OJSC “Expressbank”

Financial statements

Year ended 31 December 2015
together with independent auditors’ report

Contents

Ernst & Young Holdings (CIS) B.V.
Port Baku Towers Business Centre
South Tower, 9th floor
153, Neftchilar Ave.
Baku, AZ1010, Azerbaijan
Tel: +994 (12) 490 7020
Fax: +994 (12) 490 7017
www.ey.com/az

Ernst & Yanq Holdinqs (SiAyEs) Bi.Vi.
Port Baku Tauers Biznes Mərkəzi
Cənub Qülləsi, 9-cu mərtəbə
Neftçilər prospekti, 153
Bakı, AZ1010, Azərbaycan
Tel: +994 (12) 490 7020
Faks: +994 (12) 490 7017

Building a better working world

Independent auditors' report

To the Shareholders and Board of Directors of OJSC "Expressbank"

We have audited the accompanying financial statements of OJSC "Expressbank", which comprise the statement of financial position as at 31 December 2015, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year 2015, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these 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.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management of the audited entity, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of OJSC "Expressbank" as at 31 December 2015, and its financial performance and cash flows for the year 2015 in accordance with International Financial Reporting Standards.

Emphasis of matter – related party transactions

We draw attention to Note 24 to the financial statements, which details significant amounts of transactions with a shareholder and other related parties of OJSC "Expressbank". Our opinion is not qualified in respect of this matter.

Ernst & Young Holdings (CIS) B.V.

22 July 2016

Statement of financial position

As of 31 December 2015

(Thousands of Azerbaijani manats)

	Notes	2015	2014
Assets			
Cash and cash equivalents	5	18,250	98,441
Amounts due from credit institutions	6	544	3,345
Loans to customers	7	277,193	207,102
Investment securities available-for-sale	8	1,025	1,593
Property and equipment	9	11,968	10,200
Intangible assets	10	2,873	2,975
Foreclosed property	11	294	294
Current income tax asset		1,140	–
Other assets	13	8,848	4,455
Total assets		**322,135**	**328,405**
Liabilities			
Amounts due to customers	14	130,515	165,470
Amounts due to credit institutions	15	47,701	19,854
Current income tax liabilities		–	1,175
Deferred income tax liabilities	16	726	703
Other liabilities	13	1,164	1,210
Total liabilities		**180,106**	**188,412**
Equity	17		
Share capital		137,257	122,444
Revaluation reserve for property and equipment		577	387
Retained earnings		4,195	17,162
Total equity		**142,029**	**139,993**
Total liabilities and equity		**322,135**	**328,405**

Signed and authorized for release on behalf of the Management Board of the Bank

Mr. Emin Mammadov Chairman of the Management Board

Mr. Anar Hajizada Chief Financial Officer

Mrs. Sevda Fattayeva Chief Accountant

22 July 2016

The accompanying notes on pages 5 to 36 are an integral part of these financial statements.

Statement of profit or loss and other comprehensive income

For the year ended 31 December 2015

(Thousands of Azerbaijani manats)

	Notes	*2015*	*2014*
Interest income			
Loans to customers		42,859	37,322
Loans to banks		123	397
Investment securities available-for-sale		222	102
Amounts due from credit institutions		2	94
		43,206	**37,915**
Interest expense			
Amounts due to customers		(8,262)	(7,807)
Amounts due to credit institutions		(1,858)	(1,020)
		(10,120)	**(8,827)**
Net interest income		**33,086**	**29,088**
Provision for impairment loss on interest bearing assets	7	(13,400)	(1,337)
Net interest income after provision for impairment of interest bearing assets		**19,686**	**27,751**
Net fee and commission income	19	3,020	4,480
Net gains from dealing operations		4,826	4,389
Net gains from currency translation differences		700	7
Other income		233	51
Non-interest income		**8,779**	**8,927**
Personnel expenses	20	(11,045)	(9,667)
Depreciation and amortization	9, 10	(3,708)	(2,641)
General and administrative expenses	20	(8,189)	(5,065)
Losses on realization of AFS		(23)	–
Other impairment and provisions	12	(3,184)	(2,902)
Non-interest expenses		**(26,149)**	**(20,275)**
Profit before income tax expense		**2,316**	**16,403**
Income tax expense	16	(470)	(3,316)
Profit for the year		**1,846**	**13,087**
Other comprehensive income			
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Revaluation of vehicles		237	80
Income tax effect	16	(47)	(16)
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**190**	**64**
Other comprehensive income for the year, net of tax		**190**	**64**
Total comprehensive income for the year		**2,036**	**13,151**

The accompanying notes on pages 5 to 36 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2015

(Thousands of Azerbaijani manats)

	Share capital	*Retained earnings*	*Revaluation reserve for property and equipment*	*Total*
31 December 2013	**112,317**	**14,202**	**323**	**126,842**
Profit for the year	–	13,087	–	13,087
Other comprehensive income for the year	–	–	64	64
Total comprehensive income for the year	**–**	**13,087**	**64**	**13,151**
Capitalization of net statutory profit for the year 2013 to share capital (Note 17)	10,127	(10,127)	–	–
31 December 2014	**122,444**	**17,162**	**387**	**139,993**
Loss for the year	–	1,846	–	1,846
Other comprehensive income for the year	–		190	190
Total comprehensive income for the year	**–**	**1,846**	**190**	**2,036**
Capitalization of net statutory profit for the year 2015 to share capital (Note 17)	14,813	(14,813)	–	–
31 December 2015	**137,257**	**4,195**	**577**	**142,029**

The accompanying notes on pages 5 to 36 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2015

(Thousands of Azerbaijani manats)

	Notes	*2015*	*2014*
Cash flows from operating activities			
Interest received		27,479	39,527
Interest paid		(7,475)	(7,763)
Fees and commissions received		3,904	6,388
Fees and commissions paid		(1,469)	(1,196)
Realized gains less losses from dealing in foreign currencies		4,826	4,389
Other income received		84	35
Personnel expenses paid		(11,045)	(9,667)
General and administrative expenses paid		(8,363)	(5,550)
Cash flows from operating activities before changes in operating assets and liabilities		**7,941**	**26,163**
Net (increase)/decrease in operating assets			
Amounts due from credit institutions		2,839	363
Loans to banks		1,258	–
Loans to customers		(23,933)	(30,211)
Other assets		(713)	(384)
Net increase/(decrease) in operating liabilities			
Amounts due to customers		(85,822)	70,538
Amounts due to credit institutions		12,530	11,198
Other liabilities		(349)	(139)
Net cash flows (used in) / from operating activities before income tax		**(86,249)**	**77,528**
Income tax paid		(2,778)	(3,007)
Net cash (used in) / from operating activities		**(89,027)**	**74,521**
Cash flows from investing activities			
Purchase of investment securities available-for-sale		–	(1,569)
Proceeds from sale of investment securities available-for-sale		1,075	–
Purchase of property and equipment		(7,604)	(5,016)
Proceeds from sale of property and equipment		13	19
Acquisition of intangible assets		(263)	(745)
Net cash used in investing activities		**(6,779)**	**(7,311)**
Effect of exchange rates changes on cash and cash equivalents		15,615	(909)
Net (decrease)/increase in cash and cash equivalents		**(80,191)**	**66,301**
Cash and cash equivalents, beginning	5	98,441	32,140
Cash and cash equivalents, ending	5	**18,250**	**98,441**

Non-cash transactions performed by the Bank comprise the following:

	Notes	*2015*	*2014*
Capitalization of prior periods profit	17	14,813	10,127
Revaluation of vehicles, net of tax		190	64

The accompanying notes on pages 5 to 36 are an integral part of these financial statements.

(Thousands of Azerbaijani manats)

1. Principal activities

"Expressbank" OJSC (the "Bank") was formed on 21 June 1992 as Azernagliyyatbank Commercial Bank and operates under the laws of the Republic of Azerbaijan. On 11 March 2005 the legal structure of the Bank was changed to Open Joint Stock Company. The Bank changed its name from Open Joint Stock Commercial Bank "Azernagliyyatbank" to "Expressbank" Open Joint Stock Company on 5 March 2010. The Bank operates under banking license number 119 issued by the Central Bank of the Republic of Azerbaijan (the "CBAR") on 30 December 1992.

The Bank accepts deposits from the public and extends credit, transfers payments in Azerbaijan and abroad, exchanges currencies and provides other banking services to its commercial and retail customers. Its main office is in Baku and it has 18 branches in Baku and other cities in Azerbaijan. The Bank's registered legal address is 134C, Y. Chamanzaminli St., Ataturk Ave., Baku, AZ1130, Azerbaijan.

Starting from 7 August 2007, the Bank is a member of the deposit insurance system. The system operates under the Law on Deposit Insurance and other regulations and is governed by the Azerbaijan Deposit Insurance Fund. Insurance covers the Bank's liabilities to individual depositors for the amount up to AZN 30 for each individual in case of business failure and revocation of the CBAR banking license subject to other conditions.

As of 31 December 2015 and 2014 the following shareholders owned the outstanding shares of the Bank:

Shareholder	*2015 (%)*	*2014 (%)*
"ADOR" LLC	–	42.00
"AZENCO Group" LLC	40.00	40.00
Xammadov Hikmet	25.00	–
"EnerqoServis" LLC	17.69	17.69
Seyidov Hafiz	17.00	–
"Avtoneqliyyatservis" LLC	0.31	0.31
Total	**100.00**	**100.00**

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Bank is required to maintain its records and prepare its financial statements in Azerbaijani manat ("AZN") and in accordance with IFRS.

The Azerbaijani manat is the reporting and functional currency of the Bank as the majority of the transactions are denominated, measured, or funded in AZN. Transactions in other currencies are treated as transactions in foreign currencies. These financial statements are presented in thousands of AZN unless otherwise indicated.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below, for example, investment securities available-for-sale and vehicles.

3. Summary of accounting policies

Changes in accounting policies

The Bank has adopted the following amended IFRS which are effective for annual periods beginning on or after 1 January 2015:

Annual improvements 2010-2012 cycle

These improvements are effective from 1 July 2014 and the Bank has applied these amendments for the first time in these financial statements. They include:

IFRS 13 Short-term Receivables and Payables – Amendments to IFRS 13

This amendment to IFRS 13 clarifies in the Basis for Conclusions that short-term receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This is consistent with the Bank's current accounting policy, and thus this amendment does not impact the Bank's accounting policy.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Changes in accounting policies (continued)

IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets

The amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data on either the gross or the net carrying amount. In addition, the accumulated depreciation or amortization is the difference between the gross and carrying amounts of the asset. Since the Bank uses net basis, this amendment does not impact its accounting policy.

IAS 24 Related Party Disclosures

The amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services. This amendment had no impact for the Bank as does not receive any management services from other entities during prior periods and in 2015.

Annual improvements 2011-2013 cycle

These improvements are effective from 1 July 2014 and the Bank has applied these amendments for the first time in these fina ncial statements. They include:

IFRS 13 Fair Value Measurement

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable). The Bank does not apply the portfolio exception in IFRS 13.

Fair value measurement

The Bank measures financial instruments, such as available-for-sale securities, derivatives and non-financial assets such as premises, at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 22.

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 fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;
- Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables, or financial assets available-for-sale, as appropriate. The Bank determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

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

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amount due from the CBAR, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Borrowings

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 amounts due to customers, amounts due to the Central Bank of the Republic of Azerbaijan and government organizations, amounts due to credit institutions and debt securities issued. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the borrowings are derecognised as well as through the amortization process.

If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is recognized in profit or loss.

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into general and administrative expenses.

Measurement of financial instruments at initial recognition

When financial instruments are recognised initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Measurement of financial instruments at initial recognition (continued)

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price, then:

- if the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Bank recognizes the difference between the fair value at initial recognition and the transaction price as a gain or loss;
- in all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Bank recognizes that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. The right of set-off must not be contingent on a future event and must be legally enforceable in all of the following circumstances:

- the normal course of business;
- the event of default; and
- the event of insolvency or bankruptcy of the entity and all of the counterparties.

These conditions are not generally met in master netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

Impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions and loans to customers

For amounts due from credit institutions and loans to customers carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the statement of profit or loss and other comprehensive income.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss – is reclassified from other comprehensive income to the statement of profit or loss. Impairment losses on equity investments are not reversed through the statement of profit or loss; increases in their fair value after impairment are recognised in other comprehensive income.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in profit or loss. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the statement of profit or loss.

Renegotiation loans

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.

The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed the old loan is derecognized and the new loan is recognized;
- If the loan restructuring is not caused by the financial difficulties of the borrower the Bank uses the same approach as for financial liabilities described below;
- If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Bank recognizes the difference between the present values of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period. In case loan is not impaired after restructuring the Bank recalculates the effective interest rate.

Once the terms have been renegotiated, the loan is no longer considered past due. 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.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired;
- The Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; and

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

- The Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit and guarantees. Financial guarantees are initially recognised in the financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the statement of profit or loss. The premium received is recognised in profit or loss on a straight-line basis over the life of the guarantee.

Taxation

The current income tax expense is calculated in accordance with the regulations of the Republic of Azerbaijan.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss and other comprehensive income.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. 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.

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.

The carrying values of equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

3. Summary of accounting policies (continued)

Property and equipment (continued)

Following initial recognition at cost, vehicles are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is credited to the revaluation reserve for property and equipment included in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss, in which case the increase is recognized in profit or loss. A revaluation deficit is recognized in profit or loss, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

An annual transfer from the revaluation reserve for property and equipment to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

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
Land and buildings	14
Furniture and fixtures	4
Computers and other office equipment	4
Vehicles	4
Other fixed assets	5
Leasehold improvements	5

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.

Assets under construction includes assets being constructed by the Bank and completed assets which are not yet ready for intended use. The assets are transferred from Assets under construction category to the respective category of Property and Equipment and depreciation of these assets commences at the time when the assets are put into use.

Foreclosed property

The Bank classifies a non-current asset which the Bank took possession of in respect of non-performing loans, and is in the process of selling as foreclosed property if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

The Bank measures a foreclosed property at the lower of its carrying amount and fair value less costs to sell. The Bank recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Intangible assets

Intangible assets include computer software and licenses.

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. 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 either finite or indefinite. 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. Amortization periods and methods for intangible assets with indefinite useful lives are reviewed at least at each financial year-end.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Provisions

Provisions are recognised 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

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 recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the financial statements are authorised for issue.

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. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

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*

  Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and other advisory fees. 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*

  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.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

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.

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 from dealing operations.

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

	2015	*2014*
1 US dollar	AZN 1.5594	AZN 0.7844
1 euro	AZN 1.7046	AZN 0.9522

Standards and interpretations issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

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

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but no impact on the classification and measurement of the Bank's financial liabilities.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Revenue arising from lease contracts within the scope of IAS 17 *Leases*, insurance contracts within the scope of IFRS 4 *Insurance Contracts* and financial instruments and other contractual rights and obligations within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (or IFRS 9 *Financial Instruments*, if early adopted) is out of IFRS 15 scope and is dealt by respective standards.

Under IFRS 15 revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Bank is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Bank given that the Bank has not used a revenue-based method to depreciate its non-current assets.

(Thousands of Azerbaijani manats)

3. Summary of accounting policies (continued)

Standards and interpretations issued but not yet effective (continued)

Annual improvements 2012-2014 cycle

These improvements are effective on or after 1 January 2016 and are not expected to have a material impact on the Bank. They include:

IFRS 7 Financial Instruments: Disclosures – Servicing Contracts

IFRS 7 requires an entity to provide disclosures for any continuing involvement in a transferred asset that is derecognized in its entirety. The Board was asked whether servicing contracts constitute continuing involvement for the purposes of applying these disclosure requirements. The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and arrangement against the guidance for continuing involvement in paragraphs IFRS 7.B30 and IFRS 7.42C in order to assess whether the disclosures are required. The amendment must be applied for annual periods beginning on or after 1 January 2016, with earlier application permitted. The amendment is to be applied such that the assessment of which servicing contracts constitute continuing involvement will need to be done retrospectively. However, the required disclosures would not need to be provided for any period beginning before the annual period in which the entity first applies the amendments.

IAS 1 Disclosure Initiative

The amendments to IAS 1 *Presentation of Financial Statements* clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after 1 January 2016, with early adoption permitted.

IFRS 16 Leases

In January 2016, the IASB issued IFRS 16 *Leases* with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 *Leases*. Lessees will recognise a "right of use" asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. The Bank is currently assessing the impact of IFRS 16 on its financial statements.

IAS 12 Income Taxes

In January 2016, the IASB issued amendments to IAS 12 *Income Taxes*. The amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value and clarify recognition of deferred tax assets for unrealised losses, to address diversity in practice. Entities are required to apply the amendments for annual periods beginning on or after 1 January 2017. Earlier application is permitted. These amendments are not expected to have any impact on the Bank.

4. Significant accounting judgments and estimates

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

(Thousands of Azerbaijani manats)

4. Significant accounting judgments and estimates (continued)

Allowance for loan impairment

The Bank regularly reviews its loans and receivables to assess impairment. The Bank uses its experienced judgment to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgment to adjust observable data for a group of loans or receivables to reflect current circumstances.

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.

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 valuations of collaterals are performed based on review of similar collaterals available on the market.

Going concern

The Bank's financial statements have been prepared on a going concern basis which presumes that the Bank will continue its operations in the normal course of business for the foreseeable future.

As described in Note 24, as at 31 December 2015 and 2014 the Bank has significant amount of loans issued to its three related parties of AZN 153,550 and AZN 74,671, respectively. The Bank's ability to continue as a going concern depends on repayment of these loans by these related parties in due course which depends on their business activity.

Based on analysis made by the Bank, discussions with shareholders and related parties and subsequent loan repayments made during 2016 (Note 26), management believes that the loans will be repaid in accordance with contractual terms. Accordingly, management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has resources to continue in business for the foreseeable future.

Taxation

Tax legislation in Azerbaijan is subject to varying interpretations, and changes can occur frequently. Management interpretation of such legislation and changes, including the new law allowing financial institutions to be exempt from payment of profit tax starting 1 January 2009 (for 3 consequent years) if the current year profit is capitalized, 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 2015 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. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgment 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 judgment is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

(Thousands of Azerbaijani manats)

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2015	*2014*
Cash on hand	9,444	12,258
Current accounts with the CBAR	5,095	79,968
Current accounts with other credit institutions	3,711	6,215
Cash and cash equivalents	**18,250**	**98,441**

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 399 (2014 – AZN 1,315) and AZN 3,312 (2014 – AZN 4,900), respectively.

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	2015	*2014*
Obligatory reserve with the CBAR	536	2,630
Blocked accounts	–	711
Other amounts	8	152
	544	**3,493**
Less: allowance for impairment	–	(148)
Amounts due from credit institutions	**544**	**3,345**

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at 0.5% (2014 – 2%) of the previous month average of funds attracted from customers by the credit institution in local and foreign currency, respectively. The Bank's ability to withdraw such deposit is restricted by statutory legislation.

As of 31 December 2014, blocked accounts represent amounts blocked in a non-resident bank related to letter of credit issued by the Bank.

As of 31 December 2014, allowance for impairment represent 100% impairment allowance on a nostro account held with one non-resident bank due to its default (Note 12).

7. Loans to customers

Loans to customers comprise:

	2015	*2014*
Corporate lending	158,754	93,655
Individuals lending	133,025	116,867
Gross loans to customers	**291,779**	**210,522**
Less: allowance for impairment	(14,586)	(3,420)
Loans to customers	**277,193**	**207,102**

Individuals lending comprises consumer loans and loans issued to individual entrepreneurs.

(Thousands of Azerbaijani manats)

7. Loans to customers (continued)

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	Corporate lending 2015	*Individuals lending 2015*	*Total 2015*
At 1 January 2015	733	2,687	3,420
Charge for the year	1,330	12,070	13,400
Amounts written off	–	(2,357)	(2,357)
Recoveries	–	123	123
At 31 December 2015	**2,063**	**12,523**	**14,586**
Individual impairment	336	3,404	3,740
Collective impairment	1,727	9,119	10,846
	2,063	**12,523**	**14,586**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**939**	**6,901**	**7,840**

	Corporate lending 2014	*Individuals lending 2014*	*Total 2014*
At 1 January 2014	**1,445**	**836**	**2,281**
Charge/(reversal) for the year	(712)	2,049	1,337
Amounts written off	–	(313)	(313)
Recoveries	–	115	115
At 31 December 2014	**733**	**2,687**	**3,420**
Individual impairment	475	516	991
Collective impairment	258	2,171	2,429
	733	**2,687**	**3,420**
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	**939**	**1,683**	**2,622**

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, for the year ended 31 December 2015, comprised AZN 869 (2014 – AZN 244).

In accordance with the CBAR requirements, loans may only be written off with the approval of the Board of Directors and, in certain cases, with the respective decision of the Court.

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 corporate lending: government guarantees, real estate properties, inventory;
- For individuals lending: real estate properties, inventory and vehicles.

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.

(Thousands of Azerbaijani manats)

7. Loans to customers (continued)

Concentration of loans to customers

As of 31 December 2015, the Bank had a concentration of loans represented by AZN 169,162 due from ten largest borrowers (58% of gross loan portfolio) (2014 – AZN 97,178 or 46% of gross loan portfolio). An allowance of AZN 3,267 (2014 – AZN 346) was recognized against these loans.

Loans have been extended to the following types of customers:

	2015	*2014*
Private companies	158,754	77,227
Individuals	90,883	87,086
Individual entrepreneurs	42,142	29,781
State companies	–	16,428
	291,779	**210,522**

Loans are made principally within Azerbaijan in the following industry sectors:

	2015	*2014*
Individuals	90,883	87,086
Manufacturing	71,924	49,168
Construction	60,934	21,633
Individual Entrepreneurs	42,142	29,781
Energy	21,583	20,326
Trade and services	1,327	628
Agriculture and food processing	2,986	1,880
Other	–	20
	291,779	**210,522**

8. Investment securities available-for-sale

As of 31 December 2015 the balance of Investment securities available-for-sale was AZN 1,025 (2014 – 1,593).

On 16 September 2015, the Bank sold unsecured bonds issued by one resident bank having a nominal value of USD 1,500 and on 6 November 2015, the Bank purchased marketable securities issued by one local entity having a nominal value of USD 1,000 with annual interest rate of 9% maturing on 12 December 2017.

(Thousands of Azerbaijani manats)

9. Property and equipment

The movements in property and equipment were as follows:

	Land and buildings	*Furniture and fixtures*	*Computers and office equipment*	*Vehicles*	*Other fixed assets*	*Leasehold improve-ments*	*Assets under construc-tion*	*Total*
Cost								
31 December 2013	**180**	**4,505**	**2,559**	**765**	**349**	**3,819**	**329**	**12,506**
Additions	–	1,785	2,915	292	80	1,162	–	6,234
Effect of revaluation	–	–	–	(58)	–	–	–	(58)
Disposals	–	(29)	(7)	(127)	(2)	–	–	(165)
31 December 2014	**180**	**6,261**	**5,467**	**872**	**427**	**4,981**	**329**	**18,517**
Additions	264	1,882	856	189	37	1,293	353	4,874
Effect of revaluation	–	–	–	(42)	–	–	–	(42)
Disposals	–	(15)	(11)	(6)	–	–	–	(32)
31 December 2015	**444**	**8,128**	**6,312**	**1,013**	**464**	**6,274**	**682**	**23,317**
Accumulated depreciation								
31 December 2013	**(29)**	**(2,811)**	**(1,077)**	**(133)**	**(153)**	**(2,059)**	**–**	**(6,262)**
Depreciation charge	(7)	(866)	(493)	(189)	(78)	(716)	–	(2,349)
Effect of revaluation	–	–	–	138	–	–	–	138
Disposals	–	26	7	122	1	–	–	156
31 December 2014	**(36)**	**(3,651)**	**(1,563)**	**(62)**	**(230)**	**(2,775)**	**–**	**(8,317)**
Depreciation charge	(8)	(1,193)	(1,098)	(231)	(76)	(737)	–	(3,343)
Effect of revaluation	–	–	–	279	–	–	–	279
Disposals	–	15	11	6	–	–	–	32
31 December 2015	**(44)**	**(4,829)**	**(2,650)**	**(8)**	**(306)**	**(3,512)**	**–**	**(11,349)**
Net book value								
31 December 2013	**151**	**1,694**	**1,482**	**632**	**196**	**1,760**	**329**	**6,244**
31 December 2014	**144**	**2,610**	**3,904**	**810**	**197**	**2,206**	**329**	**10,200**
31 December 2015	**400**	**3,299**	**3,662**	**1,005**	**158**	**2,762**	**682**	**11,968**

Revaluation of vehicles

From 31 December 2013, the Bank has changed its accounting policy for measurement of vehicles to the revaluation model.

If vehicles were measured using the cost model, the carrying amounts would be as follows:

	2015	*2014*
Cost	1,333	1,150
Accumulated depreciation	(948)	(805)
Net carrying amount	**385**	**345**

Fair value of the vehicles was determined by using market comparable method. This means that valuations performed by the valuator are based on market transaction prices, adjusted for difference in the nature, location or condition of the specific property. As of the date of revaluation, 31 December 2015, the properties' fair values are based on valuations performed by "Real Prays" company – an accredited independent valuator.

Gross carrying amount of fully depreciated property and equipment is AZN 4,727 (2014 – AZN 4,312).

(Thousands of Azerbaijani manats)

10. Intangible assets

The movements in intangible assets were as follows:

	Licenses	*Computer software*	*Total*
Cost			
31 December 2013	**1,193**	**1,681**	**2,874**
Additions	670	173	843
Disposals	–	–	–
31 December 2014	**1,863**	**1,854**	**3,717**
Additions	247	16	263
31 December 2015	**2,110**	**1,870**	**3,980**
Accumulated amortization			
31 December 2013	**(189)**	**(261)**	**(450)**
Amortization charge	(29)	(263)	(292)
Disposal	–	–	–
31 December 2014	**(218)**	**(524)**	**(742)**
Amortization charge	(57)	(308)	(365)
31 December 2015	**(275)**	**(832)**	**(1,107)**
Net book value			
31 December 2013	**1,004**	**1,420**	**2,424**
31 December 2014	**1,645**	**1,330**	**2,975**
31 December 2015	**1,835**	**1,038**	**2,873**

11. Foreclosed property

As of 31 December 2015 and 2014, foreclosed property in the amount of AZN 294 is represented by two apartments which the Bank took possession of, and is available for sale. As of 31 December 2015 and 2014, the fair value of this property approximates its carrying value.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds will be used to reduce or repay the outstanding loans. In general, the Bank does not occupy repossessed properties for business use.

12. Other impairment and provisions

The movements in other impairment allowances and provisions were as follows:

	Amounts due from credit institutions	*Loans to banks*	*Guarantees issued*	*Total*
31 December 2013	**221**	**–**	**–**	**221**
(Reversal)/charge	(73)	2,908	67	2,902
31 December 2014	**148**	**2,908**	**67**	**3,123**
(Reversal)/charge	(33)	2,937	280	3,184
Write-offs	(115)	(5,845)	–	(5,960)
31 December 2015	**–**	**–**	**347**	**347**

Allowance for impairment of assets is deducted from the carrying amounts of the related assets (Notes 6). Provisions for guarantees and commitments are recorded in other liabilities (Note 13).

(Thousands of Azerbaijani manats)

13. Other assets and liabilities

Other assets comprise:

	2015	*2014*
Other financial assets		
Accrued interest receivable on guarantees and letters of credit	901	316
Settlements on money transfers	498	283
	1,399	**599**
Other non-financial assets		
Prepayments for purchase of property and equipment	4,962	2,233
Deferred expenses	1,226	1,115
Prepayments and other debtors	1,238	478
Other	23	30
	7,449	**3,856**
Other assets	**8,848**	**4,455**

Other liabilities comprise:

	2015	*2014*
Other financial liabilities		
Payments in the course of settlements	243	308
Accrued expenses	393	241
	636	**549**
Other non-financial liabilities		
Other taxes payable	–	389
Deferred income	181	205
Provision for guarantees issued	347	67
	528	**661**
Other liabilities	**1,164**	**1,210**

14. Amounts due to customers

The amounts due to customers include the following:

	2015	*2014*
Current accounts	15,430	83,072
Time deposits	115,085	82,398
Amounts due to customers	**130,515**	**165,470**
Cash held as security against letters of credit (Note 18)	6	711

As of 31 December 2015, time deposits were due to customers with annual interest rates of 1%-18% (2014 – 3-18%) and maturing through 2020 (2014 – maturing through 2019).

As of 31 December 2015, amounts due to customers of AZN 52,911 or 39% (2014 – AZN 94,974 or 57%) of total amounts due to customers were due to ten largest customers.

Included in time deposits are deposits of individuals in the amount of AZN 73,794 (2014 – AZN 53,973). In accordance with the Azerbaijan Civil Code, the Bank is obliged to repay such deposits upon demand of a depositor. In case a term deposit is repaid upon demand of the depositor prior to maturity, interest on it is paid based on the interest rate for demand deposits, unless a different interest rate is specified in the agreement.

Amounts due to customers include accounts with the following types of customers:

	2015	*2014*
Individuals	83,424	63,399
Private enterprises	42,984	56,868
State and budgetary organizations	3,995	45,040
Individual entrepreneurs	112	163
Amounts due to customers	**130,515**	**165,470**

(Thousands of Azerbaijani manats)

14. Amounts due to customers (continued)

An analysis of customer accounts by economic sector follows:

	2015	*2014*
Individuals	83,424	63,399
Insurance	41,695	28,638
Energy	3,849	45,710
Transportation	761	–
Trade and services	117	83
Individual Entrepreneurs	112	163
Construction	3	25,003
Other	554	2,474
Amounts due to customers	**130,515**	**165,470**

15. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	2015	*2014*
Current accounts	1	1
Loans from credit institutions	40,807	11,099
Amounts due to Azerbaijan Mortgage Fund	6,893	4,994
Time deposits	–	3,760
Amounts due to credit institutions	**47,701**	**19,854**

As of 31 December 2015, loans from credit institutions represent loans borrowed from two resident commercial banks, two non-resident commercial banks and one non-resident financial institution (2014 – two resident, one non-resident commercial bank and one non-resident financial organization) in the aggregate amount of AZN 40,807 (2014 – AZN 11,099) maturing through 9 February 2016 – 6 November 2016 (2014 – through 16 March 2015 – 21 December 2015), with the annual interest rates of 6.11-10% p.a. (2014 – 6.36-20% p.a.).

As of 31 December 2015, the Bank had loans borrowed from Azerbaijan Mortgage Fund amounting to AZN 6,893 (2014 – 4,994), maturing through November 2044 (2014 – November 2044) and bearing annual interest rates of 1-4% p.a. (2014 – 1-4% p.a.).

16. Taxation

The corporate income tax expense comprises:

	2015	*2014*
Current tax charge	(494)	(3,213)
Deferred tax charge – origination and reversal of temporary differences	(23)	(119)
Less: deferred tax recognised in other comprehensive income	47	16
Income tax expense	**(470)**	**(3,316)**

Deferred tax related to items charged or credited to other comprehensive income during the year is as follows:

	2015	*2014*
Revaluation of vehicles	47	16
Income tax charged to other comprehensive income	**47**	**16**

(Thousands of Azerbaijani manats)

16. Taxation (continued)

Azerbaijan legal entities have to file individual corporate income tax declarations. Standard corporate tax rate is 20% for 2015 and 2014. The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	2015	*2014*
Profit before income tax expense	**2,316**	**16,403**
Statutory tax rate	20%	20%
Theoretical income tax expense at the statutory rate	**(463)**	**(3,281)**
Tax effect of non-deductible expense	(97)	(47)
Other	90	12
Income tax expense	**(470)**	**(3,316)**

Deferred tax assets and liabilities as of 31 December and their movements for the respective years comprise:

		Origination and reversal of temporary differences			*Origination and reversal of temporary differences*		
	2013	*In the income statement*	*In other compre-hensive income*	*2014*	*In the income statement*	*In other compre-hensive income*	*2015*
Tax effect of deductible temporary differences							
Loans to banks	(11)	11	–	–	–	–	–
Foreclosed property	(59)	–	–	(59)	99	–	40
Other assets	–	–	–	–	67	–	67
Deferred tax assets/(liabilities)	**(70)**	**11**	**–**	**(59)**	**166**	**–**	**107**
Tax effect of taxable temporary differences							
Cash and cash equivalents	45	(59)	–	(14)	(6)	–	(20)
Loans to customers	(601)	298	–	(303)	59	–	(244)
Property and equipment	298	(495)	(16)	(213)	60	47	(106)
Intangible assets	16	(4)	–	12	(30)	–	(18)
Other liabilities	(272)	146	–	(126)	(319)	–	(445)
Deferred tax liabilities	**(514)**	**(114)**	**(16)**	**(644)**	**(236)**	**47**	**(833)**
Net deferred tax liabilities	**(584)**	**(103)**	**(16)**	**(703)**	**(70)**	**47**	**(726)**

17. Equity

In 22 July 2014 the shareholders of the Bank decided to capitalize its 2013 statutory profit in the amount of AZN 10,127. As a result the share capital was increased from AZN 112,317 to AZN 122,444.

According to the decision of the General Shareholders' Meeting held on 13 October 2015, the authorized share capital was further increased by AZN 14,813 from AZN 122,444 to AZN 137,257 through capitalization of retained earnings which resulted in increase of amount of each share from AZN 328.90 to AZN 368.69. As of 31 December 2015 the number of issued and fully paid ordinary shares is 372,282 (2014 – 372,282).

The share capital of the Bank was contributed by the shareholders in AZN and they are entitled to dividends and any capital distribution in AZN.

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment is used to record increases in the fair value of vehicles and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity.

(Thousands of Azerbaijani manats)

18. Commitments and contingencies

Operating environment

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

As a result of significant drop in crude oil prices, Azerbaijani manat devalued against the US dollar from AZN 0.7862 to AZN 1.0500 for 1 USD on 21 February 2015 and further to AZN 1.5500 for 1 USD on 21 December 2015. Following the second devaluation, the Central Bank of the Republic of Azerbaijan announced floating exchange rate.

These events resulted in worsening of liquidity in the banking system and much tighter credit conditions. There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Bank's future results and financial position and business prospects in a manner not currently determinable. Such adverse impacts could include deterioration of the quality of the loan portfolio, with increases in non-performing loans and decreases in loan collateral values.

Azerbaijani government announced plans to accelerate reforms and support to banking system in response to current economic challenges.

The Bank's Management is monitoring these developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Bank's business in the foreseeable future.

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 2015 is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Compliance with CBAR ratios

The CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As of 31 December 2015, the Bank was in compliance with these ratios except for ratios of

a) Maximum credit exposure of a bank per a single borrower or a group of connected borrowers 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; and

b) Loans issued to related party entities and entities acting on behalf of the latter that should not exceed 20 percent of the bank's total capital. As of 31 December 2015, the Bank's ratios were 131.7% (2014 – 140.74%) and 130.98% (2014 – 111.29%), respectively.

As a result of this non-compliance the Bank discussed with CBAR an action plan on how these breaches are going to be rectified. Management believes that the Bank will not face any sanctions in the future.

(Thousands of Azerbaijani manats)

18. Commitments and contingencies (continued)

As of 31 December the Bank's commitments and contingencies comprised the following:

	2015	*2014*
Credit related commitments		
Guarantees issued	36,040	65,435
Undrawn loan commitments	11,196	20,133
Letters of credit	120	1,259
	47,356	**86,827**
Operating lease commitments		
Not later than 1 year	1,710	1,327
Later than 1 year but not later than 5 years	2,712	4,325
Later than 5 years	–	72
	4,422	**5,724**
Less – provisions (Note 12)	(347)	(67)
Commitments and contingencies (before deducting collateral)	**51,429**	**92,484**
Less – cash held as security against letters of credit (Note14)	(6)	(711)
Commitments and contingencies	**51,423**	**91,773**

Included in guarantees issued as of 31 December 2015 the Bank made available to its one (2014 – two) major customer guarantees for AZN 34,804 (2014 – AZN 64,635) for the purpose of financing projects in construction industry.

Intermediary loans

As at 31 December 2015 and 2014, the Bank had borrowed funds from the Central Bank of the Republic of Azerbaijan which were further on-lent to state entity for financing of large scale projects implemented by the Government of Azerbaijan. Loan was collateralized by the guarantee letter received from Ministry of Finance of the Republic of Azerbaijan. The Bank acts as a servicing agent for the Central Bank of the Republic of Azerbaijan by transferring collected principal and interest payments made by the sub-borrower and earns only service fee on the loan. The intermediary loan amounting to AZN 92,492 (2014 – AZN 100,000) as at 31 December 2015 is recorded as off-balance.

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.

19. Net fee and commission income

Net fee and commission income comprises:

	2015	*2014*
Guarantees and letters of credit	1,408	2,182
Settlements operations	1,057	885
Plastic card operations	1,055	1,291
Cash operations	966	1,296
Other	3	22
Fee and commission income	**4,489**	**5,676**
Plastic card operations	(819)	(565)
Settlements operations	(307)	(199)
Cash operations	(131)	(300)
Other	(212)	(132)
Fee and commission expense	**(1,469)**	**(1,196)**
Net fee and commission income	**3,020**	**4,480**

(Thousands of Azerbaijani manats)

20. Personnel and general and administrative expenses

Personnel and general and administrative expenses comprise:

	2015	*2014*
Salaries and bonuses	(8,782)	(7,644)
Social security costs	(1,774)	(1,504)
Other	(489)	(519)
Personnel expenses	**(11,045)**	**(9,667)**

General and administrative expenses comprise:

	2015	*2014*
Occupancy and rent expenses	(2,748)	(1,448)
Marketing and advertising expenses	(1,328)	(684)
Computer software costs	(631)	(459)
Security expenses	(734)	(756)
Communications expenses	(695)	(536)
Legal and consultancy expenses	(447)	(135)
Repair and maintenance expenses	(322)	(255)
Deposit insurance fee	(243)	(93)
Printing and office supplies expenses	(227)	(244)
Business Travel and related expenses	(173)	(88)
Operating taxes expenses	(167)	(76)
Vehicle running costs	(133)	(107)
Utility expenses	(79)	(70)
Membership Fees expenses	(18)	(1)
Other expenses	(244)	(113)
General and administrative expenses	**(8,189)**	**(5,065)**

21. Risk management

Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's sustainability and profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit, liquidity, market and operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management structure

The Board of Directors is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and principles.

Management Board

The Management Board has the responsibility to monitor the overall risk process within the Bank.

The Assets and Liabilities Management Committee ("ALMC")

The ALMC is responsible for the development and implementation of strategy and tools related to all aspects of financial management of the Bank.

21. Risk management (continued)

Introduction (continued)

Risk Committee

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions.

Risk Management

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process.

Bank Treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal audit

Risk management processes throughout the Bank are audited annually by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Board of Directors.

Risk measurement and reporting systems

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risks types and activities. Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks. On a regular basis detailed reporting of industry and customer risks takes place.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry 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 and take corrective action. The Bank actively uses collateral to reduce its credit risks.

(Thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Credit-related commitments risks

The Bank makes available to its customers guarantees 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 similar risks 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 is best represented by their carrying amounts.

Where financial instruments are recorded at fair value, the amounts shown above represent 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.

Credit quality per class of financial assets

The credit quality of financial assets is managed 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.

		Neither past due nor impaired					
2015	*Notes*	*High grade*	*Standard grade*	*Sub-standard grade*	*Past due but not impaired*	*Individually impaired*	*Total*
Cash and cash equivalents (excluding cash on hand)	5	–	8,806	–	–	–	8,806
Amounts due from credit institutions	6	–	544	–	–	–	544
Loans to customers	7						
Individuals lending		3,296	94,278	2,377	26,173	6,901	133,025
Corporate lending		–	1,220	154,354	2,241	939	158,754
Investment securities available for sale		–	1,025	–	–	–	1,025
Other financial assets	13	–	1,399	–	–	–	1,399
Total		**3,296**	**107,272**	**156,731**	**28,414**	**7,840**	**303,553**

		Neither past due nor impaired					
2014	*Notes*	*High grade*	*Standard grade*	*Sub-standard grade*	*Past due but not impaired*	*Individually impaired*	*Total*
Cash and cash equivalents (excluding cash on hand)	5	–	86,183	–	–	–	86,183
Amounts due from credit institutions	6	–	3,345	–	–	148	3,493
Loans to banks		–	–	–	–	2,908	2,908
Loans to customers	7						
Individuals lending		2,078	105,533	101	7,472	1,683	116,867
Corporate lending		–	22,793	64,066	5,857	939	93,655
Investment securities available for sale		–	1,593	–	–	–	1,593
Other financial assets	13	–	599	–	–	–	599
Total		**2,078**	**220,046**	**64,167**	**13,329**	**5,678**	**305,298**

(Thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

The Bank classifies its loan related assets as follows:

High grade – counterparties with excellent financial performance, having no changes in the terms and conditions of loan agreements, no overdue in principal and interest and secured with cash collateral.

Standard grade – counterparties with stable financial performance, having no changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Sub-standard grade – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

Past due but not impaired – counterparties with satisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

Individually impaired – counterparties with satisfactory and unsatisfactory financial performance, having changes in the terms and conditions of loan agreements and overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Aging analysis of past due but not impaired loans per class of financial assets

Past due loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below.

2015	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans to customers					
Corporate lending	10,937	2,954	1,755	10,527	26,173
Individual lending	178	–	–	2,063	2,241
Total	**11,115**	**2,954**	**1,755**	**12,590**	**28,414**

2014	*Less than 30 days*	*31 to 60 days*	*61 to 90 days*	*More than 90 days*	*Total*
Loans to customers					
Individuals lending	3,743	792	702	2,235	7,472
Corporate lending	5,789	20	–	48	5,857
Total	**9,532**	**812**	**702**	**2,283**	**13,329**

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. After the selection of significant loans the Bank evaluates the collaterals, payment history, clients' creditworthiness and defines if the loan is impaired or not. Not impaired loans are evaluated according to collective assessment procedures. Loans with impairment indicators are assessed individually. Recoverable amount of impaired loans are calculated by discounting of fair value of collaterals.

(Thousands of Azerbaijani manats)

21. Risk management (continued)

Credit risk (continued)

Collectively assessed allowances

Allowances are assessed collectively for losses on loans that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the historical losses on the portfolio and expected receipts and recoveries once impaired. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as for loans.

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

	2015				*2014*			
	Azerbaijan	*OECD*	*CIS and other countries*	*Total*	*Azerbaijan*	*OECD*	*CIS and other countries*	*Total*
Assets								
Cash and cash equivalents	14,938	2,916	396	18,250	93,540	4,636	265	98,441
Amounts due from credit institutions	544	–	–	544	2,634	711	–	3,345
Loans to customers	277,193	–	–	277,193	207,102	–	–	207,102
Investment securities available-for-sale	1,025	–		1,025	1,593	–	–	1,593
Other financial assets	1,156	4	239	1,399	433	–	166	599
	294,856	**2,920**	**635**	**298,411**	**305,302**	**5,347**	**431**	**311,080**
Liabilities								
Amounts due to customers	130,515	–	–	130,515	165,470	–	–	165,470
Amounts due to credit institutions	38,645	9,056	–	47,701	9,214	5,504	5,136	19,854
Other financial liabilities	636	–	–	636	549	–	–	549
	169,796	**9,056**	**–**	**178,852**	**175,233**	**5,504**	**5,136**	**185,873**
Net assets	**125,060**	**(6,136)**	**635**	**119,559**	**130,069**	**(157)**	**(4,705)**	**125,207**

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. The methodology of the liquidity management tools and reports is approved by the Board of Directors of the Bank, prepared by the Assets and Liabilities Management Department and reviewed on the monthly basis by Asset Liabilities Committee.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. In addition, the Bank maintains a cash deposit (obligatory reserve) with the CBAR, the amount of which depends on the level of customer funds attracted.

The liquidity position is assessed and managed by the Bank primarily on a standalone basis, based on minimum liquidity ratio of 30% established by the CBAR. As of 31 December, these ratios were as follows:

	2015 (%)	*2014 (%)*
Instant Liquidity Ratio (assets receivable or realizable within one day / liabilities repayable on demand)	77	89

(Thousands of Azerbaijani manats)

21. Risk management (continued)

Liquidity risk and funding management (continued)

Analysis of financial liabilities by remaining contractual maturities

The tables below summarize the maturity profile of the Bank's financial liabilities at 31 December based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

As at 31 December 2015	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to customers	34,676	40,082	69,248	–	144,006
Amounts due to credit institutions	8,792	33,836	1,527	7,563	51,718
Other financial liabilities	636	–	–	–	636
Total undiscounted financial liabilities	**44,104**	**73,918**	**70,775**	**7,563**	**196,360**

As at 31 December 2014	*Less than 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities					
Amounts due to customers	99,731	26,830	53,220	–	179,781
Amounts due to credit institutions	9,256	6,413	1,135	5,058	21,862
Other financial liabilities	549	–	–	–	549
Total undiscounted financial liabilities	**109,536**	**33,243**	**54,355**	**5,058**	**202,192**

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies. 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.

	Less than 3 months	*3 to 12 months*	*1 to 5 years*	*Total*
2015	11,310	22,453	13,593	**47,356**
2014	44,118	19,503	23,206	**86,827**

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

The Bank does not receive any significant funds from any one organization or private individual. The maturity analysis does not exhibit any significant negative gaps in any given period.

Included in due to customers are term deposits of individuals and corporate entities. In accordance with the Azerbaijan legislation, the Bank is obliged to repay such deposits upon demand of a depositor. Refer to Note 14.

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 have any significant equity, corporate fixed income or derivatives holdings.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The ALMC on regular basis reviews the overall interest rate spreads by detailed analysis of the assets and liabilities interest rate structure. As of 31 December 2015 and 2014, the Bank does not have any financial assets and liabilities with floating interest rate.

(Thousands of Azerbaijani manats)

21. Risk management (continued)

Market risk (continued)

Currency risk

Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The Assets and Liabilities Management Committee controls currency risk by management of the open currency position on the estimated basis of AZN devaluation and other macroeconomic indicators, which gives the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The Treasury Department performs daily monitoring of the Bank's open currency position with the aim to match the requirements of CBAR.

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 AZN, 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.

Impact on profit before tax based on net assets value as at 31 December 2015 and 2014:

	2015		*2014*	
	AZN/USD +60%	*AZN/USD -15%*	*AZN/USD +35%*	*AZN/USD -8.74%*
Impact on profit before tax	(2,504)	626	(134)	33

	2015		*2014*	
	AZN/EUR +60%	*AZN/EUR -15%*	*AZN/EUR +35%*	*AZN/EUR -10.7%*
Impact on profit before tax	(38)	10	(14)	4

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 a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

(Thousands of Azerbaijani manats)

22. Fair values of financial instruments

Fair value hierarchy

2015	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Assets measured at fair value					
Investment securities available-for-sale	31 December 2015	1,025	–	–	**1,025**
Property and equipment – vehicles	31 December 2015	–	–	1,005	**1,005**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2015	18,250	–	–	**18,250**
Amounts due from credit institutions	31 December 2015	–	–	544	**544**
Loans to customers	31 December 2015	–	–	274,381	**274,381**
Foreclosed property	31 December 2015	–	–	294	**294**
Liabilities for which fair values are disclosed					
Amounts due to customers	31 December 2015	–	–	130,515	**130,515**
Amounts due to credit institutions	31 December 2015	–	–	47,701	**47,701**

2014	*Date of valuation*	*Fair value measurement using* Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	*Total*
Assets measured at fair value					
Investment securities available-for-sale	31 December 2014	1,593	–	–	**1,593**
Property and equipment – vehicles	31 December 2014	–	–	810	**810**
Assets for which fair values are disclosed					
Cash and cash equivalents	31 December 2014	98,441	–	–	**98,441**
Amounts due from credit institutions	31 December 2014	–	–	3,345	**3,345**
Loans to customers	31 December 2014	–	–	206,888	**206,888**
Foreclosed property	31 December 2014	–	–	294	**294**
Liabilities for which fair values are disclosed					
Amounts due to customers	31 December 2014	–	–	165,470	**165,470**
Amounts due to credit institutions	31 December 2014	–	–	19,854	**19,854**

(Thousands of Azerbaijani manats)

22. Fair values of financial instruments (continued)

Fair value hierarchy (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 2015	*Fair value 2015*	*Unrecognized gain/(loss) 2015*	*Carrying value 2014*	*Fair value 2014*	*Unrecognized gain/(loss) 2014*
Financial assets						
Cash and cash equivalents	18,250	18,250	–	98,441	98,441	–
Amounts due from credit institutions	544	544	–	3,345	3,345	–
Loans to customers	277,193	274,381	(2,811)	207,102	206,888	(214)
Other financial assets	1,399	1,399	–	599	599	–
			–			
Financial liabilities			–	–	–	–
Amounts due to customers	130,515	132,533	(2,018)	165,470	165,470	–
Amounts due to credit institutions	47,701	47,701	–	19,854	19,854	–
Other financial liabilities	636	636	–	549	549	–
Total unrecognized change in unrealized fair value			**(4,829)**			**(214)**

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

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 and savings accounts without a specific maturity.

Financial assets and financial liabilities carried at amortized cost

Fair value of unquoted instruments, loans to customers, customer deposits, amounts due from credit institutions and amounts due to the CBAR and credit institutions and other financial assets and liabilities is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

23. Maturity analysis of assets and liabilities

The table below shows an analysis of assets and liabilities according to when they are expected to be recovered or settled. See Note 21 "Risk management" for the Bank's contractual undiscounted repayment obligations.

	2015			*2014*		
	Within one year	*More than one year*	*Total*	*Within one year*	*More than one year*	*Total*
Cash and cash equivalents	18,250	–	18,250	98,441	–	98,441
Amounts due from credit institutions	536	8	544	3,341	4	3,345
Loans to customers	126,700	150,493	277,193	166,803	40,299	207,102
Investment securities available-for-sale	3	1,022	1,025	16	1,577	1,593
Property and equipment	–	11,968	11,968	–	10,200	10,200
Intangible assets	–	2,873	2,873	–	2,975	2,975
Foreclosed property	–	294	294	–	294	294
Current income tax asset	1,140	–	1,140	–	–	–
Other assets	6,938	1,910	8,848	3,515	940	4,455
Total	**153,567**	**168,568**	**322,135**	**272,116**	**56,289**	**328,405**
Amounts due to customers	70,240	60,275	130,515	120,741	44,729	165,470
Amounts due to credit institutions	40,934	6,767	47,701	15,027	4,827	19,854
Current income tax liability	–	–	–	1,175	–	1,175
Deferred income tax liabilities	–	726	726	–	703	703
Other liabilities	1,018	146	1,164	1,027	183	1,210
Total	**112,192**	**67,915**	**180,107**	**137,970**	**50,442**	**188,412**
Net	**41,375**	**100,653**	**142,028**	**134,146**	**5,847**	**139,993**

(Thousands of Azerbaijani manats)

24. 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 outstanding balances of related party transactions are as follows:

	2015					*2014*				
	Share-holders	*Entities under common control*	*Key manage-ment personnel*	*Other related parties*	*Total*	*Share-holders*	*Entities under common control*	*Key manage-ment personnel*	*Other related parties*	*Total*
Loans outstanding at 1 January, gross	**3,918**	**71,682**	**676**	**12**	**76,288**	**811**	**77,536**	**456**	**8**	**78,811**
Loans issued during the year	9,551	64,663	332	10	74,556	3,021	34,213	378	32	37,644
Loan repayments during the year	(510)	(35,620)	(123)	(10)	(36,263)	–	(37,912)	(165)	(28)	(38,105)
Other movements	846	9,336	49	–	10,231	86	(2,155)	7	–	(2,062)
Effect on Translation gain/loss	7,824	23,942	–	–	31,766	–	–	–	–	–
Loans outstanding at 31 December, gross	**21,629**	**134,003**	**934**	**12**	**156,578**	**3,918**	**71,682**	**676**	**12**	**76,288**
Less: allowance for impairment at 31 December	(217)	(1,340)	(21)	–	(1,578)	(22)	(173)	(12)	–	(207)
Loans outstanding at 31 December, net	**21,412**	**132,663**	**913**	**12**	**155,000**	**3,896**	**71,509**	**664**	**12**	**76,081**
Deposits at 1 January	**–**	**–**	**837**	**453**	**1,290**	**–**	**–**	**792**	**121**	**913**
Deposits received during the year	–	–	858	1,030	1,888	–	–	626	331	957
Deposits repaid during the year	–	–	(1,440)	(1,056)	(2,496)	–	–	(516)	(2)	(518)
Other movements	–	–	(53)	–	(53)	–	–	(65)	3	(62)
Effect on Translation gain/loss	–	–	474	314	788	–	–	–	–	–
Deposits at 31 December	**–**	**–**	**676**	**741**	**1,417**	**–**	**–**	**837**	**453**	**1,290**
Current accounts at 31 December	**196**	**163**	**68**	**46**	**473**	**46**	**25,908**	**106**	**14**	**26,074**
Commitments and guarantees issued	201	36,085	388	–	36,674	348	76,778	198	–	77,324

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

	Year ended 31 December 2015					*Year ended 31 December 2014*				
	Share-holders	*Entities under common control*	*Key manage-ment personnel*	*Other related parties*	*Total*	*Share-holders*	*Entities under common control*	*Key manage-ment personnel*	*Other related parties*	*Total*
Interest income on loans	1,336	12,936	93	2	**14,397**	541	12,544	56	2	**13,143**
Loan impairment (charge)/credit	(195)	(1,167)	(9)	–	**(1,371)**	74	(172)	(6)	–	**(104)**
Interest expense on deposits	–	–	(132)	(47)	**(179)**	–	–	104	39	**143**
Fee and commission income	213	3,011	3	1	**3,228**	69	4,266	1	–	**4,336**
Other operating expenses	7,757	22,862	(483)	(324)	**29,812**	–	67	–	–	**67**

As at 31 December 2015 and 2014, loans outstanding includes loans issued to one shareholder of the Bank and two entities under common control of AZN 153,550 and AZN 74,671, respectively. The Bank's ability to continue as a going concern depends on repayment of these loans by these related parties in due course. Based on analysis made by the Bank, discussions with shareholders and related parties and subsequent loan repayments made during 2016 (Note 26), management believes that the loans will be repaid in accordance with contractual terms.

(Thousands of Azerbaijani manats)

24. Related party disclosures (continued)

During 2015 the Bank has made prepayments to entities under common control in the total amount of AZN 2,211 (2014: AZN 865) for purchase of property plant and equipment.

As of 31 December 2015 and 2014 key management personnel of the Bank consisted of 4 members and compensation of key management personnel was comprised of the following:

	2015	*2014*
Salaries and other short-term benefits	374	441
Social security costs	82	97
Total key management personnel compensation	**456**	**538**

25. Capital adequacy

The objectives of management when managing the Bank's capital are (i) to comply with the capital requirements set by CBAR, (ii) to safeguard the Bank's ability to continue as a going concern and (iii) to maintain strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. Compliance with capital adequacy ratios set by CBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chief Accountant and Chairman of the Management Board. The other objectives of capital management are evaluated annually.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders or return capital to shareholders. No changes were made in the objectives, policies and processes from the previous years.

The CBAR requires each bank or banking group to: (a) hold the minimum level of total capital of AZN 50,000 (2014 – AZN 10,000); (b) maintain a ratio of total regulatory capital to the risk-weighted assets (the 'total capital ratio') at or above the prescribed minimum of 10% (2014 – 12%) and (c) maintain a ratio of tier 1 capital to the risk-weighted assets (the 'Tier 1 capital ratio') at or above the prescribed minimum of 5% (2014 – 6%).

Management believes that the Bank was in compliance with the statutory capital adequacy ratio throughout 2015.

As of 31 December 2015 and 2014, the Bank's capital adequacy ratio on this basis was as follows:

	2015	*2014*
Tier 1 capital	137,256	122,456
Tier 2 capital	3,920	18,040
Less: deductions from capital	(2,819)	(2,818)
Total capital	**138,357**	**137,678**
Risk weighted assets	**325,426**	**309,364**
Tier 1 capital adequacy ratio	41%	39%
Total capital adequacy ratio	43%	45%

26. Events after the reporting period

As described in Note 24, as at 31 December 2015 and 2014 the Bank has significant amount of loans issued to its three related parties of AZN 153,550 and AZN 74,671, respectively. During 2016 the borrowers repaid AZN 29,435 which represents approximately 75% of agreed scheduled payments for the year.