# Rabitabank OJSC

# Financial Statements
# for the year ended 31 December 2019

# Contents

KPMG

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# Independent Auditors' Report

## To the Shareholders and Supervisory Board of Rabitabank Open Joint-Stock Company

## Opinion

We have audited the financial statements of Rabitabank Open Joint-Stock Company ("the Bank"), which comprise the statement of financial position as at 31 December 2019, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

## Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Code of Ethics for Professional Accountants (including International Independence Standards) together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Azerbaijan, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the International Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Credit loss allowance for loans to customers | |
|---|---|
| Please refer to Note 15 in the financial statements. | |
| **The key audit matter** | **How the matter was addressed in our audit** |
| Loans to customers represent 48% of total assets and are stated net of allowance for expected credit losses ("ECL") that are estimated on a regular basis and are sensitive to the assumptions used.<br><br>The estimation of expected credit losses requires Management to apply significant judgments and estimation techniques to determine probability of default (PD), projected exposure at default (EAD) and loss arising at default (LGD), considering observed historical data, current economic situation and available forward-looking information. The calculation of ECL for loans to customers on an individual basis requires scenario analysis of the estimated future cash flows considering current and projected financial performance of the borrowers and estimated proceeds from realizable collateral.<br><br>Credit loss allowance for loans to customers is a key audit matter due to the significance of the balances to the Bank's financial position, and the complexity and judgement related to the estimation of ECL under IFRS 9 *Financial Instruments*. | We engaged our own specialists in financial risk management to analyse the key aspects of the Bank's methodology and policies related to ECL estimate for compliance with the requirements of IFRS 9 Financial Instruments.<br><br>To analyze the adequacy of professional judgement and assumptions made by management in relation to allowance for ECL estimate we performed the following procedures:<br><br>For loans to legal entities, for which potential changes in ECL may have a significant impact on the financial statements, we tested whether the appropriate Stages are correctly assigned by the Bank by analyzing financial and non-financial information, as well as assumptions and professional judgements, applied by the Bank.<br><br>For a sample of loans to legal entities, we tested the correctness of data inputs for PD, LGD and EAD calculation.<br><br>For a sample of Stage 3 loans to legal entities, where ECL are assessed individually, we critically assessed assumptions used by the Bank to forecast future cash flows, including estimated proceeds from realizable collateral and its expected disposal terms based on our understanding and publicly available market information.<br><br>For loans to individuals we tested the correctness of data inputs for PD, LGD and EAD calculation, timely reflection of delinquency events and loan repayments in the underlying systems and allocation of loans into the appropriate Stages. We agreed input data to supporting documents on a sample basis.<br><br>We also assessed whether the financial statements disclosures appropriately reflect the Bank's exposure to credit risk. |

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

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

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

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

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

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

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

— Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

— Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

— Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

"KPMG Audit Azerbaycan" Məhdud Məsuliyyətli Cəmiyyəti KPMG Limited Liability Company "KPMG Audit Azerbaijan"

Andrey Kouznetsov

"KPMG Audit Azerbaijan" LLC

Baku, the Republic of Azerbaijan

8 June 2020

*(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise stated)*

| | Notes | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|---|
| Interest income calculated using the effective interest method | 4 | 45,583 | 37,988 |
| Interest expense | 4 | (11,120) | (12,924) |
| **Net interest income before reversal of expected credit losses on loans to customers** | | **34,463** | **25,064** |
| Reversal of expected credit losses on loans to customers | 7 | 4,479 | 3,527 |
| Reversal of expected credit losses from due from banks and other financial institutions | 8 | - | 266 |
| **Net interest income** | | **38,942** | **28,857** |
| Fee and commission income | 5 | 9,268 | 7,915 |
| Fee and commission expense | 6 | (4,293) | (3,813) |
| **Net fee and commission income** | | **4,975** | **4,102** |
| Net gain on trading in foreign currencies | | 1,939 | 2,429 |
| Net foreign exchange gain/(loss) | | 43 | (174) |
| Loss on derecognition of financial assets measured at amortized cost | 7 | (239) | - |
| Other operating income | | 195 | 130 |
| **Operating income** | | **45,855** | **35,344** |
| Impairment losses from assets held for sale and other assets | 8 | (2,789) | (1,532) |
| Impairment losses on financial liabilities | 8 | (825) | (225) |
| Personnel expenses | 9 | (16,417) | (12,895) |
| Other general administrative expenses | 10 | (10,762) | (8,759) |
| **Profit before income tax** | | **15,062** | **11,933** |
| Income tax expense | 11 | - | - |
| **Profit for the year** | | **15,062** | **11,933** |
| **Total comprehensive income for the year** | | **15,062** | **11,933** |
| **Earnings per share** | | | |
| Basic and diluted (expressed in AZN) | 23 | **3.02** | **2.44** |

* The Bank initially applied IFRS 16 at 1 January 2019, using the modified retrospective approach. Under this approach, comparative information is not restated. See Note 2(e).

The financial statements as set out on pages 6 to 78 were approved by management on 8 June 2020 and were signed on its behalf by:

Mr. Elchin Gadimov
Chairman of the Management Board

Ms. Malahat Nazirova
Chief Accountant

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

*(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise stated)*

| | Notes | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 12 | 274,614 | 353,520 |
| Due from banks and other financial institutions | 14 | 60,285 | 88,297 |
| Loans to customers | 15 | 351,574 | 279,935 |
| Investment securities | 13 | 13,955 | 11,749 |
| Assets held for sale | 16 | 8,020 | 5,025 |
| Property, equipment and intangible assets | 17 | 9,018 | 9,114 |
| Right-of-use assets | 28 | 2,945 | - |
| Deferred tax assets | 11 | 41 | 41 |
| Other assets | 18 | 7,662 | 6,583 |
| **Total assets** | | **728,114** | **754,264** |
| **LIABILITIES** | | | |
| Deposits and balances from banks | 19 | 20,446 | 17,829 |
| Current accounts and deposits from customers | 20 | 499,588 | 581,473 |
| Other borrowed funds | 21 | 87,401 | 54,963 |
| Subordinated borrowings | 21 | 20,339 | 20,388 |
| Lease liabilities | 28 | 3,071 | - |
| Other liabilities | 22 | 8,699 | 6,103 |
| **Total liabilities** | | **639,544** | **680,756** |
| **EQUITY** | | | |
| Share capital | 23 | 102,047 | 102,047 |
| Revaluation surplus for buildings | | 2,596 | 2,688 |
| Accumulated deficit | | (16,073) | (31,227) |
| **Total equity** | | **88,570** | **73,508** |
| **Total liabilities and equity** | | **728,114** | **754,264** |

* The Bank initially applied IFRS 16 at 1 January 2019, using the modified retrospective approach. Under this approach, comparative information is not restated. See Note 2(e).

Mr. Elchin Gadimov
Chairman of the Management Board

Ms. Malahat Nazirova
Chief Accountant

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

*(Amounts are presented in thousands of Azerbaijani Manats, unless otherwise stated)*

| AZN'000 | Share capital | Revaluation surplus for buildings | Accumulated deficit | Total equity |
|---|---|---|---|---|
| **Balance as at 1 January 2018** | **89,247** | **2,783** | **(43,255)** | **48,775** |
| **Total comprehensive income** | | | | |
| Profit for the year | - | - | 11,933 | 11,933 |
| **Total comprehensive income for the year** | **-** | **-** | **11,933** | **11,933** |
| Shares issued (see Note 23) | 12,800 | - | - | 12,800 |
| Depreciation for buildings' revaluation surplus | - | (95) | 95 | - |
| **Balance as at 31 December 2018** | **102,047** | **2,688** | **(31,227)** | **73,508** |
| **Total comprehensive income** | | | | |
| Profit for the year | - | - | 15,062 | 15,062 |
| **Total comprehensive income for the year** | **-** | - | **15,062** | **15,062** |
| Depreciation for buildings' revaluation surplus | - | (92) | 92 | - |
| **Balance as at 31 December 2019** | **102,047** | **2,596** | **(16,073)** | **88,570** |

* The Bank initially applied IFRS 16 at 1 January 2019, using the modified retrospective approach. Under this approach, comparative information is not restated. See Note 2(e).

Mr. Elchin Gadimov
Chairman of the Management Board

Ms. Malahat Nazirova
Chief Accountant

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

| | Notes | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|---|
| **CASH FLOWS USED IN OPERATING ACTIVITIES** | | | |
| Interest receipts | | 50,410 | 33,288 |
| Interest payments | | (10,944) | (13,231) |
| Fee and commission receipts | | 9,268 | 7,915 |
| Fee and commission payments | | (4,293) | (3,813) |
| Net receipts from foreign exchange | | 1,939 | 2,429 |
| Other operating income receipts | | 195 | 130 |
| Personnel expenses paid | | (16,417) | (12,895) |
| Other general administrative expenses paid | | (8,343) | (8,641) |
| **(Increase) decrease in operating assets** | | | |
| Due from banks and other financial institutions | | 27,282 | (42,491) |
| Loans to customers | | (80,600) | (85,172) |
| Asset held for sale | | 2,559 | 448 |
| Other assets | | (1,104) | (1,982) |
| **Increase (decrease) in operating liabilities** | | | |
| Deposits and balances from banks | | 2,615 | 10,419 |
| Current accounts and deposits from customers | | (82,107) | 20,008 |
| Other liabilities | | 1,230 | 2,554 |
| **Net cash used in operating activities before income tax paid** | | **(108,310)** | **(91,034)** |
| Income tax paid | | - | - |
| **Cash flows used in operations** | | **(108,310)** | **(91,034)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Purchases of investment securities | | (2,159) | (250) |
| Proceeds from sale and repayment of investment securities | | - | 4,837 |
| Acquisition of property, equipment and intangible assets | | (1,001) | (1,612) |
| **Cash flows from investing activities** | | **3,160** | **2,975** |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Receipts of other borrowed funds | | 46,900 | 53,627 |
| Repayment of other borrowed funds | | (13,242) | (50,866) |
| Repayment of subordinated borrowings | | - | (4,762) |
| Proceeds from issue of share capital | | - | 12,800 |
| Payment of lease liabilities | | (1,123) | - |
| **Cash flows from financing activities** | | **32,535** | **10,799** |
| **Net decrease in cash and cash equivalents** | | **(78,935)** | **(77,260)** |
| Effect of changes in exchange rates on cash and cash equivalents | | 29 | (284) |
| Cash and cash equivalents as at the beginning of the year | | 353,520 | 431,064 |
| **Cash and cash equivalents as at the end of the year** | 12 | **274,614** | **353,520** |

* The Bank initially applied IFRS 16 at 1 January 2019, using the modified retrospective approach. Under this approach, comparative information is not restated. See Note 2(e).

Mr. Elchin Gadimov
Chairman of the Management Board

Ms. Malahat Nazirova
Chief Accountant

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

# 1. Background

## (a) Organization and operations

These financial statements comprise the financial statements of OJSC Rabitabank.

The Bank was established in the Republic of Azerbaijan as an Open Joint Stock Company in 1993. Its principal activities are deposit taking, customer account maintenance, credit operations, issuing guarantees, cash and settlement operations, and securities and foreign exchange transactions. The Bank's activities are regulated by the Central Bank of Azerbaijan (CBAR). The Bank has a general banking license, and is a member of the state deposit insurance system in the Republic of Azerbaijan.

The Bank's registered office is 28 May street 33, Baku AZ 1010, the Republic of Azerbaijan.

The Bank has 24 branches and 1 division (2018: 24 branches and 1 division). The majority of its assets and liabilities are located in the Republic of Azerbaijan.

At 31 December 2019 and 31 December 2018, the Bank had investments in two dormant subsidiaries. These subsidiaries did not perform any operations during 2019 and 2018 and are not material for the Bank purposes, therefore, they were not consolidated in these financial statements (2018: no consolidation).

The Bank is owned by:

| | 31 December 2019, % | 31 December 2018, % |
|---|---|---|
| **Shareholder** | | |
| Mr. Rauf Aliyev | 40.60 | 40.60 |
| Ms. Valida Abasova | 30.00 | 30.00 |
| Mr. Zakir Nuriyev | 11.48 | 11.48 |
| Ms. Dilara Nuriyeva | 9.11 | 9.11 |
| Mr. Seyran Nuriyev | 7.60 | 7.60 |
| Mr. Aslan Khasiyev | 1.07 | 1.07 |
| Others | 0.14 | 0.14 |
| **Total** | **100.00** | **100.00** |

## (b) Business environment

### Azerbaijan business environment

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

In addition, the first months of 2020 have seen significant global market turmoil triggered by the outbreak of the coronavirus. Together with other factors, this has resulted in a sharp decrease in the oil price and the stock market indices. These developments are further increasing the level of uncertainty in the Azerbaijani business environment.

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

# 2. Basis of preparation

## (a) Statement of compliance

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

This is the first set of the Bank's annual financial statements in which IFRS 16 Leases has been applied. The related changes to significant accounting policies are described in Note 2(e).

## (b) Basis of measurement

The financial statements are prepared on the historical cost basis except buildings are stated at revalued amounts, investment securities designated as at FVOCI are measured at fair value.

## (c) Functional and presentation currency

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

At 31 December 2019, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.700 and EUR 1 = AZN 1.9035 (31 December 2018: USD 1 = AZN 1.700 and EUR 1 = AZN 1.9468).

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

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

## (d) Use of estimates and judgments

In preparing these financial statements, management has made judgement, estimates and assumptions that affect the application of the Bank's accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

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

**Judgements**

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the financial statements is included in the following notes:

- classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding – Note 3(e)(i)
- establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL – Note 25 (d).

**Assumptions and estimations uncertainty**

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2019 is included in the following notes:

- impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information – Note 25 (d).
- loan impairment estimates - Note 15;
- building revaluation estimates - Note 17;
- estimates of fair values of financial assets and liabilities – Note 31.

## (e) Changes in accounting policies and presentation

The Bank initially applied IFRS 16 Leases from 1 January 2019.

**Leases**

The Bank applied IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings at 1 January 2019. Accordingly, the comparative information presented for 2018 is not restated – i.e. it is presented, as previously reported, under IAS 17 and related interpretations. The details of the changes in accounting policies are disclosed below. Additionally, the disclosure requirements in IFRS 16 have not generally been applied to comparative information.

***i. Definition of lease***

Previously, the Bank determined at contract inception whether an arrangement is or contains a lease under IFRIC 4 *Determining whether an Arrangement contains a Lease*. The Bank now assesses whether a contract is or contains a lease based on the definition of a lease, as explained in Note 2(f)(ii).

On transition to IFRS 16, the Bank elected to apply the practical expedient to grandfather the assessment of which transactions are leases. The Bank applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is a lease under IFRS 16.

***ii. As a lessee***

As a lessee, the Bank leases branch spaces, land, space for ATMs, motor vehicles. The Bank previously classified these leases as operating leases under IAS 17 based on its assessment of whether the lease transferred substantially all of the risks and rewards incidental to ownership of the underlying asset to the Bank. Under IFRS 16, the Bank recognises right-of-use assets and lease liabilities for leases – i.e. these leases are on-balance sheet.

**Leases classified as operating leases under IAS 17**

Previously, the Bank classified property leases as operating leases under IAS 17. On transition, for these leases, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Bank's incremental borrowing rate as at 1 January 2019. Right-of-use assets are measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.

The Bank has tested its right-of-use assets for impairment on the date of transition and has concluded that there is no indication that the right-of-use assets are impaired.

The Bank used a number of practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17. In particular, the Bank:

- did not recognise right-of-use assets and liabilities for leases for which the lease term ends within 12 months of the date of initial application.

### Leases classified as finance leases under IAS 17

The Bank had no lease classified as finance lease under IAS 17

**Impact on financial statements on transition***

On transition to IFRS 16, the Bank recognised additional right-of-use assets and additional lease liabilities with no impact on retained earnings. The impact on transition is summarised below.

| | **1 January 2019** |
|---|---|
| Right-of-use assets – property and equipment | 3,859 |
| Lease liabilities | 3,859 |

* For the impact of IFRS 16 on profit or loss for the period, see Note 28. For the details of accounting policies under IFRS 16 and IAS 17, see Note 3.When measuring lease liabilities for leases

that were classified as operating leases, the Bank discounted lease payments using its incremental borrowing rate at 1 January 2019. The weighted-average rate applied is 10%.

| | **1 January 2019** |
|---|---|
| Operating lease commitments at 31 December 2018 | 2,694 |
| Discounted using the incremental borrowing rate at 1 January 2019 | 2,341 |
| Recognition exemption for leases with less than 12 months of lease term at transition and other contracts | (317) |
| Extension options reasonably certain to be exercised | 1,835 |
| Lease liabilities recognised at 1 January 2019 | 3,859 |

A number of other new interpretations and amendments to the existing standards are effective from 1 January 2019 but they do not have a material effect on the Bank's financial statements, except the one described above.

# 3. Significant accounting policies

Except for the changes disclosed in Note 2(e), the Bank has consistently applied the following accounting policies to all periods presented in these financial statements.

## (a) Foreign currency

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

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

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

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on retranslation of equity securities at FVOCI.

## (b) Interest

***Effective interest rate***

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

***Amortised cost and gross carrying amount***

The ‘amortised cost’ of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The ‘gross carrying amount of a financial asset’ measured at amortised cost is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

***Calculation of interest income and expense***

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, see Note 3(e)(iv).

***Presentation***

Interest income calculated using the effective interest method presented in the statement of profit or loss and other comprehensive income includes:

- interest on financial assets measured at amortised cost.

Interest expense presented in the statement of profit or loss and other comprehensive income includes:

- interest on financial liabilities measured at amortised cost.

## (c) Fees and commission

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate (see Note 3(b)).

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

Other fee and commission income – including account servicing fees and sales commission – is recognised as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment period.

A contract with a customer that results in a recognised financial instrument in the Bank’s financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

## (d) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances (nostro accounts) held with the CBAR and other banks, and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of short-term commitments. The mandatory reserve deposit with the CBAR is not considered to be a cash equivalent due to restrictions on its withdrawability. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

## (e) Financial assets and financial liabilities

### *(i) Classification*

***Financial assets***

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

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

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For debt financial assets measured at FVOCI, gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest income using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When a debt financial asset measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss.

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

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss (see Note 3(e)((ii)) unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in other comprehensive income. Cumulative gains and losses recognised in other comprehensive income are transferred to retained earnings on disposal of an investment.

All other financial assets are classified as measured at FVTPL.

**Business model assessment**

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

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;

- how the performance of the portfolio is evaluated and reported to the Bank’s management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank’s stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

**Assessment whether contractual cash flows are solely payments of principal and interest**

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

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

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

**Reclassification**

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

***Financial liabilities***

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL.

Financial liabilities (including deposits by financial institutions and customers, term borrowings and other financial liabilities) are initially measured at fair value, net of transaction costs, and subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

**Reclassification**

Financial liabilities are not reclassified subsequent to their initial recognition.

### *(ii) Derecognition*

**Financial assets**

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

Any cumulative gain/loss recognised in other comprehensive income in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities, as explained in Note 3 (e)(i). Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

**Financial liabilities**

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

### *(iii) Modification of financial assets and financial liabilities*

**Financial assets**

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different (referred to as ‘substantial modification’), then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

Changes in cash flows on existing financial assets or financial liabilities are not considered as modification, if they result from existing contractual terms, e.g. changes in interest rates initiated by the Bank due to changes in the CBAR key rate, if the loan agreement entitles the Bank to do so.

The Bank performs a quantitative and qualitative evaluation of whether the modification is substantial, i.e. whether the cash flows of the original financial asset and the modified or replaced financial asset are substantially different. The Bank assesses whether the modification is substantial based on quantitative and qualitative factors in the following order: qualitative factors, quantitative factors, combined effect of qualitative and quantitative factors. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset deemed to have expired. In making this evaluation the Bank analogizes to the guidance on the derecognition of financial liabilities.

The Bank concludes that the modification is substantial as a result of the following qualitative factors:

- change the currency of the financial asset;
- change in collateral or other credit enhancement;
- change of terms of financial asset that lead to non-compliance with the SPPI criterion (e.g. inclusion of conversion feature)

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases. The Bank further performs qualitative evaluation of whether the modification is substantial.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

If such a modification is carried out because of financial difficulties of the borrower (see Note 3 (e)(iv), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest method (see Note 3 (b)).

For fixed-rate loans, where the borrower has an option to prepay the loan at par without significant penalty, the Bank treats the modification of an interest rate to a current market rate using the guidance on floating-rate financial instruments. This means that the effective interest rate is adjusted prospectively.

**Financial liabilities**

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

Bank performs a quantitative and qualitative evaluation of whether the modification is substantial considering qualitative factors, quantitative factors and combined effect of qualitative and quantitative factors. The Bank concludes that the modification is substantial as a result of the following qualitative factors:

- change the currency of the financial liability;
- change in collateral or other credit enhancement;
- inclusion of conversion option;
- change in the subordination of the financial liability.

For the quantitative assessment the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

### *(iv) Impairment*

The Bank recognises loss allowances for expected credit losses (ECL) on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments measured at amortized cost;
- financial guarantee contracts issued; and
- loan commitments issued.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition (see Note 25).

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1' financial instruments.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised are referred to as 'Stage 2' and 'Stage 3' financial instruments.

***Measurement of ECL***

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

— *financial assets that are not credit-impaired at the reporting date:* as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);

— *financial assets that are credit-impaired at the reporting date:* as the difference between the gross carrying amount and the present value of estimated future cash flows;

— *undrawn loan commitments:* as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive*; and financial guarantee contracts*: the present value of expected payments to reimburse the holder less any amounts that the Bank expects to recover.

See also Note 25.

***Restructured financial assets***

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised (see Note 3(e)(ii)) and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset (see Note 25).

- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

***Credit-impaired financial assets***

At each reporting date, the Bank assesses whether financial assets carried at amortised cost are credit-impaired (referred to as 'Stage 3 financial assets'). A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

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

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

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a loan that is overdue for 90 days or more is considered credit-impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

***POCI financial assets***

POCI financial assets are assets that are credit-impaired on initial recognition. For POCI assets, lifetime ECL are incorporated into the calculation of the effective interest rate on initial recognition. Consequently, POCI assets do not carry an impairment allowance on initial recognition. The amount recognised as a loss allowance subsequent to initial recognition is equal to the changes in lifetime ECL since initial recognition of the asset.

***Presentation of allowance for ECL in the statement of financial position***

Loss allowances for ECL are presented in the statement of financial position as follows:

- *financial assets measured at amortised cost*: as a deduction from the gross carrying amount of the assets;
- *loan commitments and financial guarantee contracts*: generally, as a provision;
- *where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn*

*component*: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision.

***Write-offs***

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'reversal of expected credit losses on loans to customers' in the statement of profit or loss and other comprehensive income.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

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

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

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

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

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

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

### *(vi) Offsetting*

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Bank currently has a legally enforceable right to set off if that right is not contingent on a future event and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the Bank and all counterparties.

## (f) Loans to customers

'Loans to customers' caption in the statement of financial position include:

- loans to customers measured at amortised cost (see Note 3(e)(i)); they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

## (g) Investment securities

The 'investment securities' caption in the statement of financial position includes:

- debt investment securities measured at amortised cost (see Note 3 (e)(i)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;
- equity investment securities designated as at FVOCI (see Note 3(e)(i)).

## (h) Deposits, subordinated borrowings and other borrowed funds

Deposits, subordinated borrowings and other borrowed funds initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. (see Note 3 (e)(v)).

## (i) Property and equipment

### *(i) Owned assets*

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses, except for buildings, which are stated at revalued amounts as described below.

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

### *(ii) Revaluation*

Buildings are subject to revaluation on a regular basis. The frequency of revaluation depends on the movements in the fair values of the buildings being revalued. A revaluation increase on a building is recognised as other comprehensive income except to the extent that it reverses a previous revaluation decrease recognised in profit or loss, in which case it is recognised in profit or loss. A revaluation decrease on a building is recognised in profit or loss except to the extent that it reverses a previous revaluation increase recognised as other comprehensive income directly in equity, in which case it is recognised in other comprehensive income

### *(iii) Depreciation*

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

The estimated useful lives are as follows:

| | |
|---|---|
| - Buildings | 50 years |
| - computers | 10 years |
| - furniture and equipment | 10 years |
| - vehicles | 7 years |

## (j) Intangible assets

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

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

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

## (k) Assets held for sale

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

## (l) Provisions

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

## (m) Financial guarantees and loan commitments

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured at the higher of the loss allowance determined in accordance with IFRS 9 (see Note 3(e)(iv)) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

The Bank has issued no loan commitments that are measured at FVTPL.

For other loan commitments the Bank recognises a loss allowance (see Note 3(e)(iv));

Liabilities arising from financial guarantees and loan commitments are included within provisions.

## (n) Share capital

### *(i) Ordinary shares*

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

### *(ii) Dividends*

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

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

## (o) Taxation

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

### *(i) Current tax*

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

### *(ii) Deferred tax*

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences:

- the initial recognition of assets or liabilities that affects neither accounting nor taxable profit or loss.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on the reversal of relevant taxable temporary differences. If the amount of taxable temporary differences is insufficient to recognise a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on the business plan for the Bank. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

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

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

In determining the amount of current and deferred tax the Bank takes into account the impact of uncertain tax positions and whether additional taxes, penalties and late-payment interest may be due.

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

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2020 and earlier application is permitted; however, the Bank has not early adopted them in preparing these financial statements.

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

*Amendments to References to Conceptual Framework in IFRS Standards*.
*Definition of a Business (Amendments to IFRS 3).*
*Definition of Material (Amendments to IAS 1 and IAS 8).*
IFRS 17 *Insurance Contracts*.

# 4 Net interest income

| | 2019 AZN’000 | 2018 AZN’000 |
|---|---|---|
| **Interest income calculated using the effective interest method** | | |
| Loans to customers | 37,866 | 27,100 |
| Cash equivalents | 4,253 | 8,136 |
| Due from banks and other financial institutions | 2,861 | 2,156 |
| Investment securities | 603 | 596 |
| | **45,583** | **37,988** |
| | | |
| **Interest expense** | | |
| Current accounts and deposits from customers | 7,369 | 9,445 |
| Deposits from banks and other borrowed funds | 2,225 | 2,006 |
| Subordinated borrowings | 1,191 | 1,473 |
| Lease liabilities | 335 | - |
| | **11,120** | **12,924** |
| | **34,463** | **25,064** |

# 5 Fee and commission income

| | 2019 AZN’000 | 2018 AZN’000 |
|---|---|---|
| Plastic card operations | 3,884 | 2,869 |
| Settlement | 2,096 | 1,741 |
| Cash withdrawal | 1,931 | 1,914 |
| Foreign exchange | 543 | 509 |
| Guarantee letters | 482 | 613 |
| Other | 332 | 269 |
| | **9,268** | **7,915** |

*Performance obligations and revenue recognition policies*

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

| Type of service | Nature and timing of satisfaction of performance obligations, including significant payment terms | Revenue recognition under IFRS 15 |
|---|---|---|
| Retail and corporate banking service | The Bank provides banking services to retail and corporate customers, overdraft facilities, foreign currency transactions, credit card transactions. Transaction-based fees for interchange, foreign currency transactions and overdrafts are charged to the customer’s account when the transaction takes place. | Revenue related to transactions is recognised at the point in time when the transaction takes place. |
| | The Bank charges comission fee to the customers for the guarantee letters issued. | Since, the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs, the Bank recognises revenue over time. |

# 6 Fee and commission expense

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Plastic card operations | 2,767 | 2,306 |
| Payment terminals | 468 | 277 |
| Settlements | 442 | 399 |
| Brokerage | 280 | 452 |
| Cash withdrawal | 152 | 233 |
| Other | 184 | 146 |
| | **4,293** | **3,813** |

# 7 Loss on derecognition of financial assets measured at amortized cost

During 2019, the Bank borrowed AZN 3,440 thousand from the CBAR with annual interest rate of 0.1% based on the decree of the President of the Republic of Azerbaijan signed on 28 February 2019 "On the additional measures related to the solution of problem loans of individuals in the Republic of Azerbaijan". These low-interest rate loans were provided by the CBAR for restructuring problem loans and were measured at fair value on initial recognition. Difference between the consideration received and the fair value of the loans was recognised as a government grant in the amount of AZN 711 thousand. According to the Decree, the Bank restructured eligible gross loans to customers of AZN 4,670 thousand with net carrying amount of AZN 2,557 thousand, by prolonging its maturity to 5 years, reducing the annual interest rate to 1% and changing its currency to AZN. The Bank recognized loss on derecognition of AZN 950 thousand.

# 8 Impairment recovery (losses)

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Reversal of expected credit losses for loans to customers | 4,479 | 3,527 |
| Impairment losses for assets held for sale | (2,787) | (1,532) |
| Reversal of expected credit losses for due from banks and other financial institutions | - | 266 |
| Impairment losses for other assets | (2) | (35) |
| Impairment losses for financial guarantee contracts | (825) | (190) |
| | **865** | **2,036** |

# 9 Personnel expenses

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Employee compensation | 14,169 | 10,526 |
| Payments to Social Security Fund | 2,248 | 2,369 |
| | **16,417** | **12,895** |

# 10 Other general administrative expenses

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| Advertising and marketing | 1,496 | 710 |
| Depreciation and amortization expense | 1,262 | 982 |
| Repairs and maintanence | 1,196 | 745 |
| Depreciation of ROU | 914 | - |
| Insurance of customer deposits | 868 | 942 |
| Office expenses | 797 | 635 |
| Premises security | 720 | 569 |
| Professional services fees | 656 | 502 |
| Membership fees | 639 | 660 |
| Taxes other than income tax | 510 | 465 |
| Communication expense | 466 | 457 |
| Transportation and travel | 263 | 251 |
| Vehicle running costs | 233 | 185 |
| Lease Expense (2018: Rent Expense) | 104 | 1,077 |
| Other expenses | 638 | 579 |
| | **10,762** | **8,759** |

# 11 Income tax expense

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| Current year tax expense | - | - |
| Movement in deferred tax assets and liabilities due to origination and reversal of temporary differences | 3,032 | 2,576 |
| Utilization of deferred tax assets not previously recognized | (3,032) | (2,576) |
| **Total income tax expense** | - | - |

In 2019, the applicable tax rate for current and deferred tax is 20% (2018: 20%).

## Reconciliation of effective tax rate for the year ended 31 December:

| | **2019 AZN'000** | **%** | **2018 AZN'000** | **%** |
|---|---|---|---|---|
| Profit before income tax | 15,062 | | 11,933 | |
| Income tax at the applicable tax rate | 3,012 | 20.0 | 2,387 | 20.0 |
| Utilization of deferred tax assets not previously recognized | (3,032) | (24.0) | (2,576) | (22.0) |
| Non-deductable costs | 20 | 4.0 | 189 | 2.0 |
| Total income tax expense | - | - | - | - |

## Deferred tax assets and liabilities

Temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes and tax losses carried forward give rise to net deferred tax assets as at 31 December 2019 and 31 December 2018. These deferred tax assets are not recognised in these financial statements. Future tax benefits will only be realised if profits will be available against which unused tax losses can be utilised and there are no changes to the law and regulations that adversely affect the Bank's ability to claim deductions in future periods. These future tax benefits are not recognised due to uncertainties concerning their realisation.

The deductible temporary differences do not expire under current tax legislation. The tax loss carry-forwards expire in 2022.

Movements in temporary differences during the years ended 31 December 2019 and 2018 are presented as follows:

| **2019**<br>**AZN'000** | **1 January 2019** | **Recognised in profit or loss** | **31 December 2019** |
|---|---|---|---|
| Tax loss carry-forward | 3,565 | (2,814) | 751 |
| Loans to customers | 2,204 | (1,051) | 1,153 |
| Property and equipment | 11 | (140) | (129) |
| Right-of-use assets | - | (589) | (589) |
| Assets held for sale | 483 | 557 | 1,040 |
| Investment securities | (30) | - | (30) |
| Due from banks and other financial institutions | 164 | (32) | 132 |
| Lease liabilities | - | 614 | 614 |
| Other liabilities | - | 423 | 423 |
| Unrecognised deferred tax assets | (6,356) | 3,032 | (3,324) |
| **Net deferred tax assets** | **41** | **-** | **41** |

| **2018**<br>**AZN'000** | **1 January 2018** | **Recognised in profit or loss** | **31 December 2018** |
|---|---|---|---|
| Tax loss carry-forward | 4,525 | (960) | 3,565 |
| Loans to customers | 4,171 | (1,967) | 2,204 |
| Property and equipment | (237) | 248 | 11 |
| Other assets | 176 | (176) | - |
| Investment securities | (30) | - | (30) |
| Due from banks and other financial institutions | 192 | (28) | 164 |
| Assets held for sale | 176 | 307 | 483 |
| Unrecognised deferred tax assets | (8,932) | 2,576 | (6,356) |
| **Net deferred tax assets** | **41** | **-** | **41** |

# 12 Cash and cash equivalents

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| **Cash on hand** | 38,647 | 31,312 |
| **Nostro accounts with the CBAR** | 69,700 | 196,477 |
| **Nostro accounts and overnight placements with other banks** | | |
| - rated from BBB- to BBB+ | 93,463 | 15,865 |
| - rated from BB- to BB+ | 1,473 | 748 |
| - rated from B- to B+ | 10,108 | 18,613 |
| - not rated | 810 | 2,564 |
| **Total nostro accounts and overnight placements with other banks** | **105,854** | **37,790** |
| **Cash equivalents** | | |
| **CBAR notes** | 41,116 | 51,981 |
| **Term deposits with the CBAR** | 19,297 | 35,960 |
| **Total cash equivalents** | 60,413 | 87,941 |
| | **274,614** | **353,520** |

Financial assets other than loans to customers are graded according to the current credit rating they have been assigned by an internationally regarded agency such as Fitch, Standard & Poor's and Moody's. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

In these financial statements ratings of financial assets and financial liabilities are converted to Fitch ratings.

As at 31 December 2019, the Bank had 2 banks (31 December 2018: 4 banks), whose balances individually exceeded 10% of equity. The gross value of these balances as at 31 December 2019 was AZN 219,069 thousand (31 December 2018: AZN 317,689 thousand).

### Loss allowance

As at 31 December 2019, all balances included in cash and cash equivalents are classified as Stage 1 and their ECL are not material as for 31 December 2019 and 31 December 2018.

# 13 Investment securities

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Investment securities measured at amortised cost | 13,553 | 11,347 |
| Investment securities designated as at FVOCI - equity instruments | 402 | 402 |
| | **13,955** | **11,749** |

All investment securities measured at amortised cost are in Stage 1 and their ECL are not material as for 31 December 2019 and 31 December 2018.

### Investment securities measured at amortised cost

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Corporate bonds | 13,017 | 11,347 |
| Government securities | 536 | - |
| **Debt securities** | **13,553** | **11,347** |

At 31 December 2019, the debt securities included corporate bonds in amount of AZN 11,195 thousand of State Oil Company of Republic of Azerbaijan with rating of BB+, carrying an annual interest rate of 5% with maturities in October 2021 and November 2021 (2018: AZN 11,347 thousand). The Bank also purchased debt securities in amount of AZN 1,822 thousand of two financial institutions with ratings of higher than B. At 1 January 2019, the Bank designated certain investments shown in the following table as equity securities at FVOCI.

**Equity investment securities designated as at FVOCI**

| AZN'000 | 2019 AZN'000 |
|---|---|
| Azerbaijan Credit Bureau LLC | 250 |
| Milli Kart LLC | 120 |
| Master Card International | 32 |
| **Equity securities** | **402** |

**Equity investment securities designated as at FVOCI**

| AZN'000 | 2018 AZN'000 |
|---|---|
| Azerbaijan Credit Bureau LLC | 250 |
| Milli Kart LLC | 120 |
| Master Card International | 32 |
| **Equity securities** | **402** |

# 14 Due from banks and other financial institutions

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| **Mandatory reserve with the CBAR** | 2,807 | 3,302 |
| **Loans and deposits with other banks** | | |
| - rated from A- to A+ | 772 | 770 |
| - rated from BBB- to BBB+ | 34,110 | 66,936 |
| - rated from B- to B+ | 15,227 | 6,947 |
| - not rated | 8,741 | 11,714 |
| **Total loans and deposits with other banks** | **58,850** | **86,367** |
| Loss allowance | (1,372) | (1,372) |
| **Net due from banks and other financial institutions** | **60,285** | **88,297** |

As at 31 December 2019, the Bank had one bank (31 December 2018: one bank), whose balance exceeded 10 % of equity. The gross value of these balance as at 31 December 2019 were AZN 34,110 thousand (31 December 2018: AZN 66,936 thousand).

### Loss allowance

As at 31 December 2019, balances in due from two banks are classified as Stage 3 and allowance is recognised by full amount of AZN 650 thousand. Other balances included in due from banks and other financial institutions are classified as Stage 1 and allowance is recognised of AZN 722 thousand.

As at 31 December 2018, balances in due from two banks are classified as Stage 3 and allowance is recognised by full amount of AZN 883 thousand. Other balances included in due from banks are classified as Stage 1 and allowance is recognised of AZN 489 thousand.

## Analysis of movements in the impairment allowance

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Balance at the beginning of the year | 1,372 | 1,638 |
| Net remeasurement of loss allowance | - | (266) |
| **Balance at the end of the year** | **1,372** | **1,372** |

## Credit risk

As of 31 December 2019 the balance in amount of AZN 8,741 thousand of not rated deposit with other banks belongs to local banks.

In 2018, balance in amount of AZN 561 thousand of not rated deposit with other banks belonged to subsidiary of Turkish Government Bank with rating close to the rating of the government and remaining balance in amount of AZN 11,153 thousand belonged to local banks.

As at 31 December 2019, included in loans and deposits with other banks were AZN 48,605 thousand bearing an annual interest rate of 2-2.5% with three non-resident banks and AZN 1,503 thousand in a blocked non-interest bearing account with other resident and non-resident banks. (31 December 2018: balance with a non-resident bank amounting to AZN 73,883 thousand bearing an annual interest rate of 2%-2.9% and AZN 1,331 thousand in a blocked non-interest bearing account with other resident and non-resident banks).

The analysis of not overdue or credit-impaired loans and deposits with other banks is presented below:

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Not overdue | 58,267 | 85,484 |
| Overdue more than 90 days and less than 360 days | 575 | - |
| Overdue more than 360 days | 8 | 883 |
| Loss allowance | (1,372) | (1,372) |
| **Total loans and deposits wih other banks** | **57,478** | **84,995** |

## Mandatory reserve with the CBAR

The mandatory reserve deposit is a non-interest bearing deposit calculated in accordance with regulations issued by the CBAR and whose withdrawability is restricted. Reserves are measured in accordance with regulations issued by the CBAR and equal to 0.5% and 1% (2018: 0.5% and 1%) of the average qualifying customer accounts balances in national and foreign currencies, respectively.

# 15 Loans to customers

| | 2019 AZN'000 | % of total gross loans | 2018 AZN'000 | % of total gross loans |
|---|---|---|---|---|
| **Loans to corporate customers** | | | | |
| Corporate loans | 251,783 | 60 % | 247,701 | 62% |
| **Total loans to corporate customers** | **251,783** | | **247,701** | |
| | | | | |
| **Loans to individual customers** | | | | |
| Cash loans | 55,070 | 13% | 39,151 | 10% |
| Mortgage loans | 40,960 | 10% | 34,937 | 9% |
| Lombard loans | 23,369 | 6% | 19,179 | 5% |
| Micro loans | 17,801 | 4% | 27,262 | 7% |
| Consumer loans | 17,311 | 4% | 19,868 | 5% |
| Car loans | 7,380 | 2% | 10,158 | 3% |
| Credit cards | 2,781 | 1% | 3,631 | 1% |
| **Total loans to individual customers** | **164,672** | | **154,186** | |
| | | | | |
| **Gross loans to customers** | **416,454** | | **401,887** | |
| Loss allowance | (64,881) | | (121,952) | |
| **Net loans to customers** | **351,574** | | **279,935** | |

The following tables show reconciliations from the opening to the closing balances of the loss allowance of loans to customers.

| AZN'000 | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3** | **Total** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **Loans to customers at amortised cost*** | | | | | | | | |
| Balance at 1 January | 2,582 | 66 | 119,304 | 121,952 | 3,324 | 700 | 108,030 | 112,054 |
| Transfer to Stage 1 | 1,639 | (6) | (1,633) | - | 1,013 | (11) | (1,002) | - |
| Transfer to Stage 2 | (1) | 16 | (15) | - | (108) | 206 | (98) | - |
| Transfer to Stage 3 | (32) | (10) | 42 | - | - | (118) | 118 | - |
| Net remeasurement of loss allowance | (1,161) | 25 | (5,727) | (6,863) | (2,233) | (711) | (1,169) | (4,113) |
| New financial assets originated or purchased | 2,346 | 39 | - | 2,385 | 586 | - | - | 586 |
| Financial assets that have been derecognized | - | - | (2,113) | (2,113) | - | - | - | - |
| Write-offs | - | - | (57,682) | (57,682) | - | - | (579) | (579) |
| Recoveries of assets previously written -off | - | - | 2,020 | 2,020 | - | - | - | - |
| Unwinding of discount on present value of ECLs | - | - | 5,182 | 5,182 | - | - | 14,004 | 14,004 |
| **Balance at 31 December** | **5,373** | **130** | **59,378** | **64,881** | **2,582** | **66** | **119,304** | **121,952** |

| AZN'000 | 2019 Stage 1 | 2019 Stage 2 | 2019 Stage 3 | 2019 Total | 2018 Stage 1 | 2018 Stage 2 | 2018 Stage 3 | 2018 Total |
|---|---|---|---|---|---|---|---|---|
| **Loan to customers at amortised cost-corporate loans*** | | | | | | | | |
| Balance at 1 January | 1,938 | - | 72,914 | 74,852 | 2,647 | 614 | 66,121 | 69,382 |
| Transfer to Stage 1 | 1,527 | - | (1,527) | - | 430 | - | (430) | - |
| Transfer to Stage 2 | - | - | - | - | (80) | 87 | (7) | - |
| Transfer to Stage 3 | (25) | - | 25 | - | - | (79) | 79 | - |
| Net remeasurement of loss allowance | (1,914) | 40 | - | (1,874) | (1,379) | (622) | 780 | (1,221) |
| New financial assets originated or purchased | 1,330 | 12 | 2,233 | 3,575 | 320 | - | - | 320 |
| Write-offs | - | - | (38,482) | (38,482) | - | - | (121) | (121) |
| Recoveries of assets previously written -off | - | - | 2,020 | 2,020 | | | | |
| Unwinding of discount on present value of ECLs | - | - | 3,048 | 3,048 | - | - | 6,492 | 6,492 |
| **Balance at 31 December** | **2,856** | **52** | **40,231** | **43,139** | **1,938** | **-** | **72,914** | **74,852** |

| AZN'000 | 2019 Stage 1 | 2019 Stage 2 | 2019 Stage 3 | 2019 Total | 2018 Stage 1 | 2018 Stage 2 | 2018 Stage 3 | 2018 Total |
|---|---|---|---|---|---|---|---|---|
| **Loan to customers at amortised cost-cash loans*** | | | | | | | | |
| Balance at 1 January | 493 | 38 | 16,845 | 17,376 | 307 | 43 | 14,926 | 15,276 |
| Transfer to Stage 1 | 17 | (2) | (15) | - | 109 | (3) | (106) | - |
| Transfer to Stage 2 | (1) | 16 | (15) | - | (15) | 47 | (32) | - |
| Transfer to Stage 3 | (4) | (7) | 11 | - | - | (24) | 24 | - |
| Net remeasurement of loss allowance | 863 | (15) | (3,480) | (2,632) | (111) | (25) | (1,070) | (1,206) |
| New financial assets originated or purchased | 859 | 25 | - | 884 | 203 | - | - | 203 |
| Financial assets that have been derecognized | - | - | (2,113) | (2,113) | | | | |
| Write-offs | - | - | (8,033) | (8,033) | | | | |
| Unwinding of discount on present value of ECLs | - | - | 937 | 937 | - | - | 3,103 | 3,103 |
| **Balance at 31 December** | **2,227** | **55** | **4,137** | **6,419** | **493** | **38** | **16,845** | **17,376** |

| AZN'000 | 2019 Stage 1 | 2019 Stage 2 | 2019 Stage 3 | 2019 Total | 2018 Stage 1 | 2018 Stage 2 | 2018 Stage 3 | 2018 Total |
|---|---|---|---|---|---|---|---|---|
| **Loan to customers at amortised mortgage-loans*** | | | | | | | | |
| Balance at 1 January | 24 | 5 | 569 | 598 | 46 | - | 563 | 609 |
| Transfer to Stage 1 | 59 | (4) | (55) | - | 10 | - | (10) | - |
| Net remeasurement of loss allowance | (33) | 8 | 23 | (2) | (33) | 5 | (15) | (56) |
| New financial assets originated or purchased | 16 | - | - | 16 | 16 | - | - | 14 |
| Write-offs | - | - | (107) | (107) | - | - | (27) | (27) |
| Unwinding of discount on present value of ECLs | - | - | 30 | 30 | - | - | 58 | 58 |
| **Balance at 31 December** | **66** | **9** | **460** | **535** | **66** | **5** | **569** | **598** |

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| **AZN'000** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **Loan to customers at amortised cost-micro loans** | | | | | | | | |
| Balance at 1 January | 85 | 23 | 20,221 | 20,329 | 77 | 22 | 19,547 | 19,646 |
| Transfer to Stage 1 | 34 | - | (34) | - | 411 | - | (411) | - |
| Transfer to Stage 2 | - | - | - | - | (6) | 60 | (54) | - |
| Transfer to Stage 3 | (2) | (3) | 5 | - | - | (11) | 11 | - |
| Net remeasurement of loss allowance | (54) | (14) | (4,548) | (4,616) | (421) | (48) | (1,826) | (2,295) |
| New financial assets originated or purchased | 76 | - | - | 76 | 24 | - | - | 24 |
| Write-offs | - | - | (6,710) | (6,710) | - | - | (146) | (146) |
| Unwinding of discount on present value of ECLs | - | - | 798 | 798 | - | - | 3,100 | 3,100 |
| **Balance at 31 December** | **139** | **6** | **9,732** | **9,877** | **85** | **23** | **20,221** | **20,329** |

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| **AZN'000** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** |
| **Loan to customers at amortised cost-consumer loans*** | | | | | | | | |
| Balance at 1 January | 27 | - | 3,333 | 3,360 | 12 | 2 | 1,206 | 1,220 |
| Transfer to Stage 1 | - | - | - | - | 16 | - | (16) | - |
| Transfer to Stage 2 | - | - | - | - | (1) | 1 | - | |
| Transfer to Stage 3 | (1) | - | 1 | - | - | (2) | 2 | - |
| Net remeasurement of loss allowance | 26 | 3 | 705 | 734 | (19) | (1) | 1,829 | 1,809 |
| New financial assets originated or purchased | - | - | - | - | 19 | - | - | 19 |
| Write-offs | - | - | (597) | (597) | - | - | (42) | (42) |
| Unwinding of discount on present value of ECLs | - | - | 250 | 250 | - | - | 354 | 354 |
| **Balance at 31 December** | **52** | **3** | **3,692** | **3,747** | **27** | **-** | **3,333** | **3,360** |

| AZN'000 | 2019 Stage 1 | 2019 Stage 2 | 2019 Stage 3 | 2019 Total | 2018 Stage 1 | 2018 Stage 2 | 2018 Stage 3 | 2018 Total |
|---|---|---|---|---|---|---|---|---|
| **Loan to customers at amortised cost-lombard loans*** | | | | | | | | |
| Balance at 1 January | - | - | 386 | 386 | - | - | 326 | 326 |
| Transfer to Stage 1 | - | - | - | - | 5 | - | (5) | - |
| Net remeasurement of loss allowance | - | - | 11 | 11 | (5) | - | 35 | 30 |
| Write-offs | - | - | (192) | (192) | - | - | (42) | (42) |
| Unwinding of discount on present value of ECLs | - | - | 28 | 28 | - | - | 72 | 72 |
| **Balance at 31 December** | **-** | **-** | **233** | **233** | **-** | **-** | **386** | **386** |

| AZN'000 | 2019 Stage 1 | 2019 Stage 2 | 2019 Stage 3 | 2019 Total | 2018 Stage 1 | 2018 Stage 2 | 2018 Stage 3 | 2018 Total |
|---|---|---|---|---|---|---|---|---|
| **Loan to customers at amortised cost- car loans*** | | | | | | | | |
| Balance at 1 January | - | - | 3,420 | 3,420 | 133 | 19 | 3,588 | 3,740 |
| Transfer to Stage 1 | - | - | - | - | 8 | (8) | - | - |
| Transfer to Stage 2 | - | - | - | - | (5) | 10 | (5) | - |
| Transfer to Stage 3 | - | - | - | - | - | (1) | 1 | - |
| Net remeasurement of loss allowance | 4 | 2 | (300) | (294) | (136) | (20) | (628) | (784) |
| New financial assets originated or purchased | 10 | - | - | 10 | - | - | - | - |
| Write-offs | - | - | (2,864) | (2,864) | - | - | (156) | (156) |
| Unwinding of discount on present value of ECLs | - | - | 33 | 33 | - | - | 620 | 620 |
| **Balance at 31 December** | **14** | **2** | **289** | **305** | **-** | **-** | **3,420** | **3,420** |

| AZN'000 | 2019 Stage 1 | 2019 Stage 2 | 2019 Stage 3 | 2019 Total | 2018 Stage 1 | 2018 Stage 2 | 2018 Stage 3 | 2018 Total |
|---|---|---|---|---|---|---|---|---|
| **Loan to customers at amortised cost- credit cards*** | | | | | | | | |
| Balance at 1 January | 15 | - | 1,616 | 1,631 | 102 | - | 1,753 | 1,855 |
| Transfer to Stage 1 | 1 | - | (1) | - | 24 | - | (24) | - |
| Transfer to Stage 2 | - | - | - | - | (1) | 1 | - | |
| Transfer to Stage 3 | - | - | - | - | - | (1) | 1 | - |
| Net remeasurement of loss allowance | (51) | - | (373) | (424) | (116) | - | (274) | (390) |
| New financial assets originated or purchased | 54 | 3 | - | 57 | 6 | - | - | 6 |
| Write-offs | - | - | (696) | (696) | - | - | (45) | (45) |
| Unwinding of discount on present value of ECLs | - | - | 58 | 58 | - | - | 205 | 205 |
| **Balance at 31 December** | **19** | **3** | **604** | **626** | **15** | **-** | **1,616** | **1,631** |

* The loss allowance in these tables includes ECL on loan commitments, because the Bank does not separately identify the ECL on the loan commitment component from those on the financial instrument component.

Significant changes in the gross carrying amount of financial instruments during the period that contributed to changes in loss allowance were as follows:

### Loans to customers at amortised cost

During the year 2019 AZN 4,013 thousand loan repayments were made directly by the government as a compensation of a devaluation effect on foreign currency loan balances, based on the decree of the President signed on 28 February 2019. The outstanding gross principal balance for AZN 4,670 thousand was derecognised as a result of substantial modification leading to the decrease in the loss allowance by AZN 2,113 thousand. As a result of restructuring the Bank recognized POCI assets in the amount of AZN 1,722 thousand and loss on derecognition of AZN 950 thousand (see Note 7).

The repayment of AZN 4,786 thousand micro loans in Stage 3 by the borrowers during the year decreased the loss allowance by AZN 4,548 thousand.

Newly issued corporate loans in the gross carrying amount of AZN 21,783 thousand which were transferred into Stage 3 during the year led to the increase in ECL by AZN 2,233 thousand.

### Credit quality analysis

The following table sets out information about the credit quality of loans to customers measured at amortised cost as at 31 December 2019 and as at 31 December 2018. Unless specially indicated, the amounts in the table represent gross carrying amounts.

Explanation of the terms: Stage 1, Stage 2 and Stage 3 are included in Note (3 (e)(iv)).

Loan categories presented in the tables below are based on the quality of loans as following: Excellent-Not overdue, Good-Overdue less than 30 days, Satisfactory-Overdue 30-89 days, Non-satisfactory-Overdue 90-179 days, Special monitoring-Overdue 180-360 days, Non-performing-Overdue more than 360 days.

| **AZN'000** | **31 December 2019** | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Corporate*** | | | | |
| Excellent | 133,388 | - | 33,814 | 167,202 |
| Good | 42,705 | - | 800 | 43,505 |
| Satisfactory | - | 596 | 206 | 802 |
| Non-satisfactory | - | - | 574 | 574 |
| Special monitoring | - | - | 1,867 | 1,867 |
| Non-performing | - | - | 37,833 | 37,833 |
| | **176,093** | **596** | **75,094** | **251,783** |
| **Loss allowance** | **(2,856)** | **(52)** | **(40,231)** | **(43,139)** |
| **Carrying amount** | **173,237** | **544** | **34,863** | **208,644** |

| **AZN'000** | **31 December 2018** | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Corporate loans*** | | | | |
| Excellent | 115,340 | - | 5,255 | 120,595 |
| Good | 40,139 | - | 239 | 40,378 |
| Satisfactory | - | 429 | 610 | 1,039 |
| Non-satisfactory | - | - | 4,075 | 4,075 |
| Special monitoring | - | - | 13,691 | 13,691 |
| Non-performing | - | - | 67,923 | 67,923 |
| | **155,479** | **429** | **91,793** | **247,701** |
| **Loss allowance** | **(1,938)** | **-** | **(72,914)** | **(74,852)** |
| **Carrying amount** | **153,541** | **429** | **18,879** | **172,849** |

| **AZN'000** | **31 December 2019** | | | | |
|---|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **POCI** | **Total** |
| **Loans to customers at amortised cost - *Cash loans*** | | | | | |
| Excellent | 47,827 | 107 | 2,216 | 1,722 | 51,872 |
| Good | 1,020 | 21 | 88 | - | 1,129 |
| Satisfactory | 5 | 148 | 141 | - | 294 |
| Non-satisfactory | - | 5 | 220 | - | 225 |
| Special monitoring | - | - | 275 | - | 275 |
| Non-performing | - | - | 1,275 | - | 1,275 |
| **Total** | **48,852** | **281** | **4,215** | **1,722** | **55,070** |
| Loss allowance | **(2,227)** | **(55)** | **(4,137)** | **-** | **(6,419)** |
| **Carrying amount** | **46,625** | **226** | **78** | **1,722** | **48,651** |

| **AZN'000** | **31 December 2018** | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Cash loans*** | | | | |
| Excellent | 20,890 | - | 180 | 21,070 |
| Good | 942 | - | 27 | 969 |
| Satisfactory | 26 | 134 | 55 | 215 |
| Non-satisfactory | - | - | 255 | 255 |
| Special monitoring | - | - | 490 | 490 |
| Non-performing | - | - | 16,152 | 16,152 |
| | **21,858** | **134** | **17,159** | **39,151** |
| **Loss allowance** | **(493)** | **(38)** | **(16,845)** | **(17,376)** |
| **Carrying amount** | **21,365** | **96** | **314** | **21,775** |

| **AZN'000** | **31 December 2019** | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Mortgage loans*** | | | | |
| Excellent | 39,721 | 7 | 74 | 39,802 |
| Good | 316 | - | 33 | 349 |
| Satisfactory | - | 296 | - | 296 |
| Non-satisfactory | - | - | 61 | 61 |
| Special monitoring | - | - | 452 | 452 |
| | **40,037** | **303** | **620** | **40,960** |
| **Loss allowance** | **(66)** | **(9)** | **(460)** | **(535)** |
| **Carrying amount** | **39,971** | **294** | **160** | **40,425** |

| AZN'000 | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Mortgage loans*** | | | | |
| Excellent | 32,776 | - | 206 | 32,982 |
| Good | 898 | - | - | 898 |
| Satisfactory | - | 311 | - | 311 |
| Non-satisfactory | - | - | 44 | 44 |
| Special monitoring | - | - | 42 | 42 |
| Non-performing | - | - | 660 | 660 |
| | **33,674** | **311** | **952** | **34,937** |
| **Loss allowance** | **(24)** | **(5)** | **(569)** | **(598)** |
| **Carrying amount** | **33,650** | **306** | **383** | **34,339** |

| AZN'000 | 31 December 2019 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Micro loans*** | | | | |
| Excellent | 7,241 | 9 | 90 | 7,340 |
| Good | 225 | - | 16 | 241 |
| Satisfactory | - | 35 | 18 | 53 |
| Non-satisfactory | - | - | 85 | 85 |
| Special monitoring | - | - | 128 | 128 |
| Non-performing | - | - | 9,954 | 9,954 |
| | **7,466** | **44** | **10,291** | **17,801** |
| **Loss allowance** | **(139)** | **(6)** | **(9,732)** | **(9,877)** |
| **Carrying amount** | **7,327** | **38** | **559** | **7,924** |

| AZN'000 | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Micro loans*** | | | | |
| Excellent | 4,779 | - | 186 | 4,965 |
| Good | 583 | - | 32 | 616 |
| Satisfactory | - | 113 | 82 | 195 |
| Non-satisfactory | - | - | 243 | 243 |
| Special monitoring | - | - | 416 | 416 |
| Non-performing | - | - | 20,828 | 20,828 |
| | **5,362** | **113** | **21,787** | **27,262** |
| **Loss allowance** | **(85)** | **(23)** | **(20,021)** | **(20,329)** |
| **Carrying amount** | **5,277** | **90** | **1,766** | **6,933** |

| AZN'000 | 31 December 2019 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Consumer loans*** | | | | |
| Excellent | 11,785 | 169 | 3,510 | 15,464 |
| Good | 333 | 20 | 3 | 356 |
| Satisfactory | - | 63 | 24 | 87 |
| Non-satisfactory | - | - | - | - |
| Special monitoring | - | - | 47 | 47 |
| Non-performing | - | - | 1,357 | 1,357 |
| | **12,118** | **252** | **4,941** | **17,311** |
| **Loss allowance** | **(52)** | **(3)** | **(3,692)** | **(3,747)** |
| **Carrying amount** | **12,066** | **249** | **1,249** | **13,564** |

| AZN'000 | 31 December 2018 | | | |
|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3* | Total |
| ***Loans to customers at amortised cost – Consumer loans*** | | | | |
| Excellent | 12,116 | - | 9 | 12,125 |
| Good | 3,464 | - | - | 3,464 |
| Satisfactory | - | 100 | 30 | 130 |
| Non-satisfactory | - | 22 | 71 | 93 |
| Special monitoring | - | - | 2,302 | 2,302 |
| Non-performing | - | - | 1,754 | 1,754 |
| | **15,580** | **122** | **4,166** | **19,868** |
| **Loss allowance** | **(27)** | **-** | **(3,333)** | **(3,360)** |
| **Carrying amount** | **15,553** | **122** | **833** | **16,508** |

| AZN'000 | 31 December 2019 | | | |
|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3* | Total |
| ***Loans to customers at amortised cost – Lombard loans*** | | | | |
| Excellent | 21,820 | 10 | 2 | 21,832 |
| Good | 1,157 | 5 | 1 | 1,163 |
| Satisfactory | 3 | 62 | - | 65 |
| Non-satisfactory | - | - | 20 | 20 |
| Special monitoring | - | - | 13 | 13 |
| Non-performing | - | - | 276 | 276 |
| | **22,980** | **77** | **312** | **23,369** |
| **Loss allowance** | **-** | **-** | **(233)** | **(233)** |
| **Carrying amount** | **22,980** | **77** | **79** | **23,136** |

| AZN'000 | 31 December 2018 | | | |
|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3* | Total |
| ***Loans to customers at amortised cost – Lombard loans*** | | | | |
| Excellent | 17,298 | - | - | 17,298 |
| Good | 1,298 | - | 4 | 1,302 |
| Satisfactory | 1 | 60 | - | 61 |
| Non-satisfactory | - | - | 6 | 6 |
| Special monitoring | - | - | 33 | 33 |
| Non-performing | - | - | 479 | 479 |
| | **18,597** | **60** | **522** | **19,179** |
| **Loss allowance** | **-** | **-** | **(386)** | **(386)** |
| **Carrying amount** | **18,597** | **60** | **136** | **18,793** |

| AZN'000 | 31 December 2019 | | | |
|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3* | Total |
| ***Loans to customers at amortised cost – Car loans*** | | | | |
| Excellent | 6,239 | - | - | 6,239 |
| Good | 283 | - | - | 283 |
| Satisfactory | - | 35 | - | 35 |
| Non-satisfactory | - | - | 27 | 27 |
| Special monitoring | - | - | 69 | 69 |
| Non-performing | - | - | 727 | 727 |
| | **6,522** | **35** | **823** | **7,380** |
| **Loss allowance** | **(14)** | **(2)** | **(289)** | **(305)** |
| **Carrying amount** | **6,508** | **33** | **534** | **7,075** |

| AZN'000 | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Car loans*** | | | | |
| Excellent | 5,750 | - | 57 | 5,807 |
| Good | 377 | - | 11 | 388 |
| Satisfactory | - | 87 | 6 | 93 |
| Non-satisfactory | - | - | 3 | 3 |
| Special monitoring | - | - | 31 | 31 |
| Non-performing | - | - | 3,836 | 3,836 |
| | **6,127** | **87** | **3,944** | **10,158** |
| **Loss allowance** | **-** | **-** | **(3,420)** | **(3,420)** |
| **Carrying amount** | **6,127** | **87** | **524** | **6,738** |

| AZN'000 | 31 December 2019 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Credit cards*** | | | | |
| Excellent | 2,117 | 40 | 9 | 2,166 |
| Good | - | - | 42 | 42 |
| Satisfactory | - | - | 12 | 12 |
| Special monitoring | - | - | 12 | 12 |
| Non-performing | - | - | 549 | 549 |
| | **2,117** | **40** | **624** | **2,781** |
| **Loss allowance** | **(19)** | **(3)** | **(604)** | **(626)** |
| **Carrying amount** | **2,098** | **37** | **20** | **2,155** |

| AZN'000 | 31 December 2018 | | | |
|---|---|---|---|---|
| | **Stage 1** | **Stage 2** | **Stage 3*** | **Total** |
| ***Loans to customers at amortised cost – Credit cards*** | | | | |
| Excellent | 1,952 | - | 6 | 1,958 |
| Good | - | - | 43 | 43 |
| Satisfactory | - | - | 7 | 7 |
| Non-satisfactory | - | - | 3 | 3 |
| Special monitoring | - | - | 7 | 7 |
| Non-performing | - | - | 1,613 | 1,613 |
| | **1,952** | **-** | **1,679** | **3,631** |
| **Loss allowance** | **(15)** | **-** | **(1,616)** | **(1,631)** |
| **Carrying amount** | **1,937** | **-** | **63** | **2,000** |

**Stage 3 loan balances also include accrued interest in amounts of AZN 37,386 thousand and AZN 63,338 thousand as at 31 December 2019 and 2018 respectively.*

The following table sets out information on loans to customers that are credit-impaired and related collateral held in order to mitigate potential losses as at 31 December 2019:

| | | | | Fair value of collateral held | | | | |
|---|---|---|---|---|---|---|---|---|
| **AZN'000** | **Gross carrying amount** | **Loss allowance** | **Carrying amount** | **Cash and deposits** | **Precious metals** | **Real estate** | **Equipments** | **Total** |
| Corporate loans | 75,094 | (40,231) | 34,863 | 12,941 | - | 21,275 | 647 | 34,863 |
| Cash loans | 4,215 | (4,137) | 78 | - | - | 78 | - | 78 |
| Mortgage loans | 620 | (460) | 160 | - | - | 160 | - | 160 |
| Micro loans | 10,291 | (9,732) | 559 | - | 122 | 145 | 292 | 559 |
| Consumer loans | 4,941 | (3,692) | 1,249 | - | - | 1,249 | - | 1,249 |
| Lombard loans | 312 | (233) | 79 | - | 79 | - | - | 79 |
| Car loans | 823 | (289) | 534 | - | - | 23 | 511 | 534 |
| Credit cards | 624 | (604) | 20 | 2 | - | - | 18 | 20 |
| **Total credit-impaired loans to customers** | **96,920** | **(59,378)** | **37,542** | **12,943** | **201** | **22,930** | **1,468** | **37,542** |

The following table provides information on collateral securing loans to customers, net of impairment, by types of collateral as at 31 December 2019:

| | | | | Fair value of collateral held | | | | |
|---|---|---|---|---|---|---|---|---|
| **AZN'000** | **Gross carrying amount** | **Loss allowance** | **Carrying amount** | **Cash and deposits** | **Precious metals** | **Real estate** | **Equipments** | **Total** |
| Corporate loans | 251,783 | (43,139) | 208,644 | 53,689 | 69 | 145,432 | 9,454 | 208,644 |
| Cash loans | 55,070 | (6,419) | 48,651 | 6 | 138 | 41,663 | 6,844 | 48,651 |
| Mortgage loans | 40,960 | (535) | 40,425 | - | - | 40,425 | - | 40,425 |
| Micro loans | 17,801 | (9,877) | 7,924 | 38 | 1,125 | 2,455 | 4,306 | 7,924 |
| Consumer loans | 17,311 | (3,747) | 13,564 | 9,764 | - | 3,786 | 14 | 13,564 |
| Lombard loans | 23,369 | (233) | 23,136 | - | 23,136 | - | - | 23,136 |
| Car loans | 7,380 | (305) | 7,075 | - | - | | 7,075 | 7,075 |
| Credit cards | 2,781 | (626) | 2,155 | 1,254 | - | 524 | 195 | 1,973 |
| **Total loans to customers** | **416,455** | **(64,881)** | **351,574** | **64,751** | **24,468** | **234,285** | **27,888** | **351,392** |

The following table sets out information on loans to customers that are credit-impaired and related collateral held in order to mitigate potential losses as at 31 December 2018:

| | | | | Fair value of collateral held | | | | |
|---|---|---|---|---|---|---|---|---|
| **AZN'000** | **Gross carrying amount** | **Loss allowance** | **Carrying amount** | **Cash and deposits** | **Precious metals** | **Real estate** | **Equipments** | **Total** |
| Corporate loans | 91,793 | (72,914) | 18,879 | 5 | - | 18,364 | 425 | 18,794 |
| Cash loans | 17,159 | (16,845) | 314 | - | - | 44 | 18 | 62 |
| Mortgage loans | 952 | (569) | 383 | - | - | 382 | - | 382 |
| Micro loans | 21,787 | (20,221) | 1,566 | - | 2 | 1,215 | - | 1,217 |
| Consumer loans | 4,166 | (3,333) | 833 | - | - | 826 | - | 828 |
| Lombard loans | 522 | (386) | 136 | - | 136 | - | - | 136 |
| Car loans | 3,944 | (3,420) | 524 | - | - | 11 | 511 | 522 |
| Credit cards | 1,679 | (1,616) | 63 | 2 | - | - | - | 2 |
| **Total credit-impaired loans to customers** | **142,002** | **(119,304)** | **22,698** | **7** | **138** | **20,842** | **954** | **21,941** |

The following table provides information on collateral securing loans to customers, net of impairment, by types of collateral as at 31 December 2018:

| | | | | Fair value of collateral held | | | | |
|---|---|---|---|---|---|---|---|---|
| **AZN'000** | **Gross carrying amount** | **Loss allowance** | **Carrying amount** | **Cash and deposits** | **Precious metals** | **Real estate** | **Equipments** | **Total** |
| Corporate loans | 247,701 | (74,852) | 172,849 | 58,746 | 15 | 81,576 | 5,286 | 145,623 |
| Cash loans | 39,151 | (17,376) | 21,775 | 6 | 25 | 1,444 | 176 | 1,651 |
| Mortgage loans | 34,937 | (598) | 34,339 | - | - | 33,724 | 2 | 33,726 |
| Micro loans | 27,262 | (20,329) | 6,933 | - | 234 | 4,471 | 1,875 | 6,580 |
| Consumer loans | 19,868 | (3,360) | 16,508 | 8,057 | - | 8,403 | 9 | 16,469 |
| Lombard loans | 19,179 | (386) | 18,793 | - | 18,787 | - | - | 18,787 |
| Car loans | 10,158 | (3,420) | 6,738 | - | - | 13 | 6,722 | 6,735 |
| Credit cards | 3,631 | (1,631) | 2,000 | 348 | - | 70 | - | 418 |
| **Total loans to customers** | **401,887** | **(121,952)** | **279,935** | **67,157** | **19,061** | **129,701** | **14,070** | **229,989** |

As at 31 December 2019 the Bank held loans (corporate, consumer) in the amount of AZN 64,751 thousand for which no loss allowance was recognised as they are collateralized by cash. During the reporting period there were no changes in the Bank's collateral policies.

### *Repossessed collateral*

During the year ended 31 December 2019, the Bank obtained certain assets by taking possession of collateral for loans to customers with a net carrying amount of AZN 8,341 (2018: 1,267 thousand).

## (o) Significant credit exposures

As at 31 December 2019, the Bank had 5 borrowers or groups of connected borrowers (31 December 2018: 6) with gross loan balances individually exceeding 10% of equity. The gross value of these loans as at 31 December 2019 was AZN 96,812 thousands (31 December 2018: AZN 93,773 thousands)

## (p) Loan maturities

The maturity of the loan portfolio is presented in Note 25, which shows the remaining period from the reporting date to the contractual maturity of the loans.

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

As at December 31, 2019 and 2018, the Bank estimates ECL for significant corporate loans in Stage 3 based on an individual review of each loan and estimation of its future cash flows. This estimate of future cash flows is dependent on factors such as the estimated value of underlying collateral and delay of 12 to 48 months in obtaining proceeds from the foreclosure of collateral. The Bank then calculates the net present value of these cash flows using a discount rate which equates to the original effective interest rate of the loan, in order to determine the required amount of ECL.

For the remaining portfolio of loans the Bank calculates ECL as described in Note 25 (d), on a collective basis. The key areas of uncertainty and assumptions used in the calculation of the collective impairment are:

- a delay in obtaining proceeds from the foreclosure of collateral;
- a discount of 20% for real estates originally appraised value,

Changes in these estimates could affect the expected credit losses. For example, to the extent that the net present value of the estimated cash flow differs by one percent, the expected credit losses on loans to customers as at 31 December 2019 would be AZN 649 thousand lower/higher (31 December 2018: AZN 1,219 thousand lower/higher).

# 16 Assets held for sale

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Balance at the beginning of the year | 7,078 | 6,259 |
| Repossessed during the year | 8,341 | 1,267 |
| Disposals | (2,559) | (448) |
| Impairment allowance | (4,840) | (2,053) |
| **Balance at the end of the year** | **8,020** | **5,025** |

As at 31 December 2019, included in assets held for sale are collaterals repossessed before 2011 in the amount of AZN 521 thousand (2018: AZN 521 thousand) represented by movable property. The impairment losses of AZN 521 thousand have been applied to reduce the carrying amount of those movable repossessed collaterals within the assets held for sale to nil.

The management's plan is to sell repossessed collaterals within a year.

## Analysis of movements in the impairment allowance

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Balance at the beginning of the year | 2,053 | 521 |
| Net charge | 2,787 | 1,532 |
| **Balance at the end of the year** | **4,840** | **2,053** |

# 17 Property, equipment and intangible assets

| AZN'000 | Buildings | Computers | Furniture and equipment | Vehicles | Computer software | Total |
|---|---|---|---|---|---|---|
| **Cost/revalued amount** | | | | | | |
| Balance at 1 January 2018 | 5,564 | 2,141 | 4,053 | 1,205 | 949 | 13,912 |
| Additions | - | 603 | 526 | 515 | 154 | 1,798 |
| **Balance at 31 December 2018** | **5,564** | **2,744** | **4,579** | **1,720** | **1,103** | **15,710** |
| **Depreciation and amortisation** | | | | | | |
| Balance at 1 January 2018 | (770) | (1,768) | (2,219) | (641) | (216) | (5,614) |
| Depreciation and amortisation | (108) | (210) | (352) | (239) | (73) | (982) |
| **Balance at 31 December 2018** | **(878)** | **(1,978)** | **(2,571)** | **(880)** | **(289)** | **(6,596)** |
| **Cost/revalued amount** | | | | | | |
| Balance at 1 January 2019 | 5,564 | 2,744 | 4,579 | 1,720 | 1,103 | 15,710 |
| Additions | - | 673 | 400 | 152 | 45 | 1270 |
| Disposals | (150) | (17) | (14) | (30) | - | (211) |
| **Balance at 31 December 2019** | **5,414** | **3,405** | **4,965** | **1,842** | **1,148** | **16,769** |
| **Depreciation and amortisation** | | | | | | |
| Balance at 1 January 2019 | (878) | (1,978) | (2,571) | (880) | (289) | (6,596) |
| Depreciation and amortisation | (108) | (337) | (411) | (307) | (99) | (1,262) |
| Disposals | 46 | 17 | 14 | 30 | - | 107 |
| **Balance at 31 December 2019** | **(940)** | **(2,298)** | **(2,968)** | **(1,157)** | **(388)** | **(7,751)** |
| **Carrying amount** | | | | | | |
| **At 31 December 2019** | **4,474** | **1,107** | **1,997** | **685** | **760** | **9,018** |
| **At 31 December 2018** | **4,686** | **766** | **2,008** | **840** | **814** | **9,114** |

There are no capitalized borrowing costs related to the acquisition or construction of property and equipment during 2019 (2018: nil).

## Revalued assets

The fair values of the Bank's buildings are categorised into Level 3 of the fair value hierarchy. During the year the Bank has not carried out revaluation, but management estimates that fair values of assets are close to their carrying amount.

The previous basis used for the appraisal is the market approach. The market approach is based on an analysis of the results of comparable sales of similar buildings. The key assumption used in applying the market approach is the selling price, in the absence of undue stress and if reasonable time is given.

The carrying value of buildings as at 31 December 2019, if they would not have been revalued, would be AZN 1,878 thousand (31 December 2018: AZN 1,998 thousand).

At 31 December 2019, the buildings were not revalued as the management of the Bank assumes that market prices of similar buildings did not significantly change.

# 18 Other assets

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Credit and debit cards receivables | 4,996 | 3,972 |
| Amounts due from payment systems | 1,254 | 628 |
| Other receivables | 106 | 759 |
| **Total other financial assets** | **6,356** | **5,359** |
| | | |
| Deferred expenses | 950 | 683 |
| Prepaid tax other than income tax | 179 | 346 |
| Prepayments for purchase of property, equipment and intangible assets | 77 | 124 |
| Other | 137 | 106 |
| Less: allowance for impairment | (37) | (35) |
| **Total other non-financial assets** | **1,306** | **1,224** |
| **Total other assets** | **7,662** | **6,583** |

As at 31 December 2019 and 2018, the Bank did not have overdue other financial assets. All other financial assets are in Stage 1 and their ECL is not material as for 31 December 2019 and 31 December 2018. All other financial assets are not rated.

# 19 Deposits and balances from banks

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| Term placements of banks | 17,342 | 17,342 |
| Correspondent accounts and overnight placements of banks | 3,104 | 487 |
| | **20,446** | **17,829** |

As at 31 December 2019, the Bank had 1 bank (31 December 2018: 1 bank), whose balance exceeded 10 % of equity. The gross value of this balance as at 31 December 2019 was AZN 10,722 thousand (31 December 2018: AZN 10,706 thousand).

# 20 Current accounts and deposits from customers

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| **Current accounts and demand deposits** | | |
| - Retail | 71,325 | 56,130 |
| - Corporate | 195,963 | 323,456 |
| **Term deposits** | | |
| - Retail | 169,502 | 166,394 |
| - Corporate | 62,798 | 35,493 |
| | **499,588** | **581,473** |

As at 31 December 2019, the Bank had 12 customers (31 December 2018: 15 customers), whose balances individually exceeded 10% of equity. The total amount of these balances as at 31 December 2019 was AZN 190,629 thousand (31 December 2018: AZN 385,726 thousand).

As at 31 December 2019, the Bank maintained customer deposit balances of AZN 64,751 thousand (31 December 2018: AZN 67,157 thousand) that served as collateral for loans.

# 21 Other borrowed funds and subordinated borrowings

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| **Subordinated borrowings** | **20,339** | **20,388** |
| **Other borrowed funds** | | |
| National Fund for Entrepreneurship Support of the Republic of Azerbaijan | 39,318 | 24,017 |
| Azerbaijan Mortgage and Credit Guarantee Fund | 36,998 | 28,283 |
| Agrarian Credit and Development Agency under the Ministry of Agriculture | 8,356 | 2,613 |
| Central Bank of the Republic of Azerbaijan | 2,729 | - |
| State Fund for Development of Information Technologies | - | 50 |
| **Total other borrowed funds** | **87,401** | **54,963** |
| | **107,740** | **75,351** |

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

The Bank signed a credit agreement on 26 November 2009 with the Entrepreneurship Development Fund of the Republic of Azerbaijan, a programme under the auspices of the Ministry for Economic Development of the Republic of Azerbaijan, for the financing of small and medium size enterprises. Under this programme, funds are made available to the Bank at an interest rate of 1.0% per annum and the Bank lends these funds on to eligible borrowers at rates not higher than 6.0%-8.0% per annum. As at 31 December 2019, the Bank has AZN 39,318 thousand (31 December 2018: AZN 24,017 thousand) payable to the fund, repayable up to November 2023. There are no financial covenants with regard to borrowing from the Entrepreneurship Development Fund of the Republic of Azerbaijan that the Bank should comply with.

*Azerbaijan Mortgage and Credit Guarantee Fund*

The Bank signed an agreement on 2 December 2016 with the Azerbaijan Mortgage and Credit Guaratee Fund, for the initial financing and refinancing of mortgage loans at an interest rate 1-4% p.a. and the Bank further on lends these funds to eligible borrowers at rates not higher than 8% p.a. As at 31 December 2019, the Bank has AZN 36,998 thousand (31 December 2018: AZN 28,283 thousand) payable to the fund, repayable up to December 2048. There are no financial covenants with regard to borrowing from the Azerbaijan Mortgage and Credit Guaratee Fund the Bank should comply with.

*Agrarian Credit and Development Agency under the Ministry of Agriculture*

The Bank signed an agreement with the Agrarian Credit and Development Agency under the Ministry of Agriculture on 24 May 2018 for financing agricultural investments. Under this programme, funds are made available to the Bank at an interest rate of 2.0% per annum and the Bank lends these funds on to eligible borrowers at rates not higher than 7.0%. As at 31 December 2019, the Bank has AZN 8,356 thousand (31 December 2018: 2,613 thousand) payable to the fund, repayable up to December 2023. There are no financial covenants with regard to borrowing from the Azerbaijan State Agency on Agricultural Credits that the Bank should comply with.

*Central Bank of Azerbaijan*

During 2019, the Bank borrowed AZN 3,440 thousand from the CBAR with annual interest rate of 0.1% based on the decree "On the additional measures related to the solution of problem loans of individuals in the Republic of Azerbaijan" signed by the President of the Republic of Azerbaijan. These loans were recorded at fair value on initial recognition. The difference between the consideration received and the fair value of the loans in amount of AZN 711 thousand was recognized as a government grant (Note: 7).

In estimating the discount rates for term borrowings from National Fund for Entrepreneurship Support of Azerbaijan Republic, Azerbaijan Mortgage and Credit Guarantee Fund and Agrarian Credit and Development Agency under the Ministry of Agriculture the Bank considers this market as a separate market from other commercial borrowing business as these loans are issued to the whole banking sector of Azerbaijan at the same terms, purposes, conditions and credit risk exposures.

*Subordinated borrowings*

As at 31 December 2019, USD denominated subordinated borrowings included deposits placed by related parties in the amount of AZN 20,339 thousand (31 December 2018: AZN 20,388 thousand) maturing between January 2021 and June 2024 and with annual average interest rate of 5.39% (31 December 2018: 6.98% per annum). In case of bankruptcy, the repayment of the subordinated borrowings will be made after repayment in full of all other liabilities of the Bank.

### Reconciliation of movements of liabilities to cash flows arising from financing activities

| | Liabilities | | |
|---|---|---|---|
| **’AZN 000** | **Other borrowed funds** | **Subordinated borrowings** | **Total** |
| **Balance at 1 January 2019** | **54,963** | **20,388** | **75,351** |
| **Changes from financing cash flows** | | | |
| Receipts of other borrowed funds | 46,900 | - | 46,900 |
| Repayment of other borrowed funds | (13,242) | - | (13,242) |
| **Total changes from financing cash flows** | **88,621** | **20,388** | **109,009** |
| **Other changes** | | | |
| Interest expense | 1,624 | 1,191 | 2,815 |
| Interest paid | (2,844) | (1,240) | (4,084) |
| **Balance at 31 December 2019** | **87,401** | **20,339** | **107,740** |

# 22 Other liabilities

| | 2019 AZN’000 | 2018 AZN’000 |
|---|---|---|
| Settlement on other operations | 3,445 | 1,965 |
| Other creditors | 2,285 | 2,379 |
| **Total other financial liabilities** | **5,730** | **4,344** |
| Taxes other than income tax payable | 879 | 494 |
| Provision for guarantee letters | 2,090 | 1,265 |
| **Total other non-financial liabilities** | **2,969** | **1,759** |
| **Total other liabilities** | **8,699** | **6,103** |

# 23 Share capital and reserves

## Issued capital

The authorised, issued and outstanding share capital comprises 4,992,611 ordinary shares (31 December 2018: 4,992,611). All shares have a nominal value of AZN 20,29 per share. During the year 2019 no ordinary shares (2018: 630,853 shares at their nominal value) were issued.
The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at annual and general meetings of the Bank.

As at 31 December 2015 an adjustment of AZN 747 thousand is included in share capital. The adjustment is resulted from the restatement of share capital due to hyperinflation period of the Republic of Azerbaijan economy between 1993 and end of 1997.

### Nature and purpose of reserves

#### Revaluation surplus for buildings

The revaluation surplus for buildings comprises the cumulative positive revalued value of buildings, until the assets are derecognised or impaired.

### Dividends

According to the legislation of the Republic of Azerbaijan, dividends can be declared for the amount not exceeding available statutory retained earnings and is limited to an amount that does not reduce statutory net assets below a share capital.

There were no dividends declared by the Bank during 2019 (2018: no dividends declared by the Bank).

### Earnings per share

| | 2019 AZN’000 | 2018 AZN’000 |
|---|---|---|
| Net profit attributable to ordinary shareholders (AZN’000) | 15,062 | 11,933 |
| Weighted average number of ordinary shares for the year ended 31 December (thousands of shares) | 4,993 | 4,887 |
| Basic and diluted earnings per share (AZN per share) | **3.02** | **2.44** |

## 24 Analysis by segment

The Bank has two reportable segments, as described below, which are the Bank’s strategic business units. The strategic business units offer different products and services, and are managed separately because they require different technology and marketing strategies. For each of the strategic business units, the chief operating decision maker reviews internal management reports on at least a quarterly basis. The following summary describes the operations in each of the reportable segments:

- retail banking – includes loans, deposits and other transactions with retail customers
- corporate banking – includes loans, deposits and other transactions with corporate customers

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before income tax, as included in the internal management reports that are based on statutory financial information and that are reviewed by the CEO. Segment profit is used to measure performance, as management believes that such information is the most pertinent in evaluating the results of certain segments relative to others who operate within these industries.

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

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

Segment breakdown of assets and liabilities is presented below:

| | **2019 AZN'000** |
|---|---|
| **ASSETS** | |
| Retail banking (unaudited) | 131,240 |
| Corporate banking (unaudited) | 579,451 |
| Other (unaudited) | 29,291 |
| **Total in management accounting (unaudited)** | **739,982** |
| Total IFRS adjustment amount | (11,868) |
| **Total per IFRS** | **728,114** |
| **LIABILITIES** | |
| Retail banking (unaudited) | 256,155 |
| Corporate banking (unaudited) | 374,511 |
| Other (unaudited) | 7,958 |
| **Total in management accounting (unaudited)** | **638,624** |
| Total IFRS adjustment amount | 920 |
| **Total per IFRS** | **639,544** |

Segment information for the main reportable segments for the year ended 31 December 2019 is presented below:

| **AZN'000** | **Retail Banking (unaudited)** | **Corporate Banking (unaudited)** | **Unallocated (unaudited)** | **Total in management accounting (unaudited)** | **Total IFRS adjustment amount** | **Total per IFRS** |
|---|---|---|---|---|---|---|
| Interest income calculated using the effective interest method | 17,994 | 23,751 | - | 41,745 | 3,838 | 45,583 |
| Fee and commission income | 3,654 | 6,344 | - | 9,998 | (730) | 9,268 |
| Net gain on trading in foreign currencies | 709 | 1,230 | - | 1,939 | - | 1,939 |
| Net foreign exchange gain (loss) | 16 | 27 | - | 43 | - | 43 |
| Other operating income | - | - | 195 | 195 | - | 195 |
| **Revenue** | **22,373** | **31,352** | **195** | **53,920** | **3,108** | **57,028** |
| Interest expense | (1,487) | (9,298) | - | (10,785) | (335) | (11,120) |
| Reversal of expected credit losses on loans to customers | (41) | (71) | - | (112) | 4,591 | 4,479 |
| Reversal of expected credit losses on due from banks and other financial institutions | (48) | (83) | - | (131) | 131 | - |
| Fee and commission expense | (2,069) | (2,224) | - | (4,293) | - | (4,293) |
| Net loss on initial recognition of financial instruments at fair value | - | - | - | - | (239) | (239) |
| Impairment losses from assets held for sale | - | - | (92) | (92) | (2,695) | (2,787) |
| Impairment losses on other assets and liabilities | - | - | - | - | (827) | (827) |
| Personnel expenses | (6,001) | (10,416) | - | (16,417) | - | (16,417) |
| Other general administrative expenses | (4,010) | (6,961) | - | (10,971) | 209 | (10,762) |
| **Segment result** | **8,717** | **2,299** | **103** | **11,119** | **3,943** | **15,062** |
| Income tax expense | - | - | - | - | - | - |
| **Net profit after taxes** | | | | | | **15,062** |

# 25 Risk management, corporate governance and internal control

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

### Corporate governance framework

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

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

Azerbaijani legislation and the charter of the Bank establish lists of decisions that are exclusively approved by the General Shareholders' meeting and that are approved by the Supervisory Board.

As at 31 December 2019 the Supervisory Board includes:

Zakir Nuriyev – Chairman of the Supervisory Board

Rashad Abbasov – Member of the Supervisory Board

Aslan Khasiyev – Member of the Supervisory Board

During the year ended 31 December 2019, Rashad Abbasov has been appointed as a member of the Board and Kamal Madatov excluded from the Board.

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

As at 31 December 2019 the Management Board included:

Elchin Gadimov – Chairman of the Management Board

Elshan Badirkhanov **–** Deputy Chairman of the Management Board

Novruzov Binnat **–** Deputy Chairman  of the Management Board

Orhan Gultekin **–** Deputy Chairman  of the Management Board

Jeyhun Ibrahimov **–** Senior Director, Member of the Board

During the year ended 31 December 2019, Binnat Novruzov has been appointed as a Deputy Chairman of and Rafael Gasimov excluded from the Management Board.

### Internal control policies and procedures

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

The purpose of internal controls is to ensure:

- proper and comprehensive risk assessment and management
- proper business and accounting and financial reporting functions, including proper authorization, processing and recording of transactions
- completeness, accuracy and timeliness of accounting records, managerial information, regulatory reports, etc.

- reliability of IT-systems, data and systems integrity and protection
- prevention of fraudulent or illegal activities, including misappropriation of assets
- compliance with laws and regulations.

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

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

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

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

The internal control system in the Bank comprises:

- the Supervisory Board and its committees,
- the Chief Executive Officer and the Management Board
- the Chief Accountant
- the Risk Management Function
- the Security Function, including IT-security
- the Human Resource Function
- the Internal Audit Function
- other employees, division and functions that are responsible for compliance with the established standards, policies and procedures, including:
  - heads of branches and heads of business-units
  - business processes managers
  - division responsible for compliance with anti-money laundering requirements
  - the legal officer – an employee responsible for compliance with the legal and regulatory requirements
  - other employees with control responsibilities

The main functions of the Internal Audit Function include the following:

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

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

Management believes that the Bank complies with the CBAR requirements related to risk management and internal control systems, including requirements related to the Internal Audit Function, and that risk management and internal control systems are appropriate for the scale, nature and complexity of operations.

## Risk management policies and procedures

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

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

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

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

The Management Board of the Bank have responsibility for controlling the Bank’s compliance with risk limits and capital adequacy ratios as established by the CBAR. With the view of controlling effectiveness of the Bank’s risk management procedures and their consistent application the Management Board of the Bank periodically receive reports prepared by the Internal Audit Function and the Risk Department, discuss the contents of these reports and consider proposed corrective actions.

Credit, market and liquidity risks both at the portfolio and transactional levels are managed and controlled through a Credit Committee and an Asset and Liability Management Committee (ALCO).

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

## (a) Market risk

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

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

Overall authority for market risk is vested in the ALCO, which is chaired by the Chairman of the Management Board. Market risk limits are approved by the ALCO based on recommendations of the Risk Department.

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

### (b) *Interest rate risk*

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

### *Interest rate gap analysis*

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

| AZN'000 | Less than 1 month | 1-3 months | 3-12 months | 1-5 years | More than 5 years | Non interest bearing | Carrying amount |
|---|---|---|---|---|---|---|---|
| **31 December 2019** | | | | | | | |
| **ASSETS** | | | | | | | |
| Cash and cash equivalents | 153,782 | - | - | - | - | 120,832 | 274,614 |
| Due from banks and other financial institutions | 4,356 | 39,818 | 8,673 | 7,438 | - | - | 60,285 |
| Loans to customers | 46,303 | 17,511 | 114,062 | 128,079 | 45,619 | - | 351,574 |
| Investment securities | - | - | - | 13,553 | - | 402 | 13,955 |
| Other financial assets | - | - | - | - | - | 6,356 | 6,356 |
| | **204,441** | **57,329** | **122,735** | **149,070** | **45,619** | **127,590** | **706,784** |
| **LIABILITIES** | | | | | | | |
| Deposits and balances from banks | 2 | 6,800 | 3,740 | 6,800 | - | 3,104 | 20,446 |
| Current accounts and deposits from customers | 10,104 | 8,806 | 171,244 | 38,219 | 3,927 | 267,288 | 499,588 |
| Subordinated borrowings | 301 | - | - | 20,038 | - | - | 20,339 |
| Other borrowed funds | 1,457 | 1,998 | 8,417 | 35,067 | 40,462 | - | 87,401 |
| Lease liability | 72 | 144 | 649 | 1,875 | 331 | - | 3,071 |
| Other financial liabilities | - | - | - | - | - | 5,730 | 5,730 |
| | **11,936** | **17,748** | **184,050** | **101,999** | **44,720** | **276,122** | **636,575** |
| | **192,505** | **39,581** | **(61,315)** | **47,071** | **899** | **(148,532)** | **70,209** |

| AZN'000 | Less than 1 month | 1-3 months | 3-12 months | 1-5 years | More than 5 years | Non interest bearing | Carrying amount |
|---|---|---|---|---|---|---|---|
| **31 December 2018** | | | | | | | |
| **ASSETS** | | | | | | | |
| Cash and cash equivalents | 104,684 | - | - | - | - | 248,836 | 353,520 |
| Due from banks and other financial institutions | 5,474 | 61,138 | 15,298 | 6,387 | - | - | 88,297 |
| Loans to customers | 40,075 | 14,531 | 58,403 | 121,041 | 45,885 | - | 279,935 |
| Investment securities | 111 | - | - | 11,236 | - | 402 | 11,749 |
| Other financial assets | - | - | - | - | - | 5,359 | 5,359 |
| | **150,344** | **75,669** | **73,701** | **138,664** | **45,885** | **254,597** | **738,860** |
| **LIABILITIES** | | | | | | | |
| Deposits and balances from banks | - | 6,800 | 3,741 | 6,800 | - | 488 | 17,829 |
| Current accounts and deposits from customers | 8,312 | 21,457 | 145,026 | 25,707 | 1,385 | 379,586 | 581,473 |
| Subordinated borrowings | 350 | - | - | 4,420 | 15,618 | - | 20,388 |
| Other borrowed funds | 937 | 1,120 | 4,503 | 18,481 | 29,922 | - | 54,963 |
| Other financial liabilities | - | - | - | - | - | 4,344 | 4,344 |
| | **9,559** | **29,377** | **153,270** | **55,408** | **46,925** | **384,418** | **678,997** |
| | **140,745** | **46,292** | **(79,569)** | **83,256** | **(1,040)** | **(129,821)** | **59,863** |

Interest rate gaps are managed principally through refinancing of interest bearing liabilities maturing in respective maturity bands with liabilities at equal or lower interest rates.

***Average effective interest rates***

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2019 and 2018. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

| | **2019 Average effective interest rate, %** | | | **2018 Average effective interest rate, %** | | |
|---|---|---|---|---|---|---|
| | **AZN** | **USD** | **EUR** | **AZN** | **USD** | **EUR** |
| **Interest bearing assets** | | | | | | |
| Cash and cash equivalents | 8.60% | 3.61% | - | 8.30% | 2.80% | - |
| Due from banks and other financial institutions | 6.21% | 1.82% | - | 8.26% | 2.54% | - |
| Loans to customers | 13.77% | 5.41% | 14.09% | 14.87% | 7.75% | 21.76% |
| Investment securities | 8.64% | 5.00% | 1.75% | - | 5.00% | - |
| **Interest bearing liabilities** | | | | | | |
| Deposits and balances from banks | - | 3.39% | - | - | 3.00% | - |
| Current accounts and deposits from customers | 8.48% | 1.74% | 0.35% | 9.33% | 1.83% | 0.40% |
| Other borrowed funds | 2.14% | - | - | 2.30% | - | - |
| Lease liability | 10% | - | - | - | - | |
| Subordinated borrowings | - | 6.02% | - | - | 6.98% | - |

***Interest rate sensitivity analysis***

The management of interest rate risk based on an interest rate gap analysis, is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of net profit or loss and equity (net of taxes) to changes in interest rates (repricing risk), based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2019 and 2018 is as follows:

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| 100 bp parallel fall | (1,363) | (919) |
| 100 bp parallel rise | 1,363 | 919 |

## (c) *Currency risk*

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

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

The following table shows the currency structure of financial assets and liabilities as at 31 December 2019:

| AZN'000 | AZN | USD | EUR | Other currencies | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | 140,449 | 124,826 | 7,807 | 1,532 | 274,614 |
| Due from banks and other financial institutions | 2,091 | 58,194 | - | - | 60,285 |
| Loans to customers | 242,490 | 109,033 | 51 | - | 351,574 |
| Investment securities | 1,774 | 11,227 | 954 | - | 13,955 |
| Other financial assets | 4,306 | 1,847 | - | 203 | 6,356 |
| **Total financial assets** | **391,110** | **305,127** | **8,812** | **1,735** | **706,784** |
| **LIABILITIES** | | | | | |
| Deposits and balances from banks | 271 | 20,175 | - | - | 20,446 |
| Current accounts and deposits from customers | 198,275 | 291,614 | 9,482 | 217 | 499,588 |
| Other borrowed funds | 87,401 | - | - | - | 87,401 |
| Subordinated borrowings | - | 20,339 | - | - | 20,339 |
| Lease liability | 3,071 | - | - | - | 3,071 |
| Other financial liabilities | 4,528 | 991 | 8 | 203 | 5,730 |
| **Total financial liabilities** | **293,546** | **333,119** | **9,490** | **420** | **636,575** |
| **Net position** | **97,564** | **(27,992)** | **(678)** | **1,315** | **70,209** |

The Bank is not required to report for the regulatory currency position compliance purposes based on the above table, rather currency position based on prudential figures is reported to the regulator.

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2018:

| AZN'000 | AZN | USD | EUR | Other currencies | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | 164,296 | 177,640 | 10,629 | 955 | 353,520 |
| Due from banks and other financial institutions | 524 | 87,773 | - | - | 88,297 |
| Loans to customers | 176,285 | 103,555 | 95 | - | 279,935 |
| Investment securities | 374 | 11,375 | - | - | 11,749 |
| Other financial assets | 4,484 | 573 | 2 | 300 | 5,359 |
| **Total financial assets** | **345,963** | **380,916** | **10,726** | **1,255** | **738,860** |
| **LIABILITIES** | | | | | |
| Deposits and balances from banks | 133 | 17,696 | - | - | 17,829 |
| Current accounts and deposits from customers | 165,419 | 407,324 | 8,540 | 190 | 581,473 |
| Other borrowed funds | 54,963 | - | - | - | 54,963 |
| Subordinated borrowings | - | 20,388 | - | - | 20,388 |
| Lease liability | | | | | |
| Other financial liabilities | 2,985 | 952 | 140 | 267 | 4,344 |
| **Total financial liabilities** | **223,500** | **446,360** | **8,680** | **457** | **678,997** |
| **Net position** | **122,463** | **(65,444)** | **2,046** | **798** | **59,863** |

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2019 and 2018, would have (decreased)/increased equity and profit or loss by the amounts shown below. This analysis is on net of tax basis and is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

| | 2019 AZN'000 | 2018 AZN'000 |
|---|---|---|
| 30% appreciation of USD against AZN (2018: 20%) | (6,718) | (10,471) |
| 30% appreciation of EUR against AZN (2018: 20%) | (163) | 327 |

A strengthening of the AZN against the above currencies at 31 December 2019 and 2018 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

## (d) Credit risk

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

The credit policy establishes:

- procedures for review and approval of loan applications;
- methodology for the credit assessment of borrowers (corporate and retail);
- methodology for the credit assessment of counterparties, issuers and insurance companies;
- methodology for the evaluation of collateral;

- credit documentation requirements;
- procedures for the ongoing monitoring of loans and other credit exposures.

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

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

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

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

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

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents (excluding cash on hand) | 235,967 | 322,207 |
| Investment securities (excluding equity securities) | 13,553 | 11,347 |
| Due from banks and other financial institutions | 60,285 | 88,297 |
| Loans to customers | 351,574 | 279,935 |
| Other financial assets | 6,356 | 5,359 |
| **Total maximum exposure** | **667,735** | **707,145** |

For the analysis of collateral held against loans to customers and concentration of credit risk in respect of loans to customers refer to Note 15.

The maximum exposure to credit risk from unrecognised contractual commitments at the reporting date is presented in Note 27.

As at 31 December 2019 the Bank has one debtor (2018: one debtor), credit risk exposure to whom individually exceeds 10% of maximum credit risk exposure.

**Credit risk - Amounts arising from ECL**

**Inputs, assumptions and techniques used for estimating impairment**

See accounting policy in Note 3(e)(iv).

***Significant increase in credit risk***

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Bank uses three criteria for determining whether there has been a significant increase in credit risk:

- quantitative test based on movement in probability of default (PD);
- qualitative indicators;
- backstop of 30 days past due.

*Credit risk grades*

The Bank allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

*Generating the term structure of PD*

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Bank collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. For some portfolios, information purchased from external credit reference agencies is also used.

The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

*Determining whether credit risk has increased significantly*

The Bank assesses whether credit risk has increased significantly since initial recognition at each reporting period. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region. What is considered significant will differ for different types of lending, in particular between corporate and retail.

As a general indicator, credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's quantitative criteria:

- For all borrowers when contractual payments are more than 30 days past due.

The credit risk may also be deemed to have increased significantly since initial recognition based on qualitative factors linked to the Bank's credit risk management processes that may not otherwise be fully reflected in its quantitative analysis on a timely basis. This will be the case for exposures that meet certain hightened risk criteria, such as placement on a watch list. Such qualitative factors are based on its expert judgement and relevant historical experience and is disclosed in below:

- For collectively assessed consumer and mortgage loans: If the Bank becomes aware of a significant decline in any particular industry and anticipates the closure of businesses or significant lay-offs within that industry

If there is evidence that there is no longer a significant increase in credit risk relative to initial recognition, then the loss allowance on an instrument returns to being measured as 12-month ECL. Some qualitative indicators of an increase in credit risk, such as delinquency of forbearance, may be indicative of an increased risk of default that persists after the indicator itself has ceased to exist. In these cases the Bank determines a probation period during which the financial asset is required to demonstrated good behaviour to provide evidence that its credit risk has declined sufficiently. Probation criteria for recovery and transfer of financial instruments to Stage 1 are as follows:

– All scheduled payments on the loan are made in time or overdue less than 30 days.

– For all loans previously classified as Stage 2 based on any information other than past due status and for which there is evidence that there is no longer a significant increase in credit risk.

Probation criteria for recovery and transfer of financial instruments to Stage 2 are as follows:

- Cure period of 6 months had passed since the loan had been classified as Stage 3, i.e. no restructuring or overdue more than 90 days occurred during 6 months preceding reporting date (Stage 3 to Stage 2).

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that**:**

- the criteria are capable of identifying significant increases in credit risk before an exposure is in default;
- the average time between the identification of a significant increase in credit risk and default appears reasonable;
- exposures are not generally transferred directly from 12-month ECL measurement to credit-impaired; and
- there is no unwarranted volatility in loss allowance from transfers between 12-month ECL (Stage 1) and lifetime ECL measurements (Stage 2).

*Definition of default*

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held);
- the borrower is past due more than 90 days on any material credit obligation to the Bank. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding; or
- it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower’s inability to pay its credit obligations.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative – e.g. breaches of covenant;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

*Incorporation of forward-looking information*

The Bank incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

The Bank formulates one economic scenario: a base case. The base case is aligned with information used by the Bank for other purposes such as strategic planning and budgeting. The historical data of defaults use the statistics of the CBAR on the share of overdue loans in total loans to individuals in the banking system. The assessment of the impact of macroeconomic information should be made at least on an annual basis.

The Bank has identified and documented key drivers of credit risk and credit losses for the entire loan portfolio (including the securities portfolio, requirements for financial institutions), using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses.

The key driver is Real GDP growth forecast. The economic scenarios used as at 31 December 2019 included the following key indicators for the Republic of Azerbaijan for the years ending 31 December 2020 through 2024.

| | **2020** | **2021** | **2022** | **2023** | **2024** |
|---|---|---|---|---|---|
| Real GDP growth | 2.10% | 2.10% | 2.10% | 2.20% | 1.70% |

Predicted relationships between the key indicator and default and loss rates on various portfolios of financial assets have been developed based on analysing historical data over the past 14 years.

When building a macroeconomic model, the Bank uses external statistics on defaults (NPL), as there is no sufficient internal statistics on defaults.

*Modified financial assets*

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 3(e)(ii).

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and interest rate. Both retail and corporate loans are subject to the forbearance policy.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired (see Note 3(e)(iv)). A customer needs to demonstrate consistently good payment behavior over a period of time before the exposure is no longer considered to be credit-impaired/ in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

*Measurement of ECL*

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);

- loss given default (LGD);
- exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

The methodology of estimating PDs is discussed above under the heading “Generating the term structure of PD”.

The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral (for certain types of portfolio), seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property (for certain types of portfolio), LTV ratios are a key parameter in determining LGD. They are calculated on a discounted cash flow basis using first available contractual rate as the discounting factor, as it is considered as the best proxy of effective interest rate at origination.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EAD is potential future amounts that may be drawn under the contract, which are estimated based on historical observations.

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower’s extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of instrument type.

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the Bank has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL are as follows.

| | | **External benchmarks used** | |
|---|---|---|---|
| | **Exposure** | **PD** | **LGD** |
| Cash and cash equivalents (excluding cash in hands) | 235,967 | Moody’s default study | S&P recovery studies |
| Due from banks and other financial institutions | 60,285 | Moody’s default study | S&P recovery studies |
| Investment securities | 13,553 | Moody’s default study | S&P recovery studies |

### Offsetting financial assets and financial liabilities

The disclosure set out in the table below include financial assets and financial liabilities that are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments, irrespective of whether they are offset in the statement of financial position.

**31 December 2019**

| Types of financial assets/liabilities | Gross amounts of recognised financial asset/liability | Net amount of financial assets/liabilities presented in the statement of financial position | Related amounts not offset in the statement of financial position: Financial instruments | Related amounts not offset in the statement of financial position: Cash collateral received | Net amount |
|---|---|---|---|---|---|
| Loans to customers | 64,751 | 64,751 | - | 64,751 | - |
| **Total financial assets** | **64,751** | **64,751** | **-** | **64,751** | **-** |
| Current accounts and deposits from customers | (64,751) | (64,751) | 64,751 | - | - |
| **Total financial liabilities** | **(64,751)** | **(64,751)** | **64,751** | **-** | **-** |

**31 December 2018**

| Types of financial assets/liabilities | Gross amounts of recognised financial asset/liability | Net amount of financial assets/liabilities presented in the statement of financial position | Related amounts not offset in the statement of financial position: Financial instruments | Related amounts not offset in the statement of financial position: Cash collateral received | Net amount |
|---|---|---|---|---|---|
| Loans to customers | 67,157 | 67,157 | - | 67,157 | - |
| **Total financial assets** | **67,157** | **67,157** | **-** | **67,157** | **-** |
| Current accounts and deposits from customers | (67,157) | (67,157) | 67,157 | - | - |
| **Total financial liabilities** | **(67,157)** | **(67,157)** | **67,157** | **-** | **-** |

## (e) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to liquidity management. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due. The liquidity policy is reviewed and approved by the Supervisory Board.

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

The liquidity management policy requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;

- maintaining debt financing plans;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;
- monitoring liquidity ratios against regulatory requirements.

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

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

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

The maturity analysis for financial liabilities as at 31 December 2019 is as follows:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | Total gross amount outflow | Carrying amount |
|---|---|---|---|---|---|---|---|
| **Non-derivative liabilities** | | | | | | | |
| Deposits and balances from banks | 3,155 | 6,900 | 3,813 | 6,802 | - | 20,670 | 20,446 |
| Current accounts and deposits from customers | 278,071 | 10,119 | 174,759 | 40,713 | 5,512 | 509,174 | 499,588 |
| Other borrowed funds | 1,599 | 2,280 | 9,630 | 40,783 | 49,874 | 104,166 | 87,401 |
| Subordinated borrowings | 402 | 201 | 904 | 22,119 | - | 23,626 | 20,339 |
| Lease liability | 94 | 187 | 842 | 2,309 | 386 | 3,818 | 3,071 |
| Other financial liabilities | 5,730 | - | - | - | - | 5,730 | 5,730 |
| **Total financial liabilities** | **289,051** | **19,687** | **189,948** | **112,726** | **55,772** | **667,184** | **636,575** |
| **Credit related commitments** | **54,646** | | | | | **54,646** | **54,646** |

The maturity analysis for financial liabilities as at 31 December 2018 is as follows:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | Total gross amount outflow | Carrying amount |
|---|---|---|---|---|---|---|---|
| **Non-derivative liabilities** | | | | | | | |
| Deposits and balances from banks | 538 | 6,891 | 3,813 | 7,009 | - | 18,251 | 17,829 |
| Current accounts and deposits from customers | 388,527 | 22,661 | 148,309 | 27,736 | 1,774 | 589,007 | 581,473 |
| Other borrowed funds | 1,035 | 1,313 | 5,338 | 22,112 | 36,432 | 66,230 | 54,261 |
| Subordinated borrowings | 466 | 233 | 1,049 | 8,102 | 15,942 | 25,792 | 20,388 |
| Other financial liabilities | 4,344 | - | - | - | - | 4,344 | 4,344 |
| **Total financial liabilities** | **394,910** | **31,098** | **158,509** | **64,959** | **54,148** | **703,624** | **678,997** |
| **Credit related commitments** | **38,478** | **-** | **-** | **-** | **-** | **38,478** | **38,478** |

In accordance with Azerbaijani legislation, individuals and legal entities can withdraw their term deposits at any time, forfeiting in most of the cases the accrued interest. These deposits are classified in accordance with their stated maturity dates. The management of the Bank does not expect that individuals and legal entities withdraw their term deposits before their stated maturity dates.

The table below shows an analysis, by contractual maturities, of the amounts recognised in the statement of financial position as at 31 December 2019:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | No maturity | Overdue | Total |
|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 274,614 | - | - | - | - | - | - | 274,614 |
| Due from banks and other financial institutions | 4,423 | 39,750 | 8,673 | 7,439 | - | - | - | 60,285 |
| Loans to customers | 11,448 | 17,511 | 114,062 | 128,079 | 45,619 | - | 34,855 | 351,574 |
| Investment securities | 81 | 45 | - | 13,427 | - | 402 | - | 13,955 |
| Other financial assets | 6,356 | - | - | - | - | - | - | 6,356 |
| **Total financial assets** | **296,922** | **57,306** | **122,735** | **148,945** | **45,619** | **402** | **34,855** | **706,784** |
| Deposits and balances from banks | 3,106 | 6,800 | 3,740 | 6,800 | - | - | - | 20,446 |
| Current accounts and deposits from customers | 277,391 | 8,805 | 171,245 | 38,220 | 3,927 | - | - | 499,588 |
| Other borrowed funds | 1,457 | 1,998 | 8,417 | 35,067 | 40,462 | | | 87,401 |
| Subordinated borrowings | 301 | - | - | 20,038 | - | - | - | 20,339 |
| Lease liability | 72 | 144 | 649 | 1,875 | 331 | - | - | 3,071 |
| Other financial liabilities | 5,730 | - | - | - | - | - | - | 5,730 |
| **Total financial liabilities** | **288,057** | **17,747** | **184,051** | **102,000** | **44,720** | **-** | **-** | **636,575** |
| **Net position** | **8,865** | **39,559** | **(61,316)** | **46,945** | **899** | **402** | **34,855** | **70,209** |
| **Cumulative liquidity gap** | **8,865** | **48,424** | **(12,892)** | **34,053** | **34,952** | **35,354** | **70,209** | **140,419** |

The table below shows an analysis, by contractual maturities, of the amounts recognised in the statement of financial position as at 31 December 2018:

| AZN'000 | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | More than 5 years | No maturity | Overdue | Total |
|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | 353,520 | - | - | - | - | - | - | 353,520 |
| Due from banks and other financial institutions | 4,920 | 61,138 | 15,432 | 6,807 | - | - - | - | 88,297 |
| Loans to customers | 12,342 | 14,535 | 58,418 | 121,070 | 45,896 | - | 27,674 | 279,935 |
| Investment securities | 80 | 31 | - | 11,236 | - | 402 | - | 11,749 |
| Other financial assets | 5,359 | - | - | - | - | - | - | 5,359 |
| **Total financial assets** | **376,221** | **75,704** | **73,850** | **139,113** | **45,896** | **402** | **27,674** | **738,860** |
| | | | | | | | | |
| Deposits and balances from banks | 489 | 6,800 | 3,740 | 6,800 | - | - | - | 17,829 |
| Current accounts and deposits from customers | 387,898 | 21,457 | 145,026 | 25,707 | 1,385 | - | - | 581,473 |
| Other borrowed funds | 937 | 1,120 | 4,503 | 18,481 | 29,220 | - | - | 54,261 |
| Subordinated borrowings | 350 | - | - | 4,420 | 15,618 | - | - | 20,388 |
| Other financial liabilities | 4,344 | - | - | - | - | - | - | 4,344 |
| **Total financial liabilities** | **394,018** | **29,377** | **153,269** | **55,408** | **46,925** | **-** | **-** | **678,997** |
| **Net position** | **(17,797)** | **46,327** | **(79,419)** | **83,705** | **(1,029)** | **402** | **27,674** | **59,863** |
| **Cumulative liquidity gap** | **(17,797)** | **28,530** | **(50,889)** | **32,816** | **31,787** | **32,189** | **59,863** | **119,727** |

The key measure used by the Bank for managing liquidity risk is the liquidity ratio stipulated by the CBAR. The Bank calculates this mandatory liquidity ratio on a daily basis in accordance with the requirement of the CBAR. This ratio is represented by the instant liquidity ratio, which is calculated as the ratio of highly liquid assets to liabilities payable on demand.

The Bank was in compliance with this ratio as at 31 December 2019 and 2018. The following table shows the mandatory liquidity ratio calculated as at 31 December 2019 and 2018.

| | Requirement | 2019, % (Unaudited) | 2018, % (Unaudited) |
|---|---|---|---|
| **Instant liquidity ratio** | Not less than 30% | 97.39% | 91.18% |

## (f) *Operational* risk

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

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

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

# 26 Capital management

The CBAR (until 28 November 2019: the FIMSA) sets and monitors capital requirements for the Bank.

Under the current capital requirements set by the CBAR, banks have to: (i) hold a minimum level of total statutory capital of AZN 50,000 thousand (31 December 2018: AZN 50,000 thousand) and (ii) maintain a ratio of total statutory capital to risk weighted assets (statutory capital ratio) at or above a prescribed minimum of 10% (31 December 2018: 10%).

The Bank provides the CBAR with information on mandatory ratios in accordance with a set form. The Risk Department controls on a daily basis compliance with capital adequacy ratios. In case values of capital adequacy ratios become close to set limits set by the CBAR and Bank's internal policy this information is communicated to the Supervisory Board.

As at 31 December 2019 and 2018, the Bank was in compliance with the requirements for minimum total statutory capital amount and ratio to risk weighted assets. The calculation of capital adequacy based on requirements set by the CBAR as at 31 December was as follows:

| | **2019 AZN'000 (unaudited)** | **2018 AZN'000 (unaudited)** |
|---|---|---|
| Total regulatory capital | 114,031 | 93,672 |
| Risk-weighted assets | 455,437 | 339,486 |
| **Capital adequacy ratio (%)** | **25.0%** | **27.6%** |

The Bank also monitors its capital adequacy levels calculated in accordance with the requirements of the Basel Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998) and Amendment to the Capital Accord to incorporate market risks (updated November 2007), commonly known as Basel I.

The following table shows the composition of the capital position calculated in accordance with the requirements of the Basel Accord, as at 31 December:

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 102,047 | 102,047 |
| Accumulated deficit | (16,073) | (31,227) |
| **Total Tier 1 capital** | **85,974** | **70,820** |
| **Tier 2 capital** | | |
| Revaluation reserve – buildings | 2,596 | 2,688 |
| Subordinated borrowings (unamortised part) | 17,386 | 17,459 |
| **Total Tier 2 capital** | **19,982** | **20,147** |
| Less: Investments | (419) | (419) |
| **Total capital** | **105,537** | **90,548** |
| **Risk-weighted assets** | | |
| On-balance sheet | 279,961 | 303,367 |
| Off-balance sheet | 54,646 | 38,478 |
| **Total risk weighted assets** | **334,607** | **341,845** |
| **Tier 1 capital ratio** | **25,69%** | **20.73%** |
| **Total capital ratio** | **31.54%** | **26.50%** |

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature and reflecting an estimate of credit, market and other risks associated with each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for unrecognised contractual commitments, with some adjustments to reflect the more contingent nature of the potential losses.

# 27 Credit related commitments

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

The Bank provides financial guarantees to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to five years.

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

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

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| **Contracted amount** | | |
| Guarantees | 34,539 | 16,864 |
| Undrawn credit lines | 20,107 | 21,614 |
| | **54,646** | **38,478** |

All guarantees balances are in Stage 1, except for one customer which is in Stage 3 and its balance equals to AZN 300 thousand. All balances of undrawn credit lines are in Stage 1.

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

# 28 Leases

## Leases as lessee (IFRS 16)

The Bank mainly leases a number of branch and office premises. The leases typically run for a period of 1-5 years, with an option to renew the lease after that date. For some leases, payments are renegotiated every three years to reflect market rentals.

Previously, these leases were classified as operating leases under IAS 17.

Information about leases for which the Bank is a lessee is presented below.

### *(i) Right-of-use assets*

Right-of-use assets mainly relate to leased branch and office premises that do not meet the definition of investment property.

| **AZN'000** | **Branch and office premises** | **Land** | **Total** |
|---|---|---|---|
| **2019** | | | |
| Balance at 1 January | 3,746 | 113 | 3,859 |
| Depreciation charge for the year | (901) | (13) | (914) |
| **Balance at 31 December** | **2,845** | **100** | **2,945** |

See Note 25 for maturity analysis of lease liabilities as at 31 December 2019.

### *(ii) Amounts recognised in profit or loss*

| **'000 AZN** | **2019** |
|---|---|
| **2019 – Leases under IFRS 16** | |
| Depreciation on ROU | 914 |
| Interest on lease liabilities | 335 |
| Expenses relating to short-term leases | 104 |
| | |
| **2018 – Operating leases under IAS 17** | |
| Lease expense | 1,077 |

### *(iii) Amounts recognised in the statement of cash flows*

| **'000 AZN** | **2019** |
|---|---|
| **Total cash outflow for leases** | (1,123) |

# 29 Contingencies

## (a) Insurance

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

## (b) Litigation

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

## (c) Taxation contingencies

The taxation system in the Azerbaijan Republic continues to evolve and is characterized by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities who have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Azerbaijan Republic suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

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

The Bank believes that accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Bank to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact the tax expense in the period that such a determination is made.

# 30 Related party transactions

## Control relationships

As at 31 December 2019 and 2018, the Bank had no ultimate controlling party.

## Transactions with the members of the Supervisory Board and the Management Board

Total remuneration included in personnel expenses for the years ended 31 December 2019 and 2018 is as follows:

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| Short-term employee benefits | 1,784 | 1,562 |
| | **1,784** | **1,562** |

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

The outstanding balances and average effective interest rates as at 31 December 2019 and 2018 for transactions with the members of the Supervisory Board and the Management Board are as follows:

| | **2019 AZN'000** | **Average effective interest rate** | **2018 AZN'000** | **Average effective interest rate** |
|---|---|---|---|---|
| **Statement of financial position** | | | | |
| Loans outstanding (gross) | 100 | 17.48% | 2,226 | 14.94% |
| Loan impairment allowance | (2) | - | (1,983) | - |
| Current accounts | 121 | - | 176 | - |
| Deposits received | 495 | 9.39% | 333 | 7.38% |
| Commitments on loans and unused credit lines | 82 | 4.27% | 94 | 8.20% |

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

| | **2019 AZN'000** | **2018 AZN'000** |
|---|---|---|
| **Profit or loss** | | |
| Interest income | 164 | 137 |
| Interest expense | (29) | (22) |
| Reversal of expected credit losses | 390 | 168 |

The outstanding balances and the related average effective interest rates as at 31 December 2019 and related profit or loss amounts of transactions for the year ended 31 December 2019 with other related parties are as follows:

| | Shareholders and close family members and entities under control | | Others* | | Total |
|---|---|---|---|---|---|
| | AZN'000 | Average interest rate, % | AZN'000 | Average interest rate, % | AZN'000 |
| **Statement of financial position** | | | | | |
| **ASSETS** | | | | | |
| Loans to customers | | | | | |
| Gross outstanding balance of short-term loans in AZN | 10 | - | - | - | 10 |
| Gross outstanding balance of long-term loans in AZN | 2,952 | 13.69% | 3,257 | 2.50% | 6,209 |
| Gross outstanding balance of long-term loans in USD | 1 | 0.00% | 35,296 | 3.63% | 35,297 |
| Total impairment allowance | (55) | - | (7,285) | - | (7,340) |
| **LIABILITIES** | | | | | |
| Current accounts and deposits from customers | | | | | |
| Current accounts | 828 | - | 251 | - | 1,079 |
| Term deposits | | | | | |
| Short-term deposits in AZN | 436 | 8% | - | - | 436 |
| Short-term deposits in USD | 14,011 | 1.00% | - | - | 14,011 |
| Long-term deposits in AZN | 2,854 | 8.61% | - | - | 2,854 |
| Long-term deposits in USD | 11,554 | 1.11% | - | - | 11,554 |
| Subordinated borrowings in USD | 14,278 | 10.33% | 6,062 | 7.50% | 20,340 |
| Commitments on loans and undrawn credit lines | 139 | 0.03% | - | - | 139 |
| **Profit or loss** | | | | | |
| Interest income | 443 | | 859 | | 1,302 |
| Interest expense | (1,083) | | (446) | | (1,529) |
| Expected credit losses | (55) | | (551) | | (606) |

The outstanding balances and the related average effective interest rates as at 31 December 2018 and related profit or loss amounts of transactions for the year ended 31 December 2018 with other related parties are as follows:

| | **Shareholders and close family members and entities under control** | | **Others*** | | **Total** |
|---|---|---|---|---|---|
| | **AZN'000** | **Average interest rate, %** | **AZN'000** | **Average interest rate, %** | **AZN'000** |
| **Statement of financial position** | | | | | |
| **ASSETS** | | | | | |
| Loans to customers | | | | | |
| Gross outstanding balance of short-term loans in AZN | 11 | 25% | - | - | 11 |
| Gross outstanding balance of long-term loans in AZN | 4,760 | 12.77% | 3,271 | 11.00% | 8,031 |
| Gross outstanding balance of long-term loans in USD | - | - | 33,608 | 5.00% | 33,608 |
| Total impairment allowance | (73) | - | (6,734) | - | (6,807) |
| **LIABILITIES** | | | | | |
| Current accounts and deposits from customers | | | | | |
| Current accounts | 1,002 | - | 834 | - | 1,836 |
| Term deposits | | | | | |
| Deposits on demand in AZN | - | - | 9 | 1.00% | 9 |
| Short-term deposits in AZN | 1,376 | 9.00% | - | - | 1,376 |
| Short-term deposits in USD | 24,430 | 1.00% | - | - | 24,430 |
| Long-term deposits in AZN | 5,955 | 12.00% | - | - | 5,955 |
| Long-term deposits in USD | 6,588 | 2.76% | - | - | 6,588 |
| Subordinated borrowings in USD | 14,327 | 11.00% | 6,062 | 7.50% | 20,389 |
| Commitments on loans and undrawn credit lines | 190 | - | 2 | - | 192 |
| **Profit or loss** | | | | | |
| Interest income | 16 | | 1 | | 17 |
| Interest expense | (2,046) | | (446) | | (2,492) |
| Impairment losses | (73) | | 163 | | 90 |

**Here others are related companies of shareholders of the Bank*

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

## Accounting classifications and fair values

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2019:

| AZN '000 | Amortised cost | FVOCI | Total carrying amount | Fair value |
|---|---|---|---|---|
| Cash and cash equivalents | 274,614 | - | 274,614 | 274,614 |
| Investment securities | 13,553 | 402 | 13,955 | 14,083 |
| Due from banks and other financial institutions | 60,285 | - | 60,285 | 57,319 |
| Loans to customers | 351,574 | - | 351,574 | 347,992 |
| Other financial assets | 6,356 | - | 6,356 | 6,356 |
| | **706,382** | **402** | **706,784** | **700,364** |
| Deposits and balances from banks | 20,446 | - | 20,446 | 20,305 |
| Current accounts and deposits from customers | 499,588 | - | 499,588 | 498,696 |
| Other borrowed funds | 87,401 | - | 87,401 | 87,401 |
| Subordinated borrowings | 20,339 | - | 20,339 | 20,339 |
| Other financial liabilities | 5,730 | - | 5,730 | 5,730 |
| | **633,504** | **-** | **633,504** | **632,471** |

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2018:

| AZN '000 | Amortised cost | FVOCI | Total carrying amount | Fair value |
|---|---|---|---|---|
| Cash and cash equivalents | 353,520 | - | 353,520 | 353,520 |
| Investment securities | 11,347 | 402 | 11,749 | 11,833 |
| Due from banks and other financial institutions | 88,297 | - | 88,297 | 88,297 |
| Loans to customers | 279,935 | - | 279,935 | 275,483 |
| Other financial assets | 5,359 | - | 5,359 | 5,359 |
| | **738,458** | **402** | **738,860** | **734,492** |
| Deposits and balances from banks | 17,829 | - | 17,829 | 17,689 |
| Current accounts and deposits from customers | 581,473 | - | 581,473 | 582,343 |
| Other borrowed funds | 54,963 | - | 54,963 | 54,963 |
| Subordinated borrowings | 20,388 | - | 20,388 | 20,388 |
| Other financial liabilities | 4,344 | - | 4,344 | 4,344 |
| | **678,997** | **-** | **678,997** | **679,727** |

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities.

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

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

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

## Fair value hierarchy

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

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

The following assumptions are used by management to estimate the fair values of financial instruments as at 31 December 2019:

- discount rates of 16.6% (2018: 17.1%) and 8.0% (2018: 14.7%) are used for discounting future cash flows from loans to individual customers in national and foreign currency, respectively;
- discount rates of 8.8% (2018: 9.3%) and 5.3% (2018: 6.1%) are used for discounting future cash flows from loans to corporate customers in national and foreign currency, respectively;
- discount rates of 8.97 % (2018: 9.46%) and 3.67 % (2018: 3.29%) are used for discounting future cash flows from due from banks in national and foreign currency, respectively;
- discount rates of 9.68 % (2018: 10.01%) and 2.40 % (2018: 2.66%) are used for discounting future cash flows from deposits from individual customers in national and foreign currency, respectively;
- discount rates of 4.71 % (2018: 5.53%) and 1.10 % (2018: 1.43%) are used for discounting future cash flows from deposits from corporate customers in national and foreign currency, respectively;
- discount rates of 9.28 % (2018: 9.46 %) and 4.55 % (2018: 3.29%) are used for discounting future cash flows from deposits and balances from banks in national and foreign currency, respectively;
- quoted market prices are used for determination of fair value of debt investment securities.

The table below analyses financial instruments measured at fair value at 31 December 2019, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

| **AZN '000** | **Level 3** | **Total** |
|---|---|---|
| Investment securities – equity | 402 | 402 |
| | **402** | **402** |

The table below analyses financial instruments measured at fair value at 31 December 2018, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

| **AZN '000** | **Level 3** | **Total** |
|---|---|---|
| Investment securities – equity | 402 | 402 |
| | **402** | **402** |

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2019:

| **AZN'000** | **Level 1** | **Level 2** | **Level 3** | **Total fair values** | **Total carrying amount** |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | - | 274,614 | - | 274,614 | 274,614 |
| Investment securities | 13,681 | | - | 13,681 | 13,553 |
| Due from banks and other financial institutions | - | 57,319 | - | 57,319 | 60,285 |
| Loans to customers | - | - | 347,992 | 347,992 | 351,574 |
| Other financial assets | - | 6,356 | - | 6,356 | 6,356 |
| | **13,681** | **338,289** | **347,992** | **699,962** | **706,382** |

| **AZN'000** | **Level 2** | **Total fair values** | **Total carrying amount** |
|---|---|---|---|
| **LIABILITIES** | | | |
| Deposits and balances from banks | 20,305 | 20,305 | 20,446 |
| Current accounts and deposits from customers | 498,696 | 498,696 | 499,588 |
| Other borrowed funds | 87,401 | 87,401 | 87,401 |
| Subordinated borrowings | 20,339 | 20,339 | 20,339 |
| Other financial liabilities | 5,733 | 5,733 | 5,730 |
| | **632,474** | **632,474** | **633,504** |

The following table analyses the fair value of financial instruments not measured at fair value, by the level in the fair value hierarchy into which each fair value measurement is categorised as at 31 December 2018:

| AZN'000 | Level 1 | Level 2 | Level 3 | Total fair values | Total carrying amount |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | - | 353,520 | - | 353,520 | 353,520 |
| Investment securities | 10,431 | - | - | 10,431 | 11,347 |
| Due from banks and other financial institutions | - | 88,297 | - | 96,075 | 88,297 |
| Loans to customers | - | - | 275,483 | 275,483 | 279,935 |
| Other financial assets | - | 5,359 | - | 5,359 | 5,359 |
| | **10,431** | **447,176** | **275,483** | **740,868** | **738,458** |

| AZN'000 | Level 2 | Level 3 | Total fair values | Total carrying amount |
|---|---|---|---|---|
| **LIABILITIES** | | | | |
| Deposits and balances from banks | 17,689 | - | 17,689 | 17,829 |
| Current accounts and deposits from customers | 582,343 | - | 582,343 | 581,473 |
| Other borrowed funds | 54,963 | - | 54,963 | 54,963 |
| Subordinated borrowings | 20,388 | - | 20,388 | 20,388 |
| Other financial liabilities | 4,344 | - | 4,344 | 4,344 |
| | **679,727** | **-** | **679,727** | **678,997** |

# 32 Events after the reporting period

The first months of 2020 have seen significant global market turmoil triggered by the outbreak of the coronavirus. To the date of these financial statements are authorized for issue, the Bank did not experience significant effect of the mentioned event.

In order to estimate the possible impact of current events on the Bank's activities, stress-testing of market risk is carried out on a timely basis in 2 scenarios under 3 sub-scenarios. The most significant risks for the Bank are a possible interest rate increase by the CBAR, devaluation of national currency and further decrease in oil prices, which will entail a negative financial result in the medium term.

The Bank carries out regular stress testing of liquidity risk. The Bank Risk Management Department monitors the Bank's liquidity status, conducts scenario analysis of prospective liquidity, monitors the Bank's compliance with mandatory liquidity ratios established by the CBAR. The results of stress testing of liquidity risk show that, applying relevant measures, the implementation of crisis situations will not lead to violations of the Bank's liquidity norms. Given the sufficiency of cash and short-term liquid assets the Bank does not expect the occurrence of events related to the shortage of liquid assets for current activities. With regard to the expected credit losses, the Bank expects the changes following under the worst scenario with 3 sub-scenarios: 10% deterioration in the loan portfolio leads to the creation of an additional expected credit losses of AZN 5,602 thousand; 20% deterioration in the loan portfolio leads to the creation of an additional expected credit losses of AZN 11,203 thousand; 25% deterioration in the loan portfolio leads to the creation of an additional expected credit losses of AZN 14,004 thousand.

For all of the scenarios the Bank developed action plan and measures in order to sustain in the medium term. The Bank anticipates that all the mandatory ratios stipulated by the CBAR will be sustained and not breached; minimum statutory capital requirement of AZN 50 mln will be maintained.

Subsequently on February 2020, the Bank declared dividends in the amount of AZN 7,000 thousand (AZN 1.40 per share).

Mr. Elchin Gadimov
Chairman of the Management Board

Ms. Malahat Nazirova
Chief Accountant