

**Central Bank of the Republic of  
Azerbaijan**

**Financial Statements  
for the year ended 31 December 2015**

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## **Independent Auditors' Report**

To the Management Board of the Central Bank of the Republic of Azerbaijan

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

### *Management's Responsibility for the Financial Statements*

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

### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### *Opinion*

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

*KPMG Azerbaijan Limited*

Baku, Republic of Azerbaijan

25 April 2016

**Central Bank of the Republic of Azerbaijan**  
Statement of Financial Position

*In thousands of Azerbaijani Manats*

	Notes	31/12/2015	31/12/2014
<b>ASSETS</b>			
Cash and cash equivalents	4	5,788,173	4,606,805
Amounts due from non-resident banks		17,784	538,044
Special Drawing Rights with the IMF	5	332,661	174,540
Trading securities	6	2,801,748	2,939,638
Derivative financial instruments	7	32	1,422
Investment securities	8	3,770,797	3,600,246
Loans to banks	9	5,812,054	3,450,152
Promissory notes from government	19	239,603	234,979
Property, equipment and intangible assets	10	97,482	98,081
Other assets	11	63,816	82,791
<b>Total assets</b>		<b>18,924,150</b>	<b>15,726,698</b>
<b>LIABILITIES</b>			
Money issued in circulation	12	5,416,751	10,845,946
Amounts due to government organisations	13	4,350,844	3,666,911
Amounts due to credit institutions	14	3,336,202	1,014,153
Amounts due to other organisations	15	6,589	6,859
Derivative financial instruments	7	-	353
Debt securities in issue	16	-	27,007
Liabilities on transactions with the IMF	5	333,327	176,643
Amounts due to international financial institutions	17	4,657	2,898
Other liabilities	18	7,307	43,671
<b>Total liabilities</b>		<b>13,455,677</b>	<b>15,784,441</b>
<b>EQUITY</b>			
Charter fund	19	500,000	10,000
Capital reserves	19	500,000	209,517
Revaluation reserve for available-for-sale financial assets		(4,914)	-
Retained earnings/ (accumulated losses)		4,473,387	(277,260)
<b>Total equity</b>		<b>5,468,473</b>	<b>(57,743)</b>
<b>Total liabilities and equity</b>		<b>18,924,150</b>	<b>15,726,698</b>

The financial statements were approved by Management on 25 April 2016 and were signed on its behalf by

**Central Bank of the Republic of Azerbaijan**  
Statement of Profit or Loss and Other Comprehensive Income

<i>In thousands of Azerbaijani Manats</i>	<b>Notes</b>	<b>2015</b>	<b>2014</b>
Interest income	20	226,745	190,986
Interest expense	20	(155)	(631)
<b>Net interest income</b>		<b>226,590</b>	<b>190,355</b>
Fee and commission income	21	12,568	10,274
Fee and commission expense	22	(7,089)	(1,430)
<b>Net fee and commission income</b>		<b>5,479</b>	<b>8,844</b>
Net gains/ (losses) from trading securities		27,552	(5,733)
Net (losses)/ gains from derivative financial instruments		(56,557)	5,465
Net gains/ (losses) from foreign exchange translation		5,823,161	(454,713)
Net gains from trading in currencies		10,615	3,823
Other operating income		5,591	6,652
<b>Operating income/ (loss)</b>		<b>6,042,431</b>	<b>(245,307)</b>
Impairment losses		(464,371)	(8,463)
Administrative and other operating expenses	23	(46,930)	(54,964)
<b>Profit/ (loss) for the year</b>		<b>5,531,130</b>	<b>(308,734)</b>
<b>Other comprehensive income</b>			
<i>Items that are or may be reclassified subsequently to profit or loss:</i>			
Revaluation reserve for available-for-sale financial assets:			
- Net change in fair value		(4,914)	-
<i>Total items that are or may be reclassified subsequently to profit or loss</i>		<i>(4,914)</i>	<i>-</i>
<b>Other comprehensive loss for the year</b>		<b>(4,914)</b>	<b>-</b>
<b>Total comprehensive income/ (loss) for the year</b>		<b>5,526,216</b>	<b>(308,734)</b>

The notes set out on pages 8 to 53 form an integral part of these financial statements.

*Central Bank of the Republic of Azerbaijan*  
*Statement of Changes in Equity*

<i>In thousands of Azerbaijani Manats</i>	<b>Charter fund</b>	<b>Capital reserves</b>	<b>Revaluation reserve for available-for-sale financial assets</b>	<b>(Accumulated losses)/ Retained earnings</b>	<b>Total equity</b>
<b>Balance as at 1 January 2014</b>	<b>10,000</b>	<b>209,517</b>	-	<b>31,474</b>	<b>250,991</b>
Loss and total comprehensive loss for the year	-	-	-	(308,734)	(308,734)
<b>Balance as at 31 December 2014</b>	<b>10,000</b>	<b>209,517</b>	-	<b>(277,260)</b>	<b>(57,743)</b>
Profit for the year	-	-	-	5,531,130	5,531,130
<b>Other comprehensive income</b>					
<i>Items that are or may be reclassified subsequently to profit or loss:</i>					
Net change in fair value of available-for-sale financial assets	-	-	(4,914)	-	(4,914)
<i>Total items that are or may be reclassified subsequently to profit or loss</i>	-	-	(4,914)	-	(4,914)
<b>Total other comprehensive income</b>	-	-	(4,914)	-	(4,914)
<b>Total comprehensive income for the year</b>	-	-	<b>(4,914)</b>	<b>5,531,130</b>	<b>5,526,216</b>
<b>Transactions with owners, recorded directly in equity</b>					
Transferred to charter fund from retained earnings	490,000	-	-	(490,000)	-
Transferred to capital reserves from retained earnings	-	290,483	-	(290,483)	-
<b>Total transactions with owners</b>	<b>490,000</b>	<b>290,483</b>	-	<b>(780,483)</b>	-
<b>Balance as at 31 December 2015</b>	<b>500,000</b>	<b>500,000</b>	<b>(4,914)</b>	<b>4,473,387</b>	<b>5,468,473</b>

<i>In thousands of Azerbaijani Manats</i>	<b>Notes</b>	<b>31/12/2015</b>	<b>31/12/2014*</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Interest receipts		219,939	60,254
Interest payments		(156)	(634)
Fee and commission receipts		12,568	10,274
Fee and commission payments		(7,089)	(1,430)
Net receipts/(payments) from trading securities		28,791	(5,345)
Net (payments)/ receipts from derivative financial instruments		(55,520)	3,509
Net receipts from trading in foreign currencies		10,615	3,823
Other operating income receipts		5,591	6,652
Administrative and other operating expenses payments		(32,952)	(44,032)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>181,787</b>	<b>33,071</b>
<b>(Increase)/decrease in operating assets</b>			
Amounts due from non-resident banks		520,260	(538,044)
Trading securities		1,541,566	(1,263,019)
Special Drawing Rights with the IMF		31	720
Loans to banks		(2,259,777)	(47,774)
Other assets		261,941	(20,267)
<b>Increase/(decrease) in operating liabilities</b>			
Money issued in circulation		(5,429,195)	(187,390)
Amounts due to government organisations		450,398	620,624
Amounts due to credit institutions		1,595,821	265,554
Amounts due to other organisations		(1,100)	(3,721)
Other liabilities		(319,323)	43,125
<b>Cash flows used in operations</b>		<b>(3,457,591)</b>	<b>(1,097,121)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of investment securities		(2,890,933)	(2,553,381)
Sale and repayment of investment securities		3,819,652	18,198
Purchases of property, equipment and intangible assets	10	(13,379)	(36,919)
<b>Cash flows from/ (used in) investing activities</b>		<b>915,340</b>	<b>(2,572,102)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from debt securities in issue		-	27,007
Repayment of debt securities in issue		(26,998)	(19,993)
Repayment of borrowings from IMF		(1,431)	(3,139)
Repayment of amounts due to international financial institutions		(330)	(110)
<b>Cash flows (used in)/ from financing activities</b>		<b>(28,759)</b>	<b>3,765</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(2,571,010)</b>	<b>(3,665,458)</b>
Effect of changes in exchange rates on cash and cash equivalents		3,752,378	(109,911)
Cash and cash equivalents as at the beginning of the year		4,606,805	8,382,174
<b>Cash and cash equivalents as at the end of the year</b>	4	<b>5,788,173</b>	<b>4,606,805</b>

\*See reclassification in comparative information in Note 3.

# 1 **Background**

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2015 for the Central Bank of the Republic of Azerbaijan.

## **Principal activity**

The Central Bank of the Republic of Azerbaijan (the “Bank”) is the central bank of the Republic of Azerbaijan, and is wholly-owned by the Republic of Azerbaijan. It acts in accordance with the “Law on the Central Bank of the Republic of Azerbaijan” effective from 10 December 2004 (the “Law”).

Article 4 of the Law sets out the goals of the Bank, which are as follows:

- The primary goal of the Bank is to ensure, within its power, the stability of prices;
- Ensure the development and strengthening of the banking and payment systems; and
- Profit making is not a primary goal of the Bank.

Article 5 of the Law sets out the functions of the Bank as follows:

- Determine and implement monetary policy;
- Organise cash circulation; in accordance with paragraph 2 of article 19 of the Constitution and the Law: issue, put into circulation, and withdraw banknotes from circulation;
- Determine and declare the official exchange rate of Azerbaijani Manat;
- Implement foreign currency regulation and control;
- Maintain and manage the gold and foreign currency reserves at its disposal;
- Manage the drawing up of the reporting balance of payments and participate in the drawing-up of the projected balance of payments of the country;
- In accordance with normative acts issued in accordance with the Laws of the Republic of Azerbaijan “On Banks”, “On Post” and “On Central Bank of the Republic of Azerbaijan”, license and regulate banking activities and supervise banking activities subject to procedures established by legislation;
- Determine, coordinate and regulate activities of payment systems;
- Implement other functions as stipulated by the legislation.

In accordance with Article 14.1 of the Law, the Bank cannot be declared bankrupt. Any deficit in capital is to be covered by the securities issued by the Government of Azerbaijan Republic.

Pursuant to the legislation of the Republic of Azerbaijan and the international treaties acceded to by the Republic of Azerbaijan, the Bank represents the Republic of Azerbaijan in relations with the central banks of foreign states, as well as international financial and credit institutions in matters relating to the Bank’s responsibilities.

The Bank may conclude agreements on cooperation with the central banks of foreign countries concerning various areas of its activities. It may also conclude clearing and settlement agreements and other agreements with foreign public and private clearing agencies, on its own behalf and on behalf of the Republic of Azerbaijan, if appropriately empowered.

The Bank may participate in the capital and activity of international organisations for the purpose of cooperation in monetary, foreign currency and banking areas.



## 1 Background, continued

At 31 December 2015, the Management Board (the “Board”) of the Bank was composed of the following members:

<b>Name</b>	<b>Position</b>
Mr. Elman Rustamov	Governor
Mr. Alim Guliyev	First Deputy Governor
Mr. Aftandil Babayev	Deputy Governor
Mr. Vadim Khubanov	Deputy Governor
Mr. Khagani Abdullayev	Deputy Governor

The Bank’s main office is located on the following address: 32 Rashid Behbudov Street, Baku, AZ1014, Azerbaijan. The Bank had six regional branches in the Republic of Azerbaijan (2014: six). As of 31 December 2015, the Bank had 646 employees (2014: 607).

### **Functional and presentation currency**

The functional currency of the Bank is Azerbaijani Manats (“AZN”) as, being the national currency of the Republic of Azerbaijan. These financial statements are presented in AZN, rounded to nearest thousand, unless otherwise stated.

### **Operating Environment of the Bank**

During 2015, the Central Bank operated under increasing negative influence of the processes happening in global economy, as well as in world energy markets and partner countries on Azerbaijani economy.

The year 2015 was marked by the weakening global economic growth, sharply cheapening global commodity prices, decreasing currency reserves in several countries, and volatile currency exchange rates. Global oil price dropped to its lowest level within the last decade.

The tightening long-term foreign shocks actualized the calls for strengthening the stability of national economy.

Changes in currency market balance and succession of devaluations in partner countries during the period of high oil prices prompted the review of currency policy and currency regime. A number of decisions have been made for balancing the balance of payments on currency policy and currency regime, protecting the strategic currency reserves of the country, and strengthening the competitiveness of national economy.

During 2015, monetary policy decisions were made taking into account the expected inflation dynamics. Under the influence of several factors, inflation remained in a single-digit level, and was lower than average inflation in trading partner countries during the reporting year.

Overall, strong economic potential in the country enabled to minimize negative impact of unfavorable international conjuncture, and stable growth path was maintained.

Furthermore, monetary policy and bank operations in Azerbaijan may be exposed to several risks resulting from the processes happening in world economy. Currently, relevant measures are underway for ensuring the Bank’s function in protecting macroeconomic stability. However, sharp changes in operating environment (including global environment) may influence the Bank’s financial position and performance to the extent, which cannot be measured reliably now.

## **2 Basis of preparation**

### **Basis of measurement**

These financial statements are prepared on the historical cost basis except that financial instruments at fair value through profit or loss, available-for-sale financial assets and investment property are stated at fair value.

### **Use of estimates and judgments**

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those estimates.

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

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies is described in the following notes:

- loan impairment estimates – Note 9;
- estimates of fair values of financial assets and liabilities – Note 29.

## **3 Significant accounting policies**

The accounting policies set out below are applied consistently to all periods presented in these financial statements.

### **Foreign currency**

Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the end of the reporting period. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit or loss for the year (as foreign exchange translation gains less losses). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

As of 31 December 2015, exchange rates for translation of foreign currency balances were as follows: 1 US Dollar = AZN 1.5594, 1 Euro = AZN 1.7046, 1 Pound sterling = AZN 2.3133 and 1 Special Drawing Right = AZN 2.1661 (31 December 2014: 1 US Dollar = AZN 0.7844, 1 Euro = AZN 0.9522, 1 Pound sterling = AZN 1.2173 and 1 Special Drawing Right = AZN 1.1364).

### **Cash and cash equivalents**

Cash and cash equivalents are short-term items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents consist of cash on hand in foreign currency and unrestricted balances on correspondent accounts including overnight deposits and deposits with a maturity of three months from origination. Cash and cash equivalents are carried at amortised cost.

## **3 Significant accounting policies, continued**

### **Financial instruments**

#### *Classification*

##### *Trading securities*

Trading securities are financial assets which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are securities included in a portfolio in which a pattern of short-term trading exists. The Bank classifies securities into trading securities if it has an intention to sell them within a short period after purchase, i.e. within one month.

##### *Available for sale financial assets*

This classification includes investment securities which the Bank intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Available for sale financial assets are carried at fair value.

##### *Investment securities held to maturity*

This classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at the end of each reporting period. Investment securities held to maturity are carried at amortised cost.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market: They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method.

Financial assets that would have met the definition of loans and receivables may be reclassified out of the fair value through profit or loss or available-for-sale category if the Bank has an intention and ability to hold them for the foreseeable future or until maturity.

Other financial instruments not included in the category of loans and receivables may be reclassified out of at fair value through profit or loss category only in the case that is unusual and highly unlikely to recur in the near term.

Derivative financial instruments and financial instruments designated as at fair value through profit or loss upon initial recognition are not reclassified out of at fair value through profit or loss category.

#### *Recognition*

Financial assets and liabilities are recognised in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument.

#### *Measurement*

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

### **3 Significant accounting policies, continued**

Subsequent to initial recognition, financial assets, including derivatives that are assets, are measured at their fair values.

Loans and receivables and held-to-maturity investments which are measured at amortised cost are measured using the effective interest method.

All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortised cost.

#### ***Amortised cost***

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

#### ***Gains and losses on subsequent measurement***

A gain or loss arising from a change in the fair value of a financial asset or liability is recognised as follows:

- a gain or loss on a financial instrument classified as at fair value through profit or loss is recognised in profit or loss;
- a gain or loss on an available-for-sale financial asset is recognised as other comprehensive income in equity (except for impairment losses and foreign exchange gains and losses on debt financial instruments available-for-sale) until the asset is derecognised, at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss. Interest in relation to an available-for-sale financial asset is recognised in profit or loss using the effective interest method.

For financial assets and liabilities carried at amortised cost, a gain or loss is recognised in profit or loss when the financial asset or liability is derecognised or impaired, and through the amortisation process.

#### ***Derecognition***

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

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

In transactions where the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if control over the asset is lost.

### 3 Significant accounting policies, continued

In transfers where control over the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred assets.

If the Bank purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

#### *Repurchase and reverse repurchase agreements*

Sale and repurchase agreements (“repo agreements”) which effectively provide a lender’s return to the counterparty are treated as secured financing transactions. Securities sold under such sale and repurchase agreements are not derecognised. The securities are not reclassified in the statement of financial position unless the transferee has the right by contract or custom to sell or repledge the securities, in which case they are reclassified as repurchase receivables. The corresponding liability is presented within amounts due to credit institutions or other organisations.

Securities purchased under agreements to resell (“reverse repo agreements”) which effectively provide a lender’s return to the Bank are recorded as loans to local banks. The difference between the sale and repurchase price is treated as interest income and accrued over the life of reverse repo agreements using the effective interest method.

If assets purchased under an agreement to resell are sold to third parties, the obligation to return securities is recorded as a trading liability and measured at fair value.

#### *Derivative financial instruments*

Derivative financial instruments include swaps, futures, forwards and spot transactions in interest rates, foreign exchanges.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in profit or loss.

#### **Property and equipment**

Items of property and equipment are stated at historical cost less accumulated depreciation and impairment losses.

#### *Depreciation*

Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Depreciation of an asset begins when it is available for use. Land is not depreciated. Estimated useful life is determined using the following annual depreciation rates:

	%
Buildings	3
Furniture and fixtures	20-25
Computer and office equipment	25
Motor vehicles	15

#### **Intangible assets**

Bank’s intangible assets have definite useful life and primarily include capitalised computer software and licenses.

### **3 Significant accounting policies, continued**

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

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 1 to 10 years.

#### **Investment property**

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in normal course of business, or for the use in production or supply of goods or services or for administrative purposes. Investment property is measured at fair value with any change recognised in profit or loss.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

#### **Impairment**

The Bank assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the Bank determines the amount of any impairment loss.

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset or group of financial assets that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the Bank, or economic conditions that correlate with defaults in the group.

In addition, for an investment in equity securities available-for-sale a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

#### ***Financial assets carried at amortised cost***

Financial assets carried at amortised cost consist principally of loans and other receivables (loans and receivables). The Bank reviews its loans and receivables to assess impairment on a regular basis.

The Bank first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

### **3 Significant accounting policies, continued**

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, the Bank uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognised in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Bank writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

#### ***Financial assets carried at cost***

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that are not carried at fair value because their fair value cannot be reliably measured. If there is objective evidence that such investments are impaired, the impairment loss is calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments are recognised in profit or loss and cannot be reversed.

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

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that is recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

#### **Money issued in circulation**

Money issued in circulation represents banknotes and coins issued by the Bank in accordance with the Law and its function as a central bank. Banknotes and coins in circulation are recorded in the statement of financial position at their nominal value net of cash in the Bank's cash offices.

### **3 Significant accounting policies, continued**

The costs of the production of notes and coins are expensed upon delivery by the suppliers to the Bank.

When notes and coins are returned to the Bank by the commercial banks they are removed from notes in circulation and depending on their condition or legal tender status, are either held under the reserve funds of the Bank off-balance sheet or destroyed.

#### **Amounts due to government organisations and other organisations**

Amounts due to government organisations and other organisations are non-derivative liabilities and are carried at amortised cost.

#### **Amounts due to credit institutions**

Amounts due to credit institutions are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortised cost. If the Bank purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

#### **Retirement and other benefit obligations**

The Bank does not have any pension arrangements separate from the state pension system of Azerbaijan. In addition, the Bank has no post-retirement benefits or other significant compensation benefits requiring accrual. In accordance with the requirements of the Azerbaijan legislation, the Bank withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. Upon retirement all retirement benefit payments are made by the state pension fund.

#### **Charter fund and capital reserves**

The Bank's capital is comprised of its authorised paid-in charter fund and capital reserves.

#### **Taxation**

The Bank is exempt from all taxes, except for taxes on employees' remuneration as a tax agent and social taxes, in accordance with the laws of the Republic of Azerbaijan.

#### **Membership with the International Monetary Fund and other international financial institutions**

Based on the provision of Article 9 of the Law of the Republic of Azerbaijan on the Central Bank of the Republic of Azerbaijan, the Bank acts as an intermediary of the Government of the Republic of Azerbaijan in transactions related to the membership of the Republic of Azerbaijan in international financial organisations (e.g. IMF, World Bank), including payment of membership fees to such organisations.

The International Monetary Fund ("IMF") is an international organisation established to promote international monetary cooperation, exchange stability and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease the balance of payments adjustments. In accordance with the presidential decree issued in 1992, the Bank acts as a depository agent in relations of the Republic of Azerbaijan with the IMF and the role of fiscal agent is performed by the Ministry of Finance of the Republic of Azerbaijan.



### **3 Significant accounting policies, continued**

Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's subscription (quota) is determined broadly on the basis of the economic size of the country and taking into account quotas of similar countries. A member's quota delineates basic aspects of its financial and organisational relationship with the IMF.

Membership fees payable to IMF are denominated in Special Drawing Rights ("SDR") and are revalued in AZN at the rate of exchange set by the IMF at year-end. Membership quota and securities issued by the Ministry of Finance of the Republic of Azerbaijan in respect of IMF quota are not presented in the statement of financial position as they do not represent the assets and liabilities of the Bank, but are disclosed in Note 5 to the financial statements.

General and special allocations received from the IMF to boost the liquidity of member countries are taken up by the Bank as an asset under SDR holdings with the IMF and on the other hand, as a liability to the Government of the Republic of Azerbaijan.

#### **Income and expense recognition**

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

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

Other fees, commissions and other income and expense items are recognised in profit or loss when the corresponding service is provided.

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

#### **Comparative information**

Comparative information is reclassified to conform to changes in presentation in the current year. Term deposits placed in foreign credit institutions in the amount of AZN 538,044 thousand classified as Cash and Cash Equivalents as at 31 December 2014 were reclassified to Amounts due from Non-resident Banks, as their maturity date was more than 3 months. Cash flows statement was amended accordingly.

### 3 Significant accounting policies, continued

#### **New standards and interpretations not yet adopted**

A number of new standards, amendments to standards and interpretations are not yet effective as at 31 December 2015, and are not applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the financial position and performance. The Bank plans to adopt these pronouncements when they become effective.

- IFRS 9 Financial Instruments is to be issued in phases and is intended ultimately to replace International Financial Reporting Standard IAS 39 Financial Instruments: Recognition and Measurement. The first phase of IFRS 9 was issued in November 2009 and relates to the classification and measurement of financial assets. The second phase regarding the classification and measurement of financial liabilities was published in October 2010. The third phase of IFRS 9 was issued in November 2013 and relates to general hedge accounting. The standard was finalised and published in July 2014. The final phase relates to a new expected credit loss model for calculating impairment. The Bank recognises that the new standard introduces many changes to accounting for financial instruments and is likely to have a significant impact on the financial statements. The Bank has not analysed the impact of these changes yet. The Bank does not intend to adopt this standard early. The standard will be effective for annual periods beginning on or after 1 January 2018 and will be applied retrospectively with some exemptions.

Various Improvements to IFRS are dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into effect not earlier than 1 January 2016. The Bank has not yet analysed the likely impact of the improvements on its financial position or performance.

### 4 Cash and cash equivalents

*In thousands of Azerbaijani Manats*

	<b>31/12/2015</b>	<b>31/12/2014</b>
<b>Cash on hand</b>	<b>597,411</b>	<b>655,106</b>
<b>Nostro accounts with non-resident banks</b>		
- rated AAA	79,552	121,684
- rated AA- to AA+	4,936,620	3,543,942
- rated A- to A+	8,077	7,432
- rated BBB- to BBB+	37,559	87,927
<b>Total nostro accounts with non-resident banks</b>	<b>5,061,808</b>	<b>3,760,985</b>
<b>Cash equivalents</b>		
<b>Term deposits with non-resident banks</b>		
- rated AAA	13,640	-
- rated A- to A+	115,314	190,714
<b>Total term deposits with non-resident banks</b>	<b>128,954</b>	<b>190,714</b>
<b>Total cash and cash equivalents</b>	<b>5,788,173</b>	<b>4,606,805</b>

No cash and cash equivalents are past due or impaired.

As at 31 December 2015 and 2014, ratings of nostro accounts and deposits with non-resident banks are disclosed based on the lowest of ratings assigned by Fitch Ratings, Standard and Poor's and Moody's agencies.

## 5 Balances with the International Monetary Fund

<i>In thousands of Azerbaijani Manats</i>	<b>31/12/2015</b>	<b>31/12/2014</b>
<b>ASSETS</b>		
Special Drawing Rights (SDR) holdings	332,661	174,540
<b>Total assets with IMF</b>	<b>332,661</b>	<b>174,540</b>
<b>LIABILITIES</b>		
Current accounts	666	656
<b>Borrowings from the IMF:</b>		
Poverty Reduction and Growth Facility	-	1,463
<b>SDR allocation:</b>		
General allocation	258,365	135,546
Special allocation	74,296	38,978
<b>Total SDR allocations</b>	<b>332,661</b>	<b>174,524</b>
<b>Total liabilities with IMF</b>	<b>333,327</b>	<b>176,643</b>

### *SDR holdings*

SDR holdings represent the current account with the IMF used for borrowings and settlements with the IMF. Interest accrued in respect of SDR holdings is calculated using the rates set by the IMF on weekly basis in accordance with short-term market rates in major money markets.

### *Current accounts*

The Bank maintains two separate accounts with the IMF for special purposes, account No. 1 and No. 2. Account No. 1 is used for paying commissions for transactions with the IMF, whereas account No.2 is used for covering expenses of IMF representatives during their visit to member countries.

### *Borrowings*

Borrowing from IMF is a 10 year loan issued to the Government of the Republic of Azerbaijan with an annual interest rate of 0.5% matured in 2015. The Government of the Republic of Azerbaijan has a legal obligation for the repayment of these funds that are maintained by the Bank on behalf of the Government of the Republic of Azerbaijan acting as a depository and the borrowing is treated by the Bank as a liability to the Government of the Republic of Azerbaijan.

### *SDR allocation*

SDR allocation is an unconditional distribution of SDRs to member countries by the IMF. A general SDR allocation became effective since 28 August 2009. The allocation is designed to provide liquidity to the global economic system by supplementing the IMF member countries' foreign exchange reserves. General SDR allocation is determined proportionate to existing IMF quotas for each member country.

Additionally, on 10 August 2009, the Fourth Amendment to the IMF Articles of Agreement providing for a special one-time SDR allocation came into force to boost global liquidity. According to the Amendment, the special allocation was made to IMF members, including the Republic of Azerbaijan on 9 September 2009.

Members and prescribed holders may use their SDR holdings to conduct transactions with the IMF. The Bank treats the allocation as foreign exchange liability to the Government of the Republic of Azerbaijan.

## 5 Balances with the International Monetary Fund, continued

### *IMF Quota and securities held in custody in respect of IMF Quota*

The IMF Quota, in the amount of SDR 160.9 million (AZN 348,525 thousand and AZN 182,847 thousand as at 31 December 2015 and 2014 respectively) has remained unchanged since 25 January 1999 and represents the membership subscription of the Republic of Azerbaijan with the IMF. Securities were issued by the Government of the Republic of Azerbaijan to guarantee these amounts. These securities are held by the Bank for which IMF is acting as the beneficiary.

## 6 Trading securities

*In thousands of Azerbaijani Manats*

	<u>31/12/2015</u>	<u>31/12/2014</u>
US Treasury notes	807,855	156,199
Notes issued by international financial institutions	639,306	587,584
Agency notes	594,289	1,468,548
Municipal bonds	303,135	259,413
Corporate bonds	287,292	36,075
UK Treasury notes	106,482	356,080
Government bonds	63,389	75,739
<b>Total trading securities</b>	<b><u>2,801,748</u></b>	<b><u>2,939,638</u></b>

No trading securities are past due or impaired.

The Bank uses reputable asset managers for the management of certain of its trading securities per set investment guidelines which include the requirement that the issuers of such securities are all domiciled in OECD countries.

All trading securities are rated above A- rating per Fitch ratings. Refer to note 24 for credit risk disclosure.

## 7 Derivative financial instruments

The fair value of derivative financial instruments as at 31 December 2015 and 2014 are as follows:

*In thousands of Azerbaijani Manats*

	<u>Notional amount</u>	<u>31/12/2015</u>		<u>Notional amount</u>	<u>31/12/2014</u>	
		<u>Fair value</u>			<u>Fair value</u>	
		<u>Assets</u>	<u>Liabilities</u>		<u>Assets</u>	<u>Liabilities</u>
Foreign exchange contracts	126,056	32	-	128,613	1,380	(156)
Future contracts	71,999	-	-	33,506	42	(197)
<b>Total derivative financial instruments</b>	<b><u>198,055</u></b>	<b><u>32</u></b>	<b><u>-</u></b>	<b><u>162,119</u></b>	<b><u>1,422</u></b>	<b><u>(353)</u></b>

## 7 Derivative financial instruments, continued

### Foreign currency contracts

The table below summarises, by major currencies, the contractual amounts of forward exchange contracts outstanding, with details of the weighted average contractual exchange rates and remaining periods to maturity. Foreign currency amounts presented below are translated at rates ruling at the reporting date.

*In thousands of Azerbaijani Manats*

	<b>Notional amount</b>		<b>Weighted average contractual exchange rates</b>	
	<b>31/12/2015</b>	<b>31/12/2014</b>	<b>31/12/2015</b>	<b>31/12/2014</b>
<b>Buy USD sell EUR</b>				
Less than 3 months	-	22,415	-	0.8138
<b>Sell USD buy EUR</b>				
Less than 3 months	74,928	62,581	1.0704	1.2346
<b>Buy USD sell GBP</b>				
Less than 3 months	-	7,002	-	0.6421
<b>Sell USD buy GBP</b>				
Less than 3 months	22,008	16,833	1.5051	1.5623
<b>Buy USD sell CAD</b>				
Less than 3 months	-	2,246	-	1.1625
<b>Sell USD buy CAD</b>				
Less than 3 months	10,580	8,051	0.7451	0.8688
<b>Buy USD sell other currencies</b>				
Less than 3 months	-	2,611	-	-
<b>Sell USD buy other currencies</b>				
Less than 3 months	18,540	6,874	-	-

## 8 Investment securities

*In thousands of Azerbaijani Manats*

	<b>31/12/2015</b>	<b>31/12/2014</b>
<b>- Held-to-maturity investments</b>		
US Treasury notes	-	1,334,654
UK Treasury notes	-	195,029
Government bonds	-	865,469
Notes issued by international financial institutions	-	850,276
Agency Notes	-	55,066
<b>Total held to maturity investments</b>	<b>-</b>	<b>3,300,494</b>
<b>- Available-for-sale investments</b>		
Notes issued by international financial institutions	355,510	-
Azerbaijan Mortgage Fund	336,154	19,678
Government bonds	334,298	-
US Treasury notes	78,348	-
UK Treasury notes	71,148	-
Securities issued by Kapital Bank OJSC	16,418	148,169
Ministry of Finance of the Republic of Azerbaijan	-	40,000
<b>Total available-for-sale investments</b>	<b>1,191,876</b>	<b>207,847</b>
<b>- Loans and advances</b>		
JSCO Aqrarkredit	2,500,000	-
Ministry of Finance of the Republic of Azerbaijan	83,216	96,200
Impairment allowance	(4,295)	(4,295)
<b>Total loans and advances less impairment allowance</b>	<b>2,578,921</b>	<b>91,905</b>
<b>Total investment securities</b>	<b>3,770,797</b>	<b>3,600,246</b>

## 8 Investment securities, continued

Due to the reason that the Bank sold significant amount of the portfolio of held-to-maturity investments on 20 February 2015, it was not able to classify any investment as held to maturity for the remained of the financial year plus two financial years after the financial year in which the event occurred. As a result, all held-to-maturity investments portfolio was reclassified to available-for-sale investments portfolio, and treated as such after 20 February 2015.

Included in loans and advances are securities of Joint-Stock Credit Organisation Aqrarkredit purchased by the Bank during 2015 with the nominal amount of AZN 2,500,000 thousand, interest rate of 0.15% and maturing in 2045. Repayment of these securities is guaranteed by the Government of Azerbaijan. These securities were purchased based on Decree of President of Azerbaijan Republic on “Actions for improvement of International Bank of Azerbaijan OJSC’s condition to prepare for the privatisation of shares owned by government” and “On approval of issue, volume, maturity and payment conditions of securities with government guarantee issued by Aqrarkredit JSCO”. Refer to note 29 for fair value disclosures.

## 9 Loans to banks

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Loans under government guarantee	3,903,736	2,214,675
Refinancing loans	1,741,141	903,851
Subordinated loans	600,410	351,133
Lender of last resort loans	75,119	24,488
<b>Gross loans to banks</b>	<b>6,320,406</b>	<b>3,494,147</b>
Impairment allowance	(508,352)	(43,995)
<b>Total loans to banks less impairment allowance</b>	<b>5,812,054</b>	<b>3,450,152</b>

### Concentration of loans to banks

As at 31 December 2015 the Bank had loans to 3 banks (2014: 3 banks), whose balances exceed 10% of equity. The gross value of these balances as at 31 December 2015 is AZN 4,493,323 thousand (2014: AZN 2,572,982 thousand).

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2015 are as follows:

<i>In thousands of Azerbaijani Manats</i>	<u>Refinancing loans</u>	<u>Lender of last resort loan</u>	<u>Total</u>
Balance at the beginning of the year	22,364	21,631	43,995
Net charge	460,879	3,478	464,357
<b>Balance at the end of the year</b>	<b>483,243</b>	<b>25,109</b>	<b>508,352</b>

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2014 are as follows:

<i>In thousands of Azerbaijani Manats</i>	<u>Refinancing loans</u>	<u>Lender of last resort loan</u>	<u>Total</u>
Balance at the beginning of the year	15,144	20,387	35,531
Net charge	7,220	1,244	8,464
<b>Balance at the end of the year</b>	<b>22,364</b>	<b>21,631</b>	<b>43,995</b>

## 9 Loans to banks, continued

### Credit quality

The following table provides information on the credit quality of loans to banks as at 31 December 2015:

<i>In thousands of Azerbaijani Manats</i>	<b>Gross loans</b>	<b>Impairment allowance</b>	<b>Net loans</b>
<b>Loans under government guarantee</b>			
Loans without individual signs of impairment	3,903,736	-	3,903,736
<b>Total loans under government guarantee</b>	<b>3,903,736</b>	<b>-</b>	<b>3,903,736</b>
<b>Refinancing loans</b>			
Loans without individual signs of impairment	793,424	-	793,424
Overdue or impaired loans:			
- not overdue	800,122	(370,949)	429,173
- overdue less than 30 days	21,401	(7,859)	13,542
- overdue 30-90 days	16,921	(6,765)	10,156
- overdue 90-179 days	264	(74)	190
- overdue 180-360 days	90,844	(86,970)	3,874
- overdue more than 360 days	18,165	(10,626)	7,539
Total overdue or impaired loans	947,717	(483,243)	464,474
<b>Total refinancing loans</b>	<b>1,741,141</b>	<b>(483,243)</b>	<b>1,257,898</b>
<b>Subordinated loans</b>			
Loans without individual sign of impairment	600,410	-	600,410
<b>Total subordinated loans</b>	<b>600,410</b>	<b>-</b>	<b>600,410</b>
<b>Lender of last resort loans</b>			
Overdue or impaired loans:			
- overdue 90-179 days	50,010	-	50,010
- overdue more than 360 days	25,109	(25,109)	-
Total overdue or impaired loans	75,119	(25,109)	50,010
<b>Total lender of last resort loans</b>	<b>75,119</b>	<b>(25,109)</b>	<b>50,010</b>
<b>Total loans to banks</b>	<b>6,320,406</b>	<b>(508,352)</b>	<b>5,812,054</b>

## 9 Loans to banks, continued

The following table provides information on the credit quality of loans to banks as at 31 December 2014:

<i>In thousands of Azerbaijani Manats</i>	<b>Gross loans</b>	<b>Impairment allowance</b>	<b>Net loans</b>
<b>Loans under government guarantee</b>			
Loans without individual signs of impairment	2,214,675	-	2,214,675
<b>Total loans under government guarantee</b>	<b>2,214,675</b>	<b>-</b>	<b>2,214,675</b>
<b>Refinancing loans</b>			
Loans without individual signs of impairment	880,126	(16,898)	863,228
Overdue or impaired loans:			
- overdue less than 30 days	3,177	(329)	2,848
- overdue 30-90 days	45	(7)	38
- overdue more than 360 days	20,503	(5,130)	15,373
Total overdue or impaired loans	23,725	(5,466)	18,259
<b>Total refinancing loans</b>	<b>903,851</b>	<b>(22,364)</b>	<b>881,487</b>
<b>Subordinated loans</b>			
Loans without individual signs of impairment	351,133	-	351,133
<b>Total subordinated loans</b>	<b>351,133</b>	<b>-</b>	<b>351,133</b>
<b>Lender of last resort loans</b>			
Overdue or impaired loans:			
- overdue more than 360 days	24,488	(21,631)	2,857
Total overdue or impaired loans	24,488	(21,631)	2,857
<b>Total lender of last resort loans</b>	<b>24,488</b>	<b>(21,631)</b>	<b>2,857</b>
<b>Total loans to banks</b>	<b>3,494,147</b>	<b>(43,995)</b>	<b>3,450,152</b>

As at 31 December 2015 included in the loan portfolio are renegotiated loans to banks in the amount of AZN 283,192 thousand (2014: AZN 416,933 thousand). The main reason for renegotiation is due to stabilisation of short-term liquidity and protection of financial stability. Renegotiated loans are included in the category of assets without individual signs of impairment in the tables above, unless the borrower fails to comply with the renegotiated terms.

### Key assumptions and judgments for estimating the loan impairment

The Bank estimates loan impairment based on an analysis of the future cash flows for loans with individual signs of impairment and based on its past loss experience for portfolios of loans for which no individual signs of impairment has been identified.

In determining the impairment allowance, management makes the following key assumptions:

- a discount of between 20% and 50% to the originally appraised value if the property pledged is sold;
- Up to 5 years for the foreclosure of collateral.



## 9 Loans to banks, continued

### Analysis of collateral and other credit enhancements

Loans to banks are subject to individual credit appraisal. The general creditworthiness of a bank tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and collateral requirement is stipulated in the legislation.

*In thousands of Azerbaijani Manats*

	31/12/2015		31/12/2014	
	Loans to banks, carrying amount	Fair value of collateral assessed as of loan date	Loans to banks, carrying amount	Fair value of collateral assessed as of loan date
<i>Loans without individual signs of impairment</i>				
Guarantee letters from government	3,903,736	3,903,736	2,214,675	2,214,675
Blocked deposits	752,615	752,615	-	-
Commercial real estate	37,808	37,808	769,697	769,697
Residential real estate	3,001	3,001	10,260	10,260
Loans without collateral	600,410	-	434,404	-
<b>Total loans without individual signs of impairment</b>	<b>5,297,570</b>	<b>4,697,160</b>	<b>3,429,036</b>	<b>2,994,632</b>
<i>Overdue or impaired loans</i>				
Commercial real estate	401,109	401,109	1,530	1,530
Residential real estate	45,986	45,986	19,586	19,586
Loans without collateral	67,389	-	-	-
<b>Total overdue or impaired loans</b>	<b>514,484</b>	<b>447,095</b>	<b>21,116</b>	<b>21,116</b>
<b>Total loans to banks</b>	<b>5,812,054</b>	<b>5,144,255</b>	<b>3,450,152</b>	<b>3,015,748</b>

The tables above excludes overcollateralisation.

## 10 Property, equipment and intangible assets

The following table provides information on the movement of property, equipment and intangible assets for the year ended at 31 December 2015:

<i>In thousands of Azerbaijani Manats</i>	<b>Land</b>	<b>Buildings</b>	<b>Furniture and fixtures</b>	<b>Computers and communication equipment</b>	<b>Motor vehicles</b>	<b>Intangible assets</b>	<b>Construction in progress</b>	<b>Total</b>
<b>Cost</b>								
Balance at 1 January 2015	15,726	42,505	51,342	14,182	2,189	48,698	-	174,642
Additions	-	402	765	3,756	30	7,612	814	13,379
Transfers	-	55	(55)	-	-	-	-	-
Disposals	-	-	(2,835)	(933)	(8)	(698)	-	(4,474)
<b>Balance at 31 December 2015</b>	<b>15,726</b>	<b>42,962</b>	<b>49,217</b>	<b>17,005</b>	<b>2,211</b>	<b>55,612</b>	<b>814</b>	<b>183,547</b>
<b>Depreciation and amortisation</b>								
Balance at 1 January 2015	-	(13,272)	(38,527)	(8,645)	(1,747)	(14,370)	-	(76,561)
Depreciation and amortisation for the year	-	(1,280)	(5,368)	(2,474)	(96)	(4,626)	-	(13,844)
Transfers	-	(1)	1	-	-	-	-	-
Disposals	-	-	2,835	931	8	566	-	4,340
<b>Balance at 31 December 2015</b>	<b>-</b>	<b>(14,553)</b>	<b>(41,059)</b>	<b>(10,188)</b>	<b>(1,835)</b>	<b>(18,430)</b>	<b>-</b>	<b>(86,065)</b>
<b>Carrying amount</b>								
<b>At 31 December 2015</b>	<b>15,726</b>	<b>28,409</b>	<b>8,158</b>	<b>6,817</b>	<b>376</b>	<b>37,182</b>	<b>814</b>	<b>97,482</b>

## 10 Property, equipment and intangible assets, continued

The following table provides information on the movement of property, equipment and intangible assets for the year ended at 31 December 2014:

<i>In thousands of Azerbaijani Manats</i>	<b>Land</b>	<b>Buildings</b>	<b>Furniture and fixtures</b>	<b>Computers and communication equipment</b>	<b>Motor vehicles</b>	<b>Intangible assets</b>	<b>Total</b>
<b>Cost</b>							
Balance at 1 January 2014	15,726	38,480	42,397	12,575	2,033	27,869	139,080
Additions	-	4,373	9,617	1,833	267	20,829	36,919
Transfers	-	-	(23)	23	-	-	-
Disposals	-	(348)	(649)	(249)	(111)	-	(1,357)
<b>Balance at 31 December 2014</b>	<b>15,726</b>	<b>42,505</b>	<b>51,342</b>	<b>14,182</b>	<b>2,189</b>	<b>48,698</b>	<b>174,642</b>
<b>Depreciation and amortisation</b>							
Balance at 1 January 2014	-	(12,192)	(35,101)	(6,498)	(1,764)	(11,431)	(66,986)
Depreciation and amortisation for the year	-	(1,217)	(4,090)	(2,381)	(94)	(2,939)	(10,721)
Transfers	-	-	15	(15)	-	-	-
Disposals	-	137	649	249	111	-	1,146
<b>Balance at 31 December 2014</b>	<b>-</b>	<b>(13,272)</b>	<b>(38,527)</b>	<b>(8,645)</b>	<b>(1,747)</b>	<b>(14,370)</b>	<b>(76,561)</b>
<b>Carrying amount</b>							
<b>At 31 December 2014</b>	<b>15,726</b>	<b>29,233</b>	<b>12,815</b>	<b>5,537</b>	<b>442</b>	<b>34,328</b>	<b>98,081</b>

## 11 Other assets

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Receivables from trade securities disposed	2,505	9,632
Loans to employees	1,057	1,062
Amounts in the course of settlement	830	85
Receivables from the sale of foreign currencies	155	31,435
Other financial assets	-	59
Impairment allowance	(26)	(12)
<b>Total other financial assets</b>	<u><b>4,521</b></u>	<u><b>42,261</b></u>
Prepayments to suppliers	54,783	36,042
Investment property	4,400	4,400
Other non-financial assets	112	88
<b>Total other non-financial assets</b>	<u><b>59,295</b></u>	<u><b>40,530</b></u>
<b>Total other assets</b>	<u><b>63,816</b></u>	<u><b>82,791</b></u>

Movements in the impairment allowance for the years ended 31 December 2015 and 2014 are as follows:

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Balance at the beginning of the year	12	14
Net charge/ (recovery)	14	(2)
<b>Balance at the end of the year</b>	<u><b>26</b></u>	<u><b>12</b></u>

## 12 Money issued in circulation

Money issued in circulation represents the amount of national currency of the Republic of Azerbaijan issued by the Bank. This comprises the AZN issued into circulation for 1 January 2006, and old Azerbaijani Manats ("AZM") issued into circulation since the introduction of the national currency in 1992. The Azerbaijani Manat was denominated on 1 January 2006 and, starting from that date, AZM 5,000 is equal to AZN 1.

During the year ended 31 December 2015 the Bank accepted new banknotes amounting to AZN 790,191 thousand from minting company (2014: AZN 10,002,500 thousand) and destroyed banknotes amounting to AZN 1,752,022 thousand (2014: AZN 1,039,032 thousand).

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Balance at the beginning of the year	10,845,946	11,033,336
Net amount of banknotes and coins withdrawn from circulation	(5,429,195)	(187,390)
<b>Balance at the end of the year</b>	<u><b>5,416,751</b></u>	<u><b>10,845,946</b></u>

## 13 Amounts due to government organisations

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Amounts due to the Central Treasury of the Republic of Azerbaijan	4,105,151	3,341,746
Amounts due to State Oil Fund of the Republic of Azerbaijan	198,375	319,951
Other demand deposits	47,318	5,214
<b>Total amounts due to government organisation</b>	<b><u>4,350,844</u></b>	<b><u>3,666,911</u></b>

Interest rate, currency and maturity analysis of amounts due to government organisations are disclosed in note 24.

## 14 Amounts due to credit institutions

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Current accounts	2,089,877	785,095
Blocked accounts	1,198,941	1,002
Mandatory reserves	47,384	228,056
<b>Total amounts due to credit institutions</b>	<b><u>3,336,202</u></b>	<b><u>1,014,153</u></b>

## 15 Amounts due to other organisations

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Public organisations	5,247	5,781
Other financial institutions	1,342	1,078
<b>Total amounts due to other organisations</b>	<b><u>6,589</u></b>	<b><u>6,859</u></b>

## 16 Debt securities in issue

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Short-term notes	-	27,007
<b>Total debt securities in issue</b>	<b><u>-</u></b>	<b><u>27,007</u></b>

As at 31 December 2015, the Bank has no short-term notes in issue.

## 17 Amounts due to international financial institutions

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Borrowings from International Development Association (IDA)	4,064	2,469
Amounts due to other international financial institutions	593	429
<b>Total amounts due to international financial institutions</b>	<b><u>4,657</u></b>	<b><u>2,898</u></b>

## 18 Other liabilities

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
Amounts payable for investment securities purchased	5,604	10,341
Amounts in the course of settlement	1,013	1,338
Advances received for the sale of foreign currencies	219	31,479
<b>Total other financial liabilities</b>	<b><u>6,836</u></b>	<b><u>43,158</u></b>
Deferred income	18	433
Other	453	80
<b>Total other non-financial liabilities</b>	<b><u>471</u></b>	<b><u>513</u></b>
<b>Total other liabilities</b>	<b><u>7,307</u></b>	<b><u>43,671</u></b>

## 19 Charter fund and reserves

The authorised and fully paid charter fund of the Bank is AZN 500,000 thousand. On 20 October 2015, as a result of amendments to the Law on the Central Bank of Azerbaijan Republic, charter fund of the Central Bank of Azerbaijan was determined to be AZN 500,000 thousand by transferring additional AZN 490,000 thousand from retained earnings.

During the year ended 31 December 2009, the Ministry of Finance of the Republic of Azerbaijan contributed additional capital to the Bank by issuing non-interest bearing promissory notes with the nominal amount of AZN 255,400 thousand with maturity in 2019. The purpose of this contribution was to cover the capital deficit of the Bank in the amount of AZN 255,399 thousand which occurred further to losses amounting to AZN 402,155 thousand arising in 2008 from the revaluation of foreign currency position of the Bank due to the appreciation of Azerbaijani Manat against foreign currencies. The notes were initially recognised at the fair value of AZN 209,517 thousand with the corresponding increase in capital reserves.

On 20 October 2015, as a result of amendments to the Law on the Central Bank of Azerbaijan Republic, capital reserves of the Bank shall not fall below its charter fund, therefore, the capital reserves of the Bank were determined to be AZN 500,000 thousand by transferring additional amount of AZN 290,483 thousand from retained earnings.

## 20 Interest income and expenses

*In thousands of Azerbaijani Manats*

	<u>2015</u>	<u>2014</u>
<b>Interest income</b>		
Loans to banks	165,461	133,417
Investment securities:		
<i>Available-for-sale investments</i>	32,725	9,069
<i>Held-to-maturity investments</i>	4,190	20,936
Trading securities	14,926	18,805
Placements with non-resident banks	4,650	3,925
Promissory notes from government	4,624	4,624
SDR holdings with the IMF	106	142
Other assets	63	68
<b>Total interest income</b>	<u><u>226,745</u></u>	<u><u>190,986</u></u>
<b>Interest expense</b>		
Liabilities on transactions with the IMF	106	142
Amounts due to international financial institutions	39	26
Debt securities in issue	10	463
<b>Total interest expense</b>	<u><u>155</u></u>	<u><u>631</u></u>
<b>Net interest income</b>	<u><u>226,590</u></u>	<u><u>190,355</u></u>

Included within various line items under interest income for the year ended 31 December 2015 is a total of AZN 25,400 thousand (2014: AZN 7,918 thousand) accrued on impaired financial assets.

## 21 Fee and commission income

*In thousands of Azerbaijani Manats*

	<u>2015</u>	<u>2014</u>
Cash withdrawal	9,544	6,772
Settlement	3,019	3,496
Other	5	6
<b>Total fee and commission income</b>	<u><u>12,568</u></u>	<u><u>10,274</u></u>

## 22 Fee and commission expense

*In thousands of Azerbaijani Manats*

	<u>2015</u>	<u>2014</u>
Cash withdrawal	5,647	537
Securities operations (management, custodian and brokerage)	1,057	823
Settlement	103	70
Other	282	-
<b>Total fee and commission expenses</b>	<u><u>7,089</u></u>	<u><u>1,430</u></u>

## 23 Administrative and other operating expenses

<i>In thousands of Azerbaijani Manats</i>	<b>2015</b>	<b>2014</b>
Staff costs	16,059	14,826
Depreciation of premises and equipment	9,218	7,782
Amortisation of software and other intangible assets	4,626	2,939
Banknotes and coin production	3,842	9,762
Regional construction and social	2,760	9,775
Financing of Financial Monitoring Service	2,395	1,543
Software maintenance	2,380	1,958
Security	1,344	1,358
Repair and maintenance	862	2,125
Office supplies	528	349
Communication	468	447
Insurance	397	213
Heating and lighting	380	345
Legal and consultancy	346	82
Occupancy and rent	268	259
Business travel	156	143
Printing	139	114
Representation	43	242
Utilities	40	41
Other	679	661
<b>Total administrative and other operating expenses</b>	<b>46,930</b>	<b>54,964</b>



## 24 Risk management

The activities of the Bank are exposed to various risks. Bank's risks are classified in the following four categories based on the "Framework Document on operational risk management of the Central Bank of Azerbaijan Republic" approved by the Management Board on 5 February 2014:

- *Strategic (policy) risks* – are the risks related with the monetary policy, financial stability, bank control and other strategic issues arising out of mandate. Strategic (policy) Risk Management is implemented by Bank's Management Board, Monetary Policy and Financial Stability Committee, as well as relevant units (Monetary Policy, Credit Organisations Activity Control, Prudential Policy and Methodology, Market operations, Strategic Management and other departments);
- *Financial risks* – is targeted at the identification, management of credit, market and liquidity risks on the management of Bank's currency reserves, Financial risk management Policy, establishment of relevant risk limits and controls, and regular monitoring of implementation of risk levels and limits. Risk management policy and procedures are regularly reviewed considering the changes in the market condition, offered products and services and innovations in the advanced practice;
- *Operational risks* – are the risks arising out of the intentional or careless behaviour of employees of Bank's units and Bank's project team, non-adequacy of the internal processes, deficiency in the technical equipment, as well as software and technical platforms of the information system, and external events. In accordance with the principles of the Basel Committee on Operational Risk Management, it is carried out on the basis of 3 lines of defence. The first line of defence consists of the Bank's structural units of the model, the second and the third lines include the Risk Management Department of the Internal Audit Department, respectively.

Functions of the Bank's risk management department include preparation, development, communication and training of the policy and methodology documents for of Bank's Operational Risks Management (ORM) and relevant supporting systems; coordination, facilitation, monitoring and reporting of the ORM and as well as the preparation of risk profile of the Bank's consolidated operations.

- *Reputational risks* – are the risks arising out of the personal life, behaviour and communication of Bank's high-ranking officials (Members of the Management Board and General Directors), as well as discrepancy between the Bank's goals and activities and the public opinion. Bank's reputational risks are managed by the Management Board, General Directors and Communication Department. Reputational losses in the result of inefficient management of strategic (policy), financial, operational risks are not considered as reputational risks. Those losses are considered as one of the risk impact categories within the strategic (policy), financial, operational risks management.

### **Financial risk management policies and procedures**

Risk management is a critical component of its banking activities. Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and daily monitoring, subject to risk limits and other controls.

The Management Board is ultimately responsible for identifying and controlling risks; however, there are separate business units responsible for managing and monitoring the various risks:

*Management Board.* The Management Board is ultimately responsible for controlling of risk management system. The Management Board is responsible for the overall risk management approach, risk tolerance levels and for approving the main principles of risk management.

## 24 Risk management, continued

Operations are allocated among members of the Management Board based on control principle. Each Board member must control the operations under his sector of responsibility.

*Investment Committee.* The Investment Committee is responsible for the preparation of “Key directions of Foreign Currency Assets management of the Central Bank of Azerbaijan Republic” in accordance with “Rules of Foreign Currency Assets management of the Central Bank of Azerbaijan Republic”, and adoption of “Operational Investment Strategy on Foreign Currency Assets management of the Central Bank of Azerbaijan Republic”, as well as control over foreign currency assets management.

*Risk Management Unit.* The Risk Management Unit of the Market Operations Department regularly controls the limits set for management of foreign currency assets in accordance with the “Regulations for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan”, “Main Directions for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan”, and “Operational Investment Strategy for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan”.

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

There are also special committees and commissions within the Bank for conducting operations and control such as the Investment Committee, Credit Committee, and Regular Commission on determination of official exchange rates of the Bank, and others.

The risk related to the Bank’s foreign currency assets is a significant risk. Segregation of duties, procedures and reporting for risk management are regulated by the “Guidelines on Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan”. Acceptable limits on managed risks are stipulated in the “Guidelines on Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan”, “Main Directions of Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan”, “Operational Investment Strategy for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan” and “Investment Rules for Management of Assets by Foreign Managers”. These limits are defined by the Investment Committee and approved by the Management Board. Ongoing control over risks is exercised by Risk Management Division of the Market Operations Department and Financial Market Operations Division of the Payment Systems and Settlements Department.

### **Credit risk**

The Bank is exposed to credit risk, which is the risk that one party will incur a loss because the other party failed to comply with its financial obligations. Exposure to credit risk arises as a result of the Bank’s lending and other transactions with counterparties giving rise to financial assets. Credit risk is managed and controlled through proper selection of investment assets, credit quality of investment assets and setting limits on the amount of investment per investment asset.

## 24 Risk management, continued

In accordance with the investment guidelines of the Bank, only investment instruments with short-term ratings of not less than A-2 (Standard & Poor's), F-2 (Fitch) or P-2 (Moody's) and long-term ratings of not less than A- (Standard & Poor's, Fitch) or A3 (Moody's) may be used for management of the Bank's assets. At the same time, the maximum amount invested in one foreign commercial bank, except the government and other central banks, is defined as the equivalent of US Dollar 200 million. Subject to the terms of the investment instrument, minimal credit rating is defined as A- (Standard & Poor's, Fitch) for investment instruments with a term of up to one month, A (Standard & Poor's, Fitch) for deposits with a term from one to twelve months, and A+ (Standard & Poor's, Fitch) for deposits with a term over twelve months. When different credit ratings are designated by the various agencies, the rating meeting the minimum required level for this asset is used.

The Bank classifies loans based on a credit rating system. This provides early identification of possible changes in the creditworthiness of counterparties. Credit rating allows the Bank to assess the potential loss as a result of the risks to which the Bank is exposed and take corrective action.

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

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
<b>ASSETS</b>		
Cash and cash equivalents	5,190,762	3,951,699
Amounts due from non-resident banks	17,784	538,044
Special Drawing Rights with the IMF	332,661	174,540
Trading securities	2,801,748	2,939,638
Derivative financial instruments	32	1,422
Investment securities	3,770,797	3,600,246
Loans to banks	5,812,054	3,450,152
Promissory notes from government	239,603	234,979
Other financial assets	4,521	42,261
<b>Total maximum exposure</b>	<b><u>18,169,962</u></b>	<b><u>14,932,981</u></b>

Collateral generally is not held against claims under derivative financial instruments and investments in securities, except when securities are held as part of reverse repurchase and securities borrowing activities.

For the analysis of collateral held against loans to banks and concentration of credit risk in respect of loans to banks refer to note 9.

### **Market risk**

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

#### ***Interest rate risk***

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

## 24 Risk management, continued

### *Interest rate gap analysis*

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments as at 31 December 2015 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>Less than 3 months</b>	<b>3-6 months</b>	<b>6-12 months</b>	<b>More than 1 year</b>	<b>Non-interest bearing</b>	<b>Carrying amount</b>
<b>31 December 2015</b>						
<b>ASSETS</b>						
Cash and cash equivalents	5,182,684	-	-	-	605,489	5,788,173
Amounts due from non-resident banks	-	9,228	8,556	-	-	17,784
Special Drawing Rights with the IMF	332,661	-	-	-	-	332,661
Trading securities	2,801,748	-	-	-	-	2,801,748
Derivative financial instruments	-	-	-	-	32	32
Investment securities	71,150	12,960	428,811	3,257,876	-	3,770,797
Loans to banks	120,701	204,985	265,562	5,220,806	-	5,812,054
Promissory notes from government	-	-	-	239,603	-	239,603
Other financial assets	3,465	-	1	1,055	-	4,521
	<b>8,512,409</b>	<b>227,173</b>	<b>702,930</b>	<b>8,719,340</b>	<b>605,521</b>	<b>18,767,373</b>
<b>LIABILITIES</b>						
Money issued in circulation	-	-	-	-	5,416,751	5,416,751
Amounts due to government organisations	-	-	-	-	4,350,844	4,350,844
Amounts due to credit institutions	-	-	-	-	3,336,202	3,336,202
Amounts due to other organisations	-	-	-	-	6,589	6,589
Liabilities on transactions with the IMF	-	-	-	-	333,327	333,327
Amounts due to international financial institutions	-	-	-	-	4,657	4,657
Other financial liabilities	-	-	-	-	6,836	6,836
	-	-	-	-	<b>13,455,206</b>	<b>13,455,206</b>
	<b>8,512,409</b>	<b>227,173</b>	<b>702,930</b>	<b>8,719,340</b>	<b>(12,849,685)</b>	<b>5,312,167</b>

## 24 Risk management, continued

A summary of the interest gap position for major financial instruments as at 31 December 2014 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>Less than 3 months</b>	<b>3-6 months</b>	<b>6-12 months</b>	<b>More than 1 year</b>	<b>Non-interest bearing</b>	<b>Carrying amount</b>
<b>31 December 2014</b>						
<b>ASSETS</b>						
Cash and cash equivalents	3,825,518	-	-	-	781,287	4,606,805
Amounts due from non-resident banks	-	538,044	-	-	-	538,044
Special Drawing Rights with the IMF	174,540	-	-	-	-	174,540
Trading securities	2,939,638	-	-	-	-	2,939,638
Derivative financial instruments	-	-	-	-	1,422	1,422
Investment securities	-	40,116	136,932	3,423,198	-	3,600,246
Loans to banks	63,276	116,747	334,208	2,935,921	-	3,450,152
Promissory notes from government	-	-	-	234,979	-	234,979
Other financial assets	41,201	11	54	995	-	42,261
	<b>7,044,173</b>	<b>694,918</b>	<b>471,194</b>	<b>6,595,093</b>	<b>782,709</b>	<b>15,588,087</b>
<b>LIABILITIES</b>						
Money issued in circulation	-	-	-	-	10,845,946	10,845,946
Amounts due to government organisations	-	-	-	-	3,666,911	3,666,911
Amounts due to credit institutions	-	-	-	-	1,014,153	1,014,153
Amounts due to other organisations	-	-	-	-	6,859	6,859
Derivative financial instruments	-	-	-	-	353	353
Debt securities in issue	27,007	-	-	-	-	27,007
Liabilities on transactions with the IMF	1,463	-	-	-	175,180	176,643
Amounts due to international financial institutions	2,898	-	-	-	-	2,898
Other financial liabilities	43,158	-	-	-	-	43,158
	<b>74,526</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>15,709,402</b>	<b>15,783,928</b>
	<b>6,969,647</b>	<b>694,918</b>	<b>471,194</b>	<b>6,595,093</b>	<b>(14,926,693)</b>	<b>(195,841)</b>

### *Interest rate sensitivity analysis*

The management of interest rate risk based on interest rate gap analysis is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of net profit or loss and equity to changes in interest rates (repricing risk) based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2015 and 2014 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>31/12/2015</b>	<b>31/12/2014</b>
100 bp parallel fall	(107,113)	(90,273)
100 bp parallel rise	107,113	90,273

An analysis of sensitivity of net profit or loss and equity as a result of changes in the fair value of trading securities and financial assets available-for-sale due to changes in the interest rates based on positions existing as at 31 December 2015 and 2014 and a simplified scenario of a 100 bp symmetrical fall or rise in all yield curves is as follows:

<i>In thousands of Azerbaijani Manats</i>	<b>31/12/2015</b>	<b>31/12/2014</b>
100 bp parallel fall	(35,846)	(28,646)
100 bp parallel rise	35,846	28,646

## 24 Risk management, continued

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2015 and 2014. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	31/12/2015				31/12/2014			
	Average effective interest rate, %				Average effective interest rate, %			
	AZN	USD	EUR	Other currencies	AZN	USD	EUR	Other currencies
<b>Interest bearing assets</b>								
Cash and cash equivalents	-	0.32	(0.15)	0.26	-	0.01	0.05	0.49
Amounts due from non-resident banks	-	-	0.02	-	-	-	0.10	-
Special Drawing Rights with the IMF	-	-	-	0.05	-	-	-	0.05
Trading securities	-	0.67	2.53	0.94	-	0.34	0.31	0.58
Investment securities	0.51	1.00	1.75	2.00	3.33	1.36	1.70	1.43
Loans to banks	3.33	2.53	-	-	4.20	2.50	-	-
Promissory notes from government	2.0	-	-	-	2.00	-	-	-
Other financial assets	5.67	-	-	-	5.88	-	-	-
<b>Interest bearing liabilities</b>								
Debt securities in issue	-	-	-	-	0.14	-	-	-
Liabilities on transactions with the IMF	-	-	-	-	-	-	-	0.50

### *Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Subject to the currency structure of assets, the value of assets of the Bank is exposed to risk of changes in exchange rates of main foreign currencies.

The foreign currency assets of the Bank are primarily maintained in US Dollars, Euro and Pound Sterling. Currency composition of assets was defined by the “Main Directions for Management of Currency Assets of the Central Bank of the Republic of Azerbaijan” approved by the resolution of the Management Board dated 9 December 2013. This document is taken as a basis by the Market Operations department of the Bank, who is the major body responsible for management of the currency risk. Also the department acts in accordance with its own charter approved by the Management Board.

Currency risk is managed through diversification of foreign currency portfolio and determination of the following parameters:

- foreign currencies subject to management;
- maximum share of the managed currency in the total assets denominated in foreign currencies (minimum volume for the base currency).

## 24 Risk management, continued

The following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2015:

<i>In thousands of Azerbaijani Manats</i>	<b>USD</b>	<b>EUR</b>	<b>Other currencies</b>	<b>Total</b>
<b>ASSETS</b>				
Cash and cash equivalents	5,448,746	99,862	239,565	5,788,173
Amounts due from non-resident banks	-	17,784	-	17,784
Special Drawing Rights with the IMF	-	-	332,661	332,661
Trading securities	2,164,502	295,031	342,215	2,801,748
Derivative financial instruments	32	-	-	32
Investment securities	78,348	689,810	71,146	839,304
Loans to banks	996,512	-	-	996,512
Other financial assets	2,505	-	-	2,505
<b>Total assets</b>	<b>8,690,645</b>	<b>1,102,487</b>	<b>985,587</b>	<b>10,778,719</b>
<b>LIABILITIES</b>				
Amounts due to government organisations	70,171	12,015	9,793	91,979
Amounts due to credit institutions	1,793,023	64,664	-	1,857,687
Amounts due to other organisations	109	4	-	113
Liabilities on transactions with the IMF	-	-	333,327	333,327
Amounts due to international financial institutions	4,064	-	-	4,064
Other financial liabilities	5,818	5	-	5,823
<b>Total liabilities</b>	<b>1,873,185</b>	<b>76,688</b>	<b>343,120</b>	<b>2,292,993</b>
<b>Net recognised position</b>	<b>6,817,460</b>	<b>1,025,799</b>	<b>642,467</b>	<b>8,485,726</b>
The effect of derivatives	(126,056)	74,928	51,128	-
<b>Net position</b>	<b>6,691,404</b>	<b>1,100,727</b>	<b>693,595</b>	<b>8,485,726</b>

## 24 Risk management, continued

The following table shows the currency structure of financial assets and liabilities as at 31 December 2014:

<i>In thousands of Azerbaijani Manats</i>	<b>USD</b>	<b>EUR</b>	<b>Other currencies</b>	<b>Total</b>
<b>ASSETS</b>				
Cash and cash equivalents	4,091,631	321,288	193,886	4,606,805
Amounts due from non-resident banks	-	538,044	-	538,044
Special Drawing Rights with the IMF	-	-	174,540	174,540
Trading securities	1,602,835	743,525	593,278	2,939,638
Derivative financial instruments	1,422	-	-	1,422
Investment securities	1,601,618	1,479,533	219,343	3,300,494
Loans to banks	507,174	-	-	507,174
Other financial assets	9,632	22,017	9,477	41,126
<b>Total assets</b>	<b>7,814,312</b>	<b>3,104,407</b>	<b>1,190,524</b>	<b>12,109,243</b>
<b>LIABILITIES</b>				
Amounts due to government organisations	377,521	63,444	64	441,029
Amounts due to credit institutions	260,612	60,822	3,660	325,094
Amounts due to other organisations	223	2	-	225
Derivative financial instruments	353	-	-	353
Liabilities on transactions with the IMF	-	-	176,643	176,643
Amounts due to international financial institutions	2,898	-	-	2,898
Other financial liabilities	41,199	621	-	41,820
<b>Total liabilities</b>	<b>682,806</b>	<b>124,889</b>	<b>180,367</b>	<b>988,062</b>
<b>Net recognised position</b>	<b>7,131,506</b>	<b>2,979,518</b>	<b>1,010,157</b>	<b>11,121,181</b>
The effect of derivatives	(60,065)	40,166	19,899	-
<b>Net position</b>	<b>7,071,441</b>	<b>3,019,684</b>	<b>1,030,056</b>	<b>11,121,181</b>



## 24 Risk management, continued

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2015 and 2014 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
15% appreciation of USD against AZN	1,003,711	1,060,716
15% appreciation of EUR against AZN	165,109	452,953

A strengthening of the AZN against the above currencies at 31 December 2015 and 2014 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

### *Other price risk*

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. Other price risk arises when the Bank takes a long or short position in a financial instrument.

An analysis of sensitivity of net profit or loss and equity to changes in securities prices based on positions existing as at 31 December 2015 and 2014 and a simplified scenario of a 10% change in all securities prices is as follows:

<i>In thousands of Azerbaijani Manats</i>	<u>31/12/2015</u>	<u>31/12/2014</u>
10% increase in securities prices	280,175	293,964
10% decrease in securities prices	(280,175)	(293,964)

### **Liquidity risk**

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Management of the liquidity risk by the Bank is based on keeping the liquidity at required level for meeting the requirements of the Bank in any condition.

In order to achieve the Bank's primary goals of maintaining currency stability and control over monetary policy, the Bank maintains operational foreign currency assets which are a group of liquid assets from its foreign currency assets to ensure timely intervention when deemed necessary. Such group of operational liquid foreign currency assets of the Bank is adequate for meeting the foreign currency demand for currency intervention, financing foreign trade equivalent of three-month import, and financing short-term foreign debt of the country. Liquidity risk management consists of identifying the liquid assets and determining the minimum liquidity limits of foreign currency assets over its investment period.

## 24 Risk management, continued

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2015:

<i>In thousands of Azerbaijani Manats</i>	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>From 1 to 5 years</b>	<b>More than 5 years</b>	<b>No maturity</b>	<b>Overdue</b>	<b>Total</b>
<b>ASSETS</b>								
Cash and cash equivalents	5,788,173	-	-	-	-	-	-	5,788,173
Amounts due from non-resident banks	-	-	17,784	-	-	-	-	17,784
Special Drawing Rights with the IMF	-	-	-	-	-	332,661	-	332,661
Trading securities	2,801,748	-	-	-	-	-	-	2,801,748
Derivative financial instruments	32	-	-	-	-	-	-	32
Investment securities	71,148	-	441,771	502,031	2,755,846	-	1	3,770,797
Loans to banks	2,526	32,866	470,547	1,331,587	3,889,218	-	85,310	5,812,054
Promissory notes from government	-	-	-	239,603	-	-	-	239,603
Property, equipment and intangible assets	-	-	-	-	-	97,482	-	97,482
Other assets	3,465	-	1	143	912	59,295	-	63,816
<b>Total assets</b>	<b>8,667,092</b>	<b>32,866</b>	<b>930,103</b>	<b>2,073,364</b>	<b>6,645,976</b>	<b>489,438</b>	<b>85,311</b>	<b>18,924,150</b>
<b>LIABILITIES</b>								
Money issued in circulation	-	-	-	-	-	5,416,751	-	5,416,751
Amounts due to government organisations	4,350,844	-	-	-	-	-	-	4,350,844
Amounts due to credit institutions	3,336,202	-	-	-	-	-	-	3,336,202
Amounts due to other organisations	6,589	-	-	-	-	-	-	6,589
Liabilities on transactions with the IMF	-	-	-	-	-	333,327	-	333,327
Amounts due to international financial institutions	4,657	-	-	-	-	-	-	4,657
Other liabilities	6,482	-	-	-	-	825	-	7,307
<b>Total liabilities</b>	<b>7,704,774</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,750,903</b>	<b>-</b>	<b>13,455,677</b>
<b>Net position</b>	<b>962,318</b>	<b>32,866</b>	<b>930,103</b>	<b>2,073,364</b>	<b>6,645,976</b>	<b>(5,261,465)</b>	<b>85,311</b>	<b>5,468,473</b>

## 24 Risk management, continued

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2014:

<i>In thousands of Azerbaijani Manats</i>	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>From 1 to 5 years</b>	<b>More than 5 years</b>	<b>No maturity</b>	<b>Overdue</b>	<b>Total</b>
<b>ASSETS</b>								
Cash and cash equivalents	4,416,365	190,440	-	-	-	-	-	4,606,805
Amounts due from non-resident banks	-	-	538,044	-	-	-	-	538,044
Special Drawing Rights with the IMF	-	-	-	-	-	174,540	-	174,540
Trading securities	2,939,638	-	-	-	-	-	-	2,939,638
Derivative financial instruments	1,422	-	-	-	-	-	-	1,422
Investment securities	-	-	177,048	3,235,244	187,954	-	-	3,600,246
Loans to banks	-	35,803	450,955	812,603	2,123,318	-	27,473	3,450,152
Promissory notes from government	-	-	-	234,979	-	-	-	234,979
Property, equipment and intangible assets	-	-	-	-	-	98,081	-	98,081
Other assets	41,199	2	65	23	972	40,530	-	82,791
<b>Total assets</b>	<b>7,398,624</b>	<b>226,245</b>	<b>1,166,112</b>	<b>4,282,849</b>	<b>2,312,244</b>	<b>313,151</b>	<b>27,473</b>	<b>15,726,698</b>
<b>LIABILITIES</b>								
Money issued in circulation	-	-	-	-	-	10,845,946	-	10,845,946
Amounts due to government organisations	3,666,911	-	-	-	-	-	-	3,666,911
Amounts due to credit institutions	1,014,153	-	-	-	-	-	-	1,014,153
Amounts due to other organisations	6,859	-	-	-	-	-	-	6,859
Derivative financial instruments	353	-	-	-	-	-	-	353
Debt securities in issue	27,007	-	-	-	-	-	-	27,007
Liabilities on transactions with the IMF	1,463	-	-	-	-	175,180	-	176,643
Amounts due to international financial institutions	2,898	-	-	-	-	-	-	2,898
Other liabilities	43,158	-	-	-	-	513	-	43,671
<b>Total liabilities</b>	<b>4,762,802</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>11,021,639</b>	<b>-</b>	<b>15,784,441</b>
<b>Net position</b>	<b>2,635,822</b>	<b>226,245</b>	<b>1,166,112</b>	<b>4,282,849</b>	<b>2,312,244</b>	<b>(10,708,488)</b>	<b>27,473</b>	<b>(57,743)</b>

## **25 Management of capital**

The capital of the Bank comprises the residual value of the Bank's assets after deduction of all its liabilities.

The Bank's objectives when managing capital are to maintain an appropriate level of capital to ensure economic independence of the Bank and ability to perform its functions. The Bank considers total capital under management to be equity disclosed in the statement of financial position.

No external capital requirements exist for the Bank as the central bank, except for the size of the charter fund and minimum amount of capital reserves stipulated by the Law of the Republic of Azerbaijan on "the Central Bank of the Republic of Azerbaijan" (the "Law").

As disclosed in Note 19, at 31 December 2015 the authorised and fully paid charter fund of the Bank was AZN 500,000 thousand (31 December 2014: AZN 10,000 thousand).

The Bank has made total profit in the amount of AZN 5,531,130 thousand for the year ended 31 December 2015. Based on article 12 of the Law, reporting year profit shall, in the first place, be directed to formation of capital reserves of the Central Bank. Upon formation of capital reserves and approval of Central Bank's annual financial statements by the auditor's opinion, clear balance of realized gain shall be transferred to the state budget.

Due to the fact that the capital reserves of the Bank at 31 December 2014 were not at the level required by the Law, there were no transfers made to the State Budget during the year 2015.

## **26 Operating leases**

The Bank leases a number of premises and equipment under operating leases. The leases typically run for an initial period of one year, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

## **27 Contingencies**

### **Litigations**

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

## 28 Related party transactions

Parties are generally considered to be related if the parties are directly or indirectly 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.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

Bodies under the state's control represent the Azerbaijan Mortgage Fund ("AMF"), the Financial Monitoring Service ("FMS"), International Bank of Azerbaijan and Azer Turk Bank. The Bank acts as supervisor of "FMS" as mandated by law, but it has no title over its assets and liabilities, has no share ownership and rights over its economic benefits arising from their activities.

### **Transactions with the members of the Management**

Total remuneration included in personnel expenses for the years ended 31 December 2015 and 2014 is as follows:

<i>In thousands of Azerbaijani Manats</i>	<u>2015</u>	<u>2014</u>
Short term employee benefits (salary)	<u>890</u>	<u>846</u>

### **Transactions with government-related entities**

The Bank is a state owned entity, and in the ordinary course of business operates with various state owned companies. Significant transactions with government owned companies include loans to banks, investment securities, promissory notes from government, placements by government and credit institutions and interest income.

## 28 Related party transactions, continued

The outstanding balances and the related average effective interest rates as at 31 December 2015 and related profit or loss amounts of transactions for the year ended 31 December 2015 with other related parties are as follows:

	Government of Azerbaijan		Management Board		Government controlled entities		Total
	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats
<b>Statement of financial position</b>							
<b>ASSETS</b>							
Investment securities	78,921	0.01	-	-	2,836,154	0.48	2,915,075
Loans to banks							
Principal balance	-	-	-	-	2,663,648	1.61	2,663,648
Promissory notes from government	239,603	2.00					239,603
Other assets	8	-	90	3.75	770	-	868
<b>LIABILITIES</b>							
Amounts due to government organisations	4,108,986	-	-	-	241,858	-	4,350,844
Amounts due to credit institutions	-	-	-	-	1,135,568	-	1,135,568
Amounts due to other organisations	5,247	-	-	-	1,342	-	6,589
Liabilities on transactions with the IMF	333,327	-	-	-	-	-	333,327
Amounts due to international financial institutions	4,657	-	-	-	-	-	4,657
Other liabilities					245	-	245
<b>Profit (loss)</b>							
Interest income	213	-	3	-	69,948	-	70,164
Interest expense	(135)	-	-	-	(12)	-	(147)
Fee and commission income	371	-	-	-	3,974	-	4,345
Other general and administrative expenses	-	-	-	-	(2,395)	-	(2,395)

## 28 Related party transactions, continued

The outstanding balances and the related average effective interest rates as at 31 December 2014 and related profit or loss amounts of transactions for the year ended 31 December 2014 with other related parties are as follows:

	Government of Azerbaijan		Management Board		Government controlled entities		Total
	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats
<b>Statement of financial position</b>							
<b>ASSETS</b>							
Investment securities	131,905	0.75	-	-	19,678	3.04	151,583
Loans to banks							
Principal balance	-	-	-	-	1,362,202	1.90	1,362,202
Impairment allowance	-	-	-	-	-	-	-
Promissory notes from government	234,979	2.00	-	-	-	-	234,979
Other assets	41	-	57	4.60	72	-	170
<b>LIABILITIES</b>							
Amounts due to government organisations	3,343,325	-	-	-	323,586	-	3,666,911
Amounts due to credit institutions	-	-	-	-	126,315	-	126,315
Amounts due to other organisations	1,562	-	-	-	5,202	-	6,764
Liabilities on transactions with the IMF	176,643	-	-	-	-	-	176,643
Amounts due to international financial institutions	2,898	-	-	-	-	-	2,898
Other liabilities	-	-	-	-	82	-	82
<b>Profit (loss)</b>							
Interest income	800	-	16	-	52,659	-	53,475
Interest expense	(25)	-	-	-	(130)	-	(155)
Fee and commission income	549	-	-	-	6,078	-	6,627
Other general and administrative expenses	-	-	-	-	(1,543)	-	(1,543)

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

### Accounting classifications and fair values

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2015:

<i>In thousands of Azerbaijani Manats</i>	<b>Trading securities</b>	<b>Designated at fair value</b>	<b>Held-to-maturity</b>	<b>Loans and receivables</b>	<b>Available-for-sale</b>	<b>Other amortised cost</b>	<b>Total carrying amount</b>	<b>Fair value</b>
Cash and cash equivalents	-	-	-	5,788,173	-	-	5,788,173	5,788,173
Amounts due from non-resident banks	-	-	-	17,784	-	-	17,784	17,784
Special Drawing Rights with the IMF	-	-	-	332,661	-	-	332,661	332,661
Trading securities	2,801,748	-	-	-	-	-	2,801,748	2,801,748
Derivative financial instruments	-	32	-	-	-	-	32	32
Investment securities	-	-	-	2,578,921	1,191,876	-	3,770,797	3,756,490
Loans to banks	-	-	-	5,812,054	-	-	5,812,054	5,638,608
Promissory notes from government	-	-	-	239,603	-	-	239,603	239,603
Other financial assets	-	-	-	4,521	-	-	4,521	4,521
	<b>2,801,748</b>	<b>32</b>	<b>-</b>	<b>14,773,717</b>	<b>1,191,876</b>	<b>-</b>	<b>18,767,373</b>	<b>18,579,620</b>
Money issued in circulation	-	-	-	-	-	5,416,751	5,416,751	5,416,751
Amounts due to government organisations	-	-	-	-	-	4,350,844	4,350,844	4,350,844
Amounts due to credit institutions	-	-	-	-	-	3,336,202	3,336,202	3,336,202
Amounts due to other organisations	-	-	-	-	-	6,589	6,589	6,589
Liabilities on transactions with the IMF	-	-	-	-	-	333,327	333,327	333,327
Amounts due to international financial institutions	-	-	-	-	-	4,657	4,657	4,657
Other financial liabilities	-	-	-	-	-	6,836	6,836	6,836
	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>13,455,206</b>	<b>13,455,206</b>	<b>13,455,206</b>



## 29 Financial assets and liabilities: fair values and accounting classifications, continued

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2014:

<i>In thousands of Azerbaijani Manats</i>	<b>Trading securities</b>	<b>Designated at fair value</b>	<b>Held-to-maturity</b>	<b>Loans and receivables</b>	<b>Available-for-sale</b>	<b>Other amortised cost</b>	<b>Total carrying amount</b>	<b>Fair value</b>
Cash and cash equivalents	-	-	-	4,606,805	-	-	4,606,805	4,606,805
Amounts due from non-resident banks	-	-	-	538,044	-	-	538,044	538,044
Special Drawing Rights with the IMF	-	-	-	174,540	-	-	174,540	174,540
Trading securities	2,939,638	-	-	-	-	-	2,939,638	2,939,638
Derivative financial instruments	-	1,422	-	-	-	-	1,422	1,422
Investment securities	-	-	3,300,494	91,905	207,847	-	3,600,246	3,599,746
Loans to banks	-	-	-	3,450,152	-	-	3,450,152	3,454,152
Promissory notes from government	-	-	-	234,979	-	-	234,979	234,979
Other financial assets	-	-	-	42,261	-	-	42,261	42,261
	<b>2,939,638</b>	<b>1,422</b>	<b>3,300,494</b>	<b>9,138,686</b>	<b>207,847</b>	<b>-</b>	<b>15,588,087</b>	<b>15,591,587</b>
Money issued in circulation	-	-	-	-	-	10,845,946	10,845,946	10,845,946
Amounts due to government organisations	-	-	-	-	-	3,666,911	3,666,911	3,666,911
Amounts due to credit institutions	-	-	-	-	-	1,014,153	1,014,153	1,014,153
Amounts due to other organisations	-	-	-	-	-	6,859	6,859	6,859
Derivative financial instruments	-	353	-	-	-	-	353	353
Debt securities in issue	-	-	-	-	-	27,007	27,007	27,007
Liabilities on transactions with the IMF	-	-	-	-	-	176,643	176,643	176,643
Amounts due to international financial institutions	-	-	-	-	-	2,898	2,898	2,898
Other financial liabilities	-	-	-	-	-	43,158	43,158	43,158
	<b>-</b>	<b>353</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>15,783,575</b>	<b>15,783,928</b>	<b>15,783,928</b>

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or transfer of liabilities. The fair value of a liability reflects its non-performance risk.

## **29 Financial assets and liabilities: fair values and accounting classifications, continued**

The Bank plays a unique role in providing concessionary loans to banks and other financial institutions in order to fund socio-economic projects, as well as providing financial support for the real sector of the economy, balancing macroeconomic and structural policies with the considerations for the economy of Azerbaijan. Management considers that concessionary loans are issued in a special market segment in which commercial lenders do not operate. Issued loans are backed by government guarantees and have unique characteristics in terms of interest rates and maturities. Taking these particular circumstances into account management believes that the carrying amount of concessionary loans that are accounted for at amortised cost represents a reasonable estimate of their fair value.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For all other financial instruments the Bank determines fair values using other valuation techniques. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

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

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

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

For more complex instruments, the Bank uses proprietary valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Example of instruments involving significant unobservable inputs include certain loans and securities for which there is no active market, certain over the counter structured derivatives, and retained interests in securitisations.

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

## **29 Financial assets and liabilities: fair values and accounting classifications, continued**

### **Fair value hierarchy**

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

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

Where third-party information, such as broker quotes or pricing services are used to measure fair value, the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, is assessed and documented. This includes:

- verifying that the broker or pricing service is approved by the Bank for use in pricing the relevant type of financial instrument;
- understanding how the fair value has been arrived at the extent to which it represents actual market transactions;
- when prices for similar instruments are used to measure fair value, how these prices have been adjusted to reflect the characteristics of the instrument subject to measurement;
- where a number of quotes for the same financial instrument have been obtained, how fair value has been determined using those quotes.

## 29 Financial assets and liabilities: fair values and accounting classifications, continued

The table below analyses financial instruments measured at fair value at 31 December 2015, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

<i>In thousands of Azerbaijani Manats</i>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
<b>Financial assets</b>			
Trading securities	2,801,748	-	2,801,748
Derivative financial instruments	-	32	32
Available-for-sale financial assets			
- Debt and other fixed income instruments	1,191,876	-	1,191,876
	<b>3,993,624</b>	<b>32</b>	<b>3,993,656</b>

The table below analyses financial instruments measured at fair value at 31 December 2014, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

<i>In thousands of Azerbaijani Manats</i>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
<b>Financial assets</b>			
Trading securities	2,939,638	-	2,939,638
Derivative financial instruments	-	1,422	1,422
Available-for-sale financial assets			
- Debt and other fixed income instruments	207,847	-	207,847
	<b>3,147,485</b>	<b>1,422</b>	<b>3,148,907</b>
<b>Financial liabilities</b>			
Derivative financial instruments	-	(353)	(353)
	<b>-</b>	<b>(353)</b>	<b>(353)</b>

The table below analyses financial instruments not measured at fair value at 31 December 2015, by the level in the fair value hierarchy, into which each fair value measurement is categorized as at 31 December 2015

<i>In thousands of Azerbaijani Manats</i>	<u>Level 1</u>	<u>Level 2</u>	<u>Total fair value</u>	<u>Total carrying amount</u>
<b>ASSETS</b>				
Cash and cash equivalents	-	5,788,173	5,788,173	5,788,173
Amounts due from non-resident banks	-	17,784	17,784	17,784
SDRs with the IMF	-	332,661	332,661	332,661
Loans to banks	-	5,638,608	5,638,608	5,812,054
Investment securities				
- Loans and advances	-	2,578,921	2,578,921	2,578,921
Promissory notes from government	-	239,603	239,603	239,603
Other financial assets	-	4,521	4,521	4,521
<b>LIABILITIES</b>				
Money issued in circulation	5,416,751	-	5,416,751	5,416,751
Amounts due to government organisations	-	4,350,844	4,350,844	4,350,844
Amounts due to credit institutions	-	3,336,202	3,336,202	3,336,202
Amounts due to other organisations	-	6,589	6,589	6,589
Liabilities on transactions with the IMF	-	333,327	333,327	333,327
Amounts due to international financial institutions	-	4,657	4,657	4,657
Other financial liabilities	-	6,836	6,836	6,836

## 29 Financial assets and liabilities: fair values and accounting classifications, continued

The table below analyses financial instruments not measured at fair value at 31 December 2014, by the level in the fair value hierarchy, into which each fair value measurement is categorized as at 31 December 2014

<i>In thousands of Azerbaijani Manats</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Total fair value</b>	<b>Total carrying amount</b>
<b>ASSETS</b>				
Cash and cash equivalents	-	5,144,849	5,144,849	5,144,849
Special Drawing Rights with the IMF	-	174,540	174,540	174,540
Loans to banks	-	3,454,152	3,454,152	3,450,152
Investment securities				
- Held to maturity investments	3,300,494	-	3,300,494	3,300,494
- Loans and advances	-	91,405	91,405	91,905
Promissory notes from government	-	234,979	234,979	234,979
Other financial assets	-	42,261	42,261	42,261
<b>LIABILITIES</b>				
Money issued in circulation	10,845,946	-	10,845,946	10,845,946
Amounts due to government organisations	-	3,666,911	3,666,911	3,666,911
Amounts due to credit institutions	-	1,014,153	1,014,153	1,014,153
Amounts due to other organisations	-	6,859	6,859	6,859
Debt securities in issue	27,007	-	27,007	27,007
Liabilities on transactions with the IMF	-	176,643	176,643	176,643
Amounts due to international financial institutions	-	2,898	2,898	2,898
Other financial liabilities	-	43,158	43,158	43,158