

“Ziraat Bank Azerbaijan” Open Joint Stock Company

**International Financial Reporting Standards Financial
Statements and Independent Auditors' Report**
December 31, 2017

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Management Board of "Ziraat Bank Azerbaijan" Open Joint Stock Company:

Opinion

We have audited the financial statements of "Ziraat Bank Azerbaijan" Open Joint Stock Company (the "Bank"), which comprise the statement of financial position as at December 31, 2017, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the audit of the Financial Statements section of our report. We are independent of the Bank in accordance with 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 these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and the Audit Committee 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 have no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

Baker Tilly Azerbaijan

March 19, 2018
Baku, the Republic of Azerbaijan

“Ziraat Bank Azerbaijan” OJSC
Statement of Financial Position

<i>In thousands of Azerbaijani Manats</i>	Notes	December 31, 2017	December 31, 2016
ASSETS			
Cash and cash equivalents and mandatory cash balances with CBAR	7, 27	68,588	44,297
Due from banks	8, 27	24,601	10,898
Available-for-sale investments	9	4,078	4,540
Loans and advances to customers	10	67,193	53,724
Premises and equipment	11	15,215	13,447
Intangible assets	11	2,690	2,280
Deferred income tax asset	20	-	21
Other assets	12	2,136	1,612
TOTAL ASSETS		184,501	130,819
LIABILITIES			
Due to banks	13	29,091	17,948
Customer accounts	14	91,051	53,053
Deferred income tax liability	20	37	-
Other liabilities	15	1,030	534
TOTAL LIABILITIES		121,209	71,535
EQUITY			
Share capital	16	50,000	50,000
Retained earnings		13,292	9,284
TOTAL EQUITY		63,292	59,284
TOTAL LIABILITIES AND EQUITY		184,501	130,819

Approved for issue and signed on behalf of the Board of Directors on March 19, 2018.

Avni Demirchi
Chairman of the Board of Directors



Vugar Rafiyev
Finance Director

“Ziraat Bank Azerbaijan” OJSC
Statement of Profit or Loss and Other Comprehensive Income

<i>In thousands of Azerbaijani Manats</i>	Notes	2017	2016
Interest income	17, 27	13,382	8,781
Interest expense	17	(3,207)	(1,589)
Net interest income		10,175	7,192
Provision for impairment losses on interest bearing assets	10	(1,091)	(135)
Net interest income		9,084	7,057
Fee and commission income	18	1,136	909
Fee and commission expense	18	(329)	(165)
Gains less losses from trading in foreign currencies		2,056	3,282
Foreign exchange translation (losses)/gains, net		(558)	893
Provision for possible guarantee losses	15	(330)	(311)
Administrative and operating expenses	19, 27	(6,045)	(4,180)
Other income, net		1	9
Profit before tax		5,015	7,494
Income tax expense	20	(1,007)	(1,521)
PROFIT FOR THE YEAR		4,008	5,973
Total comprehensive income for the year		4,008	5,973
Earnings per share for profit attributable to the owners of the Bank, basic and diluted (expressed in AZN per share)	21	80.16	119.46

“Ziraat Bank Azerbaijan” OJSC
Statement of Changes in Equity

<i>In thousands of Azerbaijani Manats</i>	Attributable to equity holders of the Bank		
	Share Capital	Retained earnings	Total
Balance at January 1, 2016	50,000	3,311	53,311
Profit and other comprehensive income for the year	-	5,973	5,973
Balance at December 31, 2016	50,000	9,284	59,284
Profit and other comprehensive income for the year	-	4,008	4,008
Balance at December 31, 2017	50,000	13,292	63,292

“Ziraat Bank Azerbaijan” OJSC
Statement of Cash Flows

<i>In thousands of Azerbaijani Manats</i>	Notes	2017	2016
Cash flows from operating activities			
Interest received		12,328	8,803
Interest paid		(3,074)	(1,558)
Fees and commissions received		1,136	909
Fees and commissions paid		(329)	(165)
Income received from trading in foreign currencies		2,056	3,282
Staff costs paid		(2,320)	(2,025)
Administrative and operating expenses paid		(3,192)	(1,421)
Taxes paid including income tax		(1,168)	(3,529)
Other income received		1	8
Cash flows from operating activities before changes in operating assets and liabilities		5,438	4,304
<i>Net (increase)/decrease in:</i>			
- mandatory cash balances with CBAR		(245)	(280)
- due from banks		(14,221)	49,247
- loans and advances to customers		(14,314)	(41,218)
- other assets		23	(20)
<i>Net increase/(decrease) in:</i>			
- due to banks		11,973	(7,003)
- customer accounts		39,466	36,278
- other liabilities		164	(62)
Net cash generated from operating activities		28,284	41,246
Cash flows from investing activities			
Proceed from/(acquisition of) investment securities available-for-sale, net		290	(4,084)
Acquisition of premises and equipment	11	(2,477)	(11,517)
Acquisition of intangible assets	11	(559)	(1,137)
Proceeds from sale of premises and equipment		-	5
Net cash used in investing activities		(2,746)	(16,733)
Net cash from financing activities		-	-
Effect of exchange rate changes on cash and cash equivalents		(1,492)	6,087
Net increase in cash and cash equivalents		24,046	30,600
Cash and cash equivalents at the beginning of the year	7	44,004	13,404
Cash and cash equivalents at the end of the year		68,050	44,004

1 Introduction

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended December 31, 2017 for “Ziraat Bank Azerbaijan” OJSC (the “Bank”).

The Bank was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is an open joint stock company limited by shares and was set up in accordance with Azerbaijani regulations. As of December 31, 2017 and 2016 the Bank’s immediate parent company was T.C. Ziraat Bankasi A.Ş.

Principal activity. The Bank’s principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Bank has been granted a full banking licence #255 issued by the Central Bank of the Republic of Azerbaijan (“CBAR”) on December 30, 2014, but the effective operations of the Bank has started from the beginning of 2015. The Bank participates in the state deposit insurance scheme, which was introduced by Azerbaijani Law, “Deposits of individuals insurance in the Republic of Azerbaijan” dated December 29, 2006. The Azerbaijan Deposit Insurance Fund guarantees full repayment of individual deposits in AZN with interest rates up to 15% and foreign currency deposits with interest rates up to 3%.

The Bank has a head office and 1 (2016: 1) branch within the Republic of Azerbaijan. The bank had 56 employees at December 31, 2017 (2016: 47).

Registered address and place of business. The Bank’s registered address is: 191, Hasan bey Zardabi Avenue, Yasamal district, Baku AZ1122, the Republic of Azerbaijan.

Presentation currency. These financial statements are presented in thousands of Azerbaijani Manats (“AZN”).

2 Operating Environment of the Bank

Republic of Azerbaijan. The Bank’s operations are conducted in the Republic of Azerbaijan. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Azerbaijani economy contracted by 1.3% (year-on-year) in the first half of 2017, driven by a decline in oil GDP (7.2%) as oil revenues were decreased due to production volumes and oil prices. On the upside, and despite continued banking sector distress, the non-oil economy expanded by 1.7% for the first time in over a year, supported by the strong performance of the agriculture and manufacturing sectors. Annual inflation remained high at 13-14% during 2017, driven mainly by an increase in government-controlled tariffs for electricity, water, and gas, and in domestic food prices. Citing inflationary pressures, the Central Bank of the Republic of Azerbaijan continued to tighten the monetary policy stance during 2017 by scaling up liquidity absorption operations. The manat has appreciated by 4.4% against the U.S. dollar since end of 2016, reflecting its stronger external position and increased liquidity absorption operations. The troubled financial sector continues to exert a negative impact on the economy. Credit contracted by 15.6% in the first half of 2017, and the quality of assets continued to deteriorate. Per official statistics, the nonperforming loan ratio reached 13% in June 2017 compared to 9% at end-2016. Although manat deposits grew in the second quarter of 2017, the customer deposits (corporate and household) shrank by 4.4% during the first seven months of 2017.

Starting from February 2016 the Central Bank of the Republic of Azerbaijan has gradually increased refinancing rate from 5% to 15% during 2017 and the minimum capital adequacy ratio was lowered from 12% to 10%.

In February 2018, Standard & Poor’s, international credit agency, affirmed long and short-term sovereign credit rating of Azerbaijan in foreign and local currency at ‘BB+/B’ upgrading rating outlook from negative to stable.

The Azerbaijani economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. While the Government has introduced a range of stabilization measures and plans to expedite reforms and support to banking system in response to current economic challenges. The Management believes it is taking appropriate measures to support the sustainability of the Bank’s business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Bank’s results and financial position in manner not currently determinable.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the

economic environment which would have an impact on the Bank’s operations and consequently what effect, if any, they could have on the financial position of the Bank.

Amidst the ongoing crisis, the government of Azerbaijan shifted its oil-oriented economic policy, dominated for two decades, to the diversification of the economy. For that purpose, a “national strategic roadmap” was adopted to formulate a correct development strategy covering 11 sectors. The implementation of the “national strategic roadmap” was assigned to the newly formed “Center for Analysis of Economic Reforms and Communications,” the aim of which is analyzing the effectiveness of conducted reforms and making new proposals.

Significant measures have been taken in custom services and taxation as well. As of August 1, 2016, new regulations to ensure more operative and transparent custom clearance (a “green corridor” and other access systems) were implemented. The new simplified procedures are intended to stimulate imports and provide favorable conditions for business and external trade. As a continuation of reforms in customs, the reception of e-declarations is introduced minimize the contact of citizens with government officials. In order to amend the existing tax system, the decree approving the “Directions of Reforms in Taxation for 2016” was signed. The presidential decree requires the Ministry of Taxes to ensure that on-site and off-tax audits are performed within short periods of time and extend the coverage of electronic tax audits to limit face-to-face contacts with taxpayers. Another important amendment on monopolistic actions was made to the Criminal Code. Besides, the latest changes in December 2016 to Taxes Code “transfer pricing” will be applied against artificially exaggerated expenses and “voluntary tax disclosure” notion included in the Code which is highly practicable in greatest economies. Furthermore, in order to prevent additional exposure to financial sanctions by the tax authority because of tax liability miscalculation, the mechanism of “determination of tax liability in advance” principle will be in force. Along with them, implementation of electronic invoices will play an important role in prevention of tax evasion and will impact positively on tax system optimization.

Azerbaijan is also trying to benefit from regional connectivity initiatives to boost transit and trade. In particular, the country is one of the sponsors of the East-West and North-South transport corridors. Construction of the Baku-Tbilisi-Kars railway line, connecting the Caspian region with Turkey, was completed in 2017. The Trans-Anatolian Natural Gas Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP) will deliver natural gas from Azerbaijan’s Shah Deniz gas field to Turkey and Europe. The economy is expected to expand from 2018 onward, supported by an acceleration of oil GDP as the Shah Deniz gas field-one of the largest gas fields in the world-begins production. Non-oil output will continue to grow at a slow pace due to limited credit growth and the weak business environment.

3 Summary of Significant Accounting Policies

Basis of preparation. These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of available-for-sale financial assets, and financial instruments categorised at fair value through profit or loss. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 5).

Financial instruments - key measurement terms. Depending on their classification financial instruments are carried at fair value, or amortised cost as described below:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market’s normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm’s length transactions or consideration of financial data of the investees, are used to measure fair value of certain financial instruments for which external market pricing information is not available.

Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either

directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note 25.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Initial recognition of financial instruments. Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recorded at trade date, which is the date on which the Bank commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

Derecognition of financial assets. The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

Cash and cash equivalents. Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include notes issued by the CBAR and all interbank placements, reverse sale and repurchase agreements with other banks with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

Mandatory cash balances with the CBAR are excluded from cash and cash equivalents and are carried at amortised cost and represent non-interest bearing mandatory reserve deposits.

Due from banks. Amounts due from banks are recorded when the Bank advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from banks are carried at amortised cost.

Loans and advances to customers. Loans and advances to customers are recorded when the Bank advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates, and has no intention of trading the receivable. Loans and advances to customers are carried at amortised cost.

Impairment of financial assets carried at amortised cost. Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events (“loss events”) that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment. The primary factors that the Bank considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment, are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

Credit related commitments. The Bank issues financial guarantees and commitments to provide loans. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the

amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the end of each reporting period.

Performance guarantees. Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts transfer non-financial performance risk in addition to credit risk. Performance guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the contract. At the end of each reporting period, the performance guarantee contracts are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the contract at the end of each reporting period, discounted to present value. Where the Bank has the contractual right to revert to its customer for recovering amounts paid to settle the performance guarantee contracts, such amounts will be recognised as loans and receivables upon transfer of the loss compensation to the guarantee’s beneficiary.

Available-for-sale investments. Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for sale financial assets are measured at fair value with gains or losses being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to profit and loss accounts. However, interest calculated using the effective interest method is recognized in profit and loss accounts.

Premises and equipment. Premises and equipment are stated at cost less accumulated depreciation and provision for impairment, where required.

Costs of minor repairs and day-to-day maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised, and the replaced part is retired.

Construction in progress is carried at cost, less any recognized impairment loss. Cost includes professional fees. Such construction in progress is classified to the appropriate categories of property and equipment when completed and ready for intended use. Construction in progress is not depreciated.

At the end of each reporting period management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset’s fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset’s value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss for the year (within other operating income or expenses).

Depreciation. Land and construction in progress are not depreciated. Depreciation on items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

<u>Useful lives in years</u>	<u>2017</u>	<u>2016</u>
Buildings	50	20
Office and computer equipment	4	4
Motor vehicles	4	4
Leasehold improvements	over the term of the underlying lease	over the term of the underlying lease

The residual value of an asset is the estimated amount that the Bank would currently obtain from the disposal of the asset less the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life. The assets’ residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Intangible assets. The Bank’s intangible assets have definite useful life and primarily include capitalised computer software. Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Development costs that are directly associated with identifiable and unique software controlled by the Bank are recorded as intangible assets if the inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight line basis over expected useful lives of 10 years.

Operating leases. Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

Due to banks. Amounts due to banks are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortised cost. If the Bank purchases its own debt, the liability 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 retirement of debt.

Customer accounts. Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

Income taxes. Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge/credit comprises current tax and deferred tax and is recognised in profit or loss for the year, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if the financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within administrative and other operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised.

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Income and expense recognition. Interest income and expense are recorded for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Bank to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Bank does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to the present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.

All other fees, commissions and other income and expense items are generally recorded on an accrual basis where applicable by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Foreign currency translation. The functional currency of the Bank is the currency of the primary economic environment in which the Bank operates. The functional and the presentation currency of the Bank, is the national currency of the Republic of Azerbaijan, Azerbaijani Manats (“AZN”).

Monetary assets and liabilities are translated into the Bank’s functional currency at the official exchange rate of the CBAR at the end of the respective reporting period. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation of monetary assets and liabilities into the Bank’s functional currency at year-end official exchange rates of the CBAR, are recognised in profit or loss for the year (as foreign exchange translation gains less losses). Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency, including equity investments, are translated using the exchange rates at the date when the fair value was determined.

Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

At December 31, 2017, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.7001 (2016: USD 1 = AZN 1.7707).

Offsetting. Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

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

Staff costs and related contributions. Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Bank. The Bank has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements, and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Impairment losses on loans and advances to customers. The Bank regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss should be recorded in profit or loss for the year, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio.

This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. A 10% increase or decrease in actual loss experience compared to the loss estimates used would result in an increase or decrease in loan impairment losses of AZN 201 thousand (2016: AZN 92 thousand), respectively.

Impairment losses for individually significant loans are based on estimates of discounted future cash flows of the individual loans, taking into account repayments and realisation of any assets held as collateral against the loans. A 10% increase or decrease in the actual loss experience compared to the estimated future discounted cash flows from individually significant loans, which could arise from differences in amounts and

timing of the cash flows, would result in an increase or decrease in loan impairment losses of AZN 10 thousand (2016: AZN 91 thousand), respectively.

Deferred income tax asset recognition. The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits, and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on a medium term business plan prepared by management and extrapolated results thereafter. The business plan is based on management expectations that are believed to be reasonable under the circumstances.

Initial recognition of related party transactions. In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Transactions with related parties are disclosed in Note 27.

Useful life of premises and equipment. The Bank assesses the remaining useful lives of items of premises and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”. These estimates may have a material impact on the amount of the carrying values of premises and equipment and on depreciation recognized in profit or loss.

In previous years the Bank has been using the depreciation rates formed in accordance with the mid-term plans and initial estimations of the useful lives. However, during 2017 the Bank’s management realized that depreciation rate for buildings differ from practical use of the assets as well as asset consumption rates used by similar size commercial banks operating in the Republic of Azerbaijan. Considering this situation the management of the Bank has adopted new depreciation rate for buildings upon investigating set of adequate information. Application of new depreciation rates has been effective prospectively starting from January 1, 2017. If the Bank was to calculate and charge depreciation expense on buildings for 2017 in accordance with previous useful lives, then this would lead to the changes in the following key indicators in the financial statements: net profit for the year would decrease to AZN 3,702 thousand, retained earnings would decrease to AZN 12,986 thousand and total assets would decrease to AZN 184,248 thousand.

5 Adoption of New or Revised Standards and Interpretations

In the current year, the Bank has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2017. The adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Bank’s accounting policies that have affected the amounts reported for the current or prior years.

Amendments to IAS 7 “Statement of Cash Flows” – The Bank has applied these amendments for the first time in the current year. The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity’s financing activities.

To achieve this objective, the IASB requires that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

Amendments to IAS 12 “Income Taxes” – The amendments to IAS 12 “Income Taxes” clarify how to account for deferred tax assets related to debt instruments measured at fair value and clarify recognition of deferred tax assets for unrealized losses, to address diversity in practice.

Annual Improvements to IFRS Standards 2014-2016 Cycle, IFRS 12 “Disclosure of Interests in Other Entities” – The Bank has applied the amendments to IFRS 12 included in *Annual Improvements to IFRS Standards 2014-2016 cycle* for the first time in the current year. The other amendments included in this package are not yet mandatorily effective and they have not been early adopted by the Bank.

IFRS 12 states that an entity need not provide summarized financial information for interests in subsidiaries, associates or joint ventures that are classified as held for sale. The amendment clarifies that this is the only concession from disclosure requirements of IFRS 12 for such interests.

Unless otherwise described above, the new Standards and Interpretations are not expected to significantly affect the Bank’s financial statements.

6 Standard and Interpretations Issued but not Yet Adopted

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

Annual Improvements to IFRS Standards 2014-2016 Cycle contains amendments to IFRS 1 and IAS 28 which are not yet mandatorily effective for the Bank.

Standard	Subject of amendment
IFRS 1 “First-time Adoption of International Financial Reporting Standards”	Deletion of short-term exemptions for the first-time adopters: The amendments delete the short-term exemptions in IFRS 1 that relate to IFRS 7, IAS 19, IFRS 12 and IAS 27.
IAS 28 “Investments in Associates and Joint Ventures”	Measuring an associate or joint venture at fair value: The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

The amendments to IFRS 1 and IAS 28 are effective for annual periods begin on or after January 1, 2018.

The IASB and FASB have issued their joint revenue recognition standard, IFRS 15 “Revenue from Contracts with Customers”, which replaces all existing IFRS and US GAAP revenue requirements. IFRS 15 specifies how and when an IFRS reporter will recognize revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 was issued in May 2014 and applies to an annual reporting period beginning on or after January 1, 2018. An earlier application is permitted.

Amendments to IAS 40 “Transfers of Investment Property” are intended to clarify that an entity can only reclassify a property to/from investment property when, and only when, there is evidence that a change in the use of the property occurred. The amendments are effective for periods beginning on or after January 1, 2018. Earlier application is permitted. An entity applies the amendments to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is also permitted if that is possible without the use of hindsight.

IFRIC 22 “Foreign Currency Transactions and Advance Consideration” addresses foreign currency transactions or parts of transactions where:

- there is consideration that is denominated or priced in a foreign currency;
- the entity recognizes a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and
- the prepayment asset or deferred income liability is non-monetary.

The Interpretations Committee came to the following conclusion that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The interpretation applies to annual reporting periods beginning or after January 1, 2018. An earlier adoption is permitted.

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

- From a classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives to be assessed based on a combination of the entity’s business model for managing the assets and the instruments’ contractual cash flow characteristics. The IAS 39 measurement categories will be replaced by: fair value through profit or loss (FVPL), fair value

through other comprehensive income (FVOCI), and amortized cost categories. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortized cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities will largely be the same as requirements of IAS 39;

- IFRS 9 will also fundamentally change the approach to loan impairment. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The Bank will be required to record an allowance for expected losses for all loans and other debt financial assets not carried at FVPL, as well as for loan commitments and financial guarantee contracts. The allowance is based on the expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case the allowance would be based on the probability of default over the life of asset.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but restatement of comparative information is not required; the effect on the transition date – January 1, 2018 – would be recorded in retained earnings. The adoption of IFRS 9 is expected to have an effect on the classification and measurement of the Bank's financial assets, but no impact on the classification and measurement of the Bank's financial liabilities. The Bank expects a significant impact on its equity due to adoption of IFRS 9 impairment requirements, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward looking elements to determine the extent of the impact.

Amendments to IFRS 2 “Share-Based Payment” – The IASB have published final amendments to IFRS 2 “Share-based Payment” that clarify the classification and measurement of share-based payment transactions. Classification and Measurement of Share-based Payment Transactions contains the following clarifications and amendments:

Accounting for cash-settled share-based payment transactions that include a performance condition

Until issue of these amendments, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

Classification of share-based payment transactions with net settlement features

The IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

Accounting for modifications of share-based payment transactions from cash-settled to equity-settled

Until issue of these amendments, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognized in respect of the cash-settled share-based payment is derecognized and the equity-settled share-based payment is recognized at the modification date fair value to the extent services have been rendered up to the modification date;
- Any difference between the carrying amount of the liability as at the modification date and the amount recognized in equity at the same date would be recognized in profit and loss immediately.

The amendments are effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

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

IFRS 16 was issued on January 13, 2016 and applies to an annual reporting period beginning on or after January 1, 2019.

IFRS 17 “Insurance contracts” was issued in May 2017 and replaced IFRS 4 “Insurance contracts”. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of

insurance contracts within the scope of the standard. An entity shall apply IFRS 17 “Insurance Contracts” to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

IFRIC 23 “Uncertainty over Income Tax Treatments” addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- whether tax treatments should be considered collectively;
- assumptions for taxation authorities’ examinations;
- the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- the effect of changes in facts and circumstances.

The interpretation applies to annual reporting periods beginning or after January 1, 2019.

Annual Improvements to IFRS Standards 2015-2017 Cycle contains amendments to four International Financial Reporting Standards (IFRSs) as result of the IASB’s annual improvements project.

Standard	Subject of amendment
IFRS 3 “Business Combinations” and IFRS 11 “Joint Arrangements”	The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
IAS 12 “Income Taxes”	The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises.
IAS 23 “Borrowing Costs”	The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

The amendments are all effective for annual periods beginning on or after January 1, 2019.

Amendments to IAS 28 “Investments in Associations and Joint Ventures” - The IASB has published amendments to IAS 28 regarding the long-term interest in associates and joint Ventures. According to the amendment the entity should apply IFRS 9 to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendment is effective for annual periods beginning on or after January 1, 2019.

Amendments to IFRS 9 “Financial Instruments” - The IASB has published amendments to IFRS 9 regarding prepayment features with negative compensation and modifications of financial liabilities.

Prepayment Features with Negative Compensation amends the existing requirement of IFRS 9 regarding termination rights in order to allow measurement at amortized cost even in the case of negative compensation payments. The IASB also clarifies that the entity recognizes any adjustment to the amortized cost of the financial liability arising from a modification or exchange in profit or loss at the date of modification or exchange.

The amendment is effective for annual periods beginning on or after January 1, 2019.

The Management is considering the implications of these standards, their impact on the financial statements and the timing of its adoption by the Bank.

7 Cash and Cash Equivalents and Mandatory Cash Balances with CBAR

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Cash on hand	4,685	4,915
Cash balances with CBAR (other than mandatory reserve deposits)	37,260	31,224
Notes issued by the CBAR with original maturities of less than one month	14,512	-
Mandatory cash balances with CBAR	538	293
Correspondent accounts and overnight placements with other banks:		
- Republic of Azerbaijan	302	304
- Republic of Turkey and OECD countries	11,072	7,561
- Non-OECD countries	219	-
Total cash and cash equivalents and mandatory cash balances with CBAR	68,588	44,297

The credit quality of cash and cash equivalents balances may be summarised based on Fitch and Moody's ratings as follows at December 31, 2017:

<i>In thousands of Azerbaijani Manats</i>	Cash balances with CBAR, including mandatory reserves	Correspondent accounts and overnight placements	Placements with other banks	Total
Neither past due nor impaired				
- Central Bank of the Republic of Azerbaijan	52,310	-	-	52,310
- BB (Fitch)	-	246	-	246
- BB - (Fitch)	-	11	-	11
- BB + (Fitch)	-	11,011	-	11,011
- BBB+ (Fitch)	-	62	-	62
- B2 (Moody's)	-	263	-	263
Total cash and cash equivalents, excluding cash on hand	52,310	11,593	-	63,903

The credit quality of cash and cash equivalents balances analysed based on Fitch Ratings' ratings at December 31, 2016 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Cash balances with CBAR, including mandatory reserves	Correspondent accounts and overnight placements	Placements with other banks	Total
Neither past due nor impaired				
- Central Bank of the Republic of Azerbaijan	31,517	-	-	31,517
- B (Fitch)	-	-	-	-
- BBB - (Fitch)	-	7,813	-	7,813
- B3 (Moody's)	-	-	-	-
- Unrated	-	52	-	52
Total cash and cash equivalents, excluding cash on hand	31,517	7,865	-	39,382

At December 31, 2017 the Bank had 2 counterparty banks (2016: 2) with aggregated cash and cash equivalent balances above AZN 1,000 thousand. The total aggregate amount of these balances was AZN 63,322 thousand (2016: AZN 38,656 thousand) or 92 % of the cash and cash equivalents and mandatory cash balances with CBAR (2016: 87 %).

The published international rating (by Standard & Poor's) of the Republic of Azerbaijan is BB+ (2016: BB+).

Interest rate analysis of cash and cash equivalents is disclosed in Note 22. Information on related party balances is disclosed in Note 27.

8 Due from Banks

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Placements with other banks with original maturities of more than three months	24,176	10,898
Blocked correspondent accounts with banks and other financial institutions	425	-
Total due from banks	24,601	10,898

Amounts due from banks are not collateralised. Analysis by credit quality of amounts due from banks outstanding at December 31, 2017 and 2016 is as follows:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
<i>Neither past due nor impaired</i>		
- A (Fitch)	5,134	-
- BB+ (Fitch)	8,197	-
- Unrated foreign banks	8,804	-
- Unrated Azerbaijani Banks	2,466	10,898
Total neither past due nor impaired	24,601	10,898

Management of the Bank did not determine any objective evidence of impairment of the balances due from banks and therefore no provision for impairment was recorded as at December 31, 2017 and 2016.

At December 31, 2017 the Bank had balances with 3 counterparty banks (2016: 1) with aggregated amount above AZN 5,000 thousands. The total aggregate amount of these deposits was AZN 22,135 thousand (2016: AZN 8,916 thousand) or 90% of the total amount due from banks (2016: 82%).

Unrated banks in which the Bank had deposit balances are among top 25 banks in the Republic of Azerbaijan based on their total assets.

Refer to Note 25 for the estimated fair value of each class of amounts due from banks. Interest rate analysis of due from banks is disclosed in Note 22. Information on related party balances is disclosed in Note 27.

9 Available-for-sale Investments

Available-for-sale investments comprises:

<i>In thousands of Azerbaijani Manats</i>	2017		2016	
	Carrying value	Nominal value	Carrying value	Nominal value
Bonds of State Oil Company of the Republic of Azerbaijan	4,078	4,078	4,248	4,248
State bonds of Ministry of Finance of the Republic of Azerbaijan	-	-	292	292
Total available-for-sale investments	4,078	4,078	4,540	4,540

Nominal interest rates per annum and maturities of these investments are as follows:

	2017		2016	
	%	Maturity	%	Maturity
Bonds of State Oil Company of the Republic of Azerbaijan	5.00%	October 17, 2021	5.00%	October 17, 2021
State bonds of Ministry of Finance of the Republic of Azerbaijan	-	-	20.00%	May 16, 2017

Currencies of available-for-sale investments are presented below:

	2017	2016
Bonds of State Oil Company of the Republic of Azerbaijan	USD	USD
State bonds of Ministry of Finance of the Republic of Azerbaijan	-	AZN

Bonds of State Oil Company of the Republic of Azerbaijan represent 2,375 bonds with nominal value of USD 1 thousand each. These bonds are traded on Baku Stock Exchange and can be sold at any time by market value.

Included in available-for-sale investments AZN 40 thousand and 43 thousand as at December 31, 2017 and 2016, respectively, represent accrued interest receivable.

10 Loans and Advances to Customers

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Corporate loans	59,237	46,823
Loans to individuals - entrepreneurs	7,955	7,471
Loans to individuals - consumer loans	2,015	353
Less provision for loan impairment	(2,014)	(923)
Total loans and advances to customers	67,193	53,724

Included in loans and advances to customers AZN 1,495 thousand and AZN 445 thousand as at December 31, 2017 and 2016, respectively, represent accrued interest receivable.

Movements in the provision for loan impairment during 2017 and 2016 are as follows:

<i>In thousands of Azerbaijani Manats</i>	Corporate loans	Loans to individuals-entrepreneurs	Loans to individuals-consumer loans	Total
Provision for loan impairment at January 1, 2016	(653)	(92)	(43)	(788)
(Provision for)/recovery of impairment during the year	(159)	(15)	39	(135)
Provision for loan impairment at December 31, 2016	(812)	(107)	(4)	(923)
(Provision for)/recovery of impairment during the year	(1,040)	13	(64)	(1,091)
Provision for loan impairment at December 31, 2017	(1,852)	(94)	(68)	(2,014)

Economic sector risk concentrations within the customer loan portfolio are as follows:

<i>In thousands of Azerbaijani Manats</i>	2017		2016	
	Amount	%	Amount	%
Trade	19,645	28.4	13,585	24.9
Manufacturing	17,329	25.0	9,058	16.6
Construction	13,557	19.6	15,718	28.8
Agriculture	6,907	10.0	837	1.5
Service	6,589	9.5	10,636	19.5
Healthcare	3,165	4.6	2,585	4.7
Consumption	2,015	2.9	353	0.5
Food processing	-	-	1,397	2.6
Real estate	-	-	478	0.9
Total loans and advances to customers (before loan impairment)	69,207	100.0	54,647	100.0

As at December 31, 2017, the Bank had 14 borrowers (2016: 14) with aggregated granted loan amounts above AZN 1,000 thousand. The total aggregate amount of these loans was AZN 57,918 thousand or 84% of the gross loan portfolio (2016: AZN 48,145 thousand or 88%).

Information about collateral as at December 31, 2017 is as follows:

<i>In thousands of Azerbaijani manats</i>	Corporate loans	Loans to individuals-entrepreneurs	Loans to individuals-consumer loans	Total
Unsecured loans	49	-	140	189
Loans guaranteed by other parties	20,677	189	118	20,984
Loans collateralised by:				
- residential real estate	13,129	6,641	170	19,940
- non-residential real estate	19,890	1,031	1,243	22,164
- cash deposits	276	-	276	552
- equipment	3,364	-	-	3,364
Total loans and advances to customers	57,385	7,861	1,947	67,193

Information about collateral as at December 31, 2016 is as follows:

<i>In thousands of Azerbaijani manats</i>	Corporate loans	Loans to individuals-entrepreneurs	Loans to individuals-consumer loans	Total
Unsecured loans		-	8	8
Loans guaranteed by other parties	33,006	628	131	33,765
Loans collateralised by:				
- residential real estate	3,633	2,170	109	5,912
- non-residential real estate	8,935	4,393	54	13,382
- cash deposits	437	173	47	657
Total loans and advances to customers	46,011	7,364	349	53,724

The disclosure above represents the lower of the carrying value of the loan or collateral taken; the remaining part is disclosed within the unsecured exposures. The carrying value of loans was allocated based on liquidity of the assets taken as collateral.

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Analysis by credit quality of loans outstanding as at December 31, 2017 is as follows:

	Corporate loans	Loans to individuals- entrepreneurs	Loans to individuals- consumer loans	Total
<i>In thousands of Azerbaijani manats</i>				
<i>Neither past due nor impaired</i>				
- Large new borrowers	31,758	-	-	31,758
- Loans to large entities	5,581	-	-	5,581
- Loans to medium size entities	11,960	-	-	11,960
- Loans to small entities	972	-	-	972
- Loans to individuals	-	2,847	702	3,549
- Restructured loans	8,814	-	-	8,814
	59,085	2,847	702	62,634
Less: impairment provision on restructured loans before renegotiating	(1,730)	-	-	(1,730)
Total neither past due nor impaired	57,355	2,847	702	60,904
<i>Collectively assessed</i>				
<i>Overdue:</i>				
- up to 30 days	152	219	7	378
- 31 to 60 days	-	153	-	153
- over 180 days	-	-	29	29
	152	372	36	560
Less impairment provisions	(122)	(29)	(34)	(185)
Total collectively assessed loans	30	343	2	375
<i>Individually assessed</i>				
<i>Overdue:</i>				
- up to 30 days	-	1,544	1,277	2,821
- 31 to 60 days	-	3,192	-	3,192
- over 60 days	-	-	-	-
	-	4,736	1,277	6,013
Less impairment provisions	-	(65)	(34)	(99)
Total individually assessed loans	-	4,671	1,243	5,914
Total loans and advances to customers	57,385	7,861	1,947	67,193

Analysis by credit quality of loans outstanding as at December 31, 2016 is as follows:

	Corporate loans	Loans to individuals- entrepreneurs	Loans to individuals- consumer loans	Total
<i>In thousands of Azerbaijani manats</i>				
<i>Neither past due nor impaired</i>				
- Large new borrowers	34,677	-	-	34,677
- Loans to medium size entities	11,635	-	-	11,635
- Loans to small entities	511	-	-	511
- Loans to individuals	-	7,471	353	7,824
Total neither past due nor impaired	46,823	7,471	353	54,647
Less impairment provisions	(812)	(107)	(4)	(923)
Total loans and advances to customers	46,011	7,364	349	53,724

The Bank did not have individually and collectively impaired loans and advances to customers as at December 31, 2016.

The Bank applied the portfolio provisioning methodology prescribed by IAS 39, *Financial Instruments: Recognition and Measurement*, and created portfolio provisions for impairment losses that were incurred, but have not been specifically identified with any individual loan, by the end of the reporting period. The Bank’s policy is to classify each loan as ‘neither past due nor impaired’ until specific objective evidence of impairment of the loan is identified. The impairment provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are individually determined to be impaired.

Past due, but not impaired, loans primarily include collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due but not impaired is the whole balance of such loans, not only the individual instalments that are past due.

The financial effect of collateral is presented by disclosing collateral values separately for (i) those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset (“over-collateralised assets”) and (ii) those assets where collateral and other credit enhancements are less than the carrying value of the asset (“under-collateralised assets”).

As at December 31, 2017 and 2016 loans totalling AZN 6,013 thousand and nil, respectively which were individually determined to be impaired were collateralized by real estate with fair value totalling to AZN 9,164 thousand and nil, respectively.

Refer to Note 25 for the estimated fair value of each class of loans and advances to customers. Interest rate, currency, maturity and geographical analysis of loans and advances to customers is disclosed in Note 22. Information on related party balances is disclosed in Note 27.

As at December 31, 2017, loans to customers included loans in the amount of AZN 8,814 thousand with original terms renegotiated (2016: nil). Otherwise these loans would be past due or impaired.

11 Premises, Equipment and Intangible Assets

	Buildings	Office and computer equipment	Leasehold improvements	Motor vehicles	CIP	Total premises and equipment	Computer software licences	Intangible CIP	Total
<i>In thousands of Azerbaijani Manats</i>									
Carrying amount at January 1, 2016	-	793	622	61	-	1,476	252	-	1,728
Additions	8,942	202	-	52	3,408	12,604	985	1,075	14,664
Disposals	-	(6)	-	-	-	(6)	-	-	(6)
Depreciation/amortization charge	(271)	(232)	(100)	(25)	-	(628)	(32)	-	(660)
Depreciation eliminated on disposal	-	1	-	-	-	1	-	-	1
Carrying amount at December 31, 2016	8,671	758	522	88	3,408	13,447	1,205	1,075	15,727
Cost at December 31, 2016	8,942	1,080	667	125	3,408	14,222	1,245	1,075	16,542
Accumulated depreciation/amortisation	(271)	(322)	(145)	(37)	-	(775)	(40)	-	(815)
Carrying amount at December 31, 2016	8,671	758	522	88	3,408	13,447	1,205	1,075	15,727
Additions	81	450	-	65	1,881	2,477	162	397	3,036
Transfers	5,053	236	-	-	(5,289)	-	1,075	(1,075)	-
Depreciation/amortization charge	(255)	(312)	(100)	(42)	-	(709)	(149)	-	(858)
Carrying amount at December 31, 2017	13,550	1,132	422	111	-	15,215	2,293	397	17,905
Cost at December 31, 2017	14,076	1,766	667	190	-	16,699	2,482	397	19,578
Accumulated depreciation/amortisation	(526)	(634)	(245)	(79)	-	(1,484)	(189)	-	(1,673)
Carrying amount at December 31, 2017	13,550	1,132	422	111	-	15,215	2,293	397	17,905

As at December 31, 2017 and 2016, premises, equipment and intangible assets did not include any fully depreciated assets.

As at December 31, 2017 and 2016, premises, equipment and intangible assets were not pledged as collateral.

As at December 31, 2017 and 2016, included in premises, equipment and intangible assets insured in the amount of AZN 14,266 thousand and AZN 9,067 thousand, respectively.

12 Other Assets

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Prepaid taxes	1,680	1,461
Prepayment for services	431	147
Settlements receivable	22	-
Accrued commission receivable	3	4
Total other assets	2,136	1,612

All of the above assets are expected to be recovered within twelve months after the year-end.

13 Due to Banks

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Short-term placements of banks	23,990	17,849
Correspondent accounts of banks and financial institutions	5,101	99
Total due to banks	29,091	17,948

Included in due to banks AZN 187 thousand and AZN 141 thousand as at December 31, 2017 and 2016, respectively, represent accrued interest payable.

Refer to Note 25 for the disclosure of the fair value of each class of amounts due to banks. Interest rate analysis of due to banks is disclosed in Note 22. Information on related party balances is disclosed in Note 27.

14 Customer Accounts

<i>In thousands of Azerbaijani Manats</i>	2017	2016
State and public organisations		
Current/settlement accounts	586	526
Other legal entities		
Current/settlement accounts	26,987	14,874
Term deposits	21,898	15,613
Individuals		
Current/settlement accounts	4,243	4,835
Term deposits	37,337	17,205
Total customer accounts	91,051	53,053

Economic sector concentrations within customer accounts are as follows:

<i>In thousands of Azerbaijani Manats</i>	2017		2016	
	Amount	%	Amount	%
Individuals	41,580	46	22,040	42
Construction	16,533	18	6,797	13
Insurance	12,040	13	15,295	29
Transportation and communications	8,774	10	-	-
Trade and other services	8,278	9	3,693	6
Manufacturing	3,097	3	4,525	9
State and public organisations	586	1	526	1
Oil and gas sector	81	-	113	-
Agriculture	80	-	-	-
Others	2	-	64	-
Total customer accounts	91,051	100	53,053	100

At December 31, 2017, the Bank had 28 customers (2016: 16) with balances above AZN 500 thousand. The aggregate balance of these customers was AZN 70,756 thousand or 78% of total customer accounts (2016: AZN 38,470 thousand or 73%).

Included in customer accounts in the amount of AZN 185 thousand and AZN 98 thousand as at December 31, 2017 and 2016, respectively is accrued interest payable.

Included in customer accounts in the amount of AZN 1,627 thousand and AZN 808 thousand as at December 31, 2017 and 2016, respectively are deposits blocked as collateral for loans issued.

Included in customer accounts in the amount of AZN 41,296 thousand and AZN 21,730 thousand as at December 31, 2017 and 2016, respectively are deposits secured by the Azerbaijan Deposit Insurance Fund.

Refer to Note 25 for the disclosure of the fair value of each class of customer accounts. Interest rate, maturity, currency and geographical analysis of customer accounts is disclosed in Note 22. Information on related party balances is disclosed in Note 27.

15 Other Liabilities

Other liabilities comprise the following:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Provision for possible guarantee losses	756	357
Payables for unused vacation rights of staff	143	144
Accrued expenses	131	33
Total other liabilities	1,030	534

All of the above liabilities balances are expected to be settled within twelve months after the year-end.

Movements in the provision for possible guarantee losses during 2017 and 2016 are as follows:

<i>In thousands of Azerbaijani Manats</i>	Guarantees	Total
Provision for possible guarantee losses at January 1, 2016	(5)	(5)
Increase in possible guarantee losses during the year	(311)	(311)
Advanced income received on guarantees	(493)	(493)
Interest income on guarantees	452	452
Provision for possible guarantee losses at December 31, 2016	(357)	(357)
Increase in possible guarantee losses during the year	(330)	(330)
Advanced income received on guarantees	(664)	(664)
Interest income on guarantees	595	595
Provision for possible guarantee losses at December 31, 2017	(756)	(756)

16 Share Capital

<i>In thousands of Azerbaijani Manats except for number of shares</i>	Number of outstanding shares	Ordinary shares	Total
At January 1, 2016	50,000	50,000	50,000
At December 31, 2016	50,000	50,000	50,000
At December 31, 2017	50,000	50,000	50,000

All ordinary shares have a nominal value of AZN 1,000 per share and rank equally. Each share carries one vote.

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As a result of capital contribution, T.C. Ziraat Bank Inc. (Republic of Turkey), Ziraat Insurance Inc. (Republic of Turkey) and Ziraat Investment Securities Inc. (Republic of Turkey) owned 99.98%, 0.01% and 0.01% of Bank’s share capital respectively.

17 Interest Income and Expense

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Interest income		
Loans and advances to customers	10,676	4,508
Due from banks	991	3,693
Cash and cash equivalents and mandatory cash balances with CBAR	917	-
Guarantees	595	452
Available-for-sale investments	203	128
Total interest income	13,382	8,781
Interest expense		
Term deposits of legal entities/customer accounts	(1,466)	(749)
Term deposits of individuals/customer accounts	(1,099)	(297)
Due to banks	(642)	(543)
Total interest expense	(3,207)	(1,589)
Net interest income	10,175	7,192

18 Fee and Commission Income and Expense

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Fee and commission income		
- Settlement transactions	868	523
- Cash transactions	250	352
- Plastic card operations	9	-
- Others	9	34
Total fee and commission income	1,136	909
Fee and commission expense		
- Settlement transactions	(155)	(56)
- Letters of credit and guarantee letters	(96)	(52)
- Cash transactions	(74)	(57)
- Plastic card operations	(2)	-
- Others	(2)	-
Total fee and commission expense	(329)	(165)
Net fee and commission income	807	744

19 Administrative and Operating Expenses

<i>In thousands of Azerbaijani Manats</i>	Note	2017	2016
Staff costs and related contribution		2,320	2,089
Depreciation of premises and equipment	11	709	628
Advertising and marketing expenses		547	225
Repair and maintenance		446	146
Professional fees		343	243
Communication expenses		228	155
Payments to the Financial Markets Supervisory Authority		210	-
Representation expenses		189	121
Payments to the Deposit Insurance Fund		165	96
Operating lease expenses		157	163
Amortisation of intangible assets	11	149	32
Office expenses		119	54
Taxes, other than income tax		89	54
Security expenses		88	-
Insurance expenses		87	54
Business trip expenses		53	16
Membership fees		22	-
Others		124	104
Total administrative and operating expenses		6,045	4,180

Included in staff costs are statutory pension contributions of AZN 314 thousand (2016: 317 thousand).

20 Income Taxes

(a) Components of income tax expense

Income tax expense recorded in profit or loss for the year comprises the following:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Current income tax expense	(949)	(1,505)
Deferred income tax expense	(58)	(16)
Income tax expense for the year	(1,007)	(1,521)

(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate

The income tax rate applicable to the majority of the Bank's 2017 and 2016 income is 20%. Reconciliation between the expected and the actual taxation charge is provided below.

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Profit before tax	5,015	7,494
Theoretical tax charge at statutory rate (20%)	(1,003)	(1,499)
- Non-deductible expenses	(4)	(22)
Income tax expense for the year	(1,007)	(1,521)

(c) Deferred taxes analysed by type of temporary difference

Differences between IFRS and statutory taxation regulations in Azerbaijan give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below.

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<i>In thousands of Azerbaijani Manats</i>	January 1, 2017	Credited/(debited) to profit or loss	December 31, 2017
Tax effect of deductible temporary differences			
Loans and advances to customers	62	28	90
Other liabilities	30	(30)	-
Tax effect of taxable temporary differences			
Premises and equipment	(71)	(56)	(127)
Net deferred tax asset/(liability)	21	(58)	(37)

<i>In thousands of Azerbaijani Manats</i>	January 1, 2016	Credited/(debited) to profit or loss	December 31, 2016
Tax effect of deductible temporary differences			
Loans and advances to customers	21	41	62
Other liabilities	16	14	30
Tax effect of taxable temporary differences			
Premises and equipment	-	(71)	(71)
Net deferred tax asset	37	(16)	21

21 Earnings per Share

Basic earnings per share are calculated by dividing the profit or loss attributable to owners of the Bank by the weighted average number of ordinary shares in issue during the year.

The Bank has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal the basic earnings per share.

Earnings per share are calculated as follows:

<i>In thousands of Azerbaijani Manats, except for number of shares</i>	Note	2017	2016
Profit for the year attributable to ordinary shareholders (thousand)		4,008	5,973
Weighted average number of ordinary shares in issue (thousand)	16	50	50
Earnings per ordinary share (expressed in AZN per share)		80.16	119.46

22 Financial Risk Management

The risk management function within the Bank is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures, in order to minimise operational and legal risks.

Credit risk. The Bank takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Bank’s lending and other transactions with counterparties giving rise to financial assets including likelihood that borrower or counterparty fails to meet their obligations in accordance with agreed terms.

The Bank’s maximum exposure to credit risk is reflected in the carrying amounts of financial assets on the statement of financial position. For guarantees and commitments to extend credit, the maximum exposure to credit risk is the amount of the commitment. Refer to Note 24. The credit risk is mitigated by collateral and other credit enhancements.

The principal credit risk management methods used is described in the formal Credit Policy adopted and implemented by the Bank. These include the setting of limits and the diversification of the credit portfolio based upon defined criterion (such as industry, duration, related persons, region, etc.). Credits will also be classified at initiation and throughout the life of the loan based upon a risk level determined using best practice rating and scoring systems. Such tools will also be used to establish appropriate provisions for potential losses as necessary. All restrictions and norms issued by the CBAR, related to lending operations, have also been carefully considered and embedded into the Bank’s credit policy.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Limits on the level of credit risk by product and industry sector are approved regularly by the Supervisory Board. Such risks are monitored on a revolving basis and are subject to an annual, or more frequent, review.

The Bank established a number of credit committees which are responsible for approving credit limits for individual borrowers:

Type of Loan	Junior Credit Committee	Senior Credit Committee
Corporate Loans	1,000 thousand USD	1,000 - 2,500 thousand USD
Mortgage	250 thousand USD	250 - 1,000 thousand USD
Consumer Loans	150 thousand USD	150 - 500 thousand USD

These limits may be increased by four times if the loan is collateralized 100% by cash deposit.

The Supervisory Board reviews and approves limits above USD 2,500 thousand and USD 1,000 thousand up to 20% of tier 1 capital for corporate and retail loans respectively.

Loan applications originated by the relevant client relationship managers are passed on to the relevant credit committee for approval of the credit limit. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees. In order to monitor credit risk exposures, regular reports are produced by the credit department and risk department’s officers based on a structured analysis focusing on the customer’s business and financial performance. Any significant exposure to customers with deteriorating creditworthiness are reported to, and reviewed by, the Management Board. Management monitors and follows up on past due balances.

The Bank’s credit department reviews the ageing analysis of outstanding loans and follows up on past due balances. Management, therefore, considers it appropriate to provide ageing and other information about credit risk.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as the result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Bank uses the same credit policies in assuming conditional obligations as it does for on-balance sheet financial instruments, through established credit approvals, risk control limits and monitoring procedures.

Market risk. The Bank takes on exposure to market risks. Market risks arise from open positions in (a) currency, (b) interest rates and (c) equity products, all of which are exposed to general and specific market movements. Management sets limits on the value of risk that may be accepted, which is monitored on a daily basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

Currency risk. In respect of currency risk, management sets limit on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

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The table below summarises the Bank’s exposure to foreign currency exchange rate risk at the end of the reporting period:

<i>In thousands of Azerbaijani Manats</i>	At December 31, 2017			At December 31, 2016		
	Monetary financial assets	Monetary financial liabilities	Net position	Monetary financial assets	Monetary financial liabilities	Net position
Azerbaijani Manats	75,607	33,436	42,171	56,743	17,673	39,070
US Dollars	86,377	85,004	1,373	55,785	51,731	4,054
Euros	1,796	1,318	478	752	1,406	(654)
Turkish Lira	292	259	33	35	71	(36)
Others	413	256	157	148	153	(5)
Total	164,485	120,273	44,212	113,463	71,034	42,429

The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

The following table presents sensitivities of profit or loss and equity to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency of the Bank, with all other variables held constant:

<i>In thousands of Azerbaijani Manats</i>	At December 31, 2017 Impact on profit or loss	At December 31, 2016 Impact on profit or loss
US Dollar strengthening by 30%	412	1,216
US Dollar weakening by 30%	(412)	(1,216)
Euro strengthening by 30%	143	(196)
Euro weakening by 30%	(143)	196
Turkish Lira strengthening by 30%	10	(11)
Turkish Lira weakening by 30%	(10)	11
Other strengthening by 30%	47	(2)
Other weakening 30%	(47)	2
Total	-	-

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the Bank.

Interest rate risk. The Bank takes on exposure 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 reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At December 31, 2017 and 2016, the Bank did not have financial instruments at variable interest rates.

The Bank monitors interest rates for its financial instruments. The table below summarises interest rates at the respective reporting date based on reports reviewed by key management personnel.

<i>In % p.a.</i>	2017			2016		
	AZN	USD	EUR	AZN	USD	EUR
Assets						
Cash and cash equivalents	13.69%	-	-	-	-	-
Due from banks	-	3.64%	-	3.00%	8.00%	-
Loans and advances to customers	19.56%	8.23%	5.00%	20.00%	9.00%	-
Available-for-sale investments	-	5.00%	-	20.00%	5.00%	-
Liabilities						
Due to banks	-	2.40%	-	-	2.50%	-
Term deposits	12.50%	1.25%	1.00%	13.00%	1.00%	1.00%
Credit related commitments	1.78%	2.63%	1.73%	1.70%	2.60%	2.00%

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The sign “-” in the table above means that the Bank does not have the respective assets or liabilities in the corresponding currency.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on “reasonably possible changes in the risk variable”. The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit before tax:

	As at December 31, 2017		As at December 31, 2016	
	Interest rate +1%	Interest rate -1%	Interest rate +1%	Interest rate -1%
Financial assets				
Cash and cash equivalents	686	(686)	-	-
Due from banks	246	(246)	109	(109)
Loans to customers	672	(672)	537	(537)
Available-for-sale investments	41	(41)	45	(45)
Financial liabilities				
Due to banks	(291)	291	(179)	179
Customer accounts	(911)	911	(531)	531
Net impact on profit before tax	443	(443)	(19)	19

Geographical risk concentrations. The geographical concentration of the Bank’s financial assets and liabilities at December 31, 2017 and 2016 is set out below:

<i>In thousands of Azerbaijani Manats</i>	Azerbaijan	OECD	Non-OECD	2017 Total
Financial assets				
Cash and cash equivalents and mandatory cash balances with CBAR	57,297	11,072	219	68,588
Due from banks	2,041	13,332	9,228	24,601
Available-for-sale investments	4,078	-	-	4,078
Loans and advances to customers	57,336	149	9,708	67,193
Other financial assets	25	-	-	25
Total financial assets	120,777	24,553	19,155	164,485
Financial liabilities				
Due to banks	29,091	-	-	29,091
Customer accounts	72,052	18,641	358	91,051
Other financial liabilities	130	-	-	130
Total financial liabilities	101,273	18,641	358	120,272
Net position in on-balance sheet financial instruments	19,504	5,912	18,797	44,213
Off-balance sheet commitments	78,977	-	-	78,977

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<i>In thousands of Azerbaijani Manats</i>	Azerbaijan	OECD	Non-OECD	2016 Total
Financial assets				
Cash and cash equivalents and mandatory cash balances with CBAR	36,736	7,561	-	44,297
Due from banks	10,898	-	-	10,898
Available-for-sale investments	4,540	-	-	4,540
Loans and advances to customers	53,724	-	-	53,724
Other financial assets	4	-	-	4
Total financial assets	105,902	7,561	-	113,463
Financial liabilities				
Due to banks	17,948	-	-	17,948
Customer accounts	44,307	8,746	-	53,053
Other financial liabilities	33	-	-	33
Total financial liabilities	62,288	8,746	-	71,034
Net position in on-balance sheet financial instruments	43,614	(1,185)	-	42,429
Off-balance sheet commitments	55,712	-	-	55,712

Liquidity risk. Liquidity risk is the risk that Bank will encounter difficulty in meeting obligations associated with financial liabilities. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs, guarantees and from margin and other calls on cash-settled derivative instruments. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Liquidity risk is managed by the Assets and Liabilities Committee of the Bank.

The Bank monitors and reports liquidity risk daily, paying particular attention to ensuring that there are optimal levels of cash and cash equivalent instruments to fund increases in assets, unexpected decreases in liabilities, as well as meeting legal requirements, while optimizing the cost of carrying any excess liquidity.

To manage liquidity risk, the Bank performs daily monitoring of future expected cash flows on clients' and banking operations, which forms part of the asset and liability management process. The Bank also has to comply with minimum levels of liquidity required by the CBAR. This ratio is calculated as the ratio of highly-liquid assets to liabilities payable on demand. The ratio was 169% and 206% at December 31, 2017 and 2016 respectively, whereas the minimum percentage required by the CBAR is 30%.

The Bank seeks to maintain a stable funding base primarily consisting of the bank's funds in CBAR. The liquidity management of the Bank requires consideration of the level of liquid assets necessary to settle obligations as they fall due; maintaining access to a range of funding sources; maintaining funding contingency plans; and monitoring liquidity ratios against regulatory requirements including minimum levels of liquidity required by the CBAR.

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The Treasury Department receives information about the liquidity profile of the financial assets and liabilities. The Treasury Department then provides for an adequate portfolio of short-term liquid assets, largely made up of short-term liquid trading securities, deposits with banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The tables below show liabilities at December 31, 2017 and 2016 by their remaining contractual maturity. The amounts of liabilities disclosed in the maturity table are the contractual undiscounted cash flows, including financial guarantees. Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in the statement of financial position is based on discounted cash flows.

The table below shows the maturity analysis of non-derivative financial assets at their carrying amounts and based on their contractual maturities, except for assets that are readily saleable if it should be necessary to meet cash outflows on financial liabilities. Such financial assets are included in the maturity analysis based

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on their expected date of disposal. Impaired loans are included at their carrying amounts net of impairment provisions, and based on the expected timing of cash inflows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The maturity analysis of undiscounted financial liabilities at December 31, 2017 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Total
Liabilities					
Due to banks	5,347	7,014	17,085	-	29,446
Customer accounts	36,304	4,645	36,148	17,485	94,582
Other financial liabilities	130	-	-	-	130
Unused loan commitments	8,093	-	-	-	8,093
Financial guarantees	70,884	-	-	-	70,884
Total potential future payments for financial obligations	120,758	11,659	53,233	17,485	203,135

The maturity analysis of undiscounted financial liabilities at December 31, 2016 is as follows:

<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Total
Liabilities					
Due to banks	278	184	17,782	-	18,244
Customer accounts	21,462	6,004	15,424	11,992	54,882
Other financial liabilities	33	-	-	-	33
Unused loan commitments	2,394	-	-	-	2,394
Financial guarantees	53,318	-	-	-	53,318
Total potential future payments for financial obligations	77,485	6,188	33,206	11,992	128,871

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment disclosed in the above maturity analysis, because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit as included in the above maturity table does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

Customer accounts classified in the above analysis based on contractual maturities. However, in accordance with Civil Code of the Republic of Azerbaijan, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to accrued interest.

The Bank does not use the above maturity analysis based on undiscounted contractual maturities of liabilities to manage liquidity. Instead, the Bank monitors expected maturities and the resulting expected liquidity gap as follows:

<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Total
December 31, 2017					
Total financial assets	70,519	17,111	33,038	43,817	164,485
Total financial liabilities	41,526	11,065	51,899	15,782	120,272
Net liquidity gap based on expected maturities	28,993	6,046	(18,861)	28,035	44,213

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<i>In thousands of Azerbaijani Manats</i>	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Total
December 31, 2016					
Total financial assets	44,567	13,286	33,544	22,066	113,463
Total financial liabilities	21,596	5,374	32,657	11,407	71,034
Net liquidity gap based on expected maturities	22,971	7,912	887	10,659	42,429

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks 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 maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of customer accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Bank would indicate that these customer accounts provide a long-term and stable source of funding for the Bank.

23 Management of Capital

The Bank manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. The adequacy of the Bank’s capital is monitored using, among other measures, the ratios established by the Basel Capital Accord 1988 and the ratios established by the FMSA in supervising the Bank.

During the past year, the Bank had complied in full with all its externally imposed capital requirements. The capital structure of the Bank consists of debt and equity attributable to equity holders of the Bank, comprising issued capital and retained earnings as disclosed in statement of changes in equity.

Compliance with capital adequacy ratios set by the FMSA is monitored monthly with reports outlining their calculation reviewed and signed by the Bank’s Financial Director, and the Head of Management Board. Other objectives of capital management are evaluated annually.

Under the current prudential capital requirements set by the FMSA banks have to: (a) hold the minimum level of total statutory capital of AZN 50,000 thousand (December 31, 2016: AZN 50,000 thousand); (b) maintain a ratio of regulatory capital to risk weighted assets (“statutory capital ratio”) at or above a prescribed minimum of 10% (December 31, 2016: 10%) and (c) maintain a ratio of Tier 1 capital to the risk-weighted assets (the ‘Tier 1 capital ratio’) at or above the prescribed minimum of 5% (December 31, 2016: 5%).

The composition of the Bank’s capital calculated in accordance with the FMSA capital requirements is as follows:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Tier 1 Capital		
Share capital	50,000	50,000
Add retained earnings	9,421	3,464
Less intangible assets	2,294	1,205
Total tier 1 capital	57,127	52,259
Current year profit	4,062	5,957
Plus: general provision for impairment	1,764	892
Total regulatory capital	62,953	59,108
Risk weighted assets	227,527	145,560
<i>Capital adequacy ratio</i>	28%	41%
<i>Tier I Capital to risk weighted assets</i>	25%	36%

24 Contingencies and Commitments

Legal proceedings. From time to time and in the normal course of business, claims against the Bank may be received. On the basis of its own estimates and both internal professional advice, management is of the opinion that no material losses will be incurred in respect of claims, and accordingly no provision has been made in these financial statements.

Tax legislation. Azerbaijani tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management’s interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities.

The Bank’s management believes that its interpretation of the relevant legislation is appropriate and the Bank’s tax, currency and customs positions will be sustained. Accordingly, at December 31, 2017 no provision for potential tax liabilities was recorded.

Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Operating lease commitments. Where the Bank is the lessee, the future minimum lease payments under non-cancellable operating leases are as follows:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Not later than 1 year	96	96
Later than 1 year and not later than 5 years	384	384
Later than 5 years	288	384
Total operating lease commitments	768	864

Compliance with covenants. As at December 31, 2017 and 2016 the Bank was not in breach of any covenants set by FMSA.

Credit related commitments. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate or cash deposits and, therefore, carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments, if the unused amounts were to be drawn down. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Bank monitors the term to maturity of credit related commitments, because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Outstanding credit related commitments are as follows:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Financial guarantees issued	70,884	53,318
Undrawn credit lines	8,093	2,394
Total credit related commitments	78,977	55,712

The total outstanding contractual amount of undrawn credit lines and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded.

Credit related commitments are denominated in currencies as follows:

<i>In thousands of Azerbaijani Manats</i>	2017	2016
Azerbaijani Manats	52,238	43,523
US Dollars	23,544	11,256
Euro	3,195	933
Total	78,977	55,712

25 Fair Value of Financial Instruments

(a) Fair values of financial instruments carried at amortised cost.

At December 31, 2017 and 2016, fair values of financial assets and financial liabilities carried at amortised cost approximated their carrying values.

(b) The methods and assumptions applied in determining fair values.

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price. Where quoted market prices were not available, the Bank used valuation techniques. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Fair value of financial assets that are measured at fair value:

<i>In thousands of Azerbaijani Manats</i>	December 31, 2017 Level 1 fair value	December 31, 2016 Level 1 fair value
<i>Available-for-sale investments</i>	4,078	4,540

Fair values analysed by level in the fair value hierarchy and carrying value of assets not measured at fair value are as follows:

<i>In thousands of Azerbaijani Manats</i>	December 31, 2017 Level 1 fair value	December 31, 2016 Level 1 fair value
<i>Cash and cash equivalents and mandatory cash balances with CBAR</i>	68,588	44,297

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<i>In thousands of Azerbaijani Manats</i>	December 31, 2017 Level 3 fair value	December 31, 2016 Level 3 fair value
FINANCIAL ASSETS		
<i>Due from banks</i>		
- Short-term placements with other banks	24,601	10,898
<i>Loans and advances to customers</i>		
- Corporate loans	59,237	46,823
- Loans to individuals – entrepreneurs	7,955	7,471
- Loans to individuals – consumer loans	2,015	353
<i>Other financial assets</i>	25	4
TOTAL	93,833	70,089

Fair values analysed by level in the fair value hierarchy and carrying value of liabilities not measured at fair value are as follows:

<i>In thousands of Azerbaijani Manats</i>	December 31, 2017 Level 3 fair value	December 31, 2016 Level 3 fair value
FINANCIAL LIABILITIES		
<i>Due to banks</i>		
- Correspondent accounts of banks	5,101	99
- Short-term placements of banks	23,990	17,849
<i>Customer accounts</i>		
- Current/settlement accounts of state and public organisations	586	526
- Current/settlement accounts of other legal entities	26,987	14,874
- Term deposits of other legal entities	21,898	15,613
- Current/demand accounts of individuals	4,243	4,835
- Term deposits of individuals	37,337	17,205
<i>Other financial liabilities</i>	130	33
TOTAL	120,272	71,034

26 Presentation of Financial Instruments by Measurement Category

For the purposes of measurement, IAS 39 “Financial Instruments: Recognition and Measurement”, classifies financial assets into the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss (“FVTPL”). Financial assets at fair value through profit or loss have two sub-categories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading. All of the Bank’s financial assets fall in the loans and receivables. All of the Bank’s financial liabilities were carried at amortised cost.

27 Related Party Transactions

Parties are generally considered to be related if the parties are under common control, or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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At December 31, 2017, the outstanding balances with related parties were as follows:

<i>In thousands of Azerbaijani Manats</i>	Parent company	Other related parties	Key management personnel
Cash and cash equivalents	11,013	219	-
Due from banks	-	9,229	-
Customer accounts	-	-	4

At December 31, 2016, the outstanding balances with related parties were as follows:

<i>In thousands of Azerbaijani Manats</i>	Parent company	Other related parties	Key management personnel
Cash and cash equivalents	7,138	-	-
Customer accounts	-	-	3

The income and expense items with related parties for 2017 were as follows:

<i>In thousands of Azerbaijani Manats</i>	Parent company	Other related parties	Key management personnel
Interest income	-	-	3
Administrative and operating expenses	-	250	7

The income and expense items with related parties for 2016 were as follows:

<i>In thousands of Azerbaijani Manats</i>	Parent company	Other related parties	Key management personnel
Administrative and operating expenses	-	156	8

At December 31, 2017, other rights and obligations with related parties were as follows:

<i>In thousands of Azerbaijani Manats</i>	Parent company	Other related parties	Key management personnel
Guarantees issued by the Bank at the year end	40,099	-	-
Guarantees received by the Bank at the year end	42,226	-	-

At December 31, 2016, other rights and obligations with related parties were as follows:

<i>In thousands of Azerbaijani Manats</i>	Parent company	Other related parties	Key management personnel
Guarantees issued by the Bank at the year end	40,099	-	-
Guarantees received by the Bank at the year end	44,138	-	-

There were no aggregate amounts lent to and repaid by related parties during 2017 and 2016.

Key management compensation is presented below:

<i>In thousands of Azerbaijani Manats</i>	2017		2016	
	Expense	Accrued liability	Expense	Accrued liability
<i>Short-term benefits:</i>				
- Salaries	541	22	364	42
Total	541	22	364	42

Compensation paid to thirteen members of execution management team is made up of a contractual salary and an annual bonus. The total compensation of executive management is included in operating expenses in the statement of profit or loss and other comprehensive income.

28 Events after the reporting date

On February 12, 2018 the Central Bank of the Republic of Azerbaijan decided to reduce the refinancing rate from 15% to 13%, the ceiling of the interest rate corridor from 18% to 16% and the floor from 10% to 8%.