

“BANK EURASIA” OPEN JOINT STOCK COMPANY

**The International Financial Reporting
Standards Financial Statements and
Independent Auditors' Report**
For the Year Ended December 31, 2018

“BANK EURASIA” OPEN JOINT STOCK COMPANY

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**STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND
APPROVAL OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2018**

The following statement is made with a view to distinguishing respective responsibilities of the management and those of the independent auditors in relation to the financial statements of "Bank Eurasia" OJSC (the "Bank").

Management is responsible for the preparation of the financial statements that present fairly the financial position of the Bank as at December 31, 2018, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the financial statements, management is responsible for:

- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Preparing the financial statements on a going concern basis, unless it is inappropriate to presume that the Bank will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Bank;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Bank, and which enable them to ensure that the financial statements of the Bank comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards of the Republic of Azerbaijan;
- Taking such steps as are reasonably available to them to safeguard the assets of the Bank; and
- Detecting and preventing fraud, errors and other irregularities.

The financial statements for the year ended December 31, 2018 were authorized for issue on May 6, 2019 by the Management Board of the Bank.

On behalf of the Management Board:


Rufat Karimov
Chairman of the Management Board

May 6, 2019
Baku, the Republic of Azerbaijan




Chingiz Amirjanov
Chief Accountant

May 6, 2019
Baku, the Republic of Azerbaijan

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and the Board of Directors of "Bank Eurasia" Open Joint Stock Company:

Qualified Opinion

We have audited the financial statements of "Bank Eurasia" Open Joint Stock Company (the "Bank"), which comprise the statement of financial position as at December 31, 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2018, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Qualified Opinion

According to IAS 24 "Related Party Disclosures", paragraph 13, the Bank should disclose the name of its ultimate controlling party. In the financial statements subject to audit, this information has not been disclosed. We were not able to obtain any evidence regarding the ultimate controlling party of the Bank.

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

Other Matter

The financial statement of the Bank as at and for the year ended December 31, 2017 were audited by another auditor who expressed a qualified opinion on those statements on April 16, 2018.

In the audit report dated April 16, 2018, the preceding auditor expressed a qualified opinion on the financial statements of the Bank for the year ended December 31, 2017 due to non-disclosure of its ultimate controlling party.

Responsibilities of Management and the Audit Committee for the Financial Statements

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

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

The Audit Committee is responsible for overseeing the Bank's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Baker Tilly Azerbaijan

May 6, 2019

Baku, the Republic of Azerbaijan

"BANK EURASIA" OPEN JOINT STOCK COMPANY

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2018

(In Azerbaijani Manats)

| | Notes | Year ended December 31, 2018 | Year ended December 31, 2017 |
|---|--------|------------------------------------|------------------------------------|
| Interest income | 7, 27 | 12,086,187 | 12,416,486 |
| Interest expense | 7, 27 | (2,719,989) | (2,772,773) |
| Net interest income before expected credit loss | | 9,366,198 | 9,643,713 |
| Recovery/(charge) of expected credit losses | 8, 27 | 578,198 | (3,520,567) |
| Net interest income | | 9,944,396 | 6,123,146 |
| Net gain on foreign exchange operations | 9 | 231,328 | 2,032,601 |
| Fee and commission income | 10 | 1,173,709 | 1,481,993 |
| Fee and commission expense | 10 | (845,739) | (833,895) |
| Change in the fair value of repossessed assets | 21 | (429,440) | (863,284) |
| Other income, net | | 19,833 | 7,106 |
| Net non-interest income | | 149,691 | 1,824,521 |
| Operating income | | 10,094,087 | 7,947,667 |
| Operating expenses | 11, 27 | (4,158,867) | (3,799,704) |
| Profit before income tax | | 5,935,220 | 4,147,963 |
| Income tax expense | 12 | (1,203,578) | (880,464) |
| Net profit for the year | | 4,731,642 | 3,267,499 |
| Other comprehensive income/(loss) | | | |
| Items that may be reclassified subsequently to profit or loss: | | | |
| Movement in fair value reserves | | | |
| - Investment securities – net change in fair value | | 90,490 | (44,108) |
| - Income tax effect of net change in fair value | | (18,098) | 8,822 |
| Other comprehensive income/(loss) for the year | | 72,392 | (35,286) |
| TOTAL COMPREHENSIVE INCOME FOR THE YEAR | | 4,804,034 | 3,232,213 |
| Earnings per share | | | |
| Basic and diluted (AZN) | 13 | 236.58 | 163.37 |

On behalf of the Management Board:

Rufat Karimov
Chairman of the Management Board

May 6, 2019
Baku, the Republic of Azerbaijan



Chingiz Amirjanov
Chief Accountant

May 6, 2019
Baku, the Republic of Azerbaijan

The notes on pages 9-82 form an integral part of these financial statements.

"BANK EURASIA" OPEN JOINT STOCK COMPANY

STATEMENT OF FINANCIAL POSITION FOR THE YEAR ENDED DECEMBER 31, 2018 (In Azerbaijani Manats)

| | Notes | December 31, 2018 | December 31, 2017 |
|---|--------|----------------------|----------------------|
| ASSETS | | | |
| Cash and balances with the Central Bank of the Republic of Azerbaijan | 14 | 52,299,324 | 55,612,286 |
| Due from banks and other financial institutions | 15 | 8,138,873 | 11,223,572 |
| Investment securities | 16 | 16,077,553 | 7,108,298 |
| Loans to customers | 17, 27 | 85,603,901 | 74,013,652 |
| Property and equipment | 18 | 3,340,288 | 4,360,821 |
| Investment property | 19 | 695,400 | - |
| Intangible assets | 20 | 281,216 | 192,036 |
| Other assets | 21 | 2,355,052 | 2,612,367 |
| TOTAL ASSETS | | 168,791,607 | 155,123,032 |
| LIABILITIES AND EQUITY | | | |
| LIABILITIES: | | | |
| Due to banks, government and other financial institutions | 22 | 43,050,466 | 34,483,121 |
| Customer accounts | 23, 27 | 59,667,096 | 56,188,923 |
| Deferred income tax liability | 12 | 557,372 | 1,130,402 |
| Current income tax liability | | - | 1,106,410 |
| Other liabilities | 24 | 649,055 | 330,095 |
| Total liabilities | | 103,923,989 | 93,238,951 |
| EQUITY: | | | |
| Share capital | 25 | 50,000,000 | 50,000,000 |
| Fair value reserve | | 37,106 | (35,286) |
| Retained earnings | | 14,830,512 | 11,919,367 |
| Total equity | | 64,867,618 | 61,884,081 |
| TOTAL LIABILITIES AND EQUITY | | 168,791,607 | 155,123,032 |

On behalf of the Management Board:


Rufat Karimov
Chairman of the Management Board

May 6, 2019
Baku, the Republic of Azerbaijan




Chingiz Amirjanov
Chief Accountant

May 6, 2019
Baku, the Republic of Azerbaijan

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"BANK EURASIA" OPEN JOINT STOCK COMPANY

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED DECEMBER 31, 2018 (In Azerbaijani Manats)

| | Share capital | Fair value reserve | Retained earnings | Total equity |
|---|---------------|--------------------|-------------------|--------------|
| January 1, 2017 | 50,000,000 | - | 8,651,868 | 58,651,868 |
| Net profit for the year | - | - | 3,267,499 | 3,267,499 |
| Other comprehensive loss for the year | - | (35,286) | - | (35,286) |
| December 31, 2017 | 50,000,000 | (35,286) | 11,919,367 | 61,884,081 |
| Impact of adopting IFRS 9 as at January 1, 2018 | - | - | (1,820,497) | (1,820,497) |
| January 1, 2018 | 50,000,000 | (35,286) | 10,098,870 | 60,063,584 |
| Net profit for the year | - | - | 4,731,642 | 4,731,642 |
| Other comprehensive income for the year | - | 72,392 | - | 72,392 |
| December 31, 2018 | 50,000,000 | 37,106 | 14,830,512 | 64,867,618 |

On behalf of the Management Board:


Rufat Karimov
Chairman of the Management Board

May 6, 2019
Baku, the Republic of Azerbaijan




Chingiz Amirjanov
Chief Accountant

May 6, 2019
Baku, the Republic of Azerbaijan

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"BANK EURASIA" OPEN JOINT STOCK COMPANY

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2018 (In Azerbaijani Manats)

| | Notes | Year ended December 31, 2018 | Year ended December 31, 2017 |
|--|--------|------------------------------------|------------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Profit before income tax | | 5,935,220 | 4,147,963 |
| Adjustments for non-cash items: | | | |
| (Recovery)/charge of expected credit losses | 8 | (578,198) | 3,520,567 |
| Change in the fair value of repossessed assets | 21 | 429,440 | 863,284 |
| Depreciation and amortization | 18, 20 | 609,585 | 574,677 |
| Foreign exchange translation loss, net | 9 | 32,306 | 141,211 |
| Change in interest accruals, net | | 432,191 | (14,389) |
| Cash inflow from operating activities before changes in operating assets and liabilities | | <u>6,860,544</u> | <u>9,233,313</u> |
| Changes in operating assets and liabilities | | | |
| (Increase)/decrease in operating assets: | | | |
| Minimum reserve deposit with the CBRA | | (75,148) | 78,780 |
| Due from banks and other financial institutions | | (1,013,357) | (152,214) |
| Loans to customers | | (13,721,701) | 4,661,198 |
| Other assets | | (210,329) | 141,446 |
| Increase/(decrease) in operating liabilities: | | | |
| Due to banks, government and other financial institutions | | 8,556,029 | 6,207,269 |
| Customer accounts | | 3,665,547 | (4,750,611) |
| Other liabilities | | 8,983 | 28,030 |
| Cash inflow from operating activities before income tax paid | | <u>4,070,568</u> | <u>15,447,211</u> |
| Income tax paid | | <u>(2,445,991)</u> | <u>(576,291)</u> |
| Net cash inflow from operating activities | | <u>1,624,577</u> | <u>14,870,920</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| (Purchase of)/proceeds from sale and redemption of investment securities | | (8,553,886) | 2,068,326 |
| Payment for property and equipment | | (243,206) | (200,678) |
| Payment for intangible assets | | (124,351) | (72,246) |
| Net cash (outflow)/inflow from investing activities | | <u>(8,921,443)</u> | <u>1,795,402</u> |

"BANK EURASIA" OPEN JOINT STOCK COMPANY

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | Notes | Year ended December 31, 2018 | Year ended December 31, 2017 |
|--|-------|------------------------------------|------------------------------------|
| Effect of exchange rate changes on cash and cash equivalents | | (176,843) | 287,827 |
| NET (DECREASE)/INCREASE IN CASH AND CASH | | (7,473,709) | 16,954,149 |
| CASH AND CASH EQUIVALENTS, <i>at the beginning of year</i> | 14 | 64,438,904 | 47,484,755 |
| CASH AND CASH EQUIVALENTS, <i>at the end of year</i> | 14 | 56,965,195 | 64,438,904 |

Interest received and paid by the Bank during the year ended December 31, 2018 amounted to AZN 12,522,470 and AZN 2,724,081, respectively (2017: AZN 12,803,725 and AZN 3,174,401, respectively).

On behalf of the Management Board:


Rufat Karimov
Chairman of the Management Board

May 6, 2019
Baku, the Republic of Azerbaijan




Chingiz Amirjanov
Chief Accountant

May 6, 2019
Baku, the Republic of Azerbaijan

The notes on pages 9-82 form an integral part of these financial statements.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

1. INTRODUCTION

Organization and its principal activity

“Bank Eurasia” Open Joint Stock Company (the “Bank”) was incorporated and is domiciled in the Republic of Azerbaijan. The Bank is an open joint stock company limited by the shares and was set up in accordance with the regulations of the Republic of Azerbaijan. The Bank’s principal business activity is commercial and retail banking operations within the Republic of Azerbaijan. The Bank is operating under a full banking license No 251 issued by the Central Bank of the Republic of Azerbaijan (“CBRA”) since November 28, 2007.

The average number of employees of the Bank as at December 31, 2018 was 79 (2017: 79).

Registered address and place of business

The Bank’s registered address is 70 Nizami Street, Baku AZ1000, the Republic of Azerbaijan.

The Bank has the following branches as at December 31, 2018 and 2017:

Sumgait Branch, located at 2, 1st avenue, Sumgait AZ5000, the Republic of Azerbaijan, operating under banking permit No 251/1 dated April 13, 2009 issued by the CBRA.

Buta Branch, located at 47, Khagani Street, Baku AZ1000, the Republic of Azerbaijan, operating under banking permit No 251/2 dated June 8, 2016 issued by the FMSA.

Shareholders of the Bank

As at December 31, 2018 and 2017, the following shareholders owned the issued ordinary shares of the Bank:

| Shareholders | December 31, 2018, % | December 31, 2017, % |
|---------------------------|---------------------------------|---------------------------------|
| “Euro Standard” LLC | 37.5 | 37.5 |
| “PMD Group” LLC | 37.5 | 37.5 |
| “Az bizneskom” LLC | 25.0 | 25.0 |
| Total shareholders | 100.0 | 100.0 |

Operating Environment of the Bank

The Bank’s operations are conducted in the Republic of Azerbaijan. As an emerging market, at the present time the Republic of Azerbaijan is developing business and regulatory infrastructure that would generally exist in a more mature market economy.

The Azerbaijani economy contracted by 1.3% growth (year-on-year) in the first half of 2017, driven by a decline in oil GDP (7.2%) as oil revenues were decreased due to production volumes and oil prices. On the upside, and despite continued banking sector distress, the non-oil economy expanded by 1.7% for the first time in over a year, supported by the strong performance of the agriculture and manufacturing sectors. Annual inflation remained high at 13-14% during 2017, driven mainly by an increase in government-controlled tariffs for electricity, water, and gas, and in domestic food prices. Citing inflationary pressures, the Central Bank of the Republic of Azerbaijan continued to tighten the monetary policy stance during 2017 by scaling up liquidity absorption operations. The manat has

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

appreciated by 4.4% against the U.S. dollar since end-2016, reflecting its stronger external position and increased liquidity absorption operations. The troubled financial sector continues to exert a negative impact on the economy. Credit contracted by 15.6% in the first half of 2017, and the quality of assets continued to deteriorate.

According to Moody's, real GDP growth accelerated further after growing 0.1% in 2017 over the first five months of 2018 by 1.6% compared with the year-earlier period, and expects the economy to grow by 2% in 2018 and 3% in 2019. Growth will be aided by higher oil prices and increased gas exports.

Moody's Investors Service says that the credit profile of Azerbaijan (Ba2 stable) reflects its relatively high levels of gross government debt and guarantees, and fragile banking sector. These features reflect the legacy impact of the fall in oil prices and steep depreciation in the manat over 2014-2016. Conversely, the country's large financial assets provide significant support to the credit profile. Moody's conclusions are contained in its annual credit analysis, "Government of Azerbaijan - Ba2 stable". This credit analysis elaborates on Azerbaijan's credit profile in terms of economic strength, low (+); institutional strength, low (-); fiscal strength, high; and susceptibility to event risk, moderate. These are the four main analytic factors in Moody's Sovereign Bond Rating methodology.

Manat has remained stable during 2018. However, uncertainty over the exchange rate in the future and the ongoing fragility of the banking system hinder policy transmission into the real economy.

In February 2018, Standard & Poor's, international credit agency, affirmed long and short-term sovereign credit rating of Azerbaijan in foreign and local currency at 'BB+/B' upgrading rating outlook from negative to stable.

The future economic growth of the Republic of Azerbaijan is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory and political developments. The Management is unable to predict, all developments in the economic environment which would have an impact on the Bank's operations and consequently what effect, if any, they could have on the financial position of the Bank. The management is currently performing sensitivity analyses under different oil prices scenarios and elaborating relevant action plans for mainlining sustainability of the business.

Azerbaijan is also trying to benefit from regional connectivity initiatives to boost transit and trade. In particular, the country is one of the sponsors of the East–West and North–South transport corridors. Construction of the Baku–Tbilisi–Kars railway line, connecting the Caspian region with Turkey, was completed in 2017. The Trans-Anatolian Natural Gas Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP) will deliver natural gas from Azerbaijan's Shah Deniz gas field to Turkey and Europe. The economy is expected to expand from 2018 onward, supported by an acceleration of oil GDP as the Shah Deniz gas field-one of the largest gas fields in the world-begins production. Non-oil output will continue to grow at a slow pace due to limited credit growth and the weak business environment.

In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support to financial system. On December 6, 2016, President of the Republic of Azerbaijan approved "Strategic road maps for the national economy and main economic sectors in Azerbaijan". The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond 2025.

Furthermore, during 2018 the government continued tight monetary policy as well as allocated foreign currency resources, which stabilised Azerbaijani manat. During 2018, CBAR gradually reduced refinancing rate from 15% to 9.75% with aim of normalising monetary policy.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, financial instruments categorised at fair value through profit or loss (“FVPL”) and at fair value through other comprehensive income (“FVOCI”). The principal accounting policies applied in the preparation of these financial statements are set out below. Apart from the accounting policy changes resulting from the adoption of IFRS 9 and IFRS 15 effective from January 1, 2018, these policies have been consistently applied to all the periods presented, unless otherwise stated.

This is the first set of the Bank’s annual financial statements in which IFRS 9 “Financial Instruments” and IFRS 15 “Revenue from Contracts with Customers” have been applied. Changes to significant accounting policies are described in Note 2.

Going concern

These financial statements have been prepared on the assumption that the Bank is a going concern and will continue in operation for the foreseeable future.

Other basis of presentation criteria

These financial statements are presented in Azerbaijani Manats (“AZN”), unless otherwise indicated. These financial statements have been prepared under the historical cost convention, except measurement at fair value of certain financial instruments.

The Bank maintains its accounting records in accordance with the laws of the Republic of Azerbaijan. These financial statements have been prepared from the statutory accounting records and have been adjusted to conform to IFRS. These adjustments include certain reclassifications to reflect the economic substance of underlying transactions including reclassifications of certain assets and liabilities, income and expenses to appropriate financial statement captions.

The principal accounting policies are set out below:

Recognition of interest income and expense

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

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

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

For financial assets that are originated or purchased credit-impaired, the effective interest rate is the rate that discount the expected cash flows (including the initial expected credit losses) to the fair value on initial recognition (normally represented by the purchase price). As a result, the effective interest is credit-adjusted.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- i) financial assets that have become credit-impaired (Stage 3), for which interest revenue is calculated by applying the effective interest rate to their AC (net of the ECL provision); and
- ii) financial assets that are purchased or originated credit-impaired, for which the original credit-adjusted effective interest rate is applied to the AC.

Recognition of fee and commission income and expense

All other fees, commissions and other income and expense items are generally recorded on an accrual basis over the period in which the services are rendered as the customer simultaneously receives and consumes the benefits as the Bank performs, usually on a straight-line basis.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, and which are earned when the Bank satisfies the performance obligation are recorded upon the completion of the transaction. Portfolio and other management advisory and service fees are recognized based on the applicable service contracts, over the period in which the services are rendered as the customer simultaneously receives and consumes the benefits as the Bank performs, usually on a straight-line basis. Asset management fees relating to investment funds are recognized over the period in which services are rendered as the customer simultaneously receives and consumes the benefits as the Bank performs, usually on a straight-line basis. The same principle is applied for wealth management, financial planning and custody services that are continually provided over an extended period of time.

Financial instruments - key measurement terms.

Depending on their classification financial instruments are carried at fair value or amortized cost as described below.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is the price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the number of instruments held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analyzed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note 30.

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

Amortized cost is the amount at which the financial instrument was recognized 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 amortization of transaction costs deferred at initial recognition and of any premium or discount to the maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortized discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of the related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortized over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Initial recognition of financial instruments

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by either observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

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

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Classification of financial instruments

From January 1, 2018 on initial recognition, a financial asset is classified as measured at: amortized cost, fair value through other comprehensive income (“FVOCI”) or fair value through profit or loss (“FVPL”).

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

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

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

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

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

All other financial assets are classified as measured at FVPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI at FVPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

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

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management’s strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank’s management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank’s stated objective for managing the financial assets is achieved and how cash flows are realised.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

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

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

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

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

Reclassification of financial assets

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

Financial assets impairment – credit loss allowance for ECL

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

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

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

The Bank applies a three stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter (“12 months ECL”). If the Bank identifies SICR since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any (“Lifetime ECL”). Refer to Note 31 for a description of how the Bank determines when a SICR has occurred. If the Bank determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL. The Bank’s definition of credit impaired assets and definition of default is explained in Note 31. For financial assets that are purchased or originated credit-impaired (“POCI Assets”), the ECL is always measured as a Lifetime ECL. POCI assets are financial assets that are credit-impaired upon initial recognition, such as impaired loans acquired. Note 31 provides information about inputs, assumptions and estimation techniques used in measuring ECL, including an explanation of how the Bank incorporates forward-looking information in the ECL models.

Presentation of allowance for ECL in the statement of financial position

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

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognized in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

Financial assets – write-off

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

Derecognition of financial assets

The Bank derecognizes financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement whilst (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 but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Cash and cash equivalents

Cash and cash equivalents include cash on hand, unrestricted balances on corresponded and term deposits with the Central Bank of the Republic of Azerbaijan (the “CBRA”) with original maturity of less or equal to 90 days, notes issued by the Central Bank of the Republic of Azerbaijan (the “CBRA”) up to 30 days and advances to banks in countries included in the Organization for Economic Co-operation and Development (“OECD”) with original maturities up to 90 days. For purposes of determining cash flows, the minimum reserve deposits required by the CBRA, commemorative coins and pledged accounts in OECD countries are not included as a cash equivalent due to restrictions on its availability. Cash and cash equivalents are carried at amortised cost because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVPL.

Minimum reserve deposits with the Central Bank of the Republic of Azerbaijan

Minimum reserve deposits with the Central Bank of the Republic of Azerbaijan represent the amount of obligatory reserves deposited with the Central Bank of the Republic of Azerbaijan in accordance with requirements established by the Central Bank of the Republic of Azerbaijan, which subject to restrictions on their availability. In view of the above the amount of the minimum reserve deposit required by the Central Bank of the Republic of Azerbaijan is not included as a cash equivalent in statement of cash flows.

Due from banks and other financial institutions

Amounts due from banks are recorded when the Bank advances money to counterparty banks. Amounts due from banks are carried at AC when: (i) they are held for the purposes of collecting contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

Loans to customers

Loans and advances to customers. Loans and advances to customers are recorded when the Bank advances money to purchase or originate a loan due from a customer. Based on the business model and the cash flow characteristics, the Bank classifies loans and advances to customers into one of the following measurement categories:

- AC: loans that are held for collection of contractual cash flows and those cash flows represent SPPI and loans that are not voluntarily designated at FVTPL, and
- FVTPL: loans that do not meet the SPPI test or other criteria for AC or FVOCI are measured at FVTPL.

Credit related commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognized in accordance with the principles of IFRS 15.

Loan commitments provided by the Bank are measured as the amount of the loss allowance. The Bank has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognized as a provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognized together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognized as a provision.

Investments in debt securities

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

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

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

Equity instruments at FVOCI

From 1 January 2018, upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit or loss. Dividends are recognized in profit or loss as other income when the right of the payment has been established, except the Bank benefits from such proceeds as recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment. Upon disposal of these instruments, the accumulated revaluation reserve is transferred to retained earnings.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Financial liabilities

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

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

Due to banks, government and other financial institutions

Amounts due to banks, government and other financial institutions are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortized cost. 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.

Customer accounts

Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortized cost.

Derecognition of financial liabilities

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

Offset of financial assets and liabilities

Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts, and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

Operating leases

Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

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

Property, equipment and intangible assets

Property, equipment and intangible assets are carried at historical cost less accumulated depreciation and amortization and any recognized impairment loss.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

Depreciation and amortization are charged on the carrying value of property, equipment and intangible assets and is designed to write off assets over their useful economic lives. The estimated useful lives, residual values and depreciation/amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis at the following annual rates:

| | |
|------------------------|-----|
| Buildings | 5% |
| Furniture and fixtures | 20% |
| Computer and equipment | 20% |
| Vehicles | 25% |
| Other fixed assets | 20% |
| Intangible assets | 10% |

Expenses related to repairs and renewals are charged when incurred and included in operating expenses unless they qualify for capitalization.

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

At the end of each reporting period, the Bank reviews the carrying amounts of its property, equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit and loss accounts.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

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

Investment properties

Investment property is property held by the Bank to earn rental income or for capital appreciation, or both and which is not occupied by the Bank. Investment property also includes assets under construction for future use as investment property, idle land or building.

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Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair values of investment properties are included in profit or loss in the period in which they arise, including the corresponding tax effect.

Investment properties are derecognised either when they have been disposed of or when they are permanently withdrawn from use and no future economic benefit is expected from their disposal. The difference between the net disposal proceeds and the carrying amount of the asset is recognised in profit or loss in the period of derecognition.

Taxation

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

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

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the statement of comprehensive income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and deferred income tax liabilities are offset and reported net on the statement of financial position if:

- The Bank has a legally enforceable right to set off current income tax assets against current income tax liabilities; and
- Deferred income tax assets and the deferred income tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

The Republic of Azerbaijan also has various other taxes, which are assessed on the Bank's activities. These taxes are included as a component of operating expenses in the statement of comprehensive income.

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Retirement and other benefit obligations

In accordance with the requirements of the legislation of the Republic of Azerbaijan state pension system provides for the calculation of current payments by the employer as a percentage of current total payments to staff. This expense is charged in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by pension funds selected by employees. The Bank does not have any pension arrangements separate from the state pension system of the Republic of Azerbaijan. In addition, the Bank has no post-retirement benefits or other significant compensated benefits requiring accrual.

Contingencies

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

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognized as a deduction from equity, net of any tax effects. Dividends on ordinary shares are recognized in equity as a reduction in the period in which they are declared.

Dividends that are declared after the reporting date are treated as a subsequent event under International Accounting Standard 10 “Events after the Reporting Date” (“IAS 10”) and disclosed accordingly.

Foreign currency translation

The functional currency of the Bank is the currency of the primary economic environment, in which it operates. The Bank’s functional currency is AZN.

Financial assets and liabilities denominated in foreign currencies are translated into AZN at the appropriate spot rates of exchange of the CBRA ruling at the end of reporting date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Profits and losses arising from these translations are included in foreign exchange translation gain/(loss) account.

Rates of exchange

The exchange rates at reporting date used by the Bank in the preparation of the financial statements are as follows:

| | December 31, 2018 | December 31, 2017 |
|---------|------------------------------|------------------------------|
| USD/AZN | 1.7000 | 1.7001 |
| EUR/AZN | 1.9468 | 2.0307 |

Reposessed assets

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

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Earnings per share

Earnings per share are determined by dividing the profit or loss attributable to owners of the Bank by the weighted average number of participating shares outstanding during the reporting year.

Staff costs and related contributions

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

Segment reporting

Operating segments are identified on the basis of internal reports about components of the Bank that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. The Bank's segmental reporting is based on the following operating segments: Retail banking (Principally handling individual customers' deposits, and providing consumer loans, overdrafts, credit cards facilities and funds transfer facilities) and Corporate banking (Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers).

The Bank measures information about reportable segments in accordance with IFRS. Information about reportable operating segment meets any one of the following quantitative thresholds:

- Its reported revenue, from both external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments; or
- The absolute measure of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss; or
- Its assets are 10 per cent or more of the combined assets of all operating segments.

If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments are identified as reportable segments (even if they do not meet the quantitative thresholds set out above) until at least 75 per cent of the Bank's revenue is included in reportable segments.

3. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The preparation of the Bank's financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the reporting date and the reported amount of income and expenses during the period ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The following estimates and judgments are considered important to the portrayal of the Bank's financial condition.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Judgements that have the most significant effect on the amounts recognized in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Measurement of ECL allowance (from January 1, 2018)

Measurement of ECLs is a significant estimate that involves determination of methodology, models and data inputs. Details of ECL measurement methodology are disclosed in Note 31. The following components have a major impact on credit loss allowance: definition of default, SICR, probability of default (“PD”), exposure at default (“EAD”), and loss given default (“LGD”), as well as models of macro-economic scenarios. The Bank regularly reviews and validates the models and inputs to the models to reduce any differences between expected credit loss estimates and actual credit loss experience. For details of ECL measurement including incorporation of forward-looking information refer to Note 31.

Credit exposure on revolving credit facilities (e.g. credit cards, overdrafts)

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

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

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

Significant increase in credit risk (“SICR”)

In order to determine whether there has been a significant increase in credit risk, the Bank compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. The assessment considers relative increase in credit risk rather than achieving a specific level of credit risk at the end of the reporting period. The Bank considers all reasonable and supportable forward looking information available without undue cost and effort, which includes a range of factors, including behavioral aspects of particular customer portfolios. The Bank identifies behavioral indicators of increases in credit risk prior to delinquency and incorporated appropriate forward looking information into the credit risk assessment, either at an individual instrument, or on a portfolio level. Refer to Note 31.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Business model assessment

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

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

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

Assessment whether cash flows are solely payments of principal and interest (“SPPI”)

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

The Bank identified and considered contractual terms that change the timing or amount of contractual cash flows. The SPPI criterion is met if a loan allows early settlement and the prepayment amount substantially represents principal and accrued interest, plus a reasonable additional compensation for the early termination of the contract. The asset’s principal is the fair value at initial recognition less subsequent principal repayments, ie instalments net of interest determined using the effective interest method. As an exception to this principle, the standard also allows instruments with prepayment features that meet the following condition to meet SPPI: (i) the asset is originated at a premium or discount, (ii) the prepayment amount represents contractual paramount and accrued interest and a reasonable additional compensation for the early termination of the contract, and (ii) the fair value of the prepayment feature is immaterial at initial recognition.

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The Bank's loan agreements allow adjusting interest rates in response to certain macro-economic or regulatory changes. Management applied judgement and assessed that competition in the banking sector and the practical ability of the borrowers to refinance the loans would prevent it from resetting the interest rates at an above-market level and hence cash flows were assessed as being SPPI.

Modification of financial assets

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

4. SIGNIFICANT ACCOUNTING POLICIES APPLICABLE BEFORE JANUARY 1, 2018

Accounting policies applicable to the comparative period ended December 31, 2017 that were amended by IFRS 9, are as follows.

Recognition of interest income and expense

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

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

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

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

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Recognition of fee and commission income and expense

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

Financial instruments

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

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

Impairment of financial assets

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

Assets carried at amortized cost

The Bank accounts for impairment losses of financial assets when there is objective evidence that a financial asset or a group of financial assets is impaired. Impairment losses are measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset’s original effective interest rate.

Such impairment losses are not reversed, unless if in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, such as recoveries, in which case the previously recognized impairment loss is reversed by adjustment of an allowance account.

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For financial assets carried at cost, impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

Loans to customers

Loans to customers are non-derivative assets with fixed or determinable payments that are not quoted in an active market, other than those classified in other categories of financial assets.

Loans granted by the Bank are initially recognized at a fair value plus related transaction costs. Where the fair value of consideration given does not equal the fair value of the loan, for example where the loan is issued at lower than market rates, the difference between the fair value of consideration given and the fair value of the loan is recognized as a loss on initial recognition of the loan and included in the statement of comprehensive income according to nature of these losses. Subsequently, loans are carried at amortized cost using the effective interest method. Loans to customers are carried net of any allowance for impairment losses.

5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

In the current year, the Bank has adopted all of the applicable new and revised Standards and Interpretations issued by the IASB and the IFRIC of the IASB that are relevant to its operations and effective for annual reporting periods ending in December 31, 2018. Except the effects of IFRS 9 “Financial Instruments”, the adoption of these new and revised Standards and Interpretations has not resulted in significant changes to the Bank’s accounting policies that have affected the amounts reported for the current or prior years.

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

Classification and Measurement. From a classification and measurement perspective, the new standard requires all financial assets, except equity instruments and derivatives to be assessed based on a combination of the entity’s business model for managing the assets and the instruments’ contractual cash flow characteristics. The IAS 39 measurement categories were replaced by: fair value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortized cost categories. IFRS 9 allows entities to continue to irrevocably designate instruments that qualify for amortized cost or FVOCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement. The accounting for financial liabilities remained largely the same as requirements of IAS 39. The Bank’s majority of financial assets were classified as financial assets measured subsequently at amortized cost. Financial liabilities of the Bank were classified as financial liabilities measured subsequently at amortized cost. The Bank does not choose to classify any financial liabilities as measured at fair value through profit or loss.

Impairment of financial assets. The Bank applies the expected credit loss model to financial assets measured at amortized cost or at fair value through other comprehensive income.

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The allowance for expected credit losses for a financial asset is measured at an amount equal to the lifetime expected credit losses if the credit risk on that financial asset has increased significantly since initial recognition.

If, at the reporting date, the credit risk on a financial asset has not increased significantly since initial recognition, the allowance for expected credit losses for that financial asset (except trade receivables, where the simplified approach is elected) is measured at an amount equal to 12-month expected credit losses. For trade and other receivables, whether they contain a significant financing component or not, measurement based on lifetime expected credit losses are applied.

IFRS 9 is effective for annual periods beginning on or after January 1, 2018. The Bank elected option not to restate comparative information, but to record the effect on the transition date – January 1, 2018 – in the retained earnings.

The following table reconciles the carrying amounts of financial instruments, from their previous measurement categories in accordance with IAS 39 into their new measurement categories upon transition to IFRS 9 on January 1, 2018:

| | <i>Measurement category</i> | | Carrying value per IAS 39 as at December 31, 2017 | Effect | | Carrying value per IFRS 9 as at January 1, 2018 |
|--|-----------------------------|--------|---|----------------|------------------|---|
| | IAS 39 | IFRS 9 | | Re-measurement | Reclassification | |
| Financial assets | | | | | | |
| Cash and balances with the CBRA | L&R | AC | 55,612,286 | - | - | 55,612,286 |
| Due from banks and other financial institutions | L&R | AC | 11,223,572 | (210,666) | - | 11,012,906 |
| Investment securities | AFS | FVOCI | 7,108,298 | - | - | 7,108,298 |
| Loans to customers | L&R | AC | 74,013,652 | (1,769,458) | - | 72,244,194 |
| Other financial assets | L&R | AC | 2,612,367 | - | - | 2,612,367 |
| Financial liabilities | | | | | | |
| Due to banks | Other FL | AC | 34,483,121 | - | - | 34,483,121 |
| Customer accounts | Other FL | AC | 56,188,923 | - | - | 56,188,923 |
| Other financial liabilities | Other FL | AC | 248,287 | - | - | 248,287 |
| Non-financial liabilities | | | | | | |
| Provision for guarantees and similar commitments | | | - | (295,497) | - | (295,497) |
| Deferred income tax liability | | | (1,130,402) | 455,124 | - | (675,278) |

The following table reconciles the closing loss allowance for financial assets in accordance with IAS 39 as at December 31, 2017 to the credit loss allowance determined in accordance with IFRS 9 as at January 1, 2018.

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| | Loan loss allowance/ Provision under IAS 39/IAS 37 at December 31, 2017 | Re-measurement on profit or loss items | Re-measurement on balance items | Credit loss allowance under IFRS 9 as at January 1, 2018 |
|--|--|--|---------------------------------|--|
| Due from banks and other financial institutions | (141,183) | (210,666) | - | (351,849) |
| Loans to customers | (16,860,474) | (1,769,458) | 2,438,295 | (16,191,637) |
| Provision for guarantees and similar commitments | - | (295,497) | - | (295,497) |
| Total credit loss allowance | (17,001,657) | (2,275,621) | 2,438,295 | (16,838,983) |

The following table analyses the impact of transition to IFRS 9 on retained earnings:

| | Retained earnings |
|--|--------------------|
| Closing balance under IAS 39 (December 31, 2017) | 11,919,367 |
| Recognition of IFRS 9 ECLs | (2,275,621) |
| Related deferred income tax effect | 455,124 |
| Restated opening balance under IFRS 9 (January 1, 2018) | 10,098,870 |
| Total change in equity due to adopting IFRS 9 | (1,820,497) |

As at January 1, 2018 the management also eliminated accrued interest in the amount of AZN 2,438,295 and respective provision of the same amount for the Stage 3 loans.

The IASB and FASB have issued their joint revenue recognition standard, IFRS 15 “Revenue from Contracts with Customers”, which replaces all existing IFRS and US GAAP revenue requirements. IFRS 15 specifies how and when an IFRS reporter will recognize revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 was issued in May 2014 and applies to an annual reporting period beginning on or after January 1, 2018. As a result of the analysis performed by the Bank, the conclusion was made that the standard had no impact on the financial statements.

Amendments to IAS 40 “Transfers of Investment Property” are intended to clarify that an entity can only reclassify a property to/from investment property when, and only when, there is evidence that a change in the use of the property occurred. The amendments further clarify that the situations listed in IAS 40 are not exhaustive and that a change in use is possible for properties under construction (i.e. a change in use is not limited to completed properties).

IFRIC 22 “Foreign Currency Transactions and Advance Consideration” addresses foreign currency transactions or parts of transactions where:

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- there is consideration that is denominated or priced in a foreign currency;
- the entity recognizes a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income; and
- the prepayment asset or deferred income liability is non-monetary.

The Interpretations Committee came to the following conclusion that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.

Amendments to IFRS 2 “Share-Based Payment” – The IASB have published final amendments to IFRS 2 “Share-based Payment” that clarify the classification and measurement of share-based payment transactions. Classification and Measurement of Share-based Payment Transactions contains the following clarifications and amendments:

Accounting for cash-settled share-based payment transactions that include a performance condition

Until issue of these amendments, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

Classification of share-based payment transactions with net settlement features

The IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

Accounting for modifications of share-based payment transactions from cash-settled to equity-settled

Until issue of these amendments, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognized in respect of the cash-settled share-based payment is derecognized and the equity-settled share-based payment is recognized at the modification date fair value to the extent services have been rendered up to the modification date;
- Any difference between the carrying amount of the liability as at the modification date and the amount recognized in equity at the same date would be recognized in profit and loss immediately.

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The Bank has adopted **Annual Improvements to IFRS Standards 2014-2016 Cycle** containing amendments below to IFRS 1 and IAS 28:

| Standard | Subject of amendment |
|---|--|
| IFRS 1 “First-time Adoption of International Financial Reporting Standards” | Deletion of short-term exemptions for the first-time adopters: The amendments delete the short-term exemptions in IFRS 1 that relate to IFRS 7, IAS 19, IFRS 12 and IAS 27. |
| IAS 28 “Investments in Associates and Joint Ventures” | Measuring an associate or joint venture at fair value: The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition. |

6. STANDARD AND INTERPRETATIONS ISSUED BUT NOT YET ADOPTED

At the date of authorization of these financial statements, other than the Standards and Interpretations adopted by the Bank in advance of their effective dates, the following Interpretations were in issue but not yet effective.

IFRIC 23 “Uncertainty over Income Tax Treatments” addresses the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. It specifically considers:

- whether tax treatments should be considered collectively;
- assumptions for taxation authorities’ examinations;
- the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- the effect of changes in facts and circumstances.

The interpretation applies to annual reporting periods beginning or after January 1, 2019.

Annual Improvements to IFRS Standards 2015-2018 Cycle contains amendments to four International Financial Reporting Standards (IFRSs) as result of the IASB’s annual improvements project.

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| Standard | Subject of amendment |
|---|--|
| IFRS 3 “Business Combinations” and IFRS 11 “Joint Arrangements” | The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business. |
| IAS 12 “Income Taxes” | The amendments clarify that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises. |
| IAS 23 “Borrowing Costs” | The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings. |

The amendments are all effective for annual periods beginning on or after January 1, 2019.

Amendments to IAS 19 “Employee Benefits Plan Amendment, Curtailment or Settlement” –

The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognized in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied.

The amendments to IAS 19 must be applied to annual periods beginning on or after January 1, 2019, but they can be applied earlier if an entity elects to do so.

Amendments to IAS 28 “Investments in Associations and Joint Ventures” – The IASB has published amendments to IAS 28 regarding the long-term interest in associates and joint Ventures. According to the amendment the entity should apply IFRS 9 to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendment is effective for annual periods beginning on or after January 1, 2019.

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Amendments to IFRS 9 “Financial Instruments” – The IASB has published amendments to IFRS 9 regarding prepayment features with negative compensation and modifications of financial liabilities.

Prepayment Features with Negative Compensation amends the existing requirement of IFRS 9 regarding termination rights in order to allow measurement at amortized cost even in the case of negative compensation payments. The IASB also clarifies that the entity recognizes any adjustment to the amortized cost of the financial liability arising from a modification or exchange in profit or loss at the date of modification or exchange.

The amendment is effective for annual periods beginning on or after January 1, 2019.

IFRS 16 “Leases”, which specifies how and IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

IFRS 16 was issued in January 13, 2016 and applies to an annual reporting period beginning on or after January 1, 2019.

IFRS 17 “Insurance contracts” was issued in May 2017 and replaced IFRS 4 “Insurance contracts”. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. An entity shall apply IFRS 17 “Insurance Contracts” to insurance contracts, including reinsurance contracts, it issues; reinsurance contracts it holds; and investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 is effective for annual reporting periods beginning on or after January 1, 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have also been applied.

IFRS 3 Business Combinations. Amendment of the definition of “Business” – The amendments will help companies determine whether an acquisition made is of a business or a group of assets.

The amended definition emphasizes that the output of a business is to provide goods and services to customers, whereas the previous definition focused on returns in the form of dividends, lower costs or other economic benefits to investors and others. Distinguishing between a business and a group of assets is important because an acquirer recognizes goodwill only when acquiring a business. According to the amendment new definition a “business” is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing *goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities*.

Companies are required to apply the amended definition of a business to acquisitions that occur on or after January 1, 2020. Earlier application is permitted.

New definition of “Material” – The IASB has issued amendments to its definition of material to make it easier for companies to make materiality judgements. The updated definition amends IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS Standards. According to the new definition, information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The changes are effective from January 1, 2020. Earlier application is permitted.

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

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

The Management is considering the implications of these standards, their impact on the financial statements and the timing of its adoption by the Bank.

7. NET INTEREST INCOME

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|---|------------------------------------|------------------------------------|
| Interest income on financial assets recorded at amortized cost comprises: | | |
| Interest income on loans to customers | 8,399,099 | 9,709,948 |
| Interest income on cash and cash equivalents | 9 | 9 |
| Interest income on investment securities | 704,599 | 718,705 |
| Interest income on due from banks and other financial institutions | 198 | 258 |
| Other interest income | 169 | 81 |
| Total interest income on financial assets recorded at amortized cost | 9,104,075 | 10,437,791 |
| Interest expense on financial liabilities recorded at amortized cost comprises: | | |
| Interest expense on customer accounts | (1,768,396) | (2,649,802) |
| Interest expense on due to banks, government and other financial institutions | (951,593) | (122,971) |
| Total interest expense on financial liabilities recorded at amortized cost | (2,719,989) | (2,772,773) |
| Net interest income before expected credit losses | 9,366,198 | 9,643,713 |

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8. RECOVERY OF EXPECTED CREDIT LOSSES

The following table provides a reconciliation between loss allowance roll-forward and the impairment losses in the statement of profit or loss and other comprehensive income per class of financial instrument.

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|----------------|------------------|--------------------|----------------|
| Due from banks and other financial institutions | - | 211,781 | 2,863 | 214,644 |
| Loans to customers | 405,654 | 4,828,600 | (4,865,002) | 369,252 |
| Recovery of expected credit losses on financial assets | 405,654 | 5,040,381 | (4,862,139) | 583,896 |
| Provision for guarantees and similar commitments | - | - | (5,698) | (5,698) |
| Total recovery of expected credit losses | 405,654 | 5,040,381 | (4,867,837) | 578,198 |

The movements in allowance for impairment losses on interest bearing assets were as follows which was calculated by using IAS 39:

| | Due from banks and other financial institutions | Loans to customers | Total |
|--------------------------|---|---------------------|---------------------|
| January 1, 2017 | (139,970) | (13,443,954) | (13,583,924) |
| Provision for impairment | (1,213) | (3,519,354) | (3,520,567) |
| Write-off of assets | - | 102,834 | 102,834 |
| December 31, 2017 | (141,183) | (16,860,474) | (17,001,657) |

9. NET GAIN ON FOREIGN EXCHANGE OPERATIONS

Net gain on foreign exchange operations comprises:

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|--|------------------------------------|------------------------------------|
| Dealing, net | 263,634 | 2,173,812 |
| Translation differences, net | (32,306) | (141,211) |
| Total net gain on foreign exchange operations | 231,328 | 2,032,601 |

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

10. FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income and expense comprise:

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|---|------------------------------------|------------------------------------|
| Fee and commission income: | | |
| Plastic card operations | 506,769 | 517,080 |
| Settlements | 494,282 | 503,086 |
| Cash operations | 134,567 | 215,125 |
| Foreign exchange operations | 21,628 | 234,546 |
| Others | 16,463 | 12,156 |
| Total fee and commission income | 1,173,709 | 1,481,993 |
| Fee and commission expense: | | |
| Plastic card operations | (514,949) | (508,324) |
| Settlements | (298,811) | (210,361) |
| Guarantee operations | (3,174) | (370) |
| Cash operations | (171) | (95,038) |
| Others | (28,634) | (19,802) |
| Total fee and commission expense | (845,739) | (833,895) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

11. OPERATING EXPENSES

Operating expenses comprise of the following items:

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|---|------------------------------------|------------------------------------|
| Staff costs | 1,825,816 | 1,678,988 |
| Depreciation and amortization | 609,585 | 574,677 |
| Payments to the Financial Markets Supervisory Authority | 338,700 | 210,000 |
| Social security costs | 258,135 | 257,072 |
| Payments to the Deposit Insurance Fund | 235,569 | 172,653 |
| Communication expenses | 196,262 | 141,222 |
| Property, plant and equipment maintenance | 149,351 | 143,214 |
| Security expenses | 113,072 | 107,815 |
| Utility expenses | 76,913 | 97,575 |
| Rent expenses | 71,428 | 37,326 |
| Service fees | 61,283 | 157,616 |
| Professional service fees | 60,561 | 32,510 |
| Taxes, other than income tax | 58,283 | 60,323 |
| Advertising expenses | 26,971 | 36,807 |
| Membership fees | 26,135 | 35,649 |
| Insurance expenses | 9,325 | 6,960 |
| Training costs | 5,894 | 1,756 |
| Business trip expenses | 5,522 | 4,442 |
| Fines, penalties and forfeits | 80 | 12,786 |
| Other expenses | 29,982 | 30,313 |
| Total operating expenses | 4,158,867 | 3,799,704 |

12. INCOME TAXES

The Bank measures and records its current income tax payable and its tax bases related to assets and liabilities in accordance with the statutory tax regulations of the Republic of Azerbaijan where the Bank operates, which differ from IFRS.

The Bank is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at December 31, 2018 and 2017 relate mostly to different methods/timing of income and expense recognition as well as to temporary differences generated by taxation bases' differences for certain assets.

Tax legislation of the Republic of Azerbaijan in particular may give rise to varying interpretations and amendments. In addition, as management's interpretation of tax legislation may differ from that of the tax authorities, transactions may be challenged by the tax authorities, and as a result the Bank may be assessed additional taxes, penalties and interest which could be material for these financial statements.

Temporary differences as at December 31, 2018 and 2017 comprise:

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | Year ended December 31, 2018 | Balance as at January 1, 2018 | Impact of adopting IFRS 9 as at January 1, 2018 | Year ended December 31, 2017 |
|--|------------------------------------|-------------------------------------|---|------------------------------------|
| Deductible temporary differences: | | | | |
| Intangible assets | 42,159 | 42,919 | - | 42,919 |
| Investment securities | - | 19,256 | - | 19,256 |
| Provision for guarantees and similar commitments | 295,497 | 295,497 | 295,497 | - |
| Other assets | 452,819 | 53,799 | - | 53,799 |
| Total deductible temporary differences | 790,475 | 411,471 | 295,497 | 115,974 |
| Taxable temporary differences: | | | | |
| Loans to customers | (1,683,255) | (2,009,914) | 1,769,458 | (3,779,372) |
| Due from banks and other financial institutions | (1,379,549) | (1,197,885) | 210,666 | (1,408,551) |
| Property and equipment | (443,299) | (580,063) | - | (580,063) |
| Investment securities | (71,234) | - | - | - |
| Total taxable temporary differences | (3,577,337) | (3,787,862) | 1,980,124 | (5,767,986) |
| Net taxable temporary differences | (2,786,862) | (3,376,391) | 2,275,621 | (5,652,012) |
| Deferred income tax liability | (557,372) | (675,278) | 455,124 | (1,130,402) |

The effective tax rate reconciliation is as follows for the years ended December 31, 2018 and 2017:

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|---|------------------------------------|------------------------------------|
| Profit before income tax | 5,935,220 | 4,147,963 |
| Statutory tax rate | 20% | 20% |
| Theoretical tax at the statutory tax rate | (1,187,044) | (829,593) |
| Revision of prior years' income tax estimation | - | (36,908) |
| Tax effect of permanent differences | (16,534) | (13,963) |
| Income tax expense | (1,203,578) | (880,464) |
| Current income tax expense | (1,339,582) | (1,645,793) |
| Deferred income tax benefit | 136,004 | 802,237 |
| Revision of prior years' income tax estimation | - | (36,908) |
| Income tax expense | (1,203,578) | (880,464) |
| Deferred income tax liability | | |
| Beginning of the year | (675,278) | (1,941,461) |
| Change in deferred income tax liability | 136,004 | 802,237 |
| Change in deferred income tax balances recognized in other comprehensive income | (18,098) | 8,822 |
| End of the year | (557,372) | (1,130,402) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

13. EARNINGS PER SHARE

The earnings per share is calculated as follows:

| | Year ended December 31, 2018 | Year ended December 31, 2017 |
|--|------------------------------------|------------------------------------|
| Profit: | | |
| Net profit for the year | 4,731,642 | 3,267,499 |
| Weighted average number of ordinary shares for basic and diluted earnings per share | 20,000 | 20,000 |
| Earnings per share – basic and diluted (AZN) | 236.58 | 163.37 |

14. CASH AND BALANCES WITH THE CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN

Cash and balances with the CBRA comprise:

| | December 31, 2018 | December 31, 2017 |
|--|----------------------|----------------------|
| Cash on hand | 8,767,409 | 12,762,473 |
| Balances with the CBRA | 9,509,495 | 4,838,440 |
| Time deposits with CBRA up to 90 days | 15,434,572 | 21,444,428 |
| Notes issued by the CBRA up to 30 days | 18,587,848 | 16,566,945 |
| Total cash and balances with the CBRA | 52,299,324 | 55,612,286 |

The balances with the CBRA as at December 31, 2018 and 2017 include AZN 463,171 and AZN 388,023 which represent the obligatory minimum reserve deposits with the CBRA. The Bank is entitled to use all funds on its correspondent account provided that average daily balance for one month period will be eventually higher than required mandatory reserve. The Bank is required to maintain the reserve balance at the CBRA at all times.

Cash and cash equivalents for the purposes of the statement of cash flows comprise the following:

| | December 31, 2018 | December 31, 2017 |
|--|----------------------|----------------------|
| Cash and balances with the CBRA | 52,299,324 | 55,612,286 |
| Due from banks in OECD countries (Note 31) | 5,130,787 | 9,216,386 |
| Less: minimum reserve deposits with the CBRA | (463,171) | (388,023) |
| Less: commemorative coins | (1,745) | (1,745) |
| Total cash and cash equivalents | 56,965,195 | 64,438,904 |

For the purpose of ECL measurement cash and cash equivalents balances are included in Stage 1. The ECL for these balances represents an insignificant amount, therefore the Bank did not recognise any credit loss allowance for cash and cash equivalents. Refer to Note 31 for the ECL measurement approach.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

15. DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

Due from banks and other financial institutions comprises:

| | December 31, 2018 | January 1, 2018 | December 31, 2017 |
|--|-------------------------|--------------------------|--------------------------|
| Correspondent accounts with other banks | 7,375,599 | 9,733,630 | 9,733,630 |
| Due from financial institutions | 736,511 | 1,466,310 | 1,466,310 |
| Pledged accounts | 163,968 | 164,815 | 164,815 |
| | <u> </u> | <u> </u> | <u> </u> |
| Less: allowance for expected credit loss | (137,205) | (351,849) | (141,183) |
| | <u> </u> | <u> </u> | <u> </u> |
| Total due from banks and other financial institutions | <u>8,138,873</u> | <u>11,012,906</u> | <u>11,223,572</u> |

Pledged accounts represent nostro accounts pledged against a guarantee given by the Bank on behalf of a customer.

As at December 31, 2018, accrued interest income included in due from banks and other financial institutions amounted to AZN 7,471 (December 31, 2017: AZN 10,105).

As at December 31, 2018 and 2017, maximum credit risk exposure of due from banks and other financial institutions amounted to AZN 8,138,873 and AZN 11,223,572, respectively.

An analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from banks and other financial institutions during the year ended December 31, 2018 is as follows:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|-------------------------|-------------------------|------------------------|-------------------------|
| Gross carrying value as at January 1, 2018 | 10,328,432 | 1,015,100 | 21,223 | 11,364,755 |
| Net change in carrying value | (2,796,287) | (278,589) | (2,863) | (3,077,739) |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - |
| Foreign exchange and other movements | (10,938) | - | - | (10,938) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| As at December 31, 2018 | <u>7,521,207</u> | <u>736,511</u> | <u>18,360</u> | <u>8,276,078</u> |
| | | | | |
| | Stage 1 | Stage 2 | Stage 3 | Total |
| ECL allowance as at January 1, 2018 | - | (330,626) | (21,223) | (351,849) |
| Net change in ECL value | - | 211,781 | 2,863 | 214,644 |
| Transfers to Stage 1 | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| As at December 31, 2018 | <u>-</u> | <u>(118,845)</u> | <u>(18,360)</u> | <u>(137,205)</u> |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

16. INVESTMENT SECURITIES

Investment securities at FVOCI comprises:

| | | December 31, 2018 | | December 31, 2017 | |
|---|-----------------------|-------------------|-------------------|-------------------|------------------|
| | Interest to nominal % | Carrying value | Nominal value | Carrying value | Nominal value |
| Ministry of Finance of the Republic of Azerbaijan | 5.00%-8.00% | 13,593,063 | 13,175,380 | 1,617,913 | 1,759,200 |
| The State Oil Company of the Republic of Azerbaijan (SOCAR) | 5.00% | 2,484,490 | 2,458,200 | 2,484,635 | 2,458,345 |
| Azerbaijan Mortgage and Credit Guarantee Fund | 3.00% | - | - | 3,005,750 | 3,000,000 |
| Total investment securities | | 16,077,553 | 15,633,580 | 7,108,298 | 7,217,545 |

Bonds of the State Oil Company of the Republic of Azerbaijan represent 1,000 bonds with nominal value of USD 1 thousand each. These bonds are traded on Baku Stock Exchange and can be sold at any time by market value.

As at December 31, 2018, accrued interest income included in investment securities amounted to AZN 397,590 (2017: AZN 72,565).

17. LOANS TO CUSTOMERS

Loans to customers comprise:

| | December 31, 2018 | January 1, 2018 | December 31, 2017 |
|---|-------------------|-------------------|-------------------|
| Corporate loans | 69,257,398 | 66,496,188 | 68,292,086 |
| Loans to individuals – mortgage loans | 22,938,957 | 11,251,497 | 10,696,681 |
| Loans to individuals – consumer loans | 4,735,177 | 3,038,382 | 3,619,349 |
| Loans to individuals – entrepreneurship loans | 2,852,033 | 6,801,321 | 7,417,567 |
| Loans to individuals – car purchase | 613,956 | 848,443 | 848,443 |
| Less: allowance for expected credit loss | (14,793,620) | (16,191,637) | (16,860,474) |
| Total loans to customers | 85,603,901 | 72,244,194 | 74,013,652 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

The following tables show the summary of reconciliations from the opening to the closing balances of gross loans and the loss allowance of loans to customers:

| | 2018 | | | |
|--|-------------------|-------------------|-------------------|--------------------|
| Gross carrying value | Stage 1 | Stage 2 | Stage 3 | Total |
| As at January 1, 2018 | 51,733,050 | 25,003,998 | 11,698,783 | 88,435,831 |
| New assets originated or purchased | 31,593,782 | - | - | 31,593,782 |
| Other movements (asset repayment, modification of assets, etc) | (13,587,535) | (1,196,325) | (3,819,467) | (18,603,327) |
| Transfer to Stage 1 | 1,411,493 | (1,411,493) | - | - |
| Transfer to Stage 2 | (48,934) | 48,934 | - | - |
| Transfer to Stage 3 | (2,502,610) | (14,220,373) | 16,722,983 | - |
| Amounts written off | - | - | (1,028,765) | (1,028,765) |
| At December 31, 2018 | 68,599,246 | 8,224,741 | 23,573,534 | 100,397,521 |

| | 2018 | | | |
|--|------------------|--------------------|---------------------|---------------------|
| Allowance for ECL of loans to customers | Stage 1 | Stage 2 | Stage 3 | Total |
| At January 1, 2018 | (744,826) | (6,035,539) | (9,411,272) | (16,191,637) |
| New assets originated or purchased | (108,315) | - | - | (108,315) |
| Net remeasurement | 235,508 | 896,188 | (654,129) | 477,567 |
| Transfer to Stage 1 | (1,149) | 1,149 | - | - |
| Transfer to Stage 2 | 6 | (6) | - | - |
| Transfer to Stage 3 | 279,604 | 3,931,269 | (4,210,873) | - |
| Amounts written off | - | - | 1,028,765 | 1,028,765 |
| At December 31, 2018 | (339,172) | (1,206,939) | (13,247,509) | (14,793,620) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

Movements in allowances for impairment losses for the year ended December 31, 2017 are disclosed below:

| | Allowance for impairment at January 1, 2017 | Write off during the year | Increase/(decrease) in allowance for impairment during the year | Allowance for impairment at December 31, 2017 |
|---|--|------------------------------|--|---|
| Corporate loans | 9,308,684 | 28,517 | 3,987,013 | 13,267,180 |
| Loans to individuals – mortgage loans | - | - | - | - |
| Loans to individuals – consumer loans | 451,808 | 35,368 | (156,028) | 260,412 |
| Loans to individuals – entrepreneurship loans | 2,740,610 | - | (133,154) | 2,607,456 |
| Loans to individuals – car purchase | 942,852 | 38,949 | (178,477) | 725,426 |
| | <u>13,443,954</u> | <u>102,834</u> | <u>3,519,354</u> | <u>16,860,474</u> |
| Total | 13,443,954 | 102,834 | 3,519,354 | 16,860,474 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

An analysis of changes in the gross carrying value and corresponding ECL in relation to corporate loans during the year ended December 31, 2018 is as follows:

| | 2018 | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| | Stage 1 | Stage 2 | Stage 3 | Total |
| Gross carrying value | | | | |
| As at January 1, 2018 | 34,693,004 | 23,567,447 | 8,235,737 | 66,496,188 |
| New assets originated or purchased | 15,199,143 | - | - | 15,199,143 |
| Other movements (asset repayment, modification of assets, etc) | (10,209,496) | (1,164,657) | (696,672) | (12,070,825) |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | (85,051) | (14,219,920) | 14,304,971 | - |
| Amounts written off | - | - | (367,108) | (367,108) |
| At December 31, 2018 | 39,597,600 | 8,182,870 | 21,476,928 | 69,257,398 |

| | 2018 | | | |
|--|------------------|--------------------|---------------------|---------------------|
| | Stage 1 | Stage 2 | Stage 3 | Total |
| Allowance for ECL of loans to customers | | | | |
| At January 1, 2018 | (559,703) | (6,033,970) | (6,716,403) | (13,310,076) |
| New assets originated or purchased | (55,579) | - | - | (55,579) |
| Net remeasurement | 240,222 | 896,445 | (1,270,766) | (134,099) |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | 85,051 | 3,931,246 | (4,016,297) | - |
| Amounts written off | - | - | 367,108 | 367,108 |
| At December 31, 2018 | (290,009) | (1,206,279) | (11,636,358) | (13,132,646) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

An analysis of changes in the gross carrying value and corresponding ECL in relation to individuals - mortgage loans during the year ended December 31, 2018 is as follows:

| | 2018 | | | |
|--|-------------------|----------------|----------------|-------------------|
| Gross carrying value | Stage 1 | Stage 2 | Stage 3 | Total |
| As at January 1, 2018 | 11,176,341 | 75,156 | - | 11,251,497 |
| New assets originated or purchased | 12,267,558 | - | - | 12,267,558 |
| Other movements (asset repayment, modification of assets, etc) | (578,745) | (1,353) | - | (580,098) |
| Transfer to Stage 1 | 75,156 | (75,156) | - | - |
| Transfer to Stage 2 | (32,250) | 32,250 | - | - |
| Transfer to Stage 3 | (86,473) | - | 86,473 | - |
| Amounts written off | - | - | - | - |
| At December 31, 2018 | 22,821,587 | 30,897 | 86,473 | 22,938,957 |

| | 2018 | | | |
|--|-----------------|----------------|----------------|-----------------|
| Allowance for ECL of loans to customers | Stage 1 | Stage 2 | Stage 3 | Total |
| At January 1, 2018 | (8,116) | (1,149) | - | (9,265) |
| New assets originated or purchased | (19,824) | - | - | (19,824) |
| Net remeasurement | (12,903) | - | - | (12,903) |
| Transfer to Stage 1 | (1,149) | 1,149 | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | 8,603 | - | (8,603) | - |
| Amounts written off | - | - | - | - |
| At December 31, 2018 | (33,389) | - | (8,603) | (41,992) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

An analysis of changes in the gross carrying value and corresponding ECL in relation to individuals - consumer loans during the year ended December 31, 2018 is as follows:

| | 2018 | | | |
|--|------------------|----------------|----------------|------------------|
| Gross carrying value | Stage 1 | Stage 2 | Stage 3 | Total |
| As at January 1, 2018 | 2,769,796 | 14,727 | 253,859 | 3,038,382 |
| New assets originated or purchased | 3,040,489 | - | - | 3,040,489 |
| Other movements (asset repayment, modification of assets, etc) | (1,267,994) | (19,984) | (55,716) | (1,343,694) |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | (16,684) | 16,684 | - | - |
| Transfer to Stage 3 | (107,591) | (453) | 108,044 | - |
| Amounts written off | - | - | - | - |
| At December 31, 2018 | 4,418,016 | 10,974 | 306,187 | 4,735,177 |

| | 2018 | | | |
|--|-----------------|----------------|------------------|------------------|
| Allowance for ECL of loans to customers | Stage 1 | Stage 2 | Stage 3 | Total |
| At January 1, 2018 | (7,400) | (58) | (182,577) | (190,035) |
| New assets originated or purchased | (32,762) | - | - | (32,762) |
| Net remeasurement | 6,020 | (619) | 90,071 | 95,472 |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | 6 | (6) | - | - |
| Transfer to Stage 3 | 19,249 | 23 | (19,272) | - |
| Amounts written off | - | - | - | - |
| At December 31, 2018 | (14,887) | (660) | (111,778) | (127,325) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

An analysis of changes in the gross carrying value and corresponding ECL in relation to individuals - entrepreneurship loans during the year ended December 31, 2018 is as follows:

| | 2018 | | | |
|--|------------------|------------------|------------------|------------------|
| Gross carrying value | Stage 1 | Stage 2 | Stage 3 | Total |
| As at January 1, 2018 | 3,092,628 | 1,336,337 | 2,372,356 | 6,801,321 |
| New assets originated or purchased | 1,076,858 | - | - | 1,076,858 |
| Other movements (asset repayment, modification of assets, etc) | (1,530,019) | - | (3,033,476) | (4,563,495) |
| Transfer to Stage 1 | 1,336,337 | (1,336,337) | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | (2,223,495) | - | 2,223,495 | - |
| Amounts written off | - | - | (462,651) | (462,651) |
| At December 31, 2018 | 1,752,309 | - | 1,099,724 | 2,852,033 |

| | 2018 | | | |
|--|------------------|----------------|--------------------|--------------------|
| Allowance for ECL of loans to customers | Stage 1 | Stage 2 | Stage 3 | Total |
| At January 1, 2018 | (169,607) | - | (1,818,884) | (1,988,491) |
| New assets originated or purchased | (52) | - | - | (52) |
| Net remeasurement | (239,691) | - | 877,052 | 637,361 |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | 408,561 | - | (408,561) | - |
| Amounts written off | - | - | 462,651 | 462,651 |
| At December 31, 2018 | (789) | - | (887,742) | (888,531) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued)

(In Azerbaijani Manats)

An analysis of changes in the gross carrying value and corresponding ECL in relation to individuals – car purchase loans during the year ended December 31, 2018 is as follows:

| | 2018 | | | |
|--|---------|----------|-----------|-----------|
| Gross carrying value | Stage 1 | Stage 2 | Stage 3 | Total |
| As at January 1, 2018 | 1,281 | 10,331 | 836,831 | 848,443 |
| New assets originated or purchased | 9,734 | - | - | 9,734 |
| Other movements (asset repayment, modification of assets, etc) | (1,281) | (10,331) | (33,603) | (45,215) |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | - | - | - | - |
| Amounts written off | - | - | (199,006) | (199,006) |
| At December 31, 2018 | 9,734 | - | 604,222 | 613,956 |

| | 2018 | | | |
|---|---------|---------|-----------|-----------|
| Allowance for ECL of loans to customers | Stage 1 | Stage 2 | Stage 3 | Total |
| At January 1, 2018 | - | (362) | (693,408) | (693,770) |
| New assets originated or purchased | (98) | - | - | (98) |
| Net remeasurement | - | 362 | (108,626) | (108,264) |
| Transfer to Stage 1 | - | - | - | - |
| Transfer to Stage 2 | - | - | - | - |
| Transfer to Stage 3 | - | - | - | - |
| Amounts written off | - | - | 199,006 | 199,006 |
| At December 31, 2018 | (98) | - | (603,028) | (603,126) |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

The table below summarizes the amount of loans secured by collateral, rather than the fair value of the collateral itself at December 31, 2018:

| | Corporate loans | Loans to individuals- mortgage loans | Loans to individuals- consumer loans | Loans to individuals- entrepreneur- ship loans | Loans to individuals- car purchase | December 31, 2018 Total |
|-------------------------------------|--------------------|---|---|---|--|-------------------------------|
| Unsecured loans | 763,418 | - | 552,792 | - | - | 1,316,210 |
| Loans collateralized by: | | | | | | |
| - real estate | 42,250,285 | 22,896,965 | 2,181,891 | 1,963,503 | - | 69,292,644 |
| - inventory | 6,140,791 | - | - | - | - | 6,140,791 |
| - cash deposits | 2,228,883 | - | 1,180,748 | - | - | 3,409,631 |
| - vehicle | - | - | - | - | 10,828 | 10,828 |
| - guarantees | 4,741,377 | - | 45,755 | - | - | 4,787,132 |
| - jewellery | - | - | 646,665 | - | - | 646,665 |
| Total loans to customers | 56,124,754 | 22,896,965 | 4,607,851 | 1,963,503 | 10,828 | 85,603,901 |

The table below summarizes the amount of loans secured by collateral, rather than the fair value of the collateral itself at December 31, 2017:

| | Corporate loans | Loans to individuals- mortgage loans | Loans to individuals- consumer loans | Loans to individuals- entrepreneur- ship loans | Loans to individuals- car purchase | December 31, 2017 Total |
|-------------------------------------|--------------------|---|---|---|--|-------------------------------|
| Unsecured loans | 6,418,776 | - | 644,050 | - | - | 7,062,826 |
| Loans collateralized by: | | | | | | |
| - real estate | 40,903,925 | 10,696,681 | 803,686 | 4,810,111 | - | 57,214,403 |
| - inventory | 6,235,023 | - | - | - | - | 6,235,023 |
| - cash deposits | 39,495 | - | 1,123,141 | - | - | 1,162,636 |
| - vehicle | - | - | - | - | 123,017 | 123,017 |
| - guarantees | 1,427,687 | - | 87,589 | - | - | 1,515,276 |
| - jewellery | - | - | 700,471 | - | - | 700,471 |
| Total loans to customers | 55,024,906 | 10,696,681 | 3,358,937 | 4,810,111 | 123,017 | 74,013,652 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

The analysis by credit quality of loans outstanding at December 31, 2017 is as follows:

| | Corporate loans | Loans to individuals- mortgage loans | Loans to individuals- consumer loans | Loans to individuals- entrepreneur- ship loans | Loans to individuals- car purchase | Total |
|---|---------------------|---|---|---|--|---------------------|
| Current and not impaired | | | | | | |
| Unsecured loans | 7,418,691 | - | 662,968 | - | - | 8,081,659 |
| <i>Loans collateralized by:</i> | | | | | | |
| - real estate | 37,171,268 | 10,696,681 | 755,498 | 4,370,924 | - | 52,994,371 |
| - inventory | 6,235,023 | - | - | - | - | 6,235,023 |
| - guarantees | 1,442,108 | - | 88,854 | - | - | 1,530,962 |
| - cash deposits | 39,495 | - | 1,123,141 | - | - | 1,162,636 |
| - jewellery | - | - | 703,855 | - | - | 703,855 |
| - vehicle | - | - | - | - | 18,478 | 18,478 |
| Total current and not impaired | 52,306,585 | 10,696,681 | 3,334,316 | 4,370,924 | 18,478 | 70,726,984 |
| <i>Past due but not impaired</i> | | | | | | |
| - 30 to 90 days overdue | 10,005,152 | - | 6,506 | - | - | 10,011,658 |
| - 90 to 180 days overdue | - | - | - | - | - | - |
| - 180 to 360 days overdue | 27,261 | - | 51,615 | 1,330,576 | 12,822 | 1,422,274 |
| - over 360 days overdue | 2,852,638 | - | 226,912 | 58,335 | 817,143 | 3,955,028 |
| Total past due but not impaired | 12,885,051 | - | 285,033 | 1,388,911 | 829,965 | 15,388,960 |
| <i>Loans individually determined to be impaired (gross)</i> | | | | | | |
| - 90 to 180 days overdue | - | - | - | - | - | - |
| - 180 to 360 days overdue | - | - | - | - | - | - |
| - over 360 days overdue | 3,100,450 | - | - | 1,657,732 | - | 4,758,182 |
| Total individually impaired loans (gross) | 3,100,450 | - | - | 1,657,732 | - | 4,758,182 |
| Gross carrying value of loans | 68,292,086 | 10,696,681 | 3,619,349 | 7,417,567 | 848,443 | 90,874,126 |
| Less provision for loan impairment | (13,267,180) | - | (260,412) | (2,607,456) | (725,426) | (16,860,474) |
| Total loans to customers | 55,024,906 | 10,696,681 | 3,358,937 | 4,810,111 | 123,017 | 74,013,652 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

Economic sector risk concentrations within the loans to customers' portfolio are as follows:

| | December 31, 2018 | | December 31, 2017 | |
|---|--------------------|---------------|-------------------|---------------|
| | Amount | % | Amount | % |
| Trade and service | 38,777,188 | 38.62 | 34,405,612 | 37.86 |
| Individuals (excluding entrepreneurs) | 28,288,090 | 28.18 | 15,164,473 | 16.69 |
| Manufacturing | 17,934,524 | 17.86 | 25,074,915 | 27.59 |
| Agriculture | 13,441,330 | 13.39 | 13,843,489 | 15.23 |
| Construction | 1,956,389 | 1.95 | 2,385,637 | 2.63 |
| Total loans to customers (gross) | 100,397,521 | 100.00 | 90,874,126 | 100.00 |

Included in loans to customers AZN 1,121,641 and AZN 4,315,517 as at December 31, 2018 and 2017, respectively, represent accrued interest receivable.

As at December 31, 2018, the Bank had loan to one customer in the amount of AZN 10,066,776 which individually exceeded 20% of the Bank's share capital (December 31, 2017: AZN 10,030,082).

As at December 31, 2018, the Bank had outstanding loans to 10 customers in the amount of AZN 51,031,755 which comprise 51% of the total loans to customers portfolio (December 31, 2017: 10 customers in the amount of AZN 41,713,619 which comprise 46% of the total loans to customers portfolio).

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

18. PROPERTY AND EQUIPMENT

Property and equipment comprise of the following:

| | Buildings | Furniture and fixtures | Computer and equipment | Vehicles | Other fixed assets | CIP | Total |
|---------------------------------|--------------------|------------------------|------------------------|------------------|--------------------|----------------|--------------------|
| At initial cost | | | | | | | |
| January 1, 2017 | 5,035,689 | 1,272,348 | 725,684 | 451,315 | 22,686 | 695,400 | 8,203,122 |
| Additions | - | 76,626 | 131,883 | - | - | - | 208,509 |
| Disposals | - | (28,817) | (125,624) | (25,320) | (448) | - | (180,209) |
| December 31, 2017 | 5,035,689 | 1,320,157 | 731,943 | 425,995 | 22,238 | 695,400 | 8,231,422 |
| Additions | - | 32,107 | 54,419 | 162,755 | - | - | 249,281 |
| Transfer to Investment property | - | - | - | - | - | (695,400) | (695,400) |
| Disposals | - | - | (55,198) | (67,720) | - | - | (122,918) |
| December 31, 2018 | 5,035,689 | 1,352,264 | 731,164 | 521,030 | 22,238 | - | 7,662,385 |
| Accumulated depreciation | | | | | | | |
| January 1, 2017 | (2,002,388) | (778,349) | (399,987) | (316,837) | (15,036) | - | (3,512,597) |
| Charge for the year | (251,861) | (140,610) | (95,254) | (48,958) | (1,530) | - | (538,213) |
| Disposals | - | 28,817 | 125,624 | 25,320 | 448 | - | 180,209 |
| December 31, 2017 | (2,254,249) | (890,142) | (369,617) | (340,475) | (16,118) | - | (3,870,601) |
| Charge for the year | (251,784) | (136,633) | (112,283) | (72,184) | (1,530) | - | (574,414) |
| Disposals | - | - | 55,198 | 67,720 | - | - | 122,918 |
| December 31, 2018 | (2,506,033) | (1,026,775) | (426,702) | (344,939) | (17,648) | - | (4,322,097) |
| Net book value | | | | | | | |
| December 31, 2018 | 2,529,656 | 325,489 | 304,462 | 176,091 | 4,590 | - | 3,340,288 |
| December 31, 2017 | 2,781,440 | 430,015 | 362,326 | 85,520 | 6,120 | 695,400 | 4,360,821 |

As at December 31, 2018 and 2017, property and equipment were not pledged as collateral for borrowings.

As at December 31, 2018 and 2017, included in property and equipment were fully depreciated assets in the amount of AZN 1,139,802 and AZN 982,959, respectively.

As at December 31, 2018 and 2017, included in property and equipment insured in the amount of AZN 850,448 and AZN 776,148, respectively.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

19. INVESTMENT PROPERTY

| | 2018 |
|--|-----------------------|
| Investment properties at fair value at January 1 | - |
| Transfer from property and equipment | 695,400 |
| Net gain from fair value change recognized in profit or loss account | - |
| Investment properties at fair value at December 31 | <u>695,400</u> |

Investment property consists of building in the amount of AZN 695,400 which was transferred from property, plant and equipment as a result of change of management decision on utilisation of underlying asset. Previously the building was expected to be used for new branch operations.

20. INTANGIBLE ASSETS

| | Intangible assets |
|---------------------------------|-------------------------|
| At initial cost | |
| January 1, 2017 | 319,924 |
| Additions | 72,246 |
| December 31, 2017 | <u>392,170</u> |
| Additions | 124,351 |
| December 31, 2018 | <u>516,521</u> |
| Accumulated amortization | |
| January 1, 2017 | (163,670) |
| Charge for the year | (36,464) |
| December 31, 2017 | <u>(200,134)</u> |
| Charge for the year | (35,171) |
| December 31, 2018 | <u>(235,305)</u> |
| Net book value | |
| December 31, 2018 | <u>281,216</u> |
| December 31, 2017 | <u>192,036</u> |

Intangible assets include software and licenses.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

21. OTHER ASSETS

Other assets comprise:

| | December 31, 2018 | December 31, 2017 |
|--|----------------------|----------------------|
| Other financial assets: | | |
| Settlement on money transfer | 369,243 | 285,018 |
| Accrued interest receivables on guarantees | 10,316 | 13,409 |
| Receivable from the intermediary | - | 42,727 |
| Total other financial assets | 379,559 | 341,154 |
| Other non-financial assets: | | |
| Reposessed assets* | 1,665,305 | 2,062,870 |
| Prepaid taxes | 152,899 | - |
| Prepayment and other debtors | 141,425 | 186,071 |
| Prepayment for property and equipment | 15,864 | 21,939 |
| Deferred expenses | - | 333 |
| Total other assets | 2,355,052 | 2,612,367 |

According to the State Registration Certificate of the Republic of Azerbaijan, the real estate collateralized for the loans to customers have been reposessed by the Bank, due to default of the borrower and included in the reposessed assets.

*As at December 31, 2018 and 2017, the fair value of reposessed assets approximates to AZN 1,665,305, and AZN 2,062,870, respectively. During the year ended December 31, 2018 the Bank recognized loss on change of fair value of reposessed assets in the amount of AZN (429,440) (2017: AZN 863,284).

| | December 31, 2018 | December 31, 2017 |
|--------------------------------|----------------------|----------------------|
| Plot of land | 1,254,000 | 1,567,500 |
| Residential property | 411,305 | 492,310 |
| Movable property | - | 3,060 |
| Total reposessed assets | 1,665,305 | 2,062,870 |

Management of the Bank intends to sell these assets, however no active program to locate a buyer and complete plan have been initiated as at the date of report.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

22. DUE TO BANKS, GOVERNMENT AND OTHER FINANCIAL INSTITUTIONS

Due to banks, government and other financial institutions comprise:

| | December 31, 2018 | December 31, 2017 |
|--|----------------------|----------------------|
| Due to National Fund for Support of Entrepreneurship | 22,002,307 | 23,419,501 |
| Due to the Azerbaijan Mortgage and Credit Guarantee Fund | 21,047,551 | 10,559,518 |
| Correspondent accounts of other banks | 608 | 7,558 |
| Due to the banks | - | 464 |
| Total due to banks, government and other financial institutions | 43,050,466 | 34,486,979 |

Included in due to banks, government and other financial institutions AZN 87,499 and AZN 76,174 as at December 31, 2018 and 2017, respectively represent accrued interest payable.

At December 31, 2018, AZN 22,002,307 thousand (2017: AZN 23,419,501) out of term borrowings represented funds borrowed from the National Fund for Support to Entrepreneurship, a program under the auspices of the Ministry of Economy of the Republic of Azerbaijan, for financing small and medium size enterprises. All borrowings from the National Fund for Support to Entrepreneurship are for five to ten years and bear an interest rate of 1% and 2% p.a. These borrowings mature between May 2019 and June 2027.

At December 31, 2018, AZN 21,047,551 (2017: AZN 10,559,518) out of term borrowings represented funds borrowed from the Azerbaijan Mortgage and Credit Guarantee Fund, a program under the auspices of the Central Bank of the Republic of Azerbaijan, for granting long-term mortgage loans to individuals. Under this program, funds made available to the Bank at an interest rate of 1-4% p.a. and the Bank further on lends these funds to eligible borrowers at rates not higher than 8% p.a. These borrowings mature between June 2020 and December 2048.

23. CUSTOMER ACCOUNTS

Customer accounts comprise:

| | December 31, 2018 | December 31, 2017 |
|---------------------------------|----------------------|----------------------|
| Time deposits | 33,403,815 | 36,838,976 |
| Current and settlement accounts | 26,263,281 | 19,349,947 |
| Total customer accounts | 59,667,096 | 56,188,923 |

As at December 31, 2018 and 2017, accrued interest payable included in customer accounts, amounted to AZN 392,664 and AZN 408,081, respectively.

Included in customer accounts in the amount of AZN 45,513,896 and AZN 42,186,682 as at December 31, 2018 and 2017, respectively are deposits secured by the Azerbaijan Deposit Insurance Fund.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

As at December 31, 2018 and 2017 customer accounts totaling AZN 5,482,769 and AZN 5,483,091 (9% and 10% of total customer accounts), respectively, were due to 1 customer, which represents a significant concentration.

Economic sector concentrations within customer accounts are as follows:

| | December 31, 2018 | December 31, 2017 |
|----------------------------------|----------------------|----------------------|
| Individuals | 46,000,752 | 42,483,422 |
| Trade and service | 6,222,032 | 4,421,763 |
| Other financial institutions | 4,145,604 | 5,270,450 |
| Construction | 1,750,768 | 106,894 |
| Insurance | 1,283,961 | 2,678,324 |
| Transportation and communication | 82,833 | 274,817 |
| Manufacturing | 55,198 | 750,149 |
| Others | 125,948 | 203,104 |
| Total customer accounts | 59,667,096 | 56,188,923 |

24. OTHER LIABILITIES

Other liabilities comprise the following:

| | December 31, 2018 | January 1, 2018 | December 31, 2017 |
|---|----------------------|--------------------|----------------------|
| Other financial liabilities: | | | |
| Payments in the course of settlement | 53,350 | 107,572 | 107,572 |
| Accrued expenses | 121,285 | 91,996 | 91,996 |
| Payable to Azerbaijan Deposit Insurance Fund | 60,129 | 48,719 | 48,719 |
| Total other financial liabilities | 234,764 | 248,287 | 248,287 |
| Other non-financial liabilities: | | | |
| Payable to State and Local Funds | 118,794 | 81,808 | 81,808 |
| Provision for guarantees and similar commitments (Note 8) | 295,497 | 295,497 | - |
| Total other liabilities | 649,055 | 625,592 | 330,095 |

25. SHARE CAPITAL

As at December 31, 2018, authorized, issued and paid-in share capital consisted of 20,000 ordinary shares with par value of AZN 2,500 each (2017: 20,000 ordinary shares with par value of AZN 2,500 each).

The below table provides a reconciliation of the ordinary shares outstanding as at December 31, 2018 and 2017:

| | Share capital |
|-------------------|------------------|
| January 1, 2017 | 50,000,000 |
| December 31, 2017 | 50,000,000 |
| December 31, 2018 | 50,000,000 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

26. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the statement of financial position. The Bank's maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

The Bank uses the same credit control and management policies in undertaking off-balance sheet commitments as it does for financial position operations. As at December 31, 2018 and 2017, the nominal or contract amounts were:

| | December 31, 2018 | December 31, 2017 |
|--|------------------------------|------------------------------|
| Contingent liabilities and credit commitments | | |
| Commitments on loans and unused credit lines | 9,219,741 | 8,026,887 |
| Guarantees issued | <u>12,114,854</u> | <u>7,079,630</u> |
| Total contingent liabilities and credit commitments | <u>21,334,595</u> | <u>15,106,517</u> |

Credit related commitments are denominated in currencies as follows:

| | December 31, 2018 | December 31, 2017 |
|--------------------|------------------------------|------------------------------|
| Azerbaijani Manats | 18,100,814 | 9,097,893 |
| US Dollars | 1,909,623 | 4,522,027 |
| Euro | <u>1,324,158</u> | <u>1,486,597</u> |
| Total | <u>21,334,595</u> | <u>15,106,517</u> |

Capital regulatory commitment

The Central Bank of the Republic of Azerbaijan requires the threshold of aggregate capital for existent banks as AZN 50 million and the Bank complies with this requirement.

Legal proceedings

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

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Taxation

Provisions of the Tax legislation of the Republic of Azerbaijan are sometimes inconsistent and may have more than one interpretation, which allows the tax authorities to take decisions based on their own arbitrary interpretation of these provisions. In practice, tax authorities often interpret the tax legislation not in favor of the taxpayers, who have to resort to court proceeding to defend their position against the tax authorities. It should be noted that the tax authorities can use the clarifications issued by the judicial bodies that have introduced the concept of “unjustified tax benefit”, “primary commercial goal of transaction” and the criteria of “commercial purpose (substance) of transaction”.

Such uncertainty could, in particular, be attributed to tax treatment of financial instruments/ derivatives and determination of market price of transactions for transfer pricing purposes. It could also lead to temporary taxable differences occurred due to loan impairment provisions and income tax liabilities being treated by the tax authorities as understatement of the tax base. The management of the Bank is confident that applicable taxes have all been accrued and, consequently, creation of respective provisions is not required.

Generally, taxpayers are subject to tax audits with respect to three calendar years preceding the year of the audit. However, completed audits do not exclude the possibility of subsequent additional tax audits performed by upper-level tax inspectorates reviewing the results of tax audits of their subordinate tax inspectorates. Also, according to the clarification of the Constitutional Court of the Republic of Azerbaijan, the statute of limitation for tax liabilities may be extended beyond the three

year term set forth in the tax legislation, if a court determines that the taxpayers has obstructed or hindered a tax inspection.

27. TRANSACTIONS WITH RELATED PARTIES

Related parties or transactions with related parties, as defined by the IAS 24 “Related party disclosures”, represent:

- (a) Parties that directly, or indirectly through one or more intermediaries: control, or are controlled by, or are under common control with, the Bank (this includes parents, subsidiaries and fellow subsidiaries); have an interest in the Bank that gives them significant influence over the Bank; and that have joint control over the Bank;
- (b) Associates – enterprises on which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- (c) Joint ventures in which the Bank is a venturer;
- (d) Members of key management personnel of the Bank or its parent;
- (e) Close members of the family of any individuals referred to in (a) or (d);
- (f) Parties that are entities controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) Post-employment benefit plans for the benefit of employees of the Bank, or of any entity that is a related party of the Bank.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Bank had the following transactions outstanding as at December 31, 2018 and 2017 with related parties:

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | December 31, 2018 | | December 31, 2017 | |
|---|------------------------------|--|------------------------------|--|
| | Related party balances | Total category as per financial statements caption | Related party balances | Total category as per financial statements caption |
| Loans to customers (gross) | | 100,397,521 | | 90,874,126 |
| - key management personnel of the Bank | 200,011 | | 259,376 | |
| - other related parties | 87,200 | | 74,691 | |
| Other Assets | | 2,355,052 | | 2,612,367 |
| - key management personnel of the Bank | 6,002 | | 6,000 | |
| - other related parties | 21,357 | | 20,250 | |
| Allowance for expected credit losses on loans to customers | | (14,793,620) | | (17,001,657) |
| - key management personnel of the Bank | (378) | | (18,735) | |
| - other related parties | (361) | | (5,395) | |
| Customer accounts | | 59,667,096 | | 56,188,923 |
| - key management personnel of the Bank | 53,112 | | 218,777 | |
| - other related parties | 434,824 | | 458,539 | |
| Commitments on loans and unused credit lines | | 9,219,741 | | 8,026,887 |
| - key management personnel of the Bank | 28,117 | | 22,463 | |
| - other related parties | 126,916 | | 103,055 | |

Included in the statement of comprehensive income for the year ended December 31, 2018 and 2017 are the following amounts which arose due to transactions with related parties:

| | December 31, 2018 | | December 31, 2017 | |
|--|----------------------------------|--|----------------------------------|--|
| | Related party transactions | Total category as per financial statements caption | Related party transactions | Total category as per financial statements caption |
| Interest income | | 12,086,187 | | 12,416,486 |
| - key management personnel of the Bank | 17,048 | | 20,239 | |
| - other related parties | 6,578 | | 7,890 | |
| Interest expense | | (2,719,989) | | (2,772,773) |
| - key management personnel of the Bank | (178) | | (7,458) | |
| - other related parties | (15,032) | | (148,433) | |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | December 31, 2018 | | December 31, 2017 | |
|--|----------------------------------|--|----------------------------------|--|
| | Related party transactions | Total category as per financial statements caption | Related party transactions | Total category as per financial statements caption |
| Recovery/(charge) of expected credit losses | | 578,198 | | (3,520,567) |
| - key management personnel of the Bank | 544 | | (18,724) | |
| - other related parties | (166) | | (5,390) | |
| Key management personnel compensation: | | 2,083,951 | | 1,936,060 |
| - short-term employee benefits | 612,876 | | 589,058 | |

28. CAPITAL MANAGEMENT

The Bank's objectives when managing capital are to comply with the capital requirements set by the FIMSA, to safeguard the Bank's ability to continue as a going concern and to maintain a sufficient capital base to achieve a capital adequacy ratio of at least 10%. Compliance with capital adequacy ratios set by the FIMSA is monitored monthly with reports outlining their calculation reviewed and signed by the Bank's Chairman of Management Board, Chief Accountant, Chief of Internal Audit Department and the Chairman of Supervisory Board. Other objectives of capital management are evaluated annually.

Under the current capital requirements set by the FIMSA in January 1, 2015, existing banks have to hold the minimum level of aggregate capital of AZN 50,000,000, however, paid-in capital for newly established banks and local branches of foreign banks shall be AZN 50,000,000. Furthermore the banks have to maintain a ratio of regulatory capital to risk weighted assets ("statutory capital ratio") at or above a prescribed minimum of 10% (December 31, 2017: 10%) and maintain a ratio of tier-1 capital to the risk-weighted assets (the "Tier-1 capital ratio") at or above the prescribed minimum of 5% (December 31, 2017: 5%).

As at December 31, 2018 the Bank has complied with all capital requirements imposed by FIMSA.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

The composition of the Bank's capital calculated in accordance with the FIMSA capital requirements is as follows:

| | December 31, 2018 | December 31, 2017 |
|--|----------------------|----------------------|
| Tier 1 capital | | |
| Share capital | 50,000,000 | 50,000,000 |
| Retained earnings | 7,476,010 | 1,125,249 |
| Total tier 1 capital | 57,476,010 | 51,125,249 |
| Deductions from tier 1 capital | | |
| Intangible assets | (281,216) | (192,036) |
| Total tier 1 capital after deductions | 57,194,794 | 50,933,213 |
| Tier 2 capital | | |
| Current year profit | 5,182,254 | 6,350,761 |
| Total reserves | 1,373,562 | 1,185,029 |
| Total tier 2 capital | 6,555,816 | 7,535,790 |
| | | |
| | December 31, 2018 | December 31, 2017 |
| Total regulatory capital after deductions | 63,750,610 | 58,469,003 |
| Total risk-weighted assets: | 109,884,975 | 94,802,356 |
| | | |
| Tier 1 capital adequacy ratio | 52% | 54% |
| Regulatory capital adequacy ratio | 58% | 62% |

29. SEGMENT REPORTING

The Bank is organized on the basis of two main business segments:

- Retail banking – representing private banking services, private customer current accounts, savings, deposits, consumer loans and mortgages;
- Corporate banking – representing direct debit facilities, current accounts, deposits, overdrafts, loan and other credit facilities, foreign currency products.

Transactions between the business segments are on normal commercial terms and conditions. Operating expenses and income tax expense are ordinarily reallocated between segments based on the split of the Bank's interest income. There are no other material items of income or expense between the business segments.

Segment information about these businesses is presented below:

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| | Retail Banking | Corporate banking | Other segments | As at and for the year ended December 31, 2018 |
|---|-------------------|----------------------|-------------------|---|
| Interest income | 2,399,638 | 8,448,657 | 1,237,892 | 12,086,187 |
| Interest expense | (1,300,367) | (1,419,622) | - | (2,719,989) |
| Recovery of expected credit losses | 191,822 | 386,376 | - | 578,198 |
| Net gain on foreign exchange operations | - | - | 231,328 | 231,328 |
| Fee and commission income | 1,106,851 | 66,858 | - | 1,173,709 |
| Fee and commission expense | (547,601) | (298,138) | - | (845,739) |
| Change in the fair value of repossessed assets | - | - | (429,440) | (429,440) |
| Other income, net | - | - | 19,833 | 19,833 |
| Operating income | 1,850,343 | 7,184,131 | 1,059,613 | 10,094,087 |
| Operating expenses | (460,602) | (2,939,328) | (758,937) | (4,158,867) |
| Profit before income tax | 1,389,741 | 4,244,803 | 300,676 | 5,935,220 |
| Segment assets | 30,334,128 | 81,451,017 | 57,006,462 | 168,791,607 |
| Segment liabilities | 46,035,060 | 56,716,810 | 1,172,119 | 103,923,989 |
| Other segment items: | | | | |
| Depreciation and amortization on property, equipment and intangible assets | - | - | 609,585 | 609,585 |
| Loans to customers | 29,479,149 | 56,124,752 | - | 85,603,901 |
| Property, equipment and intangible assets | - | - | 3,621,504 | 3,621,504 |
| Investment property | - | - | 695,400 | 695,400 |
| Customer accounts | 46,000,752 | 13,666,344 | - | 59,667,096 |
| | | | | |
| | Retail banking | Corporate banking | Other segments | As at and for the year ended December 31, 2017 |
| Interest income | 2,183,932 | 9,304,615 | 927,939 | 12,416,486 |
| Interest expense | (1,629,399) | (1,143,374) | - | (2,772,773) |
| Provision for impairment losses on interest bearing assets | 467,660 | (3,988,227) | - | (3,520,567) |
| Net gain on foreign exchange operations | - | - | 2,032,601 | 2,032,601 |
| Fee and commission income | 1,218,645 | 263,348 | - | 1,481,993 |
| Fee and commission expense | (624,079) | (209,691) | (125) | (833,895) |
| Change in the fair value of repossessed assets | - | - | (863,284) | (863,284) |
| Other income, net | - | - | 7,106 | 7,106 |
| Operating income | 1,616,759 | 4,226,671 | 2,104,237 | 7,947,667 |
| Operating expenses | (417,667) | (2,664,146) | (717,891) | (3,799,704) |
| Profit before income tax | 1,199,092 | 1,562,525 | 1,386,346 | 4,147,963 |
| Segment assets | 19,425,025 | 75,148,635 | 60,549,372 | 155,123,032 |
| Segment liabilities | 43,678,751 | 48,188,622 | 1,371,578 | 93,238,951 |
| Other segment items: | | | | |
| Depreciation and amortization on property, equipment and intangible assets | - | - | 574,677 | 574,677 |
| Loans to customers | 18,800,370 | 55,213,282 | - | 74,013,652 |
| Property, equipment and intangible assets | - | - | 4,552,857 | 4,552,857 |
| Customer accounts | 42,483,422 | 13,705,501 | - | 56,188,923 |

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30. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

| | Date of valuation | Quoted prices in active markets (Level 1) | Fair value measurement using | | Total |
|---|-------------------|--|--|--|-------------------|
| | | | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | |
| Assets measured at fair value | | | | | |
| Investment securities | December 31, 2018 | 16,077,553 | - | - | 16,077,553 |
| Assets for which fair values are disclosed | | | | | |
| Cash and balances with the CBRA | December 31, 2018 | 52,299,324 | - | - | 52,299,324 |
| Due from banks and other financial institutions | December 31, 2018 | - | - | 8,138,873 | 8,138,873 |
| Loans to customers | December 31, 2018 | - | - | 85,603,901 | 85,603,901 |
| Other financial assets | December 31, 2018 | - | - | 379,559 | 379,559 |
| Liabilities for which fair values are disclosed | | | | | |
| Due to banks, government and other financial institutions | December 31, 2018 | - | - | 43,050,466 | 43,050,466 |
| Customer accounts | December 31, 2018 | - | - | 59,667,096 | 59,667,096 |
| Other financial liabilities | December 31, 2018 | - | - | 234,764 | 234,764 |

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| | | Fair value measurement using | | | |
|---|-------------------|--|--|--|-------------------|
| | Date of valuation | Quoted prices in active markets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Total |
| Assets measured at fair value | | | | | |
| Investment securities | December 31, 2017 | 7,108,298 | - | - | 7,108,298 |
| Assets for which fair values are disclosed | | | | | |
| Cash and balances with the CBRA | December 31, 2017 | 55,612,286 | - | - | 55,612,286 |
| Due from banks and other financial institutions | December 31, 2017 | - | - | 11,223,572 | 11,223,572 |
| Loans to customers | December 31, 2017 | - | - | 74,013,652 | 74,013,652 |
| Other financial assets | December 31, 2017 | - | - | 341,154 | 341,154 |
| Liabilities for which fair values are disclosed | | | | | |
| Due to banks, government and other financial institutions | December 31, 2017 | - | - | 34,483,121 | 34,483,121 |
| Customer accounts | December 31, 2017 | - | - | 56,188,923 | 56,188,923 |
| Other financial liabilities | December 31, 2017 | - | - | 248,287 | 248,287 |

Assets and liabilities for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, without a specific maturity and variable rate financial instruments.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

31. RISK MANAGEMENT POLICIES

The risk management function within the Bank is carried out in respect of financial risks (credit, market, geographical, currency, liquidity and interest rate), operational risks and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks.

The Bank recognizes that it is essential to have efficient and effective risk management processes in place. To enable this, the Bank has established a risk management framework, whose main purpose is to protect the Bank from risk and allow it to achieve its performance objectives. Through the risk management framework, the Bank manages the following risks:

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The methods and assumptions applied in determining fair values

The estimated fair values of financial instruments have been determined by the Bank, using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. The Republic of Azerbaijan continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and, therefore, not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

Where quoted market prices are not available, the Bank used valuation techniques. The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Credit risk

The Bank takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties giving rise to financial assets.

Risk Management and monitoring is performed within set limits of authority, by the Credit Committees and the Bank's Management Board. Before any application is made by the Credit Committee, all recommendations on credit processes (borrower's limits approved, or amendments made to loan agreements, etc) are reviewed and approved by the branch risk-manager or the Risk Management Department. Daily risk management is performed by the Head of Credit Department and branches credit divisions.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Limits on the level of credit risk by a borrower and a product are approved quarterly by the Management Board.

The exposure to any one borrower including banks is further restricted by sub-limits covering on and off-balance sheet exposures which are set by the Credit Committee. Actual exposures against limits are monitored daily.

Expected credit loss (ECL) measurement – definitions

ECL is a probability-weighted estimate of the present value of future cash shortfalls (i.e., the weighted average of credit losses, with the respective risks of default occurring in a given time period used as weights). An ECL measurement is unbiased and determined by evaluating a range of possible outcomes.

Discount Rate – a tool to discount an expected loss to the present value at the reporting date. The discount rate represents the effective interest rate (EIR) for the financial instrument or an approximation thereof.

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Lifetime period – the maximum period over which ECL should be measured. For loans with fixed maturity, the lifetime period is equal to the remaining contractual period. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit. For credit cards issued to individuals, it is the period that is based on internal statistics, and it is equal to 3 years.

Lifetime ECL – losses that result from all possible default events over the remaining lifetime period of the financial instrument.

12-month ECL – the portion of lifetime ECLs that represent the ECLs resulting from default events on a financial instrument that are possible within 12 months after the reporting date that are limited by the remaining contractual life of the financial instrument.

Forward looking information – the information that includes the key macroeconomic variables impacting credit risk and expected credit losses for each portfolio segment. A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information.

Credit Conversion Factor (CCF) – a coefficient that shows that the probability of conversion of an off-balance sheet amounts to exposure on the balance within a defined period. It can be calculated for a 12-month or lifetime period. Based on the analysis performed, the Bank considers that 12-month and lifetime CCFs are the same.

Purchased or originated credit impaired (POCI) financial assets – financial assets that are credit-impaired upon initial recognition.

Low credit risk financial assets – assets that have an investment grade defined by external rating agencies or corresponding internal rating, debt instruments issued by Azerbaijan Republic and nominated in AZN, loans to companies owned by Azerbaijan Republic and nominated in AZN. The presumption, being that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has not been rebutted.

Default and credit-impaired asset – a loan is in default, meaning fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- the borrower is more than 90 days past due on its contractual payments;
- the loan is restructured less than 6 months ago and is 31-90 days past due on its contractual payments;
- the borrower has the external rating below Caa2;
- the Bank consider to sell the borrower’s debt with significant losses (more than 5% of the debt principal balance and accrued interest);
- other information available on borrower bankruptcy or default.

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The Main Credit Committee decides on recognition of the borrower as credit-impaired one based on the unlikelihood-to-pay criteria listed below:

- the borrower is insolvent;
- it is becoming likely that the borrower will enter bankruptcy;
- Other criteria reflecting difficulties with successful fulfilling of obligations by the borrower.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months.

Significant increase in credit risk (SICR) – the SICR assessment is performed on an individual basis and on a portfolio basis. For loans issued to legal entities and individuals, interbank loans and debt securities accounted for at AC or at FVOCI, SICR is assessed on an individual basis by monitoring the triggers stated below. The criteria used to identify a SICR are monitored and reviewed periodically for appropriateness by the Bank’s Risk Management Department.

The Bank considers a financial instrument to have experienced a SICR when one or more of the following quantitative, qualitative or backstop criteria have been met.

For loans issued to legal entities and bonds issued by the legal entities, interbank operations and bonds issued by the banks:

- 31-90 days past due;
- Restructured and 6-30 days past due;
- Monitoring suggests borrower has financial difficulties.

For loans to Individuals:

- 31-90 days past due;
- Restructured and 6-30 days past due;
- Refinanced loan – a special type of loan when all loans of the borrower are refinanced into one.

If there is evidence that the SICR criteria are no longer met and this has lasted at least 6 month, the instrument will be transferred back to Stage 1. If an exposure has been transferred to Stage 2 Based on a qualitative indicator, the Bank monitors whether that indicator continues to exist or has changed.

ECL measurement – description of estimation techniques

General principle

For non-POCI financial assets, ECLs are generally measured based on the risk of default over one of two different time periods, depending on whether the credit risk of the borrower has increased significantly since initial recognition. This approach can be summarized in a three-stage model for ECL measurement:

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Stage 1: a financial instrument that is not credit-impaired on initial recognition and its credit risk has not increased significantly since initial recognition; loss allowance is based on 12-month ECLs.

Stage 2: if a SICR since initial recognition is identified, the financial instrument is moved to Stage 2 but not yet deemed to be credit-impaired; loss allowance is based on lifetime ECLs.

Stage 3: if the financial instrument is credit-impaired, the financial instrument is then moved to Stage 3 and loss allowance is based on lifetime ECLs.

ECL for POCI financial assets is always measured on a lifetime basis (Stage 3), so at the reporting date, the Bank only recognizes the cumulative changes in lifetime expected credit losses.

The Bank can carry out three separate approaches for ECL measurement:

- assessment on an individual basis;
- assessment on a portfolio basis;
- assessment based on external ratings.

The Bank performs an assessment on an individual basis for the following types of loans issued to legal entities: loans with unique credit risk characteristics, individually significant loans and credit-impaired loans.

The Bank performs an assessment on a portfolio basis for the following types of assets: loans and credit-related commitments issued to legal entities (standard lending, specialized lending, loans to leasing companies, etc.), interbank loans, retail loans and loans issued to SMEs. This approach incorporates aggregating the portfolio into homogeneous segments based on borrower-specific information.

The Bank performs assessments on external ratings for the following types of loans: interbank loans, debt securities issued by the banks, legal entities and sovereigns, loans issued to sovereigns.

Principles of assessment on individual basis – ECL assessments on an individual basis are done by weighting the estimates of credit losses for different possible outcomes against the probabilities of each outcome. The Bank defines at least two possible outcomes for each loan, one of which leads to credit loss in spite of the probability of such a scenario. Individual assessment is mainly based on the expert judgement of the Problem Loans Collection Department. Expert judgements are regularly tested in order to decrease the difference between estimates and actual losses.

Principles of assessment on portfolio basis – to assess the staging of exposure and to measure a loss allowance on a collective basis, the Bank combines its exposures into segments on the basis of shared credit risk characteristics, such as that exposures to risk within a group are homogeneous.

Examples of shared characteristics include: type of customer (such as income producing real estate or leasing companies), product type (such as credit cards or cash loans), credit risk rating and date of initial recognition.

The different segments reflect differences in credit risk parameters such as PD and LGD. The appropriateness of groupings is monitored and reviewed on a periodic basis by the Risk Management Department.

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In general, ECL is the multiplication of the following credit risk parameters: EAD, PD and LGD (definitions of the parameters are provided above). The general approach used for ECL calculation is stated below. It could be applied for products assessed on a portfolio basis and for products for which the bank has credit risk ratings assessment based on borrower-specific information.

The ECL is determined by predicting credit risk parameters (EAD, PD and LGD) for the next 12 months or instrument lifetime. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has been repaid or defaulted in an earlier period).

The brief principles of calculating the credit risk parameters are as following.

The EADs are determined based on the expected payment profile, which varies by product type:

- for amortizing products and bullet repayment loans, EAD is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis.
- for revolving products, the EAD is predicted by taking the current drawn balance and adding a credit conversion factor that accounts for the expected drawdown of the remaining limit by the time of default.

Two types of PDs are used for calculating ECLs: 12-month and lifetime PD:

- 12-month PDs – the estimated probability of a default occurring within the next 12 months (or over the remaining life of the financial instrument if less than 12 months). This parameter is used to calculate 12-month ECLs. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for forward-looking information when appropriate.
- Lifetime PDs – the estimated probability of a default occurring over the remaining life of the financial instrument. This parameter is used to calculate lifetime ECLs for Stage 2 exposures. An assessment of a Lifetime PD is based on the latest available historic default data and adjusted for forward looking information when appropriate.

To calculate Lifetime PD, the Bank uses different statistical approaches depending on the segment and product type, such as the extrapolation of 12-month PDs based on migration matrixes and developing lifetime PD curves based on the historical default data. For lifetime PD calculations, the Bank uses historical default data and the extrapolation of trends for longer periods during which default data was not available.

LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by the product, stage and the availability of collateral or other credit support.

The 12-month and lifetime LGDs are determined based on the factors that impact the expected recoveries after a default event.

The approach to LGD measurement can be divided into three possible approaches:

- measurement of LGD based on the specific characteristics of the collateral;
- calculation of LGD on a portfolio basis based on recovery statistics;
- individually defined LGD depending on different factors and scenarios.

For loans secured by real estate the Bank calculates LGD based on specific characteristics of the collateral, such as projected collateral values, historical discounts on sales and other factors.

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For particular segments of the corporate, retail, interbank loan portfolio and corporate bonds LGD is calculated on a collective basis based on the latest available recovery statistics.

ECL measurement for off-balance sheet financial instruments

CCF for undrawn credit lines of legal entities, credit cards issued to individuals and financial guarantees is defined based on statistical analysis of exposure at default.

CCF for overdrafts is defined as 100% since the limits can be used by the clients at any time.

Principles of assessment based on external ratings – the principles of ECL calculations based on external ratings are the same as for their assessment on a portfolio basis. Since the clients have defined the external credit rating, credit risk parameters (PD) could be taken from the default and recovery statistics published by international rating agencies.

Forward-looking information incorporated in the ECL models. The assessment of the SICR and the calculation of ECLs both incorporate forward-looking information. The Bank has performed historical analyses and identified the key economic variables impacting credit risk and ECLs for each portfolio.

These economic variables and their associated impact on the PD vary by financial instrument. These economic variables, such as consumer price index changes, nominal and real GDP growth, nominal and real effective exchange rates, USD exchange rate changes, changes in the budget expenditures have been tested by performing statistical regression analysis to understand the impact of changes in these variables has historically had on default rates.

Based on them the Bank's Risk Management Department makes the forecast of future macroeconomic conditions, which is considered by the management of the Bank to define the next coming stage of economic cycle using not only statistical approach but also expert judgement of the management.

The assessment of SICR is performed using the Lifetime PD for retail borrowers and 12-month PD for other financial assets, along with qualitative and backstop indicators. This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether a 12-month or lifetime ECL should be recorded. Following this assessment, the Bank measures ECL as either a probability-weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running the relevant ECL model.

As with any economic forecast, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the nonlinearities and asymmetries within the Bank's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

Validation

The Bank regularly reviews its methodology and assumptions to reduce any difference between the estimates and the actual loss of credit. Such validation is performed at least once a year. The results of validation the ECL measurement methodology are communicated to the Bank management and further steps for tuning models and assumptions are defined after discussions between authorized persons.

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Assessment of loss allowance for credit related commitments

Assessment of loss allowance for credit related commitments is performed on a similar basis with balance sheet exposures by application of credit conversion factor (CCF) if the counterparty has current balance sheet exposure. Statistical information and Basel Committee values are used for calculation of CCF. If the counterparty does not have balance sheet exposure the assessment of expected credit loss allowance is performed on an individual or collective basis depending on the amount of exposure by applying CCF.

Maximum Exposure

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

The maximum credit risk for off-balance items, mainly letters of credit and guarantees, represents the gross amount of the commitment. The Bank's maximum exposure to off-balance credit risk is disclosed in Note 26 “Commitments and Contingencies”.

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

The following table presents the maximum exposure to credit risk of financial assets and contingent liabilities. For financial assets, the maximum exposure equals to a carrying value of those assets prior to any offset or collateral. For financial guarantees and other contingent liabilities, the maximum exposure to credit risk is the maximum amount the Bank would have to pay if the guarantee was called on or in the case of commitments, if the loan amount was called on.

| | Maximum exposure | Net exposure after offset | Collateral Pledged | December 31, 2018 Net exposure after offset and collateral pledged |
|--|------------------|---------------------------|--------------------|---|
| Balances with the CBRA less minimum reserve deposits with the CBRA | 43,066,999 | 43,066,999 | - | 43,066,999 |
| Due from banks and other financial institutions | 8,138,873 | 8,138,873 | - | 8,138,873 |
| Investment securities | 16,077,553 | 16,077,553 | - | 16,077,553 |
| Loans to customers | 85,603,901 | 81,547,605 | 80,231,396 | 1,316,210 |
| Other financial assets | 379,559 | 379,559 | - | 379,559 |
| Guarantees issued | 12,114,854 | 12,114,854 | - | 12,114,854 |
| Commitments on loans and unused credit lines | 9,219,741 | 9,219,741 | - | 9,219,741 |

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| | Maximum exposure | Net exposure after offset | Collateral Pledged | December 31, 2017 Net exposure after offset and collateral pledged |
|---|---------------------|------------------------------|-----------------------|---|
| Balances with the CBRA less minimum reserve deposits with the CBRA | 42,460,045 | 42,460,045 | - | 42,460,045 |
| Due from banks and other financial institutions | 11,223,572 | 11,223,572 | - | 11,223,572 |
| Investment securities | 7,108,298 | 7,108,298 | - | 7,108,298 |
| Loans to customers | 74,013,652 | 72,150,545 | 65,087,719 | 7,062,826 |
| Other financial assets | 341,154 | 341,154 | - | 341,154 |
| Commitments on loans and unused credit lines | 8,026,887 | 8,026,887 | - | 8,026,887 |
| Guarantees issued | 7,079,630 | 7,079,630 | - | 7,079,630 |

Financial assets are graded according to the current credit rating they have been issued by an internationally regarded agency such as Fitch Rating. The highest possible rating is AAA. Investment grade financial assets have ratings from AAA to BBB. Financial assets which have ratings lower than BBB are classed as speculative grade.

As at December, 31 2018 and 2017 the balances with the CBRA less minimum reserve deposits with the CBRA amounted to AZN 43,068,744 and AZN 42,461,790, respectively. The credit rating of the Republic of Azerbaijan according to the international rating agencies in 2018 corresponded to investment level BB+ (2017: BB+).

The following table details credit ratings of financial assets held by the Bank as at December 31, 2018 and 2017 (this information is prepared for all financial assets that are neither past due nor impaired):

| | BBB+ | BBB- | BB+ | B+ | B- | Not Rated | December 31, 2018 Total |
|---|-----------|---------|------------|--------|-----------|------------|-------------------------------|
| Cash balances with the CBRA, excluded mandatory reserve deposits | - | - | 43,068,744 | - | - | - | 43,068,744 |
| Due from banks and other financial institutions | 5,130,787 | 987,716 | - | 56,311 | 1,131,925 | 832,134 | 8,138,873 |
| Investment securities | - | - | 16,077,553 | - | - | - | 16,077,553 |
| Loans to customers | - | - | - | - | - | 89,885,335 | 89,885,335 |
| Other financial assets | - | - | - | - | - | 379,559 | 379,559 |

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| | BBB+ | BBB- | BB+ | B+ | B- | Not Rated | December 31, 2017 Total |
|--|-----------|---------|------------|--------|---------|------------|-------------------------------|
| Cash balances with the CBRA, excluded mandatory reserve deposits | - | - | 42,461,790 | - | - | - | 42,461,790 |
| Due from banks and other financial institutions | 9,216,386 | 220,762 | - | 72,040 | 351,332 | 1,363,052 | 11,223,572 |
| Investment securities | - | - | 7,108,298 | - | - | - | 7,108,298 |
| Loans to customers | - | - | - | - | - | 70,726,984 | 70,726,984 |
| Other financial assets | - | - | - | - | - | 341,154 | 341,154 |

The banking industry is generally exposed to credit risk through its financial assets and contingent liabilities. Credit risk exposure of the Bank is concentrated within the Republic of Azerbaijan. The exposure is monitored on a regular basis to ensure that the credit limits and creditworthiness guidelines established by the Bank's risk management policy are not breached.

Geographical concentration

The Management exercises control over the risk in the legislation and regulatory arena and assesses its influence on the Bank's activity. This approach allows the Bank to minimize potential losses from the investment climate fluctuations in the Republic of Azerbaijan.

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

| | The Republic of Azerbaijan | OECD countries | Other non-OECD countries | December 31, 2018 Total |
|---|-------------------------------|-------------------|--------------------------------|-------------------------------|
| FINANCIAL ASSETS | | | | |
| Cash and balances with the CBRA | 52,299,324 | - | - | 52,299,324 |
| Due from banks and other financial institutions | 2,020,370 | 5,130,787 | 987,716 | 8,138,873 |
| Investment securities | 16,077,553 | - | - | 16,077,553 |
| Loans to customers | 83,863,480 | 1,735,952 | 4,469 | 85,603,901 |
| Other financial assets | 379,559 | - | - | 379,559 |
| TOTAL FINANCIAL ASSETS | 154,640,286 | 6,866,739 | 992,185 | 162,499,210 |
| FINANCIAL LIABILITIES | | | | |
| Due to banks, government and other financial institutions | 43,050,466 | - | - | 43,050,466 |
| Customer accounts | 52,207,997 | 5,092,025 | 2,367,074 | 59,667,096 |
| Other financial liabilities | 234,764 | - | - | 234,764 |
| TOTAL FINANCIAL LIABILITIES | 95,493,227 | 5,092,025 | 2,367,074 | 102,952,326 |
| NET POSITION | 59,147,059 | 1,774,714 | (1,374,889) | 59,546,884 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | The Republic of Azerbaijan | OECD countries | Other non-OECD countries | December 31, 2017 Total |
|--|-------------------------------|-------------------|--------------------------------|-------------------------------|
| FINANCIAL ASSETS | | | | |
| Cash and balances with the CBRA | 55,612,286 | - | - | 55,612,286 |
| Due from banks and other financial institutions | 1,786,424 | 9,216,386 | 220,762 | 11,223,572 |
| Investment securities | 7,108,298 | - | - | 7,108,298 |
| Loans to customers | 72,270,700 | 1,737,892 | 5,060 | 74,013,652 |
| Other financial assets | 341,154 | - | - | 341,154 |
| TOTAL FINANCIAL ASSETS | 137,118,862 | 10,954,278 | 225,822 | 148,298,962 |
| FINANCIAL LIABILITIES | | | | |
| Due to banks, government and other financial institutions | 34,483,121 | - | - | 34,483,121 |
| Customer accounts | 43,974,501 | 7,787,751 | 4,426,671 | 56,188,923 |
| Other financial liabilities | 248,287 | - | - | 248,287 |
| TOTAL FINANCIAL LIABILITIES | 78,705,909 | 7,787,751 | 4,426,671 | 90,920,331 |
| NET POSITION | 58,412,953 | 3,166,527 | (4,200,849) | 57,378,631 |

Liquidity risk

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

The Assets and Liabilities Management Committee (“ALMC”) controls these types of risks by means of maturity analysis, determining the Bank’s strategy for the next financial period. Current liquidity is managed by the ALMC, which deals in the money markets for current liquidity support and cash flow optimization.

In order to manage liquidity risk, the Bank performs daily monitoring of expected future cash flows on clients’ and banking operations, which a part of the assets/liabilities management process. The Management Board sets limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

An analysis of the liquidity and interest rate risks is presented in the following table. The tables have been drawn up to detail:

- The remaining contractual maturity of non-derivative financial liabilities based on the undiscounted cash flows of financial liabilities (both interest and principal cash flows) based on the earliest date on which the Bank can be required to pay; and
- The expected maturity for non-derivative financial assets based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where the Bank anticipates that the cash flow will occur in a different period.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | Up to 1 month | 1 month to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Maturity Undefined | December 31, 2018 Total |
|--|-------------------|---------------------------|-----------------------|----------------------|-------------------|-----------------------|-------------------------------|
| FINANCIAL ASSETS | | | | | | | |
| Cash and balances with the CBRA | 34,022,420 | - | - | - | - | - | 34,022,420 |
| Due from banks and other financial institutions | 159,631 | - | 451,904 | - | - | - | 611,535 |
| Investment securities | 120,043 | 4,586,213 | 8,515,507 | 2,458,200 | - | - | 15,679,963 |
| Loans to customers | 2,559,629 | 5,119,259 | 22,958,132 | 32,500,090 | 21,645,911 | 820,880 | 85,603,901 |
| Total interest bearing financial assets | 36,861,723 | 9,705,472 | 31,925,543 | 34,958,290 | 21,645,911 | 820,880 | 135,917,819 |
| Cash and balances with the CBRA | 17,813,733 | - | - | - | - | 463,171 | 18,276,904 |
| Due from banks and other financial institutions | 7,527,338 | - | - | - | - | - | 7,527,338 |
| Investment securities | 397,590 | - | - | - | - | - | 397,590 |
| Other financial assets | 379,559 | - | - | - | - | - | 379,559 |
| Total financial assets | 62,979,943 | 9,705,472 | 31,925,543 | 34,958,290 | 21,645,911 | 1,284,051 | 162,499,210 |
| FINANCIAL LIABILITIES | | | | | | | |
| Due to banks, government and other financial institutions | 608 | - | - | 11,260,611 | 31,720,167 | - | 42,981,386 |
| Customer accounts | 2,145,398 | 8,299,034 | 18,608,219 | 4,351,164 | - | - | 33,403,815 |
| Total interest bearing financial liabilities | 2,146,006 | 8,299,034 | 18,608,219 | 15,611,775 | 31,720,167 | - | 76,385,201 |
| Due to banks, government and other financial institutions | 69,080 | - | - | - | - | - | 69,080 |
| Customer accounts | 26,263,281 | - | - | - | - | - | 26,263,281 |
| Other financial liabilities | 234,764 | - | - | - | - | - | 234,764 |
| Total financial liabilities | 28,713,131 | 8,299,034 | 18,608,219 | 15,611,775 | 31,720,167 | - | 102,952,326 |
| Liquidity gap | 34,266,812 | 1,406,438 | 13,317,324 | 19,346,515 | (10,074,256) | | |
| Cumulative liquidity gap | 34,266,812 | 35,673,250 | 48,990,574 | 68,337,089 | 58,262,833 | | |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | Up to 1 month | 1 month to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Maturity Undefined | December 31, 2017 Total |
|---|-------------------|---------------------------|-----------------------|----------------------|-------------------|-----------------------|-------------------------------|
| FINANCIAL ASSETS | | | | | | | |
| Cash and balances with the CBRA | 38,011,373 | - | - | - | - | - | 38,011,373 |
| Due from banks and other financial institutions | 255,445 | - | 1,080,800 | - | - | - | 1,336,245 |
| Investment securities | 957,206 | - | 620,182 | 2,458,345 | 3,000,000 | - | 7,035,733 |
| Loans to customers | 16,656,007 | 13,294,019 | 16,270,153 | 14,011,823 | 11,934,773 | 1,846,877 | 74,013,652 |
| Total interest bearing financial assets | 55,880,031 | 13,294,019 | 17,971,135 | 16,470,168 | 14,934,773 | 1,846,877 | 120,397,003 |
| Cash and balances with the CBRA | 17,212,890 | - | - | - | - | 388,023 | 17,600,913 |
| Due from banks and other financial institutions | 9,887,327 | - | - | - | - | - | 9,887,327 |
| Investment securities | 72,565 | - | - | - | - | - | 72,565 |
| Other financial assets | 341,154 | - | - | - | - | - | 341,154 |
| Total financial assets | 83,393,967 | 13,294,019 | 17,971,135 | 16,470,168 | 14,934,773 | 2,234,900 | 148,298,962 |
| FINANCIAL LIABILITIES | | | | | | | |
| Due to banks, government and other financial institutions | 320,000 | - | 173,413 | 9,052,458 | 24,853,518 | - | 34,399,389 |
| Customer accounts | 694,976 | 5,611,801 | 20,183,172 | 10,349,027 | - | - | 36,838,976 |
| Total interest bearing financial liabilities | 1,014,976 | 5,611,801 | 20,356,585 | 19,401,485 | 24,853,518 | - | 71,238,365 |
| Due to banks, government and other financial institutions | 83,732 | - | - | - | - | - | 83,732 |
| Customer accounts | 19,349,947 | - | - | - | - | - | 19,349,947 |
| Other financial liabilities | 248,287 | - | - | - | - | - | 248,287 |
| Total financial liabilities | 20,696,942 | 5,611,801 | 20,356,585 | 19,401,485 | 24,853,518 | - | 90,920,331 |
| Liquidity gap | 62,697,025 | 7,682,218 | (2,385,450) | (2,931,317) | (9,918,745) | | |
| Cumulative liquidity gap | 1,903,093 | 3,160,468 | 4,204,701 | 5,182,677 | 6,084,262 | | |

The majority of the Bank's interest earning assets and interest bearing liabilities are at fixed rates of interest.

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature are crucial in determining the Bank's liquidity and its susceptibility to fluctuations in interest rates and exchange rates.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

The table below displays average effective interest rates for interest bearing assets and liabilities as at December 31, 2018 and 2017. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

| | 2018 | | | 2017 | | |
|---|------------------------------------|------|------------------|------------------------------------|-------|------------------|
| | Average effective interest rate, % | | | Average effective interest rate, % | | |
| | AZN | USD | Other currencies | AZN | USD | Other currencies |
| Interest bearing assets | | | | | | |
| Cash and balances with the CBRA | 8.26 | - | - | 12.52 | - | - |
| Due from banks and other financial institutions | 16.00 | 5.00 | | 16.00 | 5.00 | - |
| Loans to customers | 10.00 | 8.30 | 26.00 | 11.28 | 11.65 | 26.00 |
| Investment securities | 7.06 | 5.00 | - | 5.87 | 5.00 | - |
| Interest bearing liabilities | | | | | | |
| Due to banks, government and other financial institutions | 2.21 | - | - | 2.03 | 0.03 | - |
| Customer accounts | 10.46 | 2.41 | 0.05 | 11.24 | 2.65 | 0.05 |

A further analysis of the liquidity and interest rate risks is presented in the following tables in accordance with IFRS 7. The amounts disclosed in these tables do not correspond to the amounts recorded on the statement of financial position as the presentation below includes a maturity analysis for financial liabilities that indicates the total remaining contractual payments (including interest payments), which are not recognized in the statement of financial position under the effective interest rate method.

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

| | Demand and less than 1 month | From 1 to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Total |
|--|------------------------------|--------------------|--------------------|-------------------|-------------------|--------------------|
| FINANCIAL LIABILITIES | | | | | | |
| Due to banks, government and other financial institutions | 80,032 | 79,425 | 728,058 | 14,974,499 | 35,569,289 | 51,431,303 |
| Customer accounts | 2,260,218 | 8,505,715 | 19,151,600 | 4,608,505 | - | 34,526,038 |
| Total interest bearing financial liabilities | 2,340,250 | 8,585,140 | 19,879,658 | 19,583,004 | 35,569,289 | 85,957,341 |
| Due to banks, government and other financial institutions | 69,080 | - | - | - | - | 69,080 |
| Customer accounts | 26,263,281 | - | - | - | - | 26,263,281 |
| Other financial liabilities | 234,764 | - | - | - | - | 234,764 |
| Total potential future payments for financial obligations | 28,907,375 | 8,585,140 | 19,879,658 | 19,583,004 | 35,569,289 | 112,524,466 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

The maturity analysis of financial liabilities at December 31, 2017 is as follows:

| | Demand and less than 1 month | From 1 to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Total |
|--|---|-------------------------------|-------------------------------|------------------------------|-------------------------|-------------------|
| FINANCIAL LIABILITIES | | | | | | |
| Due to banks, government and other financial institutions | 376,764 | 56,763 | 673,534 | 11,642,143 | 27,269,304 | 40,018,508 |
| Customer accounts | 833,366 | 5,886,329 | 20,984,965 | 10,529,279 | - | 38,233,939 |
| Total interest bearing financial liabilities | 1,210,130 | 5,943,092 | 21,658,499 | 22,171,422 | 27,269,304 | 78,252,447 |
| Due to banks, government and other financial institutions | 83,732 | - | - | - | - | 83,732 |
| Customer accounts | 19,349,947 | - | - | - | - | 19,349,947 |
| Other financial liabilities | 248,287 | - | - | - | - | 248,287 |
| Total potential future payments for financial obligations | 20,892,096 | 5,943,092 | 21,658,499 | 22,171,422 | 27,269,304 | 97,934,413 |

Customer accounts are classified in the above analysis based on contractual maturities. However, in accordance with Azerbaijani Civil Code, individuals have a right to withdraw their deposits prior to maturity, if they forfeit their right to accrued interest.

Market risk

Market risk covers interest rate risk, currency risk and other pricing risks to which the Bank is exposed. There have been no changes as to the way the Bank measures risk or to the risk it is exposed in 2018 and 2017.

The ALMC manages interest rate and market risks by matching the Bank's interest rate position, which provides the Bank with a positive interest margin. The ALMC also conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in interest rates and its influence on the Bank's profitability.

The majority of the Bank's loan contracts and other financial assets and liabilities bear fixed interest rates. The Bank monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

Interest rate risk

The Bank manages fair value interest rate risk through periodic estimation of potential losses that could arise from adverse changes in market conditions. The Management Board of the Bank conducts monitoring of the Bank's current financial performance, estimates the Bank's sensitivity to changes in fair value interest rates and its influence on the Bank's profitability.

The following table presents a sensitivity analysis of interest rate risk, which has been determined based on “reasonably possible changes in the risk variable”. The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

Impact on profit before tax:

| | As at December 31, 2018 | | As at December 31, 2017 | |
|---|-------------------------|----------------------|-------------------------|----------------------|
| | Interest rate +1% | Interest rate -1% | Interest rate +1% | Interest rate -1% |
| FINANCIAL ASSETS | | | | |
| Cash and balances with the CBRA | 340,224 | (340,224) | 380,114 | (380,114) |
| Due from banks and other financial institutions | 6,115 | (6,115) | 13,362 | (13,362) |
| Investment securities | 156,800 | (156,800) | 70,357 | (70,357) |
| Loans to customers | 856,039 | (856,039) | 740,137 | (740,137) |
| FINANCIAL LIABILITIES | | | | |
| Due to banks, government and other financial institutions | (429,814) | 429,814 | (343,994) | 343,994 |
| Customer accounts | (334,038) | 334,038 | (368,390) | 368,390 |
| Net impact on profit before tax | 595,326 | (595,326) | 491,586 | (491,586) |

Currency risk

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

The Management Board sets limits on the level of exposure by currencies, which give the Bank an opportunity to minimize losses from significant currency rates fluctuations toward its national currency. The ALMC performs daily monitoring of the Bank's open currency position with the aim to match the requirement of the CBRA. These limits also comply with the minimum requirements of the CBRA.

The Bank's exposure to foreign currency exchange rate risk is presented in the table below:

| | AZN | USD | EUR | Other currency | December 31, 2018 Total |
|---|--------------------|--------------------|------------------|-------------------|-------------------------------|
| FINANCIAL ASSETS | | | | | |
| Cash and balances with the CBRA | 43,284,867 | 5,975,961 | 2,941,906 | 96,590 | 52,299,324 |
| Due from banks and other financial institutions | 585,835 | 3,930,125 | 3,589,580 | 33,333 | 8,138,873 |
| Investment securities | 13,593,063 | 2,484,490 | - | - | 16,077,553 |
| Loans to customers | 65,188,554 | 20,344,616 | 70,731 | - | 85,603,901 |
| Other financial assets | 379,559 | - | - | - | 379,559 |
| TOTAL FINANCIAL ASSETS | 123,031,878 | 32,735,192 | 6,602,217 | 129,923 | 162,499,210 |
| FINANCIAL LIABILITIES | | | | | |
| Due to banks, government and other financial institutions | 43,049,858 | 527 | 81 | - | 43,050,466 |
| Customer accounts | 16,997,547 | 35,909,876 | 6,651,744 | 107,929 | 59,667,096 |
| Other financial liabilities | 167,447 | 55,583 | 11,722 | 12 | 234,764 |
| TOTAL FINANCIAL LIABILITIES | 60,214,852 | 35,965,986 | 6,663,547 | 107,941 | 102,952,326 |
| OPEN CURRENCY POSITION | 62,817,026 | (3,230,794) | (61,330) | 21,982 | |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) (In Azerbaijani Manats)

| | AZN | USD | EUR | Other Currency | December 31, 2017 Total |
|---|--------------------|--------------------|------------------|-------------------|-------------------------------|
| FINANCIAL ASSETS | | | | | |
| Cash and balances with the CBRA | 48,619,396 | 4,898,384 | 1,863,373 | 231,133 | 55,612,286 |
| Due from banks and other financial institutions | 615,278 | 6,539,068 | 4,006,016 | 63,210 | 11,223,572 |
| Investment securities | 4,623,663 | 2,484,635 | - | - | 7,108,298 |
| Loans to customers | 57,357,927 | 16,507,743 | 147,982 | - | 74,013,652 |
| Other financial assets | 69,618 | 158,221 | 95,510 | 17,805 | 341,154 |
| TOTAL FINANCIAL ASSETS | 111,285,882 | 30,588,051 | 6,112,881 | 312,148 | 148,298,962 |
| FINANCIAL LIABILITIES | | | | | |
| Due to banks, government and other financial institutions | 34,301,507 | 181,530 | 84 | - | 34,483,121 |
| Customer accounts | 17,225,461 | 32,507,941 | 6,374,367 | 81,154 | 56,188,923 |
| Other financial liabilities | 177,194 | 57,919 | 11,450 | 1,724 | 248,287 |
| TOTAL FINANCIAL LIABILITIES | 51,704,162 | 32,747,390 | 6,385,901 | 82,878 | 90,920,331 |
| OPEN CURRENCY POSITION | 59,581,720 | (2,159,339) | (273,020) | 229,270 | |

Currency risk sensitivity

The following tables detail the Bank's sensitivity to a 10 percent increase and decrease in the USD and EUR against the AZN. 10 percent is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the possible change in foreign currency exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Bank where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

| | As at December 31, 2018 | | As at December 31, 2017 | |
|---------------------------------|-------------------------|-----------------|-------------------------|-----------------|
| | AZN/USD +10% | AZN/USD -10% | AZN/USD +10% | AZN/USD -10% |
| Net impact on profit before tax | (323,079) | 323,079 | (215,934) | 215,934 |
| | As at December 31, 2018 | | As at December 31, 2017 | |
| | AZN/EUR +10% | AZN/EUR -10% | AZN/EUR +10% | AZN/EUR -10% |
| Net impact on profit before tax | (6,133) | 6,133 | (27,302) | 27,302 |

“BANK EURASIA” OPEN JOINT STOCK COMPANY

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2018 (Continued) *(In Azerbaijani Manats)*

Price risks

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Bank is exposed to price risks of its products that are subject to general and specific market fluctuations.

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors.

It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analysis does not take into consideration that the Bank's assets and liabilities are actively managed. Additionally, the financial position of the Bank may vary at the time that any actual market movement occurs. For example, the Bank's financial risk management strategy aims to manage the exposure to market fluctuations. As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation and taking other protective action. Consequently, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value on the statement of financial position. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Bank's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

32. EVENTS AFTER THE REPORTING PERIOD

On February 1, 2019 the Central Bank of the Republic of Azerbaijan decided to reduce the refinancing rate from 9.75% to 9.25%, the ceiling of the interest rate corridor from 11.75% to 11.25% and the floor from 7.75% to 7.25% to boost confidence in the national currency.

On February 28, 2019, the President of the Republic of Azerbaijan signed a decree “On the additional measures to solve problematic loans of individuals in the Republic of Azerbaijan” (“the Decree”). According to the Decree the increase in loan balances denominated in foreign currency resulted from devaluation of the national currency during 2015 with total exposure up to USD 10,000 in all banks will be compensated by the government.

In addition, according to the Decree the CBAR will provide loans to the banks with 0.1% interest rate and for 5 years under the state guarantee totaling to AZN 682 million in order to restructure loans to individuals with overdue days more than 360 as at the date of the Decree and issued starting January 1, 2012 till the date of the Decree with exposure of up to USD 10,000 or AZN 17,000.

In order to prevent deterioration of the currency position of banks as a result of the execution of the Decree, the CBAR will provide banks with securities totaling to USD 215 million with annual interest rate of 0.5% upon the request of the banks.