Management of the Bank does not expect that individuals and legal entities withdraw their term deposits before their stated maturity dates. Also the Bank developed a  liquidity model to manage its liquidity.

# 26 Risk management, corporate governance and internal control (continued)

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2016:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | No maturity | Overdue | Total |
|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 64,473 | - | - | - | - | - | - | 64,473 |
| Available-for-sale financial assets | 10 | - | - | 915 | - | 1,065 | - | 1,990 |
| Due from banks | 3,734 | 1,610 | 2,416 | 45,189 | - | 2,389 | - | 55,338 |
| Loans to customers | 15,915 | 20,347 | 37,520 | 77,346 | 75,154 | - | 45,379 | 271,661 |
| Other financial assets | 1,819 | - | - | - | - | - | - | 1,819 |
| **Total financial assets** | **85,951** | **21,957** | **39,936** | **123,450** | **75,154** | **3,454** | **45,379** | **395,281** |
| | | | | | | | | |
| Deposits and balances from banks | 14 | - | - | - | - | - | - | 14 |
| Current accounts and deposits from customers | 52,043 | 38,405 | 113,925 | 65,355 | 30 | - | - | 269,758 |
| Other borrowed funds | 598 | 997 | 12,281 | 44,691 | 33,261 | - | - | 91,828 |
| Other financial liabilities | 912 | - | - | - | - | - | - | 912 |
| Subordinated borrowings | - | - | 1,378 | 8,197 | 26,561 | - | - | 36,136 |
| **Total financial liabilities** | **53,567** | **39,402** | **127,584** | **118,243** | **59,852** | **-** | **-** | **398,648** |
| **Net position** | **32,384** | **(17,445)** | **(87,648)** | **5,207** | **15,302** | **3,454** | **45,379** | **(3,367)** |
| **Cumulative liquidity gap** | **32,384** | **14,939** | **(72,709)** | **(67,502)** | **(52,200)** | | | |

# 26 Risk management, corporate governance and internal control (continued)

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2015:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | No maturity | Overdue | Total |
|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 27,477 | - | - | - | - | - | - | 27,477 |
| Available-for-sale financial assets | - | 46 | - | 5,078 | - | 1,065 | - | 6,189 |
| Due from banks | 767 | 18,831 | 23,160 | 68,642 | - | 1,755 | - | 113,155 |
| Loans to customers | 22,636 | 19,452 | 75,849 | 153,883 | 42,676 | - | 68,263 | 382,759 |
| Other financial assets | 3,095 | - | - | - | - | - | - | 3,095 |
| **Total financial assets** | **53,975** | **38,329** | **99,009** | **227,603** | **42,676** | **2,820** | **68,263** | **532,675** |
| | | | | | | | | |
| Deposits and balances from banks | 2 | 7,895 | 3,134 | - | - | 133 | - | 11,164 |
| Current accounts and deposits from customers | 55,175 | 52,376 | 184,047 | 96,433 | 35 | - | - | 388,066 |
| Debt securities in issue | - | 15 | 3,150 | - | - | - | - | 3,165 |
| Other borrowed funds | 562 | 5,933 | 20,737 | 51,615 | 33,949 | - | - | 112,796 |
| Other financial liabilities | 1,774 | - | - | - | - | - | - | 1,774 |
| Subordinated borrowings | - | - | 634 | 7,458 | 23,391 | - | - | 31,483 |
| **Total financial liabilities** | **57,513** | **66,219** | **211,702** | **155,506** | **57,375** | **133** | **-** | **548,448** |
| **Net position** | **(3,538)** | **(27,890)** | **(112,693)** | **72,097** | **(14,699)** | **2,687** | **68,263** | **(15,773)** |
| **Cumulative liquidity gap** | **(3,538)** | **(31,428)** | **(144,121)** | **(72,024)** | **(86,723)** | | | |

# 26 Risk management, corporate governance and internal control (continued)

The key measure used by the Bank for managing liquidity risk is the liquidity ratio stipulated by the FIMSA.

The Bank calculates this mandatory liquidity ratio on a daily basis in accordance with the requirement of the FIMSA. This ratio is represented by the instant liquidity ratio, which is calculated as the ratio of highly liquid assets to liabilities payable on demand.

The Bank was in compliance with these ratios as at 31 December 2016 and 2015. The following table shows the mandatory liquidity ratios calculated as at 31 December 2016 and 2015.

| | Requirement | 2016, % | 2015, % |
|---|---|---|---|
| **Instant liquidity ratio** | Not less than 30% | 165.45% | 49.75% |

## (g) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Bank's operations.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and innovation. In all cases, the Bank policy requires compliance with all applicable legal and regulatory requirements.

The Bank manages operational risk by establishing internal controls that management determines to be necessary in each area of its operations.

# 27 Capital management

The FIMSA sets and monitors capital requirements for the Bank.

The Bank defines as capital those items defined by statutory regulation as capital for credit institutions. Under the current capital requirements set by the FIMSA, banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level. As at 31 December 2016, this minimum level was 10% (31 December 2015: 10%). The Bank was in compliance with the statutory capital ratio as at 31 December 2016 and 2015.

The Bank maintains capital adequacy at the level appropriate to the nature and volume of its operations.

The Bank provides the FIMSA with information on mandatory ratios in accordance with set form. Risk department controls on a daily basis compliance with capital adequacy ratios.

In case values of capital adequacy ratios become close to set limits set by the FIMSA and Bank's internal policy this information is communicated to the Supervisory Board.

The calculation of capital adequacy based on requirements set by the FIMSA were as follows:

| | 31 December 2016 AZN'000 (unaudited) | 31 December 2015 AZN'000 (unaudited) |
|---|---|---|
| Total statutory capital | 52,280 | 52,306 |
| Risk-weighted assets | 362,394 | 471,291 |
| **Capital adequacy ratio (%)** | **14%** | **11%** |

# 27 Capital management (continued)

### Reconciliation of total statutory capital to IFRS equity

The table below provides an overview of the differences in composition of the net assets as at 31 December 2016 presented in the Bank`s financial statements prepared under IFRS and total statutory capital determined under the rules and regulations of the FIMSA.

| | 31 December 2016 AZN'000 (unaudited) | 31 December 2015 AZN'000 (unaudited) |
|---|---|---|
| **Total statutory capital** | **52,280** | **52,306** |
| Differences between regulatory capital and IFRS net assets: | | |
| - share premium | (484) | (379) |
| - retained earnings | (18,752) | (14,501) |
| - loan impairment allowance | 1,501 | (20,595) |
| - interest income | (19,347) | - |
| - administrative expenses | (980) | - |
| - income tax expense | 39 | 5,532 |
| - other differences | 35 | 562 |
| - differences arising from deductions for statutory calculation | 4,805 | 4,369 |
| - intangible assets | 3,499 | 3,063 |
| - deferred tax assets | 1,306 | 1,306 |
| - statutory general allowance for impairment | (2,707) | (4,428) |
| - available subordinated debt for regulatory calculations | (16,525) | (15,959) |
| **Total IFRS equity** | **18,617** | **21,408** |

# 28 Credit related commitments

The Bank has outstanding credit related commitments to extend loans. These credit related commitments take the form of approved loans and credit card limits and overdraft facilities.

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years. The Bank also provides guarantees by acting as settlement agent in securities borrowing and lending transactions.

The Bank applies the same credit risk management policies and procedures when granting credit commitments, financial guarantees and letters of credit as it does for granting loans to customers.

The contractual amounts of credit related commitments are set out in the following table by category. The amounts reflected in the table for credit related commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum accounting loss that would be recognised at the reporting date if counterparties failed completely to perform as contracted.

| | 31 December 2016 AZN'000 | 31 December 2015 AZN'000 |
|---|---|---|
| **Contracted amount** | | |
| Guarantees | 74,695 | 21,002 |
| Undrawn credit lines | 13,924 | 28,640 |
| | **88,619** | **49,642** |

The total outstanding contractual credit related commitments above do not necessarily represent future cash requirements, as these credit related commitments may expire or terminate without being funded. The majority of loan and credit line commitments do not represent an unconditional credit related commitment by the Bank.

# 29 Operating leases

## Leases as lessee

The Bank leases a number of premises under operating leases. The leases typically run for an initial period of one to ten years, with an option to renew the lease after that date. None of the leases includes contingent rentals. The Bank does not have any non-cancellable leases.

# 30 Contingencies

## (a) Insurance

The insurance industry in the Republic of Azerbaijan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Bank does not have full coverage for its premises and equipment, business interruption, or third party liability in respect of property or environmental damage arising from accidents on its property or relating to operations. Until the Bank obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on operations and financial position.

The Bank has obtained an international comprehensive banking risk insurance policy ("BBB" – Bankers Blanket Bond) covering professional activities and crimes, including electronic and computer crimes.

## (b) Litigation

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations.

# 30 Contingencies (continued)

## (c) Taxation contingencies

The taxation system in Azerbaijan is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by various levels of authorities, which have the authority to impose severe fines and interest charges. A tax year generally remains open for review by the tax authorities for three subsequent calendar years; however, under certain circumstances a tax year may remain open longer.

These circumstances may create tax risks in the Azerbaijan Republic that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Azerbaijani tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on the financial position, if the authorities were successful in enforcing their interpretations, could be significant.

# 31 Related party transactions

## (a) Control relationships

The Bank's parent company is "Topaz Investment Limited" LLC . The Bank is controlled by Mr. V. Alekperov.

## (b) Transactions with the members of the Supervisory Board and the Management Board

Total remuneration included in personnel expenses for the years ended 31 December 2016 and 2015 is as follows:

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| Short term employee benefits | 927 | 796 |
| | **927** | **796** |

These amounts include cash benefits in respect of the members of the Supervisory Board and the Management Board.

The outstanding balances and average effective interest rates as at 31 December 2016 and 2015 for transactions with the members of the Supervisory Board and the Management Board are as follows:

| | 2016 AZN'000 | Average effective interest rate | 2015 AZN'000 | Average effective interest rate |
|---|---|---|---|---|
| **Statement of financial position** | | | | |
| Loans issued (gross) | 565 | 10% | 799 | 12% |
| Loan impairment allowance | (339) | | (12) | |
| Customer accounts | 322 | 13% | 6,216 | 11% |
| Commitments on loans and undrawn credit lines | 98 | 10% | 423 | 12% |

# 31 Related party transactions (continued)

Amounts included in profit or loss in relation to transactions with the members of the Supervisory Board and the Management Board for the year ended 31 December are as follows:

| | 2016 AZN'000 | 2015 AZN'000 |
|---|---|---|
| **Profit or loss** | | |
| Interest income | 155 | 91 |
| Interest expense | (30) | (540) |
| Impairment losses | (327) | (6) |

## (c) Transactions with other related parties

The outstanding balances and the related average effective interest rates as at 31 December 2016 and related profit or loss amounts of transactions for the year ended 31 December 2016 with other related parties are as follows:

| | Ultimate controlling party | | Shareholders | | Other related parties | | Total |
|---|---|---|---|---|---|---|---|
| | AZN'000 | Average interest rate, % | AZN'000 | Average interest rate, % | AZN'000 | Average interest rate, % | AZN'000 |
| **Statement of financial position** | | | | | | | |
| **ASSETS** | | | | | | | |
| Gross loans to customers | - | - | - | - | 1,917 | - | 1,917 |
| Impairment allowance | - | - | - | - | (38) | - | (38) |
| **LIABILITIES** | | | | | | | |
| Customer accounts | 4,787 | 13% | 2,402 | - | 7,938 | - | 15,127 |
| Subordinated borrowings | - | - | 2,285 | 8% | 33,640 | 10% | 35,925 |
| Commitments on loans | - | - | - | - | 268 | - | 268 |
| **Profit (loss)** | | | | | | | |
| Interest expense | (615) | | (181) | | (3,052) | | (3,848) |

The outstanding balances and the related average effective interest rates as at 31 December 2015 and related profit or loss amounts of transactions for the year ended 31 December 2015 with other related parties are as follows:

| | Ultimate controlling party | | Shareholders | | Other related parties | | Total |
|---|---|---|---|---|---|---|---|
| | AZN'000 | Average interest rate, % | AZN'000 | Average interest rate, % | AZN'000 | Average interest rate, % | AZN'000 |
| **Statement of financial position** | | | | | | | |
| **LIABILITIES** | | | | | | | |
| Customer accounts | - | - | 249 | - | 4,263 | - | 9,098 |
| Subordinated borrowings | 4,586 | 13% | 2,058 | 12% | 29,425 | 12% | 31,483 |
| **Profit (loss)** | | | | | | | |
| Interest expense | (590) | | (247) | | (2,053) | | (2,300) |

The majority of balances resulting from transactions with related parties mature within two years. Transactions with related parties are not secured.

# 32 Financial assets and liabilities: fair values and accounting classifications

## (a) Accounting classifications and fair values

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2016:

| AZN ’000 | Loans and receivables | Available-for-sale | Other amortised cost | Total carrying amount | Fair value |
|---|---|---|---|---|---|
| Cash and cash equivalents | 64,473 | - | - | 64,473 | 64,473 |
| Available-for-sale financial assets | - | 1,990 | - | 1,990 | 1,990 |
| Due from banks | 55,338 | - | - | 55,338 | 55,394 |
| Loans to customers | 271,661 | - | - | 271,661 | 255,202 |
| Other financial assets | 1,819 | - | - | 1,819 | 1,819 |
| | **393,291** | **1,990** | **-** | **395,281** | **378,878** |
| Deposits and balances from banks | - | - | 14 | 14 | 14 |
| Current accounts and deposits from customers | - | - | 269,758 | 269,758 | 270,696 |
| Other borrowed funds | - | - | 91,828 | 91,828 | 91,828 |
| Other financial liabilities | - | - | 1,774 | 1,774 | 912 |
| Subordinated borrowings | - | - | 36,136 | 36,136 | 32,555 |
| | **-** | **-** | **399,510** | **399,510** | **396,005** |

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2015:

| AZN ’000 | Loans and receivables | Available-for-sale | Other amortised cost | Total carrying amount | Fair value |
|---|---|---|---|---|---|
| Cash and cash equivalents | 27,477 | - | - | 27,477 | 27,477 |
| Available-for-sale financial assets | - | 6,189 | - | 6,189 | 6,189 |
| Due from banks | 113,155 | - | - | 113,155 | 113,155 |
| Loans to customers | 382,759 | - | - | 382,759 | 316,330 |
| Other financial assets | 3,095 | - | - | 3,095 | 3,095 |
| | **526,486** | **6,189** | **-** | **532,675** | **466,246** |
| Deposits and balances from banks | - | - | 11,164 | 11,164 | 11,233 |
| Current accounts and deposits from customers | - | - | 388,066 | 388,066 | 387,254 |
| Debt serurities in issue | - | - | 3,165 | 3,165 | 3,165 |
| Other borrowed funds | - | - | 112,796 | 112,796 | 100,095 |
| Other financial liabilities | - | - | 1,774 | 1,774 | 1,774 |
| Subordinated borrowings | - | - | 31,483 | 31,483 | 25,515 |
| | **-** | **-** | **548,448** | **548,448** | **529,036** |

The estimates of fair value are intended to approximate 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. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

# 32 Financial assets and liabilities: fair values and accounting classifications (continued)

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using other valuation techniques.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm’s length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

For more complex instruments, the Bank uses proprietary valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Example of instruments involving significant unobservable inputs include certain loans and securities for which there is no active market, certain over the counter structured derivatives, and retained interests in securitisations.

The following assumptions are used by management to estimate the fair values of financial instruments:

- discount rates of 5.44% - 7.78% and 13.30% - 16.47% are used for discounting future cash flows from due from banks and loans to customers, respectively.
- discount rates of 7.65% - 8.94% are used for discounting future cash flows for current accounts and deposits from customers.
- discount rates of 8.18% - 9.48% are used for discounting future cash flows for subordinated borrowings.
- quoted market prices are used for determination of fair value of available for sale financial assets except unquoted equity securities where there is no market data, as disclosed in Note 13.
- in estimating the discount rates for other borrowed funds the Bank considers this market as a separate market from other commercial borrowing business due to different terms, purposes, conditions and credit risk exposures related to these other borrowed funds and subordinated borrowings.

# 32 Financial assets and liabilities: fair values and accounting classifications (continued)

## (b) Fair value hierarchy

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- **Level 1**: quoted market price (unadjusted) in an active market for an identical instrument
- **Level 2**: inputs other than quotes prices included within Level 1 that are observable either directly (i.e, as prices) or indirectly (i.e, derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- **Level 3**: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The table below analyses financial instruments measured at fair value at 31 December 2016, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

| AZN '000 | Level 1 | Level 3 | Total |
|---|---|---|---|
| Available-for-sale financial assets | 925 | 1,065 | 1,990 |
| | **925** | **1,065** | **1,990** |

The table below analyses financial instruments measured at fair value at 31 December 2015, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

| AZN '000 | Level 1 | Level 3 | Total |
|---|---|---|---|
| Available-for-sale financial assets | 5,124 | 1,065 | 6,189 |
| | **5,124** | **1,065** | **6,189** |

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2016:

| AZN'000 | Level 2 | Level 3 | Total fair values | Total carrying amount |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | 64,473 | - | 64,473 | 64,473 |
| Due from banks | 55,394 | - | 55,394 | 55,338 |
| Loans to customers | - | 255,202 | 255,202 | 271,661 |
| Other financial assets | 1,819 | - | 1,819 | 1,819 |
| **LIABILITIES** | | | | |
| Deposits and balances from banks | 14 | - | 14 | 14 |
| Current accounts and deposits from customers | 270,696 | - | 270,696 | 269,758 |
| Other borrowed funds | - | 91,828 | 91,828 | 91,828 |
| Other financial liabilities | 912 | - | 912 | 912 |
| Subordinated borrowings | - | 32,555 | 32,555 | 36,136 |

# 32 Financial assets and liabilities: fair values and accounting classifications (continued)

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2015:

| AZN'000 | Level 2 | Level 3 | Total fair values | Total carrying amount |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and cash equivalents | 27,477 | - | 27,477 | 27,477 |
| Due from banks | 113,155 | - | 113,155 | 113,155 |
| Loans to customers | - | 316,330 | 316,330 | 382,759 |
| Other financial assets | 3,095 | - | 3,095 | 3,095 |
| **LIABILITIES** | | | | |
| Deposits and balances from banks | 11,233 | - | 11,233 | 11,164 |
| Current accounts and deposits from customers | 387,254 | - | 387,254 | 388,066 |
| Other borrowed funds | - | 100,095 | 100,095 | 112,796 |
| Other financial liabilities | 1,774 | - | 1,774 | 1,774 |
| Subordinated borrowings | - | 25,515 | 25,515 | 31,483 |

# 33 Events after reporting period

On 21 April 2017, a decision was made at a General Meeting of Shareholders of the Bank to increase share capital of the Bank for AZN 35,500 thousand through an issue of 17,750 ordinary shares at a par value of AZN 2 each. At the date these financial statements were authorised for issue, those shares were not registered, subscribed for and paid-in.

Mr. Nikoloz Shurgaia
Chairman of the Management Board

Ms. Samira Gahramanova
Financial Director