# THE INTERNATIONAL BANK OF AZERBAIJAN

**Consolidated Financial Statements**
For the Year Ended December 31, 2015

# THE INTERNATIONAL BANK OF AZERBAIJAN

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## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2015

Management is responsible for the preparation of the consolidated financial statements that present fairly the consolidated financial position of the International Bank of Azerbaijan and its subsidiaries (the "Group") as at December 31, 2015, and the consolidated results of its operations, cash flows and changes in equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance; and
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for the year ended December 31, 2015 were approved by management on April 29, 2016:

On behalf of the Board of Directors:

| | |
|---|---|
| Mr. Elmar Mammadov | Mr. Ulvi Mansurov |
| Chairman of the Board of Directors<br>Baku, the Republic of Azerbaijan | Deputy Chairman of the Board of Directors, CFO<br>Baku, the Republic of Azerbaijan |
| April 29, 2016 | April 29, 2016 |

Deloitte.

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## INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of the International Bank of Azerbaijan:

We have audited the accompanying consolidated financial statements of the International Bank of Azerbaijan and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at December 31, 2015, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

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

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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, as well as evaluating the overall presentation of the consolidated 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 consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte & Touche.

May 20, 2016
Baku, the Republic of Azerbaijan

# THE INTERNATIONAL BANK OF AZERBAIJAN

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION
## AS AT DECEMBER 31, 2015
*(in thousands of Azerbaijan Manats)*

| | Note | December 31, 2015 | December 31, 2014 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 4,34 | 1,597,696 | 593,195 |
| Mandatory cash balances with the National/Central Banks | 34 | 15,334 | 9,678 |
| Due from other banks | 5 | 102,028 | 303,639 |
| Loans and advances to customers | 6,34 | 5,635,583 | 7,854,991 |
| Financial assets at fair value through profit or loss | 7 | 906 | 14,997 |
| Other debt securities | 8,34 | 29,298 | 45,355 |
| Available-for-sale investments | 9 | 97 | 5,287 |
| Receivables from Aqrarkredit | 10,34 | 5,628,923 | - |
| Investment in associates | 11, 34 | 187 | 348 |
| Premises, equipment and intangible assets | 12 | 322,741 | 283,627 |
| Current income tax asset | | 16,946 | 4,076 |
| Deferred income tax asset | 27 | 58,503 | 24,300 |
| Other financial and insurance assets | 13,34 | 210,028 | 23,650 |
| Other assets | 14 | 39,005 | 35,625 |
| TOTAL ASSETS | | 13,657,275 | 9,198,768 |
| **LIABILITIES AND EQUITY** | | | |
| LIABILITIES: | | | |
| Due to other banks | 15,34 | 1,800,844 | 1,864,962 |
| Customer accounts | 16,34 | 7,094,114 | 4,144,678 |
| Debt securities in issue | 17 | 893,654 | 400,927 |
| Other borrowed funds | 18 | 2,262,979 | 1,563,366 |
| Current income tax liability | | 115 | 3,372 |
| Deferred income tax liability | 27 | 42,889 | 23,716 |
| Other financial and insurance liabilities | 19 | 66,355 | 66,353 |
| Other liabilities | 20 | 23,242 | 23,305 |
| Subordinated debt | 21,34 | 759,043 | 421,505 |
| TOTAL LIABILITIES | | 12,943,235 | 8,512,184 |
| EQUITY: | | | |
| Equity attributable to owners of the Bank: | | | |
| Share capital | 22 | 641,287 | 590,192 |
| Additional paid-in capital | 23 | 799,971 | - |
| Cumulative translation reserve | | (27,648) | (14,511) |
| Revaluation reserve for premises | | 40,740 | 42,160 |
| (Accumulated losses)/retained earnings | | (744,750) | 65,670 |
| Total equity attributable to owners of the Bank | | 709,600 | 683,511 |
| Non-controlling interest | | 4,440 | 3,073 |
| Total equity | | 714,040 | 686,584 |
| TOTAL LIABILITIES AND EQUITY | | 13,657,275 | 9,198,768 |

On behalf of the Board of Directors:

Mr. Elmar Mammadov

Chairman of the Board of Directors
Baku, the Republic of Azerbaijan
April 29, 2016

Mr. Ulvi Mansurov

Deputy Chairman of the Board of Directors, CFO
Baku, the Republic of Azerbaijan
April 29, 2016

The notes on pages 7-82 form an integral part of these consolidated financial statements

## THE INTERNATIONAL BANK OF AZERBAIJAN
### CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2015
*(in thousands of Azerbaijan Manats)*

| | Note | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|---|
| Interest income | 24,34 | 606,716 | 661,325 |
| Interest expense | 24,34 | (490,065) | (374,766) |
| NET INTEREST INCOME | | 116,651 | 286,559 |
| Initial recognition adjustment on interest bearing assets | | - | (2,838) |
| Provision for impairment of due from other banks | 5 | (50,739) | (6,174) |
| Provision for impairment of loans to customers | 6,34 | (948,519) | (198,471) |
| Provision for possible investment losses | 8 | (22,943) | - |
| NET INTEREST INCOME AFTER PROVISION FOR IMPAIRMENT | | (905,550) | 79,076 |
| Fee and commission income | 25,34 | 97,600 | 102,774 |
| Fee and commission expense | 25,34 | (29,854) | (29,848) |
| Provision for off balance sheet commitments | 19 | (6,850) | - |
| Fair value gain/(loss) on derivatives | | 710 | (196) |
| Gains less losses from trading in foreign currencies | | 37,418 | 30,126 |
| Foreign exchange translation losses less gains | | (89,039) | (9,294) |
| Net gain on financial assets at fair value through profit or loss | | 458 | 978 |
| Gross insurance premiums written | | 9,871 | 16,802 |
| Reinsurance premiums ceded | | (4,764) | (5,992) |
| (Decrease)/increase of provision for unearned premium, net of reinsurance | 19 | 4,996 | (1,238) |
| Net claims incurred | | (3,844) | (4,777) |
| Other income | | 3,577 | 1,219 |
| Administrative and other operating expenses | 26,34 | (128,523) | (146,056) |
| Share of loss of associates | 11,34 | (161) | (141) |
| (LOSS)/PROFIT BEFORE INCOME TAX | | (1,013,955) | 33,433 |
| Income tax benefit/(expense) | 27 | 201,768 | (7,923) |
| (LOSS)/PROFIT FOR THE YEAR | | (812,187) | 25,510 |
| OTHER COMPREHENSIVE INCOME: | | | |
| **Items that may be reclassified subsequently to profit or loss:** | | | |
| Cumulative translation reserve | | (11,423) | (11,147) |
| OTHER COMPREHENSIVE LOSS FOR THE YEAR | | (11,423) | (11,147) |
| TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR | | (823,610) | 14,363 |
| (LOSS)/PROFIT IS ATTRIBUTABLE TO: | | | |
| Owners of the Bank | | (811,840) | 25,028 |
| Non-controlling interest | | (347) | 482 |
| (LOSS)/PROFIT FOR THE YEAR | | (812,187) | 25,510 |
| TOTAL COMPREHENSIVE (LOSS)/INCOME IS ATTRIBUTABLE TO: | | | |
| Owners of the Bank | | (824,977) | 14,111 |
| Non-controlling interest | | 1,367 | 252 |
| TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR | | (823,610) | 14,363 |
| (Losses)/Earnings per share for profit attributable to the owners of the Bank, basic and diluted (expressed in AZN per share) | 27 | (0.35) | 0.01 |

On behalf of the Board of Directors:

| | |
|---|---|
| Mr. Elmar Mammadov | Mr. Ulvi Mansurov |
| Chairman of the Board of Directors<br>Baku, the Republic of Azerbaijan | Deputy Chairman of the Board of Directors, CFO<br>Baku, the Republic of Azerbaijan |
| April 29, 2016 | April 29, 2016 |

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The notes on pages 7-82 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED DECEMBER 31, 2015
*(in thousands of Azerbaijan Manats)*

| | Note | Share Capital | Additional paid-in capital | Cumulative translation reserve | Revaluation reserve for premises | Retained earnings/ (accumulated losses) | Total equity attributable to owners of the Bank | Non-controlling interest | Total equity |
|---|---|---|---|---|---|---|---|---|---|
| **December 31, 2013** | | 475,038 | - | (3,594) | 43,503 | 75,810 | 590,757 | 2,821 | 593,578 |
| Profit for the year | | - | - | - | - | 25,028 | 25,028 | 482 | 25,510 |
| Other comprehensive loss for the year | | - | - | (10,917) | - | - | (10,917) | (230) | (11,147) |
| Transfer to retained earnings | | - | - | - | (1,343) | 1,343 | - | - | - |
| Dividends paid | 22 | - | - | - | - | (14,652) | (14,652) | - | (14,652) |
| Issue of shares | 22 | 93,295 | - | - | - | - | 93,295 | - | 93,295 |
| Increase in par value of shares | 22 | 21,859 | - | - | - | (21,859) | - | - | - |
| **December 31, 2014** | | 590,192 | - | (14,511) | 42,160 | 65,670 | 683,511 | 3,073 | 686,584 |
| Loss for the year | | - | - | - | - | (811,840) | (811,840) | (347) | (812,187) |
| Other comprehensive income/(loss) for the year | | - | - | (13,137) | - | - | (13,137) | 1,714 | (11,423) |
| Additional paid in capital (net of taxes) | 23 | - | 799,971 | - | - | - | 799,971 | - | 799,971 |
| Transfer to retained earnings | | - | - | - | (1,420) | 1,420 | - | - | - |
| Issue of shares | 22 | 51,095 | - | - | - | - | 51,095 | - | 51,095 |
| **December 31, 2015** | | 641,287 | 799,971 | (27,648) | 40,740 | (744,750) | 709,600 | 4,440 | 714,040 |

On behalf of the Board of Directors:

Mr. Elmar Mammadov

Chairman of the Board of Directors
Baku, the Republic of Azerbaijan

April 29, 2016

Mr. Ulvi Mansurov

Deputy Chairman of the Board of Directors, CFO
Baku, the Republic of Azerbaijan

April 29, 2016

The notes on pages 7-82 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE YEAR ENDED DECEMBER 31, 2015
*(in thousands of Azerbaijan Manats)*

| | Note | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Interest received | | 441,339 | 413,320 |
| Interest paid | | (434,741) | (355,165) |
| Fees and commissions received | | 96,738 | 102,901 |
| Fees and commissions paid | | (31,581) | (29,999) |
| Insurance premiums received | | 10,175 | 18,834 |
| Reinsurance premiums paid | | (4,764) | (5,992) |
| Insurance claims paid | | (3,844) | (4,777) |
| Income received from trading in foreign currencies | | 38,128 | 25,524 |
| Other operating income received | | 3,577 | 1,218 |
| Staff costs paid | | (55,179) | (62,033) |
| Administrative and other operating expenses paid | | (54,168) | (63,816) |
| Cash flows from operating activities before changes in operating assets and liabilities | | 5,680 | 40,015 |
| Changes in operating assets and liabilities: | | | |
| Net (increase)/decrease in mandatory cash balances with the National/Central Banks | | (5,656) | 5,877 |
| Cash collected on behalf of a related party | | 1,321,224 | 75,000 |
| Cash paid on behalf of a related party | | (1,321,224) | (75,000) |
| Net increase in due from other banks | | 25,487 | (23,863) |
| Net increase in loans and advances to customers | | 1,580,279 | (1,201,117) |
| Net decrease in financial assets at fair value through profit or loss | | 14,549 | 8,557 |
| Net increase in other financial and insurance assets | | (73,316) | (8,714) |
| Net increase in other assets | | (9,347) | (6,302) |
| Net (decrease)/increase in due to other banks | | (1,344,197) | 61,362 |
| Net increase in customer accounts | | 480,279 | 622,546 |
| Net decrease/(increase) in other financial and insurance liabilities | | (5,736) | 5,430 |
| Net (decrease)/increase in other liabilities | | (6,533) | 1,968 |
| Cash from/(used in) operating activities before taxation | | 661,489 | (494,241) |
| Income tax paid | | (3,257) | (2,860) |
| Net cash from/(used in) operating activities | | 658,232 | (497,101) |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Payment for premises, equipment and intangible assets | | (42,306) | (72,591) |
| Proceeds from disposal of premises, equipment and intangible assets | | 4,879 | |
| Proceeds from sale of available-for-sale investments | | 6,905 | 5,032 |
| Payment for other debt securities | | - | (22,569) |
| Net cash used in investing activities | | (30,522) | (90,128) |

## CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
## FOR THE YEAR ENDED DECEMBER 31, 2015
*(in thousands of Azerbaijan Manats)*

| | Note | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|---|
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from issue of debt securities | | 69,371 | 318,101 |
| Repayments of debt securities | | (2,202) | |
| Proceeds from other borrowed funds | | 220,537 | 878,387 |
| Repayments of other borrowed funds | | (559,553) | (532,510) |
| Proceeds from subordinated debt | | 261,099 | 8,707 |
| Repayments of subordinated debt | | - | (2,421) |
| Issue of shares | | 51,095 | 93,295 |
| Dividends paid | | - | (5,745) |
| Net cash generated by financing activities | | 40,347 | 757,814 |
| Effect of exchange rate changes on cash and cash equivalents | | 336,444 | (475) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | 1,004,501 | 170,110 |
| CASH AND CASH EQUIVALENTS, beginning of year | 4 | 593,195 | 423,085 |
| CASH AND CASH EQUIVALENTS, end of year | 4 | 1,597,696 | 593,195 |

On behalf of the Board of Directors:

Mr. Elmar Mammadov

Chairman of the Board of Directors
Baku, the Republic of Azerbaijan

April 29, 2016

Mr. Ulvi Mansurov

Deputy Chairman of the Board of Directors, CFO
Baku, the Republic of Azerbaijan

April 29, 2016

The notes on pages 7-82 form an integral part of these consolidated financial statements.

## 1. ORGANIZATION

The International Bank of Azerbaijan (the "Bank") was incorporated in 1991 as a fully state-owned bank and is domiciled in the Republic of Azerbaijan. On October 28, 1992, the Bank became a joint-stock commercial bank and the Ministry of Finance of the Republic of Azerbaijan ("MoF") became the major shareholder of the Bank. As at December 31, 2015 the MoF held 82.23% (December 31, 2014: 60.06%) of the total paid-in share capital of the Bank. The Bank is regulated by the Central Bank of the Republic of Azerbaijan (the "CBAR") and conducts its business under general full banking license issued on December 30, 1992. On March 1, 2005, a Presidential Decree, which outlined the process for privatisation of the state shareholding in the Bank's share capital, was enacted. The Bank's primary business consists of commercial activities, trading with securities, foreign currencies and derivative instruments, originating loans and guarantees.

The registered office of the Bank is located at 67, Nizami Street, AZ1005, Baku, the Republic of Azerbaijan.

As at December 31, 2015 and 2014 the Bank had 35 branches operating in the Republic of Azerbaijan, 2 representative offices in London and Frankfurt.

The Bank is a parent company of a banking group:

| Name | Country of operation | Proportion of ownership interest/voting rights (%) 2015 | 2014 | Type of operation |
|---|---|---|---|---|
| The International Bank of Azerbaijan | The Republic of Azerbaijan | Parent | | Banking |
| **Subsidiaries:** | | | | |
| IBA Moscow | Russian Federation | 100.0 | | Banking |
| International Insurance Company | The Republic of Azerbaijan | 100.0 | | Insurance |
| Azericard Limited | The Republic of Azerbaijan | 100.0 | | Plastic cards |
| IBA Georgia | The Republic of Georgia | 75.0 | | Banking |
| **Associates:** | | | | |
| Joint Leasing | The Republic of Azerbaijan | 47.6 | | Leasing |
| Baku Inter-Bank Currency Exchange | The Republic of Azerbaijan | 20.0 | | Currency exchange |

The ultimate controlling party of the Group is the Government of the Republic of Azerbaijan.

On January 24, 2002, the Group registered its fully-owned subsidiary, the International Bank of Azerbaijan - Moscow, in Moscow, the Russian Federation ("IBA Moscow"). The share capital of IBA Moscow was established in the amount of EUR 10,000,000. IBA Moscow operates under a licence issued by the Central Bank of the Russian Federation (the "CBRF") on January 25, 2002. This licence allows IBA Moscow to carry out banking operations with legal entities in Russian Roubles and in foreign currencies. During the first two years after its registration due to Russian statutory requirements IBA Moscow was restricted from attracting deposits from individuals. On December 1, 2004, IBA Moscow obtained a licence from the CBRF allowing it to provide a full range of banking services to individuals. IBA Moscow's principal activity is represented by commercial banking operations. IBA Moscow has been a member of the Deposit Insurance Agency of the Russian Federation since December 2, 2004. IBA Moscow's registered office is located at the following address: Tverskaya 6, Bldg 2, Moscow, 105062, Russian Federation. IBA Moscow opened a branch in Saint Petersburg, Russian Federation on May 28, 2003 and in Yekaterinburg on August 24, 2005. Based on the decision of Supervisory Board of the Group dated December 30, 2006 and May 18, 2011 the share capital of IBA Moscow was increased by EUR 4 million and AZN 10 million respectively, during the years ended December 31, 2007 and year ended December 31, 2011, respectively. Based on the decision of Supervisory Board of the Group dated April 4, 2014 and May 23, 2014 the share capital of IBA Moscow was increased by AZN 10 million and AZN 18 million respectively, during the year ended December 31, 2014.

On February 5, 2002, the Group registered its fully-owned subsidiary International Insurance Company ("Insurance Subsidiary") at the Ministry of Justice of the Republic of Azerbaijan. The Insurance Subsidiary operates under an insurance licence issued by the Ministry of Finance of the Republic of Azerbaijan on October 15, 2009. The Insurance Subsidiary is licensed to perform a total of 33 types of insurance activities. The insurance business underwritten by the Company includes medical, auto, marine third party liability, marine hull, property, casualty, life, personal insurance, insurance banking risks, mandatory fire insurance, insurance of liability for non-performance of obligations and reinsurance. The registered office of the Insurance Subsidiary is located at 40C, J.Jabbarli Street, Baku, AZ 1065, the Republic of Azerbaijan. Based on the decision of Supervisory Board of the Group dated April 4, 2014 the share capital of Insurance subsidiary was increased by AZN 6 million during the year ended December 31, 2014.

Azericard Limited, which is 100% owned by the Bank, was established as a limited liability company on May 3, 1996. Azericard Limited was registered with the Ministry of Justice of the Republic of Azerbaijan on July 4, 1996 and commenced its operations in 1997. Azericard Limited is a member service provider for MasterCard and Visa International and acts as a clearing and authorisation centre for plastic card transactions in the Republic of Azerbaijan.

Azericard Limited is at present one of the largest providers of authorisation of plastic cards operations and clearing services in the Republic of Azerbaijan. The registered office address of Azericard Limited is: Nizami Street, 67, AZ1005, Baku, the Republic of Azerbaijan.

On November 16, 2006, the Group registered its 75% owned subsidiary, International Bank of Azerbaijan Republic - Georgia ("IBA Georgia"), in Tbilisi, the Republic of Georgia. The share capital of IBA Georgia was established in the amount of 12,000,000 Georgian Laris ("GL"), with the non-controlling interest in the amount of GL 3,000,000 paid-in equally by an Azerbaijani commercial bank and a resident individual of the Republic of Georgia. IBA Georgia started its operations under a license issued by the National Bank of Georgia ("the NBG") on February 5, 2007. IBA Georgia's registered office is located at the following address: 36 Khetagurovi str., Tbilisi, Republic of Georgia. Based on the decision of Supervisory Board of the Group dated May 18, 2011, the share capital of IBA Georgia was increased by AZN 3,750 thousand during the year ended December 31, 2013, total increase in share capital was AZN 5,000 thousand, remaining part was paid by other shareholders of IBA Georgia.

These consolidated financial statements were authorized for issue on April 29, 2016 by the Board of Directors.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

### Other basis of presentation criteria

During the first half of 2015, Azerbaijan has been impacted by a number of adverse economic conditions including the continued decline in global oil prices.

In order to support the diversification of Azerbaijan's economy, strengthen its international compatibility and export potential, as well as to provide balance of payments sustainability, the CBAR on February 21, 2015 devalued the Azerbaijani Manat (AZN) against major trading currencies by approximately 34%. As a result, the new official exchange rate of AZN to the USD fell to AZN 1.05 per U.S. dollar, and AZN to the Euro fell to AZN 1.19 per Euro. As from this date, the CBAR plans to set a daily exchange rate for the AZN against a dual currency basket comprised of the USD and the Euro. On December 21, 2015, official exchange rate of AZN to U.S. dollar fell to AZN 1.55 per U.S. dollar, and the official exchange rate of AZN to the Euro fell to AZN 1.69 per Euro, i.e. by approximately 98% and 77%, respectively from the exchange rates at the December 31, 2014.

Two devaluations of local currency has induced increase in interest rates and in administrative expenses. The portion of performing loans was at the levels which was not adequately enough to generate necessary profit. In the context of these turbulent market conditions and due to a decline in the quality of assets, increase in problematic loans and decline in liquidity position of the Group, the Government of Azerbaijan has taken a number of steps to strengthen the Group's capital position and the quality of its assets.

In order to increase the capital of the Group the Bank has issued on March 29, 2015 189,240 thousand shares at a nominal value of AZN 51,095 thousand (see Note 22).

Following an in depth review of the asset quality and liquidity position of the Group by the Central Bank of Azerbaijan Republic (CBAR) and Ministry of Finance (MoF), the President of the Republic of Azerbaijan signed a decree on July 15, 2015, about measures to improve the health of assets specifically in connection with the preparation of the government owned shares of the International Bank of Azerbaijan for further privatization process ("Decree") (see Note 10). According to the Decree, for the purposes of improvement of the financial stability of the Bank, the problematic assets are to be transferred to Closed Joint Stock Company "Aqrarkredit", a Non-bank Credit Organisation ("Aqrarkredit" CJSC), controlled by the state. The MoF together with the Bank have subsequently determined the list of the problematic assets to be transferred to Aqrarkredit CJSC. The value of the transfer would be at full value including all on and off balance sheet exposure of the Group.

On July 22, 2015 at the Extraordinary Shareholders Meeting the shareholders appointed new Board Members to the Board of the Bank. Mr. Elmar Mammadov was appointed as the Chairman of the Board and Mr. Ulvi Mansurov and Mr. Murad Shiraliyev as Deputy Chairmen.

On August 11, 2015 IBA, Aqrarkredit, MoF and the CBAR signed a Master Agreement where they agreed in principle that IBA would transfer its portfolio to Aqrarkredit in a number of tranches over a number of years from 2015 to 2017. On July 28, 2015 the first "Transfer Agreement" was signed by IBA and Aqrarkredit where through cession, specific loans and amounts were agreed to be transferred to Aqrarkredit. On December 28, 2015 IBA received a Guarantee and Commitment letter from Aqrarkredit that it would reimburse IBA in line with the "Master Agreement" (noted above) for loans on the balance sheet of IBA and IBAM totalling AZN 5.7 billion. On 24 February 2016 the second "Transfer Agreement" was signed by IBA and Aqrarkredit where through cession, specific loans and amounts of both IBA and IBAM were listed and agreed to be transferred to Aqrarkredit.

The new Management team of the Group have developed a strategy of which the main objectives are to restructure the Group's foreign debt, to remove any existing capital shortages and furthermore to optimize the organizational structure of the Group. Based on the proposal of the Board of Directors and with the aim to increase operational efficiency, to avoid duplicative work and to optimize administrative expenses, the Bank's Supervisory Board has confirmed the new organizational structure. The strategy regarding the restructuring of foreign debt has been developed and negotiations with large borrowers has been initiated and new agreements are being put into force. The Group has also commenced its restructuring process including the transfer of problematic assets to Aqrarcredit and streamlining its operations in order that the Group returns to profitability.

Management believe that the above mentioned measures will ensure that the Group will continue as a going concern and accordingly these consolidated financial statements have been prepared on the assumption that the Group will continue in operation for the foreseeable future.

These consolidated financial statements are presented in thousands of Azerbaijan Manats ("AZN"), unless otherwise indicated. These consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments that are measured at revalued amounts or fair values, as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

The Bank and its consolidated companies, registered in the Republic of Azerbaijan, maintain their accounting records in accordance with local accounting practice, foreign consolidated companies of the Bank maintain their accounting records in accordance with the law of the countries, in which they operate. These consolidated financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS.

The Group presents its consolidated statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non–current) is presented in Note 30.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The functional currency of the parent of the Group is the Azerbaijani Manat ("AZN"). The presentation currency of the consolidated financial statements of the Group is the AZN. All values are rounded to the nearest thousand Manats, except when otherwise indicated.

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expense is not offset in the consolidated statement of comprehensive income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

The principal accounting policies are set out below.

**Basis of consolidation**

These consolidated financial statements incorporate the financial statements of the Bank and entities (including structured entities) controlled by the Bank and its subsidiaries. Control is achieved when the Bank:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Bank reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Bank has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Bank considers all relevant facts and circumstances in assessing whether or not the Bank's voting rights in an investee are sufficient to give it power, including:

- the size of the Bank's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Bank, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Bank has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Bank gains control until the date when the Bank ceases to control the subsidiary. Profit or loss and each component of other comprehensive income are attributed to the owners of the Bank and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Bank and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

**Non-controlling interests**

Non-controlling interests represent the portion of profit or loss and net assets of subsidiaries not owned, directly or indirectly, by the Bank.

Non-controlling interests are presented separately in the consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

**Recognition of interest income and expense**

Interest income and expense are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for debt instruments other than those financial assets classified as financial assets 'at fair value through profit or loss' (FVTPL).

Once a financial asset or a group of similar financial assets has been written down (partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest earned on assets at fair value is classified within interest income.

**Recognition of revenue – other**

<u>Recognition of fee and commission income</u>

Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in profit or loss over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in profit or loss on expiry. Loan servicing fees are recognized as revenue as the services are provided.

Loan syndication fees are recognized in profit or loss when the syndication has been completed. All other commissions are recognized when services are provided.

**Financial instruments**

The Group recognizes financial assets and liabilities in its consolidated statement of financial position when it becomes a party to the contractual obligations of the instrument. Regular way purchases and sales of financial assets and liabilities are recognized using settlement date accounting.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

***Financial assets***

Financial assets are classified into the following specified categories: 'FVTPL', 'held-to-maturity' investments, 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

***<u>Financial assets at FVTPL</u>***

Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling it in the near term; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the 'Net gain/loss on financial assets at fair value through profit or loss' line item in the consolidated statement of income statement. Fair value is determined in the manner described in Note 33.

***Held-to-maturity investments***

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method less any impairment.

If the Group were to sell or reclassify more than an insignificant amount of held–to–maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available–for–sale. Furthermore, the Group would be prohibited from classifying any financial asset as held to maturity during the following two years.

***Available-for-sale financial assets***

Available-for-sale financial assets are non-derivatives that are either designated as available-for-sale or are not classified as (a) loans and receivables, (2) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Listed shares and listed redeemable notes held by the Group that are traded in an active market are classified as AFS and are stated at fair value. Fair value is determined in the manner described in Note 33. Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve, with the exception of other-than-temporary impairment losses, interest calculated using the effective interest method, dividend income and foreign exchange gains and losses on monetary assets, which are recognised in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the end of the reporting period. The foreign exchange gains and losses that are recognised in profit or loss are determined based on the amortised cost of the monetary asset. Other foreign exchange gains and losses are recognised in other comprehensive income.

AFS equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

***Loans and receivables***

Trade receivables, loans, other debt securities, receivables from Aqrarkredit and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'.
Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

***Impairment of financial assets***

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For listed and unlisted equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a loan or a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

For financial assets measured at amortized cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income and accumulated under the heading of investments revaluation reserve. In respect of AFS debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

***Renegotiated loans***

Where possible, the Group 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. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually 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 effective interest rate.

***Write off of loans and advances***

Loans and advances are written off against the provision for loan impairment when deemed uncollectible.
Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Group and after the Group has sold all available collateral. Subsequent recoveries of amounts previously written off are reflected as an offset to the charge for impairment of financial assets in the consolidated statement of comprehensive income in the period of recovery.

***Derecognition of financial assets***

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

- Rights to receive cash flows from the asset has expired;
- The Group 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
- The Group 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.

A financial asset is derecognized when it has been transferred and the transfer qualifies for derecognition. A transfer required that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to receive the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group reassesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the statement of financial position. If substantially all of the risks and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether of not it has retained control of the asset. If it has not retained control, the asset is derecognized. Where the Group retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

**Financial liabilities and equity instruments issued**

***Classification as debt or equity***

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

***Equity instruments***

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognised at the proceeds received, net of direct issue costs.

Repurchase of the Bank's own equity instruments is recognized and deducted directly in equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Bank's own equity instruments.

***Financial liabilities***

Financial liabilities are classified as either financial liabilities 'at FVTPL' or 'other financial liabilities'.

***Financial liabilities at FVTPL***

Financial liabilities are classified as at FVTPL when the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- It has been acquired principally for the purpose of repurchasing it in the near term; or
- On initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability and is included in the 'other gains and losses' line item in the consolidated statement of income statement. Fair value is determined in the manner described in Note 33.

***Other financial liabilities***

Other financial liabilities, including depository instruments with the Central Bank of the Republic of Azerbaijan, deposits by banks and customers, debt securities issued, other borrowed funds and other liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

***Derecognition of financial liabilities***

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. 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. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.

***Financial guarantee contracts***

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by the Group are initially measured at their fair values and, if not designated as at FVTPL, are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets ; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

***Derivative financial instruments***

Forwards and futures. Forward and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Futures contracts are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements. The main differences in the risk associated with forward and futures contracts are credit risk and liquidity risk.
The Group has credit exposure to the counterparties of forward contracts. The credit risk related to future contracts is considered minimal because the cash margin requirements of the exchange help ensure that these contracts are always honoured. Forward contracts are settled gross and are, therefore, considered to bear a higher liquidity risk than the futures contracts which are settled on a net basis. Both types of contracts result in market risk exposure.

**Cash and cash equivalents**

Cash and cash equivalents are items, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. All short-term inter-bank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

**Mandatory cash balances held with the CBAR, CBRF and NBG**

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

**The Group as lessee**

Assets held under finance leases are initially recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognised immediately in profit or loss unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Group's general policy on borrowing costs. Contingent rentals are recognised as expenses in the periods in which they are incurred.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

**Repossessed assets**

In certain circumstances, assets are repossessed following the foreclosure on loans that are in default. Repossessed assets are measured at the lower of carrying amount and fair value less costs to sell.

**Premises and equipment**

Premises held for use in the production or supply of goods or services, or for administrative purposes, are stated in the consolidated statement of financial position at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair values at the end of each reporting period.

Any revaluation increase arising on the revaluation of such premises is recognised in other comprehensive income and accumulated in equity, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously expensed. A decrease in the carrying amount arising on the revaluation of such premises is recognised in profit or loss to the extent that it exceeds the balance, if any, held in the revaluation reserve for premises relating to a previous revaluation of that asset.
Properties in the course of construction for production, supply or administrative purposes are carried at cost, less any recognised impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Such properties are classified to the appropriate categories of premises and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Depreciation on revalued premises is recognised in profit or loss. On the subsequent sale or retirement of revalued premises, the attributable revaluation surplus remaining in the revaluation reserve for premises is transferred directly to retained earnings.

Freehold land is not depreciated.

Fixtures and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is recognised so as to write off the cost or valuation of assets (other than freehold land and properties under construction) less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

| | |
|---|---|
| Premises | 2% |
| Leasehold improvements | 10% |
| Office and computer equipment | 25% |
| Banking equipment, furniture, fixtures, vehicles and other | 10%-20% |

An item of premises and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of premises and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

**Intangible assets**

***Intangible assets acquired separately***

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over their estimated useful lives from one to four years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

***Derecognition of intangible assets***

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

**Impairment of non-financial assets**

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and definitely-lived intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

***Current tax***

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

***Deferred tax***

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

***Current and deferred tax for the year***

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

***Operating taxes***

Countries where the Group operates also have various other taxes, which are assessed on the Group's activities. These taxes are included as a component of operating expenses in the consolidated statement of comprehensive income.

**Provisions**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

**Contingencies**

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

**Insurance operations**

***Insurance contracts – classification***

The Group issues contracts that transfer insurance risks. Insurance contracts are those that transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur.

***Premiums***

Upon inception of the contract, the total premiums to be received over the term of the policy coverage are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. The reserve for unearned premiums represents the proportion of premiums written in the year that relate to unexpired terms of policies in force at the end of the reporting period, calculated on a time apportionment basis.

### *Losses*

Losses including loss adjustment expenses are charged to the consolidated statement of comprehensive income as incurred. Reserves for losses represent the accumulation of estimates for incurred losses and include two types of reserves: reserve for reported but not settled losses ("RBNS") and reserve for incurred but not reported losses ("IBNR"). RBNS reserve is calculated for each unsettled claim. The estimation is made on the basis of information received by the Group during investigation of insurance cases to be settled after the end of the reporting period.

If the amount of loss is not determined, the maximum possible amount of losses not exceeding the insurance limit, stated in the insurance policy, is accepted as RBNS. IBNR is established based on actuarial methods used to determine loss development patterns based on historic information, implied expected ultimate loss ratios and implied reported claims development factors. IBNR is calculated by the Group for each line of business; the calculation includes assumptions based on prior years' claims and claims handling experience. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. The methods of determining such estimates and establishing the resulting provisions are continually reviewed and updated.
Resulting adjustments are reflected in the consolidated statement of comprehensive income (as a decrease or increase in profit before tax) as they arise. Loss provision reserve is estimated on an undiscounted basis due to the relatively quick pattern of claims notification and payment.

### *Reinsurance*

The Group assumes and cedes reinsurance in the normal course of business. Ceded reinsurance contracts do not relieve the Group from its obligations to policyholders. Reinsurance receivables include balances due from reinsurance companies for paid claims, including claims handling expenses and premiums receivable ceded to the Group. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance payables are obligations of the Group for the transfer of reinsurance premiums to reinsurers.

### Fiduciary activities

The Group provides trustee services to its customers. The Group also provides depositary services to its customers which include transactions with securities on their depositary accounts. Assets accepted and liabilities incurred under the fiduciary activities are not included in the Group's financial statements. The Group accepts the operational risk on these activities, but the Group's customers bear the credit and market risks associated with such operations. Revenue for provision of trustee services is recognized as services are provided.

### Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the entity's functional currency (foreign currencies) are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are recognised in profit or loss in the period in which they arise except for:

- Exchange differences on foreign currency borrowings relating to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on those foreign currency borrowings;
- Exchange differences on transactions entered into in order to hedge certain foreign currency risks; and
- Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognised initially in other comprehensive income and reclassified from equity to profit or loss on repayment of the monetary items.

For the purposes of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into AZN using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity (attributed to non-controlling interests as appropriate).

On the disposal of a foreign operation (i.e. a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of control over a joint arrangement that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the exchange differences accumulated in equity in respect of that operation attributable to the owners of the Group are reclassified to profit or loss.

In the case of a partial disposal that does not result in the Group losing control over a subsidiary that includes a foreign operation, the proportionate share of accumulated exchange differences are re-attributed to non-controlling interests and are not recognised in profit or loss. For all other partial disposals (i.e. reductions in the Group's ownership interest in associates or joint arrangement that do not result in the Group losing significant influence or control), the proportionate share of the accumulated exchange differences is reclassified to profit or loss.
Goodwill and fair value adjustments on identifiable assets and liabilities acquired arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the rate of exchange prevailing at the end of each reporting period. Exchange differences arising are recognised in equity.

The exchange rates used by the Group in the preparation of the consolidated financial statements as at year-end are as follows:

| | **December 31, 2015** | **December 31, 2014** |
|---|---|---|
| AZN/1 US Dollar | 1.5594 | 0.7844 |
| AZN/1 Euro | 1.7046 | 0.9522 |
| AZN/1 Russian Rouble | 0.0216 | 0.0133 |

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

**Collateral**

The Group obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Group a claim on these assets for both existing and future customer liabilities.

Repossessed collateral is measured at the lower of their previous carrying amount and fair value less costs to sell.

**Additional paid-in capital**

Additional paid-in capital (sometimes referred to as capital in excess of par value) ("APIC") is the excess amount paid by an investor over the par value of a stock issue. In addition, non-stock-related contributions from an investor, such as cash or property, are normally reflected in APIC. APIC is shown as a separate caption in the equity section of the balance sheet.

**Equity reserves**

The reserves recorded in equity (other comprehensive income) on the Group's consolidated statement of financial position include:

- 'Cumulative translation reserve' which is used to record exchange differences arising from the translation of the net investment in foreign operations, net of the effects of hedging;
- 'Revaluation reserve for premises' which includes change in fair value of buildings.

**Investments in associates**

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting, except when the investment is classified as held for sale, in which case it is accounted for in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. Under the equity method, an investment in an associate is initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate.
When the Group's share of losses of an associate exceeds the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses.

Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of IAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate.
When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 Impairment of Assets as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

When a group entity transacts with its associate, profits and losses resulting from the transactions with the associate are recognised in the Group' consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

**Critical accounting judgements and key sources of estimation uncertainty**

In the application of the Group's accounting policies, which are described above, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

***Recognition of Aqrarkredit Receivable for Second Tranche***

On December 28, 2015 the Group received a guarantee from Aqrarkredit in relation to the acquisition of problematic assets from the Group up to 5.3 billion manats. This guarantee confirms the intention by Aqrarkredit to systematically acquire the problematic assets of the Group in compliance with the

President of Azerbaijan's decree dated July 15, 2015. On February 16, 2016 Aqrarkredit issued 4 billion manats of bonds to finance the acquisition of this second tranche of problematic assets from the Group. The bonds have subsequently been purchased by the Central Bank of Azerbaijan. Also as disclosed in Note 35 to the financial statements, the Group has received 1.0 billion manats from Aqrarkredit subsequent to the year end in respect of the first and second tranches and is expecting to receive full repayment of the second tranche by the end of June 2016.

The management of the Group have therefore concluded that the receipt of the guarantee from Aqrarkredit is virtually certain and as such have derecognised the problematic assets from their balance sheet on December 28, 2015 and recognised a discounted receivable from Aqrarkredit of 5.3 billion manats in respect of this second tranche.

***Receivables from Agrarkredit***

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| First tranche | 450,000 | - |
| Second tranche | 5,268,536 | - |
| Initial loss on fair value recognition of second tranche | (89,613) | - |
| **Total receivables from Aqrarkredit** | **5,628,923** | - |

Receivable from Aqrarkredit represent amounts to be received in respect of problematic assets and off-balance sheet commitments transferred in accordance with the President's decree.

On July 15, 2015 the President of Azerbaijan signed a directive that the Group should identify its problematic assets and transfer those assets to "Aqrarkredit" Closed Joint-Stock Non-Banking Credit Organization ("Aqrarkredit") over a period of time. The value of the transfer for each asset would be the aset's carrying value prior to any impairment provisions, as recorded in the books of the Group and including all on and off balance sheet exposure of the Group, as apporpriate.

On August 11, 2015 IBA, Aqrarkredit, Ministry of Finance and the Central Bank of Azerbaijan signed a Master Agreement where they agreed in principle that IBA would transfer its problematic assets to Aqrarkredit in a number of tranches over a number of years from 2015 to 2017. On July 28, 2015 the first "Transfer Agreement" was signed by IBA and Aqrarkredit where through cession, specific problematic assets were agreed to be transferred to Aqrarkredit within the first tranche.

On December 28, 2015 IBA received a Guarantee and Commitment letter from Aqrarkredit that it would reimburse IBA in line with the "Master Agreement" (noted above) for problematic assets on the balance sheets of IBA and IBA Moscow up to AZN 5.3 billion. On 24 February 2016 the second "Transfer Agreement" was signed by IBA and Aqrarkredit where through cession, specific problematic assets of both IBA and IBA Moscow were listed and agreed to be transferred to Aqrarkredit within the second tranche.

***Key sources of estimation uncertainty***

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

***Impairment of loans and receivables***

The Group regularly reviews its loans and receivables to assess for impairment. The Group's loan impairment provisions are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group considers accounting estimates related to allowance for impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses and actual losses would require the Group to record provisions which could have a material impact on its financial statements in future periods. The Group uses management's judgment to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on past performance, past customer behavior, observable data indicating an adverse change in the payment status of borrowers in a group, and 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. The Group uses management's judgment to adjust observable data for a group of loans to reflect current circumstances not reflected in historical data.The allowances for impairment of financial assets in the consolidated financial statements have been determined on the basis of existing economic and political conditions. The Group is not in a position to predict what changes in conditions will take place in the Republic of Azerbaijan and what effect such changes might have on the adequacy of the allowances for impairment of financial assets in future periods.

As at December 31, 2015 and 2014 the gross loans and receivables totaled AZN 6,557,376 thousand and AZN 8,704,795 thousand, respectively, and provision for loan impairment amounted to AZN 921,793 thousand and AZN 849,804 thousand, respectively.

***Valuation of financial instruments***

As described in Note 33, the Bank uses valuation techniques that include inputs that are not based on observable market date to estimate the fair value of certain types of financial instruments. Note 33 provides detailed information about the key assumptions used in the determination of the fair value of financial instruments, as well as the detailed sensitivity analysis for these assumptions. The directors believe that the chosen valuation techniques and assumptions used are appropriate in determining the fair value of financial instruments.

***Recognition of Receivables from Aqrarkredit***

On December 28, 2015 the Group received a guarantee from Aqrarkredit in relation to the acquisition of problematic assets from the Group amounting to 5.3 billion manats. This guarantee again confirmed the intention by Aqrarkredit to systematically acquire the problematic assets of the Group in compliance with the President of Azerbaijan's decree dated July 15, 2015. On February 16, 2016 Aqrarkredit issued 4 billion manats of bonds to finance the acquisition of this tranche of problematic assets from the Group. The bonds have subsequently been taken up by the Government of Azerbaijan. Also as disclosed in Note 35 to the financial statements the Group has received 990 million manats from Aqrarkredit subsequent to the year end.

The management of the Group have therefore concluded that the receipt of the guarantee from Aqrarkredit is virtually certain and as such have derecognised the problematic assets from their balance sheet on December 28, 2015 and recognised a receivable from Aqrarkredit of 5.3 billion manats.

***Useful lives of property and equipment***

As described above, the Group reviews the estimated useful lives of premises and equipment at the end of each annual reporting period.

***Premises carried at revalued amounts***

Premises are measured at revalued amounts. The date of the latest appraisal was June 30, 2013. The next revaluation is preliminary scheduled as at June 30, 2016. The carrying value of revalued property amounted to AZN 92,360 thousand and AZN 72,162 thousand as at December 31, 2015 and 2014, respectively.

***Other borrowed funds***

Management has considered whether gains or losses should arise on initial recognition of loans from international financial institutions in the amount of AZN 2,262,979 thousand as at December 31, 2015 (December 31, 2014: AZN 1,563,366 thousand) and related lending. The Bank obtains long term financing from international financial institutions at interest rates, at which such institutions ordinarily lend in emerging markets and which may be lower than rates, at which the Bank could source the funds from local lenders. The amount of such borrowings as at December 31, 2015 was AZN 236,674 thousand (December 31, 2014: AZN 240,510 thousand). As a result of such financing, the Bank is able to advance funds to specific customers at advantageous rates. As the transactions are with unrelated parties, management's judgement is that these funds and the related lending are at the market interest rates and no initial recognition of gains or losses should arise. In making this judgement management also considered that these instruments are a separate market segment.

***Loans at low interest rates***

Management has considered the appropriate market interest rate for certain loans and advances where the contractual interest rate is 5% or lower. The amount of such loans as at December 31, 2015 was AZN 633,449 thousand (December 31, 2014: 5% or lower - AZN 272,267 thousand). Management has assessed that the contractual interest rates for these loans are equivalent to the alternative highest and best use of the funds provided under these loans, the majority of which are with Government bodies and state-owned entities. Had management concluded that the interest rates for these borrowings were different to the highest and best use of the funds provided, then the carrying amounts in respect of these loans in the consolidated financial statements, and the amounts recorded within interest income and losses on the origination of loans, would have been different.

***Tax legislation***

Azerbaijani, Russian and Georgian tax, currency and customs legislation is subject to varying interrelations. Refer to Note 32.

***Initial recognition of related party transactions***

In the normal course of business the Group enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis. The information on related party balances is disclosed in Note 34,

***Capital Adequacy ratio***

Capital Adequacy Ratio is calculated in accordance with the International Convergence of Capital Measurement and Capital Standards (July 1988, updated to November 2005) (or Basel Capital Accord) requirements. Such requirements are subject to interpretation and accordingly the appropriateness of the inclusion, exclusion, and/or classification of amounts included in the calculation of the Capital Adequacy Ratio requires management judgment, for example, whether the off-balance sheet commitments covered by blocked customer accounts would carry 0% risk for the purposes of calculating total risk-weighted assets. Currently, management believes that such off-balance sheet commitments carry 0% risk for the capital adequacy calculation purposes.

***Liquidity mismatch***

As disclosed in Note 30 to these consolidated financial statements, the Group has a cumulative negative liquidity gap up to twelve months as at December 31, 2015 and as at December 31, 2014. Management is confident that the Group will be able to obtain required funds in order to replace attracted liabilities with duration of up to twelve months. In particular, management believes that the continued support of its shareholders and access to borrowings from international financial institutions means that the Group would be able to obtain appropriate resources should all liabilities require settlement as disclosed in Note 30.

## 3. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)

The Group has adopted the following new or revised standards and interpretations issued by International Accounting Standards Board and the International Financial Reporting Interpretations Committee (the IFRIC) which became effective for the Group's annual consolidated financial statement for the year ended December 31, 2015:

***Amendments to IFRSs affecting amounts reported in the financial statements.***

In the current year, the following new and revised Standards and Interpretations have been adopted and have not affected the amounts reported in these consolidated financial statements.

- Amendments to IAS 19 - *Defined Benefit Plans: Employee contributions*;
- Annual Improvements to IFRSs 2010-2012 Cycle;
- Annual Improvements to IFRSs 2011-2013 Cycle;

**Amendments to IAS 19 – *Defined Benefit Plans: Employee contributions.*** The amendments require the Group to account for employee contributions as follows:
Discretionary employee contributions are accounted for as reduction of the service cost upon payments to the plans.

Employee contributions specified in the defined benefit plans are accounted for as reduction of the service cost, only if such contributions are linked to services. Specifically, when the amount of such contribution depends on the number of years of service, the reduction to service cost is made by attributing the contributions to periods of service in the same manner as the benefit attribution. On the other hand, when such contributions are determined based on a fixed percentage of salary (i.e. independent of the number of years of service), the Group should recognise the reduction in the service cost in the period in which the related services are rendered.

These amendments do not have any effect on the Group's consolidated financial statements as the Group does not have any Defined Benefit Plans.

**Annual Improvements to IFRSs 2010-2012 Cycle.** The Annual Improvements to IFRSs 2010-2012 Cycle include a number of amendments to various IFRSs, which are summarized below.

The amendments to IFRS 2 change the definition of 'vesting condition' and 'market condition' and add definitions for 'performance condition' and 'service condition' which were previously included within the definition of 'vesting condition'.

The amendments to IFRS 3 clarify that contingent consideration that is classified as an asset or liability should be measured at fair value at each reporting date, irrespective of whether the contingent consideration is a financial instrument within the scope of IAS 39 or IFRS 9 or a non-financial asset or liability.

The amendments to IFRS 8 require an entity to disclose the judgements made by management in applying the aggregation criteria to operating segments and clarify that a reconciliation of the total of the reportable segments' assets to the entity's assets should only be provided if the segment assets are regularly provided to the chief operating decision-maker.

The amendments to the basis for conclusions of IFRS 13 clarify that the issue of IFRS 13 and consequential amendments to IAS 39 and IFRS 9 did not remove the ability to measure short-term receivables and payables with no stated interest rate at their invoice amounts without discounting, if the effect of discounting is immaterial.
These amendments are considered to be effective immediately.

The amendments to IAS 16 and IAS 38 remove perceived inconsistencies in the accounting for accumulated depreciation/ amortisation when an item of property, plant and equipment or an intangible asset is revalued. The amended standards clarify that the gross carrying amount is adjusted in a manner consistent with the revaluation of the carrying amount of the asset and that accumulated depreciation/ amortisation is the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses.

The amendments to IAS 24 clarify that a management entity providing key management personnel services to a reporting entity is a related party of the reporting entity. Consequently, the reporting entity should disclose as related party transactions the amounts incurred for the service paid or payable to the management entity for the provision of key management personnel services. However, disclosure of the components of such compensation is not required.

These amendments do not have a significant effect on the consolidated financial statements.

**Annual Improvements to IFRSs 2011-2013 Cycle.** The Annual Improvements to IFRSs 2011-2013 Cycle include the following amendments to various IFRSs.

The amendments to IFRS 3 clarify that the standard does not apply to the accounting for the formation of all types of joint arrangement in the financial statements of the joint arrangement itself.

The amendments to IFRS 13 clarify that the scope of portfolio exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis includes all contracts that are within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, even if those contracts do not meet the definitions of a financial assets or financial liabilities within IAS 32.

The amendments to IAS 40 clarify that IAS 40 and IFRS 3 are not mutually exclusive and application of both standards may be required. Consequently, an entity acquiring investment property must determine whether the property meets the definition of investment property in terms of IAS 40, and whether the transaction meets the definition of a business combination under IFRS 3.

The application of these amendments does not have a significant effect on the consolidated financial statements.

The Group did not early adopt any other standard, amendment or interpretation that has been issued and is not yet effective.

***New and revised IFRSs in issue but not yet effective***

The Group has not applied the following new and revised IFRSs that have been issued but are not yet effective:

- IFRS 9 *Financial Instruments*[2];
- •IFRS 14 Regulatory Deferral Accounts1;
- •IFRS 15 Revenue from Contracts with Customers2;
- •IFRS 16 Leases
- • Amendments to IFRS 11 - Accounting for Acquisition of Interests in Joint Operations1;
- •Amendments to IAS 1 – Disclosure initiative project1;
- • Amendments to IAS 16 and IAS 38 - Clarification of Acceptable Methods of Depreciation and Amortisation1;
- • Amendments to IAS 16 and IAS 41 - Agriculture: Bearer Plants1;
- • Amendments to IAS 27 - Equity Method in Separate Financial Statements1;
- • Amendments to IFRS 10 and IAS 28 - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture1;
- • Amendments to IFRS 10, IFRS 12 and IAS 28 - Investment Entities: Applying the Consolidation Exception1
- •Annual Improvements to IFRSs 2012-2014 Cycle[1];

*1 Effective for annual periods beginning on or after 1 January 2016, with earlier application permitted.*

*2 Effective for annual periods beginning on or after 1 January 2019, with earlier application permitted.*

**IFRS 9 *Financial Instruments.*** IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting.

In July 2014 IASB issued a finalised version of IFRS 9 mainly introducing impairment requirements for financial assets and limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments. IFRS 9 is aiming at replacing IAS 39 Financial Instruments: Recognition and Measurement.
Key requirements of IFRS 9:

- **Classification and measurement of financial assets**. Financial assets are classified by reference to the business model within which they are held and their contractual cash flow characteristics. Specifically, debt instruments that are held within the business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost after initial recognition. The 2014 version of IFRS 9 introduces a 'fair value through other comprehensive income' category for debt instruments held within the business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms of the financial asset giving rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding which are measured at fair value through other comprehensive income after initial recognition. All other debt and equity investments are measured at their fair values. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.

- **Classification and measurement of financial liabilities.** Financial liabilities are classified in a similar manner to under IAS 39, however there are differences in the requirements applying to the measurement of an entity's own credit risk. IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss.
- **Impairment**. The 2014 version of IFRS 9 introduces an 'expected credit loss' model for the measurement of the impairment of financial assets, as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before a credit loss is recognized.
- **Hedge accounting**. The new general hedge accounting requirements retain the three types of hedge accounting mechanisms currently available in IAS 39. Under IFRS 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.
- **Derecognition**. The requirements for the derecognition of financial assets and liabilities are carried forward from IAS 39.

The standard is effective from 1 January 2018 with early application permitted. Depending on the chosen approach to applying IFRS 9, the transition can involve one or more than one date of initial application for different requirements.

The management of the Group anticipates that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the Group's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

**IFRS 14 *Regulatory Deferral Accounts***. IFRS 14 permits an entity which is a first-time adopter of International Financial Reporting Standards to continue to account, with some limited changes, for 'regulatory deferral account balances' in accordance with its previous GAAP, both on initial adoption of IFRS and in subsequent financial statements. The application of IFRS 14 will not have any impact on the Group's financial statements in the future as the Group is not an IFRS first-time adopter.

***IFRS 15 Revenue from Contracts with Customers***. In May 2014, IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. Specifically, the standard provides a single, principles based five-step model to be applied to all contracts with customers.

The five steps in the model are as follows:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contracts;
- Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises revenue when or as a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added on topics such as the point in which revenue is recognised, accounting for variable consideration, costs of fulfilling and obtaining a contract and various related matters. Furthermore, extensive disclosures are required by IFRS 15

The management of the Group anticipates that the application of IFRS 15 in the future may have an impact on amount and timing of revenue recognition. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

**Amendments to IFRS 11 – *Accounting for Acquisitions of Interests in Joint Operations*.** The amendments to IFRS 11 provide guidance on how to account for the acquisition of a joint operation that constitutes a business as defined in IFRS 3 Business Combinations. Specifically, the amendments state that the relevant principles on accounting for business combinations in IFRS 3 and other standards (e.g. IAS 12 Income Taxes regarding the recognition of deferred taxes at the time of acquisition and IAS 36 Impairment of Assets regarding impairment testing of a cash-generating unit to which goodwill on acquisition of a joint operation has been allocated) should be applied.
The same requirements should be applied to the formation of a joint operation if and only if an existing business is contributed to the joint operation by one of the parties that participate in the joint operation.

A joint operator is also required to disclose the relevant information required by IFRS 3 and other standards for business combinations.

The amendments should be applied prospectively to acquisitions of interests in joint operations (in which the activities of the joint operations constitute businesses as defined in IFRS 3) occurring from the beginning of annual periods beginning on or after 1 January 2016. The management of the Group anticipates that the application of these amendments to IFRS 11 may have an impact on the Group's consolidated financial statements in future periods should such transactions arise.

**Amendments to IAS 1 – *Disclosure initiative project*.** The amendments clarify the principles of disclosing information. The definition of materiality is expanded. It specifies the requirements of aggregation and disaggregation of data, clarifies that materiality applies to all parts of financial statements and even in those cases when the standards require specific disclosures materiality criteria do apply. The standard also provides more guidance on presenting the information in the statement of financial position and statement of comprehensive income as well as on the order of the notes in the financial statements.

The amendments to IAS 1 are effective for annual periods beginning on or after 1 January 2016. The management of the Group does not anticipate that the application of these amendments to IAS 1 will have a material impact on the Group's consolidated financial statements.

**Amendments to IAS 16 and IAS 38 – *Clarification of Acceptable Methods of Depreciation and Amortisation*.** The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortisation of an intangible asset. This presumption can only be rebutted in the following two limited circumstances:

a.when the intangible asset is expressed as a measure of revenue; or

b.when it can be demonstrated that revenue and consumption of the economic benefits of the intangible asset are highly correlated.

The amendments apply prospectively for annual periods beginning on or after 1 January 2016. Currently, the Group uses the straight-line method for depreciation and amortisation for its property, plant and equipment, and intangible assets respectively. The management of the Group believes that the straight-line method is the most appropriate method to reflect the consumption of economic benefits inherent in the respective assets and accordingly does not anticipate that the application of these amendments to IAS 16 and IAS 38 will have a material impact on the Group's consolidated financial statements.

**Amendments to IAS 16 and IAS 41 – *Agriculture: Bearer Plants*.** The amendments to IAS 16 and IAS 41 define a bearer plant and require biological assets that meet the definition of a bearer plant to be accounted for as a property, plant and equipment in accordance with IAS 16, instead of IAS 41. The produce growing on bearer plants continues to be accounted for as agricultural produce in accordance with IAS 41.

The management of the Group does not expect any impact on adoption of these amendments on the consolidated financial statements as the Group is not engaged in agricultural activities.

**Amendments to IAS 27 – *Equity Method in Separate Financial Statements*.** The amendments to IAS 27 allows entities to apply the equity method as one of the option for accounting for its investments in subsidiaries, joint ventures and associates in its separate financial statements. The amendments are effective from 1 January 2016 with earlier application permitted. The management of the Group does not expect any impact of these amendments on the financial statements as the Company does not prepare its separate financial statements.

**Amendments to IFRS 10 and IAS 28 – *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*.** The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture.
Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The amendments should be applied prospectively to transactions occurring in annual periods beginning on or after 1 January 2016. The management of the Group anticipates that the application of these amendments to IFRS 10 and IAS 28 may have an impact on the Group's consolidated financial statements in future periods should such transactions arise.

**Amendments to IFRS 10, IFRS 12 and IAS 28 *Investment Entities:*** The amendments to IFRS 10, IFRS 12 and IAS 28 clarify that the exemption from preparing consolidated financial statements is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all its subsidiaries at fair value in accordance with IFRS 10. The amendments also clarify that the requirement for an investment entity to consolidate a subsidiary providing services related to the former's investment activities applies only to subsidiaries that are not investment entities themselves.

The management of the Group does not anticipate that the application of these amendments to IFRS 10, IFRS 12 and IAS 28 will have a material impact on the Group's consolidated financial statements as the Group is not an investment entity and does not have any holding company, subsidiary, associate or joint venture that qualifies as an investment entity.

**Annual Improvements to IFRSs 2012-2014 Cycle.** The Annual Improvements to IFRSs 2012-2014 Cycle include the following amendments to various IFRSs.

The amendments to IFRS 5 clarify that reclassification of an asset or a disposal group from held for sale to held to distribution to owners or vice versa should not be considered changes to a plan of sale or a plan of distribution to owners and that the classification, presentation and measurement requirements applicable to the new method of disposal should be applied.
In addition, amendments clarify that assets that no longer meet the criteria for held for distribution to owners and do not meet the criteria for held for sale should be treated in the same way as assets that cease to be classified as held for sale. The amendments should be applied prospectively.

The amendments to IFRS 7 provide additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset for the purposes of the disclosures required in relation to transferred assets. In addition, amendments to IFRS 7 were made to clarify that the disclosure requirements on offsetting financial assets and financial liabilities are not explicitly required to be included in the condensed interim financial statements for all interim periods, however, the disclosures may need to be included in condensed interim financial statements to comply with IAS 34. The amendments should be applied retrospectively.

The amendments to IAS 19 clarify that the high quality corporate bonds used to estimate the discount rate for post-employment benefits should be issued in the same currency as the benefits to be paid. The amendments apply from the beginning of the earliest comparative period presented in the financial statements in which the amendments are fist applied.

The amendments to IAS 34 clarify that information required by IAS 34 that is provided elsewhere within the interim financial report but outside the interim financial statements should be incorporated by way of a cross-reference from the interim financial statements to the other part of the interim financial report that is available to users on the same terms and at the same time as the interim financial statements.

The management of the Group does not anticipate that the application of these amendments will have a significant effect on the consolidated financial statements.

## 4. CASH AND CASH EQUIVALENTS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Cash on hand | 304,829 | 191,143 |
| Cash balances with the National/Central banks (other than mandatory reserve deposits) | 1,101,289 | 108,142 |
| Correspondent accounts and overnight placements with other banks | | |
| - The Republic of Azerbaijan | 298 | 2,641 |
| - Other countries | 191,280 | 291,269 |
| **Total cash and cash equivalents** | **1,597,696** | **593,195** |

Included in cash balances with the National/Central banks (other than mandatory reserve deposits) are the balances on correspondent accounts of the Bank and its subsidiaries, IBA Moscow and IBA Georgia, with the CBAR, CBRF and NBG amounting to AZN 1,064,024 thousand, AZN 36,080 thousand and AZN 1,185 thousand as at December 31, 2015 (December 31, 2014: AZN 88,762 thousand, AZN 18,999 thousand and AZN 381 thousand), respectively.

As at December 31, 2015 overnight placement with other banks was AZN Nil (December 31, 2014: overnight placement with other banks was AZN 97,266 thousand).The analysis by credit quality of the cash and cash equivalents as at December 31, 2015 is as follows:

| | Cash balances with the National/Central banks | Correspondent accounts and overnight placements with other banks | Total |
|---|---|---|---|
| Current and not impaired: | | | |
| - Central Bank of the Republic of Azerbaijan | 1,064,024 | - | 1,064,024 |
| - Central Bank of the Russian Federation | 36,080 | - | 36,080 |
| - National Bank of the Republic of Georgia | 1,185 | - | 1,185 |
| Credit ratings of counterparty banks: | - | | - |
| - AAA | - | - | - |
| - AA | - | 95 | 95 |
| - A | - | 178,597 | 178,597 |
| - BBB | - | 7,638 | 7,638 |
| - <BBB | - | 2,119 | 2,119 |
| - not rated | - | 3,129 | 3,129 |
| **Total current and not impaired cash and cash equivalents, excluding cash on hand** | **1,101,289** | **191,578** | **1,292,867** |

As of year-end 2015, international rating for the Republic of Azerbaijan is BBB-/Stable (Fitch Ratings - issued on March 16, 2015), for the Russian Federation is BBB-/Negative (Fitch Ratings - issued on November 18, 2015) and for the Republic of Georgia is BB-/stable (Fitch Ratings - issued on October 16, 2015).

The analysis by credit quality of the cash and cash equivalents as at December 31, 2014 is as follows:

| | Cash balances with the National/Central banks | Correspondent accounts and overnight placements with other banks | Total |
|---|---|---|---|
| Current and not impaired: | | | |
| - Central Bank of the Republic of Azerbaijan | 88,762 | - | 88,762 |
| - Central Bank of the Russian Federation | 18,999 | - | 18,999 |
| - National Bank of the Republic of Georgia | 381 | - | 381 |
| Credit ratings of counterparty banks: | - | | |
| - AAA | - | - | - |
| - AA | - | 2,950 | 2,950 |
| - A | - | 187,222 | 187,222 |
| - BBB | - | 62,416 | 62,416 |
| - <BBB | - | 39,665 | 39,665 |
| - not rated | - | 1,657 | 1,657 |
| **Total current and not impaired cash and cash equivalents, excluding cash on hand** | **108,142** | **293,910** | **402,052** |

In the above tables for an analysis of credit quality of cash and cash equivalents, the management listed the classes of the banks in the order from highest to lowest credit quality as used for the purposes of internal monitoring and assessment.

Geographical, currency, liquidity and interest rate analyses of cash and cash equivalents are disclosed in Note 30. The information on related party balances is disclosed in Note 34.

## 5. DUE FROM OTHER BANKS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Term placements with other banks | 163,062 | 313,934 |
| Less: provision for impairment | (61,034) | (10,295) |
| **Total due from other banks** | **102,028** | **303,639** |

As at December 31, 2015 term placements with other banks included twelve short-term foreign currency denominated placements with non-resident banks in the total amount equivalent to AZN 36,159 thousand at annual interest rates ranging from 0.0% to 9%.
Term placements mature in January 2016 (December 31, 2014: 19 short-term foreign currency denominated placements with non-resident banks in the total amount equivalent to AZN 171,313 thousand at annual interest rates of 0.0% and 8%, respectively. Term placements mature in January and November 2015).

As at December 31, 2015 and 2014 the Group had balances due from one bank with individual exposure exceeding 10% of the Group's equity.

The analysis by credit quality of amounts due from other banks outstanding as at December 31, 2015 is as follows:

| | Term placements with other banks |
|---|---|
| Current and not impaired | |
| - BBB rated | - |
| - <BBB rated | 26,698 |
| - not rated | 34,060 |
| Total current and not impaired | 60,758 |
| *Balances individually assessed for impairment (gross)* | |
| Less than 30 days overdue | 7,804 |
| 31-60 | 5,420 |
| 61-90 | 775 |
| 91-120 | 5,250 |
| 121-150 | 21,740 |
| 181-360 | 17,363 |
| - over 360 days overdue | 43,952 |
| Total balances individually assessed for impairment (gross) | 102,304 |
| Less: provision for impairment | (61,034) |
| **Total due from other banks** | **102,028** |

The analysis by credit quality of amounts due from other banks outstanding as at December 31, 2014 is as follows:

| | Term placements with other banks |
|---|---|
| Current and not impaired | |
| - BBB rated | 11,796 |
| - <BBB rated | 93,117 |
| - not rated | 168,000 |
| Total current and not impaired | 272,913 |
| *Balances individually assessed for impairment (gross)* | |
| - over 360 days overdue | 41,021 |
| Total balances individually assessed for impairment (gross) | 41,021 |
| Less: provision for impairment | (10,295) |
| **Total due from other banks** | 303,639 |

In the above tables for an analysis of credit quality of due from other banks, the management listed the classes of the banks in the order from highest to lowest credit quality as used for the purposes of internal monitoring and assessment.

The primary factor that the Group considers whether a due from other banks balance is impaired is its overdue status. As a result, the Group presented the above ageing analysis of deposits that are individually determined to be impaired.

Movements in the provision for impairment of due from other banks were as follows:

| | Due from other banks |
|---|---|
| **December 31, 2013** | 4,121 |
| Additional provisions recognized | 6,174 |
| **December 31, 2014** | **10,295** |
| Additional provisions recognized | 50,739 |
| **December 31, 2015** | **61,034** |

The carrying value and fair value of due from other banks is disclosed in Note 33.

Geographical, currency, liquidity and interest rate analyses of due from other banks is disclosed in Note 30.

## 6. LOANS AND ADVANCES TO CUSTOMERS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Corporate loans | 5,287,915 | 7,650,654 |
| State and public organisations | 47 | 419 |
| Loans to individuals – consumer loans | 686,600 | 520,557 |
| Loans to individuals – mortgage loans | 395,307 | 263,064 |
| Loans to individuals – purchase of motor vehicles | 60,262 | 61,601 |
| Loans to individuals – employees | 13,107 | 94,104 |
| Loans to individuals – other purposes | 114,138 | 114,396 |
| | 6,557,376 | 8,704,795 |
| Less: provision for loan impairment | (921,793) | (849,804) |
| **Total loans and advances to customers** | 5,635,583 | 7,854,991 |

Movements in the provision for loan impairment during 2015 are as follows:

| | Provision for loan impairment as at January 1, 2015 | Increase in/ (recovery of) provision for impairment during the year | On disposal to Aqrarkredit | Effect of foreign currency exchange recognized | Provision for loan impairment as at December 31, 2015 |
|---|---|---|---|---|---|
| Corporate loans | 762,224 | 840,123 | (774,879) | (75,900) | 751,568 |
| State and public organisations | 111 | (99) | - | - | 12 |
| Loans to individuals – consumer loans | 62,382 | 85,229 | (9,138) | (15,955) | 122,518 |
| Loans to individuals – mortgage loans | 4,208 | 5,296 | - | (90) | 9,414 |
| Loans to individuals – employees | 6,434 | (2,307) | - | (149) | 3,978 |
| Loans to individuals – purchase of motor vehicles | 689 | 8,284 | - | (9) | 8,964 |
| Loans to individuals – other purposes | 13,756 | 11,993 | - | (410) | 25,339 |
| **Total** | 849,804 | 948,519 | (784,017) | (92,513) | 921,793 |

Movements in the provision for loan impairment during 2014 are as follows:

| | Provision for loan impairment as at 1 January, 2014 | Increase in/ (recovery of) provision for impairment during the year | Effect of foreign currency exchange recognized | Provision for loan impairment as at December 31, 2014 |
|---|---|---|---|---|
| Corporate loans | 619,694 | 196,654 | (54,124) | 762,224 |
| State and public organisations | 207 | (78) | (18) | 111 |
| Loans to individuals – consumer loans | 69,275 | (842) | (6,051) | 62,382 |
| Loans to individuals – mortgage loans | 4,364 | 225 | (381) | 4,208 |
| Loans to individuals – employees | 2,756 | 3,919 | (241) | 6,434 |
| Loans to individuals – purchase of motor vehicles | 378 | 344 | (33) | 689 |
| Loans to individuals – other purposes | 16,991 | (1,751) | (1,484) | 13,756 |
| **Total** | 713,665 | 198,471 | (62,332) | 849,804 |

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

| | December 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Construction and real estate development | 2,012,175 | 30.7 | 3,391,931 | 39.0 |
| Trade and service | 1,549,585 | 23.6 | 1,932,875 | 22.2 |
| Individuals | 1,269,414 | 19.4 | 1,053,722 | 12.1 |
| Manufacturing | 946,525 | 14.4 | 1,849,879 | 21.3 |
| Railroad and other transportation | 499,630 | 7.6 | 243,018 | 2.8 |
| Oil and gas sector, power production and distribution | 99,388 | 1.5 | 84,427 | 1.0 |
| Air transportation | 62,952 | 1.0 | 59,254 | 0.7 |
| Leasing companies | 20,008 | 0.3 | 18,074 | 0.2 |
| Communication | 16,725 | 0.3 | 14,885 | 0.2 |
| State and public organisations* | 47 | 0.0 | 419 | - |
| Other | 80,927 | 1.2 | 56,311 | 0.5 |
| **Total loans and advances to customers (before impairment)** | 6,557,376 | 100.0 | 8,704,795 | 100.0 |

*(*) State and public organisations include ministries, the Treasury and other state bodies of the Republic of Azerbaijan, excluding profit making state and public organisations that are included in the respective categories.*

Included in the gross amount of total loans and advances to customers as at December 31, 2015, are the loans granted to thirty companies amounting to AZN 3,968,214 thousand (December 31, 2014: to thirty companies amounting to AZN 3,527,364 thousand) and representing a concentration of 61% (December 31, 2014: 40.5%) of the total loan portfolio of the Group.

As at December 31, 2015 and 2014 the Group granted loans to 13 and 17 customers/group of related customers, totaling AZN 3,175,510 thousand and AZN 2,755,941 thousand, respectively, which individually exceeded 10% of the Group's equity.

Included in the gross amount of total loans and advances to customers as at December 31, 2015, are the loans granted to government institutions and state enterprises of the Republic of Azerbaijan amounting to AZN 437,553 thousand (December 31, 2014: AZN 246,859 thousand) and representing 6.1% (December 31, 2014: 2.8%) of the total loan portfolio of the Group.

Included in the gross amount of total loans and advances to customers as at December 31, 2015, are loans granted to 32 borrowers amounting to AZN 633,449 thousand (December 31, 2014: 15 borrowers, AZN 272,267 thousand) with interest rates being less than or equal to 5% (December 31, 2014: less than or equal to 5%) and representing 9.6% (December 31, 2014: 2.2%) of the total gross loan portfolio of the Group. No adjustments have been made to the contractual interest rates in relation to these amounts on initial recognition at fair value as the interest rates applicable are considered to represent the highest and best use of the funds provided given the alternative uses by the Bank of the funds extended under these agreements.

Included in the gross amount of total loans to individuals as at December 31, 2015 are outstanding balances drawn on credit cards of AZN 176,151 thousand (December 31, 2014: AZN 128,070 thousand).

The table below summarizes total amount of loans to customers before provision for impairment by type of collateral, rather than the fair value of collateral itself as at December 31, 2015 is as follows:

| | Corporate loans | State and public organisations | Loans to individuals - consumer loans | Loans to individuals - mortgage loans | Loans to individuals – employees | Loans to individuals - purchase of motor vehicles | Loans to individuals - other purposes | Total |
|---|---|---|---|---|---|---|---|---|
| Unsecured loans | 1,498,754 | 47 | 293,884 | 35,984 | 8,129 | 1,717 | 68,897 | 1,907,412 |
| Loans collateralised by: | | | | | | | | |
| - real estate | 1,404,188 | - | 39,833 | 76,053 | 2,218 | 6 | 40,072 | 1,562,370 |
| - corporate guarantee | 1,428,205 | - | 230,665 | 282,366 | 373 | - | 63 | 1,941,672 |
| - cash deposits | 35,209 | - | 93,222 | 862 | 60 | 8 | 2,255 | 131,616 |
| - movable property and equipment | 871,379 | - | 664 | - | 62 | 58,487 | 2,197 | 932,789 |
| - other | 50,180 | - | 28,332 | 42 | 2,265 | 44 | 654 | 81,517 |
| **Total loans and advances to customers** | **5,287,915** | **47** | **686,600** | **395,307** | **13,107** | **60,262** | **114,138** | **6,557,376** |

The table below summarizes total amount of loans to customers before provision for impairment by type of collateral, rather than the fair value of collateral itself as at December 31, 2014 is as follows:

| | Corporate loans | State and public organisations | Loans to individuals - consumer loans | Loans to individuals - mortgage loans | Loans to individuals – employees | Loans to individuals - purchase of motor vehicles | Loans to individuals - other purposes | Total |
|---|---|---|---|---|---|---|---|---|
| Unsecured loans | 795,982 | 380 | 214,344 | 52,657 | 7,707 | 1,050 | 24,470 | 1,096,590 |
| Loans collateralised by: | | | | | | | | |
| - real estate | 3,451,341 | - | 45,458 | 74,666 | 1,335 | 10 | 46,272 | 3,619,082 |
| - corporate guarantee | 1,052,218 | - | 169,275 | 134,616 | 1,238 | - | 25 | 1,357,372 |
| - cash deposits | 122,459 | - | 54,166 | 1,104 | 2,137 | 9 | 4,910 | 184,785 |
| - movable property and equipment | 2,117,861 | - | 2,707 | - | 55 | 60,506 | 2,958 | 2,184,087 |
| - other | 110,793 | 39 | 34,607 | 21 | 81,632 | 26 | 35,761 | 262,879 |
| **Total loans and advances to customers** | **7,650,654** | **419** | **520,557** | **263,064** | **94,104** | **61,601** | **114,396** | **8,704,795** |

The analysis by credit quality of loans outstanding as at December 31, 2015 is as follows:

| | Corporate loans | State and public organisations | Loans to individuals - consumer loans | Loans to individuals - mortgage loans | Loans to individuals – employees | Loans to individuals - purchase of motor vehicles | Loans to individuals - other purposes | Total |
|---|---|---|---|---|---|---|---|---|
| *Current and not impaired* | | | | | | | | |
| Secured loans | 2,465,173 | - | 513,255 | 357,871 | 4,696 | 35,081 | 18,426 | 3,394,502 |
| Unsecured loans | 1,200,022 | - | 105,343 | 35,890 | 6,636 | - | 9,103 | 1,356,994 |
| Loans renegotiated in 2015 | 501,532 | - | - | - | - | - | - | 501,532 |
| **Total current and not impaired** | **4,166,727** | **-** | **618,598** | **393,761** | **11,332** | **35,081** | **27,529** | **5,253,028** |
| *Past due but not impaired* | | | | | | | | |
| - up to 90 days overdue | 209,524 | - | 11,271 | 47 | 3 | 1,349 | 53 | 222,247 |
| - 90 to 180 days overdue | 56,769 | - | 3,293 | - | 14 | 2,073 | 70 | 62,219 |
| - 180 to 360 days overdue | 51,311 | - | 4,139 | - | 11 | 3,029 | 109 | 58,599 |
| - over 360 days overdue | 256,706 | 46 | 32,189 | 1,499 | 366 | 14,934 | 20,488 | 326,228 |
| **Total past due but not impaired** | **574,310** | **46** | **50,892** | **1,546** | **394** | **21,385** | **20,720** | **669,293** |
| *Impaired loans* | | | | | | | | |
| - up to 90 days overdue | 522,102 | - | 12,589 | - | 104 | 793 | 58,670 | 594,258 |
| - 90 to 180 days overdue | 3,903 | - | 44 | - | 51 | 253 | - | 4,251 |
| - 180 to 360 days overdue | 1,600 | - | 120 | - | - | 587 | - | 2,307 |
| - over 360 days overdue | 19,273 | 1 | 4,357 | - | 1,226 | 2,163 | 7,219 | 34,239 |
| Loans renegotiated in 2015 | - | - | - | - | - | - | - | - |
| **Total impaired loans** | **546,878** | **1** | **17,110** | **-** | **1,381** | **3,796** | **65,889** | **635,055** |
| **Total loans to customers (before impairment)** | **5,287,915** | **47** | **686,600** | **395,307** | **13,107** | **60,262** | **114,138** | **6,557,376** |
| **Less: provision for loan impairment** | (751,568) | (12) | (122,518) | (9,414) | (3,978) | (8,964) | (25,339) | (921,793) |
| **Total loans and advances to customers** | **4,536,347** | **35** | **564,082** | **385,893** | **9,129** | **51,298** | **88,799** | **5,635,583** |

The analysis by credit quality of loans outstanding as at December 31, 2014 is as follows:

| | Corporate loans | State and public organisations | Loans to individuals - consumer loans | Loans to individuals - mortgage loans | Loans to individuals – employees | Loans to individuals - purchase of motor vehicles | Loans to individuals - other purposes | Total |
|---|---|---|---|---|---|---|---|---|
| *Current and not impaired* | | | | | | | | |
| Secured loans | 5,521,162 | 38 | 266,367 | 208,776 | 61,804 | 49,280 | 52,754 | 6,160,181 |
| Unsecured loans | 586,464 | 273 | 186,692 | 52,526 | 4,515 | 145 | 10,554 | 841,169 |
| Loans renegotiated in 2014 | 526,559 | - | 26,725 | 152 | 21,419 | 243 | 1,363 | 576,461 |
| **Total current and not impaired** | **6,634,185** | **311** | **479,784** | **261,454** | **87,738** | **49,668** | **64,671** | **7,577,811** |
| *Past due but not impaired* | | | | | | | | |
| - up to 90 days overdue | 121,254 | 1 | 6,284 | 49 | 7 | 1,082 | 46 | 128,723 |
| - 90 to 180 days overdue | 82,377 | 2 | 859 | 26 | - | 1,179 | 104 | 84,547 |
| - 180 to 360 days overdue | 81,812 | - | 3,518 | - | 382 | 3,139 | 129 | 88,980 |
| - over 360 days overdue | 374,276 | 105 | 29,603 | 1,460 | 3,491 | 6,533 | 31,505 | 446,973 |
| **Total past due but not impaired** | **659,719** | **108** | **40,264** | **1,535** | **3,880** | **11,933** | **31,784** | **749,223** |
| *Impaired loans* | | | | | | | | |
| - up to 90 days overdue | 353,453 | - | - | 75 | 2,477 | - | 8,397 | 364,402 |
| - 90 to 180 days overdue | 43 | - | - | - | 9 | - | 10 | 62 |
| - 180 to 360 days overdue | 642 | - | 2 | - | - | - | 2 | 646 |
| - over 360 days overdue | 2,612 | - | 507 | - | - | - | 9,484 | 12,603 |
| Loans renegotiated in 2014 | - | - | - | - | - | - | 48 | 48 |
| **Total impaired loans** | **356,750** | **-** | **509** | **75** | **2,486** | **-** | **17,941** | **377,761** |
| **Total loans to customers (before impairment)** | **7,650,654** | **419** | **520,557** | **263,064** | **94,104** | **61,601** | **114,396** | **8,704,795** |
| **Less: provision for loan impairment** | (762,224) | (111) | (62,382) | (4,208) | (6,434) | (689) | (13,756) | **(849,804)** |
| **Total loans and advances to customers** | **6,888,430** | **308** | **458,175** | **258,856** | **87,670** | **60,912** | **100,640** | **7,854,991** |

In these consolidated financial statements prepared in accordance with IFRS, the Group applied the portfolio provisioning methodology prescribed by IAS 39, Financial Instruments: Recognition and Measurement, and created portfolio provisions for impairment losses that were incurred, but have not been specifically identified with any individual loan by the end of the reporting period. The Group's internal loan grading policy is to classify each loan as follows:

- Standard loans – Loans with the payments of both principal and interest are up-to-date in accordance with the agreed terms and provisions up to 10% against gross carrying amount.
- Sub-standard loans – Fully secured or expected loss is less than 50% of the unsecured amount and 10%-50% provisions against gross carrying amount.
- Doubtful loans – Indeterminable security value but expected to be significant with expected loss is 50% to less than 100% of the loan and 50%-100% provision against gross carrying amount.
- Loss (bad) loans – Loan recovery is assessed to be insignificant with no security available as alternative resource and 100% provision against gross carrying amount.

For the purposes of the above table standard and sub-standard loans have been classified either as current and not impaired or past due but not impaired loans. Doubtful and loss (bad) loans have been classified as impaired loans.

Current and not impaired, but renegotiated loans represent the carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated. Past due, but not impaired loans presented in the above table represent collateralised loans where the fair value of collateral covers the overdue interest and principal repayments. The amount reported as past due, but not impaired is the whole balance of such loans, not only the individual instalments that are past due. The primary factors that the Group considers when determining whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Group presented the above ageing analysis of loans that are impaired.

As at December 31, 2015, total estimated value of collaterals pledged by borrowers was AZN 2,209,233 thousand (December 31, 2014: AZN 3,801,911 thousand).

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| *Fair value of collateral for past due but not impaired loans* | | |
| - real estate | 1,434,935 | 1,511,135 |
| - movable property | 443,895 | 2,002,250 |
| - securities | 8,785 | 36,591 |
| - other assets | 15,223 | 133,264 |
| *Fair value of collateral for impaired loans* | | |
| - movable property | 303,539 | - |
| - real estate | 2,856 | 118,671 |
| **Total** | **2,209,233** | **3,801,911** |

The carrying value of each class of loans and advances to customers approximates fair value as at December 31, 2015 and 2014. As at December 31, 2015, the estimated fair value of loans and advances to customers was AZN 5,633,400 thousand (December 31, 2014: AZN 7,851,240 thousand). Refer to Note 33.

Geographical, currency, liquidity and interest rate analyses analysis of loans and advances to customers is disclosed in Note 30. The information on related party balances is disclosed in Note 34.

During the years ended December 31, 2015 and 2014 the Group received non-financial assets by taking possession of collateral it held as security. As at December 31, 2015 and 2014 such assets in amount of AZN 17,322 thousand and AZN 8,735 thousand, respectively, are included in other assets (Note 14).

As at December 31, 2015 and 2014 loans to customers included loans totaling AZN 501,532 thousand and AZN 576,509 thousand, respectively, whose terms were renegotiated. Otherwise these loans would be past due or impaired.

| | December 31, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|
| | Carrying value before allowance | Allowance for impairment losses | Carrying value | Carrying value before allowance | Allowance for impairment losses | Carrying value |
| Loans to customers individually determined to be impaired | 504,099 | (265,496) | 238,603 | 356,750 | (235,126) | 121,624 |
| Loans to customers collectively determined to be impaired | 130,956 | (67,680) | 63,276 | 21,011 | (11,609) | 9,402 |
| Unimpaired loans | 5,922,321 | (588,617) | 5,333,704 | 8,327,034 | (603,069) | 7,723,965 |
| **Total** | **6,557,376** | **(921,793)** | **5,635,583** | **8,704,795** | **(849,804)** | **7,854,991** |

As at December 31, 2015 and 2014 loans totaling AZN 504,099 thousand and AZN 356,750 thousand, respectively, that were individually determined to be impaired were collateralized by pledge of real estate, equipment, inventories, promissory notes and secured by guarantees with fair value totaling AZN 356,395 thousand and AZN 118,671 thousand, respectively.

## 7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Financial assets initially designated at fair value through profit or loss: | | |
| Receivables on currency SWAP agreements | 906 | - |
| Promissory notes | - | 14,997 |
| **Total financial assets at fair value through profit or loss** | **906** | **14,997** |

During the year ended December 31, 2015, the Group entered into currency SWAP agreements with non-resident banks, whereby the Group sold USD, GBP and CHF and bought EUR and USD at the transaction date and agreed to buy back the initially sold amount of USD, GBP and CHF at a predetermined future date by paying EUR and USD at the predetermined foreign exchange rate. As at December 31, 2015, the Group had fourteen outstanding currency SWAP agreements representing derivative financial instruments. The fair value of these derivative financial instruments was AZN 906 thousand as at December 31, 2015. (December 31, 2014 AZN (6,609), see Note 19). The notional amounts of these derivative financial instruments was AZN 689,729 thousand as at December 31, 2015. (December 31, 2014 AZN 215,295 thousand).

As at December 31, 2015 the promissory notes amounted to Nil AZN. (December 31, 2014: the promissory notes bear interest rates ranging from 6.9% to 12.5% with maturities in March 2015 to January 2022).

The analysis by credit quality of the financial assets at fair value through profit or loss as at December 31, 2015 and 2014 is as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Current and not impaired: | | |
| - AA- | 906 | - |
| - BBB | - | 4,210 |
| - <BBB | - | 10,787 |
| **Total current and not impaired** | **906** | **14,997** |

## 8. OTHER DEBT SECURITIES

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Other debt securities | 52,241 | 45,355 |
| Less: provision for impairment | (22,943) | - |
| **Total other debt securities** | **29,298** | **45,355** |

As at December 31, 2015 the Group owned 45,355 bonds with par value of AZN 1 thousand issued by two private companies in Azerbaijan Republic and AZN 7,236 thousand accrued interest on these bonds (December 31, 2014: 45,355 bonds with par value of AZN 1 thousand issued by two private companies in Azerbaijan Republic and nil accrued interest on these bonds). The amortized cost of these bonds as at December 31, 2015 was AZN 29,298 thousand (December 31, 2014: AZN 45,355 thousand). The bonds bear interest at 11.75% and 10% and are fully redeemable in November 18, 2016 and January 22, 2019 (December 31, 2014: the bonds bear interest at 11.75% and 10% and are fully redeemable in November 18, 2016 and January 22, 2019).

The analysis by credit quality of the other debt securities as at December 31, 2015 and 2014 is as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Current and not impaired | | |
| - not rated | - | 45,355 |
| Total current and not impaired | - | 45,355 |
| *Balances individually assessed for impairment (gross)* | | |
| - over 90 days overdue | 52,241 | - |
| Total balances individually assessed for impairment (gross) | 52,241 | - |
| Less: provision for impairment | (22,943) | - |
| **Total due from other banks** | **29,298** | **45,355** |

Movements in the provision for impairment of other debt securities were as follows:

| | Other debt securities |
|---|---|
| **December 31, 2013** | - |
| Additional provisions recognized | - |
| **December 31, 2014** | - |
| Additional provisions recognized | 22,943 |
| **December 31, 2015** | 22,943 |

The carrying value and fair value of other debt securities is disclosed in Note 33.

Geographical, currency, liquidity and interest rate analyses of other debt securities is disclosed in Note 30.

## 9. AVAILABLE-FOR-SALE INVESTMENTS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Corporate bonds | 97 | 5,287 |
| **Total available-for-sale financial assets** | **97** | **5,287** |

As at December 31, 2015 available for sale investments represent corporate bonds of local and foreign financial institutions with maturities ranging 1-4 years and interest rates 10.%-11.8% (2014: maturities 4-9 years and interest rates 4.75%-6.12%).

## 10. RECEIVABLES FROM AQRARKREDIT

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Receivables from Aqrarkredit | 5,718,536 | - |
| Initial loss on fair value recognition | (89,613) | - |
| **Total receivables from Aqrarkredit** | **5,628,923** | **-** |

Receivable from Aqrarkredit represent amounts to be received in respect of loans, promissory notes and off-balance sheet commitments transferred in accordance with President's decree.

On July 15, 2015 the President of Azerbaijan signed a directive that the Group should identify its problematic loans and transfer those loans to "Aqrarkredit" Closed Joint-Stock Non-Banking Credit Organization ("Aqrarkredit") over a period of time. The value of the transfer for each loan would be the loan`s carrying value prior to any impairment provisions, as recorded in the books of the Group and including all on and off balance sheet exposure of the Group for each customer.

On August 11, 2015 IBA, Aqrarkredit, Ministry of Finance and the Central Bank of Azerbaijan signed a Master Agreement where they agreed in principle that IBA would transfer its portfolio to Aqrarkredit in a number of tranches over a number of years from 2015 to 2017. On July 28, 2015 the first "Transfer Agreement" was signed by IBA and Aqrarkredit where through cession, specific loans and amounts were agreed to be transferred to Aqrarkredit.

On December 28, 2015 IBA received a Guarantee and Commitment letter from Aqrarkredit that it would reimburse IBA in line with the "Master Agreement" (noted above) for loans on the balance sheet of IBA and IBA Moscow totalling AZN 5.7 billion. On 24 February 2016 the second "Transfer Agreement" was signed by IBA and Aqrarkredit where through cession, specific loans and amounts of both IBA and IBA Moscow were listed and agreed to be transferred to Aqrarkredit.

## 11. INVESTMENT IN ASSOCIATES

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Baku Inter-Bank Currency Exchange (BICE) | 187 | 348 |
| Joint Leasing Company | - | - |
| **Total investments in associates** | **187** | **348** |

The table below summarises the movements in the carrying amount of the Group's investment in associates:

| | 2015 | 2014 |
|---|---|---|
| **Carrying amount as at January 1** | **348** | **489** |
| Share of loss of BICE | (161) | (141) |
| Share of loss of Joint Leasing Company | - | - |
| **Carrying amount as at December 31** | **187** | **348** |

As at December 31, 2015, the Group's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and losses, were as follows:

| Name | Total assets | Total liabilities | Revenue | Profit/ (loss) | % interest Held | Country of Incorporation |
|---|---|---|---|---|---|---|
| Joint Leasing Company | 33,781 | 33,218 | 2,024 | (1,328) | 47.6 | The Republic of Azerbaijan |
| BICE | 1,289 | 69 | 53 | (754) | 20.0 | The Republic of Azerbaijan |
| Total | 35,070 | 33,287 | 2,077 | (2,082) | | |

As at December 31, 2014, the Group's interests in its principal associates and their summarised financial information, including total assets, liabilities, revenues and losses, were as follows:

| Name | Total assets | Total liabilities | Revenue | Profit/ (loss) | % interest Held | Country of Incorporation |
|---|---|---|---|---|---|---|
| Joint Leasing Company | 34,278 | 33,109 | 2,093 | (1,155) | 47.6 | The Republic of Azerbaijan |
| BICE | 1,310 | 56 | 42 | (702) | 20.0 | The Republic of Azerbaijan |
| Total | 35,588 | 33,165 | 2,135 | (1,857) | | |

## 12. PREMISES, EQUIPMENT AND INTANGIBLE ASSETS

| | Premises | Leasehold improvements | Office and computer equipment | Banking equipment, furniture, fixtures, vehicles and other | Construction in progress | Total premises and equipment | Intangible assets | Total |
|---|---|---|---|---|---|---|---|---|
| **December 31, 2013** | 170,847 | 6,270 | 58,898 | 47,333 | 117,457 | 400,805 | 24,907 | 425,712 |
| Additions | 3,957 | 806 | 8,285 | 6,953 | 33,607 | 53,608 | 6,333 | 59,941 |
| Capitalized borrowing cost | - | - | - | - | 10,163 | 10,163 | - | 10,163 |
| Disposal/write off | - | - | (131) | (381) | (48) | (560) | (1,308) | (1,868) |
| Transfers | 1,332 | - | (2,517) | (961) | 17,637 | 15,491 | (1,928) | 13,563 |
| Effect of foreign currency exchange differences | (6,314) | (1) | (1,456) | (18) | (303) | (8,092) | (387) | (8,479) |
| Reclassified as held for sale | (559) | - | - | - | (269) | (828) | - | (828) |
| **December 31, 2014** | 169,263 | 7,075 | 63,079 | 52,926 | 178,244 | 470,587 | 27,617 | 498,204 |
| Additions | 7,650 | 667 | 6,467 | 15,933 | 7,556 | 38,273 | 4,033 | 42,306 |
| Capitalized borrowing cost | - | - | - | - | 11,217 | 11,217 | - | 11,217 |
| Disposal/write off | (4,879) | (982) | (3,132) | (1,877) | - | (10,870) | - | (10,870) |
| Transfers | 14,134 | - | 778 | - | (14,912) | - | - | - |
| Effect of foreign currency exchange differences | 7,149 | 277 | 1,350 | 478 | 144 | 9,398 | 424 | 9,822 |
| **December 31, 2015** | **193,317** | **7,037** | **68,542** | **67,460** | **182,249** | **518,605** | **32,074** | **550,679** |
| **Accumulated depreciation** | | | | | | | | |
| **December 31, 2013** | (92,593) | (2,630) | (43,982) | (41,739) | - | (180,944) | (17,359) | (198,303) |
| Depreciation charge | (4,508) | (643) | (5,540) | (3,495) | - | (14,186) | (2,408) | (16,594) |
| Eliminated on disposal/write off | - | - | 59 | 261 | - | 320 | - | 320 |
| **December 31, 2014** | (97,101) | (3,273) | (49,463) | (44,973) | - | (194,810) | (19,767) | (214,577) |
| Depreciation charge | (3,172) | (1,090) | (6,489) | (3,742) | - | (14,493) | (3,077) | (17,570) |
| Eliminated on disposal/write off | - | 963 | 3,053 | 1,975 | - | 5,991 | - | 5,991 |
| Effect of foreign currency exchange differences | (684) | (27) | (1,025) | (46) | - | (1,782) | - | (1,782) |
| **December 31, 2015** | (100,957) | (3,427) | (53,924) | (46,786) | - | (205,094) | (22,844) | (227,938) |
| **Net book value** | | | | | | | | |
| **As at December 31, 2015** | **92,360** | **3,610** | **14,618** | **20,674** | **182,249** | **313,511** | **9,230** | **322,741** |
| **As at December 31, 2014** | **72,162** | **3,802** | **13,616** | **7,953** | **178,244** | **275,777** | **7,850** | **283,627** |

As at December 31, 2015 the premises owned by the Group are carried at revalued amounts based on the independent appraiser's report. As at December 31, 2015 carrying value of these buildings totaled AZN 92,360 thousand (December 31, 2014: AZN 72,162 thousand). As at December 31, 2015, the carrying amount of premises would have been AZN 16,891 thousand (December 31, 2014: AZN 20,752 thousand) had the assets been carried at cost less depreciation.

Buildings owned by the Group were revalued by independent appraisers as at June 30, 2013. The following methods were used for the estimation of their fair value: discounted cash flow method (income approach) and method of sales comparison (comparative approach).

Included in the premises and equipment as at December 31, 2015 are office, computer equipment and furniture, vehicles and other assets with a cost of AZN 74,491 thousand (December 31, 2014: 61,083 thousand) which have been fully depreciated but were still in use by the Group as at December 31, 2015.

Details of the Group's buildings and information about the fair value hierarchy as at 31 December 2015 and 2014 are as follows:

| | Level 1 | Level 2 | Level 3 | Fair value as at December 31, 2015 |
|---|---|---|---|---|
| Buildings | - | 92,360 | - | 92,360 |
| **Total** | **-** | **92,360** | **-** | **92,360** |

| | Level 1 | Level 2 | Level 3 | Fair value as at December 31, 2014 |
|---|---|---|---|---|
| Buildings | - | 72,162 | - | 72,162 |
| **Total** | **-** | **72,162** | **-** | **72,162** |

Construction in progress mainly consists of construction and refurbishment of branch premises as well as payments made by the Group to contractors for the purposes of construction of its new office building on land purchased by the Group in the center of Baku. During the year ended December 31, 2015 the Group has capitalized AZN 11,217 thousand (December 31, 2014: AZN 10,163 thousand) of interest into qualifying assets. Upon completion, assets are transferred to premises and equipment.
Intangible assets include software and licenses.

## 13. OTHER FINANCIAL AND INSURANCE ASSETS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Receivables from shareholders | 191,648 | - |
| Amounts in the course of settlement and receivables for plastic cards transactions | 14,780 | 16,794 |
| Receivables from insurance policyholders | 3,152 | 6,433 |
| Other | 448 | 423 |
| **Total other financial and insurance assets** | **210,028** | **23,650** |

Receivables for plastic cards transactions represent receivables from other local banks for cards produced, issued and serviced for them by Azericard, the card processing subsidiary, as well as net funds receivable from other local banks for cash withdrawn from the Bank's ATMs by customers of other banks.

The analysis by credit quality of other financial and insurance assets outstanding as at December 31, 2015 is as follows:

| | Receivables from insurance policyholders | Receivables from shareholders/ Amounts in the course of settlement and receivable for plastic cards transactions | Total |
|---|---|---|---|
| *Current and not impaired* | | | |
| - not rated | 2,523 | 206,876 | 209,399 |
| Total current and not impaired | 2,523 | 206,876 | 209,399 |
| *Past due but not impaired* | | | |
| - less than 30 days overdue | 51 | - | 51 |
| Total past due but not impaired | 51 | - | 51 |
| *Receivables collectively determined to be impaired (gross)* | | | |
| - 30 to 90 days overdue | 109 | - | 109 |
| - 91 to 180 days overdue | 162 | - | 162 |
| - 181 to 360 days overdue | 357 | - | 357 |
| - over 360 days overdue | 1,519 | - | 1,519 |
| Total collectively impaired | 2,147 | - | 2,147 |
| Less: provision for impairment | (1,569) | - | (1,569) |
| **Total other financial and insurance assets** | **3,152** | **206,876** | **210,028** |

The analysis by credit quality of other financial and insurance assets outstanding as at December 31, 2014 is as follows:

| | Receivables from insurance policyholders | Amounts in the course of settlement and receivable for plastic cards transactions | Total |
|---|---|---|---|
| *Current and not impaired* | | | |
| - not rated | 4,755 | 17,217 | 21,972 |
| Total current and not impaired | 4,755 | 17,217 | 21,972 |
| *Past due but not impaired* | | | |
| - less than 30 days overdue | 189 | - | 189 |
| Total past due but not impaired | 189 | - | 189 |
| *Receivables collectively determined to be impaired (gross)* | | | |
| - 30 to 90 days overdue | 93 | - | 93 |
| - 91 to 180 days overdue | 98 | - | 98 |
| - 181 to 360 days overdue | 315 | - | 315 |
| - over 360 days overdue | 1,763 | - | 1,763 |
| Total collectively impaired | 2,269 | | 2,269 |
| Less: provision for impairment | (780) | | (780) |
| **Total other financial and insurance assets** | **6,433** | **17,217** | **23,650** |

In the above tables for an analysis of credit quality of other financial and insurance assets, the management listed the classes in the order from highest to lowest credit quality as used for the purposes of internal monitoring and assessment.

The carrying value of each class of other financial assets approximates its fair value as at December 31, 2015 and 2014. As at December 31, 2015, the estimated fair value of other financial assets was AZN 210,934 thousand (December 31, 2014: AZN 23,650 thousand). Refer to Note 33.

## 14. OTHER ASSETS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Collateral repossessed | 17,322 | 8,735 |
| Advances for purchase of intangible assets and equipment | 10,273 | 16,058 |
| Deferred expenses for plastic cards | 2,548 | 821 |
| Taxes receivable, other than income tax | 2,435 | 393 |
| Prepaid expenses | 2,196 | 5,823 |
| Deferred acquisition costs on insurance premiums written | 896 | 1,018 |
| Prepaid insurance premiums | 826 | 1,028 |
| Other assets | 2,509 | 1,749 |
| **Total other assets** | **39,005** | **35,625** |
| Current | 26,186 | 22,658 |
| Non-current | 12,819 | 12,967 |
| **Total other assets** | **39,005** | **35,625** |

Included in the advances for purchase of intangible assets and equipment as at December 31, 2015 and 2014 are prepayments for office furniture and other assets for the new Head Office building in Baku.

## 15. DUE TO OTHER BANKS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Short-term placements of other banks | 1,433,025 | 1,458,698 |
| Correspondent accounts and overnight placements of other banks | 367,819 | 226,480 |
| Overdraft with CBAR | - | 179,784 |
| **Total due to other banks** | **1,800,844** | **1,864,962** |

Included in the short-term placements of other banks as at December 31, 2015 are four short-term placements of a non-resident bank amounting to USD 281,858 thousand or AZN 439,529 thousand and correspondent accounts amounting to USD 112,921 thousand or AZN 176,090 thousand of a non-resident banks. These short-term placements bear market interest rates of 6.66 - 9.44% with maturities in October 2016 (December 31, 2014: three short-term placements amounting to EUR 178,000 thousand or AZN 169,492 thousand and correspondent accounts amounting to EUR 105,019 thousand or AZN 99.999 thousand, and USD 2,079 thousand or AZN 1,631 thousand of non-resident banks).

The carrying value of each class of due to banks approximates its fair value as at December 31, 2015 and 2014. As at December 31, 2015, the estimated fair value of due to other banks was AZN 1,797,362 thousand (December 31, 2014: AZN 1,856,694 thousand). Refer to Note 33. Geographical, currency, liquidity and interest rate analyses of due to banks is disclosed in Note 30. The information on related party balances is disclosed in Note 34.

## 16. CUSTOMER ACCOUNTS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| **State and public organisations** | | |
| - Current/settlement accounts | 3,115,546 | 649,214 |
| - Term deposits | 9,114 | 280,427 |
| - Restricted customer deposits | 104,575 | 71,273 |
| | 3,229,235 | 1,000,914 |
| **Other legal entities** | | |
| - Current/settlement accounts | 924,240 | 826,401 |
| - Term deposits | 499,847 | 373,297 |
| - Restricted customer deposits | 35,703 | 10,102 |
| | 1,459,790 | 1,209,800 |
| **Individuals** | | |
| - Current/demand accounts | 518,721 | 347,394 |
| - Term deposits | 1,886,064 | 1,586,570 |
| - Restricted customer deposits | 304 | - |
| | 2,405,089 | 1,933,964 |
| **Total customer accounts** | **7,094,114** | **4,144,678** |

As at December 31, 2015, the Group had significant concentration of customer accounts attracted from one customer – a state organisation in the oil industry totalling AZN 1,930,128 thousand, and from one government body of AZN 183,800 thousand, or 30% of total customer accounts in aggregate (December 31, 2014: one customer – a state organisation in oil industry totalling AZN 479,378 thousand, and from one government body of AZN 154,555 thousand, or 15.3% of total customer accounts in aggregate).

Included in term deposits of state and public organizations is overnight deposit of a state organization involved in the oil industry sector of the Republic of Azerbaijan totalling AZN 460,539 thousand. The interest rates on these deposits are 0.11% as of December 31, 2015 (December 31, 2014: deposits of state and public organizations are deposits of a state organization involved in the oil industry sector of the Republic of Azerbaijan totalling AZN 152,461 thousand. The interest rates on these deposits are 0.10% per annum as at December 31, 2014).

Included in the current and settlement accounts of state and public organisations as at December 31, 2015 are balances on current interest bearing accounts of state-owned enterprises and government bodies of AZN 730,979 thousand (December 31, 2014: AZN 176,387 thousand). Interest rates on these accounts vary from 0.11% to 1.5% per annum (December 31, 2014: 0.1% to 1.5% per annum).

Restricted customer deposits amounting to AZN 140,582 thousand as at December 31, 2015 (December 31, 2014: AZN 81,375 thousand) represent balances on customer accounts held by the Group as collateral for irrevocable commitments under import letters of credit issued by the Group on behalf of its customers. The information on letters of credit and guarantees outstanding as at December 31, 2015 and 2014 is disclosed in Note 32.

Economic sector concentrations within customer accounts are as follows:

| | December 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Energy | 2,948,544 | 41.6 | 699,686 | 16.9 |
| Individuals | 2,405,089 | 33.9 | 1,933,964 | 46.7 |
| Trade and services | 1,048,189 | 14.8 | 792,250 | 19.1 |
| State and public organisations* | 270,146 | 3.8 | 219,203 | 5.3 |
| Manufacturing | 125,631 | 1.8 | 119,554 | 2.9 |
| Transportation and communication | 106,614 | 1.5 | 200,769 | 4.8 |
| Construction | 52,957 | 0.7 | 88,102 | 2.1 |
| Other | 136,944 | 1.9 | 91,150 | 2.2 |
| **Total customer accounts** | **7,094,114** | **100.0** | **4,144,678** | **100.0** |

*(*) State and public organisations comprise ministries, Treasury, municipalities and other state bodies of the Republic of Azerbaijan, excluding profit making state and public organisations that are included in the respective categories.*

The carrying value of each class of customer accounts approximates its fair value as at December 31, 2015 and 2014. The estimated fair value of customer accounts is disclosed in Note 33.

Geographical, currency, liquidity and interest rate analyses of customer accounts is disclosed in Note 30. The information on related party balances is disclosed in Note 34.

## 17. DEBT SECURITIES IN ISSUE

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Eurobonds | 878,524 | 390,473 |
| Deposit certificates | 15,130 | 10,454 |
| **Total debt securities in issue** | **893,654** | **400,927** |

On June 9, 2014, the Bank has issued USD 500,000 thousand Eurobonds due in 2019 with interest rate of 5.63% per annum. Interest on these bonds is payable semi-annually. Bonds are admitted to trading on the regulated market of the Irish Stock Exchange PLC or other regulated markets for the purposes of Directive 2004/39/EC or which are to be offered to the public in any Member State of the European Economic Area.

As at December 31, 2015, deposit certificates("DC") denominated in USD in the amount of AZN 9,190 thousand bear interest rates ranging between 8.0% - 25.0% per annum and have maturities of two, three, eight, nine and ten years, deposit certificates denominated in AZN in the amount of AZN 1,800 thousand bear interest rate of 25.0% per annum and have maturities of eight, nine and ten years and deposit certificates denominated in RUR in the amount of AZN 4,140 thousand bear interest rates ranging between 9% - 14% per annum and have maturity of one year (December 31, 2014: deposit certificates denominated in USD in the amount of AZN 6,285 thousand bear interest rates ranging between 8.0%-25.0% per annum and have maturities between two and ten years, deposit certificates denominated in AZN in the amount of AZN 1,825 thousand bear an interest rate of 25.0% per annum and have maturities between eight and ten years and deposit certificates denominated in RUR in the amount of AZN 2,344 thousand bear interest rates ranging between 4.5%-10.0% per annum and have maturities of one year).

These certificates of deposit state as a condition that interest is paid each year only if certificates are held for the full period of that calendar year.

The carrying value of each class of debt securities in issue approximates its fair value as at December 31, 2015 and December 31, 2014. The estimated fair value of debt securities in issue is disclosed in Note 33.

Geographical, currency, liquidity and interest rate analyses of debt securities in issue is disclosed in Note 30.

## 18. OTHER BORROWED FUNDS

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Syndicated loan maturing on April 26, 2016 | 318,627 | - |
| Syndicated loan maturing on December 24, 2015 | - | 197,669 |
| Syndicated loan maturing on April 8, 2015 | - | 115,368 |
| Syndicated loan maturing on January 14, 2015 | - | 47,260 |
| Term borrowings from government organisations: | | |
| - National Fund for Support of Entrepreneurship (the Republic of Azerbaijan) | 203,428 | 207,891 |
| Term borrowings from other financial institutions | 1,711,420 | 979,351 |
| Accrued interest payable | 29,504 | 15,827 |
| **Total other borrowed funds** | **2,262,979** | **1,563,366** |

**Syndicated borrowings**

On April 28, 2015, Bank signed a facility agreement with foreign banks led by one of the major foreign banks in the amount of USD 97,500 thousand and EUR 98,500 thousand, with interest rates of 3 % and 3.5 % per annum, respectively. The borrowing facilities are repayable on April 26, 2016.

**Term borrowings from government organizations**

As at December 31, 2015 loans from National Fund for Support of Entrepreneurship amounting to AZN 203,428 thousand has been borrowed with annual rate of 1% and maturity period from 1 to 10 years (December 31, 2014: borrowings from National Fund for Support of Entrepreneurship amounting to AZN 207,891 thousand, which has been borrowed with the annual rate of 1% and maturity period from 1 year to 10 years).

**Term borrowings from other financial institutions**

Included in term borrowings from other financial institutions are funds attracted from twenty one foreign banks and financial institutions. The amounts drawn down under credit agreements signed with these banks amounted to USD 893,543 thousand or AZN 1,393,391 thousand and EUR 157,237 thousand or AZN 268,027 thousand. (December 31, 2014: funds attracted from twenty four foreign banks and financial institutions with amount of USD 968,883 thousand or AZN 759,992 thousand, EUR 198,499 thousand or AZN 189,011 thousand).

The Bank is obliged to comply with certain financial covenants stipulated by some of the above mentioned borrowing agreements within syndicated borrowings and term borrowings from other financial institutions. As at December 31, 2015 the Bank was in compliance with all financial covenants stipulated in borrowing agreements (December 31, 2014: Bank was in compliance with all financial covenants stipulated in borrowing agreements).

Market interest rates for the borrowings range between 0.9 % to 8.3 % per annum for the year ended December 31, 2015 (ranging between 1.07% to 8.9% per annum for the year ended December 31, 2014). All borrowings that belong to other borrowed funds category bear market interest rates.

The carrying value of each class of other borrowed funds approximates fair value as at December 31, 2015 and 2014. The estimated fair value of other borrowed funds is disclosed in Note 33.

## 19. OTHER FINANCIAL AND INSURANCE LIABILITIES

Other financial and insurance liabilities comprise the following:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Items in course of settlement | 20,736 | 16,193 |
| Payables to shareholders | 16,411 | 16,657 |
| Sundry creditors | 10,878 | 9,187 |
| Provision for off balance sheet commitments | 6,850 | - |
| Insurance reserves, net | 4,634 | 9,630 |
| Insurance premiums and broker commissions payable | 4,376 | 4,313 |
| Payables to employees | 2,470 | 3,764 |
| Payables on currency SWAP agreements | - | 6,609 |
| **Total other financial and insurance liabilities** | **66,355** | **66,353** |

During the year ended December 31, 2014, the Group entered into currency SWAP agreements with non-resident banks, whereby the Group sold USD, GBP and gold and bought EUR and USD at the transaction date and agreed to buy back the initially sold amount of USD, GBP and gold at a predetermined future date by paying EUR and USD at the predetermined foreign exchange rate. As at December 31, 2014, the Group had five outstanding currency SWAP agreements representing derivative financial instruments. The fair value of these derivative financial instruments was AZN 6,609 thousand as at December 31, 2014.

Movements in insurance reserves during the years ended December 31, 2015 and 2014 were as follows:

| | December 31, 2013 | Increase/(decrease) during the year | December 31, 2014 | Increase/(decrease) during the year | December 31, 2015 |
|---|---|---|---|---|---|
| **IBNR** | | | | | |
| Gross | 640 | (182) | 458 | 207 | 665 |
| Reinsurer's share | (226) | 47 | (179) | (122) | (301) |
| Net | **414** | **(135)** | **279** | **85** | **364** |
| **UPR** | | | | | |
| Gross | 10,767 | 3,197 | 13,964 | (6,719) | 7,245 |
| Reinsurer's share | (3,217) | (1,925) | (5,142) | 1,697 | (3,445) |
| Net | **7,550** | **1,272** | **8,822** | **(5,022)** | **3,800** |
| **RBNS** | | | | | |
| Gross | 439 | 206 | 645 | (171) | 474 |
| Reinsurer's share | (11) | (105) | (116) | 112 | (4) |
| Net | **428** | **101** | **529** | **(59)** | **470** |
| **Total** | **8,392** | **1,238** | **9,630** | **(4,996)** | **4,634** |

Movements in provision for off balance sheet commitments during the years ended December 31, 2015 and 2014 were as follows:

| | Provision for off balance sheet commitments |
|---|---|
| **December 31, 2013** | - |
| Additional provisions recognized | - |
| **December 31, 2014** | - |
| Additional provisions recognized | 6,850 |
| **December 31, 2015** | **6,850** |

The carrying value of each class of other financial liabilities approximates fair value as at December 31, 2015 and 2014. Refer to Note 33.

## 20. OTHER LIABILITIES

Other liabilities comprise the following:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Taxes payable other than income tax | 14,982 | 7,630 |
| Deferred revenue on plastic cards operations | 5,743 | 6,605 |
| Deferred commissions on insurance operations | 454 | 474 |
| Other | 2,063 | 8,596 |
| **Total other liabilities** | **23,242** | **23,305** |
| Current | 15,609 | 15,368 |
| Non-current | 7,633 | 7,937 |
| **Total other liabilities** | **23,242** | **23,305** |

Deferred revenue on plastic cards operations represents the unearned portion of revenue related to fees charged for the annual maintenance of plastic card accounts. This fee is charged upon the issuance of cards and amortised over their respective term.

## 21. SUBORDINATED DEBT

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Subordinated debt from CBAR | 600,000 | 350,000 |
| Subordinated debt from non-resident financial institutions | 157,499 | 69,969 |
| Accrued interest payable | 1,544 | 1,536 |
| **Total subordinated debt** | **759,043** | **421,505** |

On February 21, 2012, the Bank signed AZN 150,000 thousand subordinated loan agreement with the Central Bank of Azerbaijan Republic, which is treated as Tier II Capital as per capital requirements described in Note 31. This loan is to be repaid in 5 years. On December 4, 2012 the Bank signed the second subordinated loan agreement with the Central Bank of Azerbaijan Republic in the amount of AZN 100,000 thousand repayable in 7 years. On June 28, 2013 Bank signed third subordinated loan agreement with the Central Bank of Azerbaijan Republic in the amount of AZN 100,000 thousand repayable in 7 years as well.

On February 27, 2015 the Bank signed another subordinated loan agreement with the Central Bank of Azerbaijan Republic in the amount of AZN 250,000 thousand. One loan is repayable in 5 years, two loans are repayable in 7 years and one other loan is repayable in 6 years.

On February 9, 2015 the Bank signed subordinated loan agreement with non-resident financial institution in the amount of AZN 16,218 thousand. The loan is repayable in 2 years.

Interest rates on subordinated debts are at market rates. Market interest rate for these subordinated debts is 4.3 - 6.17% per annum. The repayment of Bank's subordinated debt ranks after all other creditors in case of liquidation of the Bank.

As at December 31, 2015, the estimated fair value of subordinated debt was AZN 759,043 thousand (December 31, 2014 AZN 421,505 thousand). Refer to Note 33.

Geographical, currency, liquidity and interest rate analyses of subordinated debt is disclosed in Note 30. The information on related party balances is disclosed in Note 34.

## 22. SHARE CAPITAL

The authorised, issued and paid-in capital of the Bank as at December 31, 2015 and December 31, 2014 is as follows:

| | Number of paid-in and outstanding shares (in thousands) | Ordinary Shares | Total |
|---|---|---|---|
| **As at December 31, 2013** | 1,827,068 | 475,038 | 475,038 |
| New shares paid-in | 358,829 | 93,295 | 93,295 |
| Increase in par value of shares | - | 21,859 | 21,859 |
| **As at December 31, 2014** | 2,185,897 | 590,192 | 590,192 |
| New shares paid-in | 189,240 | 51,095 | 51,095 |
| **As at December 31, 2015** | 2,375,137 | 641,287 | 641,287 |

On July 14, 2014 the shareholders of the Bank decided to increase share capital by AZN 93,295 thousand and issued 358,829,242 ordinary shares.

On October 14, 2014 the shareholders of the Bank decided to increase par value of existing one share from AZN 0.26 per share to AZN 0.27 per share by directing AZN 21,859 thousand from retained earnings to share capital.

On April 1, 2015 the shareholders of the Bank decided to increase share capital by AZN 51,095 thousand and issued 189,240,000 ordinary shares.

All ordinary shares have a nominal value of AZN 0.27 per share as at December 31, 2015 and rank equally. Each share carries one vote.

As at December 31, 2015 and December 31, 2014 the number of fully paid ordinary shares in issue was 2,375,137 and 2,185,897 thousand respectively.

As at December 31, 2015 and 2014, the Ministry of Finance of the Republic of Azerbaijan ("MoF") paid all subscribed shares and held 82.23% and 60.06% of the total paid-in share capital of the Bank, respectively.

As at December 31, 2015, the Group's employees held 2.37% of the total share capital of the Bank, or 56,229 thousand ordinary shares with a par value of AZN 15,182 thousand (December 31, 2014: 4.81% or 105,167 thousand ordinary shares with a par value of AZN 28,395 thousand).

In 2015 the Group did not declared any dividends (2014: AZN 0.01 per share totalling AZN 14,652 thousand).

## 23. ADDITIONAL PAID-IN CAPITAL

On July 15, 2015 the President of Azerbaijan signed a directive that the Group should identify its problematic loans and transfer those loans to "Aqrarkredit" over a period of time. The value of the transfer for each loan would be the loan`s carrying value prior to any impairment provisions, as recorded in the books of the Group and including all on and off balance sheet exposure of the Group for each customer.

Since Aqrarkredit is also ultimately controlled by the Ministry of Finance any excess of amounts received or receivable from Aqrarkredit over the carrying amount of transferred loans have been recognized as additional paid-in capital of the Group. As of 31 December 2015 AZN 999,964 has been credited to the additional paid-in capital net of taxes of AZN 199,993

## 24. INTEREST INCOME AND EXPENSE

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| **Interest income comprises:** | | |
| Interest income on financial assets recorded at amortized cost: | | |
| - interest income on unimpaired financial assets | 560,207 | 624,549 |
| - interest income on impaired financial assets | 46,509 | 36,776 |
| **Total interest income** | **606,716** | **661,325** |
| Interest income on financial assets recorded at amortized cost comprises: | | |
| Loans and advances to customers | 599,255 | 634,900 |
| Due from other banks and correspondent accounts | 1,086 | 19,442 |
| Interest income on other debt securities | 6,375 | 6,983 |
| **Total interest income** | **606,716** | **661,325** |
| **Interest expense comprises:** | | |
| Deposits from banks and other borrowed funs | 232,755 | 175,721 |
| Customer accounts | 184,603 | 161,435 |
| Subordinated debt | 40,018 | 25,261 |
| Debt securities | 32,689 | 12,349 |
| **Total interest expense** | **490,065** | **374,766** |
| **Net interest income** | **116,651** | **286,559** |

For information on related party transactions, see Note 34.

## 25. FEE AND COMMISSION INCOME AND EXPENSE

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| **Fee and commission income:** | | |
| - Plastic cards operations | 54,223 | 41,930 |
| - Transactions with foreign currencies and securities | 20,380 | 22,461 |
| - Settlement transactions | 9,264 | 16,979 |
| - Cash transactions | 9,176 | 12,101 |
| - Guarantees issued | 3,080 | 2,540 |
| - Letters of credit issued | 951 | 1,517 |
| - Servicing intermediary loans | 356 | 886 |
| - Other | 170 | 4,360 |
| Total fee and commission income | 97,600 | 102,774 |
| **Fee and commission expense:** | | |
| - Settlement transactions | 16,448 | 19,348 |
| - Cash transactions | 7,001 | 3,327 |
| - Guarantees | 2,583 | 2,713 |
| - Plastic cards operations | 2,169 | 2,691 |
| - Policy acquisition costs on insurance operations | 1,637 | 1,323 |
| - Other | 16 | 446 |
| Total fee and commission expense | 29,854 | 29,848 |
| **Net fee and commission income** | 67,746 | 72,926 |

For information on related party transactions, see Note 34.

## 26. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| Staff costs | 55,179 | 62,033 |
| Depreciation of premises and equipment | 14,493 | 14,186 |
| Rent | 5,696 | 5,284 |
| Charity and financial aid | 5,418 | 9,067 |
| Advertising and marketing services | 5,161 | 9,200 |
| Software maintenance | 4,849 | 3,507 |
| Consultancy and other professional services | 4,097 | 4,654 |
| External labour and guarding | 3,507 | 4,021 |
| Amortisation of software and other intangible assets | 3,077 | 2,408 |
| Communication | 2,556 | 2,433 |
| Premises and equipment maintenance | 2,554 | 3,113 |
| Fees paid to deposit insurance fund | 2,489 | 2,273 |
| Customs duties and taxes other than on income | 2,301 | 8,485 |
| Training | 2,125 | 1,190 |
| Stationary, books, printing, and other supplies | 1,018 | 1,381 |
| Purchase of plastic cards | 730 | 1,414 |
| Business trips | 636 | 898 |
| Other | 12,637 | 10,509 |
| **Total administrative and other operating expenses** | 128,523 | 146,056 |

Included in staff costs are obligatory payments to the State Social Protection Fund of the Republic of Azerbaijan of AZN 9,462 thousand (2014: AZN 11,385 thousand).

Included in charity and financial aid expenses incurred during the year are AZN 4,418 thousand paid to "Inter" professional football club (2014: AZN 7,600 thousand paid to "Inter" professional football club).

Rental expenses are related to the lease of the Group's branch buildings in Baku and in the regions of the Republic of Azerbaijan, exchange offices and rental costs associated with ATMs installed, for example, in department stores and hotels.

For information on related party transactions, see Note 34.

## 27. INCOME TAXES

Income tax expense comprises the following:

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| Current tax | (9,481) | (6,141) |
| Deferred tax | 211,249 | (1,782) |
| **Income tax benefit/(expense) for the year** | **201,768** | **(7,923)** |

The income tax rate applicable to the majority of the Group's income is 20% as at December 31, 2015 and 2014. The income tax rate applicable to the operations of IBA Moscow and IBA Georgia is 20% as at December 31, 2015 and 2014.

Reconciliation between the expected and the actual taxation charge is provided below.

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| **IFRS (loss)/profit before income tax** | **(1,013,955)** | **33,433** |
| Theoretical tax charge at statutory rate (20%) | 202,791 | (6,687) |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| -Non deductible expenses | (1,023) | (1,236) |
| **Income tax benefit/(expense) for the year** | **201,768** | **(7,923)** |

Differences between IFRS and Azerbaijani, Russian and Georgian statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the rate of 20%:

| | December 31, 2014 | (Charged)/ credited to profit or loss | Charged directly to other comprehensive income | December 31, 2015 |
|---|---|---|---|---|
| **Tax effect of deductible/(taxable) temporary differences** | | | | |
| Losses on assets and liabilities at non-market rates | 2,434 | - | - | 2,434 |
| Deferred revenue recognition | 1,094 | (128) | - | 966 |
| Provision for letters of credit and guarantees | 1,311 | 1,648 | - | 2,959 |
| Accruals and other | 1,041 | 7,191 | - | 8,232 |
| Provision for loan impairment | 990 | 207,526 | - | 208,516 |
| Additional paid-in capital | - | - | (196,219) | (196,219) |
| Premises, equipment and intangible assets | (16,962) | (3,829) | - | (20,791) |
| Revenue accruals | 1,566 | 623 | - | 2,189 |
| Tax effect of share of loss of associates | 96 | 32 | - | 128 |
| Tax effect of fair value gain of derivatives | (51) | (142) | - | (193) |
| Tax loss carry forwards | 4,817 | 4,024 | - | 8,841 |
| Tax effect of deferral of loan origination fee | 1,008 | (90) | - | 918 |
| Other | 3,240 | (5,606) | - | (2,366) |
| **Recognised deferred tax asset** | **584** | **211,249** | **(196,219)** | **15,614** |

In the context of the Group's current structure and applicable tax legislation, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity and the same taxation authority.

| | December 31, 2013 | (Charged)/ credited to profit or loss | Charged directly to other comprehensive income | December 31, 2014 |
|---|---|---|---|---|
| **Tax effect of deductible/(taxable) temporary differences** | | | | |
| Losses on assets and liabilities at non-market rates | 3,397 | (963) | - | 2,434 |
| Deferred revenue recognition | 1,094 | - | - | 1,094 |
| Provision for letters of credit and guarantees | (5,339) | 6,650 | - | 1,311 |
| Accruals and other | 1,041 | - | - | 1,041 |
| Provision for loan impairment | (6,371) | 7,361 | - | 990 |
| Premises, equipment and intangible assets | (16,962) | - | - | (16,962) |
| Revenue accruals | 1,566 | - | - | 1,566 |
| Tax effect of share of loss of associates | 68 | 28 | - | 96 |
| Tax effect of fair value gain of derivatives | (51) | - | - | (51) |
| Tax loss carry forwards | 21,019 | (16,202) | - | 4,817 |
| Tax effect of deferral of loan origination fee | - | 1,008 | - | 1,008 |
| Other | 2,954 | 286 | - | 3,240 |
| | 2,416 | (1,832) | - | 584 |
| Deferred tax asset not recognized | (50) | 50 | - | - |
| **Recognised deferred tax asset** | 2,366 | (1,782) | - | 584 |

The tax loss carry forwards partially expires in 2016 and the Group can charge tax loss carry forwards against income in future years.

The composition of the total net deferred tax asset of the Group after offsetting within the individual entities comprising the Group is, as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Total net deferred tax asset | 58,503 | 24,300 |
| Total net deferred tax liability | (42,889) | (23,716) |
| **Total net deferred tax asset of the Group** | 15,614 | 584 |

## 28. (LOSSES)/EARNINGS PER SHARE

Basic earnings per share are calculated by dividing the profit or loss attributable to owners of the Bank by the weighted average number of ordinary shares in issue during the year, excluding treasury shares. There were no treasury shares outstanding as at December 31, 2015 and 2014.

Basic and diluted earnings per share:

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| (Loss)/profit for the year attributable to ordinary shareholders | (811,840) | 25,028 |
| Weighted average number of ordinary shares in issue (thousands) | 2,312,045 | 2,091,315 |
| **Basic (losses)/earnings per ordinary share (expressed in AZN per share)** | (0.35) | 0.01 |

## 29. SEGMENT ANALYSIS

The chief operating decision maker, the Chairman of the Board of Directors, reviews the Group's internal reporting in order to assess its performance and allocate resources. The operating segments have been determined based on these reports as follows:

- Banking – representing private and corporate banking services, private and corporate customer current accounts, savings, deposits, investment savings products, custody, credit and debit cards, consumer loans and mortgages, direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency and derivative products for retail and corporate customers.
- Insurance – representing the activities carried out by the Group's insurance subsidiary.
- Card processing – representing the activities carried out by the Group's card processing subsidiary.

The Chairman of the Board of Directors assesses the performance of the operating segments based on a measure of adjusted profit before income tax. This measurement basis excludes the effects of non-recurring expenditure from the operating segments, such as impairment of premises. Other information provided to the Chairman of the Board of Directors is measured in a manner consistent with that in these consolidated financial statements, except that segment assets reported to the Chairman of the Board of Directors exclude deferred income tax asset which is managed on a central basis. These are part of the reconciliation to total consolidated statement of financial position assets. In addition to that, the Group does not allocate depreciation and amortisation expenses, as well as share of profit or loss of the associates among its segments. These are the part of the reconciliation to items of the consolidated statement of the comprehensive income.

Segment information for the reportable segments of the Group for the years ended December 31, 2015 and 2014 is set out below:

| | Banking | Insurance | Card processing | Total |
|---|---|---|---|---|
| **Year ended December 31, 2015** | | | | |
| External revenues: | | | | |
| - Interest income | 624,118 | 1,123 | 1,055 | 626,296 |
| - Fee and commission income | 78,637 | - | 24,446 | 103,083 |
| - Other operating income | 40,777 | 10,076 | - | 50,853 |
| Total revenue | 743,532 | 11,199 | 25,501 | 780,232 |
| Inter-segment revenue | (19,437) | - | (5,613) | (25,050) |
| Revenue from external customers | 724,095 | 11,199 | 19,888 | 755,182 |
| External expenses: | | | | |
| - Interest expense | 509,632 | - | - | 509,632 |
| - Fee and commission expense | 33,565 | 1,637 | 135 | 35,337 |
| Total expense | 543,197 | 1,637 | 135 | 544,969 |
| Inter-segment expense | (25,050) | - | - | (25,050) |
| Expense from external customers | 518,147 | 1,637 | 135 | 519,919 |
| **Total segment (loss)/profit** | (922,112) | 5,598 | 31,243 | (885,271) |
| **Year ended December 31, 2014** | | | | |
| External revenues: | | | | |
| - Interest income | 674,806 | 746 | 311 | 675,863 |
| - Fee and commission income | 97,414 | - | 18,333 | 115,747 |
| - Other operating income | 31,080 | 17,065 | - | 48,145 |
| Total revenue | 803,300 | 17,811 | 18,644 | 839,755 |
| Inter-segment revenue | (15,244) | - | (12,266) | (27,510) |
| Revenue from external customers | 788,056 | 17,811 | 6,378 | 812,245 |
| External expenses: | | | | |
| - Interest expense | 389,301 | - | - | 389,301 |
| - Fee and commission expense | 41,445 | 1,323 | 55 | 42,823 |
| Total expense | 430,746 | 1,323 | 55 | 432,124 |
| Inter-segment expense | (27,510) | - | - | (27,510) |
| External expense | 403,236 | 1,323 | 55 | 404,614 |
| **Total segment profit** | 156,568 | 4,483 | 18,579 | 179,630 |
| **Total assets reported** | | | | |
| December 31, 2015 | 13,562,148 | 17,337 | 19,287 | 13,598,772 |
| December 31, 2014 | 9,126,910 | 26,751 | 20,807 | 9,174,468 |
| **Total liabilities reported** | | | | |
| December 31, 2015 | 12,888,805 | 9,464 | 2,077 | 12,900,346 |
| December 31, 2014 | 8,468,416 | 16,628 | 3,424 | 8,488,468 |
| **Other segment items** | | | | |
| Capital expenditure, 2015 | 53,523 | - | - | 53,523 |
| Capital expenditure, 2014 | 69,610 | - | - | 69,610 |

Total consolidated revenues comprise interest income, fee and commission income and other operating income and are reconciled to the sum of these items on the face of the consolidated statement of comprehensive income.

Total consolidated expenses comprise interest expense and fee and commission expense and are reconciled to the sum of these items on the face of the consolidated statement of comprehensive income.

A reconciliation of adjusted profit before income tax to total profit before income tax is provided as follows:

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| **Adjusted profit before income tax for reportable segments** | (885,271) | 179,630 |
| Depreciation | (14,493) | (14,186) |
| Amortisation | (3,077) | (2,408) |
| Other operating expenses | (110,953) | (129,462) |
| Share of post-tax loss of associates | (161) | (141) |
| **Profit before income tax** | (1,013,955) | 33,433 |

The adjustments are attributable to the following:

- The Group does not allocate depreciation and amortisation to the segments.
- The Group does not allocate share of loss of associates to segments.

Reportable segments' assets are reconciled to total assets as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| **Total segment assets** | 13,598,772 | 9,174,468 |
| Deferred income tax assets | 58,503 | 24,300 |
| **Total assets per consolidated statement of financial position** | 13,657,275 | 9,198,768 |

Reportable segments' liabilities are reconciled to total assets as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| **Total segment liabilities** | 12,900,346 | 8,488,468 |
| Deferred income tax liabilities | 42,889 | 23,716 |
| **Total liabilities per consolidated statement of financial position** | 12,943,235 | 8,512,184 |

The Group applies an asymmetric approach regarding the allocation of non-current assets and related depreciation charges between segments, whereby the Group allocates non-current assets between segments whereas does not allocate related depreciation charges.

The adjustments are attributable to the following:

- Deferred income tax assets are not calculated for the purpose of internal management reporting.

Geographical information for non-current assets other than financial and insurance assets and taxes:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| The Republic of Azerbaijan | 312,356 | 291,255 |
| The Russian Federation | 14,690 | 10,496 |
| The Republic of Georgia | 8,165 | 3,756 |
| **Total non-current assets per consolidated statement of financial position** | 335,211 | 305,507 |

Revenues for each individual country for which the revenues are material are reported separately as follows:

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| The Republic of Azerbaijan | 672,968 | 722,527 |
| The Russian Federation | 74,251 | 82,880 |
| The Republic of Georgia | 7,963 | 6,838 |
| **Total consolidated revenues** | 755,182 | 812,245 |

Provision for impairment of loans to customers for each individual country is reported separately as follows:

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| The Republic of Azerbaijan | (739,350) | (138,384) |
| The Russian Federation | (202,491) | (59,096) |
| The Republic of Georgia | (6,678) | (991) |
| **Total consolidated provision for impairment of loans to customers** | (948,519) | (198,471) |

The following is an analysis of the Group's revenue from continuing operations from its major products and services.

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| Interest income on corporate loans | 549,890 | 560,128 |
| Interest income on retail loans | 48,282 | 94,285 |
| Fee and commission income from banking operations | 97,600 | 102,774 |
| Other revenue from banking operations | 28,323 | 30,869 |
| Income from insurance activities | 11,199 | 17,811 |
| Income from card processing activities | 19,888 | 6,378 |
| **Total consolidated revenues** | 755,182 | 812,245 |

## 30. FINANCIAL RISK MANAGEMENT

The Group has exposure to financial risks which include credit, liquidity, market and operational risks. The taking of risk is integral to the Group's business. The Group's risk management function's aim is to achieve an appropriate balance between risk and return and to minimise potential adverse effects on the Group's financial performance.

### The risk management framework

The risk management function is an integral part of the Group's internal control system and is centralised. The Group's risk management policies and approaches aim to identify, analyse, mitigate and manage the risks faced by the Group. This is accomplished through setting appropriate risk limits and controls, continuously monitoring risk levels and the adherence to limits and procedures and ensuring that business processes are correctly formulated and maintained.

Risk Management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, as part of its risk culture, emphasises integrity, management and employee standards in order to maintain and continuously improve upon a conservative control environment.

**Risk management bodies and governance**

Risk management policy, assessment, approval, monitoring and controls are conducted by a number of specialised bodies within the Group. These bodies also oversee the risk management policies and controls at the Group's subsidiaries. The Group has established executive bodies, committees and departments, which conform to Azerbaijani, Russian, Georgian laws, the CBAR, CBRF, NBG regulations and the best industry practices.

The Supervisory Board of the Group has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing and approving risk management policies as well as several key risk limit approval authorities, including significantly large exposures, economic and product sector limits. It also delegates certain authority levels to the Executive Board and the Credit Committee.

Established by, appointed by and reporting directly to the Supervisory Board are the Executive Board, the Risk Management Department, the Audit Committee ("AC"), the Credit Committee and the Asset and Liability Committee ("ALCO") and Committee of Information Technology.

The Executive Board is responsible for the implementation and monitoring of risk mitigation measures and ensuring that the Group operates within the established risk parameters. The Member of the Executive Board responsible for risk management along with the Risk Management Department, which reports to this Director, are responsible for the overall risk management functions, ensuring the implementation of common principles and methods for identifying, measuring, mitigating, managing and reporting both financial and non-financial risks.

The Risk Management Department is responsible for establishing risk management methodologies and ensuring that the risk appetite of the Group is correctly reflected in the strategic and business plans of the Group. It is the main forum for discussing and recommending changes in all risk approaches and procedures to the Executive and Supervisory Boards. It ensures that the Risk Management Department, the Credit Committee and ALCO, as well as the Executive Board, address all potential risks facing the Group prepared by the Management and reviewed by the Audit Committee and reports on these issues to the Supervisory Board.

ALCO is responsible for the management and optimisation of the Group's asset and liability structure. It is an integral part of the risk management process that focuses on various market risks, including liquidity, foreign currency and interest rate risks. ALCO's functions include making recommendations for approval of strategies, policies and limits associated with the aforementioned risks. It is responsible for providing timely and reliable information and reports regarding these risk areas. ALCO assists in setting pricing policies and funding strategies. It is also responsible, along with other risk management and controlling units of the Group, for ensuring that Treasury and other relevant units work with the parameters set by ALCO, the Risk Management Department, the Executive Board and the Supervisory Board.

The information Technology Committee is chaired by the Deputy Chairman of the Executive Board and responsible for determination of strategy of use of IT and communication technologies. It ensures that structures of the Bank uses modern technologies for providing high level services to its clients. The Information Technology Committee defines IT procedures. All major IT issues are presented to the Supervisory Board for discussion with prior consent of the Executive Board.

**The Audit Committee**

The Audit Committee ("AC") is responsible for overseeing and monitoring the internal control framework of the Group and for assessing the adequacy of risk management policies and procedures, as an integral part of the internal control system of the Group. The AC members cannot be part of the management structure of the Group. They provide recommendations to the Executive Board, the Risk Management Department and the Supervisory Board on development of the framework, as well as their views on, the quality of risk management and compliance with established policies, procedures and limits. The AC supervises the work of the Internal Audit, which reports directly to the AC. The Internal Audit's working plans, schedule of audits and its reports, including non-planned audits, are closely reviewed and approved by the AC. Implementation plans based on the AC's recommendations, including status reports, are approved by the Executive Board and reported to the Executive Board, the Supervisory Board and the General Meeting of the Shareholders.

### Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations when due. The major portion of credit risk arises from the Groups' loans and advances to customers and banks and other on and off balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of credit risk exposures such as individual customer and counterparty default risk and industry risk.

The general credit risk approval structure, for corporate legal entities, private individuals and financial organisations, is as follows:

| | |
|---|---|
| Supervisory Board | The Supervisory Board reviews and approves limits above AZN 5 million and meets on a regular basis |
| Executive Board | The Executive Board reviews and approves limits above 1% of total regulatory capital up to a maximum limit of AZN 5 million and meets on a regular basis |
| Credit Committee | The Credit Committee reviews and approves limits up to 1% of total regulatory capital and meets on a regular basis |

The Supervisory Board also approves general limits so as to control and manage risk diversification:

- Portfolio limits: Corporate loans, retail loans and interbank exposures as percentages of the total portfolio;
- Portfolio limits: Secured facilities and unsecured facilities as percentages of the total portfolios and as a percentage of the retail portfolio; and
- Economic sector and product exposures: as a percentage of the corporate and retail portfolios.

The Executive Board also approves limits and authority levels for exposures, as follows:

- By branch;
- By collateral type and loan to value ratios; and
- By individual authority.

As at December 31, 2015, the breakdown of the loan portfolio by economic and product sectors is provided in Note 6.

### Credit risk management

Credit risk policy is developed by the Risk Management Department and Executive Board in line with the risk profile and strategic plans of the Group. It is approved by the Supervisory Board.

This policy establishes:

- Procedures for generating, analysing, reviewing and approving counterparty risk exposures;
- The methodology for the credit assessment of counterparties;
- The methodology for the credit rating of counterparties;
- The methodology for the evaluation and control of collateral;
- Credit documentation requirements;
- Loan administration procedures;
- Procedures for the ongoing monitoring of credit exposures; and
- Loan loss provisioning policy.

Loan/credit requests are originated and generated by client managers and credit inspectors. Credit applications within approved authority limits are approved by the branches or relevant business generating units. Then copies of these approved requests are submitted to the Corporate Business Department for post-control, including being assigned a rating and input into a monitoring schedule.

Risk exposure requests above these limits are sent to the Credit Committee. The Credit Committee performs a secondary analysis and issues a report, rating and opinion.
If the credit request is below a certain authorised limit and receives a positive opinion from the Credit Committee, and is signed off by the appropriate individuals, then the request is considered approved.

If the opinion of risk management is negative then the request is sent to the Credit Committee for adjudication. If approved and the transaction is in an amount higher than the competence of the Credit Committee then it is sent to the Executive Board for approval. Large transactions, as defined above, have to be submitted to the Supervisory Board for approval.

The Group uses a scoring system based on an analysis of four basic criteria: creditworthiness, financial performance, credit history and other risks. The Group uses this system for decision-making purposes to lend to new borrowers. For the quality of its existing loan portfolio, the Group uses the classification as disclosed in Note 6 to these consolidated financial statements.

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

For certain retail loan products, a credit scoring system is used, plus the Group uses its internal database and that of the CBAR to identify potentially risky customers. Credit assessments are done on a portfolio basis concentrating on amount and term limits, approval procedures, target groups, types of product, default statistics, loan/value ratios (if applicable), and pricing.

The following table presents the maximum exposure to credit risk of balance sheet and off balance sheet financial assets. For financial assets in the balance sheet, the maximum exposure is equal to the carrying amount of those assets prior to any offset or collateral. The Group's maximum exposure to credit risk under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

| | Maximum exposure | Offset | Net exposure after offset | Collateral pledged | Net exposure |
|---|---|---|---|---|---|
| **December 31, 2015** | | | | | |
| Cash and cash equivalents (excluding cash on hand) | 1,292,867 | - | 1,292,867 | - | 1,292,867 |
| Mandatory cash balances with the National/Central banks | 15,334 | - | 15,334 | - | 15,334 |
| Due from other banks | 102,028 | - | 102,028 | - | 102,028 |
| Loans and advances to customers | 5,635,583 | (113,114) | 5,522,469 | (3,883,623) | 1,638,846 |
| Financial assets at fair value through profit or loss | 906 | - | 906 | - | 906 |
| Other debt securities | 29,298 | - | 29,298 | - | 29,298 |
| Available-for-sale investments | 97 | - | 97 | - | 97 |
| Receivables from Aqrarkredit | 5,628,923 | - | 5,628,923 | - | 5,628,923 |
| Other financial and insurance assets | 210,028 | - | 210,028 | - | 210,028 |
| Guarantees issued | 1,504,316 | - | 1,504,316 | - | 1,504,316 |
| Import letters of credit | 349,245 | (140,852) | 208,393 | - | 208,393 |
| Commitments to extend credit and undrawn credit lines | 93,569 | - | 93,569 | - | 93,569 |
| **December 31, 2014** | | | | | |
| Cash and cash equivalents (excluding cash on hand) | 402,052 | - | 402,052 | - | 402,052 |
| Mandatory cash balances with the National/Central banks | 9,678 | - | 9,678 | - | 9,678 |
| Due from other banks | 303,639 | (11,000) | 292,639 | - | 292,639 |
| Loans and advances to customers | 7,854,991 | (182,023) | 7,672,968 | (5,011,460) | 2,661,508 |
| Financial assets at fair value through profit or loss | 14,997 | - | 14,997 | - | 14,997 |
| Other debt securities | 45,355 | - | 45,355 | - | 45,355 |
| Available-for-sale investments | 5,287 | - | 5,287 | - | 5,287 |
| Other financial and insurance assets | 23,650 | - | 23,650 | - | 23,650 |
| Guarantees issued | 1,335,398 | - | 1,335,398 | - | 1,335,398 |
| Import letters of credit | 772,597 | (81,375) | 691,222 | - | 691,222 |
| Commitments to extend credit and undrawn credit lines | 67,066 | - | 67,066 | - | 67,066 |

**Collateral and other credit enhancements**

Exposure to credit risk is also assessed and managed, in part, by obtaining, controlling and monitoring collateral in the form of mortgage interests over property, pledge of assets and securities and other collateral including deposits, corporate and personal guarantees.

While collateral is an important mitigating factor in assessing the credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather than to rely solely on security. Collateral is considered as a secondary source of repayment. In limited cases, depending on the customer's standing or on the type of product or amounts, the facilities may be unsecured. The Group has in place various limits on the unsecured portions of its risk portfolio.

The principal types of collateral accepted by the Group are as follows:

- Real estate
- State guarantees
- Corporate guarantees
- Cash deposits
- Movable property and equipment
- Other including precious metals

Strict appraisal, documentation and, where applicable, registration procedures are in place for all forms of collaterals. Loan to value ratios are approved by the Executive Board and controlled by the Corporate Business Department. The loan to value limits as of December 31, 2015 are as follows:

| **Type of collateral** | **Ratio of loan amount to liquid value of collateral** |
|---|---|
| Real estate | up to 60% |
| Precious metals | up to 80% |
| Machinery, equipment | up to 50% |
| Inventory | up to 60% |
| Vehicles, transport | up to 70% |
| Term deposit | up to 80% |

However, management notes that the above limits may at certain times be overridden based on commercial considerations.

The Corporate Business Department is responsible for establishing a schedule of monitoring events, fulfilling this plan and notifying the appropriate parties if the monitoring results are unsatisfactory and recommending a plan of action. The Risk Management Department physically monitors all transactions above an established amount plus does selected checks of transactions below this amount. All transactions above a certain amount are first monitored either before or at least within one month of disbursement. Following this, risk exposures are monitored according to a schedule.

The Risk Management Department is charged with compiling and reporting on all counterparty credit risk issues, including compliance with all limits, risk concentrations, portfolio trends, past due and default statistics, loan loss reserves and collateral statistics. Besides regular monthly reporting, they also compile reports on adherence to selected credit procedures.

**Related party lending**

The CBAR has strict definitions regarding the category of "related parties". Mainly, these are corporate entities owned/controlled by the Shareholders or the private individual shareholders themselves or immediate family members. Also included are individuals with senior management/authority positions in the Group. The largest loan per related party private individual may not be more than 3% of the consolidated capital of the Group. Per related corporate entity, the limit is 10%. The overall limit for related party risk exposure is 20%. Pricing and other terms and conditions must be done on an arms-length basis. The Bank may at times be in breach of certain statutory covenants set out by the CBAR on related party balances. For information on potential consequences of those breaches refer to Note 32.

**Past due, non-performing loans**

The Group has in place procedures for reporting and dealing with past-due and non-performing loans from the first day past-due. Up to 60-day past-dues are all handled by the relevant business units unless obvious problems are identified earlier. Unsecured retail loans over 60-days past-due are automatically transferred to the Problematic Loans Department. Corporate loans over 90-days past-due are also transferred to this department. If the Problematic Loans Department is unsuccessful in collecting these obligations, then legal proceedings are instituted. When a loan is deemed uncollectible, recommendations to write-off these amounts are presented to the Credit Committee and the Executive Board. Final decisions regarding write-offs are taken by the Supervisory Board. All past-dues statistics are reported to the Credit Committee on at least a monthly basis. All corporate loan past-due issues are individually reported to the Credit Committee.

**Provision for loan impairment – reserve policy**

The Group establishes an allowance for loan losses that represents its estimate of losses incurred in its risk exposures.

The CBAR also has a reserving policy, which is a minimum standard for banks. The categories with reserve requirements are as follows:

| | |
|---|---|
| Standard assets | 1% |
| Controllable assets | 5% |
| Unsatisfactory assets | 30% |
| Assets-at-risk | 60% |
| Hopeless assets | 100% |

These categories are strictly defined.

In its IFRS reporting, the Group utilises the methodology contained in IAS 39 – Financial Instruments: Recognition and Measurement.

**Management of insurance risks**

*Insurance risk*

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and, therefore, unpredictable for each individual insurance contract.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits may be greater than estimated. Insured events are random and the actual number and amount of claims and benefits will vary from year to year from the level established using statistical techniques.

The Group manages its insurance risk by means of established internal procedures which include underwriting authority levels, pricing policy, approved reinsurers list and ongoing monitoring.

*Estimation of insurance loss reserves*

Loss provisions are calculated based on the Group's historical data. In calculating the estimated cost of unpaid claims (both reported and not), the Group's estimation techniques include a combination of loss ratio-based estimates (where the loss ratio is defined as the ratio between the ultimate cost of insurance claims and insurance premiums earned in a particular financial year in relation to such claims) and an estimate based upon actual claims experience using predetermined formulae where a greater weight is given to actual claims experience as time passes.

The initial loss ratio estimate is an important assumption in the estimation technique and is based on previous years' experience, adjusted for factors such as premium rate changes, anticipated market experience and historical claims inflation. The initial estimate of the loss ratios used for the current year (before reinsurance) are analysed by type of risk for current and prior year premiums earned.

*Sources of uncertainty in the estimation of future claim payments*

Claims on insurance contracts are payable on a claims-occurrence basis. The Group is liable for all insured events that occurred during the term of the contract. As a result, liability claims are settled within a short period of time, which historically has not exceeded 3 months from the end of the contract term. There are several variables that affect the amount and timing of cash flows from insurance contracts. These mainly relate to the inherent risks of the activities carried out by both corporate and individual contract holders and the risk management procedures they adopted. The compensation paid on insurance contracts in the Group's portfolio primarily consists of monetary awards granted for:

- medical insurance;
- physical damage to motor vehicles (for motor vehicle insurance covers); and
- financial loss, bodily injury and physical damage suffered by the third parties (caused by the vehicle owners).

Such awards are lump-sum payments that are calculated by the Group's in-house underwriters as the present value of the lost earnings and rehabilitation expenses that the injured party will incur as a result of the accident.

*Reinsurance policy*

An element of the Group's motor, property, third party liability, employer liability and cargo portfolios is reinsured with local and foreign insurance companies under reinsurance agreements that reduce the potential maximum exposure that the Group is subject to.

*Diversification*

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

**Market risk**

The Group is exposed to market risks. Market risks arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements. The Group manages market risk through policies of very limited exposures to these risks and periodic estimations of the Group's positions regarding these risks.

The Group does not have any trading positions in financial instruments. Its exposure to the securities market is the investment, from time to time, in the CBAR notes, Azerbaijan Ministry of Finance obligations and securities issued by other banks in order to help manage its consolidated liquidity position. The Group does not normally trade in the derivatives market, except for trading in currency SWAP agreements.

**Currency risk**

The Group is exposed to the effects of fluctuations in the prevailing local/foreign currency exchange rates on its consolidated financial position. Currency risk is the risk that movements in foreign exchange rates will affect the Group's income or the value of its portfolios of financial instruments.

The main element in the Group's risk policy regarding foreign currency risk is that there is no conscious effort to take a trading position in any currency. Limited open positions occur as a natural consequence of business operations only. The Group uses every effort to match its assets and liabilities by currency.

Exposure to foreign exchange risk faced by the Bank is also limited by the CBAR normative requirements, which place a 10% of capital limit on open positions in any single foreign currency and a 20% open limit on all foreign currencies.

The foreign exchange exposures are managed by the Chief Financial Officer and Central Treasury department. The reports on open currency positions prepared by the Treasury department are reviewed by ALCO.

The table below summarises the Group's consolidated exposure to foreign currency exchange rate risk at the end of the reporting period:

| | December 31, 2015 | | | | December 31, 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | Monetary financial and insurance assets | Monetary financial and insurance liabilities | Foreign currency SWAP agreements | Net position | Monetary financial and insurance assets | Monetary financial and insurance liabilities | Foreign currency SWAP agreements | Net position |
| AZN | 9,787,665 | 2,392,032 | - | 7,395,633 | 4,502,986 | 2,717,272 | - | 1,785,714 |
| USD | 3,077,016 | 9,408,076 | 679,027 | (5,652,033) | 3,200,376 | 4,571,418 | 37,280 | (1,333,762) |
| EUR | 155,276 | 846,517 | (663,413) | (1,354,654) | 937,145 | 971,012 | (129,491) | (163,358) |
| RR | 147,786 | 185,763 | - | (37,977) | 180,663 | 101,684 | - | 78,979 |
| Other | 52,150 | 44,601 | (14,708) | (7,159) | 29,622 | 100,405 | 85,602 | 14,819 |
| Total | 13,219,893 | 12,876,989 | 906 | 343,810 | 8,850,792 | 8,461,791 | (6,609) | 382,392 |

In the above table, monetary financial and insurance assets and liabilities columns exclude the financial assets and liabilities arising from foreign currency SWAP agreements, which are disclosed in a separate column.

Foreign currency SWAP agreements in the amount of EUR payables of AZN 675,022 thousand, GBP payables of AZN 11,566 thousand, CHF payables of AZN 3,148 thousand USD receivable of AZN 679,027 thousand and EUR receivables of AZN 11,609 thousand, resulted in net fair value gain on derivatives in the amount of AZN 906 thousand (December 31, 2014 USD payables of AZN 92,421, EUR payables of AZN 129,491 thousand, GBP receivables of AZN 13,999 thousand, XAU receivables of AZN 71,603 thousand and USD receivable of AZN 129,701 thousand resulted in net fair value loss on derivatives in the amount of AZN 6,609 thousand). Refer to Note 7 and 19. All foreign currency SWAP agreements are short-term which mature in January and February 2015 (December 31, 2014: January and February 2015). The above analysis includes only monetary assets and liabilities. Investments in equities and non-monetary assets are not considered to give rise to any material currency risk.

The Group has extended loans and advances denominated in foreign currencies. Depending on the revenue stream and cost structure of the borrower, the possible appreciation of the currencies, in which loans and advances have been extended against the Azerbaijani Manat may, adversely affect the borrower's repayment ability and, therefore, increase the potential of future loan losses.

***Currency risk sensitivity***

The following table details the Group's sensitivity to a 35% increase and decrease in the AZN against the relevant foreign currencies (2014 – 35%). 35% is the sensitivity rate used due to recent devaluation of AZN. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 35% (2014 – 35%) change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations with the Group where the denomination of the loan is in a currency other than the functional currency of the lender or the borrower. A negative number below indicates an increase in profit and other equity where the AZN strengthens 35 % against the relevant currency. For a 35% weakening of the AZN against the relevant currency, there would be a comparable impact on the profit and other equity, and the balances below would be positive.

Effect on profit or loss and equity:

| | USD impact | | EUR impact | | RR impact | |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Strengthening by 35% (2014:35%) | (1,978,212) | (466,817) | (474,129) | (57,175) | 13,292 | 27,643 |
| Weakening by 35% (2014:35%) | 1,978,212 | 466,817 | 474,129 | 57,175 | (13,292) | (27,643) |

In management's opinion, the sensitivity analysis is unrepresentative of the inherent foreign exchange risk because the year-end exposure does not reflect the exposure during the year.

***Interest rate risk***

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its consolidated financial position and consolidated cash flows. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected movements arise. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

At present, the Group manages its interest rate risk by matching, where possible, its maturity and/or repricing positions. In addition, the Group's monthly interest margins are continually reviewed in order to reprice its assets when deemed appropriate. Operational procedures set the acceptable interest rate margin usually at a minimum 5%. ALCO, Chief Financial Officer and the Accounting and Budgeting Department constantly monitor the maintenance of this margin. ALCO is also responsible for preparing interest rate movement reports and forecasts. At present, through the Group's matching policies for expected repricing and relatively high interest rate margins achieved in the Group's markets, the Group does not more actively manage this risk.

ALCO, Chief Financial Officer and Accounting and Budgeting Department are responsible for managing interest rate risk, the Risk Management Department is responsible for controlling the risk and the Executive Board must approve all guidelines and asset/liability repricing reports.

The sensitivity analyses below have been determined based on the exposure to interest rates at the end of the reporting period. For floating rate liabilities, the analysis is prepared assuming the amount of the liability outstanding at the end of the reporting period was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Group's profit and equity for the year ended December 31, 2015 would decrease/increase by AZN 35,447 thousand and AZN 28,358 thousand, respectively (December 31, 2014: decrease/increase by AZN 1,184 thousand and AZN 947 thousand ,respectively). This is mainly attributable to the Group's exposure to interest rates on its variable rate borrowings

The Group monitors interest rates for its financial instruments. The table below summarises interest rates based on reports reviewed by key management personnel:

| | | | 2015 | | | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | USD | AZN | EUR | RR | Other | USD | AZN | EUR | RR | Other |
| **Assets** | | | | | | | | | | |
| Cash and cash equivalents | 0.3 | - | - | - | - | 0.3 | - | - | - | - |
| Due from resident banks | 13.92 | 6.26 | - | - | 9.0 | 6.4 | 6.3 | - | - | - |
| Due from non-resident banks | 4.77 | - | - | - | - | 4.1 | - | 6.4 | - | - |
| Loans and advances to customers – individuals | 12.91 | 13.91 | 12.67 | 17.15 | 4.78 | 16.2 | 21.3 | 14.8 | 16.0 | 15.3 |
| Loans and advances to customers – corporate | 10.91 | 7.53 | 13.08 | 16.48 | 4.52 | 12.9 | 10.6 | 12.5 | 16.2 | 13.7 |
| Financial assets at fair value through profit or loss | - | - | - | - | - | - | - | - | 8.7 | - |
| Other debt securities | - | 11.4 | - | - | - | - | 12.1 | - | - | - |
| Receivables from Aqrarkredit | - | - | - | - | - | - | - | - | - | - |
| **Liabilities** | | | | | | | | | | |
| Customer accounts – individuals | 9.5 | 11.1 | 7.0 | 14.6 | 8.0 | 10.8 | 10.1 | 7.5 | 4.4 | 7.1 |
| Customer accounts – corporate | 6.9 | 4.0 | 5.5 | 10.6 | - | 8.3 | 4.5 | - | - | - |
| Due to other banks | 6.9 | - | 2.9 | - | - | 6.2 | 5.8 | 3.9 | - | 5.5 |
| Debt securities in issue – Eurobonds | 5.7 | - | - | - | - | 5.6 | - | - | - | - |
| Debt securities in issue – deposit certificates | 16.0 | 25.0 | - | - | - | 14.1 | 25.0 | - | - | - |
| Other borrowed funds | 6.8 | 1.4 | 2.4 | - | - | 3.2 | 1.0 | 2.3 | - | - |
| Subordinated debt | 6.2 | 5.3 | - | - | - | 6.2 | 6.0 | - | - | - |

The sign "-" in the table above means that the Group does not have the respective assets or liabilities in the corresponding currency.

### *Geographical risk concentrations*

The geographical concentration of the Group's consolidated financial assets and liabilities as at December 31, 2015 is set out below:

| | The Republic of Azerbaijan | OECD countries | Other non-OECD countries | Total |
|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | |
| Cash and cash equivalents | 1,357,086 | 157,743 | 82,867 | 1,597,696 |
| Mandatory cash balances with the National/Central banks | - | - | 15,334 | 15,334 |
| Due from other banks | 65,869 | 8,269 | 27,890 | 102,028 |
| Loans and advances to customers | 5,392,415 | - | 243,168 | 5,635,583 |
| Financial assets at fair value through profit or loss | - | 906 | - | 906 |
| Other debt securities | 29,298 | - | - | 29,298 |
| Available-for-sale investments | 62 | - | 35 | 97 |
| Receivables from Agrakredit | 5,628,923 | - | - | 5,628,923 |
| Other financial and insurance assets | 207,714 | - | 2,314 | 210,028 |
| **TOTAL FINANCIAL ASSETS** | 12,681,367 | 166,918 | 371,608 | 13,219,893 |
| **FINANCIAL LIABILITIES:** | | | | |
| Due to other banks | 99,351 | 968,141 | 733,352 | 1,800,844 |
| Customer accounts | 6,329,383 | 7,339 | 757,392 | 7,094,114 |
| Debt securities in issue | 16,707 | 872,807 | 4,140 | 893,654 |
| Other borrowed funds | 253,447 | 1,934,687 | 74,845 | 2,262,979 |
| Other financial and insurance liabilities | 64,486 | - | 1,869 | 66,355 |
| Subordinated debt | 600,176 | 158,867 | - | 759,043 |
| **TOTAL FINANCIAL LIABILITIES** | 7,363,550 | 3,941,841 | 1,571,598 | 12,876,989 |
| **NET POSITION** | 5,317,817 | (3,774,923) | (1,199,990) | |
| **CREDIT RELATED COMMITMENTS** | 1,947,130 | - | - | |

Assets, liabilities and credit related commitments have generally been based on the country, in which the counterparty is located. Balances with Azerbaijani counterparties actually outstanding to/from off-shore companies of these Azerbaijani counterparties are allocated to the caption "Azerbaijan". Cash on hand has been allocated based on the country, in which they are physically held.

The geographical concentration of the Group's consolidated assets and liabilities as at December 31, 2014 is set out below:

| | The Republic of Azerbaijan | OECD countries | Other non-OECD countries | Total |
|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | |
| Cash and cash equivalents | 267,726 | 284,934 | 40,535 | 593,195 |
| Mandatory cash balances with the National/Central banks | - | - | 9,678 | 9,678 |
| Due from other banks | 119,549 | 23,630 | 160,460 | 303,639 |
| Loans and advances to customers | 7,136,743 | 151,126 | 567,122 | 7,854,991 |
| Financial assets at fair value through profit or loss | - | - | 14,997 | 14,997 |
| Other debt securities | 45,355 | - | - | 45,355 |
| Available-for-sale investments | 2,109 | - | 3,178 | 5,287 |
| Other financial and insurance assets | 20,132 | - | 3,518 | 23,650 |
| **TOTAL FINANCIAL ASSETS** | 7,591,614 | 459,690 | 799,488 | 8,850,792 |
| **FINANCIAL LIABILITIES:** | | | | |
| Due to other banks | 265,515 | 668,183 | 931,264 | 1,864,962 |
| Customer accounts | 3,276,880 | 29,334 | 838,464 | 4,144,678 |
| Debt securities in issue | 9,229 | 389,161 | 2,537 | 400,927 |
| Other borrowed funds | 232,047 | 1,041,607 | 289,712 | 1,563,366 |
| Other financial and insurance liabilities | 59,635 | - | 6,718 | 66,353 |
| Subordinated debt | 350,000 | 71,505 | - | 421,505 |
| **TOTAL FINANCIAL LIABILITIES** | 4,193,306 | 2,199,790 | 2,068,695 | 8,461,791 |
| **NET POSITION** | 3,398,308 | (1,740,100) | (1,269,207) | |
| **CREDIT RELATED COMMITMENTS** | 2,175,061 | - | - | |

### *Other risk concentrations*

As a part of its management of risk concentrations, management monitors concentrations of credit risk on the basis of the statutory limits set by the CBAR, as follows:

- The aggregate amount of loans, the fair value of the collateral of which is greater than 100% of the carrying amount of the loan and greater than 150% of the carrying amount of the loan in case if collateral is real estate, may not exceed 20% of the total statutory capital calculated in accordance with the CBAR's guidance;
- The aggregate amount of loans, the fair value of the collateral, calculated as per CBAR guidelines, of which is less than 100% of the carrying amount of the loan, and less than 150% of the carrying amount of the loan in case if the collateral is real estate, may not exceed 7% of the total statutory capital calculated in accordance with the CBAR's guidance; and
- The ratio of the aggregate amount of significant loans (loans with a carrying amount of AZN 1 million and above) to the statutory capital calculated in accordance with the CBAR's guidance may not be higher than 8.

For IFRS reporting purposes, the Group, monitors concentrations of credit risk by obtaining reports listing exposures to borrowers with aggregated loan balances in excess of 10% of net assets. The Group discloses any such concentrations within the respective notes in its consolidated financial statements.

### *Liquidity risk*

Liquidity risk is the risk that the Group will encounter difficulty in settling its financial obligations. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments and insurance obligations as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Executive Board and Supervisory Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The CBAR has in place minimum levels of liquidity required. Loan agreements with international financial institutions also have minimum liquidity covenants in their agreements with the Group. Management's consideration on compliance with these covenants is disclosed in Note 32.

The Chief Financial Officer, Central Treasury and Accounting and Budgeting Departments are charged with the following responsibilities:

- Monitoring compliance with the liquidity requirements of the CBAR as well as the liquidity requirements through covenants contained in the agreements with foreign lenders;
- Daily reports to management, including reporting to management on the forecast levels of cash flows in the main currencies (AZN, USD, EUR), cash positions, balance sheet changes;
- Constantly controlling/monitoring the level of liquid assets;
- Monitoring of deposit and other liability concentrations;
- Maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

ALCO is responsible for ensuring that Chief Financial Officer and Central Treasury department properly manages the Group's consolidated liquidity position. Decisions on liquidity positions and management are made by the Executive Board.

The undiscounted maturity analysis of liabilities as at December 31, 2015 is as follows:

| | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Due to other banks | 509,960 | 687,938 | 635,076 | 12,348 | - | 1,845,322 |
| Customer accounts | 5,221,308 | 451,389 | 948,323 | 635,015 | 617,910 | 7,873,945 |
| Debt securities in issue | 4,184 | 116,385 | 34,682 | 1,017,553 | - | 1,172,804 |
| Other borrowed funds | 187,642 | 92,700 | 897,196 | 1,154,943 | 283,034 | 2,615,515 |
| Other financial and insurance liabilities | 46,791 | 1,001 | 4,294 | 28,800 | - | 80,886 |
| Subordinated debt | 3,448 | 8,475 | 31,029 | 594,738 | 252,568 | 890,258 |
| Commitments to extend credit and undrawn credit lines | 93,569 | - | - | - | - | 93,569 |
| Import letters of credit | 95,288 | 34,880 | 204,901 | 23,255 | - | 358,324 |
| Guarantees issued | 87,315 | 232,597 | 627,120 | 568,892 | 84,667 | 1,600,591 |
| **Total potential future payments for financial obligations** | **6,249,505** | **1,625,365** | **3,382,621** | **4,035,544** | **1,238,179** | **16,531,214** |

The undiscounted maturity analysis of liabilities as at December 31, 2014 is as follows:

| | Demand and less than 1 month | From 1 to 3 months | From 3 to 12 months | From 12 months to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Due to other banks | 638,845 | 530,345 | 613,940 | 146,054 | - | 1,929,184 |
| Customer accounts | 1,989,098 | 326,915 | 1,022,658 | 835,132 | 381,743 | 4,555,546 |
| Debt securities in issue | 2,058 | 3,677 | 16,546 | 481,364 | - | 503,645 |
| Other borrowed funds | 75,012 | 156,529 | 378,923 | 884,367 | 290,689 | 1,785,520 |
| Other financial and insurance liabilities | 42,161 | 1,560 | 6,141 | 16,491 | - | 66,353 |
| Subordinated debt | 2,110 | 4,220 | 18,988 | 385,804 | 103,700 | 514,822 |
| Commitments to extend credit and undrawn credit lines | 67,066 | - | - | - | - | 67,066 |
| Import letters of credit | 211,185 | 77,304 | 454,118 | 51,540 | - | 794,147 |
| Guarantees issued | 77,568 | 206,632 | 557,115 | 505,387 | 75,216 | 1,421,918 |
| **Total potential future payments for financial obligations** | 3,105,103 | 1,307,182 | 3,068,429 | 3,306,139 | 851,348 | 11,638,201 |

The Group does not use the above undiscounted maturity analysis to manage liquidity. Instead, the Group monitors contractual maturities of carrying values of assets and liabilities.

The following two tables show carrying amounts of financial assets and financial liabilities of the Group grouped on the basis of the remaining period from the end of the reporting period to their contractual maturity date.

The analysis of carrying values of assets and liabilities by contractual maturities may be summarised as follows as at December 31, 2015:

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | Over 12 months | Total |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | | |
| Cash and cash equivalents | 1,597,696 | - | - | - | 1,597,696 |
| Mandatory cash balances with the National/Central banks | 15,334 | - | - | - | 15,334 |
| Due from other banks | 15,780 | 2,752 | 3,580 | 79,916 | 102,028 |
| Loans and advances to customers | 119,448 | 759,866 | 492,122 | 4,264,147 | 5,635,583 |
| Financial assets at fair value through profit or loss | 906 | - | - | - | 906 |
| Other debt securities | 4 | - | - | 29,294 | 29,298 |
| Available-for-sale investments | 35 | - | - | 62 | 97 |
| Receivables from Aqrarkredit | 500,000 | 2,177,776 | 2,951,147 | - | 5,628,923 |
| Other financial and insurance assets | 8,195 | 8,146 | 193,384 | 303 | 210,028 |
| **TOTAL FINANCIAL ASSETS** | 2,257,398 | 2,948,540 | 3,640,233 | 4,373,722 | 13,219,893 |
| **FINANCIAL LIABILITIES:** | | | | | |
| Due to other banks | 503,837 | 967,593 | 317,396 | 12,018 | 1,800,844 |
| Customer accounts | 4,860,884 | 796,862 | 449,546 | 986,822 | 7,094,114 |
| Debt securities in issue | 96 | 108,675 | 1,750 | 783,133 | 893,654 |
| Other borrowed funds | 163,496 | 411,784 | 423,051 | 1,264,648 | 2,262,979 |
| Other financial and insurance liabilities | 46,791 | 1,001 | 4,294 | 14,269 | 66,355 |
| Subordinated debt | - | 1,580 | - | 757,463 | 759,043 |
| **TOTAL FINANCIAL LIABILITIES** | 5,575,104 | 2,287,495 | 1,196,037 | 3,818,353 | 12,876,989 |
| **NET LIQUIDITY GAP AS AT DECEMBER 31, 2015** | (3,317,706) | 661,045 | 2,444,196 | 555,369 | |
| **CUMULATIVE LIQUIDITY GAP AS AT DECEMBER 31, 2015** | (3,317,706) | (2,656,661) | (212,465) | 342,904 | |

The analysis of carrying values of assets and liabilities by contractual maturities may be summarised as follows as at December 31, 2014:

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | Over 12 months | Total |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | | |
| Cash and cash equivalents | 593,195 | - | - | - | 593,195 |
| Mandatory cash balances with the National/Central banks | 9,678 | - | - | - | 9,678 |
| Due from other banks | 120,455 | 72,700 | 39,845 | 70,639 | 303,639 |
| Loans and advances to customers | 539,955 | 621,896 | 706,625 | 5,986,515 | 7,854,991 |
| Financial assets at fair value through profit or loss | - | 1,502 | 2,829 | 10,666 | 14,997 |
| Other debt securities | 116 | - | - | 45,239 | 45,355 |
| Available-for-sale investments | 23 | - | - | 5,264 | 5,287 |
| Other financial and insurance assets | 14,556 | 6,358 | 439 | 2,297 | 23,650 |
| **TOTAL FINANCIAL ASSETS** | 1,277,978 | 702,456 | 749,738 | 6,120,620 | 8,850,792 |
| **FINANCIAL LIABILITIES:** | | | | | |
| Due to other banks | 415,698 | 978,070 | 311,443 | 159,751 | 1,864,962 |
| Customer accounts | 1,973,422 | 628,310 | 646,174 | 896,772 | 4,144,678 |
| Debt securities in issue | 4 | 654 | 186 | 400,083 | 400,927 |
| Other borrowed funds | 74,171 | 201,898 | 286,985 | 1,000,312 | 1,563,366 |
| Other financial and insurance liabilities | 42,161 | 1,560 | 6,141 | 16,491 | 66,353 |
| Subordinated debt | - | - | - | 421,505 | 421,505 |
| **TOTAL FINANCIAL LIABILITIES** | 2,505,456 | 1,810,492 | 1,250,929 | 2,894,914 | 8,461,791 |
| **NET LIQUIDITY GAP AS AT DECEMBER 31, 2014** | (1,227,478) | (1,108,036) | (501,191) | 3,225,706 | |
| **CUMULATIVE LIQUIDITY GAP AS AT DECEMBER 31, 2014** | (1,227,478) | (2,335,514) | (2,836,705) | 389,001 | |

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Group and its exposure to changes in interest and exchange rates.

Management believes that in spite of a substantial portion of customers' accounts being on demand, diversification of these deposits by number and type of depositors, and the past experience of the Group would indicate that these customer accounts provide a long-term and stable source of funding for the Group. Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with the Civil Code of the Republic of Azerbaijan, individuals have a right to withdraw their deposits prior to maturity if they forfeit their right to a certain portion of accrued interest.

The short-term liquidity gap of the Group at 31 December 2015 has been negatively impacted by the increase in demand and less than 1 month category of customer deposits amounting to AZN 2,903,873 thousand. This increase has been driven by customer demand to place funds in either foreign exchange denominated deposit or demand accounts as a result of the devaluations of the Manat in February and December 2015. These balances even though significant have remained stable during 2015.

During January and February 2016 customer accounts and due to other banks amounting to AZN 587,395 thousand and included into "Up to 1 month" or "From 1 to 6 months" categories have been already prolonged for periods up to 12 months. Management is currently in the process of negotiating new maturities of borrowings and amounts due to banks with an extension of maturities in a three to five year window. In addition they are looking at other potential financing methods such as public issuances.

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

The contractual maturity dates are set out in Note 18 for the individual term borrowings and in Note 21 for the subordinated debt of the Group.

***Other price risks***

Equity price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.

The sensitivity analyses below have been determined based on the exposure to equity price risks at the end of the reporting period.

If equity prices had been 5% higher/lower:

- Net profit for the year ended December 31, 2015 and 2014 would increase/decrease by AZN 2 and AZN 53 thousand, respectively as a result of the changes in fair value of equity investments; and

- Other equity reserves would increase/decrease by AZN 5 thousand and by AZN 453 thousand as at December 31, 2015 and 2014, respectively, as a result of the changes in fair value of equity investments.

The Group's sensitivity to equity prices has not changed significantly from the prior year.

***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 Group cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes.

## 31. MANAGEMENT OF CAPITAL

The objectives of management when managing the Group's capital are (i) to comply with the capital requirements set by the CBAR, (ii) to safeguard the Group's ability to continue as a going concern and (iii) to maintain a sufficient capital base to achieve a capital adequacy ratio based on Basel I of at least 6%. Compliance with capital adequacy ratios set by the CBAR is monitored monthly with reports outlining their calculation reviewed and signed by the Head of Audit Committee, First Deputy of Chairman of the Board, Chief Financial Officer, Internal Audit Department and Accounting and Budgeting Department. The other objectives of capital management are evaluated on an ongoing basis.

Under the current capital requirements set by the CBAR banks have to: (a) hold the minimum level of total statutory capital of AZN 50,000 thousand (December 31, 2014: AZN 10,000 thousand); (b) maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 10% (December 31, 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% (December 31, 2014: 6%).

Under the current capital requirements set by the CBRF, banks have to (i) comply with the capital requirements set by the Central Bank of the Russian Federation, (ii) safeguard the Bank's ability to continue as a going concern and (iii) maintain a sufficient capital base to achieve a capital adequacy ratios of total (8%) and Tier 1 capital (4%) to risk weighted assets.

Under the current capital requirements set by the NBRG, banks have to (i) comply with the capital requirements set by the National Bank of Republic of Georgia, (ii) safeguard the Bank's ability to continue as a going concern and (iii) maintain a sufficient capital base to achieve a capital adequacy ratios of total (12%) and Tier 1 capital (8%) to risk weighted assets.

As at December 31, 2015, the Bank has complied with all capital requirements imposed by CBAR. (The Bank was in compliance with these requirements at December 31, 2014).

The Group and the Bank are also subject to requirements established by covenants stated in loan agreements, including capital adequacy levels calculated in accordance with the requirements of the Basel Accord, as defined in the International Convergence of Capital Measurement and Capital Standards (updated April 1998). The composition of the Group's capital calculated in accordance with Basel I, based on the consolidated financial statements of the Group, is as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 641,287 | 590,192 |
| Additional paid in capital (net of tax) | 799,971 | - |
| (Accumulated losses)/Retained earnings | (744,750) | 65,670 |
| Non-controlling interest | 4,440 | 3,073 |
| Less: Intangible assets | (9,230) | (7,850) |
| **Total qualifying Tier 1 capital** | **691,718** | **651,085** |
| **Tier 2 capital** | | |
| Reserves (1.25% of total risk-weighted assets) | 82,389 | 114,254 |
| Revaluation reserve for premises | 40,740 | 42,160 |
| Subordinated debt(up to 50% of Tier 1) | 345,859 | 294,984 |
| **Total qualifying Tier 2 capital limited to 100% of Tier 1 capital** | **468,988** | **451,398** |
| Less: Investments in equity shares | (187) | (348) |
| **Total regulatory capital** | **1,160,519** | **1,102,135** |
| **Risk-weighted assets:** | | |
| On-balance sheet | 4,874,979 | 7,618,643 |
| Off-balance sheet | 1,716,125 | 1,521,707 |
| **Total risk-weighted assets** | **6,591,104** | **9,140,350** |
| Capital Ratios: | | |
| Tier 1 capital | 10.49% | 7.12% |
| Total capital | 17.61% | 12.06% |

As an integral part of the Bank's capital management procedures the Chief Financial Officer performs regular monitoring of compliance with the externally imposed capital requirements and the monitoring reports are reviewed and approved by Head of Audit Committee, Chairman of the Board of Directors and the Head of Internal Audit Department. As at December 31, 2015 the Group and Bank have complied with all externally imposed capital requirements.

## 32. CONTINGENCIES AND COMMITMENTS

***Legal proceedings*** – From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these consolidated financial statements.

***Taxation*** – Commercial legislation of the Republic of Azerbaijan, including tax legislation, may allow more than one interpretation. In addition, there is a risk of tax authorities making arbitrary judgments of business activities. If a particular treatment, based on management's judgment of the Group's business activities, was to be challenged by the tax authorities, the Group may be assessed additional taxes, penalties and interest.

Such uncertainty may relate to the valuation of financial instruments, valuation of provision for impairment losses and the market pricing of deals. Additionally such uncertainty may relate to the valuation of temporary differences on the provision and recovery of the provision for impairment losses on loans to customers and receivables, as an underestimation of the taxable profit. The management of the Bank believes that it has accrued all tax amounts due and therefore no allowance has been made in the consolidated financial statements.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. In the case of criminal investigation statute of limitation may be extended up to seven years based on the court decision.

***Operating environment*** – Emerging markets such as Azerbaijan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Azerbaijan continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future stability of the Azerbaijan economy is heavily influenced by reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Because Azerbaijan produces and exports large volumes of oil and gas, its economy is particularly sensitive to the price of oil and gas on the world market. During 2014-2015 and then in the first quarter of 2016, the oil price decreased significantly. As a result, Azerbaijani manat devalued against the US dollar and other major currencies. In December 2015, the Central Bank of the Republic of Azerbaijan announced floating exchange rate. In January 2016, Standard & Poor's, international credit agency, has downgraded long-term and short-term foreign and national currency sovereign ratings.

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 Group's future results and financial position and business prospects, including deterioration of the quality of the loan portfolio, increase of non-performing loans and decrease in loan collateral values and losses on investment securities.

Azerbaijani government announced plans to accelerate reforms and support the banking system in response to current economic challenges. The Group's management is taking measures to support sustainability of the Group's business in the foreseeable future.

***Compliance with covenants*** – The Bank is obligated to comply with certain financial covenants in relation to borrowed funds. These covenants include stipulated ratios, debt to equity ratios and various other financial performance ratios. The Bank has not breached any of these covenants as at December 31, 2015.

As at December 31, 2015, the Group and the Bank has complied with all externally imposed capital requirements as per Basel I and CBAR statutory capital. (As at December 31, 2014 the Group and the Bank has complied with all externally imposed capital requirements as per Basel I and CBAR statutory capital).

The Bank did not achieve full compliance with certain statutory ratios neither as at December 31, 2015 nor as at December 31, 2014. As a result of this non-compliance the Bank provided to CBAR an action plan on how these breaches are going to be rectified. The plan contains a complete list of measures that would rectify current breaches and will bring IBAR into full compliance with all CBAR statutory requirements by December 31, 2015.

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

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Outstanding credit related commitments are, as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Guarantees issued | 1,504,316 | 1,335,398 |
| Import letters of credit | 349,245 | 772,597 |
| Commitments to extend credit and undrawn credit lines | 93,569 | 67,066 |
| **Total credit related commitments** | **1,947,130** | **2,175,061** |

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. Credit related commitments are denominated in currencies as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Azerbaijani Manats | 126,839 | 415,566 |
| US Dollars | 1,347,948 | 1,160,846 |
| Euro | 407,417 | 460,311 |
| Other | 64,926 | 138,338 |
| **Total** | **1,947,130** | **2,175,061** |

As at December 31, 2015, the Group had a significant concentration of import letters of credit of AZN 328,651 thousand issued to 5 entities or 94% of total import letters of credit (December 31, 2014: import letters of credit of AZN 702,288 thousand issued to 20 entities or 90.9% of total import letters of credit). As at December 31, 2015, the Group also had a significant concentration of guarantees of AZN 1,352,872 thousand issued to 20 entities or 90% of total guarantees issued (December 31, 2014: guarantees of AZN 1,186,505 thousand issued to 20 entities or 88.9% of total guarantees issued).

As at December 31, 2015, allowance of AZN 6,850 thousand (December 31, 2014: Nil) had been provided against possible losses on credit related commitments. Refer to Note 19

As at December 31, 2015, credit related commitments of AZN 140,852 thousand (December 31, 2014: AZN 81,375 thousand) are secured by blocked customer deposits. Refer to Note 16.

***Intermediary loans*** – As at December 31, 2015, the Group had borrowed funds amounting to AZN 2,140,922 thousand (December 31, 2014: AZN 819,698 thousand) on behalf of the Government of the Republic of Azerbaijan from certain financial institutions and state organizations for the purposes of providing intermediary loans to state-owned enterprises and government bodies of the Republic of Azerbaijan. The loan agreements signed between the Group and these financial institutions and state organizations are secured by unconditional letters of guarantee of the Government of the Republic of Azerbaijan, whereby the Government acts as the primary obligor in relation to these borrowings or secured by customer deposits of the borrowing state organization. As a result, the Group acts as a loan-servicing agent for the Government of the Republic of Azerbaijan by transferring collected principal and interest payments to financial institutions and state organizations and earns commission income on servicing these intermediary loans.

As the Group does not receive any interest margin and does not bear the risks for these intermediary loans, the Group has recorded these intermediary loans on off-balance sheet accounts. Similarly funds received by the Group to finance these intermediary loans in the corresponding amounts have also been recorded on off balance sheet accounts.

Funds borrowed by the Group for the purposes of providing intermediary loans are as follows:

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Funds borrowed from CBAR and given to two state organizations | 2,140,922 | 819,698 |
| **Total funds borrowed for the purposes of providing intermediary loans and transferred to off-balance sheet accounts** | **2,140,922** | **819,698** |

## 33. FAIR VALUE OF FINANCIAL INSTRUMENTS

IFRS defines fair value as 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.

**Fair value of the Group's financial assets and financial liabilities measured at fair value on a recurring basis**

Some of the Group's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used).

| Financial assets/ financial liabilities | Fair value as at | | Fair value hierarchy | Valuation technique(s) and key input(s) | Significant unobservable input(s) | Relationship of unobservable inputs to fair value |
|---|---|---|---|---|---|---|
| | December 31, 2015 | December 31, 2014 | | | | |
| 1) Non-derivative financial assets at fair value through profit or loss (see Note 7) | - | 14,997 | Level 1 | Quoted bid prices in an active market. | N/A | N/A |
| 2) Available-for-sale investments (see Note 9) | 97 | 5,287 | Level 1 | Quoted bid prices in an active market. | N/A | N/A |
| 3) Currency SWAP agreements | 906 | (6,609) | Level 2 | Discounted cash flows. Future cash flows are estimated based on forward exchange rates (from observable forward exchange rates at the end of the reporting period) and contract forward rates, discounted at a rate that reflects the credit risk of various counterparties. | N/A | N/A |

There were no transfers between Level 1 and 2 in the period.

**Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)**

Except as detailed in the following table, the directors consider that the carrying amounts of financial assets and financial liabilities recognised in the consolidated financial statements approximate their fair values.

| | December 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| | Carrying value | Fair value | Carrying value | Fair value |
| Cash and cash equivalents | 1,597,696 | 1,597,696 | 593,195 | 593,195 |
| Mandatory cash balances with the National/Central banks | 15,334 | 15,334 | 9,678 | 9,678 |
| Due from other banks | 102,028 | 102,674 | 303,639 | 304,394 |
| Loans and advances to customers | 5,635,541 | 5,633,400 | 7,854,991 | 7,851,240 |
| Other debt securities | 29,298 | 27,186 | 45,355 | 42,453 |
| Receivables from Aqrarkredit | 5,628,923 | 5,628,923 | - | - |
| Other financial and insurance assets | 210,934 | 210,934 | 23,650 | 23,650 |
| Due to other banks | 1,800,844 | 1,797,362 | 1,864,962 | 1,856,694 |
| Customer accounts | 7,110,525 | 7,114,894 | 4,144,678 | 4,157,276 |
| Debt securities in issue -Eurobonds | 878,524 | 804,308 | 390,473 | 389,072 |
| Debt securities in issue - DC | 15,130 | 14,620 | 10,454 | 11,345 |
| Other borrowed funds | 2,262,979 | 2,264,503 | 1,563,366 | 1,566,949 |
| Other financial and insurance liabilities | 64,475 | 64,475 | 66,353 | 66,353 |
| Subordinated debt | 759,043 | 759,043 | 421,505 | 421,505 |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| | | | December 31, 2015 | |
| Cash and cash equivalents | - | 1,597,696 | - | 1,597,696 |
| Mandatory cash balances with the National/Central banks | - | 15,334 | - | 15,334 |
| Due from other banks | - | 102,674 | - | 102,674 |
| Loans and advances to customers | - | 5,633,400 | - | 5,633,400 |
| Other debt securities | - | 27,186 | - | 27,186 |
| Receivables from Aqrarkredit | | 5,628,923 | | 5,628,923 |
| Other financial and insurance assets | - | 210,934 | - | 210,934 |
| Due to other banks | - | 1,797,362 | - | 1,797,362 |
| Customer accounts | - | 7,114,894 | - | 7,114,894 |
| Debt securities in issue -Eurobonds | 804,308 | - | | 804,308 |
| Debt securities in issue - DC | - | 14,620 | - | 14,620 |
| Other borrowed funds | - | 2,264,503 | - | 2,264,503 |
| Other financial and insurance liabilities | - | 64,475 | - | 64,475 |
| Subordinated debt | - | 759,043 | - | 759,043 |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| | | | December 31, 2014 | |
| Cash and cash equivalents | - | 593,195 | - | 593,195 |
| Mandatory cash balances with the National/Central banks | - | 9,678 | - | 9,678 |
| Due from other banks | - | 304,394 | - | 304,394 |
| Loans and advances to customers | - | 7,851,240 | - | 7,851,240 |
| Other debt securities | - | 42,453 | - | 42,453 |
| Other financial and insurance assets | - | 23,650 | - | 23,650 |
| Due to other banks | - | 1,856,694 | - | 1,856,694 |
| Customer accounts | - | 4,157,276 | - | 4,157,276 |
| Debt securities in issue -Eurobonds | 359,340 | - | | 359,340 |
| Debt securities in issue - DC | - | 11,345 | - | 11,345 |
| Other borrowed funds | - | 1,566,949 | - | 1,566,949 |
| Other financial and insurance liabilities | - | 66,353 | - | 66,353 |
| Subordinated debt | - | 421,505 | - | 421,505 |

The fair values of the financial assets and financial liabilities included in the level 2 and level 3 categories above have been determined in accordance with generally accepted pricing models based on a discounted cash flow analysis, with the most significant inputs being the discount rate that reflects the credit risk of counterparties.

The fair value of loans and advances to customers, other debt securities, due from other banks, due to other banks, customer accounts, debt securities in issue and other borrowed funds is estimated by discounting the scheduled future cash flows of the individual assets/liabilities through the estimated maturity using market rates as at the respective year-end.

## 34. RELATED PARTY TRANSACTIONS

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

As at December 31, 2015, the outstanding balances with shareholders are substantially all with the Parent.

| | Shareholders | Management | Government bodies and state-owned entities | Associates |
|---|---|---|---|---|
| **Cash and cash equivalents** | | | | |
| Mandatory cash balances with the CBAR | - | - | 1,064,024 | - |
| Gross amount of loans and advances to customers (contractual interest rate: 3 - 22% p.a.) | - | - | 437,553 | 15,300 |
| Provisions for loan impairment | - | - | (10,349) | (156) |
| Investment in associates | - | - | - | 187 |
| Other debt securities | - | - | - | 10,000 |
| Receivables from Aqrarkredit | - | - | 5,628,923 | - |
| Other financial and insurance assets | 191,648 | - | - | - |
| **Due to other banks** | | | | |
| Correspondent accounts of other banks | - | - | - | - |
| **Customer accounts** | | | | |
| Current/settlement accounts | 228 | 80 | 1,508,069 | 22 |
| Term deposits (contractual interest rate: 4.5 – 17.2% p.a.) | 1,938 | 80 | 460,539 | - |
| Subordinated debt | - | - | 600,000 | - |

The income and expense items with related parties for the year 2015 were as follows:

| | Shareholders | Management | Government bodies and state-owned entities | Associates |
|---|---|---|---|---|
| Interest income | 1,834 | - | 54,182 | 1,155 |
| Interest expense | 176 | - | 3,958 | - |
| Provision for impairment of loans to customers | 1,770 | 7 | 11,093 | (156) |
| Fee and commission income | 16 | - | - | 22 |
| Share of loss of associates | - | - | - | 115 |

As at December 31, 2015, other rights and obligations with related were as follows:

| | Government bodies and state-owned entities | Associates |
|---|---|---|
| Guarantees issued | 495,776 | 16,778 |
| Commitments to extend credit and undrawn credit lines | 6,859 | - |

As at December 31, 2014, the outstanding balances with shareholders are substantially all with the Parent.

| | Shareholders | Management | Government bodies and state-owned entities | Associates |
|---|---|---|---|---|
| Cash and cash equivalents | | | | |
| Mandatory cash balances with the CBAR | - | - | 88,762 | - |
| Gross amount of loans and advances to customers (contractual interest rate: 1 - 25% p.a.) | 43,174 | 210 | 246,859 | 12,993 |
| Provisions for loan impairment | (1,770) | (7) | (21,442) | - |
| Investment in associates | | | | 348 |
| Other debt securities | - | - | - | 10,000 |
| Due to other banks | | | | |
| Correspondent accounts of other banks | - | - | 179,784 | - |
| Customer accounts | | | | |
| Current/settlement accounts | 113 | - | 720,487 | 342 |
| Term deposits (contractual interest rate: 0.18 - 9% p.a.) | 30 | - | 280,427 | - |
| Subordinated debt | - | - | 350,000 | - |

The income and expense items with related parties for the year 2014 were as follows:

| | Shareholders | Management | Government bodies and state-owned entities | Associates |
|---|---|---|---|---|
| Interest income | 1,334 | 9 | 62,881 | 1,198 |
| Interest expense | - | - | - | - |
| Provision for impairment of loans to customers | (1,453) | 49 | 2,683 | 73 |
| Fee and commission income | - | - | 44,364 | 29 |
| Staff costs | - | (698) | - | - |
| Operating expenses | - | - | - | - |
| Share of loss of associates | - | - | - | (141) |

As at December 31, 2014, other rights and obligations with related parties were as follows:

| | Government bodies and state-owned entities | Associates |
|---|---|---|
| Guarantees issued | 320,891 | 15,894 |
| Commitments to extend credit and undrawn credit lines | 5,320 | - |

The Group is controlled by the Government of the Republic of Azerbaijan. Therefore, in accordance with IAS 24 transactions with the Government, the Ministry of Finance of the Republic of Azerbaijan and state-owned companies of the Republic of Azerbaijan are included in the above related party balances and transactions.

During the year ended December 31, 2015, the total remuneration of key management personnel of the Group amounted to AZN 556 thousand (2014: AZN 698 thousand) and comprised of:

| | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|
| Short-term benefits: | | |
| - salaries | 507 | 546 |
| - performance bonuses | 49 | 152 |
| **Total** | 556 | 698 |

## 35. SUBSEQUENT EVENTS

On January 21, 2016 and February 22, 2016 Aqrarkredit had repaid AZN 500,000 thousand and AZN 490,000 thousand, accordingly in respect of the Bank's first and second tranches receivable.

Based on the decision of Board of Directors of the Group dated October 30, 2015 the share capital of IBA Moscow was increased by USD 30 million, on March 28, 2016.

The shareholders of the Bank are planning to increase the share capital of the Bank in the amount of AZN 500,000 thousand during 2016, subject to approval by the shareholders at the Annual General Meeting.