“AccessBank” Closed Joint Stock Company
Financial statements

Year ended 31 December 2019
together with independent auditor’s report

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Independent Auditor's Report

To the Shareholders and Management Board of AccessBank CJSC:

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of CJSC "AccessBank" (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.

What we have audited

The Bank's financial statements comprise:

- the statement of financial position as at 31 December 2019;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

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 Auditor's responsibilities for the audit of the financial statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

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 International Financial Reporting Standards, 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.

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

PricewaterhouseCoopers Audit Azerbaijan LLC

Baku, the Republic of Azerbaijan

02 June 2020

Statement of financial position

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	2019	2018
Assets			
Cash and cash equivalents	7	132,198	145,694
Amounts due from credit institutions	8	9,586	4,423
Derivative financial assets	9	807	-
Investment in debt securities	10	33,978	1,764
Loans to customers	11	563,651	521,342
Property and equipment	13	31,150	32,596
Intangible assets	13	15,317	18,583
Right of use assets	14	4,791	-
Deferred income tax assets	16	16,026	24,928
Repossessed collateral	15	44,880	23,898
Other financial assets	17	8,976	4,764
Other assets	17	1,930	1,390
Total assets		**863,290**	**779,382**
Liabilities			
Amounts due to credit institutions	18	1,047	486
Derivative financial liabilities	9	5,143	10,619
Amounts due to customers	19	689,392	513,449
Borrowed funds	20	37,136	212,418
Lease liabilities	14	4,616	-
Other financial liabilities	17	5,854	2,901
Other liabilities	17	2,784	3,737
Deferred income	22	1,075	-
Subordinated debt	21	22,383	65,060
Total liabilities		**769,430**	**808,670**
Equity			
Share capital	23	258,718	140,258
Accumulated deficit		(164,888)	(169,576)
Unrealized gains on investment securities		30	30
Total equity/(Deficit of equity)		**93,860**	**(29,288)**
Total liabilities and equity		**863,290**	**779,382**

Signed and authorized for release on behalf of the Management Board of the Bank on 2 June 2020.

Anar Hasanov — Chairman of the Management Board

Elshan Hajiyev — Executive Director of Accounting

The accompanying notes on pages 5 to 71 are an integral part of these financial statements.

Statement of profit or loss and other comprehensive income

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2019*	*2018*
Interest income			
Loans to customers		95,286	84,586
Investment in debt securities		1,376	962
Cash and cash equivalents		801	420
Amounts due from credit institutions		594	858
Interest revenue calculated using effective interest method		**98,057**	**86,826**
Interest expense			
Amounts due to customers		(39,007)	(27,942)
Borrowed funds		(4,818)	(17,515)
Subordinated debt		(2,198)	(6,089)
Amounts due to credit institutions		(1,767)	(123)
Interest expense for lease liability	14	(454)	-
		(48,244)	**(51,669)**
Net interest income		**49,813**	**35,157**
Credit loss (expense)/ reversal	11	(1,711)	21,312
Net interest income after credit loss reversal/(expense)		**48,102**	**56,469**
Fee and commission income	26	8,762	11,043
Fee and commission expense	26	(4,058)	(4,231)
Net gains/(losses) from foreign currency operations:			
- foreign exchange transactions		2,661	3,112
- translation differences		(9)	(9)
- foreign currency derivatives		(2,683)	(21,527)
Gains less losses from modification of financial assets measured at amortised cost, that did not lead to derecognition	11	(879)	-
Government grant income		11,040	-
Gain on extinguishment of debt	4	21,540	-
Other income		247	325
Non-interest expense		**36,621**	**(11,287)**
Personnel expenses	27	(30,217)	(33,316)
General and administrative expenses	27	(31,926)	(19,542)
Depreciation and amortization	13,14	(8,509)	(7,871)
Other impairment reversal/(charge)		(481)	454
Other operating expenses		**(71,133)**	**(60,275)**
Profit/(loss) before income tax expense		**13,590**	**(15,093)**
Income tax (charge)/credit	16	(8,902)	6,289
Profit/(loss) for the year		**4,688**	**(8,804)**
Other comprehensive income		-	37
Income tax relating to components of other comprehensive income		-	(7)
Total comprehensive income/(loss) for the year		**4,688**	**(8,774)**

The accompanying notes on pages 5 to 71 are an integral part of these financial statements.

Statement of changes in equity

(Figures in tables are in thousands of Azerbaijani manats)

	Note	*Share capital*	*Accumulated deficit*	*Unrealized gain on investment securities*	*Total Equity (Deficit of equity)*
Balance at 1 January 2018		**140,258**	**(160,772)**	**–**	**(20,514)**
Loss for the year			(8,804)	–	**(8,804)**
Other comprehensive income for the year		–	–	30	**30**
Total comprehensive loss for the year		**–**	**(8,804)**	**30**	**(8,774)**
31 December 2018		**140,258**	**(169,576)**	**30**	**(29,288)**
Increase in share capital	4	118,460	-	-	**118,460**
Profit for the year		-	4,688	-	**4,688**
Other comprehensive income for the year		-	-	-	**-**
Total comprehensive loss for the year		**-**	**4,688**	**-**	**4,688**
31 December 2019		**258,718**	**(164,888)**	**30**	**93,860**

The accompanying notes on pages 5 to 71 are an integral part of these financial statements.

Statement of cash flows

(Figures in tables are in thousands of Azerbaijani manats)

	Notes	*2019*	*2018*
Cash flows from operating activities			
Interest received		84,147	65,610
Interest paid		(46,857)	(54,809)
Fees and commissions received		8,642	11,163
Fees and commissions paid		(4,058)	(4,231)
Realized losses from transactions with foreign currency derivatives		(8,966)	(25,918)
Realized gains less losses from exchange transactions in foreign currencies		2,661	3,112
Government grant income		11,040	
Other income received		247	328
Personnel expenses paid		(30,964)	(33,002)
Other operating expenses paid		(28,945)	(17,191)
Cash flows used in operating activities before changes in operating assets and liabilities		**(13,053)**	**(54,938)**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		(5,219)	25,071
Loans to customers		(52,151)	(20,643)
Other financial assets		(4,191)	1,932
Other assets		(145)	(35)
Net increase/(decrease) in operating liabilities			
Amounts due to credit institutions		278	(11,221)
Amounts due to customers		172,683	74,844
Other financial liabilities		380	1,630
Other liabilities		(706)	(1,494)
Net cash flows from operating activities before income tax		**97,876**	**15,146**
Income tax paid		-	–
Net cash from operating activities		**97,876**	**15,146**
Cash flows from investing activities			
Purchase of property and equipment		(1,614)	(228)
Acquisition of intangible assets		(1,868)	(1,133)
Purchase of Investment securities		(306,922)	–
Proceeds from redemption of investment securities		274,708	37,466
Net cash (used in)/ from investing activities		**(35,696)**	**36,105**
Cash flows from financing activities			
Proceeds from borrowed funds	24	8,165	-
Government Grant received	22	1,075	–
Repayment of borrowed funds	24	(83,316)	(27,055)
Repayment of principal lease liabilities	24	(1,156)	-
Net cash used in financing activities		**(75,232)**	**(27,055)**
Effect of expected credit loss on cash and cash equivalents		-	30
Effect of exchange rates changes on cash and cash equivalents		(444)	(1,562)
Net (decrease)/ increase in cash and cash equivalents		**(13,496)**	**22,664**
Cash and cash equivalents, beginning	5	145,694	123,030
Cash and cash equivalents, ending	5	**132,198**	**145,694**

The accompanying notes on pages 5 to 71 are an integral part of these financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

AccessBank Closed Joint Stock Company (the "Bank") was incorporated in the Republic of Azerbaijan on 5 September 2002. The Bank operates under the license number 245 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR").

The Bank's principal business activity is commercial banking operations within the Republic of Azerbaijan, with a focus on serving micro and small business customers.

The Bank participates in the state deposit insurance scheme, which was introduced by the Azerbaijani Law, *Deposits of Individuals Insurance in Azerbaijan Republic* dated 29 December 2006. Starting 2 March 2016 deposits accepted by the Fund's member banks with the annual interest rate 3% in the foreign currency and 15% in the national currency are fully insured for 3 (three) years.

The Bank has twenty eight branches within the Republic of Azerbaijan as at 31 December 2019 (2018– twenty eight). The Bank's registered address is 3 Tbilisi Avenue, Baku, AZ1065, Azerbaijan.

As at 31 December 2019 and 2018, the following shareholders owned the outstanding ordinary shares of the Bank:

Shareholders	***2019 %***	***2018 %***
Asian Development Bank (ADB)	19.90	-
European Investment Bank (EIB)	17.39	-
IFC (International Finance Corporation)	16.56	20.86
FMO	9.41	-
Austrian Development Bank (OeEB)	9.17	-
Swiss Investment Fund for Emerging Markets AG, c/o Obviam DFI AG	8.89	-
ResponsAbility Management Company S.A	7.11	-
Other shareholders with individually less than 3% ownership	11.57	-
EBRD (European Bank for Reconstruction and Development)	-	18.54
KFW (KreditanstaltfürWiederaufbau)	-	18.54
BSTDB (Black Sea Trade and Development Bank)	-	20.49
Access Microfinance Holding AG	-	17.82
LFS Financial Systems GmbH	-	3.75
Total	**100.00**	**100.00**

2. Operating Environment of the Bank

The Republic of Azerbaijan displays certain characteristics of an emerging market. Current and future growth and stability of the economy is largely dependent upon the effective implementation of economic, fiscal and monetary measures undertaken by government as well as crude oil prices and stability of Azerbaijani manats.

Following the sharp economic contraction in 2016 due to negative impact of the decline in oil prices and devaluations of national currency against major international currencies, the government accelerated reforms in support of long-term economic stability and sustainability. Based on the economic reforms involving institutional changes, inflation was stable at a low single-digit rate, the economic growth remained positively zoned, the exchange rate of the national currency was sustainable and positive trends emerged in the foreign sector.

Despite a number of ongoing fragilities in the systemic risks, the banking sector stability was safeguarded in parallel with lending recovery. The implementation of the Presidential Decree on "Additional measures on resolving problematic loans of individuals" has led to compensation of individuals and restructuring of defaulted loans of individuals helped to improve bad loan problem in the banking sector.

The international rating agencies have maintained credit ratings of Azerbaijan during 2019 with stable outlook. In July, Moody's has upgraded the outlook of Azerbaijan's banking system from stable to positive and the agency affirms that Azerbaijan's growing economy and the high level of state support contributed the most to the positive forecast on the country's banking system. According to World Bank's Doing Business report 2020, Azerbaijan improved its position in the ease of doing business rank to 34.

The Bank's Management is monitoring these developments in the current environment and taking precautionary measures as it considers necessary in order to ensure the sustainability and development of the Bank's business in the foreseeable future. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

3. Significant Accounting Policies

Basis of preparation. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the initial recognition of financial instruments at fair value, and by the revaluation of financial instruments categorised at fair value through profit or loss ("FVTPL") and at fair value through other comprehensive income ("FVOCI"). The principal accounting policies applied in the preparation of these financial statements are set out below. Apart from the accounting policy changes resulting from the adoption of IFRS 16 effective from 1 January 2019, these policies have been consistently applied to all the periods presented, unless otherwise stated. Refer to Note 5.

Financial instruments – key measurement terms. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees, are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Recurring fair value measurements are those that the accounting standards require or permit in the statement of financial position at the end of each reporting period. Refer to Note 29.

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

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

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the gross carrying amount of the financial instrument.

The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount, which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

3. Significant Accounting Policies (Continued)

Financial instruments – Initial recognition. Financial instruments at FVTPL are initially recorded at fair value. All other financial instruments are initially recorded at fair value adjusted for transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets. After the initial recognition, an ECL allowance is recognised for financial assets measured at AC and investments in debt instruments measured at FVOCI, resulting in an immediate accounting loss.

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

Financial assets – classification and subsequent measurement – measurement categories. The Bank classifies financial assets in the following measurement categories: FVTPL, FVOCI and AC. The classification and subsequent measurement of debt financial assets depends on: (i) the Bank's business model for managing the related assets portfolio and (ii) the cash flow characteristics of the asset.

Financial assets – classification and subsequent measurement – business model. The business model reflects how the Bank manages the assets in order to generate cash flows – whether the Bank's objective is: (i) solely to collect the contractual cash flows from the assets ("hold to collect contractual cash flows",) or (ii) to collect both the contractual cash flows and the cash flows arising from the sale of assets ("hold to collect contractual cash flows and sell") or, if neither of (i) and (ii) is applicable, the financial assets are classified as part of "other" business model and measured at FVTPL.

Business model is determined for a group of assets (on a portfolio level) based on all relevant evidence about the activities that the Bank undertakes to achieve the objective set out for the portfolio available at the date of the assessment. Factors considered by the Bank in determining the business model include the purpose and composition of a portfolio, past experience on how the cash flows for the respective assets were collected, how risks are assessed and managed and how the assets' performance is assessed. Refer to Note 4 for critical judgements applied by the Bank in determining the business models for its financial assets.

Financial assets – classification and subsequent measurement – cash flow characteristics. Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the Bank assesses whether the cash flows represent solely payments of principal and interest ("SPPI").

Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the financial asset is classified and measured at FVTPL. The SPPI assessment is performed on initial recognition of an asset and it is not subsequently reassessed. Refer to Note 4 for critical judgements applied by the Bank in performing the SPPI test for its financial assets.

Financial assets – reclassification. Financial instruments are reclassified only when the business model for managing the portfolio as a whole changes. The reclassification has a prospective effect and takes place from the beginning of the first reporting period that follows after the change in the business model. The Bank did not change its business model during the current and comparative period and did not make any reclassifications.

Financial assets impairment – credit loss allowance for ECL. The Bank assesses, on a forward-looking basis, the ECL for debt instruments measured at AC and FVOCI and for the exposures arising from loan commitments and financial guarantee contracts. The Bank measures ECL and recognises credit loss allowance at each reporting date. The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions.

3. Significant Accounting Policies (Continued)

Debt instruments measured at AC are presented in the statement of financial position net of the allowance for ECL. For loan commitments and financial guarantees, a separate provision for ECL is recognised as a liability in the statement of financial position. For debt instruments at FVOCI, changes in amortised cost, net of allowance for ECL, are recognised in profit or loss and other changes in carrying value are recognised in OCI as gains less losses on debt instruments at FVOCI.

The Bank applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter ("12 Months ECL"). If the Bank identifies a significant increase in credit risk ("SICR") since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any ("Lifetime ECL"). Refer to Note 28 for a description of how the Bank determines when a SICR has occurred. If the Bank determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Bank's definition of credit impaired assets and definition of default is explained in Note 28. Note 28 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Bank incorporates forward-looking information in the ECL models.

As an exception, for certain financial instruments, such as credit cards, that may include both a loan and an undrawn commitment component, the Bank measures expected credit losses over the period that the Bank is exposed to credit risk, that is, until the expected credit losses would be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. This is because contractual ability to demand repayment and cancel the undrawn commitment does not limit the exposure to credit losses to such contractual notice period.

Financial assets – write-off. Financial assets are written-off, in whole or in part, when the Bank exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event. The Bank may write-off financial assets that are still subject to enforcement activity when the Bank seeks to recover amounts that are contractually due, however, there is no reasonable expectation of recovery.

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

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, except for "impaired" restructured cases. If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss (refer to "modification" section below), to the extent that an impairment loss has not already been recorded. Loans modified during the period include those in Stage 3 with the related modification loss suffered by the Bank.

Financial assets – modification. The Bank sometimes renegotiates or otherwise modifies the contractual terms of the financial assets. The Bank assesses whether the modification of contractual cash flows is substantial considering, among other, the following factors: any new contractual terms that substantially affect the risk profile of the asset (eg. profit share or equity-based return), significant change in interest rate, change in the currency denomination, new collateral or credit enhancement that significantly affects the credit risk associated with the asset or a significant extension of a loan when the borrower is not in financial difficulties.

3. Significant Accounting Policies (Continued)

If the modified terms are substantially different, the rights to cash flows from the original asset expire and the Bank derecognises the original financial asset and recognises a new asset at its fair value. The date of renegotiation is considered to be the date of initial recognition for subsequent impairment calculation purposes, including determining whether a SICR has occurred. The Bank also assesses whether the new loan or debt instrument meets the SPPI criterion. Any difference between the carrying amount of the original asset derecognised and fair value of the new substantially modified asset is recognised in profit or loss, unless the substance of the difference is attributed to a capital transaction with owners.

In a situation where the renegotiation was driven by financial difficulties of the counterparty and inability to make the originally agreed payments, the Bank compares the original and revised expected cash flows to assets whether the risks and rewards of the asset are substantially different as a result of the contractual modification. If the risks and rewards do not change, the modified asset is not substantially different from the original asset and the modification does not result in derecognition.

The Bank recalculates the gross carrying amount by discounting the modified contractual cash flows by the original effective interest rate and recognises a modification gain or loss in profit or loss. Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions.

When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- Change in currency of the loan;
- Change in counterparty;
- If the modification is such that the instrument would no longer meet the SPPI criterion.

Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

Financial liabilities – measurement categories. Financial liabilities are classified as subsequently measured at AC, except for (i) financial liabilities at FVTPL and (ii) financial guarantee contracts and loan commitments.

Financial liabilities – derecognition. Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

An exchange between the Bank and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms and conditions of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. 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% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in loan covenants are also considered. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

Modifications of liabilities that do not result in extinguishment are accounted for as a change in estimate using a cumulative catch up method, with any gain or loss recognised in profit or loss, unless the economic substance of the difference in carrying values is attributed to a capital transaction with owners.

Cash and cash equivalents. Cash and cash equivalents are short-term items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include cash on hand, amounts due from the CBAR, excluding obligatory reserves, and unrestricted balances on correspondent accounts including overnight deposits and deposits with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents, both in the statement of financial position and for the purposes of the statement of cash flows. Cash and cash equivalents are carried at AC because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

3. Significant Accounting Policies (Continued)

Mandatory cash balances with the CBAR. Mandatory cash balances with the CBAR are carried at AC and represent non-interest bearing mandatory reserve deposits, which are not available to finance the Bank's day to day operations, and hence are not considered as part of cash and cash equivalents for the purposes of the statement of cash flows.

Amounts due from credit institutions. Amounts due from credit institutions are obligatory reserves with CBAR and placements with other banks and credit institutions with original maturities of more than three months. Amounts due from credit institutions are carried at AC when: (i) they are held for the purposes of collecting contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

Investments in debt securities. Based on the business model and the cash flow characteristics, the Bank classifies investments in debt securities as carried at AC, FVOCI or FVTPL. Debt securities are carried at AC if they are held for collection of contractual cash flows and where those cash flows represent SPPI, and if they are not voluntarily designated at FVTPL in order to significantly reduce an accounting mismatch.

Debt securities are carried at FVOCI if they are held for collection of contractual cash flows and for selling, where those cash flows represent SPPI, and if they are not designated at FVTPL. Interest income from these assets is calculated using the effective interest method and recognised in profit or loss. An impairment allowance estimated using the expected credit loss model is recognised in profit or loss for the year. All other changes in the carrying value are recognised in OCI. When the debt security is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from OCI to profit or loss.

Investments in debt securities are carried at FVTPL if they do not meet the criteria for AC or FVOCI. The Bank may also irrevocably designate investments in debt securities at FVTPL on initial recognition if applying this option significantly reduces an accounting mismatch between financial assets and liabilities being recognised or measured on different accounting bases.

Loans to customers. Loans to customers are recorded when the Bank advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Bank classifies loans to customers into one of the following measurement categories: (i) AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and (ii) FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Impairment allowances are determined based on the forward-looking ECL models. Note 24 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Bank incorporates forward-looking information in the ECL models.

***Financial guarantees*.** Financial guarantees require the Bank to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight-line basis over the life of the guarantee. At the end of each reporting period, the guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition. In addition, an ECL loss allowance is recognised for fees receivable that are recognised in the statement of financial position as an asset.

Loan commitments. The Bank issues commitments to provide loans. These commitments are irrevocable or revocable only in response to a material adverse change. Such commitments are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight-line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at (i) the remaining unamortised balance of the amount at initial recognition, plus (ii) the amount of the loss allowance determined based on the expected credit loss model, unless the commitment is to provide a loan at a below market interest rate, in which case the measurement is at the higher of these two amounts. The carrying amount of the loan commitments represents a liability. For contracts that include both a loan and an undrawn commitment and where the Bank cannot separately distinguish the ECL on the undrawn loan component from the loan component, the ECL on the undrawn commitment is recognised together with the loss allowance for the loan. To the extent that the combined ECLs exceed the gross carrying amount of the loan, they are recognised as a liability.

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

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting date.

Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

In addition, there are various operating taxes in Azerbaijan such as VAT, property tax, withholding tax and others which become relevant as a result of the Banks's operations. These taxes are included as a component of general and administrative expenses.

Property and equipment*.* Equipment is carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

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

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

Depreciation. Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings and leasehold improvements	5-50
Furniture and office equipment	4-5
Computer equipment	4-5
Motor vehicles	4

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Repossessed collateral. In certain circumstances, collateral is repossessed following the foreclosure on loans that are in default. Repossessed collateral is initially recognized at fair value when acquired and subsequently measured in at the lower of carrying amount and net realizable value and reported within 'Other assets'.

3. Significant Accounting Policies (Continued)

Intangible assets. Intangible assets include computer software and licenses. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortized over the useful economic lives of 10 years and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Accounting for leases by the Bank as a lessee from 1 January 2019. The Bank leases office premises. Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Bank. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is recognised at cost and depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payment that are based on an index or a rate;
- amounts expected to be payable by the lessee under residual value guarantees;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option, and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs, and
- restoration costs.

As an exception to the above, the Bank accounts for short-term leases and leases of low value assets by recognising the lease payments as an operating expense on a straight-line basis.

In determining the lease term, management of the Bank considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated).

The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee.

Accounting for operating leases by the Bank as a lessee prior to 1 January 2019. Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease. Operating leases included leases of apartments, cars, 1 square meter area for the Bank's automated teller machines and payment terminals.

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

3. Significant Accounting Policies (Continued)

Amounts due to customers and credit institutions. Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include customer accounts and term deposits placed by individuals, state and corporate customers, as well as credit institutions. All amounts represent non-derivative liabilities and are carried at AC.

Borrowed funds. Borrowed funds include borrowings from international lenders and the government agencies, namely the Central Bank of the Republic of Azerbaijan, Entrepreneurship Development Fund, and Agency for Agro Credit and Development under the Ministry of Agriculture. These financial instruments are initially measured at fair value, net of transaction costs, and subsequently measured at amortized cost using the effective interest method.

Subordinated debt. Subordinated debt can only be paid in the event of a liquidation after the claims of other higher priority creditors have been met. Subordinated debt is carried at AC.

Derivative financial instruments. Derivative financial instruments, including foreign exchange contracts, interest rate futures, forward rate agreements, currency and interest rate swaps, and currency and interest rate options are carried at their fair value.

The Bank also enters into offsetting loans with its counterparty banks to exchange currencies. Such loans, while legally separate, are aggregated and accounted for as a single derivative financial instrument (currency swap) on a net basis where (i) the loans are entered into at the same time and in contemplation of one another, (ii) they have the same counterparty, (iii) they relate to the same risk and (iv) there is no apparent business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

All derivative instruments are carried as assets when fair value is positive, and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the year (Net gains/(losses) from foreign currency operations: foreign currency derivatives). The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors.

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

Provisions. Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Share capital. Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognized as additional paid-in capital.

Dividends. Dividends are recorded in equity in the period in which they are declared. Any dividends declared after the end of the reporting period and before the financial statements are authorised for issue, are disclosed in the subsequent events note. The statutory accounting reports of the Bank are the basis for profit distribution and other appropriations.

Contingencies. Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured.

3. Significant Accounting Policies (Continued)

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

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

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

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for financial assets that have become credit impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their AC, net of the ECL provision.

Fees and commissions. The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- *Fee income earned from services that are provided over a certain period of time*

Fee and commission income is recognised over time on a straight line basis as the services are rendered, when the customer simultaneously receives and consumes the benefits provided by the Bank’s performance.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

- *Fee income from providing transaction services*

Fee and commission income is recognised at a point in time when the Bank satisfies its performance obligation, usually upon execution of the underlying transaction. The amount of fee or commission received or receivable represents the transaction price for the services identified as distinct performance obligations. Fees arising from negotiating or participating in the negotiation of a transaction for a third party are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

Sales and purchases of foreign currencies and currency conversion. The Bank sells and purchases foreign currencies in the cash offices and through the bank accounts, as well as exchanges foreign currencies. The transactions are performed at the exchange rates established by the Bank, which are different from the official spot exchange rates at the particular dates. The differences between the official and Bank’s rates are recognised as gains less losses from foreign exchange transactions at a point in time when a particular performance obligation is satisfied.

Foreign currency translation. The financial statements are presented in Azerbaijani Manat, which is the Bank’s functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the statement of profit or loss and other comprehensive income as net gains (losses) from foreign currency translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(Figures in tables are in thousands of Azerbaijani manats)

3. Significant Accounting Policies (Continued)

Differences between the contractual exchange rate of a transaction in a foreign currency and the CBAR exchange rate on the date of the transaction are included in gains/ losses from dealing operations.

The Bank used the following official exchange rates at 31 December in the preparation of these financial statements:

	2019	**2018**
1 US dollar	AZN 1.7000	AZN 1.7000
1 Euro	AZN 1.9035	AZN 1.9468

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

Government grant*.* The benefit of a government loan at a below market rate of interest is accounted for as a government grant under IAS 20 while the relevant standard for measurement of the loan is IFRS 9. The benefit is measured as the difference between the initial carrying value of the loan determined in accordance with IFRS 9 and the proceeds received. The amount of benefit is deferred by the Bank and recognised under other liabilities (Note 22). The amount is then recognised in the income statement proportionately to the interest expense accrued using the effective interest rate method.

Compensation received from the government in accordance with Presidential Decree on “Additional measures on resolving problematic loans of individuals in the Republic of Azerbaijan” is directly recognised in the income statement.

Changes in presentation. During the year the Bank has restated prior year financial statements as detailed in sections below:

A. Offsetting error in fee and commission income and expense

Fee and commission income and expense were presented as net amount in the statement of profit or loss and other comprehensive income for the year ended 31 December 2018 with details disclosed in the notes to the financial statements. However, following the requirement on offsetting, the Bank reclassified fee and commission income and expense from net to gross presentation in the statement of profit or loss and other comprehensive income.

B. Offsetting error of cost of recovery with impairment recoveries

Costs incurred on recoveries of loans to customers were presented within credit loss expenses in the statement of profit or loss and other comprehensive income for the year ended 31 December 2018. These costs represent amounts paid out to collectors and the amount was reclassified from “credit loss reversal“ line to “general and administrative expenses” line. The total amount of reclassification for 2018 is AZN 2,928 thousand.

C. Re-classifications from “Other assets” and “Other liabilities” financial statement line items

- The Bank reclassified “repossessed collateral” balance from “Other assets” line to a separate line in the statement of financial position for the year ended 31 December 2019, which was presented within “Other assets” line in comparative period. The Bank believes that such presentation is more relevant to the users of the financial statements
.
- The Bank reclassified other financial assets and other financial liabilities from “other assets” and “other liabilities” balances respectively to separate lines on the statement of financial position following the requirement on presentation of line items in the statement of financial position.

D. Reclassification to “Borrowed funds” from “Amounts due to credit institutions”

The Bank has reclassified some borrowings which are “term borrowings” by nature from “Amounts due to credit institutions” to “Borrowed funds” line in the statement of financial position with further disclosure in the notes.

(Figures in tables are in thousands of Azerbaijani manats)

3. Significant Accounting Policies (Continued)

The effect of reclassifications for presentation purposes was as follows for the statement of financial position as at 31 December 2018:

	As originally presented	Changes in presentation	As reclassified at 31 December 2018
Other assets	30,052	(28,662)	1,390
Repossessed collateral	-	23,898	23,898
Other financial assets	-	4,764	4,764
Other liabilities	6,638	(2,901)	3,737
Other financial liabilities	-	2,901	2,901
Amounts due to credit institutions	8,363	(7,877)	486
Borrowed funds	204,541	7,877	212,418
Total assets	***779,382***	***-***	***779,382***
Total liabilities	***808,670***	***-***	***808,670***
Total equity	***(29,288)***	***-***	***(29,288)***

The effect of restatements on classification errors was as follows for the statement of profit or loss and other comprehensive income for the year ended 31 December 2018:

	As originally presented	Correction of Classification Error	As restated for the year ended 31 December 2018
Net fee and commission income	6,812	(6,812)	-
Fee and commission income	-	11,043	11,043
Fee and commission expense	-	(4,231)	(4,231)
Credit loss reversal	18,384	2,928	21,312
Net interest income after credit loss reversal/(expense)	***53,540***	**2,928**	***56,468***
General and administrative expense	(16,614)	(2,928)	(19,542)
Other operating expenses	***(57,347)***	***(2,928)***	***(60,275)***
Loss for the year	***(8,804)***	***-***	***(8,804)***

The reclassifications in the statement of financial position had an impact on information in Notes 15, 17, 18, 20, 26, 27 and had no impact on any other captions in the statement of financial position and related note disclosures.

4. Critical Accounting Estimates, and Judgements in Applying Accounting Policies

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

Going Concern. Management prepared these financial statements on a going concern basis. As at 31 December 2018, the Bank was in breach of the regulatory capital adequacy ratios required by Financial Markets Supervisory Authority (FIMSA) and financial covenants stipulated by borrowing agreements with the international lenders as at 31 December 2018 (Notes 20 and 21).

On 15 November 2018, a group of existing international lenders entered into a debt restructuring agreement to recapitalize the Bank. The Parties have decided to make certain amendments to the terms of the Original Restructuring Agreement and hence on 26 February 2019 have entered into Agreement in order to amend and restate the Original Restructuring Agreement. This recapitalization was completed successfully on 15 March 2019. Related measures included a Tier-1 capital increase by AZN 140,000

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

thousand, thereof AZN 118,460 thousand by way of debt to equity conversion and AZN 21,540 thousand through debt forgiveness. Furthermore, existing senior debt of AZN 21,994 thousand was converted into Tier-2 eligible subordinated debt and a further AZN 21,994 thousand in senior debt was provided as contingent capital to be converted into either Tier-1 or Tier-2 capital in the event of regulatory non-compliance as of 31 October 2020 (Notes 20 and 21). As a result of these measures, the Bank became compliant with the regulatory capital adequacy ratios as at 31 March 2019 in accordance with the prudential report submitted to Financial Markets Supervision Authority (“FIMSA”).

Management believes that the Bank was in compliance with regulatory ratios at 31 December 2019. As of 31 December 2019, the Bank’s Capital Adequacy ratios were 7.55% (2018 – 2.04%) of minimum required 5%. Financial Covenants stipulated by borrowing agreements with the international lenders were waived in respect of existing or future non-compliance with any financial covenants as at 31 December 2019.

Deferred income tax asset recognition. The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on a medium term business plan prepared by management and extrapolated results thereafter. The business plan is based on management expectations that are believed to be reasonable under the circumstances. Key assumptions in the business plan are loan portfolio growth and major macroeconomic indicators’ movement in line with expectations. Following the recapitalization during 2019, the Bank has entered its 5 (five) year strategic plan and Management believes that forecasted growth and income included in the plan are achievable given existing circumstances. Expected business portfolio growth, strengthening risk management function and enhancement of operational costs are main criteria the plan based on. Key diver of income growth of the Bank is interest income generated by loans to SME and Micro segments. The expansion of the customer base combined with reduced cost of funds will be another factor contributing to the growth of operational income. Improving operating efficiency remains key priority for the Bank. Increasing business volumes significantly while maintaining a constant staff base will allow improving cost-income ratio and delivering services to clients in a more efficient and attractive way. Several projects to digitize key business processes, increase automation and promote self-service are important in achieving this priority. Business projections are considerate of potential risks involved and are scenario-weighted. For the movement of tax losses carry forward and their expected utilisation refer to Note 16.

Changes to models and ECL inputs during the period As part of a continuous process to enhance models to reflect market developments and newly available data, Bank has updated ECL provisioning model in the course of 2019. Major changes in impairment methodology include:

- Default definition and stage determination
- Pooling and collective assessment
- Individual assessment criteria
- Loss given default

The Bank has changed the previously used logit regression model to derive PD model estimate to migration matrices between PAR buckets, repaid and written-off states.

Default definition and stage determination

Bank has changed default definition that it uses in estimating IFRS 9 expected credit losses due to the internal risk management policies and procedures. A change in ECL resulting from using an updated default definition, which is an input into the ECL estimation methodology, is a change in estimate under the definition in IAS 8, since this resulted from new developments, including data improvements for restructuring flag in the loan portfolio module.

Default and written-off credit exposures are considered as absorbing states in the transition matrixes performed to model PD. Thus, they reflect cumulative probabilities and therefore time in default.

For 2019, the Bank has applied probation periods before moving financial assets from Stage 3 to 2 or from Stage 2 to 1 and has assigned at restructuring date Stage 2 or Stage 3 to financial assets considering the bank’s contamination concept at borrower level.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Pooling and collective assessment

Until 2018, the Bank was pooling borrowers in its loan portfolio solely by client segments, as defined by its internal policies, as these have different sources of income and are differently impacted by macroeconomic changes. The bank had three pools: microenterprises (Micro), small and medium enterprises (SME) and private persons, including loans to staff (Retail). IFRS 9 suggests that loans are grouped in pools of loans based on shared credit risk characteristics, which may change over time, as new information becomes available.

The loan portfolio originally disbursed before 2016 was significantly impacted by the macroeconomic crisis and a significant part of this portfolio, if not written-off, has been restructured.

Prior to 2016 the bank had much of its customer loan portfolio in USD and since 2015 the bank has disbursed loans mostly in AZN. Following the financial sector crisis after two devaluations of AZN currency, there was insufficient historical data since 2016 to perform required changes based on the new credit risk drivers. The lack of historical data was due to the fact that the economic recession was too recent and there was a significant decrease in the number and volume of disbursements after the first and second significant devaluations of the currency.

Currently there is sufficient historical data and a higher number of newly originated portfolio towards the end of 2018 and during 2019. This enabled the Bank to further pool within each client segment the portfolios into the 6 pools for PD modelling based on their restructuring status and original disbursement dates prior or after the last macroeconomic crisis. It should be noted that due to enough historical data, the LGD was still computed based on three pools: microenterprises, SME and retail.

Individual assessment criteria

Individually significant credit exposures are now defined as the top 50 (fifty) credit exposures by obligor who are in Stage 3 at the end of the latest reporting date and financial instruments and securities for which the Bank assesses individually their ECL. The bank has decided to do a more in-depth individual assessment of its top Stage 3 credit exposures based on probability-weighted scenarios. This required the increase of its individual assessment threshold as the more in-depth assessment requires more internal resources to collect the forward-looking information required to comply with the standards.

Loss given default

Cure assumption is incorporated into LGD for collectively assessed loans, as well as introduction of another layer for LGD calculations to reflect time in default by adding:

- Time since last default event
- EAD at the time of default, 1 year, 2 years and 3 years since last default,
- Probation period fulfilment counter, and
- Sub-pools within current pools for LGD of 1 year, 2 years, 3 years and 4 years since last default.

The bank was calculating LGD for collective assessment considering 12 months workout period (i.e. after default only cash-inflows within the next 12 months are considered as recoveries) as most of the portfolio was smaller credit exposures often not collateralized with hard collateral. However, the bank was calculating LGD for individual assessment considering a four years workout period. With the increase in the threshold of the individually assessed credit exposures, part of the previously individually assessed credit exposures are now collectively assessed. As the current model has bigger credit exposures, with high real estate collateral coverage, which are collectively assessed, the workout period has been increased to four years to capture collateral realization from real estate sale or repossession in case of default. Based on the bank’s subject matter expert’s experience the workout period for recoveries given default can take up to four years, especially if legal proceedings are initiated. Thus, the past approach is now extended to the whole collectively assessed loan portfolio.

Nevertheless, although the bank applies a workout period of four years, in practice this is not applied for all LGD estimation, as when a financial asset is written off during the workout period, all eventual recoveries after the write off are disregarded. Most of the loan portfolio unsecured with hard collateral is written-off within 1 to 2 years after default if the situation that lead to the default is permanent. Furthermore, at least 12 months since default occurred was considered in 2019’s calculations to ensure there was enough time since default for some recoveries to have occurred. Thus, LGD rates decreased from those calculated for 2018.

As a result of factors analysed above, effect of changes to inputs from the current model using the revised stage determination, contamination concept, individual assessment criteria, loss given default change, EAD for revolving financial assets and stage transfer considerations the ECL for collectively and individually assessed loans have increased by AZN 35,891 thousand (refer to Note 11).

(Figures in tables are in thousands of Azerbaijani manats)

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Migration of EAD between the reporting periods

There was a migration of EAD due to changes in the individual assessment threshold, stages determination, application of contamination concept, probation periods and migration of the customers’ loan portfolio. Of the individually assessed portfolio as of 31 December 2018, a significant part of Stage 3 financial assets migrated to Stage 3 as collectively assessed due to the change in the individually assessed threshold (EAD of AZN 64 million is now collectively assessed as of 31 December 2019). A significant part of Stage 3 financial assets as of 31 December 2018 has been written off during 2019. For the write-offs amount refer to Note 11.

ECL measurement. Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 9 and 23. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default (“PD”), exposure at default (“EAD”), and loss given default (“LGD”), as well as models of macro-economic scenarios. The Bank regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience. Impact of forward-looking assumptions correlated with ECL level and their assigned weight is not significant.

The Bank used supportable forward looking information for measurement of ECL, primarily an outcome of its own macro-economic forecasting model. The most significant forward looking assumptions that correlate with ECL level and their assigned weights were as follows at 31 December 2019:

Variable	Scenario	Assigned weight	2020	2021	2022
GDP growth rate	Base	50%	3.0%	3.7%	3.0%
	Upside	25%	3.5%	4.2%	4.2%
	Downside	25%	2.5%	2.0%	2.0%
FX rate					
(1 USD to AZN)	Base	50%	1.7	1.7	1.7
	Upside	25%	1.7	1.7	1.7
	Downside	25%	1.9	2.1	2.1
Oil price					
(Brent) in USD	Base	50%	55-65	55-65	55-65
	Upside	25%	70	75	75
	Downside	25%	50	50	50
Crisis	Base	50%	-	-	-
	Upside	25%	-	-	-
	Downside	25%	1%	-	-

As a result of the most recent developments bank did additional sensitivity analysis by changing the weights of base, upside and downside scenarios. In this regard, the weight of downside scenario was increased up to 35%, and the weights for base and upside scenarios decreased down to 45% and 20% respectively. These changes would result in an increase in ECL by AZN 3,846 thousand at 31 December 2019.

A 10% increase or decrease in PD or LGD estimates would result in an increase or decrease in total expected credit loss allowances of AZN 4,852 thousand at 31 December 2019 (31 December 2018: increase or decrease of AZN 8,015 thousand).

A 10% increase or decrease in PD or LGD estimates for the Micro segment would result in an increase or decrease in total expected credit loss allowances of AZN 1,634 thousand at 31 December 2019 (31 December 2018: increase or decrease of AZN 1,191 thousand). A 10% increase or decrease in PD or LGD estimates for the SME segment would result in an increase or decrease in total expected credit loss allowances of AZN 2,871 thousand at 31 December 2019 (31 December 2018: increase or decrease of AZN 6,435 thousand). A 10% increase or decrease in PD or LGD estimates for the Retail & Staff segments would result in an increase or decrease in total expected credit loss allowances of AZN 347 thousand at 31 December 2019 (31 December 2018: increase or decrease of AZN 389 thousand).

Credit exposure on revolving credit facilities (e.g. credit cards, overdrafts). For certain loan facilities, the Bank's exposure to credit losses may extend beyond the maximum contractual period of the facility. This exception applies to certain revolving credit facilities, which include both a loan and an undrawn commitment component and where the Bank's contractual ability to demand repayment and cancel the undrawn component in practice does not limit its exposure to credit losses.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

For such facilities, the Bank measures ECLs over the period that the Bank is exposed to credit risk and ECLs are not mitigated by credit risk management actions. Application of this exception requires judgement. Management applied its judgement in identifying the facilities, both retail and commercial, to which this exception applies. The Bank applied this exception to facilities with the following characteristics: (a) there is no fixed term or repayment structure, (b) the contractual ability to cancel the contract is not in practice enforced as a result of day-to-day management of the credit exposure and the contract may only be cancelled when the Bank becomes aware of an increase in credit risk at the level of an individual facility, and (c) the exposures are managed on a collective basis.

Further, the Bank applied judgement in determining a period for measuring the ECL, including the starting point and the expected end point of the exposures. The Bank considered historical information and experience about: (a) the period over which the Bank is exposed to credit risk on similar facilities, including when the last significant modification of the facility occurred and that therefore determines the starting point for assessing SICR, (b) the length of time for related defaults to occur on similar financial instruments following a SICR and (c) the credit risk management actions (eg the reduction or removal of undrawn limits), prepayment rates and other factors that drive expected maturity. In applying these factors, the Bank segments the portfolios of revolving facilities into sub-groups and applies the factors that are most relevant based on historical data and experience as well as forward-looking information.

Significant increase in credit risk (“SICR”). In order to determine whether there has been a significant increase in credit risk, the Bank compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Bank considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioural aspects of particular customer portfolios. The Bank identifies behavioural indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 29.

Should ECL on all loans to customers be measured at lifetime ECL (that is, including those that are currently in Stage 1 measured at 12-months ECL), the expected credit loss allowance would be higher by AZN 688,614 as of 31 December 2019 (31 December 2018: higher by AZN 526,867).

Business model assessment. The business model drives classification of financial assets. Management applied judgement in determining the level of aggregation and portfolios of financial instruments when performing the business model assessment. When assessing sales transactions, the Bank considers their historical frequency, timing and value, reasons for the sales and expectations about future sales activity. Sales transactions aimed at minimising potential losses due to credit deterioration are considered consistent with the “hold to collect” business model. Other sales before maturity, not related to credit risk management activities, are also consistent with the “hold to collect” business model, provided that they are infrequent or insignificant in value, both individually and in aggregate. The Bank assesses significance of sales transactions by comparing the value of the sales to the value of the portfolio subject to the business model assessment over the average life of the portfolio. In addition, sales of financial asset expected only in stress case scenario, or in response to an isolated event that is beyond the Bank’s control, is not recurring and could not have been anticipated by the Bank, are regarded as incidental to the business model objective and do not impact the classification of the respective financial assets.

The “hold to collect and sell” business model means that assets are held to collect the cash flows, but selling is also integral to achieving the business model’s objective, such as, managing liquidity needs, achieving a particular yield, or matching the duration of the financial assets to the duration of the liabilities that fund those assets.

The residual category includes those portfolios of financial assets, which are managed with the objective of realising cash flows primarily through sale, such as where a pattern of trading exists. Collecting contractual cash flow is often incidental for this business model.

The Bank’s debt securities are classified as held to collect based on the assumption that these securities would only be sold in a stress case scenario.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Assessment whether cash flows are solely payments of principal and interest ("SPPI"). Determining whether a financial asset's cash flows are solely payments of principal and interest required judgement. The time value of money element may be modified, for example, if a contractual interest rate is periodically reset but the frequency of that reset does not match the tenor of the debt instrument's underlying base interest rate, for example a loan pays three months interbank rate but the rate is reset every month. The effect of the modified time value of money was assessed by comparing relevant instrument's cash flows against a benchmark debt instrument with SPPI cash flows, in each period and cumulatively over the life of the instrument. The assessment was done for all reasonably possible scenarios, including reasonably possible financial stress situation that can occur in financial markets. In case of a scenario with cash flows that significantly differ from the benchmark, the assessed instrument's cash flows are not SPPI and the instrument is then carried at FVTPL.

The Bank identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset's principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual par amount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (ii) the fair value of the prepayment feature is immaterial at initial recognition. The Bank's loan agreements allow adjusting interest rates in response to certain macro-economic or regulatory changes. Management applied judgement and assessed that competition in the banking sector and the practical ability of the borrowers to refinance the loans would prevent it from resetting the interest rates at an above-market level and hence cash flows were assessed as being SPPI.

Modification of financial assets. When financial assets are contractually modified (e.g. renegotiated), the Bank assesses whether the modification is substantial and should result in derecognition of the original asset and recognition of a new asset at fair value. This assessment is based primarily on qualitative factors, described in the relevant accounting policy and it requires significant judgment. In particular, the Bank applies judgment in deciding whether credit impaired renegotiated loans should be derecognised and whether the new recognised loans should be considered as credit impaired on initial recognition. The derecognition assessment depends on whether the risks and rewards, that is, the variability of expected (rather than contractual) cash flows, change as a result of such modifications. Management determined that risks and rewards did not change as a result of modifying such loans and therefore in substantially all such modifications, the loans were neither derecognised nor reclassified out of the credit-impaired stage.

Write-off policy. Financial assets are written-off, in whole or in part, when the Bank exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. . Management considered the following indicators that there is no reasonable expectation of recovery: liquidation or bankruptcy proceedings, fair value of collateral is less than the costs to repossess it or enforcement activities were completed. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. A write-off constitutes a derecognition event.

Taxation. Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. As such, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three years including the year of review. Management believes that as of 31 December 2019 its interpretation of the relevant legislation is appropriate and that the Bank's tax position will be sustained.

Determination of collateral value. Management monitors market value of collateral on a regular basis. Management uses its experienced judgement or independent opinion to adjust the fair value to reflect the current circumstances. The amount and collateral required depend on the assessment of credit risk of the counterparty.

Initial recognition of related party transactions. In the normal course of business the Bank enters into transactions with its related parties. IFRS 9 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. Terms and conditions of related party balances are disclosed in Note 31.

4 Critical Accounting Estimates, and Judgements in Applying Accounting Policies (Continued)

Determining lease term. The Bank leases office premises from third parties under contracts which do not have contractual maturity dates and are automatically renewed unless either party submits a termination notice. The Bank determines non-cancellable lease period for such leases, taking into consideration penalties that would be incurred upon termination, including economic disincentives such as leasehold improvements, cost of relocating or the importance of the premises to the Bank's operations. As a result, the lease term for most significant office premises has been determined as a period of 3-5 years, and for the land lease as a period of 40 years.

Revision of useful lives of property and equipment. The estimation of the useful lives of items of property, plant and equipment is a matter of judgment based on the experience with similar assets. The future economic benefits embodied in the assets are consumed principally through use. However, other factors, such as technical or commercial obsolescence and wear and tear, often result in the diminution of the economic benefits embodied in the assets. Management assesses the remaining useful lives in accordance with the current technical conditions of the assets and estimated period during which the assets are expected to earn benefits for the Bank. The following primary factors are considered: (a) the expected usage of the assets; (b) the expected physical wear and tear, which depends on operational factors and maintenance program; and (c) the technical or commercial obsolescence arising from changes in market conditions.

5. Adoption of New or Revised Standards and Interpretations

Adoption of IFRS 16, Leases. The Bank has adopted IFRS 16 retrospectively from 1 January 2019 with certain simplifications and exemptions, and has not restated comparatives for the 2018 reporting period, as permitted under the transitional provisions of IFRS 16. The reclassifications and the adjustments arising from the new leasing requirements are therefore recognised as an adjustment to the opening balance of retained earnings as of 1 January 2019.

On adoption of IFRS 16, the Bank recognised lease liabilities in relation to leases which had previously been classified as operating leases under the principles of IAS 17, *Leases*.

These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 8.62%.

In applying IFRS 16 for the first time, the Bank has used the following practical expedients permitted by the standard:

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics,
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review – there were no onerous contracts as at 1 January 2019,
- accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases,
- excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application, and
- using hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The Bank has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Bank relied on its assessment made applying IAS 17, *Leases*, and IFRIC 4, *Determining whether an Arrangement contains a Lease*.

The measurement principles of IFRS 16 are only applied after 1 January 2019.

(Figures in tables are in thousands of Azerbaijani manats)

5. Adoption of New or Revised Standards and Interpretations (Continued)

The following table presents reconciliation of the operating lease commitments reported as of 31 December 2018 and lease liability recognised at 1 January 2019:

	1 January 2019
Total future minimum lease payments for non-cancellable* operating leases as at 31 December 2018	**8,114**
Effect of discounting to present value	(2,285)
Less short-term leases not recognised as a liability	(21)
Less low-value leases not recognised as a liability	(222)
Lease liability recognised as at 1 January 2019	**5,586**
Advances paid to lessors	212
Right-of-use asset recognised as at 1 January 2019	**5,799**

Effect of discounting is mostly due to the land lease extending for 40 years, where the change in the present value of future lease payments becomes negligible after discounting beyond 30 years. For the carrying value of land lease refer to Note 14.

* Non-cancellable leases include those cancellable only: (a) upon the occurrence of some remote contingency, (b) with the permission of the lessor, (c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or (d) upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.

The change in accounting policy affected the following items in the statement of financial position on 1 January 2019:

	Notes	**Impact of adopting IFRS 16**
Increase in right-of-use assets	14	5,799
Increase in lease liabilities	14	5,586
Decrease in other assets	17	212

The associated right-of use assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet as at 31 December 2018. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The recognised right-of-use assets relate to the following types of assets:

	31 December 2019	**1 January 2019**
Properties for own use	4,791	5,799
Total right-of-use assets	**4,791**	**5,799**

The recognised lease liabilities classified as follows:

	31 December 2019	**1 January 2019**
Current portion	1,158	1,335
Non-current portion	3,458	4,251
Total lease liabilities	**4,616**	**5,586**

Amendment to IAS 12, Income Taxes, included in the Annual Improvements to IFRSs 2015-2017 cycle. The Bank adopted the changes to IAS 12, *Income Taxes*, with effect from 1 January 2019. As a result of these amendments, the tax benefits of distributions on perpetual instruments that are classified as equity under IFRS but are considered as liabilities for tax purposes are no longer recognised directly in equity but in profit or loss because these tax benefits are linked more directly to past transactions or events that generated distributable profits than to the distributions to owners. The amendment was applied retrospectively and the comparative information was restated.

5. Adoption of New or Revised Standards and Interpretations (Continued)

The following amended standards became effective from 1 January 2019, but did not have any material impact on the Bank:

- IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019).
- Prepayment Features with Negative Compensation – Amendments to IFRS 9 (issued on 12 October 2017 and effective for annual periods beginning on or after 1 January 2019).
- Amendments to IAS 28 “Long-term Interests in Associates and Joint Ventures” (issued on 12 October 2017 and effective for annual periods beginning on or after 1 January 2019).
- Annual Improvements to IFRSs 2015-2017 cycle – amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 (issued on 12 December 2017 and effective for annual periods beginning on or after 1 January 2019).
- Amendments to IAS 19 “Plan Amendment, Curtailment or Settlement” (issued on 7 February 2018 and effective for annual periods beginning on or after 1 January 2019).

6. New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2020 or later, and which the Bank has not early adopted.

IFRS 17 "Insurance Contracts"(issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2021). IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately.

Definition of a business – Amendments to IFRS 3 (issued on 22 October 2018 and effective for acquisitions from the beginning of annual reporting period that starts on or after 1 January 2020).The amendments revise definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if are no outputs. The definition of the term ‘outputs’ is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a ‘concentration test’. The assets acquired would not represent a business if substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets).

Definition of materiality – Amendments to IAS 1 and IAS 8 (issued on 31 October 2018 and effective for annual periods beginning on or after 1 January 2020).The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The Bank is currently assessing the impact of the amendments on its financial statements.

6. New Accounting Pronouncements (Continued)

Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020). The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting. The Bank is currently assessing the impact of the amendments on its financial statements.

Interest rate benchmark reform – Amendments to IFRS 9, IAS 39 and IFRS 7 (issued on 26 September 2019 and effective for annual periods beginning on or after 1 January 2020). The amendments were triggered by replacement of benchmark interest rates such as LIBOR and other inter-bank offered rates (‘IBORs’). The amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by the IBOR reform. Cash flow hedge accounting under both IFRS 9 and IAS 39 requires the future hedged cash flows to be ‘highly probable’. Where these cash flows depend on an IBOR, the relief provided by the amendments requires an entity to assume that the interest rate on which the hedged cash flows are based does not change as a result of the reform. Both IAS 39 and IFRS 9 require a forward-looking prospective assessment in order to apply hedge accounting. While cash flows under IBOR and IBOR replacement rates are currently expected to be broadly equivalent, which minimises any ineffectiveness, this might no longer be the case as the date of the reform gets closer. Under the amendments, an entity may assume that the interest rate benchmark on which the cash flows of the hedged item, hedging instrument or hedged risk are based, is not altered by IBOR reform. IBOR reform might also cause a hedge to fall outside the 80–125% range required by retrospective test under IAS 39. IAS 39 has therefore been amended to provide an exception to the retrospective effectiveness test such that a hedge is not discontinued during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside this range. However, the other requirements for hedge accounting, including the prospective assessment, would still need to be met. In some hedges, the hedged item or hedged risk is a non-contractually specified IBOR risk component. In order for hedge accounting to be applied, both IFRS 9 and IAS 39 require the designated risk component to be separately identifiable and reliably measurable. Under the amendments, the risk component only needs to be separately identifiable at initial hedge designation and not on an ongoing basis. In the context of a macro hedge, where an entity frequently resets a hedging relationship, the relief applies from when a hedged item was initially designated within that hedging relationship. Any hedge ineffectiveness will continue to be recorded in profit or loss under both IAS 39 and IFRS 9. The amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present. The amendments require entities to provide additional information to investors about their hedging relationships that are directly affected by these uncertainties, including the nominal amount of hedging instruments to which the reliefs are applied, any significant assumptions or judgements made in applying the reliefs, and qualitative disclosures about how the entity is impacted by IBOR reform and is managing the transition process. The Bank is currently assessing the impact of the amendments on its financial statements.

Classification of liabilities as current or non-current – Amendments to IAS 1 (issued on 23 January 2020 and effective for annual periods beginning on or after 1 January 2022). These narrow scope amendments clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Liabilities are non-current if the entity has a substantive right, at the end of the reporting period, to defer settlement for at least twelve months. The guidance no longer requires such a right to be unconditional. Management’s expectations whether they will subsequently exercise the right to defer settlement do not affect classification of liabilities. The right to defer only exists if the entity complies with any relevant conditions as of the end of the reporting period. A liability is classified as current if a condition is breached at or before the reporting date even if a waiver of that condition is obtained from the lender after the end of the reporting period. Conversely, a loan is classified as non-current if a loan covenant is breached only after the reporting date. In addition, the amendments include clarifying the classification requirements for debt a company might settle by converting it into equity.

‘Settlement’ is defined as the extinguishment of a liability with cash, other resources embodying economic benefits or an entity’s own equity instruments. There is an exception for convertible instruments that might be converted into equity, but only for those instruments where the conversion option is classified as an equity instrument as a separate component of a compound financial instrument. The Bank is currently assessing the impact of the amendments on its financial statements.

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

(Figures in tables are in thousands of Azerbaijani manats)

7. Cash and Cash Equivalents

Cash and cash equivalents comprise:

	2019	*2018*
Cash on hand	42,243	61,744
Current accounts with the CBAR	69,808	28,866
Current accounts with other banks	7,319	24,491
Time deposits with the credit institutions up to 90 days	12,828	30,600
	132,198	**145,701**
Less – allowance for impairment	-	(7)
Total cash and cash equivalents	**132,198**	**145,694**

As at 31 December 2019, Current accounts with other banks consist of correspondent account balances with resident and non-resident banks in the amount of AZN 772 thousand (2018: AZN 3,130 thousand) and AZN 6,547 thousand (2018: AZN 21,361 thousand), respectively.

As at 31 December 2019, time deposits with the credit institutions up to 90 days consist of short-term deposits placed in CBAR in in the amount of AZN 12,828 thousand (2018 - two non-resident banks AZN 30,600 thousand).

The table below discloses the credit quality of cash and cash equivalents balances based on credit risk grades at 31 December 2019. Refer to Note 29 for the description of the Bank's credit risk grading system.

	Current accounts with the CBAR	**Current accounts with other banks**	**Time deposits with the credit institutions up to 90 days**	**Total**
- Excellent	-	3,912	-	3,912
- Good	69,808	2,590	12,828	85,226
- Satisfactory	-	817	-	817
Total cash and cash equivalents, excluding cash on hand	**69,808**	**7,319**	**12,828**	**89,955**

The table below discloses the credit quality of cash and cash equivalents balances based on credit risk grades at 31 December 2018.

	Current accounts with the CBAR	**Current accounts with other banks**	**Time deposits with the credit institutions up to 90 days**	**Total**
- Excellent	-	21,240	-	21,240
- Good	28,866	3,251	30,600	62,717
Total cash and cash equivalents, excluding cash on hand	**28,866**	**24,491**	**30,600**	**83,957**

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Bank did not recognise any credit loss allowance for cash and cash equivalents. Refer to 28 for the ECL measurement approach.

Financing transactions that did not require the use of cash and cash equivalents, and were excluded from the statement of cash flows are as follows:

	Note	**2019**	**2018**
Non-cash financing activities			
Forgiven debt	4, 20	(21,540)	-
Debt converted to share capital	4, 20, 21	(118,460)	-
Other movement		(734)	1,102
Non-cash financing activities		**140,734**	**1,102**

(Figures in tables are in thousands of Azerbaijani manats)

8. Amounts Due from Credit Institutions

Amounts due from credit institutions comprise:

	2019	*2018*
Obligatory reserve with the CBAR	4,075	3,093
Blocked current accounts with credit institutions	2,082	1,324
Short-term loans	3,429	-
Other	-	8
	9,586	**4,425**
Less- credit loss allowance	-	(2)
Amounts due from credit institutions	**9,586**	**4,423**

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 0.5% and 1% (2018 – 0.5% and 1%) of the previous month average of funds attracted from customers by the credit institution in local and foreign currency, respectively.

As at 31 December 2019, blocked current accounts with credit institutions represent current accounts with two non-resident credit institutions of AZN 2,081 thousand (2018– 1,324 thousand) blocked against guarantees issued for three customers.

The following table contains an analysis of balances due from credit institutions (excluding mandatory reserve with CBAR) by credit quality at 31 December 2019 based on credit risk grades and discloses those balances by three stages for the purpose of ECL measurement. Refer to Note 29 for the description of credit risk grading system used by the Bank and the approach to ECL measurement, including the definition of default and SICR as applicable to due from credit institutions balances. The carrying amount of due from credit institutions balances at 31 December 2019 below also represents the Bank's maximum exposure to credit risk on these assets:

	Stage 1 (12-months ECL)	**Total**
Placements with other banks		
- Excellent	856	856
- Good	4,082	4,082
- Satisfactory	4,648	4,648
Gross carrying amount	**9,586**	**9,586**
Credit loss allowance	-	-
Carrying amount	**9,586**	**9,586**

The following table contains an analysis of due from other banks balances by credit quality at 31 December 2018 based on credit risk grades and discloses due from other banks balances by three stages for the purpose of ECL measurement.

	Stage 1 (12-months ECL)	**Stage 2 (lifetime ECL for credit impaired)**	**Total**
Placements with other banks			
- Excellent	3,099	-	3,099
- Good	294	1032	1,326
Gross carrying amount	**3,393**	**1,032**	**4,425**
Credit loss allowance	-	(2)	(2)
Carrying amount	**3,393**	**1,030**	**4,423**

(Figures in tables are in thousands of Azerbaijani manats)

9. Derivative Financial Assets and Liabilities

The Bank enters into derivative financial instruments for trading purposes. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of the credit risk.

	2019			*2018*		
	Notional amount	***Fair value***		***Notional amount***	***Fair value***	
		Asset	***Liability***		***Asset***	***Liability***
Foreign exchange contracts						
Forwards and swaps – foreign	20,736	-	(4,864)	44,690	–	(10,416)
Forwards and swaps – domestic	44,518	807	(279)	20,375	–	(203)
Total derivative assets/(liabilities)		**807**	**(5,143)**		**–**	**(10,619)**

Foreign exchange derivative financial instruments entered into by the Bank are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. Derivatives have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in market interest rates, foreign exchange rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

Forwards contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

10. Investment in Debt Securities

	2019	**2018**
Debt securities at FVOCI	1,764	1,764
Debt securities at AC	32,214	-
Total investments in debt securities	**33,978**	**1,764**

The table below discloses investments in debt securities at 31 December 2019 by measurement categories and classes:

	Debt securities at FVOCI	**Debt securities at AC**	**Total**
Azerbaijani government bonds	-	32,214	32,214
Corporate bonds	1,724	-	1,724
Other	40	-	40
Total investments in debt securities at 31 December 2019 (fair value or gross carrying value)	**1,764**	**32,214**	**33,978**
Credit loss allowance	-	-	-
Total investments in debt securities at 31 December 2019 (carrying value)	**1,764**	**32,214**	**33,978**

(Figures in tables are in thousands of Azerbaijani manats)

10. Investment in Debt Securities (Continued)

The table below discloses investments in debt securities at 31 December 2018 by measurement categories and classes:

	Debt securities at FVOCI	**Total**
Corporate bonds	1,724	1,724
Other	40	40
Total investments in debt securities at 31 December 2018	**1,764**	**1,764**
Credit loss allowance	-	-
Total investments in debt securities at 31 December 2018	**1,764**	**1,764**

(a) Investments in debt securities at FVOCI

The debt securities at FVOCI as at 31 December 2019 are not collateralised. (2018: not collateralised)

The ECL for the debt securities at FVOCI as at 31 December 2019 represented an insignificant amount, therefore the Bank did not recognise any credit loss allowance. (2018: ECL insignificant, not recognised)

(b) Investments in debt securities at AC

The following table contains an analysis of debt securities at AC by credit quality based on credit risk grades and discloses the balances by three stages for the purpose of ECL measurement. Refer to Note 28 and the approach to ECL measurement, including the definition of default and SICR as applicable to debt securities at AC. The carrying amount of debt securities at AC at 31 December 2019 below also represents the Bank's maximum exposure to credit risk on these assets:

	Stage 1 (lifetime ECL for SICR)	**Total**
Azerbaijani government bonds		
- Good	32,214	**32,214**
Gross carrying amount	32,214	**32,214**
Carrying amount	32,214	**32,214**

Financial assets are classified to Stage 1 using the general provisioning model. Transition Matrix is used and forward looking information is already incorporated in external assigned PD ratings. Please refer to Note 28 for external ratings and corresponding PDs table.

The debt securities at AC as at 31 December 2019 are not collateralised.

Azerbaijani Government bonds are issued at local currency, Azerbaijani Manats, and repayment is guaranteed by Government of Azerbaijan. As of 31 December 2019 and 31 December 2018, ECL was not material.

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers

Loans to customers comprise:

	2019	*2018*
SME loans	304,881	409,276
Micro loans	308,750	234,738
Retail loans	70,835	60,762
Gross loans to customers	**684,466**	**704,776**
Less: credit loss allowance	(120,815)	(183,434)
Loans to customers	**563,651**	**521,342**

As at 31 December 2019, out of the total amount of loans 30% (2018–50%) are denominated in foreign currencies.

Included in the retail loans are mortgage and staff loans gross amount of which comprises 12% and 5% respectively of total gross loans to customers respectively (2018: 18% and 6%).

Gross carrying amount and credit loss allowance amount for loans to customers at AC by classes at 31 December 2019 and 31 December 2018 are disclosed in the table below:

	31 December 2019			**31 December 2018**		
	Gross carrying amount	**Credit loss allowance**	**Carrying amount**	**Gross carrying amount**	**Credit loss allowance**	**Carrying amount**
SME loans	304,881	(88,218)	216,663	409,276	(131,512)	277,764
Micro loans	308,750	(26,924)	281,826	234,738	(44,455)	190,283
Retail loans	70,835	(5,673)	65,162	60,762	(7,467)	53,295
Total loans to customers at AC	**684,466**	**(120,815)**	**563,651**	**704,776**	**(183,434)**	**521,342**

For more detailed information on related party balances refer to Note 30.

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

The following tables disclose the changes in the credit loss allowance and gross carrying amount for loans to customers carried at amortised cost between the beginning and the end of the reporting and comparative periods:

Loan to customers – SME	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**219,863**	**17,772**	**171,641**	**409,276**
Movements with impact on credit loss allowance charge for the period:				
New assets originated or purchased	95,634	-	-	95,634
Derecognised during the period	(84,694)	(10,795)	(44,100)	(139,589)
Transfers:				
- to lifetime (from Stage 1 to Stage 2)	(19,258)	19,258	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(124,182)	(9,780)	133,962	-
Total movements with impact on credit loss allowance charge for the period	**(132,500)**	**(1,317)**	**89,862**	**(43,955)**
Movements without impact on credit loss allowance charge for the period:				
Amounts written off	-	-	(65,866)	(65,866)
Unwinding of discount (for Stage 3)	-	-	5,426	5,426
At 31 December 2019	**87,363**	**16,455**	**201,063**	**304,881**

Loans to customers – SME	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	(35,960)	(12,701)	(82,851)	(131,512)
Movements with impact on credit loss allowance charge for the period:				
New assets originated or purchased	(492)	-	-	(492)
Derecognised during the period	4,752	4,262	11,437	20,451
Transfers:				
- to lifetime (from Stage 1 to Stage 2)	4	(417)	-	(413)
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	31,145	6,548	(43,881)	(6,188)
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	(838)	(838)
Changes to models and inputs used for ECL calculations	-	863	(28,910)	(28,047)
Unwinding of discount	-	-	(1,619)	(1,619)
Total movements with impact on credit loss allowance charge for the period	**35,409**	**11,256**	**(63,811)**	**(17,146)**
Movements without impact on credit loss allowance charge for the period:				
Write-offs	-	-	65,866	65,866
Unwinding of discount (for Stage 3)	-	-	(5,426)	(5,426)
At 31 December 2019	**(551)**	**(1,445)**	**(86,222)**	**(88,218)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

Loan to customers – SME	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**255,210**	**7,620**	**183,998**	**446,828**
New assets originated or purchased	101,350	–	–	101,350
Assets repaid	(104,203)	(2,811)	(27,713)	(134,727)
Transfers to Stage 1	4,679	(3,106)	(1,573)	-
Transfers to Stage 2	(17,433)	17,773	(340)	-
Transfers to Stage 3	(19,340)	(1,692)	21,032	-
Recoveries	–	–	165	165
Amounts written off	(400)	(12)	(3,928)	(4,340)
At 31 December 2018	**219,863**	**17,772**	**171,641**	**409,276**

Loans to customers – SME	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(48,422)**	**(5,107)**	**(90,328)**	**(143,857)**
New assets originated or purchased	(841)	–	–	(841)
Assets repaid	4,586	803	14,334	19,723
Transfers to Stage 1	(3,068)	2,447	621	**-**
Transfers to Stage 2	8,756	(8,933)	177	-
Transfers to Stage 3	6,109	907	(7,016)	-
Unwinding of discount (recognised in interest revenue)	**–**	**–**	(4,207)	(4,207)
Impact on period end ECL of exposures transferred between stages during the period	1,204	284	140	1,628
Changes to models and inputs used for ECL calculations	(4,684)	(3,114)	(335)	(8,133)
Recoveries	**–**	**–**	(165)	(165)
Amounts written off	400	12	3,928	4,340
At 31 December 2018	**(35,960)**	**(12,701)**	**(82,851)**	**(131,512)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

Loan to customers – Micro	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**189,401**	**3,368**	**41,969**	**234,738**
Movements with impact on credit loss allowance charge for the period:				
New assets originated or purchased	245,733	-	-	245,733
Derecognised during the period	(138,315)	(6,867)	(14,556)	(159,738)
Transfers:				
- to lifetime (from Stage 1 to Stage 2)	(31,945)	31,945		-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(30,231)	(1,373)	31,604	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	13	-	(13)	-
Total movements with impact on credit loss allowance charge for the period	**45,255**	**23,705**	**17,035**	**85,995**
Movements without impact on credit loss allowance charge for the period:				
Amounts written off	-	-	(14,817)	(14,817)
Unwinding of discount (for Stage 3)	-	-	2,834	2,834
At 31 December 2019	**234,656**	**27,073**	**47,021**	**308,750**

Loans to customers – Micro	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(17,059)**	**(2,039)**	**(25,357)**	**(44,455)**
Movements with impact on credit loss allowance charge for the period:				
New assets originated or purchased	(1,246)	-	-	(1,246)
Derecognised during the period	8,059	1,063	11,538	20,660
Transfers:				
- to lifetime (from Stage 1 to Stage 2)	37	(368)	-	(331)
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	7,479	849	(12,805)	(4,477)
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	(39)	(39)
Changes to models and inputs used for ECL calculations	242	(67)	(8,077)	(7,902)
Unwinding of discount	-	-	(1,117)	(1,117)
Total movements with impact on credit loss allowance charge for the period	**14,571**	**1,477**	**(10,500)**	**5,548**
Movements without impact on credit loss allowance charge for the period:				
Write-offs	-	-	14,817	14,817
Unwinding of discount (for Stage 3)	-	-	(2,834)	(2,834)
At 31 December 2019	**(2,488)**	**(562)**	**(23,874)**	**(26,924)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

Loan to customers – Micro	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**145,924**	**1,284**	**69,924**	**217,132**
New assets originated or purchased	156,778	-	-	156,778
Assets repaid	(100,536)	(836)	(7,330)	(108,702)
Transfers to Stage 1	296	(59)	(237)	-
Transfers to Stage 2	(3,218)	3,368	(150)	-
Transfers to Stage 3	(8,545)	(340)	8,885	-
Recoveries	-	-	1,416	1,416
Amounts written off	(1,298)	(49)	(30,539)	(31,886)
At 31 December 2019	**189,401**	**3,368**	**41,969**	**234,738**

Loan to customers – Micro	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(31,445)**	**(788)**	**(49,354)**	**(81,587)**
New assets originated or purchased	(2,742)	-	-	(2,742)
Assets repaid	8,052	444	2,434	10,930
Transfers to Stage 1	(175)	46	129	-
Transfers to Stage 2	2,341	(2,424)	83	-
Transfers to Stage 3	6,016	248	(6,264)	-
Unwinding of discount (recognised in interest revenue)	-	-	(2,604)	(2,604)
Impact on period end ECL of exposures transferred between stages during the period	271	22	43	336
Changes to models and inputs used for ECL calculations	(675)	364	1,053	742
Recoveries	–	–	(1,416)	(1,416)
Amounts written off	1,298	49	30,539	31,886
At 31 December 2018	**(17,059)**	**(2,039)**	**(25,357)**	**(44,455)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

Loan to customers – Retail	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2019	**50,263**	**217**	**10,282**	**60,762**
Movements with impact on credit loss allowance charge for the period:				
New assets originated or purchased	52,051	-	-	52,051
Derecognised during the period	(32,816)	(659)	(8,361)	(41,836)
Transfers:				
- to lifetime (from Stage 1 to Stage 2)	(3,448)	3,448	-	-
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	(10,063)	(125)	10,188	-
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	18	-	(18)	-
Total movements with impact on credit loss allowance charge for the period	**5,742**	**2,664**	**1,809**	**10,215**
Movements without impact on credit loss allowance charge for the period:				
Amounts written off	-	-	(1,404)	(1,404)
Unwinding of discount (for Stage 3)	-	-	1,262	1,262
At 31 December 2019	**56,005**	**2,881**	**11,949**	**70,835**

Loans to customers – Retail	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2019	**(1,907)**	**(123)**	**(5,438)**	**(7,468)**
Movements with impact on credit loss allowance charge for the period:				
New assets originated or purchased	(336)	-	-	(336)
Derecognised during the period	336	30	5,548	5,914
Transfers:				
- to lifetime (from Stage 1 to Stage 2)	91	(187)	-	(96)
- to credit-impaired (from Stage 1 and Stage 2 to Stage 3)	1,154	67	(1,852)	(631)
- to 12-months ECL (from Stage 2 and Stage 3 to Stage 1)	-	-	(1,997)	(1,997)
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	(2)	(2)
Changes to models and inputs used for ECL calculations	332	1	(1,399)	(1,066)
Unwinding of discount	-	-	(136)	(136)
Total movements with impact on credit loss allowance charge for the period	**1,577**	**(89)**	**162**	**1,650**
Movements without impact on credit loss allowance charge for the period:				
Write-offs	-	-	1,407	1,407
Unwinding of discount (for Stage 3)	-	-	(1,262)	(1,262)
At 31 December 2019	**(330)**	**(212)**	**(5,131)**	**(5,673)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

Loans to customers – Retail	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
Gross carrying value as at 1 January 2018	**39,863**	**179**	**6,984**	**47,026**
New assets originated or purchased	40,718	-	-	40,718
Assets repaid	(23,372)	(92)	(1,821)	(25,285)
Transfers to Stage 1	96	(37)	(59)	-
Transfers to Stage 2	(165)	182	(17)	-
Transfers to Stage 3	(6,841)	(12)	6,853	-
Recoveries	-	-	285	285
Amounts written off	(36)	(3)	(1,943)	(1,982)
At 31 December 2018	**50,263**	**217**	**10,282**	**60,762**

Loans to customers – Retail	***Stage 1***	***Stage 2***	***Stage 3***	***Total***
ECL as at 1 January 2018	**(1,841)**	**(97)**	**(3,575)**	**(5,513)**
New assets originated or purchased	(4,092)	-	-	(4,092)
Assets repaid	240	24	960	1,224
Transfers to Stage 1	(37)	27	10	-
Transfers to Stage 2	41	(42)	1	-
Transfers to Stage 3	4,124	3	(4,127)	-
Unwinding of discount (recognised in interest revenue)			(264)	(264)
Impact on period end ECL of exposures transferred between stages during the period	8	-	-	8
Changes to models and inputs used for ECL calculations	(386)	(41)	(100)	(527)
Recoveries	-	-	(285)	(285)
Amounts written off	36	3	1,943	1,982
At 31 December 2018	**(1,907)**	**(123)**	**(5,437)**	**(7,467)**

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to Customers (Continued)

The following tables discloses the changes in the credit loss allowance amount for loans to customers carried at amortised cost between the beginning and the end of the reporting by classes:

	SME	***Micro***	***Retail***	***Total***
ECL as at 1 January 2019	**(131,512)**	**(44,455)**	**(7,467)**	**(183,434)**
Movements in ECL impacting credit loss expense				
ECL of exposures transferred between stages during the period	(6,601)	(4,808)	(2,724)	(14,133)
New assets originated or purchased	(492)	(1,246)	(336)	(2,074)
Assets derecognised during the period	20,451	20,660	5,914	47,025
Changes to models and inputs used for ECL calculations	(28,047)	(7,902)	(1,066)	(37,015)
Total credit loss expense on Loans	**(14,689)**	**6,704**	**1,788**	**(6,197)**
Movements in ECL impacting other profit and loss line items				
Changes to contractual cash flows due to modifications not resulting in derecognition	(838)	(39)	(2)	(879)
Unwinding of discount	(1,619)	(1,117)	(136)	(2,872)
Total Impact on Profit and Loss accounts other than credit loss reversal/(expense)	**(2,457)**	**(1,156)**	**(138)**	**(3,751)**
Movements in ECL without impact on profit and loss accounts				
Write-offs	65,866	14,817	1,407	82,090
Unwinding of discount (for Stage 3)	(5,426)	(2,834)	(1,263)	(9,523)
Total movements in ECL without impact on profit and loss accounts	**60,440**	**11,983**	**144**	**72,567**
Total ECL movement	**43,294**	**17,531**	**1,794**	**62,619**
ECL as at 31 December 2019	**(88,218)**	**(26,924)**	**(5,673)**	**(120,815)**

The credit loss allowance for loans to customers recognised in the period is impacted by a variety of factors, details of ECL measurement are provided in Note 28. Below main movements in the table are described:

- Transfers between Stage 1, 2 and 3 due to balances experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments derecognised in the period;
- Impact on the measurement of ECL due to changes to model assumptions, including changes in PDs, EADs and LGDs in the period, arising from update of inputs to ECL models;
- Unwinding of discount due to the passage of time because ECL is measured on a present value basis;
- Foreign exchange translations of assets denominated in foreign currencies and other movements; and
- Write-offs of allowances related to assets that were written off during the period.

Unwinding of discount on Stage 3 financial assets under "*Movements with impact on credit loss allowance charge for the period"* is reported within "interest income" so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

The following tables contain analyses of the credit risk exposure of loans to customers measured at AC and for which an ECL allowance is recognised. The carrying amount of loans to customers below also represents the Bank's maximum exposure to credit risk on these loans.

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans to customers (continued)

The credit quality of loans to corporate customers carried at amortised cost is as follows at 31 December 2019:

	Stage 1 (12-months ECL)	Stage 2 (lifetime ECL for SICR)	Stage 3 (lifetime ECL for credit impaired)	Total
SME loans				
Less than 30 days	87,362	13,846	86,753	187,961
31 to 90 days overdue	-	2609	4,778	7,387
91-180 days overdue	-	-	385	385
181 to 360 days overdue	-	-	14,297	14,297
Over 360 days overdue	-	-	94,851	94,851
Gross carrying amount	**87,362**	**16,455**	**201,064**	**304,881**
Credit loss allowance	(551)	(1,446)	(86,221)	(88,218)
Carrying amount	86,811	**15,009**	**114,843**	**216,663**
Micro loans				
Less than 30 days	234,656	26,558	17,216	278,430
31 to 90 days overdue	-	515	567	1,082
91-180 days overdue	-	-	1,319	1,319
181 to 360 days overdue	-	-	6,812	6,812
Over 360 days overdue	-	-	21,106	21,106
Gross carrying amount	**234,656**	**27,073**	**47,020**	**308,749**
Credit loss allowance	(2,488)	(562)	(23,873)	(26,923)
Carrying amount	232,168	**26,511**	**23,147**	**281,826**
Retail loans				
Less than 30 days	55,981	2,619	4,190	62,790
31 to 90 days overdue	25	262	147	434
91-180 days overdue	-	-	183	183
181 to 360 days overdue	-	-	575	575
Over 360 days overdue	-	-	6,852	6,852
Gross carrying amount	**56,006**	**2,881**	**11,947**	**70,834**
Credit loss allowance	(331)	(212)	(5,130)	(5,673)
Carrying amount	**55,675**	**2,669**	**6,817**	**65,161**

Collateral and other credit enhancements

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

The main types of collateral obtained are as follows:

- For micro loans, cash, charges over real estate properties, inventory, vehicles and third party guarantees;
- For SME loans, cash, charges over real estate properties, inventory and vehicles;
- For retail loans, cash, charges over credited consumer appliances, vehicles, mortgages over residential properties and third party guarantees;

(Figures in tables are in thousands of Azerbaijani manats)

- For mortgage loans, mortgages over residential properties;
- For staff loans, cash, vehicles and mortgages over residential properties.

11. Loans to Customers (Continued)

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

The Bank calculates LGD rate of individually impaired loans in Stage 3 using discounted value of collaterals. As at 31 December 2019, maximum exposure of such loans amounted to AZN 105,265 thousand (31 December 2018: AZN 202,618 thousand) for which ECL of AZN 34,682 thousand (31 December 2018: 95,585 thousand) was created. If these loans were not collateralised, then ECL amount for these loans would be AZN 58,700 thousand (31 December 2018: AZN 177,243 thousand) based on the collective assessment.

Description of collateral held for loans carried at amortised cost is as follows at 31 December 2019:

	SME loans	Micro loans	Retail loans	Total
Loans collateralised by:				
- residential real estate	99,753	37,604	8,512	145,869
- other real estate	1,667	778	1,251	3,696
- deposits	2,415	365	10,071	12,851
- land	4,167	3,385	179	7,731
- vehicles	6	2,870	9	2,885
- equipment	40,838	75,953	781	117,572
- other	3	-	-	3
Total	**148,849**	**120,955**	**20,803**	**290,607**
Unsecured exposures	67,814	160,870	44,359	273,043
Total carrying value loans to customers at AC	**216,663**	**281,825**	**65,162**	**563,650**

Description of collateral held for loans carried at amortised cost is as follows at 31 December 2018:

	Corporate loans	General purpose consumer loans	Mortgage loans	Total
Loans collateralised by:				
- residential real estate	102,155	22,233	21,526	145,914
- other real estate	166	52	17	235
- deposits	3,763	621	6,924	11,308
- land	6,586	1,482	273	8,341
- vehicles	187	1,490	44	1,721
- equipment	113,835	126,572	12,478	252,885
- other	1,188	-	149	1,337
Total	**227,880**	**152,450**	**41,411**	**421,741**
Unsecured exposures	49,884	37,840	11,877	99,601
Total carrying value loans to customers at AC	**277,764**	**190,290**	**53,288**	**521,342**

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

The Bank obtains collateral valuation at the time of granting loans and generally updates it every two years. For considering the liquidity of pledged assets bank applies haircut to market values of collaterals. Due to bank's policy haircut applied differs depending on property types.

(Figures in tables are in thousands of Azerbaijani manats)

11. Loans and Advances to Customers (Continued)

For property types as residential and non-residential properties bank applies haircut up to 30%, whereas big business properties as hotels, agricultural lands, production lines have a haircut up to 50%. For movable asset collaterals bank applies haircut up to 70% from market value. In addition, bank uses services from external valuators depending on the total exposure of the borrower.

The extent to which collateral and other credit enhancements mitigate credit risk for financial assets carried at amortised cost that are credit impaired, is presented by disclosing collateral values separately for (i) those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset ("over-collateralised assets") and (ii) those assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets"). The effect of collateral on credit impaired assets at 31 December 2019 is as follows.

	Over-collateralised Assets		**Under-collateralised assets**	
	Carrying value of the assets	Value of collateral	Carrying value of the assets	Value of collateral
Credit impaired assets:				
Loans to customers carried at AC				
SME loans	103,829	493,500	112,834	52,323
Micro loans	69,199	241,362	212,627	53,579
Retail loans	19,751	138,329	45,410	1,190

The effect of collateral on credit impaired assets at 31 December 2018 is as follows.

	Over-collateralised Assets		**Under-collateralised assets**	
	Carrying value of the assets	Value of collateral	Carrying value of the assets	Value of collateral
Credit impaired assets:				
Loans to customers carried at AC				
SME loans	136,553	314,883	141,211	91,327
Micro loans	101,764	277,637	88,526	51,771
Retail loans	31,512	89,807	21,781	10,094

Concentration of loans to customers

As at 31 December 2019, the Bank had a concentration of loans represented by AZN 71,900 thousand due from the twenty (2018–twenty) largest third party borrowers (10.51% of gross loan portfolio) (2018: AZN 89,841 thousand or 12.75% of gross loan portfolio). An allowance of AZN 20,204 thousand (2018: AZN 40,668 thousand) was recognized against these loans.

Loans are made principally within Azerbaijan in the following industry sectors (amounts are presented prior to allowance):

	2019	***2018***
Trade	262,076	296,505
Services	146,770	237,880
Agriculture	109,999	80,799
Household	92,312	26,838
Manufacturing	48,617	44,823
Transportation	23,701	16,273
Other	368	1,658
	683,843	**704,776**

(Figures in tables are in thousands of Azerbaijani manats)

12. Credit loss reversal/(expense) and other impairment and provisions

The table below shows the ECL charges and reversals on financial instruments recorded in the profit or loss and other comprehensive income for the year ended 31 December 2019 and 31 December 2018 respectively:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Written-off loans*	*Total*
Loans to customers	11	51,559	12,642	(70,398)	-	(6,197)
Recoveries from written off loans		-	-	-	4,546	4,546
Credit loss reversal/(expense) on financial assets		**51,559**	**12,633**	**(70,398)**	**4,546**	**(1,651)**
Financial guarantees	25	(60)	-	-	-	(60)
Credit related commitments		(60)	-	-		(60)
Total credit loss reversal/(expense)		**51,499**	**12,633**	**(70,398)**	**4,546**	**(1,711)**

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents	7	31	(1)	-	30
Amounts due from credit institutions	8	84	(2)	-	82
Loans to customers	11	25,048	(8,935)	5,070	21,183
Credit loss reversal/(expense) on financial assets		**25,163**	**(8,938)**	**5,070**	21,295
Financial guarantees	25	(25)	41	-	16
Credit related commitments		**(25)**	**41**	-	16
Total credit loss reversal/(expense)		**25,138**	**(8,897)**	**5,070**	**21,311**

Provision for ECL for credit related commitments are recorded in other liabilities.

(Figures in tables are in thousands of Azerbaijani manats)

13. Property and Equipment and Intangible Assets

The movements in property and equipment were as follows:

	Buildings and leasehold improvements	*Furniture and office equipment*	*Computer equipment*	*Motor vehicles*	*Total Property and equipment*	*Intangible assets*
Cost						
31 December 2018	**50,568**	**11,596**	**8,236**	**1,005**	**71,405**	**36,644**
Additions	112	294	1,208	-	1,614	987
Disposals	(1,305)	(336)	(92)	(41)	(1,774)	-
31 December 2019	**49,375**	**11,554**	**9,352**	**964**	**71,245**	**37,631**
Accumulated depreciation						
31 December 2018	**(19,126)**	**(11,153)**	**(7,641)**	**(889)**	**(38,809)**	**(18,061)**
Depreciation /amortization charge	(2,177)	(377)	(440)	(70)	(3,064)	(4,253)
Disposals	1,305	336	95	42	1,778	-
31 December 2019	**(19,998)**	**(11,194)**	**(7,986)**	**(917)**	**(40,095)**	**(22,314)**
Net book value						
31 December 2018	**31,442**	**443**	**595**	**116**	**32,596**	**18,583**
31 December 2019	**29,377**	**360**	**1,367**	**47**	**31,150**	**15,317**

	Buildings and leasehold improvements	*Furniture and office equipment*	*Computer equipment*	*Motor vehicles*	*Total Property and equipment*	*Intangible assets*
Cost						
31 December 2017	**50,568**	**11,643**	**8,164**	**1,212**	**71,587**	**35,513**
Additions	–	13	192	71	276	1,131
Disposals	–	(60)	(120)	(278)	(458)	–
31 December 2018	**50,568**	**11,596**	**8,236**	**1,005**	**71,405**	**36,644**
Accumulated depreciation						
31 December 2017	**(16,815)**	**(10,436)**	**(7,138)**	**(1,038)**	**(35,427)**	**(14,026)**
Depreciation/amortization charge	(2,311)	(777)	(621)	(128)	(3,837)	(4,034)
Disposals	–	60	118	277	455	–
31 December 2018	**(19,126)**	**(11,153)**	**(7,641)**	**(889)**	**(38,809)**	**(18,060)**
Net book value						
31 December 2017	**33,753**	**1,207**	**1,026**	**174**	**36,160**	**21,487**
31 December 2018	**31,442**	**443**	**595**	**116**	**32,596**	**18,584**

(Figures in tables are in thousands of Azerbaijani manats)

14. Right of Use Assets and Lease Liabilities

The Bank leases various offices premises and land. Rental contracts are typically made for fixed periods of 1 to 8 years and may have extension options as described below.

Until 31 December 2018 leases of premises and equipment were classified as operating leases. From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability from the date when the leased asset becomes available for use by the Bank.

The right of use assets by class of underlying items is analysed as follows:

	Note	Land	Buildings	Total
Carrying amount at 1 January 2019		**613**	**5,186**	**5,799**
Additions		-	186	186
Depreciation charge		(7)	(1,187)	(1,194)
Carrying amount at 31 December 2019		**606**	**4,185**	**4,791**

Interest expense on lease liabilities was AZN 453 thousand.

Expenses relating to short-term leases (included in general and administrative expenses) and to leases of low-value assets that are not shown as short-term leases are included in general and administrative expenses:

	2019
Expense relating to short-term leases	71
Expense relating to leases of low-value assets that are not shown above as short-term leases	51

Total cash outflow for leases in 2019 was AZN 1,610 thousand.

The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as collateral for borrowings.

Extension and termination options are included in a number of office premises leases across the Bank. These are used to maximise operational flexibility in terms of managing the assets used in the Bank’s operations. Termination options held are exercisable by both parties, the Bank and lessors, whereas the extension options are exercisable only by the Bank.

15. Repossessed Collateral

As of 31 December 2019 and 2018, Repossessed Collateral in the amount of AZN 44,880 thousand and AZN 23,898 thousand is represented by 386 and 219 apartments, respectively, which the Bank took possession of, and is available for sale. As of 31 December 2019 the fair value of this property exceeds its carrying value and is in the amount of AZN 53,467.

(Figures in tables are in thousands of Azerbaijani manats)

16. Taxation

(a) Components of income tax (expense) / benefit

Income tax expense comprises the following:

	2019	2018
Current tax	-	-
Deferred tax (charge)/credit − origination and reversal of temporary differences	(8,902)	6,289
Income tax (expense)/credit for the year	**(8,902)**	**6,289**

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

The income tax rate applicable to the Bank's 2019 income is 20% (2018: 20%). A reconciliation between the expected and the actual taxation charge is provided below.

	2019	2018
Profit/(loss) before tax	**13,590**	**(15,093)**
Theoretical tax charge/credit at statutory rate (2019: 20%; 2018: 20%)	(2,718)	3,019
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Non-deductible expenses	(89)	(64)
Change in unrecognised deferred tax assets	(5,556)	3,186
Prior year tax actualization	(539)	
Other		148
Income tax (expense)/credit for the year	**(8,902)**	**6,289**

(c) Tax loss carry forwards (TLCF)

The Bank has unrecognised potential deferred tax assets in respect of unused tax loss carry forwards of AZN 34,463 thousand (2018: AZN 21,959 thousand). For the tax losses movement refer to the table below:

Year	2016 TLCF	2017 TLCF	2018 TLCF	2019 TLCF	Total
2020	1,757	-	-	-	1,757
2021	2,309	-	-	-	2,309
2022	-	3,035	-	-	3,035
2023	-	-	505	3,484	3,989
2024	-	-	-	5,242	5,242
Recoverable	**4,066**	**3,035**	**505**	**8,726**	**16,332**
TLCF brought	**24,798**	**8,764**	**505**	**16,779**	**50,846**
Unrecoverable / expired	**(20,732)**	**(5,729)**	**-**	**(8,053)**	**(34,514)**

(Figures in tables are in thousands of Azerbaijani manats)

16. Taxation (Continued)

(d) Deferred taxes analysed by type of temporary difference

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

	31 December 2017	IFRS 9	OCI	Credited/ (charged) to profit or loss	31 December *2018*	IFRS 16 (Note 5)	Credited/ (charged) to profit or loss	31. December 2019
Tax effect of deductible temporary differences								
Credit Loss allowance for Loans	2,642	12,282	-	2,457	17,381	-	(17,381)	-
Amortisation expense	-	-	-	-	-	-	229	229
Depreciation expense	323	-	-	70	393	-	(355)	38
Lease liability								
Personnel expenses	-	16	-	1	17	-	74	91
Fair valuation of Derivative financial assets	2,433	-	-	(883)	1,550	-	(1,454)	96
Interest Expense on Borrowed funds	-	-	-	-	-	-	18	18
Losses available for offset against future taxable income	33,594	-	-	1,076	34,670	-	16,176	50,846
Other	53	-	-	128	181	-	(174)	7
Gross deferred tax asset	**39,045**	**12,298**	**-**	**2,849**	**54,192**	**1,160**	**(3,076)**	**52,276**
Unrecognised deferred tax asset	(19,823)	(12,322)	-	3,186	(28,959)		(5,555)	(34,514)
Deferred tax asset	**19,222**	**(24)**	**-**	**6,035**	**25,233**	**1,160**	**(8,631)**	**17,762**
Tax effect of taxable temporary differences								
Interest Income on Cash and Cash Equivalents	(36)	7	-	(94)	(123)	-	95	(28)
Interest Income from Amounts due from credit institutions	-	17	-	(33)	(16)	-	16	-
Fair valuation of securities at FVOCI	-	-	(7)	-	(7)	-	-	(7)
Fair valuation of Derivative financial assets	(375)	-	-	375	-	-	-	-
Interest Expense on Amounts due to credit institutions	-	-	-	(23)	(23)	-	-	(23)
Credit Loss allowance for Loans	-	-	-	-	-	-	(720)	(720)
Amortisation expense	(128)	-	-	(8)	(136)	-	136	-
Right of use asset	-	-	-	-	-	(1,160)	202	(958)
Personnel expenses	(37)	-	-	37	-		-	-
Deferred tax liability	**(576)**	**24**	**(7)**	**254**	**(305)**	**(1,160)**	**(271)**	**(1,736)**
Net deferred income tax asset/(liability)	**18,646**	**-**	**(7)**	**6,289**	**24,928**	**-**	**(8,902)**	**16,026**

(e) Current and deferred tax effects relating to each component of other comprehensive income

Current and deferred tax effects relating to each component of other comprehensive income are as follows:

	2019			2018		
	Before-tax amount	**Income tax (expense) / benefit**	**Net-of-tax amount**	**Before-tax amount**	**Income tax (expense) / benefit**	**Net-of-tax amount**
Debt securities at FVOCI - Unrealised gain	-	-	-	37	(7)	30
Other comprehensive income	**-**	**-**	**-**	**37**	**(7)**	**30**

(Figures in tables are in thousands of Azerbaijani manats)

17. Other Financial and Non-financial Assets and Liabilities

	2019	*2018*
Other financial assets		
Settlements through payment terminals	5,157	1,734
Settlements on money transfers and plastic cards	1,720	1,315
Cash blocked by Visa/Master Cards	2,086	1,597
Other	13	118
	8,976	**4,764**
Other non-financial assets		
Deferred expenses	992	1,344
Prepayments for acquisition of property, equipment and intangible assets	907	26
Other	31	20
	1,930	**1,390**

Prepayments for acquisition of property, equipment and intangible assets include prepayments made in December 2019 for CRM program, its implementation, purchase of server equipment and computers.

Other liabilities comprise:

	2019	*2018*
Other financial liabilities		
Settlements on money transfer	2,602	2,149
Payables for professional services	3,251	752
	5,854	**2,901**
Other non-financial liabilities		
Payables to employees	1,746	3,108
Taxes, other than income tax	840	403
Other	199	226
	2,784	**3,737**

Provision for guarantees issued and credit related commitments included in other non-financial liabilities is AZN 161 thousand (2018: AZN 101 thousand)

18. Amounts Due to Credit Institutions

Amounts due to credit institutions comprise

	2019	*2018*
Current accounts	764	–
Time deposits	283	486
Amounts due to credit institutions	**1,047**	**486**

19. Amounts Due to Customers

The amounts due to customers include the following:

	2019	**2018**
Individuals		
- Current accounts	120,829	86,984
- Time deposits	443,086	327,910
Other legal entities		
- Current accounts	76,202	68,363
- Time deposits	19,031	7,760
Entrepreneurs		
- Current accounts	30,244	22,432
- Time deposits	-	-
Current accounts	**227,275**	**177,779**
Term deposits	**462,117**	**335,670**
Total amounts due to customers	**689,392**	**513,449**
Held as security against guarantees (Note 25)	549	229

(Figures in tables are in thousands of Azerbaijani manats)

19. Amounts due to customers (Continued)

As of 31 December 2019, amounts due to customers of AZN 47,745 thousand or 7% (2018- AZN 55,306 thousand or 11%) of total amounts due to customers were due to 10 largest customers. As at 31 December 2019, 32% (2018 – 48%) of amounts to due to customers were denominated in foreign currencies.

Economic sector concentrations within customer accounts are as follows:

	2019	***%***	***2018***	***%***
Individuals	563,445	82	414,895	81
Trade and services	34,796	5	42,191	8
Individual Entrepreneurs	30,372	4	22,104	4
Insurance	19,544	3	8,493	2
Other	41,235	6	25,766	5
Amounts due to customers	**689,392**	**100**	**513,449**	**100**

20. Borrowed Funds

	2019	**2018**
Borrowed funds at AC		
Senior loan	22,096	-
Syndicated loans	-	23,041
Bilateral borrowings	-	181,500
Term borrowings from Central Bank of the Republic of Azerbaijan	3,893	-
Borrowings from other State Funds	11,147	7,877
Total borrowed funds at AC	**37,136**	**212,418**
Total borrowed funds	**37,136**	**212,418**

As at 31 December 2018, the Bank's indebtedness under the syndicated and bilateral loan agreements was outstanding to one and eight international financial institutions in the aggregate amount of AZN 23,041 thousand and AZN 181,500 thousand respectively. Following restructuring mentioned below these loans are accounted for as "senior loan" by the Bank.

In March 2018, the group of international lenders entered into immediate standstill agreement with the Bank according which principal repayments on borrowings were ceased and the Bank became liable for payment of interest only. This decision was made in frame of supporting the Bank on recapitalisation plan (Note 4).

On 15 November 2018, a group of existing international lenders entered into a debt restructuring agreement to recapitalize the Bank. The Parties have decided to make certain amendments to the terms of the Original Restructuring Agreement and hence on 26 February 2019 have entered into Agreement in order to amend and restate the Original Restructuring Agreement. According to this agreement on 5 March 2019 AZN 7,970 thousand out of syndicated and AZN 46,066 thousand out of bilateral borrowings were converted into the Bank's equity. In addition, on 15 March AZN 3,244 thousand out of syndicated and AZN 18,750 thousand out of bilateral borrowings were converted into the Bank's Tier-2 eligible subordinated debt. Moreover, 40% of debt from one financial institution in the amount of AZN 21,540 thousand was forgiven. According to the Restructuring agreement If the Bank is not in compliance with the Capital Adequacy Ratios as of 31 October 2020, unless the Restructured Shareholders otherwise agree, each Senior Lender and the Company shall be obliged to promptly procure the "conversion" of the Contingent Capital into either subordinated debt or equity of the Company. The fair value of the new debt approximates the present value of the future cash flows under the negotiated terms.

In November 2019, the Bank received borrowings from CBAR at amount of AZN 4,967 thousand for 5 years period with annual interest rate of 0.1% per annum in accordance with the Presidential Decree dated on 28 February 2020. Loans received from a government that have a below-market rate of interest are recognised and measured in accordance with IFRS 9. The benefit of the below-market rate of interest is measured as the difference between the initial carrying value of the loan, determined in accordance with IFRS 9, and the proceeds received, in accordance IAS 20. (Note 22). The difference in amount of AZN 1,108 thousand was accounted for as a government grant in accordance with IAS 20 at inception.

(Figures in tables are in thousands of Azerbaijani manats)

20. Borrowed funds (Continued)

As of 31 December 2019, the Bank had loans borrowed from National Fund for Support of Entrepreneurship and Agency for Agro Credit and Development under the Ministry of Agriculture amounting to AZN 7,889 thousand and AZN 3,258 thousand (2018 - AZN 7,877 thousand and AZN 0), maturing through September 2026 and January 2022 (2018 - November 2048 and January 2022) and bearing annual interest rates of 1% and 2% (2018 - 1% p.a. and none) respectively.

Refer to Note 29 for the disclosure of the fair value for borrowed funds.

21. Subordinated Debt

As at 31 December 2019 and 2018, the Bank had subordinated loans from nine financial institutions in the aggregate amount of AZN 22,383 thousand (2018 – AZN 65,060 thousand from three financial institutions) and carries a fixed interest rate of 6% p.a. until 31 December 2020 and 11.5% p.a thereafter until maturity on 31 March 2027. The subordinated loans rank after all other creditors of the Bank in case of liquidation.

In line with the restructuring agreement AZN 64,424 thousand out of subordinated loans was converted into the Bank’s equity on 5 March 2019.

22. Deferred Income

In November 2019, the Bank received borrowings from CBAR with fixed contractual interest rate lower than the market interest rate in accordance with the Presidential Decree dated on 28 February 2020 related to problematic loans of individuals in the Republic of Azerbaijan. The carrying value of the loan at inception 3,859 thousand, represented the future cash flows relating to the loan discounted at the market effective interest rate. The difference of AZN 1,108 thousand between the contractual and carrying value of the loan, at inception, was recorded as government grant deferred income and is amortised through interest expense until the loan’s maturity date in five years.

	2019	2018
Deferred income at 1 January	-	-
Grant received	1,108	-
Amortisation of deferred income to match related depreciation	(33)	-
Deferred income at 31 December	**1,075**	**-**

The Bank restructured a pre-approved by the government authority portfolio of problematic loans of individuals under the terms of Presidential Decree equalling to the amount of borrowing received from the CBAR.

The Bank also obtained and recognised as a government grant of AZN 11,040 thousand compensation received from the government in accordance with Presidential Decree on “Additional measures on resolving problematic loans of individuals in the Republic of Azerbaijan” which was directly recognised in the income statement.

23. Equity

As at 31 December 2019, the Bank had 60,875 thousand authorized, issued and fully paid ordinary shares (2018 –33,002 thousand) with a nominal value of AZN 4.25 per share.

On 05 March 2019, Bank’s share capital increased in AZN 118,460 thousand. Capital increase was made by conversion of the Bank’s existing senior and subordinated debt into equity. The share capital of the Bank was raised by the shareholders in AZN and they are entitled to dividends and any capital distribution in AZN.

(Figures in tables are in thousands of Azerbaijani manats)

24. Reconciliation of Liabilities Arising from Financing Activities

The table below sets out movements in the Bank's liabilities from financing activities for each of the periods presented. The items of these liabilities are those that are reported as financing activities in the statement of cash flows.

	Note	Borrowed funds	Subordinated debt	Lease liabilities	Total
Liabilities from financing activities at 1 January 2018		**230,544**	**65,020**	-	**295,564**
Redemption of principal		(27,055)	–	-	**(27,055)**
Foreign currency translation		(10)	–	-	**(10)**
Proceeds from State Funds / additions		7,877	-	-	**7,877**
Other non-cash movements		1,062	40	-	**1,102**
Liabilities from financing activities at 31 December 2018		**212,418**	**65,060**	-	**277,478**
Adoption of IFRS 16, *Leases*		-	-	5,586	-
Liabilities from financing activities at 1 January 2019		**212,418**	**65,060**	**5,586**	**283,064**
Redemption of principal		(83,316)	-	(1,156)	**(84,472)**
Change in accrued interest		(3,048)	(514)	-	**-**
Restructuring (transfer)	20	(21,995)	21,995	-	**-**
Forgiven debt	20	(21,540)	-	-	**(21,540)**
Converted to share capital	20	(54,036)	(64,424)	-	**(118,460)**
Additions		-	-	186	**186**
Proceeds from State Funds / additions		8,166	-	-	**8,166**
Government grant received (IAS 20)	22	1,075	-	-	**1,075**
Other non-cash movements		(588)	266	-	**(321)**
Liabilities from financing activities at 31 December 2019		**37,136**	**22,383**	**4,616**	**64,135**

(Figures in tables are in thousands of Azerbaijani manats)

25. Commitments and Contingencies

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

Taxation. Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review.

Management believes that its interpretation of the relevant legislation as of 31 December 2019 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Compliance with the Central Bank of the Republic of Azerbaijan ratios.

The Central Bank of the Republic of Azerbaijan requires banks to maintain certain prudential ratios computed based on statutory financial statements. Management believes that the Bank was in compliance with prudential ratios at 31 December 2019 (Note 4).

As at 31 December 2018, the Bank was in compliance with these ratio except for:

- Tier I Capital Adequacy ratio;
- Total Capital Adequacy ratio;
- Minimum Capital requirements:
- The ratio of maximum credit exposure per a single borrower or a group of related borrowers ratio that should not exceed 7 percent of the bank's Tier 1 capital when the market value of the security of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value; The ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 20 percent of the bank's Tier 1 capital when the market value of the security of credit exposures is more than 100 percent of such credit exposures, or the market value of real estate collateral of loans is above 150% of the loan value;
- Leverage ratio;
- Aggregate Open Currency Position.

The Bank submitted to FIMSA the Recapitalization Plan dated 6 July 2018 and Restructuring Agreement dated 15 November 2018 entered into between the Bank, international lenders and existing shareholders of the Bank, envisaging increase of the Bank's capital for the purposes of restoring compliance with Regulatory capital requirements.

In accordance with the prudential report submitted to FIMSA, breaches of the abovementioned ratios were eliminated following the increase of the Bank's capital on 15 March 2019 (Note 4) and the new "Rules on limits for the open currency position in banks" that became effective on 1 March 2019.

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

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

(Figures in tables are in thousands of Azerbaijani manats)

25. Commitments and Contingencies (Continued)

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

Outstanding credit related commitments are as follows:

	2019	2018
Credit related commitments		
Guarantees issued	7,916	5,592
Undrawn loan commitments	7,025	3,507
	14,941	**9,099**
Less : provisions for credit related commitments (Note 17)	(161)	(101)
Total credit related commitments, net of provision	**14,780**	**8,998**
Less: deposits held as security against guarantees (Note 19)	(549)	(229)
Commitments and contingencies	**14,231**	**8,769**

Insurance. The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

26. Fee and Commission Income

Net fee and commission income comprises:

	2019	2018
Fee and commission income		
Settlement operations	4,375	3,547
Cash operations	1,220	3,756
Plastic cards	3,027	3,610
Other	140	130
Total fee and commission income	**8,762**	**11,043**
Fee and commission expense		
Plastic cards	(2,964)	(3,150)
Cash operations	(126)	(57)
Settlement operations	(370)	(107)
Central Credit Registry fees	(220)	(271)
Other	(378)	(646)
Total fee and commission expense	**(4,058)**	**(4,231)**
Net fee and commission income	**4,704**	**6,812**

27. Personnel, General and Administrative Expenses

Personnel expenses comprise:

	2019	*2018*
Salaries	(26,001)	(28,315)
Social security costs	(4,058)	(4,891)
Other employee related expenses	(158)	(110)
Personnel expenses	**(30,217)**	**(33,316)**

(Figures in tables are in thousands of Azerbaijani manats)

27. Personnel, General and Administrative Expenses (Continued)

General and administrative expenses comprise:

	2019	*2018*
Costs of debt recovery	12,562	2,928
Consultancy and other professional services	7,605	5,276
Deposit insurance fee	2,461	1,710
Data processing	2,071	2,401
Repair and maintenance	1,446	821
Communications	1,334	1,237
Advertising and marketing expenses	872	687
Stationery and office supplies	774	1,031
Security services	608	601
Taxes other than income tax	579	352
Business travel expenses	153	189
Occupancy and rent	119	1,516
Other expenses	1,342	793
Total general and administrative expenses	**31,926**	**19,542**

28. Risk Management

Introduction

The Bank is exposed to financial and operational risks. Risk exposure is integral to the Bank's business. The Bank's risk management function's aim is to achieve an appropriate balance between risk and return and to minimise potential adverse effects on the Bank's financial performance.

Risk Management Framework

The Management Board is the primary body responsible for the risk management function in the Bank. The risk management function is carried out in respect of financial risks and operational risks. Financial risk comprises market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The primary objectives of the financial risk management function of the Management Board are (i) determining and assessing the specific risks of the Bank's activity, (ii) establishing risk limits and (iii) ensuring that the exposures stay within these limits. The Management Board is also responsible for ensuring an appropriate balance between risk and return, whilst minimizing any potential adverse effects on the Bank's financial performance. The operational risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

The Bank's risk management methodology, policies and assessment procedures are designed to identify, analyse, mitigate and manage the risks faced by the Bank. This is accomplished through setting of appropriate risk limits and controls, whilst ensuring suitable monitoring of risk levels and compliance with the limits and procedures on an on-going basis. The risk management policies and procedures are reviewed regularly to reflect changes in market conditions, and new products and services offered. This is to ensure that "best practices" are implemented in the Bank.

Risk Management Bodies and Governance

Risk management policies and processes around the assessment, approval, monitoring and control of risks are performed by a number of specialized bodies within the Bank, including committees and departments which comply with the requirement of the respective Azerbaijani laws, the CBAR regulations and industry best practices.

The Supervisory Board has overall responsibility for the oversight of the risk management framework. This includes the management of key risks, along with the review and approval of risk management policies and key risk limits such as large exposures, economic and product sector limits. It also delegates certain risk supervision authority levels to the Management Board, the Risk Committee and the Asset and Liability Committee ("ALCO").

(Figures in tables are in thousands of Azerbaijani manats)

28. Risk Management (Continue)

Overall roles and responsibilities for the risk management framework are shown below:

Responsibility area	***Supervising body***	***Executive Management***
Strategic and organizational risk	Supervisory Board	Management Board
Credit risk	Management Board / Risk Committee	Business Banking / Risk Department
Market and liquidity risk	Risk Committee, ALCO	Finance/Treasury
Operational risks	Management Board	Internal Audit / Risk Department

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties fail to discharge their contractual obligations. The Bank identifies, measures, monitors and controls the risk inherent in individual credits or transactions as well as the risk of the entire portfolio. The Bank sets limits on the amount of risk it is willing to accept for individual counterparties and for sector, region, industry and product concentrations and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed, to take corrective action and to provide adequate capital against credit risk incurred.

Credit-related commitments risks

The Bank offers guarantees to its customers which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to risks similar to loans and these are mitigated by the same control processes and policies.

The maximum exposure to credit risk for the components of the statement of financial position, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the carrying value represents the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

For more detail on the maximum exposure to credit risk for each class of financial instrument, references shall be made to the specific notes. The effect of collateral and other risk mitigation techniques is shown in Note 9.

Impairment assessment

IFRS 9’s impairment requirements have been applied to all debt instruments that are measured at amortized cost and to off-balance sheet lending commitments such as overdrafts, credit cards, credit lines and financial guarantees (hereafter “Financial Assets”). The bank currently does not have any financial assets that are measured at FVOCI.

Provisions are taken upon initial recognition of the financial asset, based on the expected credit losses (ECL) at the time of initial recognition. For individually significant credit exposures, defined the TOP 50 credit exposures by obligor who are at the end of the latest reporting date in Stage 3, and for financial instruments and securities, the bank assesses individually their ECL. For credit exposures that are not individually significant and credit exposures that are significant but for which there is no objective evidence of impairment the ECL are assessed collectively.

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

The bank applies IFRS 9's three stage approach to impairment for financial assets at initial recognition and at each reporting date as follows:

- **Stage 1**: the bank recognizes a credit loss allowance equal to 12-month ECL. These are calculated for financial assets where there has not been a significant increase in credit risk since initial recognition, and they represent the ECL from potential default events that might materialize within 12 months of the reporting date for those financial assets.
- **Stage 2**: the bank recognizes a credit loss allowance equal to lifetime ECL for the financial assets where there has been a significant increase in credit risk since initial recognition. This requires the computation of ECL based on the lifetime probability of default (i.e. the probability of default occurring over the remaining lifetime of a financial asset).
- **Stage 3**: the bank recognizes a loss allowance equal to lifetime ECL, reflecting a PD of 100%, for the financial assets that are deemed credit impaired.

For credit risk modelling purposes Bank has applied 3 stage approach to impairment of financial assets. At initial recognition, financial assets (except for POCI) are assigned to Stage 1. Based on the contamination concept (including its exceptions), if there is a SICR the financial asset is transferred to Stage 2 and to Stage 3 based on the obligor's default status. POCI are assigned to Stage 3 at origination.

Significant increase in credit risk (SICR)

Financial assets classified as Stage 2 have experienced a SIRC since initial recognition. The bank uses two criteria to determine if there has been a SICR:

- A backstop of 30 days past due for all its credit products,
- A financial asset has been restructured and was not more than 90 days past due.

To determine whether there is a SICR for a financial asset the bank has considered all reasonable and supportable information that is relevant without undue cost or effort. The information on PD at initial recognition and subsequent reporting dates has not been kept and thus are not traceable. Thus, a PD threshold above which financial assets are placed in Stage 2 could not be applied. The bank has planned throughout 2020 to develop and implement in its core banking system the tracking of the PD at each reporting date and at future initial recognitions for each financial asset.

Financial assets, with the exception of POCI (purchased or originated credit impaired), can also move to Stage 1 from Stage 2 should the credit risk subsequently reduce or no longer represent a SIRC since initial recognition. The bank has applied a probation period of 6 months for non-restructured credit exposures and 12 months for all restructured credit exposures, regardless of whether a financial asset has less than 31 days past due at the reporting date. This probation period resets whenever the credit exposure is re-restructured with standard restructured classification or every time it exceeds 30 days past due. Financial assets can also move to Stage 2 (and afterwards Stage 1, except for POCI) from Stage 3 should the financial asset no longer be credit impaired. The bank has applied a probation period of 12 months for all credit exposures that were credit impaired, regardless of whether a financial asset has less than 91 days past due at the reporting date. This probation period resets whenever the credit exposure is re-restructured with restructured impaired classification or every time it exceeds 90 days past due. For non-restructured credit exposures, additionally during the probation period obligors must have paid at least interest to move to a lower Stage, while for restructured credit exposures, obligors must have paid 10% of the principal in the last time the borrower fulfilled the Stage 3 criteria. POCI financial assets cannot move from Stage 3 to another Stage regardless of the obligor's days past due or default status.

Contamination concept

For both restructuring and days past due the bank applies the contamination concept to all its financial assets. Contamination refers to the concept that if any part of a credit exposure towards an obligor is restructured and/or in days past due all the credit exposure is treated as restructured and/or in days past due. Furthermore, the bank applies the contamination concept by the worse classification, i.e. restructuring classification and/or days past due.

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

However, the contamination concept is not applied for these cases:

- Credit products with technical problems to close them in the core banking system,
- Any part of a credit exposure that is deemed insignificant, i.e. which represents less than 20% of the total credit exposure.

Definition of default and cure

The bank has defined a default event as any of the below criteria:

- A backstop of 90 days past due for all its credit products,
- Restructured impaired if last restructuring was performed in the last 12 months,
- Purchased and credit impaired at origination (POCI).

Except for POCI, if 12 months after the last default event the borrower is no longer considered as defaulted if:

- There was no other default event within the last 12 months,
- The borrower paid at least 10% of the outstanding principal 12 months before.

This definition is in line with the regulatory definition of default used by the bank for capital and regulatory reporting, as well as IFRS 9's rebuttable presumption that default does not occur later than when a payment of principal or interest is 90 days past due.

PD estimation process

12-months PD is calculated based on average monthly discrete-time migration matrices between PAR buckets, repaid and written-off states which are powered to 12. Average yearly discrete-time migration matrices are then derived by powering the 12-month migration matrix to the number of remaining lifetime of pools of homogenous portfolios, these are used to calculate lifetime cumulative PD for Stage 2. For Stage 3 and POCI financial assets, PD is equal to 100%.

To assess accuracy of PD calculations, area under the curve (AUC) with confidence levels of 95% under the assumption of normal distribution. For all pools of loan portfolios, the AUC was higher than 63% with confidence levels of 95%. Furthermore, binomial test was performed for each Stage in the transition matrixes. For all 6 pools, all PAR buckets were significantly overestimated at a confidence level of 95%. From a risk point of view, underestimation is more critical, however for Stage 3 PD is assumed to be 100% and not the PD estimated by the transition matrix modelling.

For off-balance sheet customer financial assets, the following ECL rates are applied:

- if the borrower has on-balance sheet credit exposures: the borrower's ECL rate, considering the Bank's contamination concept;
- if the borrower has no on-balance sheet credit exposures: Stage 1 non-restructured ECL rate depending on the borrower's client segment (i.e. microenterprise, SME or retail).

LGD was calculated for all collective assessed borrowers as the net present value of discounted cash-flows taking into consideration:

- All repayments, including repossessed collateral,
- All partial writes-offs of accrued interest and/or principal.

To avoid bias, LGD was only calculated for borrowers for whom the first default date had occurred more than 12 months before the latest reporting date. Cash-flows were discounted by using the effective interest rate of each financial asset at the reporting date. IFRS 9 requires expected discounted cash flows from collateral and other credit enhancements. Although the bank requests different types of collateral from borrowers, only future recoveries from real estate collateral was considered, as from the experience of the bank these are the most likely to be realized. The bank does periodical re-valuation of these and thus the current collateral (liquidation) value of the real estate collateral was used.

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

As for the Micro and Retail & Staff portfolios the bank does not typically take real estate as collateral, the bank has reflected real estate collateral in the ECL calculation for only for its SME portfolio as future expected recoveries. Expected cash-flows from future recoveries from the realization/repossession of real estate was discounted assuming the cash-flow occurs 4 years from the first default date. No CCF was computed for real estate as from the historical data available there was no strong correlation between PD and real estate prices.

Nevertheless, any past recoveries from any type of collateral sale/repossession was considered for the calculation of LGD of all loan customer portfolios and discounted according to the date on which the cash-inflow occurred. Forward-looking estimates were added as an overlay to adjust the 12-month and lifetime ECL.

Individually assessed allowances

Individual assessment is performed at borrower level with exposure above USD 500,000 in default. (2018: credit exposures more than 5 thousand USD equivalent and is overdue for more than 90 days and is covered by hard collateral).

Individual assessments are performed based on a probability-weighted 2-scenario net present value of expected cash-flows resulting from either repayment expectations and/or sale/repossession of collateral. Cash-flows were discounted by using the effective interest rate of each financial asset at the reporting date. The 2 scenarios used are:

1. Scenario 1 " recovery (cash and collateral sale)" represents all expected inflows from cash repayments and collateral sale (regardless of whether the sale is to be performed by: seizure and sale through court, repossession of assets or agreement with borrower to sell and repay fully or partially the credit exposure). This scenario assumes that the client or personal guarantors still have sources of income, however it might not be enough to repay the full amount owed and thus inflows from collateral realization might be required.
2. Scenario 2 "only collateral sale" represents all expected inflows from collateral sale (regardless of whether the sale is to be performed by: seizure and sale through court, repossession of assets or agreement with borrower to sell and repay fully or partially the credit exposure). This scenario assumes that the client or personal guarantors no longer have other sources of income and thus only recoveries from collateral are expected.

There are only 2 possibilities of repayments (cash and collateral) through which the borrower can repay its credit exposure. For individual assessed borrowers, the bank has identified payment ability in cash based on their business and discussions and consent with the borrower. Based on these assessments, the bank has concluded that most of businesses are able to generate cash flows and only some of these businesses will not be able to generate income, thus collateral will be only source of repayments. Taking into consideration this conclusion, the weights of 70 – 30% have been applied to the 1st and 2nd scenario respectively. The approach was based on expert judgment and expected future cash flows of the clients in addition to some extra defaults on cash payments for each case. Mathematically and logically these weights have small impact on results as quality of payments (forecasted cash flows) are specific for each client. And if the cash flows are zero then collateral will be the only source of repayments.

Collectively assessed allowances

When estimating ECLs (expected credit losses) for collective assessments, IFRS 9 suggests that loans are grouped in pools of loans based on shared credit risk characteristics. Examples of the criteria given in the Standards are:

- Instrument type,
- Credit risk ratings,
- Collateral type,
- Date of initial recognition,
- Remaining term of maturity,
- Industry,
- Geographic location of the borrower.

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

The Standards also foresee that the criteria used as a basis to pool the financial instruments may change over time, as new information becomes available.

The Bank by now has sufficient historical data to distinguish between the loans that were affected by the macroeconomic crisis caused by the aforementioned events in 2015, thus the bank is able to increase the number of pooled sub-portfolio to fulfil the IFRS 9 requirements that exposures must be aggregated by shared credit risk characteristics.

The loan portfolio originally disbursed before 2016 was significantly impacted by the macroeconomic crisis and a significant part of this portfolio, if not written-off, has been restructured. As restructuring is performed due to temporary or permanent financial difficulties that the borrowers are facing, the future performance of restructured portfolio might differ significantly from non-restructured portfolio's performance. In the past the bank could not separate these portfolios, as the data related to the non-restructured loan portfolio of the bank (i.e. originally disbursed after 2015) was too little to develop a statistical model to assess this portfolio collectively. Furthermore, prior to 2016 the bank had much of its customer loan portfolio in USD and since 2015 the bank has disbursed loans mostly in AZN.

Until 2018, the bank was pooling borrowers in its loan portfolio solely by client segments, as defined by its internal policies, as these have different sources of income and are differently impacted by macroeconomic changes. Thus, the bank had 3 pools: microenterprises (Micro), small and medium enterprises (SME) and private persons, including loans to staff (Retail).

Currently, mainly due to a higher number of newly originated portfolio towards the end of 2018 and during 2019, the bank has enough data to further pool within each client segment the portfolios into the following 6 pools for PD modelling, based on their restructuring status and if they were originally disbursed prior or after the last macroeconomic crisis:

Micro	SME	Retail
Restructured loans Non-restructured loans disbursed prior to 2016	Restructured loans Non-restructured loans disbursed prior to 2016	Restructured loans Non-restructured loans disbursed prior to 2016
Non-restructured loans disbursed after 2015	Non-restructured loans disbursed after 2015	Non-restructured loans disbursed after 2015

Restructured loans and non-restructured loans disbursed prior to 2016 have been most affected by the macroeconomic crisis, thus the bank has pooled these customer loan portfolios together.

The main rationale for further disaggregating these pools of portfolios was that currently there is sufficient data to further group the customer loan portfolio into more homogenous groups based on their shared credit risk characteristics. The bank tested whether there was enough data to model ECLs with less aggregated pools of portfolio with enough accuracy and concluded that the discriminatory power was sufficient within confidence levels of 95%. With this the bank has ensured that the bank has applied all due effort to fulfil the Standards requirement to group financial assets by shared credit risk characteristics. It should be noted that due to enough historical data, the LGD was still computed based on 3 pools: microenterprises, SME and retail.

Loss given default

If an obligor defaults, the bank calculates the LGD applying the contamination concept as described above. The LGD that the bank will incur depends on:

- The EAD of the obligor,
- the workout period,
- the recoveries within the workout period from repayments, collateral realization or repossession of collateral.
- Years since the last default

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

Based on expert judgment the bank estimates that the workout period is up to four years or until write-off since the first date the obligor defaults. That is, recoveries from written-off portfolio are not considered for LGD calculation.

Exposure at default (EAD)

For revolving financial assets and off-balance credit commitments, based on expert judgment, EAD is considered as the approved limit and/or commitment with the Bank. Thus, it does not match the amount outstanding in the financial statements of the Bank. This portfolio represents on average less than 1% of the total outstanding portfolio and thus there is insufficient historical information to model EAD. Thus, the bank has opted for a more conservative approach by assuming that there is a high probability that in case of default the borrower will have drawn fully or almost fully the approved limit before there are evidences of SICR. Due to the size of this portfolio the assumption has immaterial impact in the final ECL calculation.

For all remaining financial assets, the Bank has considered the outstanding credit exposure (including accrued interest) at the reporting date

Forward looking modelling

In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, such as:

- GDP Growth;
- Brent oil price;
- FX rate; and
- Dummy variable as proxy for crisis

To incorporate forward-looking information into the ECL allowances, the Bank has calculated an overlay based on a probability-weighted 3-scenarios model:

- Baseline Scenario reflects the most probable state of the economy balanced by risks from both sides. The bank has used macroeconomic forecasts provided by the CBAR (Central Bank of Azerbaijan Republic) and the State Statistical Committee, covering several macroeconomic variables which were deemed as the most relevant for the portfolio (e.g. foreign exchange rates, capital investment, nominal average wages, Brent oil prices, GDP growth) and reflect those institutions' view of the most likely development for those variables. These variables are forecasted over a three-year period. In the absence of further forecasted years which would match the remaining lifetime of the financial assets the bank has taken the 3rd forecasted year for the remaining forecasted years. The alternative scenarios consider different types of shocks. The shocks are selected based on their relevance to current circumstances
- Adverse and Upside Scenarios - was generated by the expert judgement of the Bank taking into the account the predictions of governmental and international financial institutions.

The most probable scenario is based on the predictions of governmental and international financial institutions, therefore the probability of this scenarios is 50 %. The rest scenarios: Adverse and Upside has equal chances and each of them has the probability of 25 %. And historically there have been too rare cases when actual results differed from projected ones beyond 25 % threshold.

Credit quality per class of financial assets

External ratings. External ratings are assigned to counterparties by independent international rating agencies, such as S&P, Moody's and Fitch. These ratings are publicly available. Such ratings and the corresponding range of PD are applied for the following financial instruments: amounts due from the CBAR, balances on correspondent accounts including overnight deposits and term deposits, investment in debt securities.

Master scale credit risk grade	Corresponding ratings of external international rating agencies (Moody's)	Corresponding PD interval
Excellent	Aaa to Ba1	0,01% - 0,5%
Good	Ba2 to B1	0,51% - 3%
Satisfactory	B2, B3	3% - 10%
Special monitoring	Caa1+ to Ca	10% - 99,9%
Default	C	100%

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

Each master scale credit risk grade is assigned a specific degree of creditworthiness:

- *Excellent* – strong credit quality with low expected credit risk;
- *Good* – adequate credit quality with a moderate credit risk;
- *Satisfactory* – moderate credit quality with a satisfactory credit risk;
- *Special monitoring* – facilities that require closer monitoring and remedial management; and
- *Default* – facilities in which a default has occurred.

External ratings are assigned to counterparties by independent international rating agencies, such as S&P, Moody's and Fitch. These ratings are publicly available.

The credit quality of financial assets is assessed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related lines in the statement of financial position, based on the Bank's credit rating system.

As at 31 December 2019 cash and cash equivalents as well as amounts due from credit institutions held at the CBAR and OECD investment grade banks are classified as high grade. Cash and cash equivalents held in other banks is included in standard grade.

As at 31 December 2019	*Note*		*High grade*	*Standard grade*	*Sub-standard grade*	*Impaired*	*Total*
Financial guarantees	20	Stage 1	-	5,904	-	-	**5,094**
		Stage 2	-	-	2,012	-	**2,012**
		Stage 3	-	-	-	-	-
Undrawn loan commitment	20	Stage 1	-	7,025	-	-	**7,025**
Total			**133,526**	**388,605**	**45,827**	**264,974**	**832,932**

As at 31 December 2018 guarantees and loan commitments with good debt service are included in the standard grade, where the customers are with stable financial performance. Sub-standard grade loans consist of restructured loans with no overdue days.

As at 31 December 2018	*Note*		*High grade*	*Standard grade*	*Substandard grade*	*Impaired*	*Total*
Cash and cash equivalents, except for cash on hand	5	Stage 1	80,706	3,251	–	–	**83,957**
		Stage 2	–	722	–	–	**722**
Amounts due from credit institutions	6	Stage 1	3,099	294	–	–	**3,393**
		Stage 2	–	1,032	–	–	**1,032**
Investment in debt securities		Stage 2	-	1,764	-	-	**1,764**
Loans to customers	9						
- SME Loans		Stage 1	–	219,863	–	–	**219,863**
		Stage 2	–	–	17,772	–	**17,772**
		Stage 3	–	–	–	171,641	**171,641**
- Micro Loans		Stage 1	–	189,401	–	–	**189,401**
		Stage 2	–	–	3,368	–	**3,368**
		Stage 3	–	–	–	41,969	**41,969**
- Retail, Mortgage and Staff Loans		Stage 1	–	50,263	–	–	**50,263**
		Stage 2	–	–	217	–	**217**
		Stage 3	–	–	–	10,282	**10,282**
Investment securities	8	Stage 1	1,724	–	40	–	**1,764**
Financial guarantees	20	Stage 1	279	4,171	–	–	**4,450**
		Stage 2	–	–	1,142	–	**1,142**
		Stage 3	–	–	–	–	**–**
Undrawn loan commitment	20	Stage 1	–	3,507	–	–	**3,507**
Total			**85,808**	**472,504**	**22,539**	**223,892**	**804,743**

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

The geographical concentration of Bank's financial assets and liabilities is set out below:

	2019				2018			
	Azerbaijan	*OECD*	*CIS and other countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other countries*	*Total*
Assets								
Cash and cash equivalents				**132,198**	93,548	51,571	575	**145,694**
Amounts due from credit institutions	8,729	856	–	**9,585**	4,131	292	–	**4,423**
Investment securities	33,978	–	–	**33,978**	1,764	–	–	**1,764**
Loans to customers	563,652	–	–	**563,652**	521,342	–	–	**521,342**
Other financial assets	6,660	2,086	163	**8,909**	2,382	1,945	437	**4,764**
	735,727	**11,764**	**831**	**748,322**	**623,167**	**53,808**	**1,012**	**677,987**
Liabilities								
Amounts due to credit institutions	1,045	–	-	**1,045**	8,263	–	100	**8,363**
Amounts due to customers	658,803	9,286	21,303	**689,392**	484,673	12,224	16,552	**513,449**
Borrowed funds	15,040	22,096	–	**37,135**	–	158,172	46,369	**204,541**
Other financial liabilities	8,600	37	–	**8,637**	2,882	–	19	**2,901**
Derivative financial liabilities	(1,138)	5,477	–	**4,339**	203	10,416	–	**10,619**
Subordinated loans	–	22,383	–	**22,388**	–	65,060	–	**65,060**
	682,350	**59,279**	**21,303**	**762,931**	**496,021**	**245,872**	**63,040**	**804,933**
Net assets/(liabilities)	**53,377**	**(47,513)**	**(20,472)**	**(14,607)**	**127,146**	**(192,064)**	**(62,028)**	**(126,946)**

Liquidity risk and funding management

Liquidity risk is the risk that the Bank cannot meet its payment obligations when they fall due under normal or stress circumstances. To limit this risk, management has established a broad range of diversified funding sources in addition to its core deposit base. As part of the asset-liability management the Bank monitors and steers its liquidity position based on the expected future cash in and outflows on a daily basis.

The Bank pursues a policy of keeping at all times a comfortable level of liquid funds mainly in form of cash on accounts with the CBAR and highly rated international banks in OECD countries. In addition, the Bank maintains with the CBAR a cash deposit (obligatory reserve), the amount of which depends on the level of customer deposits attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis and is monitored against regulatory requirements. A key ratio set up by the CBAR for assessing the liquidity position is the Instant Liquidity Ratio which is defined as the relation of highly liquid assets to liabilities payable on demand. The ratio was 62% as at 31 December 2019 (80% as at 31 December 2018), as compared to the minimum percentage required by the CBAR of 30%.

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

Maturity analysis of assets and liabilities

Analysis of financial liabilities by remaining contractual maturities

The table below shows liabilities at 31 December 2019 by their remaining contractual maturity. The amounts of liabilities disclosed in the maturity table are the contractual undiscounted cash flows, including gross finance lease obligations (before deducting future finance charges), gross loan commitments and financial guarantees. Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in the statement of financial position is based on discounted cash flows.

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

Financial derivatives are included at the contractual amounts to be paid or received, unless the Bank expects to close the derivative position before its maturity date in which case the derivatives are included based on the expected cash flows. For the purposes of the maturity analysis, embedded derivatives are not separated from hybrid (combined) financial instruments.

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

Repayments which are subject to notice are treated as if notice were given immediately. In accordance with the Azerbaijan legislation, the Bank is obliged to repay the principal amounts of a term deposit upon demand of a depositor. However, in line with its deposit retention history the Bank expects the average deposit tenors to exceed the contractual maturities of its customer deposits that are displayed below. Term deposits of individuals are included in due to customers at their contractual maturities. The borrowed funds from international lenders are shown in the below table based on the contractual repayment schedules.

	Less than 1 month	***1 to 6 months***	***6 to 12 months***	***1 to 5 years***	***More than 5 years***	**Total**
Financial Liabilities						
Amounts due to credit institutions	(764)	-	(283)	-	-	(1,047)
Amounts due to customers	(271,315)	(181,596)	(186,666)	(81,032)	-	(720,609)
Borrowed funds	(490)	(4,553)	(28,473)	(27,378)	(922)	(61,816)
Lease liabilities	(70)	(744)	(639)	(5,026)	(2,227)	(8,706)
Subordinated debt	-	(660)	(660)	(11,107)	(28,317)	(40,744)
Gross settled swaps						
- inflows	-	-	-	44,008	-	44,008
- outflows	-	-	-	(44,396)	-	(44,396)
Net settled derivatives	-	(2,911)	(1,163)	(780)	(289)	(5,143)
Gross loan commitments	(7,026)	-	-	-	-	(7,026)
Financial guarantees	(7,917)	-	-	-	-	(7,917)
Other financial liabilities	(1,942)	-	-	-	-	(1,942)
Total potential future payments for financial obligations	**(276,306)**	**(194,960)**	**(224,156)**	**(128,160)**	**(31,756)**	**(855,338)**

The table below shows liabilities at 31 December 2018 by their remaining contractual maturity

	Less than 1 month	***1 to 6 months***	***6 to 12 months***	***1 to 5 years***	***More than 5 years***	***Total***
Financial liabilities						
Amounts due to credit institutions	(500)	(330)	(1,875)	(7,372)	–	(10,077)
Amounts due to customers	(201,211)	(112,720)	(168,742)	(48,631)	–	(531,304)
Borrowed funds	(204,541)	–	–	–	–	(204,541)
Subordinated loans	(31,171)	(756)	(1,609)	(47,942)	–	(81,478)
Gross settled derivative financial instruments						
- contractual amounts payable	–	(20,375)	–	–	–	(20,375)
- contractual amounts receivable	–	20,000	–	–	–	20,000
Financial guarantees	(5,592)	–	–	–	–	(5,592)
Gross loan commitments	(3,507)	–	–	–	–	(3,507)
Other financial liabilities	(2,901)	–	–	–	–	(2,901)
Total undiscounted financial liabilities	**(441,387)**	**(158,621)**	**(175,557)**	**(104,210)**	**-**	**(879,775)**

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called. The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

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

The maturity analysis of financial instruments at 31 December 2019 is as follows:

	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	132,198	-	-	-	-	132,198
Investments in debt securities	29,055	3,000	-	1,923	-	33,978
Amount due from credit institutions	9,586	-	-	-	-	9,586
Loans to customers	90,502	178,436	139,217	155,089	407	563,651
Net settled derivatives	-	-	-	807	-	807
Other financial assets	8,976	-	-	-	-	8,976
Total	**270,317**	**181,436**	**139,217**	**157,819**	**407**	**749,196**
Liabilities						
Amounts due to credit institutions	(764)	-	(283)	-	-	(1,047)
Amounts due to customers	(267,869)	(168,486)	(175,839)	(77,198)	-	(689,392)
Borrowed funds	(401)	(2,425)	(3,603)	(23,302)	(7,405)	(37,136)
Lease liabilities	(70)	(725)	(602)	(2,850)	(369)	(4,616)
Subordinated debt	(253)	(1,265)	(1,518)	(12,518)	(6,830)	(22,383)
Net settled derivatives	-	(2,911)	(1,163)	(780)	(289)	(5,143)
Gross loan commitments	(7,026)	-	-	-	-	(7,026)
Financial guarantees	(7,917)	-	-	-	-	(7,917)
Other financial liabilities	(5,854)	-	-	-	-	(5,854)
Total potential future payments for financial obligations	**(276,936)**	**(180,308)**	**(189,280)**	**(119,097)**	**(14,893)**	**(780,514)**
Liquidity gap arising from financial instruments	**(6,618)**	**1,128**	**(50,063)**	**38,722**	**(14,486)**	**(31,317)**

The table below shows an analysis of financial assets and financial liabilities according to when they are expected to be due or settled.

	2018		
	Within one year	***More than one year***	***Total***
Cash and cash equivalents	145,694	–	145,694
Amounts due from credit institutions	4,423	–	4,423
Investment securities	–	1,764	1,764
Loans to customers	366,629	154,713	521,342
Other financial assets	4,764	-	4,764
Total	**521,510**	**156,477**	**677,987**
Amounts due to credit institutions	-	486	486
Amounts due to customers	471,559	41,890	513,449
Borrowed funds	204,541	–	204,541
Other financial liabilities	2,901	–	2,901
Derivative financial liabilities	2,317	8,302	10,619
Subordinated loans	31,060	34,000	65,060
Gross loan commitments	3,507	-	3,507
Financial guarantees	5,592	-	5,592
Total	**721,477**	**84,678**	**806,155**
Net	**(199,967)**	**71,799**	**(128,168)**

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

Negative gap in 2018 was caused by borrowings from foreign financial institutions. Refer to Note 20 for further analysis.

The Bank's capability to repay its liabilities relies on its ability to realize an equivalent amount of assets within the same period of time. The maturity analysis does not reflect the historical stability of current accounts. Their liquidation has historically taken place over a longer period than indicated in the tables above. These balances are included in amounts due in less than one month in the tables above. Management believes that in spite of a substantial portion of customer accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Bank indicates that these customer accounts provide a long-term and stable source of funding for the Bank.

Included in due to customers are term deposits of individuals. In accordance with the Azerbaijan legislation, the Bank is obliged to repay the principal amounts of such deposits upon demand of a depositor. Refer to Note 19.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates and foreign exchanges. The Bank does not maintain any trading positions. Non-trading positions are managed and monitored using sensitivity analysis. Except for concentrations in foreign currencies, the Bank has no significant concentrations of market risk.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates (e.g. such as LIBOR rates) will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Bank's statement of profit or loss and other comprehensive income.

The sensitivity of the statement of profit or loss and other comprehensive income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate (LIBOR) non-trading financial assets and financial liabilities held at 31 December.

Currency	***Increase in basis points in %2019***	***Sensitivity of net interest income 2019***	***Increase in basis points in %2018***	***Sensitivity of net interest income 2018***
USD	0.5	-	0.50	(326)

Currency	***Decrease in basis points in %2019***	***Sensitivity of net interest income 2019***	***Decrease in basis points in %2018***	***Sensitivity of net interest income 2018***
USD	(0.15)	-	(0.15)	98

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBAR regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the manat, with all other variables held constant on the statement of profit or loss and other comprehensive income (due to the fair value of currency sensitive non-trading monetary assets and liabilities). The effect on equity does not differ from the effect on the statement of profit or loss and other comprehensive income. A negative amount in the table reflects a potential net reduction in statement of profit or loss and other comprehensive income or equity, while a positive amount reflects a net potential increase.

(Figures in tables are in thousands of Azerbaijani manats)

28 Risk Management (Continued)

Currency	*Increase in exchange rate* in % in 2019*	*Effect on profit before tax 2019*	*Increase in exchange rate* in % in 2018*	*Effect on profit before tax 2018*
USD/AZN	14.00	47,400	14.00	(20,210)
EUR/AZN	14.00	2,891	14.00	–
GBP/AZN	14.00	587	14.00	-

* *This means appreciation of the currencies indicated in the table against AZN.*

Currency	*Decrease in exchange rate** in % in 2019*	*Effect on profit before tax 2019*	*Decrease in exchange rate** in % in 2018*	*Effect on profit before tax 2018*
USD/AZN	(3.00)	(10,156)	(3.00)	4,331
EUR/AZN	(3.00)	(867)	(3.00)	–
GBP/AZN	(3.00)	(176)	(3.00)	-

** *This means devaluation of the currencies indicated in the table against AZN.*

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but it has a control framework to manage such risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

The Bank has adopted detailed procedures for managing operational risks which are centred on a strict KYC (Know Your Customer) policy and which serve to protect the Bank, its customers and the laws. The procedures have been prepared in accordance with FATF (Financial Action Task Force) and other international recommendations. The implementation of the T24 banking software further improves operational risk management by allowing up-to-date information on all activities available for management analysis at any time.

The Internal Audit Department (IAD) plays an active role in the risk management process. The IAD focuses on and reviews the major regulatory, financial and operational risks which the Bank is facing to ensure the efficiency of the processes and controls. A risk based audit approach was adopted with the emphasis on processes in areas of higher risk. Internal control mechanisms were tested to assess their adequacy and appropriateness to the Bank's business. In all audited areas, the management establishes relevant controls over activities that correspond to the level of risks inherent to these activities and processes.

29. Fair Value Measurement

Fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

(Figures in tables are in thousands of Azerbaijani manats)

29. Fair Value Measurement (Continued)

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Derivative financial assets	31 December 2019	-	-	807	**807**
Investment securities	31 December 2019	33,938	-	40	**33,978**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2019	42,244	89,955	-	**132,198**
Amounts due from credit institutions	31 December 2019	-	9,586	-	**9,586**
Loans to customers	31 December 2019	-	-	568,794	**568,794**
Other financial assets	31 December 2019	-	8,976	-	**8,976**
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2019			5,143	**5,143**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2019	-	16,085	-	**16,085**
Amounts due to customers	31 December 2019	-	-	693,703	**693,703**
Borrowed funds	31 December 2019	-	11,148	25,987	**37,135**
Subordinated loans	31 December 2019	-	-	22,383	**22,383**

		Fair value measurement using			
	Date of valuation	*Quoted prices in active markets (Level 1)*	*Significant observable inputs (Level 2)*	*Significant unobservable inputs (Level 3)*	*Total*
Assets measured at fair value					
Derivative financial assets	31 December 2018	–	–	–	**–**
Investment securities available-for-sale	31 December 2018	1,724	–	40	**1,764**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2018	61,744	83,950	–	**145,694**
Amounts due from credit institutions	31 December 2018	–	4,423	–	**4,423**
Loans to customers	31 December 2018	–	–	529,417	**529,417**
Other Financial assets	31 December 2018	–	4,764	-	**4,764**
Liabilities measured at fair value					
Derivative financial liabilities	31 December 2018	–	10,619	–	**10,619**
Liabilities for which fair values are disclosed					
Amounts due to credit institutions	31 December 2018	–	486	–	**486**
Amounts due to customers	31 December 2018	–	–	512,488	**512,488**
Borrowed funds	31 December 2018	–	7,877	204,541	**212,418**
Subordinated loans	31 December 2018	–	–	65,060	**65,060**

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate their fair value.

(Figures in tables are in thousands of Azerbaijani manats)

29. Fair Value Measurement (Continued)

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying value 2019	*Fair value 2019*	*Unrecognised gain/(loss) 2019*	*Carrying value 2018*	*Fair value 2018*	*Unrecognised gain/(loss) 2018*
Financial assets						
Loans to customers	563,651	568,794	5,143	521,342	529,417	8,075
Investment securities	32,214	32,214	-	-	-	-
Financial liabilities						
Amounts due to customers	689,392	693,703	(4,311)	513,449	512,488	961
Total unrecognised change in fair value			**832**			**9,036**

As of 31 December 2019 and 2018, the fair value of cash and cash equivalents, amounts due from credit institutions and other financial current assets and liabilities is estimated to approximate carrying value. As of 31 December 2019 and 2018, the carrying value of amounts due to credit institutions, borrowed funds and the subordinated loans approximate their fair values as their interest rates are close to the market indices.

Valuation techniques and assumptions

The following describes the methodologies and assumptions used to determine fair values for assets and liabilities recorded at fair value in the financial statements and those items that are not measured at fair value in the statement of financial position, but whose fair value is disclosed.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Investment securities

Investment securities primarily consist of debt securities. These securities are valued using price quotations at the reporting date. Not quoted securities were valued by using similar observable transactions occurred close to reporting date.

Financial assets and financial liabilities carried at amortized cost

The fair value of loans to customers, customer deposits, amounts due from credit institutions and amounts due to credit institutions and borrowed funds is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits.

30. Related Party Disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. The Bank controls transactions with related parties to assure they are carried out at market terms. The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

(Figures in tables are in thousands of Azerbaijani manats)

30. Related Party Disclosures (Continued)

	2019				*2018*			
	Share-holders	***Entities under control of shareholders***	***Key management personnel***	***Other***	***Share-holders***	***Entities under control of shareholders***	***Key management personnel***	***Other***
Loans outstanding at 1 January, gross	**–**	**–**	**–**	**24**	**–**	**–**	**48**	**–**
Loans issued during the year	–	–	–	5	–	–	102	153
Loan repayments during the year	–	–	–	(30)	–	–	(130)	(123)
Foreign currency translation difference	–	–	–	–	–	–	–	–
Other movements	–	–	–	–	–	–	4	2
Loans outstanding at 31 December, gross	**–**	**–**	**–**	**(1)**	**–**	**–**	**24**	**32**
Less: allowance for impairment at 31 December					–	–	–	–
Loans outstanding at 31 December, net	**–**	**–**	**–**	**–**	**–**	**–**	**24**	**32**
Derivatives at 1 January					**1,822**	**–**	**–**	**–**
Net (losses)/gains on fair value of derivatives entered into	–	–	–	–	(1,822)	–	–	–
Derivatives at 31 December	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Deposits at 1 January	**–**	**–**	**792**	**1,182**	**–**	**–**	**619**	**912**
Deposits received during the year	–	–	6,798	1,937	–	–	844	1,284
Deposits repaid during the year	–	–	(7,642)	(3,221)	–	–	(671)	
Foreign currency translation difference	–	–			–	–	–	(1,014)
Other movements	–	–	52	102	–	–	–	–
Deposits received, at 31 December	**–**	**–**	**–**	**–**	**–**	**–**	**792**	**1,182**
Borrowings at 1 January	**–**	**6,621**	**–**	**–**	**–**	**6,396**	**–**	**–**
Borrowings received during the year	151,754	–	–	–	–	1,570	–	–
Borrowings repaid during the year	(82,094)	–	–	–	–	(1,345)	–	–
Foreign currency translation difference	–	–	–	–	–	–	–	–
Transfer	6,621	(6,621)						
Other movements	(148)	–	–	–	–	–	–	–
Conversion into capital	(54,037)	–	–	–	–	–	–	–
Borrowings at 31 December	**22,096**	**–**	**–**	**–**	**–**	**6,621**	**–**	**–**
Current accounts at 31 December		**–**	**1**	**–**	**–**	**–**	**247**	**194**
Subordinated loans at 1 January	**30,278**	**–**	**–**	**–**	**30,263**	**–**	**–**	**–**
Subordinated loans received during the year	58,822	–	–	–	–	–	–	–
Subordinated loans repaid during the year	(1,857)	-	-	-	-	-	-	-
Foreign currency translation difference	-				–	–	–	–
Other movements	563	–	–	–	15	–	–	–
Conversion into capital	(64,423)	–	–	–	–	–	–	–
Subordinated loans at 31 December	**23,383**	–	–	–	**30,278**	**–**	**–**	**–**

(Figures in tables are in thousands of Azerbaijani manats)

30. Related Party Disclosures (continued)

The income and expense arising from related party transactions are as follows:

	2019				*2018*			
	Share-holders	***Entities under common control***	***Other related parties***	***Key mana-gement personnel***	***Share-holders***	***Entities under common control***	***Other related parties***	***Key mana-gement personnel***
Interest income on loans	–	–	–	2	–	–	1	5
Interest expense on deposits	–	–	–	(7)	–	–	(84)	(65)
Interest expense on borrowings	(3,555)	–	–	–	–	(1,345)	–	–
Interest expense on subordinated loans	(2,198)	–	–	–	(2,590)	–	–	–
Other operating expenses	(547)	–	(2,623)	–	(167)	–	–	–

During 2019 an amount of AZN 2,623 thousand is expensed under a consulting services agreement with a related party which provides key management and consulting services to the Bank. Included in the amount is the fee of AZN 231 thousand incurred for the provision of key management personnel by the management entity.

During 2018 an amount of AZN 131 thousand is expensed under a management service agreement with LFS, under which LFS provides management and consulting services to the Bank.

Key management compensation is presented below:

	2019		**2018**	
	Expense	**Accrued liability**	**Expense**	**Accrued liability**
Short-term benefits:				
- Salaries	723	18	2,002	-
- Short-term bonuses			713	-
SSPF to life	39	-	398	-
- Benefits in-kind	71		-	
Post-employment benefits:				
- State pension and social security costs	70		200	
Total	**903**	**18**	**3,314**	**-**

31. Events after the Reporting Period

The existence of novel coronavirus (Covid-19) was confirmed in early 2020 and has spread across mainland China and beyond, causing disruptions to business and economic activity. While this is still an evolving situation at the time of issuing these financial statements, it appears that the negative impact on global trade and on the Bank may be more severe than originally expected. Certain currencies to which the Bank is exposed have weakened, stock markets have declined, and commodity prices are lower. On the other side, the lack of growth in oil demand and decline in global oil prices may directly impact the operating environment of the Bank.

The Bank has considered the outbreak of the COVID-19 (Coronavirus) pandemic and its current and future potential effects on the Bank. Management consider that the outbreak is a non-adjusting post balance sheet event that does not impact the measurement of assets and liabilities in the financial statements as of 31 December 2019. The impact of this outbreak on the macroeconomic forecasts will be incorporated into the Bank's IFRS 9 estimates of expected credit loss provisions in 2020.

In order to measure the effect of COVID-19 (Coronavirus) pandemic and declining oil price on economy and the Bank’s loan portfolio, scenario analysis has been conducted. Considering the uncertainty created by the abovementioned events, the Bank expects deterioration of the loan portfolio. It is clear that COVID-19 (Coronavirus) pandemic caused lockdown of several industries and partial activity of overall economy to some extent. As announced, Azerbaijan Government plans to support business activities (which are affected by COVID-19 (Coronavirus) pandemic) and unemployed population in order to mitigate losses incurred by those segments.

(Figures in tables are in thousands of Azerbaijani manats)

31. Events after the Reporting Period (Continued)

As of 31 December 2019, the gross loan portfolio was AZN 684,467 thousand, of which AZN 613,632 thousand or 90% belongs to Business customers and AZN 70,835 thousand or 10% belongs to consumers. At the same time, the Bank has off-balance exposure from guarantees and credit lines at the amount of AZN 14,780 thousand.

The COVID-19 pandemic has direct effect on several industries, which are estimating the amount of AZN 85,831 thousand or 17% of overall business loan portfolio. The Bank expects that the mentioned exposure will move to stage 2 during the second quarter of the year. For consumer loans, the effect will be temporary, and some deterioration will be observed in the short run, then as economic lockdown is eliminated, gradual improvement will occur, and the quality of consumer loans will return to the prior level. The Bank granted consumer loans only to those who have official workplace, salary, work experience and satisfactory credit history. The great majority of these customers did not lose their jobs and they will be repaying their loans on time after the quarantine rules are relaxed. Considering the abovementioned expectations, the Bank prepared the most likely scenario based on the information currently available and the uncertainties involved. These assumptions are the following (occurring simultaneously):

- For business loans, directly impacted industries (services and non-alimentary production) will move to stage 2
- Stage 1 PD will increase by 25% for business loans
- Stage 1 PD will increase by 5% for consumer loans
- The macroeconomic environment conditions will worsen and ECL would increase by 10%
- LGD remains the same for all segments as it already represents a crisis period as historical data includes the 2015 crisis

If all of these assumptions will crystallise the possible increase in overall expected credit loss can be around AZN 4,701 thousand.

On April 23, 2020, a discussion was held on the mechanism for applying the decision "On additional measures to support the population and business in the context of a coronavirus pandemic" adopted by the Board of CBAR. Summary of the CBAR resolution on loans is as below:

1) *Individuals.* Delays in payments (principal or interest) will not be subject to either transfer to overdue balance nor to penalties. The credit history of the borrowers will not be negatively affected in the Central Credit Registry of the CBAR records until 30 September 2020. Mortgage loans issued through AMCGF (by 1 March 2020) are subject to the restructuring until 30 September 2020 upon the request of borrowers.

2) *Legal entities and individual entrepreneurs.* Loans issued to legal entities or individuals engaged in entrepreneurship activities by March 1, 2020, that have satisfactory quality and interest rates subsidized by the state, are subject to restructuring upon borrower's' request. Whether the loan is restructured or not, delays in payments (principal and interest) will not be counted as overdue nor subject to penalties. The credit history of the borrowers will not be negatively affected in the Central Credit Registry of the CBAR records until 30 September 2020. In addition, Banks may extend the term of Entrepreneurship Development Fund loans upon request of entrepreneurs. More detailed plans of implementation are under discussion between the Banks and CBAR.

The Bank has been compliant with all regulatory ratios for the results at 31 March 2020.

- Capital adequacy ratios were higher than regulatory minimums. Tier 1 and Total Regulatory Capital adequacy ratios were 7.7% and 12.8% respectively, where prudential requirement is 5% and 10%. Sensitivity analysis show that existing capital buffers give a confidence to absorb the risks could appear due to COVİD results.

(Figures in tables are in thousands of Azerbaijani manats)

31. Events after the reporting period (Continued)

- Market risks were also in compliance with regulatory requirements. During the 1st quarter FX rates of AZN to USD were stable at the level of 1.70. After the oil price drop in the beginning of March there was deterioration in the FX markets, but the situation has been managed by the Bank through sufficient currency buffers held with CBAR and derivative instruments and foreign currency demand was met. Bank has managed open currency position to be on balanced level which was in line with internal policy.
- Liquidity ratios was 67% higher compared to regulatory threshold, even though customer behavior changed due to COVID and oil price shock. Uncertainty regarding the situation and quarantine regime introduced led the customers to withdraw part of their deposits from the banks. As a result, there was a pressure on liquid fund of The Bank as well. But with the existing comfort liquidity buffer situation was managed and all requirements of the clients were met. The Bank has internal early warning liquidity ratios for managing the risks and daily liquidity reports to monitor the trends on customer funds.
- The Bank took additional measures for optimization of costs by postponing non critical capital projects and strict control over operational expenses.

(Figures in tables are in thousands of Azerbaijani manats)

32. Abbreviations

The list of the abbreviations used in these financial statements is provided below:

Abbreviation	Full name
AC	Amortised Cost
ALCO	Asset and Liability Committee
AUC	Area Under the Curve
CBAR	Central Bank of Azerbaijan Republic
EAD	Exposure at Default
ECL	Expected Credit Loss
EIR	Effective Interest Rate
FATF	Financial Action Task Force
FIMSA	Financial Markets Supervisory Authority
FVOCI	Fair Value through Other Comprehensive Income
FVTPL	Fair Value Through Profit or Loss
FX	Foreign Exchange
GDP	Gross Domestic Product
IAD	Internal Audit Department
IAS	International Accounting Standards
IBOR	Inter-bank offered rates
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
KYC	Know Your Customer
LGD	Loss Given Default
LIBOR	London Inter-bank Offered Rate
OCI	Other comprehensive income
OECD	Organisation for Economic Co-operation and Development
PD	Probability of Default
POCI	Purchased or Originated Credit-Impaired
SICR	Significant Increase in Credit Risk
SPPI	Solely Payments of Principal and Interest
SPPI test	Assessment whether the financial instruments' cash flows represent Solely Payments of Principal and Interest
SME	Small and Medium Size Enterprises
TLCF	Tax Loss Carry Forward
VAT	Value Added Tax